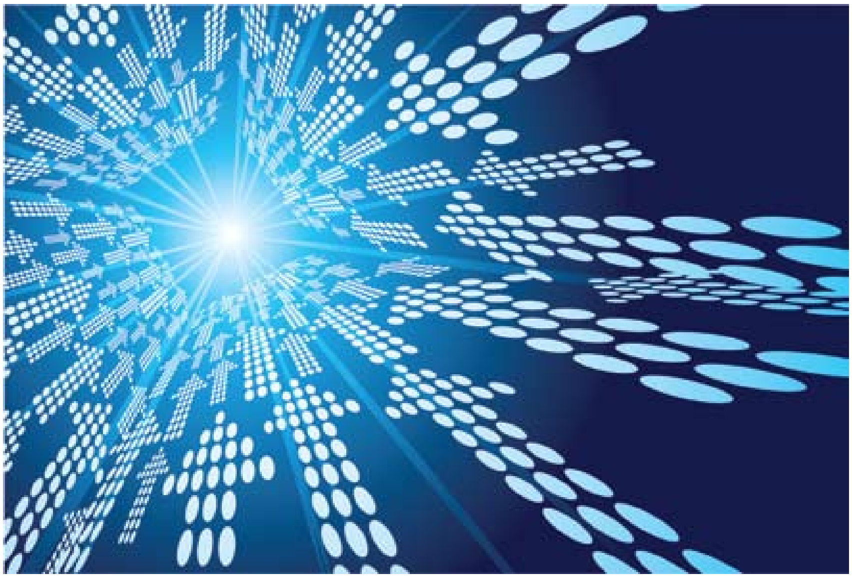


Enterprise Risk Management

A need to hasten the obliteration of legacy IT systems

By Anna DeSimone

Back in the 1980s, IBM mainframe systems were the heart of a bank's computer structure. During this period, integrated retail banking systems were introduced so that branch service representatives had informational database tools to help in cross-selling deposit and consumer loan products.

Soon the industry became flooded with applications that enabled floor personnel to sell loans. Many of these integrated applications took months or years to roll out due to the far-reaching challenges of getting one end of the system to "talk" to the other. Typically, an applications developer would ask, *why duplicate effort or repeat data-entry steps?* Summarily, systems were built with this concept in mind: *if the data exists in our organization, we can access it.* While customer service representatives were able to save a few minutes typing a customer's address in an on-line application for a home loan, an institution's over-reliance on capturing existing data grew problematic.

Venturing into the secondary mortgage market presented mortgage lenders with the opportunity to offer more affordable loans to customers while earning handsome profits. It was very common, however, that secondary market investors or securitizers had compulsory loan amortization algorithm specifications based on 360-day calendar years, a technical obstacle for institutions whose infrastructure was based on a 364-day calendar year. The issuance of a Truth-in-Lending disclosure based on the incorrect calendar year is one example of system incompatibility often discovered after the lender distributed hundreds of thousands of dollars in restitution payments to borrowers as a result of under-disclosed Annual Percentage Rates (APRs).

When something is not working or procedures are vague, employees will often return to their former, often manual, processes. The exception to this is the APR computation — one is very unlikely to see a Hewlett-Packard 93C sitting on a loan officer's desk. Hence the second wave of "bundled applications" was promoted as solutions offering "seamless" integration within the organization's IT architecture.

The priority to hasten the abandonment of legacy systems in favor of robust all-encompassing systems achieves four principal objectives:

First – The Sales Level

Financial institutions need a single platform to control the daily rate quotation for deposit and loan products and their related terms and qualifying parameters.

The scope of the Enterprise Risk Management technology model spans across all divisions and service areas and should cover both internal and external processes.

A regulatory examiner in today's environment is not going to render A-1 ratings to an institution after reviewing a few policy manuals, a small sampling of loans or sampling of anti-money-laundering logs.

