Fannie Mae Single-Family Credit Risk Management

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Updated October 2016
Our mission is to provide liquidity and stability in the secondary mortgage market.

There are four primary business activities of the Single-Family Credit Guaranty business:

1. **Mortgage Acquisitions**: Facilitate the purchase of single-family mortgage loans, generally for the purpose of securitizing them.

2. **Mortgage Securitizations**: Securitize single-family mortgage loans delivered to us by lenders into Fannie Mae MBS in lender swap transactions; we assume and manage credit risk, for which we receive guaranty fees.

3. **Credit Risk Management**: Set and maintain standards for origination and servicing; price and manage the credit risk on loans in our single-family guaranty book of business.

4. **Credit Loss Management**: Work to prevent foreclosures and reduce costs of defaulted loans through foreclosure alternatives, management of foreclosures and real estate owned (REO) properties, and through pursuing contractual remedies from lenders, servicers, and providers of credit enhancement.

Fannie Mae does not originate loans or lend money directly to consumers. We facilitate the flow of global capital into the U.S. mortgage market by assuming and managing credit risk.
Market Influence/Role in Setting Market Standards

Our role is to provide liquidity to the mortgage market.

- We guarantee MBS to facilitate transactions in the TBA market, allowing mortgage lenders to hedge and/or fund their origination pipelines
- We purchase loans principally for the purpose of securitizing them

Our Single-Family Business manages credit risk exposure we take when issuing MBS.

- Fannie Mae drives market standards through our guides, tools, data standards, and constant engagement with our lending partners
- Our delegated business model relies on our rep and warrant framework accompanied by lender oversight and post-purchase quality control (QC)

- Standardization increases transparency, making it easier for participants to sell and securitize loans at competitive prices
- Fannie Mae’s comprehensive risk management approach ensures standards are updated regularly to address evolving credit issues in our acquisition standards and credit portfolio in a timely manner

As the largest guarantor of U.S. mortgages, we play a major role in setting the standards for the housing finance market.
Supporting Sustainable Homeownership

We are committed to supporting the housing recovery and helping to build a better housing finance system for the future:

- Establish and implement industry standards to help borrowers sustain homeownership
  - Rigorous assessment of capacity to pay: income, obligations and assets
  - Review of credit history backed by documented evidence
  - Appraisal requirements ensure comprehensive review of the collateral

⇒ Borrower eligibility is only as good as the loan origination process that follows

- With our partners, we have launched industry-wide tools and solutions to:
  - Clarify and simplify the underwriting process
  - Create consistent sets of loan-level and property appraisal data
  - Enforce checks and balances on loans as they are delivered to us

Our loan review defect rate has fallen significantly and our serious delinquency (SDQ) rate has declined every quarter since the first quarter of 2010.
Comprehensive Risk Management Approach

1. Lender Requirements and Standards
   - Requirements and approval process for new lenders
   - Lender risk management
   - Counterparty risk management

2. Setting Credit Policy
   - Credit philosophy and policy development
   - Underwriting and eligibility
   - Communicating credit policy to lenders

3. Tools to Enhance Loan Origination Quality
   - Desktop Underwriter®
   - Data standards
   - Appraisal data delivery, strategy, Collateral Underwriter®, Analytics Tool,
   - EarlyCheck™

4. Loan Delivery Controls
   - Data delivery compliance and loan eligibility validation
   - Loan documents and custodial requirements

5. Loan Level Quality Control
   - Representations and warranties framework
   - Loan review process
   - Post-purchase loan reviews – findings
   - Improved Manufacturing Quality

6. Lender Monitoring and Quality Control
   - Lender loan quality monitoring and control
   - Quality assurance oversight & loan eligibility
   - Lender training and feedback

7. Loan Servicing
   - Servicing roles and eligibility
   - Policy and compliance oversight
   - Servicer performance management
   - Performance monitoring
   - Incentives
   - Remedies for non-performance

8. Foreclosure Prevention & Management
   - Borrower outreach
   - Loss mitigation options
   - Foreclosure management
   - Engagement of law firms

9. Credit Portfolio Management Real Estate
   - Valuation
   - Marketing and sales
   - Fulfillment
Lender Requirements and Standards

- Lenders are reviewed for readiness to do business with Fannie Mae
- Monitor lender profile and performance through a hands-on risk management framework to holistically manage and oversee our lender partner
- Monitor lenders’ financial risk to ensure compliance with Fannie Mae requirements to minimize potential exposure

Delegated business model requires rigorous management and oversight of our lender partners.
Lender Requirements/Approval Process

Prospective Lenders are reviewed for:

- **Business Readiness**
  - Business history, origination volume, funding capacity

- **Financial Readiness**
  - Two years audited financials, interim financial statement, call reports

- **Management Readiness**
  - Resumes for owners, principal officers, and key managers

- **Operational Risk Readiness**
  - Quality Control processes & procedures, servicing & default, and sub-servicers monitoring

Assessment for Lender/Servicer approval includes a comprehensive review of key functional areas and potentially an on-site lender assessment.
Lender Requirements/Approval Process

Approval or rejection of a lender’s application is at Fannie Mae’s sole discretion. At a minimum, to be considered for approval to sell and service residential first mortgages, a lender must:

- have net worth of at least $2.5 million, plus a dollar amount that represents 0.25% of the unpaid principal balance of its total servicing portfolio;\(^{(1)}\)
- for non-depository institutions, minimum liquidity requirement of at least 0.035% of UPB of agency servicing plus an incremental 2.0% of the UPB of agency servicing in excess of 6% 90+ days delinquent;\(^{(1)}\)
- have as its principal business purpose, the origination, selling, and/or servicing of residential mortgages;
- have adequate facilities and experienced staff;
- be duly organized, validly existing, properly licensed (in good standing), or authorized to conduct its business in each of the jurisdictions in which it originates, sells, and services residential mortgages.

The approval process involves collaboration across key business areas responsible for managing risk:

Lenders undergo a rigorous approval process, designed to result in high loan quality and performance as well as reduced reliance on lender representations and warranties.

\(^{(1)}\) Effective 12/31/2015
Pre-Contract Assessment by Mortgage Origination Risk Assessments (MORA)

- On-site pre-approval lender reviews conducted for all non-regulated applicants as well as any regulated applicant based on predetermined requirements.

- A Pre-Contract Assessment by MORA encompasses both a desk review and an on-site review; areas covered include:
  - Organizational Structure and Governance
  - Retail/Wholesale/Correspondent
  - Underwriting
  - Appraisal Review and Approval
  - Quality Control
  - Quality Control Reports and File Reviews
  - Site/System Walkthrough

Pre-contract assessments help us determine the quality of a lender’s manufacturing process and the effectiveness of its controls, with the goal of driving continuous lender improvement.
Lender Risk Management

Dedicated customer risk management function aligned by region

- Assess, monitor, and positively influence lender’s credit culture through ongoing interaction, regular onsite visits, and senior-level engagement
- Monitor acquisition profile, performance, and lender’s overall book of business to ensure compliance with corporate risk expectations and tolerance
- Lead remediation efforts to address performance/quality issues
- Serve as lender’s contact for risk policy and interpretation
- Monitor loan quality, loan delivery, and anti-fraud measures
- Provide lenders with training, expertise, and assistance on credit quality issues or efforts
- Provide hands-on engagement with lenders and act as key touch point for all aspects of lender credit risk management
- Independent reporting relationship from customer sales teams

Fannie Mae’s customer risk management team provides holistic hands-on risk management based on lender segments.
Lenders are monitored based on the credit quality of the portfolios they deliver; the Acquisition Credit Index (ACI) model rank orders the risk of the acquired loans based on multiple credit attributes such as FICO, LTV, and DTI.

A dedicated mortgage analytics team continuously produces and monitors extensive reporting on acquisitions and book.

- **Early Delinquency Reporting** compares actual loan performance against expected performance.
- **ACI Tail Report** monitors the risk of the loans that are on the edge of the credit box.
- **Rapidly growing business segments & lenders, acquisition trends, profile & performance reports, risk limits & triggers**
- **Loan Acquisition and performance trends** are reviewed monthly by senior management.

Based on analysis of key metrics, Risk and Policy teams conduct deep dives on underperforming segments of business to determine if any actions are needed; such actions could include:

- Changes to underwriting guidelines or eligibility criteria, changes to Desktop Underwriter® (DU®), enactment of additional upfront controls, additional lender monitoring, or training.
Our primary exposures to institutional counterparty risk are with mortgage seller/servicers that service the loans that back our Fannie Mae MBS, and those that are obligated to repurchase loans from us or reimburse us for losses in certain circumstances.

We rate all of our counterparties on both a quantitative and qualitative basis. This rating helps define our risk tolerance and maximum exposure for each counterparty. Our framework is composed of:

### Counterparty Ratings

Internal ratings make assessments that cover the following areas:

- Profitability
- Asset Quality
- Capitalization
- Liquidity / Funding
- Portfolio Concentration

### Counterparty Limits

Internal exposure limits are tracked on a daily basis for all counterparties and are based on:

- Internal Ratings
- Financial Capacity

Actions we have taken or may take to mitigate our risk to troubled sellers/servicers with whom we have material counterparty exposure include:

- Require guaranty of obligations by higher-rated entities, reduce or eliminate exposures and/or certain business activities, transfer exposures to third-parties, require collateral to secure obligations and suspend or terminate seller/servicer relationship
The lender management framework creates a valuable feedback mechanism, leading to continuous enhancement of risk controls.

