

# New Priorities

BY JEFFREY MOUHALIS

**T**here is no question that the mortgage and housing segment has been through a tremendously difficult adjustment since June 2006, when U.S. home prices peaked. At that time, most of the subprime adjustable-rate mortgage (ARM) resets were still off in the future, unemployment was dropping and the economy was still humming along. In mid-2006, new homes were on the market less than four months on average, and the housing inventory, while climbing, was not yet alarming. ● What a difference a year makes. ● By mid-2007, subprime ARM resets were flooding the industry, and record numbers of borrowers were either failing or struggling to manage the increase in their mortgage payments. Compounded by investor pressures, the credit markets have experienced a strain on liquidity that continues to threaten financial institutions across the country. Meanwhile, home values have fallen precipitously in some markets, appreciated at a much slower pace in others or simply flattened out in areas of the country that had previously enjoyed steady growth. ● Largely as a result of exposure to the subprime meltdown, liquidity constraints and general economic uncertainty, financial institutions have undergone a seismic shift in almost every area of their business. In the mortgage technology area, there

**The tough business environment faced by mortgage industry players during the last year has caused a shift in technology priorities.**

are three significant issues that have either been caused by or identified as a result of the market upheaval that I believe will continue to drive technology decisions for the foreseeable future.

### **Overwhelming volume**

Exacerbated by an overwhelming volume of ARM resets in a concentrated period of time, mortgage servicers are now burdened with heavy collections activity, workouts, loan modifications, default and foreclosure processing, and real estate-owned (REO) management. They are struggling to handle mountains of paperwork, with some servicers requiring months to complete each loan-modification agreement.

Meanwhile, steep losses continue to mount. In response, mortgage companies are implementing dramatic expense-reduction initiatives, in some cases requiring work-force reductions, while regulators pressure servicers to address the plight of a rapidly growing number of distressed borrowers with unprecedented speed.

To complicate matters further, there is a shortage of seasoned loss-mitigation professionals to handle the load. While employees are reassigned to augment the efforts of the loss-mitigation team, an inordinate amount of time and rigorous training are required to ensure productive results.

In the face of the massive influx of distressed borrowers and mounting losses, financial institutions also are turning to the latest technology to supercharge their back-end efficiency and help them cope with the daunting volume. Servicers that rely on robust technology tools can get more done in less time, with fewer resources and lowered costs.

One example of such tools is the Fidelity National Information Services (FIS) Customer CareNet (CCN) Web site, an online destination that is private-labeled by FIS for servicers processing loans on the company's Mortgage Servicing Package (MSP) system. FIS CCN offers a loss-mitigation module that allows delinquent customers to create their own repayment plans.

Servicers can disallow access to this feature altogether or enable it based on eligibility criteria that best fits their risk tolerance—such as customers with fewer than two or three delinquent payments. Additionally, servicers can use this same Web site to gather borrower financial information such as detailed income and expense data. Having a collector gather these data manually is time-consuming and often requires multiple calls, as borrowers may not have the information readily available.

By allowing self-service loss mitigation, financial institutions empower delinquent borrowers to work through a variety of approved scenarios and determine the repayment schedule that best

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meets their particular circumstances. Once a plan is selected, borrower notifications can be automated and the servicing system updated to reflect the selected plan, as well as track the customer's adherence to the agreed-upon payment schedule.

The time and cost savings for servicers can be significant, and borrowers get started on their workout program weeks or months before they might otherwise get through the servicer's loss-mitigation process. If the borrower fails to follow through on the plan, the servicer is automatically notified and can move forward with its default process.

Another example of the industry working smarter and more efficiently is to use information from the U.S. Postal Service (USPS) and its Confirm® service to monitor when mortgage payments are sent. When servicers issue their monthly billing statements, they can include a return envelope printed with a special bar code from the USPS, known as a PLANET® code. The USPS has equipment that electronically reads the bar code when borrowers drop their payments into the mail, and automatically transmits that information to the appropriate financial institution.

This allows servicers to remove the loan from their outboard calling queues, thus avoiding the cost of calling customers to check on payments that are past their due date but already in the mail and on the way. As institutions have started to monitor slowly paying accounts much more closely, this solution can help them avoid unnecessary outbound calling.

