



Walking the Risk Tightrope

In the new mortgage market lenders have no choice but to automate more if they want to be risk averse and compliant.

Gone are the days when there was a ready investor for any and every loan originated. The existing investors — mainly Fannie Mae, Freddie Mac and FHA — are asking lenders for better quality loans. And they want to see that those loans are of better quality, too. As a result, lenders are being forced to step up and rethink their risk mitigation strategies.

“There’s a common phrase that says lenders are becoming risk averse, but I’m not sure they are. I think they’re becoming more risk informed,” noted Tom Madison, senior vice president and general

By [Anthony Garritano](#)

manager, mortgage services at Equifax. "They want to understand the risk they're taking on by doing a loan and they're being selective about the risk they take on, at the same time. Lenders got in the habit of lending without any introspection about risk because the thought was that the value of the property would continue to increase.

"We see four pillars to risk management. First, you need to ascertain a borrower's propensity to repay. Credit is a part of that, but lenders want more. Second, lenders are looking at income, but not stated income. Third, they're looking at the assets and wealth associated with that borrower. Last, they want to know the value of the property now and where it's going. There's clearly a thirst for more and better technology these days."

Equifax has recently acquired a number of companies to position itself as the place for lenders to turn to in order to automate risk mitigation. Most recently, Equifax acquired Rapid Reporting, a privately held national provider of IRS tax transcript information and Social Security number authentication services. Equifax will pay \$72.5 million in cash for the company.

Further, in late October Equifax also reached a definitive agreement to acquire IXI Corp., a firm that collects, analyzes and delivers consumer wealth and asset data. Equifax will pay \$124 million in cash for the company. IXI directly measures data on more than \$10 trillion in U.S. consumer assets and investments, representing over 42% of all U.S. consumer invested assets.

Going back, Equifax also acquired TALX in a stock and cash transaction valued at approximately \$1.4 billion, including the assumption of debt. TALX is a provider of employment verification and related human resource/payroll services. TALX provides products and services including employment and income verification, pay reporting, hiring and employment tax management services. The Work Number

service, created by TALX in 1995, has over 142 million employment records.

The Work Number also added to its offering when it acquired Discover Source, a provider of tax transcript fulfillment and authentication services to clients primarily in the mortgage, insurance and legal industries.

"What is very, very clear is that lenders are becoming creative and concise about the data they receive," noted Mr.



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**—John Walsh
MDA DataQuick**

Madison. "For example, many people have property data but the foreclosures are a more recent occurrence. Lenders want that data to use before they make a decision these days, too."

In fact, lenders like Brand Bank, which has recently retooled its secondary approach, are opting to automate as a vehicle to be more risk averse. "We're moving away from a decentralized wholesale loan model to a centralized bulk mandatory delivery model," explained Mack Mullins, vice president of capital markets and secondary marketing at Brand Bank. "We are going to sell the loan when it's closed vs. once the borrower locks. Now that we're managing the risk internally data is critical.

"I was hired in May of 2009 to develop their secondary market infrastructure. After looking at what they had, it was obvious that we didn't have a quality system of record. I had a history of working with DataTrac and I knew the system would support our initiative. However, we went out and looked at other options, but kept coming back to Del Mar DataTrac.

"The system we ultimately chose had to integrate well without front-

end point-of-sale and our new pricing system, NYLX. It also had to be easy to use and have real-time data. If you are going to manage the risk, you have to know the information, see it as it comes in and do predictive analysis. Without technology you can't put in the stop-gaps and filters and gates dictated by your business to increase loan quality. This technology allows us to originate from start to finish and

manage that loan."

And Brand Bank's story isn't out of the ordinary. More and more lenders are looking to more closely integrate their systems and get visibility at the data level so they can be more confident in the loans being originated. Cornerstone Mortgage Co., for example, uses a variety of different vendors to automate risk. Going forward, they will be pushing to use these tools even closer to the point-of-sale.