- On-site visits for both regulated and unregulated entities prior to approval
- Delivery volume limits based on net worth and lender operational capacity
- Increased loan file reviews of initial deliveries and more frequent onsite visits by risk team
- Dynamic pricing

- Quicker identification of lenders with substantial volume or business mix changes
- Quality control file reviews with direct feedback
- Additional in-depth and onsite assessment of operational competency and compliance, as required

- Guide language specifically provides us with the ability to establish business limits for lenders
- Development of methodology to enforce business limits

Our continuous improvements to the framework feed the standards we set in the marketplace.
Setting Credit Policy

Credit Philosophy and Policy Development
- Continuous policy development process to enable sustainable homeownership over the long term and to maintain strong performance of our book of business

Underwriting and Eligibility
- Establish requirements for determining the borrower’s capacity and willingness to repay the loan and the adequacy of the property as collateral

Communications
- Fannie Mae’s *Selling Guide* is the external face of our risk tolerance
Credit Philosophy and Policy Development

- Establish and maintain credit policies that promote **sustainable homeownership** by focusing on the borrower’s willingness and capacity to repay the mortgage obligation, and the adequacy of the property as collateral.

- Create underwriting and eligibility requirements that:
  - Address each stage of the loan lifecycle
  - Consider various scenarios so that borrowers have a higher probability of making their monthly housing payment
    - Throughout different housing and economic cycles
    - Regardless of home value fluctuations
    - In cases where payment increases may occur (e.g., ARM products)

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**Fannie Mae’s comprehensive credit philosophy considers all stages of the loan life cycle, including various economic scenarios.**
Fannie Mae closely monitors the performance and quality of acquisitions, and makes necessary policy and process changes to maintain strong performance of the book.
Starting in 2008, Fannie Mae initiated policy changes that focused on strengthening sustainable homeownership.

(1) Fannie Mae’s Refi Plus™ program still allows for a streamline documentation option, which does not require full documentation.
Fannie Mae’s ongoing communications are designed to be timely and transparent in order to keep lenders and the market informed of up-to-date policy and requirement changes.

<table>
<thead>
<tr>
<th>Source</th>
<th>Description</th>
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<tbody>
<tr>
<td>The Selling Guide</td>
<td>Is a legal contract and informs lenders about our policies and requirements for the origination, underwriting, and delivery of mortgages that Fannie Mae will purchase or securitize</td>
</tr>
<tr>
<td>Announcements</td>
<td>Describe new, supplemental, or modified policies and procedures and amend the Selling Guide or documents posted on <a href="http://www.FannieMae.com">www.FannieMae.com</a></td>
</tr>
<tr>
<td>Lender Letters and Notices</td>
<td>Provide information that lenders need but that does not require an update to Selling Guide text</td>
</tr>
<tr>
<td>Master Selling &amp; Servicing Contract (MSSC)</td>
<td>Establishes the lender’s contractual relationship with Fannie Mae, and sets forth the terms and conditions for the lender to sell mortgages to Fannie Mae</td>
</tr>
<tr>
<td>Seller Negotiated Contracts</td>
<td>Establishes negotiated guideline exceptions that are acceptable due to alignment with our credit risk appetite and the lender’s overall control environment</td>
</tr>
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*Selling Guide (download PDF), Announcements, Lender Letters, Notices - All available on Fanniemae.com and AllRegs® & all constitute part of the selling contract between Fannie Mae and the lenders.*
Tools to Enhance Loan Origination Quality

Desktop Underwriter (DU)
- Conducts comprehensive examination of multiple risk factors to evaluate mortgage delinquency risk
- Assesses eligibility for delivery to Fannie Mae

Data Standards (Uniform Loan Delivery Dataset)
- Improves data accuracy, simplifies the exchange of data, and increases credit risk management capabilities by ensuring that loan data delivered is complete and accurate

Collateral Underwriter® (CU™)
- Gives lenders access to the same appraisal data and analytics used by Fannie Mae
- Identifies potential appraisal issues so lenders can proactively manage them

EarlyCheck™
- Allows lenders to make corrections and avoid delivery of ineligible loans
- Helps identify potential data issues early in the loan process

Our goal is to increase transparency to enable all parties to see and evaluate risk early in the loan origination process.
Desktop Underwriter (DU)

Fannie Mae’s proprietary automated underwriting system that assists lenders in the underwriting of mortgage loans

- DU helps lenders make informed credit decisions; specifically:
  - Evaluates mortgage delinquency risk and arrives at a risk assessment recommendation by relying on a comprehensive examination of the primary and contributory risk factors in a mortgage application
  - Automates Fannie Mae’s underwriting eligibility guidelines and credit policies for the mortgage industry, including listing the steps necessary for the lender to complete the processing of the loan file and providing objective analysis of mortgage loan applications
  - Improves efficiency of the loan origination process and enables the efficient deployment of new policies and products to lenders

In 2015, over 1,800 lenders used DU, and over 90%\(^{(1)}\) of loans were evaluated through DU.

\(^{(1)}\) 2015 new acquisitions, excluding loans acquired under Fannie Mae’s Refi Plus and HARP initiatives
**Desktop Underwriter (DU)**

Originator Inputs
Data into DU

DU Engine
Processes Data

DU Underwriting Findings Report

- Loan Application Data
- Credit Report Data
- Risk Assessment
- Eligibility Assessment
- Risk Assessment
- Eligibility for delivery to Fannie Mae
- Income and assets documentation requirements
- Underwriting conditions related to data integrity and loan delivery requirements

**Loan is Eligible for Delivery to Fannie Mae**

- Loans that receive an Approve/Eligible recommendation meet Fannie Mae’s credit risk standards/assessment and loan eligibility requirements

**Lender Fulfills Conditions**

- Lender satisfies all approval conditions
DU Risk Assessment Factors and Findings

- DU performs a comprehensive evaluation of each borrower’s credit profile and other mortgage risk factors, weighting each based on the amount of risk it represents and its importance to the recommendation.
- The results of the evaluation are analyzed to arrive at the underwriting recommendation.

**Credit Profile Risk Factors**
- Credit History, Delinquent Accounts, Installment Loans, Revolving Credit Utilization, Public Records, Foreclosures & Collections, Credit Inquiries

**Additional Risk Factors**
- Borrower’s Equity & LTV, Liquid Reserves, Loan Purpose, Loan Term, Loan Amortization Type, Occupancy Type, Debt-to-Income Ratio, Property Type, Co-Borrowers, Self-Employment

- The DU Underwriting Findings report summarizes the overall underwriting recommendation, which tells the lender if the loan satisfies Fannie Mae’s credit risk standards and mortgage loan eligibility criteria.
- The DU Underwriting Findings report also outlines steps necessary for the lender to complete for processing the loan file.

**DU performs a detailed analysis of credit and mortgage risk factors to assess creditworthiness.**
Appraisal Data Delivery

- Fannie Mae relies on receiving quality appraisal data to evaluate the adequacy of the property as collateral for the loan.
- To help mitigate credit risk, in 2011 Fannie Mae rolled out common standards and requirements for appraisal submission as part of our ongoing effort with Freddie Mac and FHFA to enhance the accuracy and quality of data required at loan delivery.

**Uniform Appraisal Dataset (UAD)**
- Defines all fields required for a complete appraisal submission.
- Standardizes critical data points on the appraisal, facilitating appraisal analytics and messaging.

**Uniform Collateral Data Portal® (UCDP®)**
- A single portal for the electronic submission of appraisal data to the GSEs.
- Performs checks to validate that certain data is in compliance with the UAD requirements.

UCDP is the largest and most complete repository of standardized appraisal data, which will improve the quality of appraisals and benefit the industry as a whole.
**Appraisal Data Strategy**

- Collection of appraisal data enables development of external tools and internal risk models to improve assessment of collateral value:
  - Proprietary appraisal delivery rules and messaging provides lenders with real-time feedback on critical appraisal data quality and eligibility issues.
  - Database of appraisals, public records, Multiple Listing Services (MLS) data, census data, home price indices, geospatial data, and other sources provides extensive property data repository.
  - Sophisticated web-based appraisal analytics tool empirically models the localized drivers of appraisal quality and valuation.
  - Enhanced ability to identify appraisal/valuation defects in our post-purchase QC processes drives discretionary QC sampling and assists in uncovering potential valuation issues.
  - Our analytics provide aggregate quality metrics to parties of the transaction.
  - Enhanced data analytics helps to drive clear and more effective appraisal policies.
  - The Appraiser Quality Monitoring framework allows detection and management of collateral risk issues at the appraiser level.
  - The Collateral Underwriter, integrated into DU, provides additional transparency and certainty by giving lenders access to the same appraisal analytics used in Fannie Mae’s quality control process.

