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New Rules Emphasize the Importance of Having an Effective Quality Control Program

Forward thinking and successful mortgage operations executives are embracing the building of effective quality control (QC) plans into their operations. The days of the "check the box" QC plans are gone. Now, each mortgage operations must have their own customized QC plan which addresses the specific risks of their organization. The consequences are far too high for not having an effective QC plan.

Fannie Mae and Freddie Mac (i.e. GSEs) will refuse to buy loans that do not comply with their requirements. They have made it a high priority to increase the number and scope of audits of their "approved sellers". These audits include an extensive review of QC plans and a sample of the loans these sellers originate and/or service. As a result of these GSEs audits, organizations have lost their privilege to their sell loans to the GSEs. These reviews have also resulted in significant repurchase requests.

The regulators, such as the Consumer Financial Protection Bureau (CFPB), are imposing heavy penalties, such as monetary fines and cease and desist orders for not having an effective QC plans. In the underwriting section of the CFPB's examination manual, it specifically states that the examiners will "confirm that the lender has an adequate Quality Assurance Program, both pre-funding and post-closing, to detect and correct any violations of its underwriting policies".

Compliance with consumer regulations has be a major priority for mortgage lending/servicing operations. These days, it is critical to have an effective QC plan. The final rules issued by the CFPB on the "ability-to-repay" and "Qualified Mortgages" (QM) require mortgage operations to have robust procedures and systems in place to comply with these new requirements. For example, the Federal Housing Finance Agency (FHFA), which is the government conservator of Fannie Mae and Freddie Mac, issued a requirement in May 2013 that limited Fannie Mae and Freddie Mac to only purchase QM loans.

Government agencies /regulators, investors and rating agencies are taking a much deeper examination at mortgage operations QC plans and the organization's adherence with these plans. While regulatory requirements from the agencies and entities do vary to some degree, these requirements for QC plans are very similar and have the following characteristics:

- Tailored to the scope of the mortgage business, such as mortgage product types, channels of production, locations of business, type of originators.
- Designed to detect deficiencies in the origination of mortgage loans.
- Evaluates and monitors the overall quality of the processes.
- Provides effective reporting to senior management.

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- The plan is well documented and followed and understood at all level in the organization.

Many organizations outsource their quality control function. It is important to select a QC provider that understands and effectively addresses these new requirements. But just as important, it is critical that the mortgage lending operation has an effective vendor management process in place. The responsibility of having an effective QC plan cannot be outsourced. This responsibility remains firmly with the mortgage operation. The lender must have documented procedures in place to monitor and measure the quality of the outsourced work and take appropriate action if deficiencies are found in the work provided by the outsourced QC firm.

In the development or updating the organization's QC plan, the first step should be to conduct a risk assessment of the organization's mortgage operation. The risk assessment is a review of the operation to determine the risks that can affect the organization if proper mitigating controls are not in place. The risks are ranked in terms of severity, impact, and probability of occurrence to determine how to prioritize efforts to prevent these risks. An effective risk assessment provides the unique operational information to develop an effective QC plan.

Prior to these new regulatory requirements, many organizations did not have a prefunding QC process. The prefunding requirements do not specify detailed procedures and the sample sizes to be reviewed. It is left up to the mortgage lender to determine what is appropriate for an effective prefunding QC plan.

With these new rules, all mortgage lenders must have a robust and effective QC program in place. In future audits and exams, the agencies and regulators will be thoroughly assessing these programs. Most importantly, they will be determining if management taking their QC program seriously and staffing the QC team with qualified professionals to effectively execute the QC program. No longer will "canned" QC programs be acceptable. These plans must be customize to the organization's operations and followed in practice.

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