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Crossing The Finish Line With Confidence: How QC Checkpoints Ensure Loan Quality

Just as in professional car racing, using quality control "pit stops" throughout the life of a mortgage can help lenders ensure loan quality.

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In motorsports, pit stops are crucial to the continuous high performance of vehicles. Racing teams usually follow a planned schedule of pit stops for refueling, tire changes, mechanical adjustments and repairs. Choosing the optimum strategy of how many pit stops to make and when to make them is one of the most important features of having a successful race. Teams must carefully weigh the time spent in the pit against the time gained on the track and the adjustments made during the stops. In essence, pit stops help racing teams control the quality of a race.

Similarly, there are checkpoints throughout the life of a mortgage loan that can help a lender control its quality. Quality control (QC) checks during the origination, sale and servicing of mortgage loans help to ensure their viability. Like high-performing race cars, high-performing mortgage loans must be cared for with consistency, precision and timeliness. A robust QC program with regular checkpoints can improve efficiency and minimize buybacks.

Today's track conditions: slippery

As you know, the intense regulatory environment in which lenders operate today has evolved mainly as a result of the government's efforts to

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prevent fraud. Those efforts have also forced the industry's hand in terms of having to address the frequency and thoroughness of loan quality reporting. Fannie Mae's requirement for lenders to internally audit at least 10% of their mortgage loans, coupled with the U.S. Department of Housing and Urban Development's (HUD) proposed allowance for Federal Housing Administration loan loss reserves, is forcing lenders to find creative ways to manage the increased workload and costs associated with regulatory compliance.

The upcoming implementation of the TILA-RESPA Integrated Disclosures (TRID) rule, set to take effect on Aug. 1, is adding even more fuel to the fire. The rule establishes new forms that will replace the good faith estimate, the initial and final truth in lending disclosures, and the HUD-1 settlement statement. In ad-

dition, the loan estimate must be placed in the mail or delivered no later than the third business day after receiving the loan application and no later than the seventh day before closing. The closing disclosure must be provided to the borrower three days before closing. Furthermore, lenders must keep copies of the loan estimate for three years after closing and retain copies of all closing disclosure-related documents for five years after closing. There are also several other substantive changes that will affect dates, documents and processes. A far-greater degree of accuracy and thoroughness will be required of lenders. New QC checks will be critically important to ensure lenders are in full compliance with these significant changes.

Presently, loan audits simply don't happen as frequently and efficiently as they should because of manpower issues. In addition, QC checks are occasionally put on the back burner because they can create a drag on loan production velocity. At the same time, it is difficult for many lenders to get their hands on actionable reporting. To manage all of these concerns, QC is sometimes outsourced to multiple vendors. This, in turn, creates a new challenge: the need to manage all of them.

Planning a pit strategy

Regular QC programs, from pricing through payoff, combined with strategic investments in technology, can provide the business intelligence necessary to not only ensure regulatory compliance, but also to ensure there is a continuum of quality across mortgage loan portfolios. In the long run, QC checks will reduce business expense and minimize risk.

Because different lenders have different QC policies, they will naturally have different methods for tracking and analyzing data. However, the junctures at which the data is reviewed should be consistent among all lenders, such as before initial disclosure, after drawing documents, if/when there is a change of circumstances and during post-funding reviews.

Pre-closing: At this stage, it is important to implement a series of validations that will yield data detailing possible areas that need a closer examination, including the following:

■ Re-verification of employment, income and assets;

■ Verification of undisclosed debt;

■ Review of automated underwriting approval; and

■ Verification of compliance with lender, state and federal guidelines.

Post-closing: After a mortgage loan has been funded and closed, both manual and automated audits should be conducted to ensure files were packaged and delivered properly. In addition to the Fannie Mae and Freddie Mac requirement to review a random 10% of each loan type of your closed loans, gathered data should be verified once again to identify discrepancies, inconsistencies and possible omissions, using the following validations:

■ Re-verification of employment, income and assets;

■ Review of automated underwriting approval;

■ Appraisal review;

■ Audit reports; and

■ Comparison of signatures, initials and dates.

Looking for red flags

Every lender's QC efforts should be geared toward carefully reviewing those things that make loans high risk. By design, QC checks raise some obvious red flags that point to potential fraud schemes. These red flags represent typical inconsistencies often found in fraudulently obtained mortgages. Although the very presence of one or more red flags in a file does not necessarily mean there was fraudulent intent, it could signal the need for a more detailed review of the mortgage. These red flags are useful tools for identifying the types of documentation or lack of documentation that may lead to the discovery of fraud in a mortgage file. These discoveries should then be used to modify origination policies to prevent the fraud from recurring. The following is a sampling of red flags commonly caught in mortgage loan file reviews:

■ Mortgage loan application red flags:

- Unsigned or undated loan application;
- Invalid Social Security number; and
- Number of years on the job is inconsistent with the borrower's age.

■ Credit report red flags:

- Invalid Social Security number or if different from that on other documents;
- Significant differences between the original and new credit report; and
- "Also known as" (AKA) or "doing business as" (DBA) is indicated.

■ Employment and income red flags:

- Evidence of white-outs or alterations;
- Squeezed-in numbers; and

- Income doesn't sync with type of employment.

■ Legal and closing document red flags:

- Power of attorney used without explanation;
- Names and addresses of property seller and buyer vary from other loan documentation; and
- Evidence of white-outs or alterations without initials.

How to finish the race and win

There are many different ways to implement a successful QC program. Manpower and money often dictate how well it is accomplished.

For example, a fluctuation in staffing can negatively affect QC work in terms of how and when it is done. If an organization does not properly and swiftly adjust for staffing changes, it could easily fall out of compliance. As QC work becomes backlogged, more and more items are overlooked or simply go unverified. In an ideal world, it is best to have a separate department that is charged with performing QC checks and nothing else. Loading QC responsibilities on top of other job functions, while tempting from a cost and manpower standpoint, can compromise the thoroughness and accuracy of QC programs. If a dedicated internal QC department is not feasible, then outsourcing some of the QC checks to a third-party supplier is a reasonable, and often necessary, compromise. However, it is best to work with a small number of QC suppliers so they can be more easily managed.

It is also critically important to utilize both manual and automated QC methodologies for verifying information and uncovering discrepancies. Technology cannot do the job alone. The fact is, there is simply no substitute for the human sniff test. Using manual checklists, staff members and automated QC programs to eyeball documentation is one of the best ways to win the race.

Putting a program of systematic QC checks in place throughout the life of a mortgage loan ensures enhanced loan performance and greater productivity, while minimizing the risk of repurchase and the potential for losses. It is a sound investment from which lenders will reap great returns. QC checks are a constructive way to proactively manage compliance requirements. At the same time, they can generate solid business intelligence for process improvements going forward.

Like a NASCAR team that relies on a smart pit strategy to improve its odds for winning a race, mortgage lenders that institute QC checkpoints throughout the life of their loans can be confident that they'll be taking a victory lap around the quality and compliance racetrack. SME

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