*A uniform data standards and collection system is transforming the industry by identifying higher risk appraisals prior to or shortly after delivery, rather than after the loan has defaulted.*
Collateral Underwriter

- Fannie Mae’s proprietary appraisal risk assessment application developed to support proactive management of appraisal quality and drive QC selections
- Inclusive of over 20 million electronic appraisal records as of February 2016
- Proprietary statistical models and algorithms generate output that alerts the lender to potential property eligibility or policy compliance, overvaluation, and appraisal quality issues

**DATA INTEGRITY**

- With most comps observed multiple times, we identify inconsistencies within an appraiser’s body of work and relative to peers
- Appraisals with multiple or particularly egregious errors or discrepancies receive higher risk scores in Collateral Underwriter

**COMPARABLE SELECTION**

- CU’s comp selection model considers physical similarity, location, and date of sale. Significance of each varies from market-to-market
- Appraiser-provided comps are judged against a pool of available sales in the market – not against arbitrary guidelines

**ADJUSTMENTS**

- Statistically-derived, market-specific adjustments are estimated by the model for differences in physical features, time, and location
- Appraisers’ adjustments that are materially different from model and peer adjustments are flagged and lead to higher risk scores

**RECONCILIATION**

- CU examines the relationship between the appraised value and the adjusted/unadjusted range of comparable values
- Appraised values that are supported by a single comp or outside the range of comp values are flagged and lead to higher risk scores

**Advanced data-driven analytics help to uncover poor practices, inconsistencies, and potential fraud to drive a more targeted post-purchase QC process and better industry practices.**
Collateral Underwriter
Lender Engagement

- The tool was made broadly available to lenders in early 2015
- Provides additional transparency and certainty by giving lenders access to the same appraisal analytics used in Fannie Mae’s quality control process
- Performs an automated risk assessment of appraisals submitted to the Uniform Collateral Data Portal® (UCDP®) and returns a risk score, flags, and messages to the submitting lender
- CU risk score and messages are available to all UCDP users in real-time
- Lenders may use the CU risk score to segment appraisals by risk profile, resulting in more efficient resource allocation, workflow management, and collateral risk management processes
- Lenders may address and correct appraisal issues up front and before the loan is closed and delivered
- Available at no charge so lenders can take full advantage of the application for quality control and risk management purposes

External Distribution of CU supports more proactive management of appraisal quality by empowering lenders to address potential issues prior to loan delivery.
Collateral Underwriter

The main appraisal page includes a comparable sales map, message center, details for the appraiser-provided comps, and links to additional information and functionality.
The “Datapraisal” displays the results of CU’s comp selection model. Appraiser-provided comparables are ranked along up to 20 model-selected sales in the subject market.
Collateral Underwriter
Configurable Comp Searches

Users can perform comparable searches by defining specific parameters for geographic boundaries, time frames, and physical characteristics.

Users can draw specific geographic areas from which to choose comps.

Users may also set specific parameters for comp physical characteristics and time frame.
Collateral Underwriter’s Market Trend and Heat Map functionality provides users detailed insight into local market trends.

The Market Trend function shows market appreciation or decline relative to prior sales of the subject property.

Heat Maps display Census Block Group-level statistics such as median sales price, price/GLA, median days on market, etc.
Collateral Underwriter
Aerial and Street-View Photography

Users can easily access aerial and street-view photography from the appraisal page with a simple point-and-click of the subject or any comparable on the CU property map.

CU provides a birds-eye view of the subject and comparables. Users can easily move between properties, rotate camera angle, zoom-in/zoom-out, etc.

Street view imagery for the subject or any comparable can be accessed through the CU interface.
100% of deliveries are assessed to help drive discretionary QC reviews and assist reviewers in uncovering potential eligibility issues.

The Loan Quality Center (LQC) uses the tool as a forensic means to aid in QC reviews; in cases where Fannie Mae requests a loan file from lenders, a full underwriting review is completed and the results are documented.

Tool Contents and Capabilities

- “Red flag” messages to the LQC highlight potential loan defects
- DU simulator aids in determining overall loan eligibility impact if the facts of a DU loan change
- Eligibility grids aid in determining overall eligibility of loans that cannot be assessed via DU simulator
- Aggregates data from loan delivery, Fannie Mae loan histories, DU submissions, credit reports, appraisals, deed records, and agent performance histories
- Aids in determining pricing impacts to lender as a result of findings from the loan review
- Leverages third party data to provide data to the reviewer to validate borrower income

The Underwriting Risk Assessment Tool supports loan reviews by identifying data anomalies that may impact the overall eligibility of a loan and selects those loans for review based on a comprehensive risk assessment.
EarlyCheck™

EarlyCheck is a tool that assists lenders in identifying and correcting potential eligibility and/or data issues as early in a lender’s business process as possible, with the goal of helping lenders identify potential problems prior to delivery.

**Key Objectives**

- Assist lenders with identifying and correcting potential eligibility and/or data issues before loans are sold to Fannie Mae
- Enable lenders to access delivery edits from loan origination to delivery
- Make available regardless of loan underwriting method
  - DU loans, manually-underwritten loans, and non-DU AUS loans

**Benefits**

- Optional service that helps identify potential data issues early in the loan process when they can be remedied more effectively
- Provides more certainty that a loan can be delivered to Fannie Mae
- Helps improve loan origination process
- Less manual error resolution during the delivery process
- Provides real-time results in a user-friendly report or data file

As a key loan quality tool in the marketplace, the purpose of EarlyCheck is to help our lenders identify and correct loan defects as early in the origination process as possible.
Loan Delivery Controls

- Lenders use Fannie Mae’s web-based application to deliver loans
- At a point in the delivery process, eligibility rules are systematically applied; data variances from standard rules are stopped and reviewed against the contract

- Custodian conducts an independent review of required custody documents the seller delivers to determine whether they conform to the data and documentation provisions of the Guides
Data Delivery Compliance and Loan Eligibility Validation

All loans delivered to Fannie Mae run through automated validation processes to ensure data validity and loan eligibility.

The loan delivery process allows lenders to evaluate data files against Fannie Mae rules and help ensure that the loans meet Fannie Mae’s data quality and eligibility requirements.
Loan Documents and Custodial Requirements

Document Custodian

- Custodian must meet specific eligibility requirements and be approved by Fannie Mae
- Custodian conducts an independent review of all required custody documents the seller delivers to determine whether they conform to the data and documentation provisions of the Guides

- In order for Fannie Mae to provide funding to the lender, the loan or pool must be **certified** by a document custodian prior to loan purchase or pool closing
- Document Custodians must meet Fannie Mae’s eligibility requirements as outlined in the Requirements for Document Custodians (RDC) and the Fannie Mae Selling Guide in order to be an approved Fannie Mae custodian
- At any time, with or without cause, Fannie Mae has the right to require a document custodian to transfer documents to a different document custodian

The Document Custodian assures that all documents conform to Fannie Mae’s requirements and maintains physical possession of the note and other key documents.
Loan Level Quality Control

- Provide lenders a higher degree of certainty and clarity regarding their repurchase exposure and liability on future deliveries, as well as consistency around repurchase timelines and remedies.

- Reviews of performing loans measure the quality of new acquisitions and target potential problem loans; reviews of non-performing loans aim to mitigate potential credit losses.

- Results of loan reviews are used to identify steps to drive policy, process or procedure changes to mitigate risk.

- Trends in defect rates are used to drive policy and process changes, and initiate lender training and additional lender reviews.

Representations and Warranties Framework

Post-Purchase Loan Reviews

Post-Purchase Loan Reviews - Findings

Improving Manufacturing Quality
**Representation & Warranties Framework**

- The representation & warranties framework effective for loans acquired on or after January 1, 2013 provides lenders with:
  - Relief of obligation to repurchase mortgage loans that are in breach of certain **underwriting and eligibility** reps and warranties that meet a defined payment history standard
  - No relief for breaches of certain “life of loan” reps and warranties, including matters related to fraud, misrepresentation, clear title, legal compliance, eligibility, and Fannie Mae Charter

- To align with the framework, Fannie Mae:
  - Enhanced its credit risk management processes and deployed state of the art tools with the goal of catching loan defects early in the process
  - Increased the focus of its post-purchase quality control process on review of performing loans shortly after delivery and prior to the sunset of certain underwriting reps & warranties as defined in the framework

- The framework provides lenders with a higher degree of certainty and clarity around repurchase exposure, and also provides lenders with tools and feedback to bolster their quality control processes

*Bulk deliveries and certain negotiated transactions may be excluded

**Payment history requirements differ for Refi Plus and DU Refi Plus programs

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Fannie Mae developed state of the art tools and analytics to complement the framework, helping to identify defective loans earlier in the process.
Establish enhanced quality controls to effectively manage risk, including:

- increased loan-level QC reviews earlier in the loan lifecycle
- increased discretionary sampling driven by automated risk-assessment tools, in addition to ongoing statistically valid random loan-level sampling
- 100% of deliveries are assessed by our models to assist in selecting loans for the loan-level QC review process
- consistent standards and practices for determining repurchases and repurchase exceptions, and tolerance levels for loans determined to be eligible with findings
- robust oversight of lenders and their quality control practices

