

# Selling Guide Announcement SEL-2015-11

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## Selling Representations and Warranties Framework – Origination Defects and Remedies

Fannie Mae, jointly with Freddie Mac, and at the direction of the Federal Housing Finance Agency (FHFA), is announcing the origination defects and remedies framework (the “remedies framework”) which expands upon provisions contained in the representations and warranties framework introduced in *Selling Guide Announcement SEL-2012-08, New Lender Selling Representations and Warranties Framework*, and subsequently updated in Announcements SEL-2014-05, *Lender Selling Representations and Warranties Framework Updates* and SEL-2014-14, *Lender Selling Representations and Warranties Framework Updates*.

The remedies framework is specifically related to corrections of identified origination defects, and available repurchase alternatives. This framework provides clarity on the process followed in categorizing origination defects, lender corrections of such defects, and available remedies. In addition, it provides more transparency regarding Fannie Mae’s discretion on loan-level decisions when reviewing a loan during a quality control review. The remedies framework does not affect any servicing duties, responsibilities, or obligations.

In adopting and clarifying the origination remedies framework, lenders remain responsible for underwriting and delivering investment quality mortgage loans in accordance with the terms of the Lender Contract.

### **Effective Date**

The remedies framework is effective for whole loans purchased, and mortgage loans delivered into MBS with pool issue dates, on and after January 1, 2016.

### **Background**

While the mortgage industry has undergone significant changes in the last few years, selling representations and warranties continue to remain important, by promoting liquidity and providing the necessary assurances that allow Fannie Mae to purchase mortgage loans in an efficient and responsible manner without reviewing each loan individually prior to its purchase or securitization. They also provide Fannie Mae with remedies to address situations where a lender’s obligations to meet the requirements of the Lender Contract have not been met.

Over the last several years, Fannie Mae and Freddie Mac, at the direction of FHFA, have worked to refine the representations and warranties framework. As part of this process, all parties have listened closely to lender concerns about the impact that loan repurchases have had on mortgage lending, and understand the need to address these concerns in ways that are mutually satisfactory. The result will ensure there is liquidity in the housing finance market and provide access to credit for borrowers. Through the introduction of the remedies framework, Fannie Mae and Freddie Mac are working to provide clarity and transparency regarding origination defects and remedies, and expect these changes will enable lenders to manage risk more effectively.

### **Overview**

After completing a full-file quality control review, Fannie Mae will categorize defects in one of three ways:

- findings,

- price-adjusted loans, and
- significant defects.

Mortgage loans with defects categorized as “findings” will not require a correction or a remedy from the lender. Loans categorized as “price-adjusted loans” require the lender to pay the applicable loan-level price adjustment fee (LLPA) that should have been paid to Fannie Mae when the loan was purchased or securitized by Fannie Mae. If a loan has one or more defects categorized as a “significant defect,” Fannie Mae will require the repurchase of the loan, or may offer the lender a repurchase alternative.

At any time during the appeals process, the lender will have the right to correct any significant defect in the specified time frame and in the manner required by the Lender Contract. If the significant defect is corrected in accordance with the terms of the Lender Contract, Fannie Mae will rescind or close-out (as applicable) the related remedy request.

As a reminder, the scope of full-file quality control reviews under the remedies framework remains the same for performing loans and non-performing loans.

## Definitions

The following terms relate to the remedies framework:

**Correction:** Action taken by the lender, typically through delivery of documentation or information to Fannie Mae, that demonstrates that the identified significant defect

- did not, in fact, exist at the time of loan purchase or securitization, or
- has been corrected in the time frame and manner specified in the *Selling Guide* such that the defect is no longer considered by Fannie Mae to be a significant defect.

Examples of corrections include, but are not limited to, de minimis corrections (defined below) and the acquisition of required insurance.

**Counterparty Status:** In connection with the remedies framework, Fannie Mae’s assessment of a lender’s financial capacity which could determine which remedy Fannie Mae will offer to a lender for a loan with a significant defect.

**Defect:** A loan-level deficiency that breaches a term contained in the Lender Contract in effect at the time of loan purchase or securitization.

**De Minimis Correction:** Minor amount not to exceed \$500 (or such higher amount as the lender and Fannie Mae may agree) that, when remitted, refunded, or otherwise provided, corrects or otherwise resolves an identified significant defect. A de minimis correction cannot be made

- in connection with any loan where the correction would result in a specific required minimum borrower contribution not being met, or
- to correct a violation of Charter requirements.

**Finding:** One or more defects that, when considered with other loan features, does not necessitate a change in the price of the loan or result in the loan being unacceptable even if the true and accurate facts about the loan had been known at the time Fannie Mae purchased or securitized the loan.

