Announcement 08-26  
October 14, 2008

Amends These Guides: Selling

Comprehensive Risk Assessment Approach to Manual Underwriting

Introduction

*Selling Guide, Part X, Chapter 3: Comprehensive Risk Assessment*

Every mortgage loan delivered to Fannie Mae must be underwritten to establish that the borrower has the willingness and ability to repay the debt and that the property is sufficient collateral for the mortgage loan. Fannie Mae offers two underwriting methods lenders may use to make a decision about whether to approve or decline a mortgage application – Desktop Underwriter® (DU®) or manual underwriting. Each method uses a risk assessment that relies on a comprehensive examination of the primary and contributory risk factors in a mortgage application to reach an underwriting recommendation that is based on the cumulative effect of the total comprehensive risk.

Fannie Mae considers DU’s risk assessment to be a more precise measure of comprehensive risk and the standard by which Fannie Mae assesses default risk on all mortgage loans. With the exception of certain transactions that must be underwritten through DU, a lender may prefer to manually underwrite some or all of the mortgage loans it originates and sells to Fannie Mae. Fannie Mae expects a lender that chooses to manually underwrite to thoroughly assess the default risk of the mortgage loans by using the comprehensive risk assessment approach that is outlined in this Announcement.

To assist lenders with this comprehensive risk assessment, Fannie Mae is introducing the Comprehensive Risk Assessment Worksheet for Manual Underwriting. This worksheet condenses and translates instructions for manual underwriting into a tool for lenders to use when they assess the cumulative effect (both positive and negative) that various risk factors have on mortgage loan performance. In addition to streamlining the text in the *Selling Guide*, this Announcement updates the policy on contributory risk factors to align with DU
and recent research on risk factors that impact default. The worksheet is attached to this Announcement and is also posted on eFannieMae.com. In addition, the Comprehensive Risk Assessment Case Study that currently exists in Part X, Chapter 3, Exhibit 1 of the Selling Guide is no longer applicable.

The basic objectives for underwriting the borrower and the property remain the same. A lender must assess the overall default risk of a mortgage application and determine whether or not the mortgage loan is eligible for delivery to Fannie Mae. The lender continues to be responsible for obtaining all necessary information to make an informed underwriting decision and for including in the individual mortgage file sufficient documentation and justification to support the underwriting decision.

**Fannie Mae Comprehensive Risk Assessment Worksheet for Manual Underwriting**

The following information outlines the steps for using the worksheet. Complete instructions are documented directly in the worksheet. Refer to the Attachment for additional information.

The lender must first determine that the mortgage loan satisfies Fannie Mae’s eligibility criteria by performing a preliminary review of the borrower's application. The lender's level of review to determine whether an application meets the applicable eligibility criteria should be the same for each mortgage loan. This eligibility review must occur before underwriting begins because predictive risk factors are incorporated into eligibility grids, specifically: loan-to-value (LTV), combined loan-to-value (CLTV), and home equity combined loan-to-value (HCLTV) ratios (collectively referred to as LTV ratios); representative credit score; product type; purpose; occupancy; and number of units.

The overall risk of a mortgage application is determined by first evaluating the primary risk factors and then analyzing the effect that contributory risk factors have on the primary risk factors. The worksheet lays out the three steps necessary to conduct a comprehensive risk assessment and provides instructions for each one:

- **Step 1 – Assess Primary Risk.** The primary risk factors in a mortgage application are the combined *equity investment* (as measured by the LTV ratios) and *credit history* for all of the borrowers applying for the mortgage loan (as measured by the representative credit score). A mortgage loan at the maximum eligible LTV ratios and minimum eligible representative credit score is deemed to have high primary risk.

- **Step 2 – Assess Contributory Risk.** Contributory risk factors are those risk factors that are not of sufficient weight by themselves for a lender to use as the basis for reaching an underwriting decision. However, when combined with primary risk factors or other contributory risk factors, they either increase or decrease the overall risk of a mortgage application. The contributory risk factors that have the greatest influence on mortgage loan performance, and that have not already been taken into consideration as part of the eligibility review are:
− mortgage term,
− total debt-to-income ratio,
− liquid financial reserves,
− previous mortgage payment history,
− prior bankruptcy or foreclosure, and
− presence of co-borrowers.

Certain contributory risk factors may have greater influence on mortgage loan performance than others. However, contributory risk factors only become meaningful when they are considered with other risk factors.

- **Step 3 – Assess comprehensive risk of the mortgage loan as a whole.** The cumulative effect of the layering of risk factors in a mortgage application – without sufficient offsets to lower the risks – will increase the risk of mortgage loan default. In addition to determining whether the mortgage loan meets Fannie Mae’s eligibility criteria and reviewing the acceptability of the documentation in the file, the lender must assess the comprehensive risk of the mortgage loan before deciding whether to deliver it to Fannie Mae.

