
To: Freddie Mac Sellers and Servicers

October 19, 2012

SUBJECT: QUALITY CONTROL AND ENFORCEMENT PRACTICES

On September 11, 2012, Freddie Mac issued *Single-Family Seller/Servicer Guide* (“Guide”) Bulletin 2012-18, which announced that, at the direction of the Federal Housing Finance Agency (FHFA) and jointly with Fannie Mae, it was implementing a new selling representation and warranty framework that would apply to Mortgages with Settlement Dates on or after January 1, 2013. Under the new representation and warranty framework, for Mortgages that establish an acceptable payment history and satisfy certain eligibility criteria, Freddie Mac will not exercise its remedies in connection with a Seller’s breach of certain selling representations and warranties generally relating to the underwriting of the Borrower, the Mortgaged Premises, and the project in which the Mortgaged Premises is located.

Integral to the new representation and warranty framework is Freddie Mac’s quality control review process and enforcement in connection with violations of the sale representations, covenants and warranties set forth in the Purchase Documents. Simultaneously with issuance of Bulletin 2012-18, we published the September 11, 2012 Industry Letter, which generally described our current quality control practices and provided an overview of future changes to our quality control and enforcement processes that would be implemented in support of the new representation and warranty framework.

Today Freddie Mac issued Bulletin 2012-22 announcing revisions to the quality control time lines and enforcement requirements first previewed in the September 11, 2012 Industry Letter. Based on industry feedback, today we are also expanding on the description in the September 11, 2012 Industry Letter of some of our quality control and enforcement processes and practices that are affected by the new representation and warranty framework.

In this Industry Letter, which is issued at the direction of FHFA and in coordination with Fannie Mae, we are providing supplemental information on the following topics, identifying what is new and specifying the effective date of each new provision:

- Quality control principles
- Quality control sample process
- Quality control review practices
- Enforcement practices
- Ongoing communications with Seller/Servicers about quality Mortgages

In addition, we are providing Seller/Servicers with additional guidance regarding the life of loan representations and warranties related to misstatements, misrepresentations, omissions and data inaccuracies that relate to the new representation and warranty framework.

OVERVIEW OF QUALITY CONTROL PRINCIPLES

The quality control review process is one method of validating whether the loans we purchase were originated in accordance with applicable underwriting standards, and it provides our Sellers with tangible data about the quality of their loan origination process. As such, every Seller/Servicer is subject to quality control review of Mortgages sold to Freddie Mac. In connection with the new representation and warranty framework, we will continue our efforts to confirm the Mortgages we buy comply with the Purchase Documents.

Our objective is to continue improving upon our quality control processes. Freddie Mac’s quality control efforts will be focused on identifying loans that were not originated in accordance with applicable underwriting and eligibility requirements. We view the origination quality risk as distinct from the credit risk associated with a loan. While there may be instances where the two risks overlap, the quality control reviews for the new representation and warranty framework will focus on identifying those loans that fail to meet underwriting and eligibility requirements.

We expect that our Sellers will use our quality control review results, as well as the various loan evaluation tools made available by Freddie Mac, Fannie Mae and the mortgage finance industry, to improve their own loan origination process. Together, Freddie Mac and its Sellers should have a shared goal of improving the quality of loan originations.

To this end, Freddie Mac will continue to enhance its ongoing quality control sampling and review efforts by using some of the technology and data-gathering tools it has implemented to evaluate Borrower credit and capacity, the collateral, and product eligibility.

These tools include:

- **Loan Prospector®** – This is Freddie Mac’s automated loan evaluation system that helps increase a Seller’s productivity and ability to make informed credit decisions
- **Home Value Explorer® (HVE)** – The HVE data appears on the Loan Prospector feedback certificate and can be used as a tool in underwriting the appraisal report
- **Uniform Appraisal Dataset (UAD)** – The UAD defines all fields required for an appraisal submission for specific appraisal forms and standardizes definitions and responses for a key subset of fields; it is intended to enhance the accuracy and integrity of collateral data
- **Uniform Collateral Data Portal® (UCDP®)** – This portal is used for the electronic submission of the UAD and provides error messages regarding UAD data fields that are incomplete or incorrectly completed
- **Uniform Loan Delivery Dataset (ULDD)** – The recently-implemented ULDD expanded the number of loan-level data elements provided to Freddie Mac in connection with the sale of a Mortgage, and standardized definitions and valid values for each of the data elements; the ULDD is intended to enhance the accuracy and integrity of loan data
- **Freddie Mac Selling System** – Freddie Mac’s web-based system for selling Mortgages provides edit rules and field-level help messages

