Need for Reviews Becomes Selective

Today the key to buyback prevention lies less in finding what could cause them than taking the factors known to cause them and weighting them properly to find which truly require more in-depth review.

"We think that lenders are kind of at a tipping point because of how much information they're being presented and having to interpret through and make a decision on," Lloyd G. Booth, president and chief operations officer of the Greenwood Village, Colo.-based Blueberry Systems LLC, told this publication.

Citing an example, Booth noted challenges related to interpreting all the different fraud detection services that are now being layered in on top of the loans. Most now pull a 40-or-so-page report for each mortgage. This can be a challenge for production staff "to be able interpret that much data and make a decision on what they're seeing there," he said.

Most fraud vendors do provide a proprietary "fraud score" that may give users a quicker read on the loan's potential risk, but "there really isn't a standard fraud score," Booth noted. Because different vendors have different scores, this presents "kind of an interesting dilemma because ultimately the lenders are trying to figure out the propensity for fraud and then deliver that to an investor but there's not really a standard of assessing a fraud score to the industry yet."

In addition to the score, "there are pages and pages of alerts and the alerts may be that the subject property is in a neighborhood that's known for its high foreclosure rate," he said. "Well, if I'm asking the underwriter to look at every one of the loans that has that particular issue in it, pretty soon you're desensitized to that data.

"The user just gets desensitized. They're passing every loan through because they're tired of looking at 40 pages," Booth said, noting that in cases like these, "it doesn't matter how good the data was, it didn't do...any good.

"If I have an underwriter that's underwriting two separate loans and they both give that...alert [that] the property is in a high foreclosure neighborhood, it's going to mean different things depending on what the underwriter's looking at. What we're trying to do is take some of that human intuition and plug it into a workflow process so that we only have the people look at the really problem loans. The normal loans we can push through," he said.

Booth said this is why over the last year or so it has partnered with CoreLogic "to be able to workflow enable the integration of their product.

"Before that, like every other system out there, the fraud report was handed off to a user," he said. "Last year we started working with CoreLogic be able to build workflow enabled rules around that service.

"We're working with CoreLogic to be able to automate some of those processes so that their system and our system only react to the loans that cross a specific threshold, so that people can look at that data...only when they absolutely have to have a person involved rather than having every single loan examined.

"What we can do is we can go through our workflow and through our rules engine say, if I have these 10 parameters in my loan and we have a scorecard system that's built into our system you can create any number of scorecards, any (kind) of grades that you want...an overall risk grade, for example," Booth said.

"[Using] those parameters that you'd look at, we'll create a scorecard. We have an algorithm that matches up our score with the fraud score along with the alerts. [Using] the combination of those values and the fraud report, we flag it, stop the loan and take a look at [it.]"

In other words, "we're taking the fraud scores that come from the vendors and [combining] them with whatever the lender wants to lay on top of that as a risk factor for a particular loan, based off of what their underwriters would normally [look at]," he said.

"There's such an overwhelming amount of information that's available to the user and we're really funneling it through the neck of the hourglass," said Booth, noting that lenders are "running out of resources to make all of those interpretations, so you need to find ways that those vendors and loan production systems work together to make that process more efficient."

Without such filtering of information, the industry could continue to be plagued by false positives, he said. (When asked about some of the common underwriting "filters" that might be used in conjunction with fraud data and scores in trying to identify buybacks, Booth responded to a mention of owner-occupancy status as "really one of the places you want to look at.")

When asked if such filtering, when used to identify potential buybacks, offers enough protection from them, Booth said, "I think it is part of it. I don't think there is any silver bullet for protecting the lender right now. You have to order the right services in terms of product fraud detection and compliance. You have to have the right business rules in place."

As far as how the partnership with CoreLogic is structured in conjunction with achieving this aim, Booth said when it comes to all the company's business partners it has been "intent on not creating relationships with vendors that were based on revenue sharing schemes." In other words, users pay for the usage of the technologies separately, so that there is no splitting of revenue between them that could create a conflict of interest.