"We run a fraud tool upfront," said Julie Piepho, executive vice president at Cornerstone. "We use another tool to look for APR discrepancies and state law discrepancies five different times throughout the cycle of the loan. We use Mavent there. We check credit with Kroll and we check employment through Rapid Reporting as well as the borrower's identity through a social security check through Rapid Reporting, as well.

"Technology helps us know our customer. Our referrals all come from partners or past clients. So, we may not know the customer, but we know they come from a trusted source. The technology helps us get to know our

clients and help them. If you had a manual process, you wouldn't be able to catch fraud, for example. If you're not automating the Social Security check and someone gives you a fake ID you wouldn't know that."

In the end, lenders have to be more risk averse because both GSEs expect repurchases to continue to increase. Fannie Mae and Freddie Mac are becoming increasingly concerned that mortgage lenders and servicers will not be able to honor their obligations to repurchase bad loans. Fannie expects repurchase and reimbursement requests will remain high in 2009 and into 2010. The GSE already has a significant number of requests that have not been paid. "Due to the current housing and economic environment and the adverse impact on our servicers, we may be unable to recover outstanding loan repurchase and reimbursement obligations resulting from breaches of representations and warranties," Fannie says in its third-quarter financial statement. Fannie does not disclose the amount it collects from servicers, but Freddie Mac reported that its servicers have repurchased \$2.7 billion in bad loans during the first three quarters of 2009, including \$960 million in the third quarter alone.

"Investors are QCing the whole file to even determine if the borrower is who they say they are these days," said Ms. Piepho. "It's not normal quality control. So, we have to be ahead of the investor in preventing fraud. We've been using these risk mitigation technologies for about four years now. What we're doing now is using the fraud tools at the point-of-sale.

"Going forward, we're looking at Motivity Solutions for dashboard and scorecard reporting. We can put key performance indicators in there to see what everyone is doing. As investors are drilling down, there is going to be a trend where lenders also need to drill down to see what each individual is doing. How many errors did the

processor have? What was the fallout rate for this processor? I can't do that quickly without technology.

"We all have to continue to drill down to the loan level to know that every facet of the loan is correct," concluded Ms. Piepho. "It's all about credit and data quality. We can't say we know the borrower can make the payment and take a risk on the collateral or vice versa. You have to know everything about every loan today. You have to verify everything that goes into the file."

That's why vendors like MDA DataQuick are continually introducing new technology to help lenders know the value of the property at least. You can know everything about the borrower, but if the property doesn't support the loan, it shouldn't be done.

"Many lenders pay for the appraisal upfront and include it in the closing cost," noted John Walsh, president of MDA DataQuick. "Well, in some cases with loan fallout being what it is, lenders eat that cost. With a lender we're talking to that has cost them \$20 million a year. So, we have proposed that they use a solution that renders an automated valuation. An AVM is nothing new, but what we're talking about is providing a trusted set of data that would act

another AVM, they need someone to tell them that this value is trusted.

"Historically lenders have done several desktop reviews. Right now, this process is human-being driven," added Mr. Walsh. "Most lenders will tell you this is as much an art as it is a science. Conversely, we provide a suite of answers that come back and say this is a reasonable value or this value can't be confirmed and you need a human. Through this method you've created a replicable process, you've taken human error out and you can have your experts focus just on the deals they need to look at."

In the end, it comes down to lenders getting a grip on their data and consolidating it at the loan level all in one location, according to Gabe Minton, chief strategy officer at business intelligence automation vendor Motivity Solutions. "Lenders have several systems. I laugh when I hear systems say they're end-to-end because in all cases those end-to-end systems are integrated to other end-to-end systems. At some key point the data is on one or more of your systems and you export that data to someone else. To attack data quality, you want business intelligence and reports in near real time.



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—Sheila Plunkett
Dexma

as a preview for the lender and the borrower to reduce processing cost.

"The biggest issue still lies in assessing the value of loans in servicing or held in investment. Lenders are ordering multiple valuations on given properties every month because they do not trust what they get from the appraiser, BPO or AVM. The world doesn't need

"Having that control to look at your loan-level data at any time and run reports off it is huge. Images are helpful. There has been a huge migration to imaging on the front office. E-disclosure adoption is growing dramatically and imaging the closing package is picking up. That's helpful, but if they're just images you still have risk. You can bring up

an image and look at it at anytime, but you need to know what happened to the data in that image.”

