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MBA Newslink Question-and-Answer
With Gagan Sharma, president, BSI Financial Inc., Irving, Texas

***MBA NEWSLINK*: What is the state of residential mortgage underwriting today?**

Gagan Sharma: Fortunately, old-fashioned, sound underwriting is coming back into fashion. From 2005 through about 2008, a lot of residential mortgage lenders forgot or ignored basic underwriting procedures. We have seen a lot of improvements already, with underwriters and upfront people working harder to create a cleaner loan product. Now, the underwriting process consists of multiple layers of checkpoints. For example, some lenders run two credit checks on loan applicants: one at the beginning of the application process, and another a week or two before the closing to make sure nothing has happened in the meantime. We are involved in this post-closing quality control (QC) to ensure performance of the loan. Post-close QC business started going up toward the middle of last year.

***NewsLink:* What does the post-close quality control process consist of?**

Sharma: Post-close QC isn't new. At its most basic, it means checking for errors in the underwriting process after the loan has closed, but before it's "too late," so to speak. We makes sure loan documents are properly signed, financial disclosures are done correctly, appraisals are reasonably accurate, and borrower financial ratios are realistic. Bear in mind, a solid post-close QC process has to go beyond an obligatory checklist in search of expected errors. Ultimately our goal is not to tell clients how to underwrite their loans, and we don't provide legal advice. It's the responsibility of the lender or investor to set the guidelines. Rather, we make sure underwriters are following their own guidelines or their investors' guidelines. That creates protections should a buyback be considered. We also look to find improvements in the underwriting process and provide more thorough documentation; in short, make certain that everyone is doing it right. Clients also usually want us to advise them on the accuracy of the appraisal. After we're done, we submit a report to senior management for review to create an action plan for improvements.

***NewsLink:* Is post-close QC outsourced or done in-house?**

Sharma: Not surprisingly, the largest lenders usually do their own post-close QC themselves, but most others tend to outsource this function. But, whichever way it's done, post-close QC must be independent of the underwriting department. Investors and warehouse lenders usually prefer that an independent third-party perform the QC function.

***NewsLink:* What if post-close QC is not done?**

Sharma: Nowadays, if you don't do post-close QC, you can't sell your loans or get a warehouse line of credit. If you sell loans to the secondary market, investors require that the loan seller have a strong post-close QC process in place. Warehouse lenders expect it, too. Fannie Mae, for example, requires that 10 percent of loans it buys have gone through a post-close QC process within 45 to 60 days of the end of the month that the loans were originated.

NewsLink: **What does this do to the pre-closing underwriting process?**

Sharma: Well, that's interesting, because a more demanding post-close QC process typically produces a longer and more strenuous up-front underwriting process. There are also new HUD and GSE requirements that lenders must comply with that add more documentation to the loan file. So, it now takes several extra hours to fund a loan because of all the auditing and checking that is done at funding. It adds a lot of time to the process because we're basically do a "mini audit" as part of the pre-closing process.

NewsLink: **Are lenders on board with this?**

Sharma: Lenders don't like delays (who does?) so we still see some resistance. It's definitely harder to close loans than it used to be. Hopefully, though, the work we're doing now will improve the process and make underwriting more accurate and there will be fewer defaults or repurchase demands later on.

NewsLink: **What other benefits are there besides better up-front underwriting?**

Sharma: As mentioned, post-close QC plays a big role when a loan investor or mortgage insurance company demands that the servicer repurchase a loan for allegedly not living up to its specifications. By providing a thorough post-close QC process, we can help our servicing clients defend against claims that a loan was allegedly misrepresented. This also comes into play in a foreclosure when, for example, a borrower claims he was not given the proper disclosures at closing, we can go back and prove whether that was the case. Most of the buyback requests we get are the result of the appraisal. We take the appraisal apart piece-by-piece. Most of the time we find that the appraiser was overly aggressive. But, we must remember that local real estate markets can change quickly, and there are always pockets of stability in an otherwise weak local real estate market.

NewsLink: **Do you do quality control on loans that have been modified?**

Sharma: Yes. We perform quality control on a percentage of loans that we modify as part of our servicing QC process. This is important now due to the large numbers of loans in default or being modified. Because of our post-close QC work, we have built a knowledge base of what goes on in the origination process. We can take that information to do QC on default servicing. But it works both ways. We use our knowledge of defaulted loans to improve the underwriting of newly originated loans. Servicing QC is important when loans are modified. There needs to be a quality control check after the modification is done to look for errors to try to make sure the mod doesn't fail – or to go back and find out why it did to make sure it doesn't happen again.