

For Deeper Insight, Collaborate Across Business Lines

To gain perspective of a borrower's complete risk profile, consider analytic modeling that covers mortgage, home equity and lending portfolios.

by Shelley Leonard

Whether financial institutions maintain their first mortgages, home equity loans and retail loans on the same platform, or manage their portfolios on separate platforms within distinct business units, holistic portfolio management offers actionable insight to reduce risk and improve results across the enterprise.

For example, first-mortgage and home equity portfolios have some distinct commonalities based on the fact that the homeowner's real estate asset is collateral for both loan types. Yet, the loans in these portfolios also reflect important differences. Whereas first mortgages are generally a lower-touch product, as long as borrowers are making their monthly payments, home equity lines are more transaction-oriented. Mortgage portfolios typically have less churn than home equity portfolios, making retention a more significant management issue for home equity portfolio managers.

As the real estate market stabilizes and improves, marketing initiatives to increase the utilization of lines are likely to ramp up and become more aggressive, while first-mortgage portfolio managers will work to identify high-quality prospects for new mortgage products.

The challenge is to leverage commonalities and best-practice strengths that have been developed in each line

of business, without requiring that diverse portfolios be managed as one. Whether the portfolios reside on separate servicing platforms or the same one, there are important risk management advantages and process synergies that can be gained through collaboration. In fact, when diverse portfolios are analyzed to drive performance, critical insights are gained that can translate into increased customer satisfaction, improved business processes and better financial results for the institution.

Practical matters

There are several key areas that must be addressed in order to progress toward a collaborative strategy across multiple lines of business. They include enterprise-level data access for risk analysis; stratification based on loan performance and factors such as propensity to default; and prioritization of loss mitigation, customer service or marketing initiatives. However, close collaboration among various lines of business will require institutions to first develop a framework that allows servicers to effectively leverage the commonalities of each business unit, without minimizing their unique differences.

Each portfolio manager is accountable for the financial performance of the loans in his or her portfolio and utilizes strategies to maximize that performance independent of what other portfolio managers may be doing.

This independence has its advan-

tages. Each business-unit executive is completely focused on managing the nuances of his or her customer relationships, monitoring a given portfolio to identify borrowers who may be struggling, initiating loss mitigation strategies and incenting profitable relationships. As a result, portfolio managers are the experts for their respective product types and bring unique strengths to the table.

It is important to establish a framework for collaboration that emphasizes common goals across lines of business, while allowing portfolio managers to maintain accountability and responsibility for their respective areas. This enables the financial institution, as well as the individual portfolio managers, to benefit from the collaboration in significant ways.

Risk can be more appropriately quantified, and mitigation practices can be leveraged across portfolios to improve overall results. Through the use of analytics, identifying niche markets, designing profitable products and improving vendor management are all actionable. While the leverage points will be unique to each financial institution, other potential benefits include workflow efficiency gains and reduced operating expenses.

The entire premise of holistic management through line-of-business collaboration rests on the ability to apply analytical modeling to the combined mortgage, home equity and consumer lending portfolios. This often requires data access and retrieval from multiple platforms - or, in those circumstances where the servicing platform is the same for multiple portfolio types, simply opening up the lines of communication among those portfolios.

How this is accomplished is very specific to each institution, but it does not have to be dependent on the type of servicing or banking systems the servicer currently uses. By adopting industry-standard consolidated databases and customizable dashboards delivered through a business intelligence tool, servicers can apply tailored credit-risk models, analytics and data tools across lines of business to generate accurate risk assessments.

Developing a customer-centric view through the use of analytics allows for in-depth knowledge of customers' behavioral patterns, risk propensity and appetite for specific features. This knowledge then becomes instrumental in the design or the fine-tuning of products that are well received by the institution's client base, resulting in a profitable, loyal customer. Proper use of analytics can help institutions strengthen their loss mitigation approaches to better communicate with borrowers and determine more sustainable workouts. It can also improve marketing, increase target-customer retention and reduce costs associated with third-party vendors.

Institutions often originate the first mortgage but not the home equity loan, and vice versa. From a total-risk perspective, it is still important to incorporate data on the status of all loans secured by the same real estate - regardless of who originated, services or owns the loan - to get the complete risk picture for a particular customer.

While the financial institution may not bear the financial risk of these loans, it is still vitally important for risk management to understand the total picture in order to effectively prioritize and determine loss mitigation approaches. In addition, the cross reference among property, customer and product allows higher customer retention and improved business strategies.

Risk stratification

Risk analysis and stratification aren't new. Using the tremendous amount of loan-level data that is

available in the industry and deploying analytical modeling that applies known risk factors to the unique conditions of each loan, institutions can measure and segment customers based on risk. Measurements like propensity to prepay and propensity to default on all products secured by real estate are important indicators of a borrower's financial situation, allowing servicers to take mitigating steps, far in advance of an actual default, and to understand the inherent market risk and valuation of their portfolios.

Portfolio managers currently apply risk models to their respective portfolios to identify and stratify risk into bands for prioritization for loss mitigation, customer retention and proactive marketing initiatives. What is significant is that when lending portfolios are analyzed together, it changes the stratification.

As a simple example, consider the case of a first mortgage with a low remaining balance. The value of the home easily exceeds what is owed, so when risk modeling indicates that the borrower may be headed for trouble, it is prioritized behind those mortgages with a higher outstanding balance - particularly those that also have a higher loan-to-value ratio.

However, the borrower may have a home equity in the consumer lending unit with a high balance - especially because borrowers may tap their home equity to supplement income as their financial condition deteriorates. When the risk analysis is applied to the combined portfolios, the stratification changes, and the borrower receives a higher priority, as well as more aggressive loss mitigation efforts.

By analyzing the first mortgage, home equity and even retail lending portfolios together, servicers take a tremendous step forward to truly understand the risks they face with their portfolios. From this point, a wide range of collaborative options are available. The most important is appropriate prioritization of loans for

loss mitigation efforts, regardless of how they are handled. Given the results of the combined analysis, portfolio managers can adjust their prioritization/severity bands to more effectively determine their loss mitigation approach with borrowers and help minimize losses for their institution.

Servicers may also want to maximize their combined portfolio customer insight by deploying joint customer-communications initiatives across multiple portfolios. For example, in the case of a mortgage and/or home equity default, the potential synergies are perhaps obvious - one loss mitigator instead of two, communications with borrowers about both loans at the same time, modifying the first mortgage and the home equity loan simultaneously, etc. Of course, the specifics will be unique to each institution, but the possibilities are intriguing.

Risk management collaboration across business units enables initiatives that extend beyond loss mitigation to also help improve new business results. By applying the same robust risk management modeling to combined portfolios, servicers can identify the best prospective candidates for specific marketing campaigns for any product line and even tailor product offers to best suit the unique situations of their customers.

Managers can help their organizations move the focus away from debates about the merits of one platform versus another, or how the practices used in one business unit are better than the other. Instead, the dialogue should be about how to leverage the true strengths - and the critical borrower information - that is available across the enterprise. **SM**



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