**Price-Adjusted Loan (PAL):** One or more defects that, when considered with other loan features, and based on the facts of the loan as purchased or securitized by Fannie Mae, result in a loan that was otherwise eligible for delivery to Fannie Mae had the correct data been delivered and LLPA been paid to Fannie Mae by the lender.

**Remedy:** An action to resolve a significant defect elected by Fannie Mae pursuant to the Lender Contract in effect at the time of loan purchase.

**Repurchase Alternative:** Remedies other than repurchase of the identified loan. Repurchase alternatives could include, but are not limited to:

Performing Loans	Non-performing Loans
<ul style="list-style-type: none"> <li>▪ Risk fee</li> <li>▪ Recourse/Repurchase agreement</li> <li>▪ Indemnification agreement</li> <li>▪ Mortgage insurance stand-in agreement</li> <li>▪ Collateralized indemnification agreements (collateral in lieu of repurchase or collateralized recourse)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Make-whole payment</li> <li>▪ Split loss</li> <li>▪ Loss reimbursement</li> </ul>

**Significant Defect:** One or more defects that either necessitate a change to the price at which the loan was acquired or result in the loan being unacceptable for purchase had the true and accurate information about the loan been known at time of purchase. Loans with findings and PALs are not loans with significant defects.

In determining whether there is a significant defect, Fannie Mae must give due consideration to the severity of the defect. In addition, in order to be a significant defect, the defect must relate to one of the following:

- (a) the underwriting of the borrower’s creditworthiness and capacity (for example, borrower’s income, borrower credit/liabilities, and borrower assets) or borrower eligibility and qualification (for example, area median income, first-time home buyer, lawful presence in the United States);
- (b) the underwriting criteria related to property or project eligibility (for example, residential use and condo eligibility), the property appraisal, or the physical condition of the property;
- (c) mortgage loan or product terms and criteria (for example, products that may require special lender approval as a prerequisite for delivery, the criteria described in the *Eligibility Matrix* [such as LTV ratio, occupancy, credit score, loan purpose, and loan product], and terms such as ineligible transaction types and limitations on cash out to the borrower that determines the type of refinance) or any terms and criteria set forth in any negotiated exception or variance;
- (d) a life-of-loan representation and warranty (as described in A2-2.1-06, *Life-of-Loan Representations and Warranties*);
- (e) requirements applicable at time of loan purchase (for example, no defaults, all taxes and insurances have been paid or escrows established, and no modification, encumbrance, subordination or release of mortgage);
- (f) the warranties and obligations of lender regarding the FHFA Suspended Counterparty Program;
- (g) the existence, sufficiency, or enforceability of any required insurance or guaranty; or

- (h) the form and/or execution of Fannie Mae required mortgage documents that without which make the loan ineligible for sale or limit the enforceability of the required loan terms (for example, Uniform Residential Loan Application, power of attorney, Texas 50(a)(6) mortgage documents, or nonstandard and special purpose documents such as living trusts).

## **Process for Remediating Origination Defects**

The steps below provide an overview of the process developed in support of the remedies framework. The steps describe the process that Fannie Mae will follow to categorize defects, allow corrections to defects, and remedy defects through either a repurchase request or repurchase alternative.

### ***Step 1 – Identification of Findings, PALs, and Significant Defects***

After a full-file quality control review is completed, Fannie Mae will designate any defect(s) as resulting in a finding, PAL, or significant defect. Fannie Mae's repurchase letters will continue to detail the specific significant defects found during the quality control review which will assist the lender in preparing a detailed response.

If Fannie Mae designates the defect as resulting in a finding, Fannie Mae will not require a correction or a remedy from the lender. However, Fannie Mae may request a data update from the lender.

If Fannie Mae designates the defect as resulting in a PAL, the lender must pay to Fannie Mae the applicable LLPA that should have been paid when the loan was purchased by Fannie Mae had the true and accurate facts about the loan been known at the time of purchase. Fannie Mae may not demand repurchase of a PAL and the lender may not voluntarily repurchase a PAL.

If Fannie Mae identifies a significant defect, Fannie Mae will require repurchase of the loan or may offer the lender a repurchase alternative.

Fannie Mae also checks for data discrepancies (which could be independent of a full-file quality control review) that may result in the assessment of an LLPA.

### ***Step 2 – Correcting Certain Significant Defects***

During the appeals process described in A2-3.2-03, *Additional Policies Related to Mortgage Loan Repurchases*, of the Guide, a lender has the right to provide a correction of any significant defects in the specified timeframe and in the manner provided in the Guide. Any additional documentation or information that the lender provides is subject to the same standard of quality control review as the initial loan file documentation.