In addition to these data-gathering and validation tools, Freddie Mac will continue to provide Sellers with timely, meaningful information on their loan quality, and greater transparency and predictability regarding the remedies it may exercise when a defective loan is identified in the quality control review process.

Overview of Quality Control Principles	
<i>What is new?</i>	While the technology and data-gathering tools described in this section are continually enhanced and expanded, the quality control principles described in this section are not new.
<i>When is this effective?</i>	The provisions of this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

QUALITY CONTROL SAMPLE PROCESS

Random and targeted sampling

Under our core performing loan sample process and strategy, we select a random sample of new Mortgage deliveries that ensures statistical validity. For our larger Sellers, the random sample is selected based on the purchase volume of a particular Seller and the Seller's prior period defect rate. For the remaining Sellers, the random sample is based on the total purchase volume and the prior period defect rate for the entire group of Sellers. Note that we do not intend to make changes in how we calculate and report Seller/Servicer defect rates, which will continue to be a key metric of Seller performance.

The random sample is augmented with targeted samples for certain risk characteristics and/or Sellers, with a focus on loans that have indications of origination defects. A targeted sample is selected based on several factors, including the credit and the collateral profiles of the loans delivered by the Seller, Freddie Mac's projected performance of the loans delivered by the Seller, Freddie Mac's operational assessment of the Seller and, if applicable, the delivery volume of concentrated products.

Random and targeted sample sizes

Mortgages are generally selected for performing loan review from Mortgages sold to Freddie Mac during the previous month. As communicated in the September 11, 2012 Industry Letter, we do not anticipate making any material changes to our random sample size or process in the near future. With respect to the targeted samples, consistent with our past practices, the size of the sample is directly affected by the quality and volume of loans a Seller delivers to Freddie Mac. Additionally, as we avail ourselves of the new technology and data-gathering tools to analyze loan-level data, we expect our performing targeted samples for Mortgages sold under the new representation and warranty framework will generally increase in the aggregate across all loans and all Sellers. This increase will likely occur as early as January 2013 and will likely fluctuate based on the Seller's loan quality. As we have in the past, we will continue to refine our sampling methodology based on loan quality and ongoing industry changes.

File request time lines for performing loan reviews

As announced in the September 11, 2012 Industry Letter, we will be requesting Mortgage files for performing loan reviews between 30 and 120 days after Mortgage purchase; we anticipate that the vast majority of Mortgage file requests will occur within the 30-day time frame. Our goal is to complete performing loan file reviews and provide Seller/Servicers with notice of any deficiencies within 60 - 90 days of our receipt of the entire Mortgage file, with most loan file reviews occurring within the 60-day time frame. This will result in Seller/Servicers receiving notices of any deficiencies closer to the origination date.

Non-performing and anti-predatory lending compliance reviews

Freddie Mac's non-performing loan sample process and review strategy will remain as currently communicated. Additionally, we do not anticipate making any changes to our anti-predatory lending compliance review sampling process. Compliance with applicable laws and regulations remains the sole responsibility of Sellers.

Quality Control Sample Process	
<i>What is new?</i>	Freddie Mac's targeted samples for performing loans will likely increase across all loans and Sellers.
<i>When is this effective?</i>	The increase in targeted samples will be effective as early as January 2013. All other provisions of this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

QUALITY CONTROL REVIEW PRACTICES

Mortgage file review process (other than Freddie Mac Relief Refinance MortgagesSM)

Freddie Mac applies a different Mortgage file review process and scope depending on whether the loan is a Relief Refinance Mortgage or a non-Relief Refinance Mortgage. This section describes the Mortgage file review process and scope for Mortgages other than Relief Refinance Mortgages.

