Top Three Quality Control Trends You Need to Know for 2015

ARMCO
ACES RISK MANAGEMENT

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Executive Summary

2015 is shaping up as another year of significant changes in the mortgage industry. Rather than abating, increased regulatory scrutiny continues to raise the stakes for mortgage lenders' operations. As a result, quality control will be front and center among lenders' enterprise risk management strategies and truly mission-critical to their success.

According to the **2014 Third Quarter Mortgage Lender Sentiment Survey** of senior mortgage executives conducted by Fannie Mae, compliance risk is reported as the top area of focus by most lenders. Additionally, 72% of the lenders surveyed say new regulations have had a significant impact on their business. 72% reported spending more on compliance this year than last year. Lenders also reported increased reliance on outsourcing due to increased regulations and associated costs, particularly in relation to post-closing quality control review and servicing.

Lenders should dedicate the time to assess the effectiveness of their current quality control systems knowing the risks that lie ahead.

From a QC perspective, the following three topics are certain to affect mortgage lenders in 2015. This guide can help you determine whether your quality control solutions provider is prepared to address these risks, and if not, prepare you to seek out audit technology and risk management solutions that will support your success.

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01 The Changing Nature of Risk for Mortgage Professionals

There has been significant reduction in underwriting and credit quality risk in recent years. Although troubling for lending volume, QM and QRM have made it difficult for unqualified consumers to obtain mortgage loans, without resorting to outright fraud. So where is the risk now?

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This risk of making bad loans has been replaced by the risk of bad business practices that can result in debilitating drains on your organization in the form of lost time and money, fines, repurchases and reputational loss. For example, customer care matters more than ever, and how you handle everything related to the customer – from the timing and clarity of disclosures, to documentation of income and assets, to customer complaint management – is under unforgiving scrutiny by the Consumer Financial Protection Bureau (CFPB) and Government-Sponsored Enterprises (GSEs).

An audit from the CFPB or GSEs used to be seen as a question of “if”. Now it is a question of “when”, and if you are not building audit preparedness into your quality control processes, you may find yourself in a disruptive bind during your next examination. Reconstructing data and processes for auditors on the fly significantly increases your operational risk and needs to be taken seriously.

02 Mortgage Lender Accountability and Responsibility

Regulators have made it clear through various guidelines that outsourcing, contracting, subcontracting, or even eliminating certain functions does not reduce a lender's or servicer's accountability for those functions. Counterparty and vendor oversight must therefore be a critical component of a financial institution's quality plan now and going forward.

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Examples of this are numerous:
Correspondent and wholesale lending have made a significant comeback in the past year because many lenders don't want the cost and complexity associated with maintaining and compensating their own internal staff of loan officers. But if you're dealing with a correspondent lender that is not adhering to loan originator compensation regulations properly, that is still your problem. Whether you touch a loan as a middleman or in another capacity, you are now both responsible and held accountable for compliance - even if the entity that originated and funded the loan is the party that fails to adhere to strict regulatory requirements.

Similarly, each of the GSEs requires lenders to perform both pre-funding AND post-closing quality control on their loans. Although the post-closing requirement has been around for decades, recent regulations no longer allow lenders to evade that requirement by outsourcing quality control. GSE, CFPB and OCC requirements are now explicit that the lender is responsible for its vendors' and outsourcers' work.

Outsourcing remains a useful strategy to addressing gaps or deficiencies in internal processes, but since you are still responsible for work done by your third-party providers you either need an internal capacity to "audit your auditor" or you need to hire a second vendor to oversee the results of your primary vendor and report back to you.

And this trend applies not just to Originations but to Servicing as well: Servicers are responsible for the actions of their sub-servicers. With all of the new consumer protection regulations put in place as recently as this year, monitoring for compliance with CFPB and GSE disclosure and process requirements for Servicing is no small feat. Servicers who ignore the need for such oversight, including tracking and identification of process defects and creation of action plans to remedy such defects, do so at their own peril.