Align on a consistent set of standards and practices for managing the repurchase process, including specific timelines and standards for remedy types and usage, including remedies for non-compliance

Enhanced quality control processes help Fannie Mae and lenders effectively manage within the new framework.
Loan Review Process

In support of the new rep and warrant framework, Fannie Mae updated its processes, which will help to:

- Validate that the loans Fannie Mae purchases were originated in accordance with applicable underwriting and eligibility requirements
- Provide lenders with actionable data and feedback about the quality of their loan origination process and loans delivered to Fannie Mae\(^\text{(1)}\)

### Fannie Mae’s Post Purchase File Review Process
- Validate that the loans Fannie Mae purchases were originated in accordance with applicable underwriting and eligibility standards
- First an automated, data-driven read of every loan delivered; if selected, a human review

### Data Changes and Pricing Adjustments
- Capture and execute required data and pricing changes upon delivery of loan and communicate to lender to ensure compliance

### Repurchases, Alternate Remedies and Appeals Processes
- Repurchase requests and alternate remedies are triggered if robust automated and human reviews deem them necessary in order to ensure that loans entering Fannie Mae’s portfolio meet all eligibility requirements

\(^\text{(1)}\) Loan underwriting feedback is only available to lenders utilizing Desktop Underwriter
Post-Purchase Loan Reviews

Post-Purchase review process holds lenders accountable for loan quality.

Random Selections (New Acquisitions)
- Monthly random loan file selections
- Statistically valid sample, including lender stratified sample
- Purpose: determine overall loan defect rate and trends
- Use results to drive action at the lender level and policy level to reduce the defect rate
- Lender comparisons help drive improved QC lender processes

Discretionary/Targeted Selections (New Acquisitions)
- 100% of acquisitions undergo automated data analysis tools, including Collateral Underwriter and the underwriting risk assessment tool
- This automated process helps to drive discretionary loan selections
- Additional discretionary selections target new and emerging risk lenders
- Enforce remedy before loan defaults

Non-Performing Loans
- 100% of non-performing loans undergo a predictive model-driven analysis
- Model assigns a repurchase risk score and any loan above the cutoff score is selected for hands-on review
- Use results to enforce reps and mitigate losses
- Non-performing loan review volumes have dropped in recent years due to sharp reduction in defaulted loans

Reviews of performing loans measure the quality of new acquisitions and target potential problem loans. Reviews of non-performing loans aim to mitigate potential credit losses.
Post-Purchase Loan Reviews - Findings

Recent Top Findings Categories for post-purchase loan reviews include:

- **Income**
  - Failure to properly calculate self-employed income
  - Failure to properly calculate rental losses

- **Asset**
  - Insufficient reserves
  - Undocumented large deposits

- **Property**
  - Use of dissimilar comparable sales
  - Inappropriate selection of comparable sales – proximity (did not consider or use comparable sales available that were closer to subject property)

Results of loan reviews are used to identify steps to drive policy, process, or procedure changes to mitigate risk.
Improving Manufacturing Quality

- As of March 31, 2016, the eligibility defect rate for our single-family non-Refi Plus loan acquisitions in the year ended July 31, 2015 was .94%
- We actively enforce our contractual rights when a loan defect is uncovered; remedies are based on the significance of the defect and impact on loan eligibility, including:
  - Loan repurchase
  - Indemnification
  - Pricing Adjustment (for loans that are otherwise eligible under Fannie Mae guidelines)
  - Repurchase Alternatives that do not require repurchase, but instead require either payment of risk fees or agreement to provide recourse to compensate for the risk of the defect and motivate the lender to correct its manufacturing process

- Slightly higher repurchase request rates in 2013+ compared to 2009-2012 are attributable to tools introduced in 2013 that have improved our ability to identify loans with underwriting defects, as well as our shift in the primary focus of our quality control reviews from the time a loan defaults to shortly after the loan is delivered to us
- Failure by a seller/servicer to repurchase a loan or to otherwise make us whole for our losses may result in the imposition of sanctions up to and including termination

Beginning in 2013, Fannie Mae employed an enhanced sampling methodology and quality control reviews at the time of loan acquisition to work with lenders to decrease defects and repurchases over time.

Loans Subject to Repurchase Request
Data as of June 30, 2016

<table>
<thead>
<tr>
<th>Year Loan Delivered to Fannie Mae</th>
<th>Percentage of loans subject to repurchase request</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-2008</td>
<td>3.76%</td>
</tr>
<tr>
<td>2009-2012</td>
<td>0.18%</td>
</tr>
<tr>
<td>2013</td>
<td>0.37%</td>
</tr>
<tr>
<td>2014</td>
<td>0.47%</td>
</tr>
<tr>
<td>2015*</td>
<td>0.23%</td>
</tr>
</tbody>
</table>

*Figure applicable to loans delivered in the year ending November 2015

Source: Fannie Mae 2016 Second Quarter Form 10-Q
Lender Monitoring and Quality Control

- Provide a consistent platform to evaluate lenders through a review of the lenders quality control program, procedures, and reporting, including a monthly feedback mechanism.

- Leverage the results of random and discretionary post-purchase reviews to test the effectiveness of Fannie Mae’s lender quality control reviews and to shape policy.

- Provide training and education materials for internal and external audiences designed to foster loan quality and reduce defects.
Evaluating the Effectiveness of a Lender’s Origination and Quality Control Processes

Loan Origination Controls & Loan Quality Assessment (LOLA) team conducts rigorous monitoring through an integrated framework to ensure lenders have effective controls in place to meet operational, eligibility, QC, and data quality guidelines:

- In-depth reviews of a lender’s origination processes
- Designed to assess the quality of a lender’s manufacturing process, and the effectiveness of their controls
- Review and respond to the potential data changes that are identified from Fannie Mae’s models
- Analyzes data changes that do not result in the level of a repurchase and determines next steps
- Enhanced process to quickly monitor risks associated with new lenders and/or lenders that may have emerging growth and/or potentially elevated risk
- Ensure that lenders have effective quality control programs in place
- Conduct testing to determine the adequacy and effectiveness of lender’s quality control processes and procedures
Mortgage Origination Risk Assessment (MORA)

- Fannie Mae conducts rigorous lender origination process reviews including file level testing, procedural review, control reports and an intense interview protocol.
- Assessment covers nine key functional areas, including a detailed questionnaire as well as loan file sampling to validate the lender’s controls are working properly:
  - Organizational Structure/Governance
  - Compliance/Internal Audit
  - Business Continuity
  - Secondary Marketing
  - Origination Channels
  - Technology
  - Underwriting/Appraisal
  - Closing/Post-Closing/Funding
  - Quality Control

- Additional lenders are selected for MORA reviews on a discretionary basis using defined risk criteria.
- Origination reviews are complemented by ongoing lender servicing reviews.
- All lenders with MORA reviews resulting in High or Medium risk issues cited are required to provide detailed action plans outlining issue remediation plans.
Targeted Lender Oversight

Rapid oversight of production from new lenders and those with key changes in volume/profile

By middle of month, flag prior month’s deliveries for:
- Volume Spikes
- Increase in Third Party Origination Volume
- Dormant Lender Deliveries

This is evaluated with other factors:
- MORA Selection Tool
- Loan-Level QC Review Results
- Loan Performance Metrics
- New Lender Volume
- Counterparty Data
- Customer Engagement/Market Intel

Potential Actions:
- Originator Assessment (MORA)
- Discretionary File Reviews
- QC Specialist Review
- Risk Manager Onsite
- Combination of Above
- Continue Monitoring

Results:
- Continue Current Relationship*
- Limit or Reduce Volume*
- Stop Doing Business

*May have remediation requirements as a condition.

Targeted lender oversight process is designed to rapidly assess potential emerging risks.
Lender Loan Quality Monitoring and Control

- Continuous review of lender QC processes and practices to ensure compliance with Fannie Mae guidelines
- Assess lenders to ensure that they have effective quality control programs in place
- Identify and remediate findings, defects, and trends that are occurring in the lenders quality control process
- Establish action plans to address deficiencies and/or misalignment
- Provide monthly feedback on loan quality to internal and external stakeholders
- Assist lenders with establishing an effective quality control program
- Hold lenders accountable for hitting their defect rate targets
Lender Training and Feedback

- Lender training opportunities are based on topics identified in the feedback loop process and common loan defects
- Lender-facing QC Specialists are aligned with account teams; among other things, the QC Specialist:
  - Supports the lender with action planning to address top defect items
  - Provides analysis and recommendations related to the quality of a lender’s loan and manufacturing processes, to be used as an input for Fannie Mae account teams and risk managers during executive engagement with the lender
  - Identifies and helps to remediate findings, defects, and trends that are occurring in the lender’s quality control process

- Fannie Mae provides both on-site and electronic training designed to foster loan quality and reduce defects
  - The Training Resource Catalog located at https://www.fanniemae.com/singlefamily/servicing-learning-center offers a comprehensive and robust collection of resources that is readily available to lenders
  - Beyond the Guide offers lenders additional ideas for enhancing quality control efforts beyond the minimum standards reflected in Fannie Mae’s Selling Guide; these ideas include approaches that may prevent critical errors in the origination process
  - The QC self-assessment tool provides help to executives and managers with QC responsibilities to analyze the state of their quality control programs
  - Fannie Mae conducts annual QC boot camps for intensive in-person training on our lender QC requirements
Loan Servicing

Servicer Roles and Eligibility
- Direct (Master) Servicers
- Subservicers

Policy and Compliance Oversight
- Servicing Guide & Servicing Alignment Initiative (SAI)
- Servicer Quality and Risk Reviews (SQR)

Servicer Performance Management
- Measure, monitor, manage overall performance
- Targeted consultative assistance
- Servicer Support Center

Performance Monitoring
- Servicer Total Achievements and Rewards (STAR)™ Program
- Servicer Capability Model, Operational Assessments
- Performance Scorecard

Incentives
- Enhanced Loss Mitigation Incentives

Remedies for Non-Performance
- Compensatory Fees and Servicing Remedies
Fannie Mae contracts with other entities to perform servicing functions under our supervision.