As communicated in the September 11, 2012 Industry Letter, Mortgages sampled are reviewed on a comprehensive basis by evaluating the entirety of the Mortgage file (containing the documents listed in Guide Chapters 46, *Freddie Mac's Postfunding Quality Control Review*, and 47, *Mortgage File Contents*) and the applicable Purchase Documents, with a primary focus of identifying significant deficiencies. Freddie Mac reviews the Mortgage file against the loan program eligibility requirements set forth in the Purchase Documents, and conducts an in-depth analysis of the credit and capacity of the Borrower, including the Borrower's ability to repay the loan, and an analysis of the underlying collateral.

When reviewing a Mortgage on a comprehensive basis, there may be circumstances in which certain findings may be deemed deficient, but when considered with other loan features, the Mortgage may be deemed overall to be of acceptable quality. Similarly, some individual defects are significant in and of themselves; in other cases, a Mortgage file may present a layering of deficiencies that, when considered comprehensively, make the Mortgage unacceptable.

If the review of the Mortgage file indicates that the loan characteristics differ from the applicable loan delivery data, but the loan would be eligible for sale to Freddie Mac under other terms set forth in the Purchase Documents, Freddie Mac may determine that the loan is acceptable. However, Freddie Mac may impose a condition to retain the loan, such as requiring the Seller/Servicer to cure the deficiency or to agree to an alternative remedy to repurchase (refer to the section titled "Alternatives to repurchase and discontinuation of the feedback program" below).

Mortgage File Review Process (Other than Relief Refinance Mortgages)	
<i>What is new?</i>	Although Freddie Mac has not previously provided the specificity regarding a comprehensive review that is set forth in this section, this is not a change in quality control review practices. We continue to be committed to considering the Mortgage file as a whole when making a determination on eligibility of a sampled loan.
<i>When is this effective?</i>	The provisions in this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

Mortgage file review process – Relief Refinance Mortgages

For Relief Refinance Mortgages, Freddie Mac reviews the Mortgage file against the loan program eligibility requirements set forth in Chapters A24, *Freddie Mac Relief Refinance MortgagesSM – Same Servicer*, B24, *Freddie Mac Relief Refinance MortgagesSM – Open Access*, and C24, *Freddie Mac Relief Refinance MortgagesSM – Same Servicer with LTV Ratios Less than or Equal to 80%*, and the other Purchase Documents, as applicable. Freddie Mac will evaluate, among other things, whether the Relief Refinance Mortgage was originated for one of the purposes specified in the Purchase Documents, and whether any secondary financing complies with the requirements of the Purchase Documents.

However, Freddie Mac does not conduct a full analysis of the credit and capacity of the Borrower for Relief Refinance Mortgages – Same Servicer. Additionally, Freddie Mac does not review the value, condition and marketability of the property securing any Relief Refinance Mortgages.

If the review of the Mortgage file indicates that the Relief Refinance Mortgage characteristics differ from the applicable loan delivery data, but the Relief Refinance Mortgage would be eligible for sale to Freddie Mac under other terms set forth in the Purchase Documents, Freddie Mac may determine that the loan is acceptable. However, Freddie Mac may impose a condition to retain the loan, such as requiring the Seller/Servicer to cure the deficiency or to agree to an alternative remedy to repurchase (refer to the section titled “Alternatives to repurchase and discontinuation of the feedback program” below).

Mortgage File Review Process – Relief Refinance Mortgages	
<i>What is new?</i>	Some of the eligibility requirements for Relief Refinance Mortgages recently changed. However, this will not result in a change in our quality control review practice, which is to review the Mortgage file against the loan program eligibility requirements.
<i>When is this effective?</i>	The practice of reviewing the Relief Refinance Mortgage file against the loan program eligibility requirements as described in this section is currently effective and is anticipated to remain in effect after implementation of the new representation and warranty framework.

Subsequent Mortgage file review process

Prior to establishing an acceptable payment history (that is, either 12 or 60 months for Relief Refinance Mortgages, and either 36 or 60 months for other Mortgages), our objective is to complete comprehensive reviews on loans at the time we initially select and review the Mortgage file. If new information is discovered, such as a title defect that prevents a foreclosure, we may review that new information.