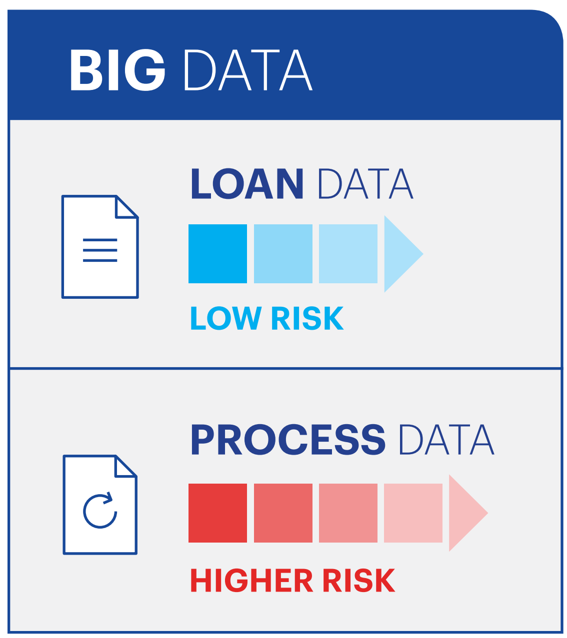
03 2015: The Year of Big Data

Already a common theme in many other industries, big data will gain traction in residential finance in 2015. For the mortgage industry, the ability to capture, understand, and analyze data and, through that ability, improve processes is certain to define competitiveness for everyone in the mortgage lending supply chain.

"Big data will gain traction in residential finance in 2015"

In thinking about big data in the mortgage industry, there are two types to consider – loan data and process data. When lending risk resided in underwriting, loan data became critically important. We've now reached a point where underwriting standards are so high that the risk of making a flawed decision based on bad consumer information is relatively minimal for the typical lender. Today and moving into the next year, the risk is your exposure to running afoul of your auditors, reputational risk, fines and unnecessary buyback requests due to ignorance of deficiencies in your policies and procedures.

For example, loan quality control defect rates continue to be as high as 10% and more at certain lenders. Typically, these are not loans that are in danger of default because of the borrower's inability to pay. Their defects rest in the manufacturing process, and the largest single category of those defects, according to our client data, is missing documentation. What's interesting about this is that it is a fairly curable issue if you uncover it early in the supply chain through timely execution of proper quality control processes and communication with the areas of responsibility.



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03 2015: The Year of Big Data Continued...

However, if you aren't capturing and tracking this process data, you'll never catch that kind of defect in a timely manner. Trying to find a missing document or disclosure in a loan file when your auditor is in town is at best a big waste of time and resources and at worst results in fines and repurchases down the road.

In 2015, mortgages businesses need to accept that there is no way to sidestep the increased cost of compliance in the current lending environment. Decreasing volumes and increasing costs have certainly created a perfect storm for lenders. Surviving that storm demands a more sophisticated understanding of your loan manufacturing processes plus the higher and better use of analytics to identify and remedy process/production issues. Leveraging "big data" to your advantage through tracking, trending, benchmarking and action planning is a strategy for success in a challenging environment.

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About ACES Web Audit Technology™

Once you've determined where your risk resides, and accepted both responsibility and accountability for risk management, you need to control and understand your data. This ability to understand your business in the context of the entire mortgage lifecycle will drive your future success. ARMCO's ACES Web Audit Technology™ is a web-based mortgage quality control platform that fills your loan audit needs. ACES (Automated Compliance and Evaluation System) enables your understanding of your quality, your ability to control it and to convey it.

Reduce your anxiety, increase your QC productivity and embrace powerful communication and reporting possibilities with a system of record like none other.

About ACES Analytics

ACES Analytics leverages leading business analytics and dashboarding tools so you can compare your quality control results to industry peers. ARMCO's experience working with many clients and partners is that no two organizations perform QC exactly alike.

Overall loan ratings and even ways of classifying exceptions (loan defects) vary from organization to organization. The only way to truly understand the quality of your loans is to benchmark against others, using results standardized and normalized via ARMCO's proprietary technology.

About ARMCO

ARMCO – ACES Risk Management delivers web-based audit technology solutions with powerful data and analytics to the nation's top mortgage lenders, servicers, investors and outsourcing professionals. A trusted partner devoted to client relationships, ARMCO offers best-in-class quality control software for U.S. banks, mortgage companies and service providers giving them the technology and data needed to support loan integrity, meet regulatory requirements, reduce risk and drive positive business decisions.

Experience ultimate control – turn to ARMCO to put your mortgage QC plans, policies and procedures in motion.

For more information, visit www.armco.us or call 1-954- 590-0477.

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