




Re-evaluating Your QA Process

MBA Quality Assurance
Conference

October 1, 2007


Impact of Competition and New Technology on Quality Control



MBA Quality Assurance Conference Washington, DC October 1-2, 2007

**Hakki C. Etem, Founder
Cogent Economics**

Investment Banks: The New Big Dogs on the Block

- 
- Long time players in secondary market
 - Vertical integration achieved more recently
 - \$1 Trillion Subprime explosion

Consequences:

- Relative quality discipline of Fannie + Freddie fades as their prominence (and volumes) decline
- Liar loans + 100% CLTV -- If traditional underwriting is set aside, who needs QC?

Pressure at Mortgage Firm Led To Mass Approval of Bad Loans




Maggie Hardiman cringed as she heard the salesmen knocking the sides of desks with a baseball bat as they walked through her office. *Bang! Bang!*

" 'You cut my [expletive] deal!' " she recalls one man yelling at her. " 'You can't do that.' " *Bang!* The bat whacked the top of her desk. As an appraiser for a company called New Century Financial, Hardiman was supposed to weed out bad mortgage applications. Most of the mortgage applications Hardiman reviewed had problems, she said. But "you didn't want to turn away a loan because all hell would break loose," she recounted in interviews. When she did, her bosses often overruled her and found another appraiser to sign off on it.

Washington Post May 7, 2007

A Cross-Country Blame Game



William D. Dallas, the founder and chief executive of Ownit, acknowledges loosening lending standards but says he did so reluctantly and under pressure from his investors, particularly Merrill Lynch, which wanted more loans to package into lucrative securities.

He recalls being asked to make more "stated income" loans, in which lenders do not verify the information provided by borrowers and brokers with tax returns, pay stubs or other documentation. The message, he said, was simple: You are leaving money on the table -- do more of them.

Mr. Dallas, a trim 51-year-old who has been in the mortgage business for more than 25 years, said he disagreed, but complied. "If I can sell it at a profit," he said, "why would I not do it?"

The New York Times May 8, 2007



We Told You So!

Investment Banks

Consequences:

- Relative quality discipline of Fannie + Freddie fades as their prominence (and volumes) decline
- Liar loans + 100% CLTV -- If traditional underwriting is set aside, who needs QC?
- Confusion of QC with Due Diligence reviews:
 - Steep learning curve for many as they learn the differences.
- Quality issues accompany rapid growth and consolidation

Technological Advances

- File Imaging Systems
- Fraud Screening Tools
- Credit Scores

Recent improvements to Imaging Systems make QC supremely portable

- But Outsourcing presents special challenges and requires active management
- QC Outsourcing has now moved offshore, compounding the challenges

Fraud Screening Tools


All Fraud, All the Time

- Third-party fraud prevention and screening procedures, even fraud insurance, is routinely substituted for traditional QC.
- Subprime losses due to flawed loan products and minimal UW guidelines will dwarf fraud-related losses.

Hubris and the risk managers

- Explosion of subprime lending owes much to flawed bond ratings
- Predictive credit models, and the efficacy of credit scores, will be severely tested in the short run.
- A boon to Fannie and Freddie

Top Lender Sees Mortgage Woes for 'Good' Risks



Countrywide Financial, the nation's largest mortgage lender, said yesterday that more borrowers with good credit were falling behind on their loans and that the housing market might not begin recovering until 2009 because of a decline in house prices that goes beyond anything experienced in decades ...

What was added to the worries yesterday was the idea that even credit-worthy homeowners would default on mortgages at higher rates as home prices fall — and that even a well-run company like Countrywide could be hit by big losses.

—*The New York Times* July 25, 2007



We Told You So!



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Julie Woodley

Pre-funding QC Pitfalls and Practical Fixes



■ Identify your weak points.

- Sr. Management support and buy in
- Staff
- What are the risks

■ Monitor who you do business with.

- Broker Monitoring
 - Appraiser Monitoring
 - Fraud Schemes

Pre-funding QC Pitfalls and Practical Fixes

■ Use some type of pre-funding fraud tool.

- Employee Verifications:

- Occupancy Fraud

- Assets

- Identity issues

- OFAC issues

- Credit Reporting issues

■ Turn times are vital.

- There will be many against you.

- Be proactive in your approach

■ Train everyone

- Ask yourself-if I was a crooked broker or seller, how would I try to get a bad loan through this companies system?
- Outline a checklist of items you feel should be reviewed-who will do this?
- Outline strict timeframes to have these reviews completed.
 - QC PF Analyst will review the file and return a result with in 2 hours
 - Partnership with your UW Management to set up a process
 - Map out your complete process with time frames

■ Zero tolerance for fraud

- Providing the feedback to your Management teams
- Don't continue to do business with sellers or others that you know are giving you fraudulent documents
- Stand Tough!


