MORTGAGE COMPLIANCE

Ensuring Quality Originations

Is It Time to Review Your Quality Assurance Program and Your Quality Control Plan?

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Many credit unions have a process in place to review their quality assurance program, including the quality control plan, on an annual basis. This review typically includes a process and content comparison to Fannie Mae, Freddie Mac, HUD, and/or their private investor's quality-control requirements.

But how often do credit unions perform a best practices review?

Meeting the minimum quality assurance requirements will keep investors and regulators happy, but are the minimum requirements sufficient to ensure quality loans for the credit union and its members?

To help ensure you are originating quality loans, consider the following best practices:

1. Be proactive and consistent with your scope.

Many lenders only consider revision to their quality-control process and scope when a change is made by a regulatory agency or investor. However, the mortgage industry is experiencing lower volumes and tightening margins. During these periods, it is common for lenders to revise procedures to become more efficient, roll out new products, and task certain personnel with new or additional roles.

These types of changes may be happening overnight or monthly; however, many lenders may only review the scope of their quality control reviews on an annual basis. This can lead to missed findings and unsaleable loans.

Management should ask, "How does this change affect our quality-control scope?" with every change to procedures, products, or personnel. The answer could be to revise certain sampling methods, update your quality control plan, or revise the audit checklist used by the quality-control analyst.

2. Use your most experienced individuals to perform the quality-control reviews.

Many institutions hire pre-funding or post-closing personnel that lack experience in underwriting or have less experience than the individuals that they are reviewing. Taking an experienced underwriter out of production may cause production issues at first, but it will pay higher dividends in the end when their experience is leveraged to the entire organization through quality control feedback.

A similar approach should be taken if your institution outsources any or all of the quality-control process to third-party vendors. A quarterly or semi-annual process should be adopted that allows you to receive and review the resumes of the individuals that are performing the reviews. Ensuring experienced individuals are reviewing the file will help reduce missed or false findings.

3. Be creative and timely with your sampling methods.
Most investors provide good details regarding the sampling requirements for pre-funding and post-closing quality control. However, these requirements often include some latitude and recommendation for lenders.

A lender should review its sampling methodology monthly and base any revisions on past quality-control results and changes to procedures, products and personnel. Many lenders correctly base their discretionary sample on higher-risk profiles but fail to recognize what their past results are telling them about what should be considered higher risk or fail to consider new products in this sample.

Further, sampling for targeted reviews can promote improvement in newer personnel or identify areas of concern for the lender.

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4. Include robust trending in your reporting.
Whether performing quality control internally or via a third-party vendor, your process should include the capability to trend findings in the area of responsibility, as well as the individual finding.

For example, a lender should have the capability to identify which underwriters may need further training in the calculation of rental income or which processors may need help with the documentation required for gifts.

Reporting trends by not only defect categories, as required by most investors, but also individual findings will identify specific issues and improve overall quality.

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5. Commit to a 90-day audit cycle.
A typical quality-control audit cycle requirement is 120 days for post-closing reviews. However, by committing to a 90-day audit cycle, a lender has the ability to make timely changes to procedures and personnel and is aware of any major issues at least 30 days sooner.

6. Recognize that quality assurance is part of the entire process.
Many lenders view quality assurance as simply pre-funding and post-closing audits. However, higher quality originations and a better lending experience for the member are both possible when a lender adopts a philosophy that quality originations begin with (a) the initial application and instituting the use of automated tools, (b) hard stops in underwriting and (c) educating members and staff on mortgage fraud.

7. Evaluate the pros and cons of using a third-party vendor.
It is becoming more common for lenders, regardless of volume, to use a third-party vendor to perform all or a portion of the quality-control functions. But how does a lender determine if using an outside provider best suits the needs of the organization?