"Our philosophy from a systems standpoint is that [it is] almost impossible to be everything to everybody all the time...Fraud, product and pricing, compliance and even doc prep are areas where we thought there were really good companies out there. We didn't necessarily want to compete at that level [so] we looked around for companies that we wanted to create...interfaces with...CoreLogic, in our mind, they were approaching the problem along the same lines.

"We can use anybody's system that [users] want to," he added. "Vendors that we think are either the best in class or ones that...have the closest alignment of our philosophies, those [interfaces are] built into our core system.

"Everything...can be configured and tweaked to the lender's specification, although we do have an out-of-the-box solution that [can be used as] starting point...and then the lender can go from there and start to make changes and evolve the system however they see fit."

While a high profile issue, fraud is only one possible cause of buybacks so automation has been targeting other types of data integrity as well, Booth noted.

"Typically anything that is misrepresented might not cause a buyback [but you're] certainly going to have reps and warranties in question there. If the loan never stops performing it may not be an issue [but] if it does those guys are looking for any reason they can to push it back on the lender," he said.

"If you talk about buybacks [today] usually it's not some huge overt problem with the loan, it is some small, insignificant piece that if you look at the loan...at some high level view everything looks OK. Usually the things that we're seeing causing the buybacks are the smaller undercurrents," said Booth. "It used to be investors were only looking for those problems in a loan if the loan went into default, but now they're looking for those problems more as a matter of course before they'll buy them from the lender and so they're really scrutinizing those and the little things matter."

Having automation that double-checks and documents data integrity in general as well as improves workflow throughout the origination process can help address this, he said, noting that loan information has been evolving from something viewed on somewhat of a static basis to something that has as more of a dynamic nature. In contrast to workflow management, when it comes to having audited data throughout the process, more information can be better to have on record than less.

As an example he cited the somewhat similar need to provide data integrity aimed at mitigating variances in the lock-to-loan process, which is one of the first places the company began addressing the issue.

"While that might not create a buyback issue, [like a buyback] it does create a profitability issue for the lender," Booth explained. In a loan-to-lock variance, for example, a loan might come in as a single-family residence and, as it got produced, turn out to be a PUD. A 720 credit score a lock is based on could out to be in reality a 680 or a 650 or a ZIP code could turn out to be wrong. "If nobody tells anybody about that and the system doesn't stop anything, the investor still buys the loan but the lender takes a haircut on it.

"All of those things are small enough that the investor's still probably going to buy it. It's probably not going to make the loan ineligible but it does impact the lender's profitability. That's very closely related to the buyback situation, it's just the buyback situation is a weightier problem but fundamentally it's the same kind of issue: the data changed from what it was going to be and that's because there was some fraud that wasn't uncovered or some other piece of information was interpreted incorrectly. It's the same kind of problem where we started off with one kind of data we made a decision [based on it] and the data changed.

"What we found when we were looking was that most of the systems that were out there, the kinds of data validations they would [do] when the loan first comes in and the lock request happens, most of the systems were looking at that and saying, as soon as that happens 'freeze the interest rate, freeze the FICO score and anything that has to do with product and pricing. We're going to go ahead and freeze it so that somebody has to ask secondary if they can open that up,'" he said.

"So when we designed our system, one of the things that we look at was how do we address the fact that data needs to evolved as it moves through the loan production process? It's not that it can't change it's just that we have to know when it changes, where it changed from, who changed it and what we're supposed to do with it [if it changed]."

This can be applied similarly on the buyback side, Booth said, referencing a situation in which it might be used.

Say, for example, a lender had a loan that went through the automated underwriting, resulting in a AU finding that showed "OK, the borrower needs to come to closing with [theoretically, to use a round number] $500.