**Updated Guidance on Specific Risk Factors**

The potential contribution of certain risk factors to increase or decrease the overall risk has been updated to reflect current research. The changes are noted below.

- **Presence of co-borrowers** is no longer considered a significant risk offset; however, the presence of a co-borrower with a strong credit history decreases risk.

- **Liquid financial reserves** are another contributory risk factor. Fannie Mae has revised the amount of reserves that increase or decrease risk. Refer to the worksheet for additional information. (The standard requirement for documentation of minimum reserves, as discussed in the Selling Guide, Part X, Chapter 6, is unchanged.)

- **Type of employment** has been removed from the list of contributory risk factors. When all other risk factors are held constant, the default rate for a self-employed borrower is not significantly higher than that for a salaried borrower. This risk assessment in underwriting is separate and distinct from the requirement to identify and document a stable monthly income for every borrower, which may be more difficult or complex to complete for a self-employed borrower. Once a stable monthly income figure has been documented, the risk of the mortgage loan should not be viewed as greater for a self-employed borrower than for a salaried borrower.

The worksheet incorporates these changes and reflects the revisions regarding prior bankruptcy, prior foreclosure, and prior deed-in-lieu recently published in Announcement 08-16: Bankruptcy, Foreclosure, and Conversion of Principal Residence Policy Changes; and Revised Property Value Representation and Warranty Requirements.
As a reminder, when reviewing any of these risk factors as part of a comprehensive risk assessment, the lender is required to determine that the borrower meets minimum eligibility criteria as presented in the Selling Guide. The lender remains fully responsible for evaluating the default risk of each mortgage loan, assessing the adequacy of the property as collateral for the mortgage requested, and determining whether or not it is appropriate to deliver the mortgage loan to Fannie Mae.

**Effective Date**

Use of the worksheet or inclusion of it in the mortgage file is not required, but it is highly recommended. However, all mortgage applications dated on or after January 1, 2009 that are manually underwritten must be underwritten using the revised comprehensive risk assessment guidelines.

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Lenders who have questions about Announcement 08-26 should contact their Customer Account Team.

Michael A. Quinn  
Senior Vice President  
Single-Family Risk Officer
OVERVIEW
This Comprehensive Risk Assessment Worksheet is a tool to assist the lender in identifying the approximate likelihood of mortgage default risk for a manually underwritten loan. It does not represent a specific eligibility recommendation and may not be used to override a Desktop Underwriter® underwriting recommendation. This worksheet is divided into 3 steps. Follow the instructions to complete steps 1, 2, and 3 in order. Lender’s representations and warranties apply.

Note: Before using this worksheet, first confirm that the mortgage loan under review meets the eligibility requirements as described in the Selling Guide.

STEP 1: PRIMARY RISK ASSESSMENT

INSTRUCTIONS FOR STEP 1
The first step in a comprehensive risk assessment is to identify the primary risk of the mortgage loan being reviewed.

Assess the primary risk factors using the chart at the right. Locate the intersection of the LTV (CLTV or HCLTV if subordinate financing exists) and the representative credit score for the mortgage loan (determined per the instructions in the Selling Guide).

After identifying the level of primary risk based on the location in the chart, mark the appropriate box below that represents the primary risk of the mortgage loan under review (low, moderate, or high).

A mortgage loan at the maximum eligible LTV/CLTV/HCLTV and minimum eligible representative credit score should be considered to have high primary risk.

Step 1: Assess Primary Risk Based On Equity Investment and Credit History
Use these boxes to mark your assessment of primary risk

<table>
<thead>
<tr>
<th>Equity Investment and Credit History</th>
<th>Low Risk</th>
<th>Moderate Risk</th>
<th>High Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>LTV/CLTV (Representative Credit Score)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

INSTRUCTIONS FOR STEP 2: Contributory Risk Assessment
Read the following notes before using the chart on the next page:
- Property type, occupancy type, transaction (purpose) type, and product type are all contributory risk factors already taken into consideration as part of Fannie Mae's eligibility criteria for standard products and special products. The items listed below are those contributory risk factors not already incorporated into our eligibility criteria.
- For each row on the chart, circle the box that includes the characteristic that applies to the mortgage loan under review. For example, if the mortgage loan has a total debt-to-income (DTI) ratio of 36%, circle the middle box (>30% and ≤40%) under the Risk-Neutral heading. Continue until you have circled one box per row, or determined that it is not applicable.
- Areas shaded and marked with an "N/A" do not apply. For example, the lack of a prior bankruptcy does not decrease risk and mortgage terms greater than 25 years do not increase risk.
- If the specific mortgage loan being requested must meet a higher minimum eligibility requirement (e.g., 6 months' reserves for an investment property), that minimum eligibility requirement must be viewed as risk-neutral rather than a factor that decreases the risk of the mortgage loan.
STEP 2: ASSESS CONTRIBUTORY RISK FACTORS