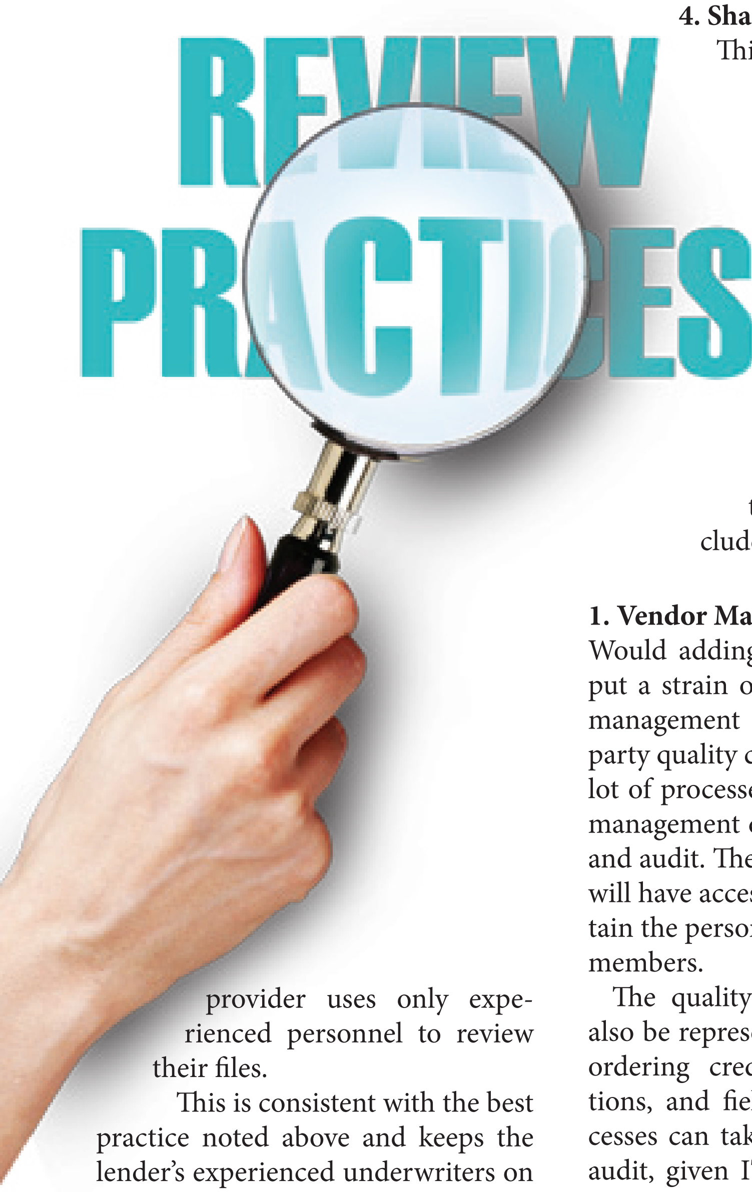
THIRD-PARTY BENEFITS

There are many benefits to using a third-party provider which include:

1. Cost control and independence:
As noted above, the mortgage industry is experiencing tightening margins and lower volume levels and as such, maintaining the cost of full-time employees that are independent of the origination process can be challenging.

Further, internal pre-funding and post-closing reviews often result in disagreements between sales and operations. Having an outside, independent review can alleviate these disagreements and promote a more cohesive relationship between the two departments.

2.Experience:
Although outsource providers have many different methods and philosophies, several use a model which includes the use of experienced analysts with underwriting backgrounds. By performing a proper vendor due diligence, a lender can identify these providers and ensure that the outsource



provider uses only experienced personnel to review their files.

This is consistent with the best practice noted above and keeps the lender's experienced underwriters on the front lines.

3. Reverification process:
Any lender that has been through a recent regulatory or investor audit of its quality-control process can attest that the reverification process receives a lot of attention—and rightfully so—as reverifications can identify misrepresentation and fraud.

A reverification department or analyst can be very costly for a lender to maintain when considering the volume of mail, multiple sources of reverifications, second attempts and record retention. Most third-party providers have established departments that are adept at handling this part of the process with only out-of-pocket expenses passed to the lender.

4. Sharing best practices:
Third-party quality control firms can observe industry trends, processes and best practices at their many clients, and can share those learnings with you.

THIRD-PARTY DRAWBACKS

Some possible drawbacks to using a third-party provider include the following:

1. Vendor Management:
Would adding an additional vendor put a strain on your current vendor management department? Third-party quality control providers have a lot of processes for a lender's vendor management department to consider and audit. The quality control vendor will have access to loan files that contain the personal information of your members.

The quality control provider will also be representing the lender when ordering credit reports, reverifications, and field reviews. These processes can take considerable time to audit, given IT security and privacy concerns.

2. Time and Cost:
Most investors require lenders to monitor their quality control vendor. Typically, this is accomplished by a "check-the-checker" type of review in which the lender performs a re-review of the entire loan file using the audit checklist used by the vendor and comparing the findings. These reviews must be performed by an individual independent of the origination process and cannot be outsourced.

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The cost of these reviews is often overlooked by the lender. Further consideration should be given to time spent by the personnel working with the vendor each month. Typically, this individual or individuals are in the compliance or risk departments and have other responsibilities. Considerable time can be spent by these individuals each month if the quality control vendor is not performing as expected.

For example, these individuals may find themselves responding to similar incorrect findings month after month or rewriting quality control reports because the vendor does not offer a customized solution.

REVIEW YOUR PRACTICES

Regardless of whether you continue to perform your quality control internally or outsource it to a third party, it is a good time to review your practices—both against investor requirements and industry best practices. In a time of lower volumes and tightening margins, this will help ensure that you are originating quality loans.

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