

Industry Makes Early Plans to Exterminate Y2K Bug

Homeowners Can Supplement Pest-Control Efforts

by James J. Cotton

IT'S JANUARY 1, 2000, AND America's homeowners are waking up to a new year. The change from 1999 to 2000 may not seem apocalyptic on the surface. After all, electronic date changes have proceeded automatically and transparently year after year. But this time, computer programs that reliably have interpreted a two-digit year in billions of lines of computer code could very well—and very mistakenly—read the ambiguous 00 as the year 1900 instead of 2000. On the first New Year's Day of the next millennium, then, homeowners could experience far more headaches than usual.

Suppose, for example, a mortgage company notice goes out informing some customers that their next loan payments are due in 1900—100 years ago. Or, imagine the same company's computer system shuts down, leaving the firm with no way to process payments in the weeks ahead. Even worse, what happens if the company loses all of its payment records or its computer

James J. Cotton is vice president of Freddie Mac's customer support department.



systems don't recognize payments already made? These technical difficulties—and ensuing problems with mistaken borrower foreclosure notices and diminished lender liquidity—are all possibilities. Curing these kinds of financial headaches would take a lot more than a couple of aspirin.

Taking Preventative Measures

With less than 200 business days left until the Year 2000, companies in the financial arena, and every other business sector, are working feverishly to preempt technology headaches. The objective is to ensure that computer systems and products are Year 2000 compatible—or Y2K ready—meaning they will

function come 1/1/00. Given the electronic interdependency of businesses and critical service companies such as telecommunication and utility providers, this task is dauntingly complex. Individual companies must worry not only about their own systems but also about the systems of any companies with which they interact.

Currently, the financial community is ahead of the game. The financial-services sector recently beat out 11 other industry sectors ranked according to their Y2K readiness by the consulting firm Cap Gemini America. The financial-services industry earned an 87-percent preparedness rating. Government agencies, in contrast, placed last, with a 67-percent Y2K-ready rating.

Financial institutions are out in front for several reasons. First and foremost, they cannot afford to get caught unprepared. An estimated 90 percent of all bank-asset records are tracked electronically, and virtually all banking transactions involve electronic processing.

Second, the **Federal Financial Institutions Examination Council**

(www.ffiec.gov) required financial institutions to renovate all key products and electronic processes for the date change by Dec. 31, 1998. Federally regulated banks, thrifts and credit unions also had to ensure the reliable functioning of the third-party systems, products and services on which they depend.

To meet the 1998 year-end deadline, lending institutions began by defining the problem and designating resources to address it. Then the scope of the Y2K challenge was evaluated on a companywide basis. That included any impacts on software-driven information systems and equipment—such as vaults and security systems—and devices that depend on embedded microchips. Lenders also completed code enhancements and other system upgrades or replacements. Finally, they had to test the new systems to validate their business functionality.

Mortgage Community Teams Up

The Examination Council's guidelines are directed at individual banking institutions, but the greater mortgage-lending community is engaged in a wider, cooperative effort to make Y2K preparations. Leading the charge is the Year 2000 Inter-Industry Work Group, which was founded under the auspices of the Mortgage Bankers Association. The group's membership is drawn from a cross-section of lenders, third-party vendors,

Companies that otherwise compete for market share or profits are working together against an immovable deadline to ensure common Y2K preparedness.

government agencies and investors. Companies that otherwise compete for market share or profits are working together against an immovable deadline to ensure common Y2K preparedness.

The centerpiece of the working group's preparations is an industrywide, systems-readiness test. Using key mortgage-transaction processes—origination, **secondary mortgage marketing** and **servicing**—the testing will assess the ability of one institution's systems to communicate with another company's systems in a Y2K environment. The test is sponsored by secondary-mortgage-market firms Freddie Mac and Fannie Mae; ALLTEL

Corp., the largest U.S. provider of software and processing services to residential-lending firms; and First American Financial Corp., a real estate and financial-services company. The test is intended to detect any potential problems while there is still time to correct them, thus avoiding critical-system failures and subsequent industry disruption in 2000.

Keeping tabs on the preparations throughout the financial sector is the President's Council on Year 2000 Conversion (www.y2k.gov). This watchdog group of government and industry leaders convened by President Clinton assesses the Y2K readiness of key industry segments. These segments include those that Americans rely on for vital services, such as telecommunications, transportation and finance. So while the mortgage industry is working to make sure homeowners do not experience problems with their mortgages, the President's Council is working to avoid millennial disasters on other fronts that could lead to power failures, food shortages or, in a worst-case event, general infrastructure collapse.

Freddie Mac Steps Up to the Plate

In addition to furthering the industry's efforts, Freddie Mac has made Year 2000 readiness the corporation's top priority. Freddie Mac has dedicated 1 in 10 employees to this endeavor; that's

more than 320 people diligently examining and updating 3,000 computers and 12 million lines of computer code. The company estimates that Y2K expenses—including systems modifications, business-continuity planning, external and internal testing and response integration—will total from \$125 million to \$150 million.

As of Dec. 31, 1998, Freddie Mac had completed 99 percent of the work on the company's key systems—those that support both external and internal applications. Under a separate initiative, Freddie Mac delivered on a key promise to customers by issuing Y2K versions of nearly a dozen mortgage-industry applications before October 1998.

All of these efforts are paying off. In a small-scale test last November and December involving 10 of the firm's largest customers, Freddie Mac simulated business transactions bearing a 2000 date. All systems performed flawlessly during this test, which bodes well for Freddie Mac's participation this year in the Mortgage Bankers Association's Year 2000 Readiness Test. During the upcoming test, more than 600 of Freddie Mac's customers will interact with the company to flush out any last-minute Y2K problems.

Freddie Mac is not limiting its preparation efforts to the firm's mortgage-origination partners,



however. Early in 1999, the company put its investor and dealer services partnerships through similar Y2K-readiness simulations. Among the mission-critical service providers involved in these trial runs were the Federal Reserve Bank, the MBS Clearing Corp. and Wall Street securities dealers. The exercises confirmed the company's continued ability to package and sell mortgages as reliable securities, which is essential to fulfilling Freddie Mac's corporate mission.

What If...

So what if, despite diligent testing of mission-critical systems, the financial sector falters on Jan. 1, 2000? How will deposits, investments and payment transactions be affected? Could the failure to record a mortgage payment result in foreclosure proceedings? What about a mortgage payment that registers as 100 years late?

Homeowners and depositors needn't resort to hiding their life

savings in sock drawers or going to other extremes. They can draw some measure of comfort in the fact that all financial institutions are required to maintain back-up records. To play it safe, though, homeowners and depositors likewise can take steps to mitigate their Y2K risks.

One grass-roots consumer group recommends that homeowners make the first one or two mortgage payments of the Year 2000 ahead of time. Similarly, the Federal Deposit Insurance Corp. advises depositors at the nation's banks and savings institutions to keep receipts and maintain accurate records of financial transactions—loan payments, deposits, withdrawals, interest accruals, savings and checking account balances, automated-teller-machine transactions—for a few months in advance of the millennium rollover plus a few months beyond. Accurate records are a good defense against the millennium bug, whether the bug strikes a bank, a mortgage company, an insurance agency or even the Internal Revenue Service.

The countdown to the new millennium continues, and the President's Council, federal regulators, lending institutions and other companies such as Freddie Mac remain focused on Y2K preparations. If homeowners take steps to prepare as well, then they should awaken to at least one less headache on New Year's Day, 2000. SMM