The use of electronic solutions can also help streamline processes, reduce both time and costs, increase convenience for the customer and the financial institution, and improve overall customer satisfaction. Electronic solutions can be leveraged for time-sensitive processes such as settling loan-modification agreements online to eliminate the need to send documents back and forth between the lender and borrower. Online transactions can also help dramatically reduce the 15 percent to 30 percent fall-out rate that occurs when servicers send out repayment-plan documents to obtain wet signatures. In fact, some servicers are seeing the fall-out rate drop by half, saving numerous follow-up calls, delays and wasted effort.

By using an electronic closing solution, financial institutions can literally create the workout plan or loan-modification agreement while the company's loss-mitigation person is on the phone with a borrower, and send it back to him or her immediately. If the borrower has access to a computer and Internet connection, he or she can remotely go through the documents page-by-page while still on the phone with the servicer's representative. The borrower indicates approval of each page of the agreement by clicking the appropriate

box on the computer screen, then e-mails it back to the lender. In some cases, no further action is required; however, if a loan modification requires a wet signature, a solution such as FIS ClosingStream™ allows the borrower to authorize the lender to sign the documents on the borrower's behalf by using a power-of-attorney instrument.

Electronic solutions can deliver a fast and easy alternative to the traditional face-to-face settlement process so financial institutions and their customers move through the workout or loan-modification process much more efficiently. By using them, servicers can greatly lessen the time it takes to complete a loan modification and get more borrowers through the process.

### **Failed analytics**

In many respects, the current upheaval in the mortgage industry is the result of failed analytics. This includes risk models that didn't sufficiently model the range of potential change in key indicators that might occur, assumptions that were flawed, over-reliance on historical trends, incomplete or inaccurate data, and so on. Analytics affect almost everything in the mortgage business today, from the type of loan products that are offered to the property-value assumptions that are made and the lowered credit thresholds that are established for loan approvals.

In the wake of unprecedented loan losses and borrower unrest, financial institutions and investors are intent on better leveraging sophisticated analytical models that can help them more accurately predict risk—including prepayment and default propensity—whether for one mortgage loan or across an entire portfolio.

To conduct an authoritative risk analysis of prepayment propensity, for example, factors such as interest rates; the value of housing in the form of, for example, the Home Price Index (HPI)—an indicator produced by the Office of Federal Housing Enterprise Oversight (OFHEO); a range of borrower and loan-level characteristics and so on must be analyzed using a very sophisticated model. The propensity to default on a loan is a function of a combination of income, rate resets and/or changes in personal circumstances along with the borrower's equity, which is a function of the local HPI. As the value of a borrower's home declines, the willingness and/or ability to make payments can also decline.

These complex factors are difficult, but not impossible, to model. Simulations of the HPI can be conducted at the metropolitan statistical area (MSA) level to demonstrate the correlation of loan performance across a range of possible macroeconomic outcomes. By incorporating additional factors such as valuation trends on a single property and in the surrounding neighborhood, along with

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the type of loan product, attributes of the loan and so on, predictive analytics can produce extremely accurate results when key factors are properly weighted and modeled.

The importance of accurate analytics goes without saying, but their impact can be far-reaching. With advanced data and analytics, lenders and investors can literally determine the economic value of a loan and a portfolio, giving all market participants a better understanding of both risks and rewards.

As a result, servicers and investors are seeking out and investing in leading-edge analytics solutions that incorporate a broader range of accurate data from proven sources. They are requiring solutions that offer a much deeper level of analysis and modeling sophistication. In particular, predictive analytics models that generate a score or other clear indication of risk allow institutions to incorporate that factor into an automated decisioning solution to drive policy-based decisions across the enterprise.

Hand-in-hand with the demand for better analytics and predictive modeling is the requirement for data at an increasingly granular level. Originators need data to uncover mortgage fraud, verify everything from property value to credit score and income, and determine best-fit mortgage products. At the same time, investors need data to conduct their due-diligence process and make portfolio buying and selling decisions. Finally, third-party vendors need data to fulfill orders for flood insurance, title work and closing documents and a great deal more.

The need to get the right data at the right time to the right place is tremendous. Web services technology is a big part of the solution.

Web services offer a cleaner, faster and more secure way of accessing and interacting with data, regardless of where the data reside. Once Web services have been implemented, they can be reused endlessly by any authorized party and can be leveraged across multiple applications and multiple processes within applications to dramatically impact efficiency.