"So the automated underwriting findings came back with an [approval]... the loan went through and somewhere in the process the borrower ended up getting a $49 credit from one of the fees that were in the transaction and so what happened was the loan closed, the borrower brought in [$451] instead of $500. The loan performed fine for two years or 18 months [then] the loan went into default after that." This resulted in a potentially costly buyback concern.

"That's a small discrepancy, but when the loan stopped performing the investor was looking for somebody to buy that problem back from them and because that's a discrepancy, they were able to go back to the lender and say, 'now it's your problem,'" Booth said.

"With our system we're able to say before you go to closing, 'here's the numbers that we fed into your AU engine, here's the numbers in the loan now and if there's a discrepancy we can program [the automation] to take any course of action that the lender thinks is appropriate."

Blueberry addresses this through what it calls a universal data model. "You have to have an extensible database. That's important because you want to be able to have all of the data in your database of record that makes up the loan. You have to be able to share data with other resources...and [you have to] be able to understand the state of data, meaning that if the data comes in one way it's that way all the way through the process."

To track and get a record of the process, the company created what it calls its data audit framework on top of the universal data model. "It's a tool that lets [the user] do snapshot audits at various points in the production process to help the lender identify when there's a problem," he said. "One of the ways that they'll use it is that they'll snapshot the data that was aggregated as it went to the automated underwriting engine and as the loan progresses through.

"If the loan data evolves away from what was sent to the automated underwriting engine we can actually stop that loan from going to closing if that's what needs to happen or we can direct it in different ways through the workflow and can identify [if] that data changes.

"That's one of the ways that we deal with buybacks: understanding when the data changed, who changed it and how we address that," Booth said. "I can present a report to the investor or anybody else that's interested [showing], 'these are the five times this data element changed...and this was the action that was taken.'

"The historical evolution of that data tells a whole lot about whether it's accurate," he said.

Also, "You have to be able to have the right processes in place that allow you to be able to react to the changes in data, like something changing in the parameters that went into automated underwriting," Booth said.

"A lot of systems don't...say what's different in this loan today than what I submitted to the automated underwriting engine a week ago and if they don't, what ends up happening is the user has to pore through those fields to find the one that's different or the ones that are different and that's really what we are trying to do is to automate some of that process."

When asked if he could quantify how effective this strategy has been in mitigating buyback risk, Booth noted that clients are loath to allow him to share such statistics publicly and they would be anecdotal.

But he added that he could say that the first client that applied a similar strategy to mitigating loan lock variance risk was able to cap its losses and see relatively significant savings in the first year of using the technology.

"One of the things that we're working toward is we're working with a couple of different lenders' internal quality control departments to be able to integrate quality control processes directly into the production cycle," he added. "So as part of moving the loan from processing to underwriting, for example, the lender will be able to define a set of quality control questions and rules that they want to have answered and recorded before that loan can move to the next level. So everybody can quality control the loan if you enter the process and find when we had a problem. What we're trying to do is do it during the process so that we can catch those kind of problems before they ever hit the closing side."

All this means automating a great deal of data and a lot of need for users to set parameters, which can lead back to the problem of creating almost too much information and a need to prioritize and management.

While users do like having the ability to customize systems somewhat, Booth said the automation is designed to be more manageable in that it comes out of the box with a set of best practices for audits that the company recommends users start with and tweak as they use the system.

Booth said the best practices are based on "listening to the lenders and finding out what's causing buybacks.

"We wrote an investors' tracking module as a way for our lenders to deliver loans to their investors. Those investors will send back a list of stipulations saying, 'I can't buy this...because of these things'...and so we started looking at the kinds of things investors were kicking back.

"So some of it's...that kind of data and some of it's talking to both the production people and the executives at the lender side."

Blueberry Systems also shares offices with Cherry Creek Mortgage and will confer with that company on issues.

Booth added, when asked, that the company's parameters for "best practices" do not stay static but are rather continually updating and honed based on such feedback.

"Every day they evolve," he said.