

DUE DILIGENCE - CASE STUDY

In Brief

- One of the Federal Home Loan Banks had concerns regarding the integrity of the data for loans from a member bank which were being pledged as collateral for a line of credit
- Indecomm performed data integrity and underwriting reviews on a sample of loans
- Material deficiencies were found and Indecomm's client reduced their funding facility and increased their hair cut to reduce exposure risks

Client Information

Indecomm's client is one of the 12 Federal Home Loan Banks (FHLB) in the United States.

Background

- The FHLB provided a \$1 billion mortgage funding facility for a large member bank that purchases residential mortgages in bulk third party originators
- The member bank is responsible for sending key loan data regarding the loans pledged and providing a risk grade for each pledged loan. The risk grade establishes the "haircut" percentage

Problem Statement

- The FHLB was concerned about the integrity of the loan level data provided by the member bank and if the risk grades were accurate
- The FHLB was concerned if the collateral is being pledged properly

Solution Summary and Key Benefits

- Indecomm selected a representative sample of loans pledged on a specific day to perform various due diligence tests and reviews. The review included:
 - o Verified with the FHLB and the member bank's document custodians to verify if the mortgage notes were pledged to the FHLB for the specific day
 - o Performed a data integrity review by matching the data provided to the FHLB with the source data in the sample loan files
 - o Underwrote the pledge loans in the sample to determine if they met the member bank's underwriting criteria and if the assigned risk grade was accurate
- Indecomm evaluated the member bank's loan purchase processes to determine if they met industry best practices

The Results

- Indecomm found material deficiencies in a high percentage of the sample of pledged loans especially regarding underwriting and risk grading
- The FHLB significantly reduced the amount of the funding facility available to the member bank and increased the haircuts for pledged loans
- The member bank failed about 12 months after the FHLB changed the terms of the line of credit and the FHLB's exposure to losses was minimal