Web services can be aggregated to call up data and, based on those results, automatically call up other Web services to launch additional tasks. This allows financial institutions to eliminate some business processes and automate others. All this can be accomplished with a high level of security.

Web services can also be used to help servicers quickly identify loans in advance of ARM resets. By pinpointing these loans earlier, servicers can evaluate borrower data such as prior delinquencies, and access investor and geographic parameters to make informed decisions surrounding loss-mitigation options.

Data access, robust analytics and predictive modeling will continue to be areas of significant investment for the foreseeable future. These investments will begin at the origination desk and continue through the mortgage chain all the way to Wall Street.

### Heightened regulatory requirements

Ever since the peak of the real estate boom in mid-2006, there has been a dramatic increase in the pace of change in the regulatory environment. The government's intense interest in gathering more information and exercising stricter control over the nation's mortgage markets has exploded into an unprecedented level of new reporting requirements.

Both the Department of Housing and Urban Development (HUD) and the Department of Veterans Affairs (VA) rewrote their default reporting systems in 2007 to accommodate an increase in the type of data servicers are required to report. Fannie Mae and Ginnie Mae are currently rewriting their systems to reflect new requirements as well.

HUD's new requirements offer a good example of the increased level of reporting that servicers now face. Traditionally, HUD required servicers to simply provide a "point-in-time" month-end status report on mortgage loans. Today, however, institutions are required to report every status change that occurred on every loan throughout the month as part of their month-end report.

So a loan that becomes 90 days delinquent, goes into foreclosure and then results in bankruptcy within the same month would generate three events in the month-end report. Each event must be reported in a specific sequence. More than ever, the GSEs want to monitor what's called the "logical progression matrix" to make sure all mandated steps are taken within the required time frames as a loan moves from a delinquent status through loss mitigation, foreclosure and bankruptcy.

In response to this increased scrutiny, servicers must invest in the technology and processes that are necessary to enable very precise monitoring and reporting of everything that happens with a mortgage or home-equity loan. This includes the actions taken by the third parties that institutions often use to support their loss-mitigation efforts such as appraisers, outsourced default-processing centers and so on. Institutions must also be certain that their mortgage servicing platform is updated to keep pace with regulatory changes, either through a service bureau arrangement or by dedicating the necessary resources to get the job done.

Home-equity lines of credit (HELOCs) and loans are another area of increased regulatory risk for those institutions that are servicing these products on consumer servicing platforms.

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These platforms were not built to handle the complex reporting requirements associated with real estate-backed loans, and those requirements become exponentially more difficult to manage when loans start to fail.

If a home-equity loan borrower declares bankruptcy, financial institutions must track both the pre-petition delinquency—the payments that were delinquent before the bankruptcy—and the post-petition delinquency associated with the bankruptcy payment plan. Because home-equity lines are secured by real estate, many of the same guidelines surrounding loss mitigation and foreclosure processing (often varying by property location) must be employed. Consumer servicing platforms are not designed to meet these needs.

At least partly because of the complex regulatory environment, many financial institutions are moving home-equity lines and loans from their consumer servicing platform to a mortgage servicing platform to better manage both risk and compliance. With HELOCs serviced on a mortgage servicing platform, servicers can more easily and consistently deal with the rapid changes in regulatory reporting requirements and better manage the risk that is associated with HELOCs moving into the first-lien position.

Some institutions have indicated that as many as 25 percent to 30 percent of home-equity loans are in the first-lien position, requiring them to track property tax payments and insurance coverage in addition to delinquencies, loan modifications, foreclosure and bankruptcy proceedings.

### Up to the challenge

As financial institutions continue to evaluate and reset priorities to better insulate themselves from needless credit, liquidity and regulatory risk, we can expect to see a paradigm shift in the factors used to weigh technology investment decisions. The current turmoil in the mortgage segment demands a new way of thinking, because business as usual is no longer good enough. The mortgage industry of the future will be leaner, better informed and far more efficient as a result of the business and market realities of today.

Financial institutions can and will weather the storm by leveraging technologies that allow them to do more with less in a fraction of the time. While they are investing in the leading-edge tools that will help them move toward a stronger, more sustainable future, they will continue to foster the American dream of homeownership for generations to come. **MB**

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