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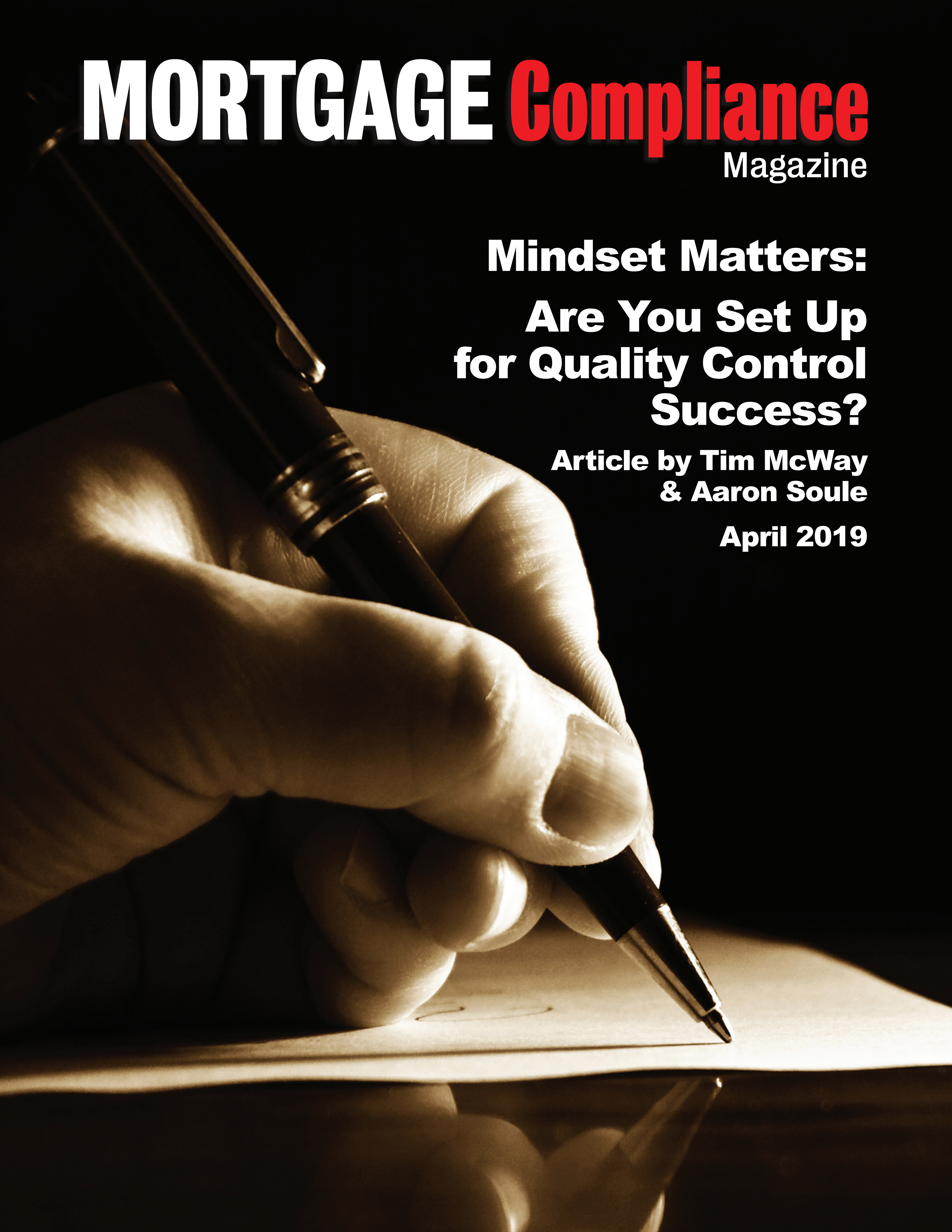

Mindset Matters: Are You Set Up for Quality Control Success?

Article by Tim McWay & Aaron Soule

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BY TIM McWAY & AARON SOULE

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Decreasing volumes and shifts toward new products have led to a new mindset regarding quality control. With increased investor, warehouse lender, and regulatory scrutiny of quality control, it is critical to embrace best practices and move beyond the "get it done" approach that in the past may have been more prevalent. Lenders who are successful with quality control adopt strategies that not only keep them compliant, but also lower costs, improve loan quality, and provide for competitive advantage by allowing them to more rapidly add new products.