- Sets servicing standards and requirements
- Monitors the direct servicers’ performance
- May remove direct servicers with or without cause
- Approves any transfer of servicing prior to transfer
- Fannie Mae may acquire MSRs in certain circumstances to leverage specialty servicers for high-touch servicing strategies
- Collects payments from borrowers
- Makes servicing advances
- Pursues loss mitigation strategies for defaulted loans
- Ensures foreclosure proceedings are conducted appropriately
- Takes actions as set forth in the Servicing Guide and MBS Trust Agreement
- Oversees subservicer performance and compliance

- Assigned by the direct servicer
- The direct servicer remains fully liable for the performance of all servicing obligations
In performing duties related to the servicing of mortgage loans, servicers must have the following:

- **Experience**: Escrow management, general servicing, investor reporting, custodial funds, default management, quality control
- **Written Procedures**: Fully documented procedures that address all aspects of performing loan servicing, delinquency prevention, default servicing, and foreclosure management
- **Quality Assurance**: Quality assurance processes that are designed, documented, and implemented to ensure servicing practices comply with Fannie Mae’s requirements
- **Staffing and Training**: Staffing levels and training to support acceptable performance standards
- **Procedures for Escalated Cases**: Comprehensive processes and written procedures to promptly respond to escalated cases
- **Master / Subservicer Responsibilities**: Comprehensive processes and written procedures for subservicer selection, oversight, performance assessment and compliance monitoring
Fannie Mae’s ongoing communications are designed to be timely and transparent in order to keep servicers and the market informed of up-to-date policy and requirement changes through Fannie Mae’s *Servicing Guide*.

<table>
<thead>
<tr>
<th>Source</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Servicing Guide</strong></td>
<td>The <em>Servicing Guide</em> explains how to become an approved Fannie Mae servicer and the policies and requirements for performing normal and routine servicing obligations.</td>
</tr>
<tr>
<td><strong>Announcements</strong></td>
<td>Servicing Announcements describe changes to policies and requirements within the <em>Servicing Guide</em>.</td>
</tr>
<tr>
<td><strong>Lender Letters and Notices</strong></td>
<td>Communicate new or modified policies and requirements that may be temporary in nature, reminders of existing policies, or advanced notice of policy changes with future effective dates to be included in future <em>Servicing Guide</em> updates.</td>
</tr>
<tr>
<td><strong>Servicing Notices</strong></td>
<td>Provide notification of information not impacting the <em>Servicing Guide</em> content, such as updates to an exhibit on Fannie Mae’s website.</td>
</tr>
<tr>
<td><strong>Exhibits and Forms Incorporated by Reference</strong></td>
<td>Information about specific forms the servicer must use to fulfill the policies and requirements contained in the <em>Servicing Guide</em>.</td>
</tr>
<tr>
<td><strong>Communication Avenues</strong></td>
<td>The <em>Servicing Guide</em> is available on Fannie Mae’s corporate website; announcements, updates, servicing notices and lender letters are communicated in the following ways:</td>
</tr>
<tr>
<td></td>
<td>• Posting the documents on Fannie Mae’s website and the AllRegs® website, and</td>
</tr>
<tr>
<td></td>
<td>• Email notification to servicers that subscribe to Fannie Mae’s email subscription service and select the option “Servicing News”.</td>
</tr>
</tbody>
</table>
The Servicing Alignment Initiative (SAI) is an FHFA-led effort to establish consistent policies and processes for the servicing of delinquent loans owned or guaranteed by Fannie Mae or Freddie Mac.

Objectives:
- Simplify our requirements for servicers and homeowners
- Increase servicer accountability
- Improved service to borrowers
- More efficient processing of loan modifications

Servicer Motivation:
- Tiered loan modification incentives tied to solution delivery timing
- Uniform compensatory fees

Four key areas are aligned:
- Borrower Contacts
- Delinquency Management Practices
- Loan Modifications and Foreclosure Alternatives
- Foreclosure Timelines

The Servicing Alignment Initiative is a joint GSE effort aimed to ensure servicers are better and more consistently prepared to help at-risk homeowners.
Compliance Oversight
Servicer Quality and Risk (SQR) Reviews

- Measures compliance against the Fannie Mae *Servicing Guide* and decisioning of loss mitigation programs
- SQR Reviews are a combination of loan level and procedural compliance testing
- SQR uses a random sampling for trend identification within the overall population
- Servicers can be selected for risk based targeted reviews
- Standalone cash management reviews are conducted quarterly on select servicers

**Plan**
- Servicer Inclusion
- Sampling Methodology
- Test Plans
- Review scheduling

**Perform**
- Engagement Letter
- Kickoff meeting
- Document requests
- Execute review
- Preliminary findings

**Report**
- Exit meeting
- Confirmation of findings
- Issue Final report
- Issue Action Plan

**Remediate**
- Action plan approval
- Tracking and Reporting
- Escalation
- Clearance / Validation

---

**Ongoing Communication and Training**
SQR reviews are designed to test a servicer’s quality control processes and compliance across key servicing functions.

SQR reviews cover Process Areas across the entire loan life cycle.

- **Customer Service**: Escalations, Call Center compliance to required SLA's tracked monthly.
- **Collections/Delinquent Servicing**: Behavior Models, Solicitations, Forbearance Plans, Repayment Plans.
- **Loan Administration**: Payoffs, SCRA.
- **Investor Reporting/Cash Management**: Custodial Accounting, Cash Receipts.
- **Loss Mitigation**: Retention Solutions, Liquidation Solutions, Making Home Affordable.
- **Foreclosure/Bankruptcy**: Timeline Management, BK Chapter Compliance.

Loan level and procedural testing is performed across areas posing most significant risk to Fannie Mae.

<table>
<thead>
<tr>
<th>Mortgage Insurance</th>
<th>Hazard Insurance</th>
<th>Flood Insurance</th>
<th>Loss Drafts</th>
<th>Property Taxes</th>
<th>HOA/Co-op</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Acceptable carrier • Active policies on required loans • Timely and accurate reporting on canceled policies • Accurate MI payments</td>
<td>• Amount and type of coverage • Deductible amounts • Mortgagee clause • Proper rating of carrier</td>
<td>• Amount and type of coverage • Deductible amounts • Mortgagee clause • Evidence of remapping when discontinuing • Currency of premiums</td>
<td>• Submission of proper forms • Appropriate and timely release of funds • Monitoring of restoration process • Handling of interest on loss draft proceeds</td>
<td>• Timeliness of tax payments (escrowed loans) • Procedure to verify timely tax payments (non-escrowed loans)</td>
<td>• Verify required coverage for condo/co-op • Addressing delinquent HOA premiums</td>
</tr>
</tbody>
</table>
Compliance Oversight
Servicer Quality and Risk (SQR) Reviews

- Final Reports are issued with prescribed corrective actions and expected resolution due dates for each finding tracked in an action plan
- If remediation is not completed by the agreed upon due date or if a servicer is unable to clear a finding, the issue is escalated to cross-functional leadership

- Monthly reports are reviewed to maintain awareness of all open findings and the current status
- SQR provides quarterly status updates and will make recommendations for action for servicers with overall ratings of Needs Significant Improvement or Unsatisfactory and if remediation efforts are stalled or unacceptable to resolve the open finding
- Guidance is issued by leadership for required action

SQR escalates issues that exceed approved action plan dates or if the servicers actions are insufficient to remediate the findings based on remediation retesting results.
Servicer Performance Management

- Performance management teams measure, monitor and manage overall servicer performance commensurate with TDQ and SDQ volume
  - Provide monthly or quarterly performance goals to servicers
  - Discuss performance against each goal and track action items to improve
  - Follow up on remediation of findings from servicer compliance reviews (SQR)

- Subject matter experts work with targeted servicers in a consultative manner to improve performance through effective:
  - Collections
  - Modifications
  - Short sales/Deeds-in-Lieu of foreclosure (DILs)
  - Bankruptcy monitoring
  - Foreclosure processing
  - Accurate reporting