We do not intend to re-review the underwriting on loans previously reviewed. This is particularly the case with respect to sampled performing loans for which the Borrower subsequently meets the payment history requirements of the new representation and warranty framework.

However, as noted above, if Freddie Mac obtains additional information about the loan, either before or after the Borrower meets the payment history requirements, that indicates the Mortgage may violate one of the life of loan selling representations and warranties described in Bulletin 2012-18, Freddie Mac may, at its discretion, request the Mortgage file for an additional quality control review.

For Mortgages that were not subject to a quality control review by Freddie Mac and that first became delinquent after the Borrower met the payment history requirements of the new representation and warranty framework, Freddie Mac may require a non-performing quality control review if it becomes aware of information that would indicate the Mortgage violates one of the life of loan selling representations and warranties or any of the other loan eligibility criteria described in Bulletin 2012-18.

Subsequent Mortgage File Review Process	
<i>What is new?</i>	The subsequent Mortgage file review process described in this section is new, based on Bulletin 2012-18, in which Freddie Mac announced the new representation and warranty framework.
<i>When is this effective?</i>	The subsequent Mortgage file review process described in this section will be effective for Mortgages with Settlement Dates on and after January 1, 2013 .

ENFORCEMENT PRACTICES

Repurchase and appeal process

When Freddie Mac identifies a defective Mortgage, it issues a repurchase request that describes the defects that render the Mortgage ineligible for purchase by Freddie Mac. The defects that would give rise to a repurchase request consist of errors or failures that would have resulted in Freddie Mac’s refusal to

purchase the Mortgage at the time of delivery had they been known. Employing the tools described in the “Overview of Quality Control Principles” section should help decrease the number of Freddie Mac repurchase requests over time as fewer ineligible loans are delivered. For more details regarding the remedy alternatives available for loan defects that do not rise to the level of a repurchase request, see the “Alternatives to repurchase and discontinuation of the feedback program” section below.

Freddie Mac will continue to maintain a process for Seller/Service providers to appeal repurchase requests. Our data shows that the appeals process is very effective for loans with defects such as missing documentation or other curable deficiencies. A substantial proportion of the repurchase requests we issue are resolved and the repurchase request is rescinded because the Seller/Service provider provides documentation or otherwise cures the defect identified in the repurchase request within the time period specified by Freddie Mac (if Freddie Mac has offered a cure).

Under the appeals process, when Freddie Mac issues a repurchase request with respect to a particular Mortgage, the Seller/Service provider is entitled to review and respond to the loan-level findings within 60 days and to provide any required documentation to address the deficiencies identified in the repurchase request, with the goal of resolving significant deficiencies. The goal of Freddie Mac and the Seller/Service providers should be to resolve repurchase requests as expeditiously as possible during the first appeal. However, if Freddie Mac denies the initial appeal and the Seller/Service provider discovers new information to support its contention that the Mortgage complies with the Purchase Documents, a second appeal will be permitted within 15 days, provided the Seller/Service provider submits documentation concerning the new information with its appeal.

Repurchase and Appeal Process	
<i>What is new?</i>	With Bulletin 2012-22, Freddie Mac is describing the process for filing a second appeal, supported by new information. This is a new provision.
<i>When is this effective?</i>	The second appeal process is a new provision that will be effective on and after January 1, 2013 . All other provisions in this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

Alternatives to repurchase and discontinuation of the feedback program

In certain circumstances, Freddie Mac may provide the Seller/Service provider with an alternative to the immediate repurchase of the identified Mortgage. In each such case, Freddie Mac will notify the Seller/Service provider of the type and terms of the repurchase alternative. The alternatives may include any one or more of the following, as determined by Freddie Mac in its sole discretion:

