Cutler Consulting, Inc.

Strategic Mortgage Partners

Case Study - Regulatory Compliance

Develop and implement a comprehensive action plan for top ten mortgage bank to obtain a satisfactory rating from the OCC.

Background

A top ten mortgage banking company became a division of a national bank and was subject to OCC regulation for the first time in its 24 year history. The OCC performed a safety and soundness review of the mortgage banking company, resulting in a "deficient" rating. In reviewing the case, there were a number of early warning signs symptomatic of an ailing mortgage company. These included inconsistent earnings, management turnover, deteriorating credit quality, excessive cost cutting and inefficient integration of acquisitions. The OCC identified several key areas that required immediate corrective action: senior management talent, strategic and technology planning, credit quality of servicing portfolio, employee morale, controls and oversight, and valuation of the servicing assets.

Analysis

The company lacked focus and direction. High CEO turnover resulted in constant changes in strategic direction and made long term planning impossible. Controls were in place but inadequate to properly address credit, compliance and servicing hedging risks. Servicing economics and product profitability analysis were lacking. Technology needed to be updated to better manage the origination and hedging functions. The retail production group lacked leadership and automation. The credit quality of the servicing portfolio was below average, as evidenced by the number of delinquencies and loans with FICO scores below 620. The Capital Markets group relied on batch processes as opposed to real time information. Temporary unsalable loans remained in closed loan inventory for as long as six months. The servicing acquisition strategy needed refinement.

Cutler Consulting is a management consulting company specializing in residential real estate finance.

Recommendations

Stabilize Management Team

- ◊ Hire CEO with vision and goals consistent with bank and rest of management team.
- ◊ Hire head of Production with responsibility for all channels.
- ◊ Increase accountability for all department managers by providing clearly defined objectives.

Establish Credit Administration Department

Responsible for oversight and monitoring:

- ◊ delinquencies
- ◊ loan deficiencies
- ◊ credit scores
- ◊ quality control findings
- ◊ repurchases
- ◊ correspondents/broker relationships
- ◊ underwriting,
- ◊ mortgage insurance relationships

Develop and Implement Strategic Plan

- ◊ Concentrate on production that is the most profitable to the company.
- ◊ Best Practices methodologies should be implemented in all areas of the company.
- ◊ Pursue acquisitions that meet internal hurdle rate of return.
- ◊ Organize the company into four lines of business – Production, Servicing,/Operations, Capital Markets/Risk Management and Accounting/Servicing Hedging.
- ◊ Acquire systems and technology to properly report and manage risks.

Develop and Implement a Technology Plan

- ◊ Install a LOS that provides real time information to production, capital markets and operations.
- ◊ Acquire risk management system such as QRM.
- ◊ Align technology resources with business users.

Develop and Implement plan to improve Credit Quality

- ◊ Establish thresholds for brokers and correspondents delivering loans with FICO scores < 620.
- ◊ Initiate a risk based fee for loans with FICO scores < 620.

Strengthen Control Functions

- ◊ Establish Compliance Committee to oversee all regulatory and compliance issues.
- ◊ Pricing for servicing should be separated from MSR valuation and hedging.
- ◊ Establish ALCO committee to coordinate and monitor all capital markets activities.
- ◊ Eliminate temporary unsalable loans within 120 days of closing.
- ◊ Establish detailed reporting and business reviews for the four lines of business.

MSR Valuation and Hedging

- ◊ Hire experts to value and hedge the servicing asset.
- ◊ Limit servicing portfolio to major investors. Sell small investor servicing to increase operational efficiency.
- ◊ Establish a servicing released premium that incorporates state specific prepayment speeds.
- ◊ Determine what servicing is really worth to the company. Keep profitable servicing and sell unprofitable servicing.

Employee Morale

- ◊ Design and implement employee opinion survey.
- ◊ Involve employees in company through "talk it up" sessions and "lunch and learn sessions.
- ◊ Develop standard employee evaluation rating form.

Results

- ◊ Overall credit quality of the servicing portfolio improved as the number of loans with FICO scores < 620 declined., reducing loss mitigation expense by 10%.
- ◊ Efficiency gains in servicing as a result of consolidation of investors reduced per loan cost to service by 15%.
- ◊ Real time pipeline management information gained via QRM Risk Management system allowed reduction in optional coverage, saving approximately $50,000 in monthly fees.
- ◊ The time to cure temporary unsalable loans was reduced 35%.
- ◊ Net income increased 20% as a result of increased accountability gained through dynamic management reporting and implementation of business reviews.
- ◊ The company achieved a "satisfactory "rating on its OCC safety and soundness review.
- ◊ Employee morale improved significantly, as evidenced by employee opinion survey taken one year after initial survey.