- All servicers
  - Supported by Servicer Support Center for answering policy and process questions
  - Lower TDQ and SDQ volume servicer performance managed proactively through monitoring and outreach

Servicing Management is dedicated to the task of driving servicers to focus on excellence through direct interactions and the sharing of best practices.
Performance Monitoring

STAR™ Program – Overview

The STAR™ Program Reference Guide communicates exactly how servicers will be measured

Monthly scorecards help servicers understand their performance against our expectations

Operational assessments are conducted throughout the year across all key servicing functions – with heavy emphasis on the customer and process reliability

Servicers are eligible for STAR Performer recognition by demonstrating consistent performance in three separate functional process areas

The STAR Program supports the industry by establishing a transparent framework to recognize our servicing partners for performance, consult on best practices, and improve performance.
Performance Monitoring
STAR™ Program – Servicer Capability Model

Business Objectives
- Minimize credit losses
- Increase operational efficiency
- Improve homeowner experience

Critical Success Factors
- Manage technology to meet business objectives
- Implement internal controls and risk mgmt
- Recruit and retain skilled employees
- Provide governance and change mgmt
- Maintain well managed processes
- Effectively manage and oversee vendors
- Ensure information integrity and quality
- Maintain strategic and resourceful mgmt
- Satisfy customer needs
- Utilize performance mgmt system
- Practice sound financial mgmt
- Adhere to regulatory and compliance requirements

Processes
- General Servicing
  - Investor Reporting / Accounting
  - Loan Administration
  - Customer Service
  - Investor Relationship Management
  - Vendor Management
- Collections and Loss Mitigation
  - Collections
  - Loss Mitigation
- Timeline Management
  - Bankruptcy ("BK")
  - Foreclosure ("FCL")
  - Property Preservation / Post-FCL Management

Key Capability Indicators
- People Management
- Results / Outcomes
- Processes and Controls
- Customer Measures
- Technology and Data

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Servicer capabilities are assessed across each key functional area, including a review of relevant people strategies, processes, and applicable metrics.
Performance Monitoring
STAR™ Program – Scorecard

Profile Based Performance Management

General Servicing
- Transition to 60+
- Shortage Percentage
- Multi-Ocurrence Hard Reject
- Multi-Ocurrence Soft Reject
- Average Speed to Answer
- Abandonment Rate

Solution Delivery
- 60+ to Cure
- Retention Efficiency
- Liquidation Efficiency
- 12 Month Mod Performance
- Average Speed to Answer
- Abandonment Rate

Timeline Management
- Average Age Beyond Timeline
- Beyond Timeline Resolution Rate
- Timely DataGram Filing
- Title Issue Resolution Rate
- Timely MFR Referral

2016 STAR Program Year Scorecard Metrics

Metrics and weights are selected based on the correlation between how servicers performed on these metrics to the impact those same servicers had on reducing Fannie Mae’s credit losses.
Incentives
Enhanced Loss Mitigation Incentives

- Tiered incentives tied to solution delivery timing:
  - Mods: Incentives as high as $2,100 for Home Affordable Modification Program (HAMP) mods at <=120 days delinquent (DLQ)
  - Short Sales & DILs: Incentives as high as $2,500 for closings at <=210 days DLQ
- Encourages earlier contact and faster solution delivery, designed to:
  - Improve outreach and service to borrowers
  - Achieve better post-mod performance
  - Align investor and servicer benefits
  - Increase value returned to taxpayers
- Faster solution delivery leads to better pull through and post-loss mitigation performance, increasing performance on key STAR metrics
- Small scale pilots are used to research effectiveness of incentive options

Incentives are leveraged to motivate servicers to deliver improved performance.
Fannie Mae actively monitors servicers and enforces remedies for servicing breaches:

1. **Define Observed Harm**
2. **Define Remedies**
3. **Monitor for Breaches**
4. **Select and Enforce Remedies**
5. **Finalize or Escalate**

Fannie Mae generally follows a waterfall approach to enforcing remedies for servicing defects:

- **Opportunity to Cure** – Servicers typically are given an opportunity to correct a servicing defect
- **Repurchase Alternative** – If the servicer is unable to correct the servicing defect, Fannie Mae’s primary remedy generally is a repurchase alternative (e.g., indemnification for actual monetary damages incurred by Fannie Mae)
- **Repurchase** – A form of remedy whereby the servicer purchases either the mortgage loan or the property that was securing the mortgage loan, typically used when no other remedy is available and the servicing defect jeopardizes Fannie Mae’s security interest or is incompatible with Fannie Mae systems

Fannie Mae also assesses compensatory fees in certain circumstances to compensate Fannie Mae for damages caused by poor performance by the servicer.

**Servicing remedies and compensatory fees are enforcement mechanisms that Fannie Mae uses to emphasize the importance of servicer performance and compliance to its Servicing Guide.**
Foreclosure Prevention and Management

Borrower Outreach
- Quality Right Party Contact is a uniform standard for communicating with the borrower about resolution of the mortgage loan delinquency
- Know Your Options Customer Care scripting and training improve servicers’ engagement with borrowers

Loss Mitigation Options
- Servicer must evaluate a borrower in need of assistance for all available workout options
- The loss mitigation hierarchy is designed to provide the most appropriate workout option to a borrower while minimizing credit losses to Fannie Mae
- Servicing Management Default Underwriter™ (SMDU™) evaluates options

Foreclosure Management
- Servicers play a key role in ensuring that foreclosure proceedings are conducted appropriately
- Monitoring foreclosure practices and ensuring adherence to policy as well as federal and local regulations is critical to minimize risk and loss to Fannie Mae

Engagement of Law Firms
- Servicers are responsible for selection, management, and monitoring of attorneys
- Fannie Mae maintains controls for attorney monitoring
Borrower Outreach

Quality Right Party Contact (QRPC) is a uniform standard for communicating with the borrower, co-borrower, or a trusted advisor (collectively referred to as “borrower”) about resolution of the mortgage loan delinquency. The servicer must make every attempt to achieve QRPC.

The purpose of QRPC is to:

- Determine the reason for the delinquency and whether it is temporary or permanent in nature
- Determine whether or not the borrower has the ability to repay the mortgage loan debt
- Educate the borrower on the availability of workout options, as appropriate
- Obtain a commitment from the borrower to resolve the delinquency
## Borrower Outreach

<table>
<thead>
<tr>
<th>Efforts to Contact Borrower by Phone</th>
<th>Efforts to Solicit Loss Mitigation by Mail</th>
<th>Foreclosure Related Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1-30</strong></td>
<td><strong>31-60</strong></td>
<td><strong>61-90</strong></td>
</tr>
<tr>
<td><strong>91-120</strong></td>
<td><strong>121-150</strong></td>
<td><strong>151-180</strong></td>
</tr>
<tr>
<td><strong>181-210</strong></td>
<td><strong>211-240</strong></td>
<td><strong>241-270</strong></td>
</tr>
<tr>
<td><strong>270-360</strong></td>
<td><strong>361-390</strong></td>
<td><strong>391-420</strong></td>
</tr>
</tbody>
</table>

### Day 36: No later than day 36, collection calls every five days until Quality Right Party Contact, Borrower Response Package received, or delinquency status is resolved

### Day 210: Servicer is authorized to continue outbound contact attempts until Quality Right Party Contact, Borrower Response Package received, or delinquency status is resolved

### Borrower Outreach

- **Modification Related Activities When Borrower Response Package (BRP) Received**
  - Servicer has 30 days to evaluate borrower for a workout option and provide an Evaluation Notice to borrower within 5 days of decision
  - Borrower may appeal a denial for modification within 14 days of receiving evaluation; the servicer then has an additional 30 days to review the appeal
  - If granted modification, borrower enters into a Trial Period Plan which has a duration of 3-4 months depending on delinquency at start of trial
Borrower Outreach

Know Your Options Customer Care leverages a servicer's ownership model to establish consultative customer relationships, maintain right party contact, and properly position on all available workout solutions.

Provides servicers with guidance and training about using an ownership model (Single Point of Contact/SPOC) under a consultative relationship approach.

The Know Your Options Customer Care team is responsible for setting standards related to call monitoring and engages directly with servicers to conduct routine training and call calibration.

Fannie Mae Benefits

- Reduction in credit losses saves tax payer dollars
- Reduction in foreclosures and SDQ
- Suite of solutions available to homeowners earlier in the delinquency cycle results in better loan performance and helps increase profitability

Servicer Benefits

- Improved response rates and take-up rates
- Improved STAR performance
- Minimize reputational risk with homeowners
- Set standard of customer service excellence in the industry
- Increased incentives for earlier loss mitigation resolution
- Reduction in compensatory fees and operational expenses – fewer follow up calls and letters

Homeowner Benefits

- All options to avoid foreclosure are discussed early in the delinquency
- Early engagement promotes relationship building and homeowner advocacy
- The SPOC increases satisfaction with the loss mitigation experience
- More options available earlier in the delinquency cycle increases the likelihood of the customer remaining in their home

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Loss Mitigation Options
Fannie Mae’s Loss Mitigation Hierarchy

The servicer must evaluate a borrower in need of assistance for all available workout options based on the hardship type, duration of delinquency, and his or her intention to remain in the property. The servicer must first consider a reinstatement when the delinquency resulted from a temporary hardship that has been resolved and the servicer has determined that the borrower has the ability to bring the mortgage loan current.