The documentation submitted to correct a significant defect must be based on information or data that either

- was available at the time of underwriting (and no later than the note date), or
- covers the time of underwriting so long as such evidence meets the applicable documentation requirements set forth in the Lender Contract.

Lenders have the ability to correct defects during the appeals process related to property, flood, or mortgage insurance.

If the lender does not repurchase the loan or perform any repurchase alternative in accordance with the Lender Contract, the lender continues to have the obligation to correct any significant defect in accordance with the Guide.

### ***Step 3 – Fannie Mae Review of Lender Response and Mortgage Loan Reassessment***

During the appeals process described in A2-3.2-03, *Additional Policies Related to Mortgage Loan Repurchases*, of the Guide, Fannie Mae will conduct a loan reassessment by reviewing any corrections submitted by the lender in accordance with the applicable Lender Contract in order to determine whether a significant defect still exists.

If a lender submits additional documentation and/or information or takes steps which correct all significant defects in accordance with the Lender Contract, Fannie Mae will rescind or close out, as applicable, the remedy request.

If, following reassessment, all significant defects have not been corrected in accordance with the Lender Contract, the lender must comply with the remedy request on a timely basis.

If, following reassessment, Fannie Mae determines that the loan is a PAL, the lender must pay Fannie Mae the LLPA that should have been paid when the loan was purchased by Fannie Mae had the true and accurate facts about the loan been known at the time of purchase.

Fannie Mae may consider a loan with a significant defect for a repurchase alternative depending on Fannie Mae's commercially reasonable determination that the loan is retainable. Fannie Mae will determine whether the loan is retainable based on the lender's counterparty status and whether the loan was an acceptable investment at the time of purchase. If a repurchase alternative is offered on a loan with a significant defect, the lender can conclude that a full-file quality control review has been completed. However, if a repurchase alternative is offered on a loan where a lender self-reports a defect, the lender cannot conclude that a full-file quality control review has occurred nor is representation and warranty relief granted.

At any time during the appeals process, a lender has the right to propose a repurchase alternative following the identification of a significant defect. Fannie Mae will in good faith consider and respond to the lender's proposed repurchase alternative.

Fannie Mae may offer or decline to offer the lender certain repurchase alternatives based on the lender's counterparty status to the extent there are future obligations required as part of the repurchase alternative. Other factors to be considered by Fannie Mae may include, but are not limited to, the failure to maintain a quality loan origination process and the lender's ability and willingness to comply with other provisions of the Guide.

If a loan has multiple significant defects, and the lender is successful in correcting some, but not all, of the significant defects, Fannie Mae may continue to pursue repurchase as a remedy if the loan has significant defects after the loan reassessment is complete. If a loan has multiple significant defects and the lender is successful in correcting all of them, but there remains a defect that makes the loan a PAL after reassessment, Fannie Mae may subsequently notify the lender of the LLPA that remains due.

#### **Step 4: Range of Possible Outcomes**

**Finding:** If the loan has had a full-file quality control review completed with only findings discovered, the loan will receive origination representation and warranty relief, subject to any life-of-loan representations and warranties. If a loan has not had a full-file quality control review, it may still receive representation and warranty relief through other provisions under the representation and warranty framework described in A2-3.2-02, *Enforcement Relief for Breaches of Certain Representations and Warranties Related to Underwriting and Eligibility*, of the *Selling Guide*.

**PAL:** The appeals process for a PAL will result in one of the following outcomes:

- rescission of the request after the payment of the LLPA, or
- payment of the LLPA.

If the PAL has had a full-file quality control review completed without the identification of any significant defects, the loan will receive representation and warranty enforcement relief when the lender pays the LLPA. Loans that have not had a full-file quality control review will not receive representation and warranty relief, even upon the payment of an LLPA, but may still receive relief through other provisions under the representations and warranties framework (as described in A2-3.2-02, *Enforcement Relief for Breaches of Certain Representations and Warranties Related to Underwriting and Eligibility*).

**Significant Defects:** The appeals process for loans with significant defects may result in a range of outcomes, including

- rescission or close out, as applicable, of the remedy request;
- agreement on a repurchase alternative; or
- fulfillment of the remedy request.

If Fannie Mae offers a repurchase alternative after a repurchase demand has been issued, the lender has the option to repurchase the loan instead of accepting the repurchase alternative.

If a loan with a significant defect has had a full-file quality control review, it will receive representation and warranty enforcement relief if

- all significant defects have been corrected, or
- a repurchase alternative has been offered and accepted, and fully executed and completed by the lender in compliance with any related terms, including the expiration of all applicable time frames.

### ***Selling Guide Updates***

Specific changes related to the adoption of the remedies framework will be made to the *Selling Guide* later this year.

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Lenders who have questions about this Announcement should contact their Account Team.

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