- **Recourse** – An agreement by the Seller/Service provider to provide recourse for the life of the loan or for some other specified time period
- **Collateralized recourse** – Recourse as described above, with respect to which the Seller/Service provider’s obligation is secured by a specified collateral account
- **Indemnification** – An agreement by the Seller/Service provider to indemnify, defend and hold harmless Freddie Mac from any losses, costs, claims, actions, damages, liabilities, judgments, counterclaims or defenses to which Freddie Mac may become subject relating to the Mortgage
- **Collateralized indemnification** – Indemnification as described above, with respect to which the Seller/Service provider’s obligation is secured by a specified collateral account
- **Loss share** – An agreement between Freddie Mac and the Seller/Service provider to each pay a specified proportion of the losses that have arisen or may arise in the future relating to the Mortgage
- **Loss reimbursement** – An agreement by the Seller/Service provider to reimburse Freddie Mac for specified losses relating to the Mortgage

- **Pricing adjustment** – The assessment by Freddie Mac and payment by the Seller/Servicer of a guarantee fee adjustment or an additional delivery fee with respect to the Mortgage

The feedback program that Freddie Mac made available to most Seller/Servicers will be discontinued, and will no longer be offered as an alternative to repurchase. However, we will be providing Seller/Servicers with quality control results information that is similar to what had been provided through the feedback program, as well as greater flexibility in repurchase alternatives.

Alternatives to Repurchase and Discontinuation of the Feedback Program	
<i>What is new?</i>	The process of offering alternatives to repurchase is not new, since Freddie Mac has always asserted the right to offer repurchase alternatives. However, this is the first time we have specifically described the alternatives. Discontinuing the feedback program is new.
<i>When is this effective?</i>	Discontinuing the feedback program will be effective for Mortgages with Settlement Dates on and after January 1, 2013 . The other provisions of this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

Considerations in determining alternative to repurchase

In determining whether to offer an alternative to repurchase, Freddie Mac considers a number of factors, including the following.

- **Type of loan defect** – Certain types of loan defects cannot be cured, violate internal policies, and/or are deemed egregious, and will not be considered for an alternative to repurchase. An example of such a Mortgage is a loan product, such as an interest-only loan, that Freddie Mac does not currently purchase. Other examples of loans that will not be offered a repurchase alternative include loans with significant misrepresentation by any party of the transaction, loans that violate the Freddie Mac Charter Act, loans without appropriate mortgage insurance coverage, and loans that violate State or federal lending laws.
- **Misidentified loans delivered without a fee** – Some loans may be considered ineligible because they were misidentified and delivered without the appropriate delivery fee or other pricing adjustment. In these cases, Freddie Mac may consider offering a pricing adjustment or imposition of a fee as an alternative to repurchase.
- **Seller/Servicer’s financial viability** – Other alternatives to repurchase may be based on the financial viability of the Seller/Servicer as a counterparty, so that a financially sound counterparty might be permitted to provide recourse on the loan, while a financially weaker Seller/Servicer might be required to collateralize the obligation
- **Other factors** – Freddie Mac may also consider other factors, such as:
 - Any compensating factors related to the loan
 - Layering of risks that exist on the loan
 - The status of the loan (that is, whether it is performing or non-performing)
 - The potential loss associated with the defective loan
 - The Seller/Servicer’s past repurchase practices

In each case, Freddie Mac’s decision to offer a repurchase alternative and the terms and conditions of the alternative will be at Freddie Mac’s sole discretion.

Considerations in Determining Alternative to Repurchase	
<i>What is new?</i>	The factors we consider in determining whether to offer a repurchase alternative are not new, but this is the first time we have specifically described those factors.
<i>When is this effective?</i>	The provisions in this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

ONGOING COMMUNICATIONS WITH SELLER/SERVICERS ABOUT QUALITY MORTGAGES

As discussed in the September 11, 2012 Industry Letter, Freddie Mac provides Seller/Serviceicers with ongoing analysis of their overall quality control performance, including identifying repurchases by defect types and reporting frequent or common defects. This information is provided through a variety of methods that range from regular electronic transmissions to more formal periodic discussions.

Our goal is to continue engaging in frequent, meaningful exchanges of information with our Seller/Serviceicers on quality trend analyses and significant underwriting deficiencies we have identified through our quality control review process. Freddie Mac believes such communications strengthen the alignment between Freddie Mac and its Sellers on what constitutes a significant underwriting deficiency, and provide both parties a clear understanding of underwriting philosophy and how this applies to loan-level findings. We require that Seller/Serviceicers implement and enforce strong underwriting processes and, if necessary, we will work with Seller/Serviceicers to develop action plans to improve underwriting quality.