A summary of the most frequently used Fannie Mae workout options available to assist a borrower experiencing a hardship relating to a conventional first lien mortgage loan are below:

<table>
<thead>
<tr>
<th>Temporary Hardship</th>
<th>Unresolved Hardship</th>
<th>Resolved Hardship</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Forbearance Plan</td>
<td>Repayment Plan</td>
</tr>
</tbody>
</table>

Retention:
The servicer must first consider a reinstatement when the delinquency resulted from a temporary hardship that has been resolved and the servicer has determined that the borrower has the ability to bring the mortgage loan current.

Permanent Hardship:
A borrower who is experiencing a hardship that has resulted in a permanent or long-term decrease in income or increase in expenses.

Current to 89 Days Delinquent:
- HAMP
- Standard Modification

≥ 90 Days Delinquent:
- Streamlined Modification
- HAMP
- Standard Modification

Liquidation:
- Short Sale
- Mortgage Release

- Short Sale
- Mortgage Release

Fannie Mae’s loss mitigation hierarchy is designed to provide the most appropriate workout option to a borrower while minimizing credit losses to Fannie Mae.

(1) The servicer must refer to the Fannie Mae Servicing Guide for the requirements related to eligibility for a workout option.
To reduce the credit losses Fannie Mae ultimately incurs on its book of business, the company has been focusing its efforts on several strategies, including reducing defaults by offering home retention solutions, such as loan modifications:

<table>
<thead>
<tr>
<th>Loss Mitigation Options</th>
<th>Loan Modification Options</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HAMP</strong></td>
<td>• HAMP is one of the key initiatives under the Obama Administration’s Making Home Affordable Program, aimed at helping borrowers who are currently delinquent or at imminent risk of default by making their mortgage payment more affordable and sustainable; seeks to lower a borrower’s monthly mortgage payment to 31% of their gross monthly income</td>
</tr>
<tr>
<td><strong>Standard Modification</strong></td>
<td>• Provides the borrower with an affordable and sustainable monthly payment by capitalizing arrearages, reducing interest rate, extending mortgage loan term, and offering forbearance (if applicable)</td>
</tr>
<tr>
<td><strong>Streamlined Mod</strong></td>
<td>• Provides borrowers who are at least 90 days delinquent with the opportunity to lower their monthly mortgage payments through a non-documentated modification (BRP is not required)</td>
</tr>
<tr>
<td><strong>Cap and Extend Modification for Disaster Relief</strong></td>
<td>• Provides a modification solution for borrowers who have experienced a short-term or temporary hardship that has been resolved, where the borrower has the ability to make the full contractual monthly payments but remains delinquent</td>
</tr>
<tr>
<td><strong>Streamlined Modification Post Disaster Forbearance</strong></td>
<td>• The property securing the mortgage loan must be located in a FEMA Declared Disaster Area eligible for Individual Assistance, and a BRP is not required to qualify for modification</td>
</tr>
</tbody>
</table>
Servicing Management Default Underwriter™ (SMDU) is a proprietary loss mitigation platform used by servicers for real-time evaluation and decisioning of Fannie Mae loss mitigation programs.

**Key Benefits**
- Ensures accurate and consistent interpretation and delivery of Fannie Mae policy
- Reduces liability through limited representations and warranties relief
- Facilitates faster adoption of Fannie Mae loss mitigation programs
- Decreases costs associated with implementing and maintaining Fannie Mae loss mitigation guidelines and programs
- Enables access to new products
- Increases productivity through process improvements
- Enhances customer service by quickly providing borrowers with accurate and consistent decisions
Maintain an accurate foreclosure timeline and status tracking system as well as all related foreclosure documentation

Processes that facilitate, and monitor foreclosure attorney inquiries and response times

Key Metrics
- % of sales held inventory pull-through rate
- 180+ days delinquent no referral
- Sales held to foreclosure inventory
- Foreclosure holds to inventory
- Loans Beyond Foreclosure Timeline Standard
- Average Age of Loans Beyond Foreclosure Timeline Standard

Process Rating
- Optimizing
- Managed
- Standardized
- Initial
- Undeveloped

Servicers play a key role in ensuring that foreclosure proceedings are conducted appropriately. Metrics track their performance and influence their STAR rating.
## Engagement of Law Firms

<table>
<thead>
<tr>
<th>Servicer responsibilities in law firm engagement:</th>
<th>Selection</th>
<th>Oversight</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Training</td>
<td>Retention</td>
</tr>
<tr>
<td></td>
<td>Suspension</td>
<td>Termination</td>
</tr>
<tr>
<td></td>
<td>Performance Management</td>
<td>Compliance Monitoring</td>
</tr>
</tbody>
</table>

- Fannie Mae requires servicers to:
  - Select law firms that meet Fannie Mae’s minimum requirements
  - Monitor firm performance and oversee firm compliance with Fannie Mae requirements
  - Maintain procedures that document firm selection, retention, performance monitoring, and compliance oversight and maintain evidence of firm due diligence and procedural adherence
  - Escalate matters requiring attention to Fannie Mae within two business days and maintain robust processes and procedures around file transfers and subsequent notification to Fannie Mae

- Fannie Mae conducts on site law firm visits to assist in introducing best practices and performance enhancing processes
- Fannie Mae retains the right to direct the servicer to suspend referrals, transfer files or terminate a law firm as necessary.

**Servicers are responsible for engaging and managing law firms. Fannie Mae sets servicer requirements and maintains the right to take direct action with respect to a law firm as necessary.**
Management of Law Firms

- Servicers are primarily responsible for managing the performance and overseeing the compliance of Mortgage Default Counsel (MDC) firms, but Fannie Mae retains the right to take direct action with firms as necessary.

  - A cross-functional, officer-level group within Fannie Mae responsible for ensuring consistent and coordinated responses to issues with MDC firms.

- Fannie Mae maintains a schedule of allowable fees and costs on a state by state basis and requires servicers to ensure that fees charged by MDC fall within these allowable amounts.

- SQR reviews test servicer compliance with MDC requirements; identified issues are included in remediation plans.
  - Reviews test to ensure that adequate controls are in place.
  - Controls help ensure that referrals are only made to approved and retained firms.

- Dedicated Fannie Mae Team
  - Assists servicers in monitoring the performance of MDC firms and mitigates risk by escalating concerns.
Single-Family Real Estate

- Full range of distressed real estate capabilities utilized for management of the industry’s largest portfolio. Disposed of over 1.5 million homes since 2009.
- Disposition capabilities include Non-performing Loan (NPL) Sales, Short Sales, Foreclosure Auction Sales, REO Retail Sales, REO Auction Sales & REO Pool Sales.
- Fannie Mae utilizes a best execution strategy to sell properties at any point in the process based on an NPV comparison to a sale of a move-in ready home sold to an owner-occupant.
- Fannie Mae utilizes a 100% In-House REO Sales team leveraging a 2,600 member nationwide Realtor network. Sales teams are dispersed geographically based on volumes.
- Fannie Mae leverages our Homepath.com website which had 24M visits in 2015 to market our REO properties, provide information to the public, and as a short sale portal for real estate agents.
- Peer performance based on publicly available severity levels and MLS data shows placement among the industry leaders.

Single-Family Real Estate is focused on minimizing loss severities by maximizing sales prices and supporting neighborhood stabilization.
REO Platform Overview

1. Property Acquisition

- Prepare Property “Secure & Make Ready for Sale”
  - Initial Property Inspection within 24 hrs
  - Tenant Protection Directive compliance
  - Risk Controlled
    - Eviction & Redemption
    - Property Preservation
    - Repair Bid Review
    - Property & Vendor QC
    - Title Curative / Vesting
    - Closing Management

2. Property Valuation “Get the Value Right”

- Multiple valuation products & data points
  - Appraisal & BPO
  - External market data
  - Internal data – market & historical
- Value Reconciliation – forward view of markets
- Local Market Field Appraisers/Trainers

3. REO Listing & Sales Management Tools Strategy & Best Execution

- Agent Assignment Tool
- List Price Guidance
- Repair Recommendation Tool
- Homepath.com (Offer Online, First Look Clock)
- Workflow, task-based system which includes
- Property & Vendor QC (includes secret shopper)

4. REO Sales Execution Channels

- Owner Occupant
  Note: Includes sales to qualified Public Entities & Non-Profits

- Individual Investor

- Pool & Auction Sales

Single-Family Real Estate
Fannie Mae maintains an in-house property valuation team to determine property values.

- A team of Fannie Mae employees, including representatives throughout the country in Fannie Mae’s top markets who provide market intelligence and inspect properties that have been valued.
- Leverage a panel of 2,000 third party appraisers and ten national Broker Price Opinion (BPO) & alternative value vendors providing property condition and value information.

**Why are we different?**

1. **Best-in-Class Staff** – experienced leadership and extensively trained reviewers; field reps in key markets providing vendor training, inspections and local market knowledge.

