

Divide and Conquer

By Joel Farrand

The Obama Administration has indicated that it wants to see 500,000 trial mortgage loan modifications in place before the end of this year. This has turned up the heat on servicers yet another notch, requiring them to move troubled borrowers through their loss mitigation processes faster and in greater numbers.

Certainly, the government's Making Home Affordable (MHA) programs have gained momentum since their implementation earlier this year, opening the floodgates of borrowers who hope to qualify for a modification. Of course, not every homeowner is eligible for – or wants a modification. Nonetheless, servicers must address each and every troubled loan, determine and communicate resolution options to borrowers, and manage the intensive process that is required to either get the loan back to performing status or get it off the books. For many servicers, this challenging and time-consuming process might be required for thousands of borrowers in a single portfolio.

The sheer volume of work is certainly overwhelming, but many innovative tools are available to help servicers automate and streamline their operating practices. Still, efficient and productive workload management is not just about deploying new automation or workflow tools. It is much more about maximizing those tools to ensure that the right work is done at the right time by the right people. To accomplish this, servicers must take a deeper look into their portfolios to better understand the make-up of their risk.

Segmenting the Portfolio

When it comes to defining an effective strategy for moving troubled loans through the pipeline toward resolution, servicers must first conduct a comprehensive analysis of their portfolio to assess their risk on a loan-by-loan basis.

Servicers can deploy excellent data sources and sophisticated modeling to help them determine the level of default risk that is associated with each loan in their portfolio. By using predictive analytics to identify those loans with the highest risk of rolling forward and/or reaching seriously delinquency within 6 to 12 months and looking at their staffing and operational capacity, servicers can segment their accounts into low, medium and high risk tranches. This is invaluable information for the servicer's risk management team, and helps the entire organization prepare for and manage both current and future volumes.

However, this should not be the end of the segmentation analysis. By digging a bit deeper, advanced analytics can match each loan's risk of default score to primary loss severity factors - like LTV and outstanding balances - for a much more revealing view of risk. This is where the value of segmentation jumps to an entirely new level.

Operating According to Risk

Even though an account's propensity to default score may show a moderate to low risk of serious delinquency, that same account might have a very high loss severity potential, significantly raising the stakes for the servicer. In response, servicers can

establish more aggressive early warning measures such as deeper scans of the borrower's status on a more frequent basis.

Conversely, servicers may differentiate an account with a high risk of default - but a low balance or LTV – by assigning a loss mitigation approach that is more appropriate to the potential for loss. This is as it should be. Servicers certainly need to see this bigger picture before determining their best course of action for any account.

Portfolio segmentation based on a more comprehensive view of risk allows servicers to make a dramatic and positive impact on all aspects of their operations. Far beyond simple identification of risk in their portfolios, they can customize loss mitigation initiatives more accurately and effectively than ever before. Not only does it help them prioritize the timing and nature of loss mitigation initiatives, but it helps them make more effective use of their resources, develop and communicate risk-appropriate offers and convert risk tranche segments into innovative contact strategies and treatments.

This segmentation process can – and should – be performed for each stage of delinquency. Borrowers that miss one payment should immediately be scored for the probability that they will miss a second payment. Borrowers who miss a second payment should immediately be scored to determine the probability that they will miss a third. At each step along the way, servicers can make highly informed decisions about what actions to take next and prioritize those actions according to risk.

Borrower Communication Strategies

Once accounts have been segmented according to their propensity to default and risk severity status, servicers can deploy a variety of proactive strategies to reach out to borrowers according to their risk tranche. Communications with lower risk accounts can be handled by junior loss mitigation professionals using automated dialing, for example, while higher risk accounts are handled by very skilled, experienced loss mitigation experts using outreach strategies like manual calling, personalized letters and emails.

Portfolio segmentation is also extremely effective as the basis for routing inbound borrower communications. As calls come in, servicers can immediately route calls based on the risk tranche, level of complexity associated with the status of the account, and the type of offer that will be discussed. Since the level of complexity generally increases with the level of risk, lower risk borrowers who can be offered standard options like refinancing, debt consolidation or short-term repayment plans can be effectively handled by junior loss mitigation professionals. Borrowers with a higher risk profile will generally require a more experienced loss mitigation professional to discuss a long-term repayment plan or loan modification.

At the highest risk levels, conversations often move beyond loan modification options to a discussion of liquidation actions such as short sale, deed-in-lieu or foreclosure. This is where servicers should focus their most highly skilled and experienced loss mitigation experts. These seasoned professionals can handle the often difficult and very sensitive conversations that must occur to ultimately help distressed borrowers reach a final decision.

Portfolio segmentation makes it possible for servicers to assign the right people to the right jobs at the right time for maximum effectiveness. Not only are human resources deployed more appropriately, but as a result, servicers are more efficient, borrowers are able to move through the system more quickly, and both servicers and borrowers are able to reach a resolution much sooner.

Ultimately, portfolio segmentation is about giving servicers a more transparent view into their true risk, and leveraging that knowledge into significant operational advantage. Our previous experience shows that servicers can potentially reduce their losses by 5% - 15% in the first full year of using these techniques. Especially in today's challenging environment, few accomplishments could deliver more value.

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