Second – The Disclosure Level
Financial institutions need to control the creation and delivery of consumer disclosures and guarantee consistency with respect to form and formulae.

Third – The Monitoring Level
Financial institutions need a system for monitoring activities on an inter-departmental level to ensure that personnel workflow steps and processes conform to internal policy.

Fourth – The Reporting Level
Financial institutions need a system that abstracts information to the Board of Directors, investors, regulators and supervisory agencies.

The scope of the **Enterprise Risk Management** technology model spans across all divisions and service areas and should cover both internal and external processes. Legacy systems generally remain self-contained within their areas of specialty, such as merchant card processing, home equity lending, vehicle leasing, etc. Today's technology choices offer a much wider berth, and with an added bonus —real-time data communications with external agencies and services providers, such as loan settlement agents, mortgage insurance companies, housing finance agencies, and so forth. The graph illustrates the enterprise-wide system operating on a horizontal level.

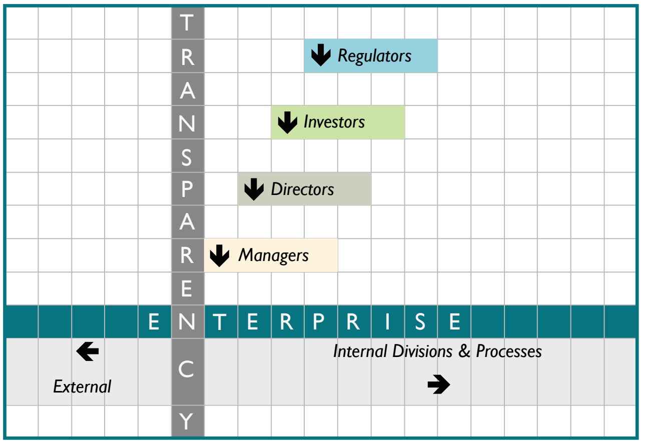
The enterprise-wide system enables compliance managers to monitor timely consumer disclosure of compliance documents in all product areas. Consumer lending risk managers, for instance, are able to view activity reports that segment product by loan type, investor, and rate-lock expire. The risk manager may want to drill down data into segmented groups. Working with information in smaller groups enables managers to monitor risk exposure in critical areas, such as high loan-to-value, lower credit score and so forth.

Sound enterprise risk management systems ideally function as an "early detection warning system" so that incidents are captured early on. Incident tracking is implemented by area of risk, while incident reporting is monitored by area of responsibility. Information becomes aged. The sooner deficiencies are uncovered, the sooner remediation and process improvement can be put into place. The cost of training and re-work diminishes.

Transparency is illustrated as a vertical sector in viewing the operational risk model. Logically, this coincides with the "10,000 foot view" that is a conversational expression used by stakeholders who rely upon executive summaries. A multi-dimensional risk management technology program ideally can produce roll-up summaries of activities across all business units and produce abstracts aptly structured for the administrator or overseer.

Access to federal funds, subsidy programs and secondary market agency programs come with stipulations. A regulatory examiner in today's environment is not going to render A-1 ratings to an institution after reviewing a few policy manuals, a small sampling of loans or sampling of anti-money-laundering logs. The government sponsored secondary market agency or building society in today's risk environment is going to ask the institution to produce reports upon request, such as the rate of defects found in an external auditor's random review of closed loan files.

Twenty-five years ago, financial institutions around the world held on to their unwavering trust and confidence in "Big Blue" and conversions took years to deploy. Times have changed. Banks are vulnerable to lowered safety and soundness ratings, stiff penalties for compliance errors, money laundering and suspicious transaction violations, to name a few. A business unit can become immobilized by unmitigated exposure of confidential consumer information. The need to hasten the obliteration of legacy IT will open the door to implementing state-of-the art technology enhancements that strengthen internal control and promote sound and sustainable banking.