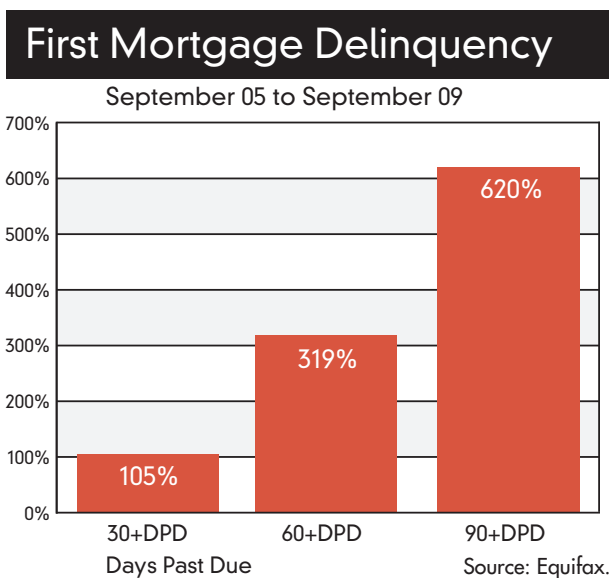
Vendors like Motivity and others are introducing new tools to help lenders get a better handle on risk. For example, Motivity created a dashboard scorecard that can count how many times a piece of data was changed, any third-party services the lender used, if e-disclosures were used and it also looks at the metrics to see how long it took each department to originate that loan. If it took 20 days to underwrite that loan vs. the normal five, something was going on there. Data like that could be a good indicator of the health of that loan.

“A lot of lenders are taking hits with buybacks,” said Sheila Plunkett, Dexma’s vice president of sales and marketing. “However, lenders are also investing a lot in workflow. They want the investor to have visibility. Technology is a construct and a framework for closing better quality loans. Technology, however, is only as good as those using it. Even with the best airbag, you can still crash that car and die if you have a bad driver behind the wheel.”

The key to success in the secondary market is the ability to respond to the unexpected and stay on course. Yet many lenders – particularly small and midsized lenders that don’t have sizable technology budgets – still rely on spreadsheets to manage their locked loan pipeline and investor commitments. The lack of timely and accurate data prevents these lenders from keeping apace.

To this end, Dexma has launched Dexma Secondary Marketing Center, which is Web-based, offering lenders a real-time window into their daily position. Lenders can track their locked loan pipeline, assign loans to commitments dynamically and monitor progress toward delivery.

“What we’ve done is assess where gaps might be between secondary and origination,” added Ms. Plunkett. “Lenders can extend locks and be sure they are properly pricing right with



this new tool. Because midtier lenders re-enter a lot of data around secondary transactions, it’s sort of like trading on the stock market and buying based on yesterday’s price. There’s also a full audit trail in the tool so you have complete visibility. There is also an alert capability. If a lock breaks and the loan no longer meets the criteria there is an alert sent out. You get access to real-time data all around.”

Simply put, the mortgage landscape has changed. Delinquencies continue to increase, as does regulation. Leonard Ryan, president at compliance vendor QuestSoft, said, “A couple of years ago

business, I’ve never seen such a focus on detail. We are creating infrastructure to get all the moving parts together. The next challenge to the industry is repurchases around compliance.

“That’s new. Before they were looking at underwriting criteria and the appraised value, but today they’re looking at how you completed the application, for example. Those are things that were not given as much importance in the past. Investors are even asking for repurchases on performing loans. Things are changing every three or four weeks. We’re using technology to keep up.” **MT**

you didn’t spend much time on certain things, but we’ve had a major new regulation every two months of this year. In our case we’ve seen daily changes that we as a compliance vendor have to keep up with.”

And lenders are responding to these challenges. “There’s a concentration on how to get things right,” noted John Johnston, senior EVP at Pacific Mercantile Bank. “In my 30 years in this

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