SERVICING MANAGEMENT®

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Some Sensible Strategies In A Volatile Market

As foreclosure rates rise and investors tighten requirements, servicers are increasingly relying on due diligence and Web-based technology to meet demands.

BY JEFF MOUHALIS

The volatility of the mortgage market has cut a wide swath across the industry. As credit and product requirements tighten, originators see their businesses slow. As the volume of foreclosures and bankruptcies grows, default outsourcing and field services companies flourish. And as loans fail, some lenders take tremendous losses while others shut their doors.

It is the classic best-of-times, worst-of-times scenario. Depending on how you are situated in the market, you could be having a great year - or struggling to make the next payroll. The drama is playing out with big winners and big losers all in the same mix, making the mortgage industry a living, breathing study in contradictions.

With 20/20 hindsight, we can all see how this dichotomy was created. The demand for subprime securities on Wall Street shot through the roof, fueling an all-out push to originate as many of these loans as possible.

The industry was flooded with an influx of new originators attracted by fast money, and as investors bid up loan prices, the market became overheated. Even in the more conservative Alt-A market, extremely liberal loan products were available, including those that either did not require originators to report a borrower's income on the 1003, or allowed them to accept a stated income without any verification.

To an outsider, the industry may look as though it is in chaos, and there is certainly a great deal of change under way. Still, there are some trends that have emerged that make a great deal of sense and are bringing order to the market evolution that is taking place.

Pre-purchase due diligence

Conducting a standard due diligence process on closed loans is not new for servicers, but today, the frequency and intensity of loan-level due diligence are staggering. In the past, servicers typically did a basic legal review of each loan to make sure loan documents were signed, titles were in order and Truth In Lending calculations were correct.

Rarely did they look at the underwriting decisions or conditions. In fact, if investors tried to dig much deeper, originators would simply take their business elsewhere.

Now, lenders and servicers are taking pre-purchase due diligence initiatives to new heights, including direct calls to borrowers to ask them questions about their loans to make sure they understand things like adjustable interest-rate provisions and prepayment penalties. These calls are also made to verify that borrowers plan to occupy the homes they have used for collateral.

Lenders and servicers may also run automated valuation models on properties to verify values - and if the results don't jibe with the loan package, they order full-blown appraisals. Depending on the outcome of the due diligence process, investors can and will refuse to buy these closed loans if they don't feel comfortable that the loans will perform as expected.

This change is an astonishing swing of the pendulum. Even when originators get a rate lock from a lender and a commitment to purchase the loan, the deal will now not go through if there is even a hint of dirt under the rug.

Not only that, but originators can't take their business elsewhere because investors everywhere are requiring the same thing. This dramatic change means lenders are the ones walking away from deals instead of originators, and this scenario is likely to continue for the foreseeable future.

Due diligence outsourcing

For some time, servicers have been outsourcing at least part of their due diligence process to third parties, especially for the purchase of bulk packages. However, with foreclosure numbers hitting new records, many servicing shops are experiencing capacity problems and looking to out-

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side business partners to help them manage their volume.

This shift has created a whole new cottage industry of firms willing to handle the due diligence needs of financial institutions throughout the mortgage space. Wall Street firms employ third parties to help them identify problems that require portfolio sellers to buy back specific mortgages. Servicers use third parties for the same reason - employing them to find anything in a defaulted loan they can use to trigger a contractual buyback.

Since third-party providers can give servicers immediate backlog relief and help them avoid the time and investment required to ramp up their own capacity, this trend to more outsourcing will likely continue for now.

Even after foreclosure and bankruptcy volumes fall to more rational levels, the intensity of due diligence is unlikely to subside, and third parties can bring welcome bandwidth and specialized expertise to the process.

Collections, loss mit demand

Not surprisingly, servicers are demanding a greater level of sophisticated technology support to help them better manage their collections and loss mitigation initiatives. They want dynamic solutions that can help their staff identify best-fit workout solutions based on answers borrowers give to customized questions. They need effective forbearance tracking and calculations, and they need a comprehensive history of all collections and loss mit interactions for probable auditor reviews.

Servicers also need technology tools that are easy to implement and operate so that new employees can be trained more quickly and become more productive faster. These and other critical capabilities must be delivered on a robust, flexible system that can readily manage the vagaries of the marketplace.

Real-time data access

There is a growing demand for access to data that can support analytical and predictive modeling and help servicers better prepare for the future. This area is rapidly becoming a top priority, not only for uses like credit and fraud risk scoring, but also to enhance customer experience and sell more products to borrowers.

Real-time data access is invaluable to the loss mitigation team, which needs to know when scheduled loan payments have been made, and to customer support representatives, who must respond to payoff requests and balance inquiries.

Access is also vitally important to institutions that want to enable higher levels of customer self-service and package product offers based on each customer's unique relationship with the organization.

In addition, servicers have ongoing relationships with outside business partners, like tax administration firms, that require access to specific customer data in order to efficiently manage their assigned tasks. Allowing verified users real-time access to customer data can drive both time and costs out of servicing operations.

Acquisitions and new entrants

As some lenders inevitably falter and fail, excellent loan portfolio purchase opportunities become available for healthier servicers. The value of scratch-and-dent portfolios has declined substantially, and for investors that can afford the risk and the wait on return on investment, the market is good.

This environment has also attracted the attention of venture capital firms like Cerberus. Unlike publicly held financial institutions that must disclose and, therefore, grow - or at least maintain - their earnings per price from quarter to quarter, venture capital firms can come in and purchase deeply discounted assets knowing they won't perform well in the short term.

However, these same assets can be a good investment for the long term, based on the assumption that there will be a return to a more rational market.

Web services

Most servicers are making use of Web services technology to increase process efficiency and save time in their operations. Fortunately, once the connection points and infrastructure for Web services have been built, financial institutions can take it to the next level, expanding their utilization of Web services to further streamline operations and improve real-time data access and communications with business partners.

By using Web services, authorized business partners can access the specific customer data they need to do their work and even update those data if they are given permission. Outdated processes like faxing and calling to request information can be eliminated completely with the use of Web services technology.

As we move forward, there will be increased aggregation of Web services that will allow one service to deliver information to other services that will then automatically trigger a series of predetermined transactions or events.

This capability will give servicers another round of significant cost-saving opportunities, as Web services are reused by applications, business processes and business partners.

While there is certainly a great deal of fallout in the market, the current correction in the industry will have long-term benefits for everyone. Certainly, we have seen a dramatic swing from the broad liberalization of the mortgage market to the current clampdown on lending policies and product features.

Eventually, however, the industry will find a new equilibrium as it continues to fund the homeownership dreams of qualified buyers.

Servicers must reinforce their strengths - through internal changes and outsourcing to providers and technology partners - to better position themselves in today's volatile market. It may be a rocky ride, but healthy servicers will survive and grow despite the challenges. In fact, many of them will come out ahead. SM

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