Show Management that Effective QC Works

• **Show Sr. Management the items that you are identifying and what their potential losses would have been to your company had you funded these loans. Numbers talk!**

• **Remember – fraud loans = defaults**

• **Defaults = Foreclosures and repurchases**

• **FC and Repurchases = losses to your company**



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Mike Ellis

Sr. Vice President

Green Point Mortgage Funding

Current QC



Role

Pre and Post-Funding Audit,
Measurement and Analysis

Scope

Loan Production

Outputs

Findings, Reports, Analysis,
Recommendations

*Strategic Business
Impact*

Feedback

Transition QC



Role

Development and Acceptance of
Process Improvement Methodologies

Scope

Broader Concept of Operational Risk

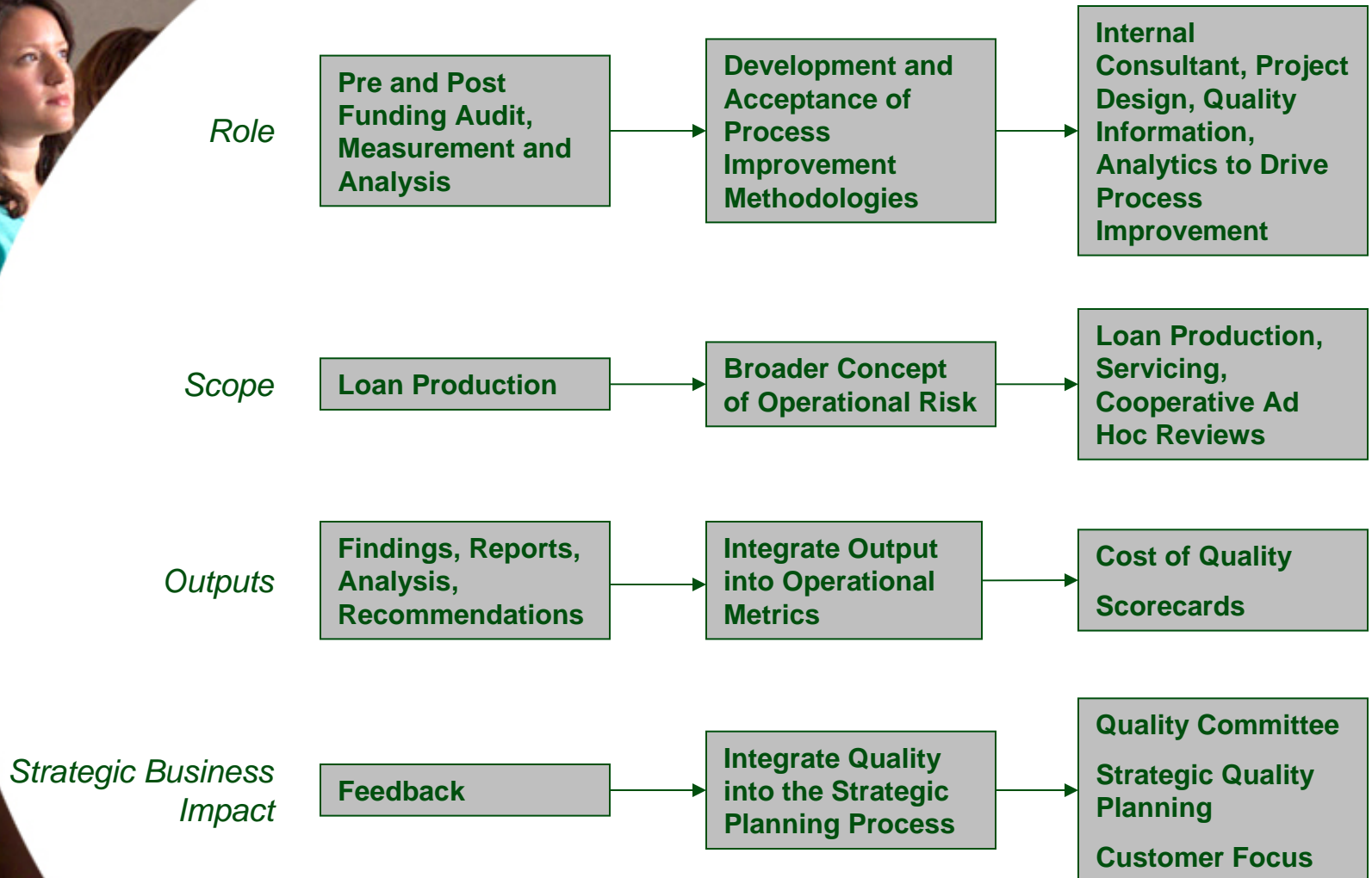
Outputs

Integrate Output into Operational
Metrics

*Strategic Business
Impact*

Integrate Quality into the Strategic
Planning Process

Future QC



Challenges

- **Swings in volume**
- **Increased scrutiny**
 - **Investors**
 - **Regulators**
- **Enterprise Integration**

Solutions

- **Process Improvement Tools**
 - **Enhanced Analysis**
- **Outsourcing**
- **Offshoring**
- **Technology**