BE PROACTIVE AND FLEXIBLE IN ALL PHASES OF THE QUALITY CONTROL PROCESS

Most investors provide specific details regarding the sampling requirements for prefunding and post-closing quality control. However, these requirements often include some latitude and recommendations 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 provide valuable feedback for newer personnel or identify areas of concern for the lender. Prefunding and discretionary samples should be evaluated and changed, as often as necessary, based on findings from the post-closing reviews. Doing this allows the lender to address areas of concern and make corrections to deficient areas in a rapid manner.

As the business changes, it is important to consider changes to prefunding sampling and discretionary reviews. Turnover, new employees, and new products such as non-QM or jumbo are potential selection targets over and above the more traditional high-risk areas such as cash-out refinances, non-owner occupied, and high LTV loans. This does not mean that the overall sampling size needs to change, just the composition of the discretionary reviews. The frequency of the changes to discretionary reviews will vary by lender. For some with rapid evolving business models, the changes may be made as frequently as monthly. For others, quarterly or annual re-evaluation of the targets for discretionary reviews may be appropriate.

To effectively use its quality control resources, an organization must be proactive and flexible in managing its prefunding and post-closing questionnaires. Typically, prefunding review questionnaires remain static, yet it is the perfect time in the review process to address concerns from previous post-closing issues. Building in flexibility to the questionnaire allows these findings to be reviewed prior to closing. On a monthly basis, an evaluation of the root cause of findings for post-closing reviews should be completed to update the prefunding questionnaire. For instance, if a lender is finding verbal verifications of employment missing, incomplete, or not in the required timeframe repeatedly in the post-closing review, an update to the prefunding questionnaire will eliminate this issue. These updates to the prefunding review scope allow the lender to address specific concerns before closing. Ideally, the lender's auditing program or software should allow the administrator to update the prefunding and post-closing review questionnaires in real time.

COMMUNICATE VERBALLY TO ENHANCE OPEN AND EFFECTIVE COMMUNICATION

Email is a great way to communicate quickly and easily; however, it is usually not the best way to ensure open and effective conversations. Successful lenders are more likely to take the time to address issues face-to-face or on the telephone whether that communication is between the third-party vendor and the internal team, or between the internal reviewer and the internal team. Meetings can be scheduled as needed, but a standing scheduled weekly or biweekly call to discuss the overall process is equally valuable. Communicating on a regular basis can eliminate delays in the audit, poor file delivery, and unreliable quality.

Successful lenders embrace the findings review and rebuttal process as an opportunity to find solutions and correct issues resulting in higher loan quality, which is an area where email and automated review processes have been the standard. Automated reviews are more like a checklist, which may not reveal relevant data, and tends to keep faulty origination processes in place. Taking the time to meet and discuss findings yields better results and avoids a defensive mindset. While all lenders will prioritize the critical and major findings, the minor findings and missing document issues should be dealt with as well. Even though they do not impact the review findings in the same manner as critical and major findings, they do take time to note in the reviews and research. If all the findings could get to the root cause to eliminate them, it would save all parties involved in the review process time, which in turn lowers costs. This approach involves proactive communication between the reviewer and the individual(s) responsible for responding to findings. By asking the right questions during the response phase, some findings will be eliminated quickly, saving time overall. Doing this monthly, as the preliminary findings are completed will ensure that the audit moves forward. As multiple months of reviews are open at any given time, making sure each part of the process is on track is vital. This communication helps ensure everyone is on the same page from sample selection through the final report for each month and allows the team to leave the meeting with clarity on respective responsibilities.

PROVIDE REMOTE ACCESS TO THE THIRD-PARTY VENDOR

While some lenders manage quality control in-house, 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. When quality control is outsourced, there is an opportunity to use technology to allow for a more timely, secure, and efficient audit. For lenders ▷

that use a third-party quality control provider, allowing the vendor access to the loan origination system (LOS) to review file documents can benefit the lender in several ways. Since the origination process is still largely driven by documents, a lender that compiles and delivers an imaged file from scratch will need to designate staff to complete the task. With large loan samples this can take hours and lead to errors such as missing documentation. The impact of not allowing LOS access can be increased costs for staffing needs, and a slow down on the vendor side if the files are incomplete. The back and forth between lender and vendor will lead to additional days in the review process, and more than likely an increased number of defects related to missing documentation. Allowing LOS access can result in a lower cost associated with lending staff having to be involved in the audit process, a lower gross defect rate, and less time responding to defects. Overall, the lender will be more likely to stay on track with investor reporting requirements.

In a time of lower volumes and tightening margins, adopting a new mindset towards quality control will help ensure that you are originating quality loans, managing your costs effectively and remaining competitive.

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