About the Author

Anna DeSimone is President and Founder of Bankers Advisory, Inc., Belmont Massachusetts, USA, a audit and consulting company specializing in mortgage quality assurance and regulatory compliance. She has published 30 guidebooks on many topics of including mortgage fraud, predatory lending, identity theft and international mortgage banking. She can be reached at *anna@bankersadvisory.com*

Mortgage Lending Solutions for Troubled Markets

By Anna DeSimone

Governments globally have initiated a range of programs in response to the negative equity and low-mobility crisis, including targeted job-creation programs, credits to lenders and monetary stimulus aimed at raising housing prices.

Creation of wealth began with farmers who planted something into the land and earned income from harvesting food. Others created wealth from something taken from the ground, such as oil, coal and other minerals. In many countries around the world, an employed individual or family with modest income could embark on the creation of wealth simply by purchasing a home.

During the dot.com bubble, property values soared and periods of low-interest rates and innovative mortgage programs bolstered home sales. Many homeowners refinanced their properties at lowered rates and some tapped into their home equity, often using proceeds for home improvement. However, after the crashing of the information technology boom, the housing market softened in the United States and many global economies.

Mortgage debt that exceeds property value is known as **negative equity**. ***For many homeowners, the paradigm had shifted from wealth creation to wealth destruction.***

Some housing markets have faltered and others have stabilized. In the United States, negative equity peaked at 15.5 million loans the first quarter of 2012 according to the LPS Mortgage Monitor, published by Lender Processing Services. Down 35% over the last 12 months to 9.8 million as of Q3 2012, the highest percentage of negative equity remains in the "sand states" such as Arizona, California, Florida and Nevada.

Real estate markets have been fragile in recent years and a number of countries have experienced declining property values, including Australia, Denmark, Ireland, Italy, Japan, Netherlands, Spain and Sweden. In Ireland, according to Central Bank data, half of all home loans are in negative equity. Of the near 800,000 home mortgages in arrears for three months or more, about 14 per cent have been restructured. Last year, more than 400 Irish families surrendered their keys without the bank having to resort to full legal action.

"When people's homes are underwater, they find it hard to move to take new jobs." Harvard economist Lawrence Katz testified to the U.S. Congress in 2010, adding "Homeowners with negative equity are hesitant to sell their houses at a loss thereby reducing mobility from distressed areas."

Government officials and prudential regulators in both U.S. and global nations have initiated a range of policies and programs in response to the negative equity and low-mobility crisis. Programs include targeted job-creation programs,

Foreclosure Avoidance Programs

	Description	*Benefit to Borrower*	*Benefit to Lender*
SHORT SALE	Proceeds of the sale falls short of the principal balance. Terms vary regarding interim payment collection, loan deficiency recapture or principal forgiveness.	Fair and impartial way to dispose of property in orderly fashion. Government subsidy programs offer counseling and relocation assistance.	Reduces exposure to property damage by working with realty and property agents; may provide financial credits or tax incentives.
LOAN MODIFICATION	Change to the loan's monthly payment, interest rate, term or outstanding principal. Major U.S. program is called HAMP.	Builds trust between lender and borrower through counseling and more affordable payment restructuring.	Sustains property condition and strengthens customer communication.
DEED IN LIEU	Borrowers transfer property ownership back to the lender by surrendering title.	Borrowers deal squarely with their lender and walk away from a distressed situation with dignity.	Avoids uncertainty and enables faster and more expedient disposition of property.

The Home Affordable Modification Program, known as HAMP is now looked upon as the industry standard practice for lenders to analyze potential modification applicants and has helped well over 1 million struggling homeowners at risk of foreclosure.

credits to lenders and monetary stimulus aimed at raising housing prices.

In the United States, the rate of foreclosure has declined 21% from 917,000 in 2011 to 767,0000 in 2012 according to CoreLogic Market Pulse, February 2013. Since the financial crisis began in September 2008, there have been approximately 4.12 million completed foreclosures across the country.