<table>
<thead>
<tr>
<th>Contributory Risk Factor</th>
<th>Significantly Decreases Risk</th>
<th>Decreases Risk</th>
<th>Risk-Neutral</th>
<th>Increases Risk</th>
<th>Significantly Increases Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage Term</td>
<td>≤15 years</td>
<td>&gt;15 and ≤25 years</td>
<td>≥25 years</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Total DTI Ratio</td>
<td>≤10%</td>
<td>&gt;10% and ≤30%</td>
<td>&gt;30% and ≤40%</td>
<td>&gt;40% and ≤45%</td>
<td>&gt;45%</td>
</tr>
<tr>
<td>Liquid Reserves</td>
<td>≥24 months</td>
<td>&lt;24 and ≥6 months</td>
<td>&lt;6 and ≥2 months</td>
<td>&lt;2 and ≥1 months</td>
<td>&lt;1 month</td>
</tr>
<tr>
<td>Previous Mortgage Payment History</td>
<td>0 x 30 days late within 24 months</td>
<td>0 x 30 days late within 12 months</td>
<td>1 x 30 days late within 12 months</td>
<td>2 x 30 days late or 1 x 60 days late within 13 – 24 months</td>
<td></td>
</tr>
<tr>
<td>Prior Bankruptcy (BK)</td>
<td>None</td>
<td>Any history of BK</td>
<td>Any BK within 5 years* OR repeat filer</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Prior Foreclosure (FC), Deed-in-lieu (DIL), or Preforeclosure Sale | None | Any history of FC, DIL, or preforeclosure sale | • FC within 6 years*  
• DIL within 5 years*  
• Preforeclosure sale within 3 years* |
| Presence of Co-Borrower  | Co-borrower with applicable credit score ≥700 |

* Refer to the Selling Guide for minimum elapsed time requirements since BK or FC, etc., and for guidance on identifying and documenting extenuating circumstances that may apply.

INSTRUCTIONS FOR STEP 3: Comprehensive Risk Assessment

Read the following notes before making a final assessment of risk:

- Review the contributory risk factors that apply to the mortgage loan under review to determine how they affect the primary risk assessment (Step 1). Generally, the presence of two or more contributory risk factors that are identified as “decreases risk” or “increases risk” will result in the comprehensive risk level shifting to a different risk rating from the one established in Step 1.
- Take into consideration whether the representative credit score and LTV/CLTV/HCLTV are at the minimum and maximum, respectively, per the applicable eligibility grid or whether the mortgage loan has either a credit score cushion (above the minimum for that transaction, property, and product type) or has an LTV/CLTV/HCLTV cushion (below the maximum LTV/CLTV/HCLTV) or both. Consider whether these factors present a risk layering or risk mitigating effect.
- If the mortgage loan is below the minimum credit score and at the maximum LTV/CLTV/HCLTV per the eligibility criteria, identify and document contributory risk factors that sufficiently decrease risk to deliver the mortgage loan to Fannie Mae, as long as the representative credit score is at or above the applicable floor (the higher of 580 or 40 points below the minimum score per the eligibility grid).
- The lender must fully document the results of its comprehensive risk assessment (which includes preparing a statement to indicate the reasons the lender determined that the mortgage loan could be delivered to Fannie Mae despite its high comprehensive risk). If the lender is not able to identify and document sufficient strength among the contributory risk factors to reduce the high comprehensive risk, it should not deliver the mortgage loan to Fannie Mae.

STEP 3: ASSESS COMPREHENSIVE RISK OF THE MORTGAGE LOAN OVERALL

Use these boxes to mark your comprehensive risk assessment, expressed in terms of likelihood of a mortgage default

<table>
<thead>
<tr>
<th>Risk Level</th>
<th>Low Risk</th>
<th>Moderate Risk</th>
<th>High Risk</th>
</tr>
</thead>
</table>

Lender's Responsibility for the Final Comprehensive Risk Assessment:

The lender’s evaluation of the mortgage loan default risk, assessment of the adequacy of the property as security for the mortgage, determination of whether the mortgage loan satisfies the eligibility criteria, and evaluation of the acceptability of the documentation in the mortgage file should all enter into the decision of whether or not it is appropriate to deliver the mortgage loan to Fannie Mae.