Ongoing Communications with Seller/Serviceicers about Quality Mortgages	
<i>What is new?</i>	Nothing contained in this section is new; it reflects the same process that has been in effect.
<i>When is this effective?</i>	The provisions in this section are currently effective and are anticipated to remain in effect after implementation of the new representation and warranty framework.

LIFE OF LOAN REPRESENTATIONS AND WARRANTIES RELATED TO MISSTATEMENTS, MISREPRESENTATIONS, OMISSIONS AND DATA INACCURACIES

Bulletin 2012-18 describes a number of representations and warranties for which the Seller/Serviceicer remains responsible for the life of the loan. The following information is intended to re-emphasize the requirements pertaining to misstatements, misrepresentations, omissions and data inaccuracies that apply **after** a loan has demonstrated an acceptable payment history and qualified for enforcement relief. Note that this section addresses only a subset of the requirements in Bulletin 2012-18 pertaining to misstatements, misrepresentations, omissions and data inaccuracies. Refer to the Bulletin for the complete requirements.

Misstatements, misrepresentations and omissions

If the Seller/Serviceicer or Freddie Mac discovers that one party to the transaction has misstated, misrepresented or omitted information used to originate that loan, the loan is still eligible for relief if it otherwise satisfied the representation and warranty relief eligibility requirements. The following example provided in Bulletin 2012-18 illustrates a scenario where there was an individual Borrower misrepresentation, but the loan is eligible for relief:

- A Borrower borrows \$10,000 from his friend as part of a down payment on a home. He has promised to pay his friend back with interest. The Borrower provides a falsified gift letter to the Seller. Once the Borrower has established an acceptable payment history, the Seller/Serviceicer would *not* be required to repurchase the loan even if the Seller/Serviceicer subsequently discovered that part of the

down payment was borrowed because the Borrower's misstatement to the Seller affected only one loan.

Mortgages that have a misstatement, misrepresentation or omission that involves two or more parties to the transaction **and** two or more loans are not eligible for relief. The following example from Bulletin 2012-18 illustrates an omission that involved two or more parties and two or more Mortgages sold to Freddie Mac:

- A realtor and a property developer decide that in order to sell several new homes faster, they provide several Borrowers with a \$15,000 rebate outside of closing that was not disclosed in the sales contract or HUD-1 Settlement Statement. This practice is in violation of Freddie Mac's interested party contribution requirements. In this instance, the Seller/Servicer *must* repurchase the Mortgages, if requested, even if the Borrowers have established acceptable payment histories and the Mortgages are otherwise eligible for relief.

Data inaccuracies

The requirements of Bulletin 2012-18 pertaining to data inaccuracies addresses the operational or other risks related to the Seller's failure to deliver accurate data to Freddie Mac. Our focus will be on identifying delivery data that differs from the information documented in the Mortgage files on multiple loans. If the information in the Mortgage files indicates the loans were not eligible for sale to Freddie Mac under the Purchase Documents, Seller/Servicers may be required to repurchase the Mortgages, or Freddie Mac may offer an alternative remedy to repurchase. The example provided in Bulletin 2012-18 that illustrates a data issue of this nature is as follows:

- As a result of a system upgrade, a coding error is introduced into a Seller's system such that the Indicator Score is incorrectly calculated and the Seller reports inaccurate Indicator Scores at loan delivery. A review of the credit reports in the Seller's origination files shows that for multiple Mortgages the actual Indicator Scores were lower than those reflected in the data provided at delivery, and the actual Indicator Scores did not meet Freddie Mac's eligibility requirements. The Seller/Servicer would be responsible for remedying the systemic error, and may be required to repurchase the affected Mortgages.

CONCLUSION

Seller/Servicers that have questions about this announcement should contact their Freddie Mac representative or call (800) FREDDIE.

Sincerely,



Laurie A. Redmond
Vice President
Offerings Effectiveness