2. **Data & Tools** – Collateral Underwriter & MLS; market leading valuation volume (>2.5M since 2009) creating trending analyses.

3. **Vendor Performance** – highly trained appraiser panel and BPO/alternative providers; vendor scorecards continually refine vendor panels.

The Single-Family Valuation team determines property values to support REO sales, short sales, bids for foreclosure sales, and NPL sales.
Pre-foreclosure Loan Disposition Options

Short Sales

- In 2012, Fannie Mae began moving from a delegated short sales model to one that is completely managed in house as of mid-2014
- Pricing is determined in conjunction with Fannie Mae’s valuations team and negotiated directly with the buyer’s agent
- All borrower communications are distributed through the servicer
- By managing the short sales process in-house, Fannie Mae achieves lower severity sales reducing credit losses over a delegated model

Mortgage Release

- Mortgage release provides borrowers an expedited option to relieve their mortgage by avoiding negotiations through a real estate agent.
- The mortgagor deeds the collateral property back to the mortgagee in exchange for release of repayment obligations under the mortgage
- Once a mortgage release agreement is reached, Fannie Mae will not pursue deficiency judgment against the borrower
- A borrower may choose between three options upon mortgage release; immediate vacancy, a 3 month transition, or 12 month transition
  - 3 Month: Borrower completes mortgage release but is permitted to live in the property rent free for 90 day period
  - 12 Month: Borrower continues lease for 12 months after mortgage release with rent determined through a review of the former owners financial ability in conjunction with a market review
- The mortgage release option contributes to an average net present value savings over REO
**Property Disposition Paths**

1. **Borrower Delinquent**
   - Loan Modified
   - Short Sale
   - Mortgage Release
   - Third Party Purchase at Foreclosure Sale
   - REO Disposition

2. **Loan Modification Offered**
   - Qualify & Accept?
     - YES
     - NO
   - Short Sale Option Offered
     - Offer Accepted
     - Offer Received
     - Mortage Release Offered
     - Borrower Accepts
     - Borrower Declines
     - Foreclosure Sale
     - Sold to Third Party
     - REO Inventory
     - No

3. **Non-Performing Loan Sales**
   *Number of loans / properties*
## Real Estate Fulfillment

### Occupied Property Management
- Hybrid In-house/Outsourcing and Risk-based Framework for Eviction and Redemption Issue Follow-up
- Attorney and Property Management Company Oversight & Performance Management
- Robust Relocation Assistance Program
- Multiple Lease Products Offered
- Occupied Sales

### Property Maintenance & Field QC
- National and Regional Suppliers Providing Initial and Ongoing Maintenance Services
- Expansive Product and Service Offerings – Clear Boarding, Landscaping, Roof/Gutter Cleaning, Fence Repair
- Multiple Layers of Quality Control – Broker Signoffs (BSO), Inspection Firms, and Fannie Mae Employed Field Reps
- Comprehensive Oversight Structure – Vendor Management, Field Service Guide, Homepath.com Escalation Path
- Diverse Set of Inspection Products – Vacant, Occupied, Repair, JV Rental Pool

### Title, Closing, HOA Operations
- Title curative and Disposition Functions Leveraging Local and National Attorneys and Companies
- Flexible Capacity Model for Title Issue Follow-up and Closing Activities
- HOA/COA Identification, Negotiation, and Payment Facilitation
- Multiple Disposition Channel Support

### Repairs
- Vast Repair Contractor Network
- In-house/Outsourcing Repair Bid Review and Repair Job Oversight
- Economies of Scale/Unit-based Pricing - Roofing, Plumbing, Carpentry, Electrical, Drywall, and Carpet/Vinyl
- Specialized Products & Strategic Alliances
- Data-centric Decision Making
- Quality Assurance of Repairs

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Occupied Property Management

Leased Properties

Fannie Mae attempts to obtain a copy of the lease, or tenancy information to qualify occupants as tenants

- Bona fide leases are honored, or a 60 day notice to vacate is provided when applicable.
- Expired leases may be extended on a month to month basis, depending on tenant needs

- Properties with existing leases are held as “do not market” until the lease expires. Properties with Fannie Mae leases are marketed 60 days prior to lease expiration
- Appropriate notice to vacate is sent prior to lease expiration by the property manager

- Property Management companies are Fannie Mae’s eyes and ears on the ground for marketed properties performing weekly inspections (Fannie Mae’s agents get involved on leased properties when marketed for sale)
- Fannie Mae is responsible for repairs
- Fannie Mae utilizes a network of vendors to perform these repairs nationwide

Non leased-Occupied Properties

- Fannie Mae offers a “Relocation Assistance” “RA” program aka (Cash for Keys)
  - Payout amount varies by state and with incentive for quick occupant relocation
  - For owner occupied properties eviction is pursued simultaneously with Relocation Assistance
  - Non owner occupied we exhaust the RA first and then order the eviction.
  - Fannie Mae pursues a lock out route in only 10-15% of cases
Property Maintenance & Repairs

- Fannie Mae performs maintenance on 100% of our assets via a network of national and regional providers that perform the initial clean out and ongoing maintenance including cutting grass, cleaning interiors, and ensuring in general that homes are free of safety hazards
  - Maintenance continues until sale closes
  - Leverage economies of scale to control costs
- A suite of checklists and a robust QC process collectively ensure that our requirements are met and that properties are staged appropriately (staging refers to maximizing curb appeal). This process is collectively monitored by our agents, our third-party QC firms, and Fannie Mae field reps.
- Although property repairs are primarily concentrated in paint and flooring, they can also include light carpentry, installation of appliances and HVAC systems, and fixture replacement
- We leverage economies of scale through contracts with national flooring vendors, appliance manufacturers, HVAC system providers and other suppliers

Throughout the disposition process, Fannie Mae employs a robust quality control layer, leveraging a network of 100+ repair contractors to maximize cost savings and efficiency.
Pricing Strategies

- After a property is listed, we regularly review and evaluate property specific factors to ensure consistent and accurate pricing strategies:
  - Number of offers received
  - Number of showings conducted
  - Identified target buyer
  - Price adjustments
  - Incentives such as closing cost assistance
  - Need to replace agent
  - Alternative disposition strategies

- The agent, along with the Fannie Mae Asset Manager performs systematic reviews of the market to determine the appropriate valuation while the property remains listed; reviews are also conducted whenever changing market conditions command.

- Additionally, Fannie Mae convenes a SF Real Estate Meeting which meets regularly discussing market trends and monitoring current market values versus appraised values making upward or downward price adjustments. Modeling and Analytics attendees provide MSA and state level list price guidance to the sales team helping to further calibrate our pricing strategies.

- Expertise in local and national markets allows Fannie Mae to implement optimal disposition strategies to mitigate loss.

Fannie Mae monitors property activity, making adjustments to improve the potential for sale.
HomePath® and FirstLook™

- HomePath is the branding used for all Fannie Mae-owned properties and their sales transactions.
- HomePath.com allows buyers and agents to search Fannie Mae’s inventory of move-in ready foreclosed properties, access tools and resources, and get help with the buying process.
- A convenient system allows users to search for properties based on specified criteria and submit an offer online.
- Fannie Mae’s innovative First Look marketing period was created to promote homeownership and contribute to neighborhood stabilization — gives preference to owner-occupant buyers.
- For participating Servicers, HomePath.com gives agents the ability to submit short sale offers and consideration.

Owner occupants generally pay more for properties and are positive contributors to neighborhood stabilization.
For More Information
Additional Resources

Single-Family Loan Performance Data

Single-Family Selling Guide
https://www.fanniemae.com/content/guide/selling/index.html

Single-Family Servicing Guide
https://www.fanniemae.com/singlefamily/servicing

Loan Quality Page
https://www.fanniemae.com/singlefamily/loan-quality

Origination & Underwriting Learning Center
https://www.fanniemae.com/singlefamily/originating-underwriting-learning-center?taskId=task-67

https://www.fanniemae.com/content/announcement/sel1208.pdf
https://www.fanniemae.com/content/announcement/sel1405.pdf
https://www.fanniemae.com/content/announcement/sel1414.pdf
Lender Letters: Fannie Mae’s Quality Control Process
https://www.fanniemae.com/content/announcement/ll1205.pdf
https://www.fanniemae.com/content/announcement/ll1207.pdf

QC Self-Assessment Worksheet

Collateral Underwriter
https://www.fanniemae.com/singlefamily/collateral-underwriter

Manage your Post-Purchase Risk: Strategies to Increase Your Confidence in Loan and Data Quality
https://www.fanniemae.com/content/tool/manage-post-purchase-risk.pdf
For More Information
Additional Resources

STAR Reference Guide
https://www.fanniemae.com/content/tool/star-reference-guide.pdf

STAR Operational Performance Scorecard White Paper 2014
https://www.fanniemae.com/content/tool/star-credit-scorecard-whitepaper.pdf

Servicing Management Default Underwriter (SMDU)

Know Your Options Customer CARE
https://www.fanniemae.com/singlefamily/know-your-options

Fannie Mae Housing Industry Forum
http://www.housingindustryforum.com/
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