During 2012, 23.9% of all U.S. home sales consisted of distressed sales. Distressed sales consist of bank owned real estate (REO) and "short sales" where the lender agrees to reduce the principal balance so that under-water properties may be sold closer to market value. Short sales generally bring in prices that are higher than foreclosures and help sustain neighborhood property values.

An official program of the U.S. Department of Treasury and Department of Urban Development (HUD) is the ***Making Home Affordable Program***, created by the U.S. Financial Stability Act of 2009. The program was built as collaboration with banks, services, credit unions, the FHA, the VA, the USDA and the Federal Housing Finance Agency, to create standard loan modification guidelines for lenders to take into consideration when evaluating a borrower for a potential loan modification. The ***Home Affordable Modification Program***, known as HAMP is now looked upon as the industry standard practice for lenders to analyze potential modification applicants and has helped well over 1 million struggling homeowners at risk of foreclosure.

The Home Affordable Foreclosure Alternatives (HAFA) Program is also administered by HUD and offers struggling homeowners with an opportunity to transition to more affordable housing. Options include a short sale or a Deed-in-Lieu (DIL) of foreclosure. The Deed-in-Lieu option allows borrowers to give the title back to the lender, transferring ownership back to them. In a short sale, the homeowner is not responsible for any deficiency that may occur after the home is sold and is completely released from the mortgage debt after the property sale. Borrowers are protected from negative credit scores when utilizing a HAFA alternative and the agency provides homeowners with $3,000 in relocation assistance.

Between 2007 and the third quarter of 2012, there were 400,000 foreclosures in Spain, according to data from the General Council of the Judiciary. The Popular Legislative Initiative (ILP), **Platform for those Affected by Mortgage**, promoted by the citizen movement Plataforma de Afectados por la Hipoteca (PAH) calls for payment in kind, meaning that a person's debts are written off once they have surrendered their home.

Countries all over the world have defied gravity in order to stabilize housing markets affected by negative equity. Banks and building societies in many countries deal with secondary market mortgage backed securities programs and other housing finance agencies. Through these partnerships and affordable housing incentives, over time we shall see more foreclosure alternatives and options for homeowners to safeguard their homes and financial security.

About the Author

Anna DeSimone is President and Founder of Bankers Advisory, Inc., Belmont Massachusetts, USA, a audit and consulting company specializing in mortgage quality assurance and regulatory compliance. She has published 30 guidebooks on many topics of including mortgage fraud, predatory lending, identity theft and international mortgage banking. She can be reached at *anna@bankersadvisory.com*

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Housing and Mortage Data – Select Countries

Country	Housing Price Index Yearly % Change	Total Housing Units	Owner Occupancy	Housing Expenditure	Outstanding Mortgage Balance (USD millions)
Australia	- 5.10	7,596,182	69.2%	20.4%	$ 969,397
Austria	+ 4.26	3,339,375	50.41%	19.0%	$ 116,994
Canada	- 2.67	11,562,975	68.4%	24.1%	$ 1,007,492
Germany	+ 3.27	81,465,300	43.2%	21.0%	$ 1,536,260
India	+ 1.12	192,671,808	86.6%	9.9%	$ 64.973
Ireland	- 9.60	1,469,521	74.5%	12.6%	–
Italy	- 3.20	27,427,508	80.0%	16%	$ 391,013
Japan	- 2.93	82,314,204	55.61%	19.9%	$ 2,208,235
Russian Federation	- 7.88	142,754,098	84.7%	–	$ 45,931
South Africa	+ 2.30	11,205,705	61.3%	9.7%	$ 97,187
Spain	- 15.20	14,187,169	85.0%	13.1%	$ 906,944
Switzerland	+ 3.27	3,040,713	40.0%	19.5%	$ 728,575
United Kingdom	- 1.80	24,500,413	69.0%	19.3%	$ 1,691,344
United States	- .577	115,000,000	66.5%	21.0%	$10,167,078

Source: Bankers Advisory International Compendium 2013,
Compiled by William R. Slap, Intern, Wesleyan University 2015