



SERVICING SURVEILLANCE

Today's investors demand visibility into servicers' operations to actively manage risk and ensure proper default practices.

By Vincent Spoto

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Throughout the last several years, the industry has become increasingly aware of the need for sound and prudent residential mortgage loan servicing practices to help manage risk, maximize cash flows, and minimize defaults. Investors, banks, monoline insurers, private mortgage insurers, GSEs, rating agencies, and other regulatory bodies and pertinent third parties all recognize the critical role loan servicing plays in helping maintain and improve residential mortgage performance.

Investors who incurred losses now look at the role residential mortgage servicers play in helping manage loans and curtail or minimize defaults. Prior to the start of this decade, investors seeking recourse for damages incurred focused primarily on loan origination and underwriting malfeasance in order to identify fraud or representation and warranty breaches related to defaulted loans. Most recently, however, the burden associated with loan origination fraud and underwriting malfeasance has shifted with greater focus now placed on loan servicing and corrective measures servicers can take to address shortfalls and, ultimately, reduce loss severities.

Aside from keeping with sound and prudent business practices, the rising number of defaults in today's environment necessitates the need for increased servicer vigilance across collections, loss mitigation, default management, and asset maintenance and disposition. Best practices for servicing surveillance start with a proactive program to monitor servicer performance. Investors and other third parties want to ensure a formal servicing surveillance function exists with a primary goal of maximizing cash flows, mitigating loss severities, and ensuring proper liquidity is maintained over servicing assets. And in today's increasingly complex and rigorous regulatory environment, it is essential to actively monitor servicer performance and ensure complete transparency is consistently maintained with the borrower.

CFPB Compliance

A servicer's overall compliance with regulatory standards is a critical area to review. Clearly, compliance with guidelines established by the Fair Credit Reporting Act (FCRA), the Real Estate Settlement Procedures Act (RESPA), the Truth-In-Lending Act (TILA), and the Fair Debt Collection Practices Act (FDCPA)—to name only a few—is essential; failure to do so potentially inhibits the borrower's ability to pay and adversely impacts a servicer's reputation (as well as its bottom line due to the potential imposition of fines and penalties).

Newly issued servicing standards from the Consumer Financial Protection Bureau (CFPB) touch on a variety of servicing functions including, but not limited to, key areas such as loan transfers,

foreclosure processing, payment processing, fee assessments and billing statement processing, proper and timely handling of borrower complaints and disputes, escrow administration, early intervention with delinquent borrowers, loss mitigation practices, bankruptcy administration, and force-placed insurance.

The goal of the CFPB in issuing these guidelines is to prevent borrowers from receiving unwelcome surprises and run-arounds from their mortgage servicers—to put the “service” back into mortgage servicing, essentially. More important, the guidelines are written to assist borrowers with maintaining homeownership, preserving their ability to pay, and ultimately averting losses. Limiting losses is “near-and-dear” to an investor's heart; as such, establishing and executing a sound mortgage loan surveillance function that incorporates CFPB compliance is critical.

Surveillance Strategies

The most effective strategies for optimizing servicer performance incorporate collaborative interactions between investors and servicers, including on-site audit reviews and ongoing performance feedback. By applying a consistent set of performance-based metrics to a portfolio, opportunities can be identified and recommendations made that enable servicers to keep pace with the market while still improving performance. Reviewing and analyzing servicing data on a consistent basis allows for the identification of performance patterns, underlying gaps in procedural requirements, and overall process effectiveness.

Servicing surveillance professionals can assist servicers in achieving optimal performance by:

- » Emphasizing the importance of maintaining a consistent and simple process.
- » Ensuring a robust control environment exists for compliance with CFPB and other regulatory guidelines and that maximum borrower transparency is maintained.
- » Ensuring proper staffing is in place and robust training is provided.
- » Focusing on asset performance and key processing metrics to drive continuous process improvements.

- » Emphasizing areas most important to the servicing business, such as homeownership preservation, robust and timely loss mitigation and foreclosure alternatives, strong internal controls, seamless loan transfers, and cost containment.
- » Tailoring an approach to the individual needs of each servicer.

Consistent management of servicer performance in accordance with this criterion may result in material improvements in collateral performance. The benefit to firms embracing this methodology is that not only will process throughput likely increase but also: (1) investor confidence will grow, (2) cash flow velocity should improve, (3) defaulted loans and loss severities should decrease, and (4) the overall borrower experience may be further enhanced.

The Organization

A key component critical to the success of a servicing surveillance organization is proper staffing. It is recommended that staff have significant mortgage banking experience with exposure to a variety of servicers and best practices.

Generally, the experience of professional staff should encompass two main areas: (1) default management (debt collection, loss mitigation, foreclosure processing, bankruptcy, and REO administration) and (2) servicing operations (loan boarding, servicing transfers, cash applications, investor reporting, escrow administration, mortgage insurance processing, customer service, and dispute management).

Because both default management and servicing operations house functions critical to driving successful asset performance, they represent the foundation of a successful servicing surveillance function. Absent such a structure, the surveillance function may not perform optimally.

Additionally, the most effective servicing surveillance organization operates best when it can draw upon past experiences and best practices followed by other servicers. Such experience allows surveillance personnel to expediently identify problems, recommend potential areas for improvement, and provide appropriate remedies to servicers in order to optimize collateral performance. Independence is also critical, so servicer surveillance personnel maintain an “arms-length” stature at all times and are not influenced by investors, issuers, rating agencies, asset managers, or others.

The Approach

From an audit perspective, servicers should receive on-site field reviews on a rotating basis, generally every 12 to 15 months. These reviews are usually initiated with a formal request for information (RFI) to obtain data on items such as delinquencies, volumes, cash flow, organizational structure, staffing, turnover statistics, management biographies, and critical policies and procedures.

Auditors should also request recent reports by internal and external audit teams, regulatory agencies, and other critical third parties with corrective action plans provided as appropriate. When issues are identified, more frequent field reviews may be warranted. The results of these evaluations should be documented with formal reports issued that summarize findings and recommendations; these reports, along with formal follow-up regimens to monitor the status of corrective actions, should be shared and discussed with servicing management.

This in-depth field audit approach is critical in order to get a “hands-on” feel for the servicing organization, its staff and culture, and the servicer’s ability to work with borrowers to preserve homeownership. Collectively, this approach may provide alternatives to servicers that will curtail loan delinquencies and minimize loss severities.

Surveillance professionals who are knowledgeable in different sub-specialties within each of the default management and servicing operations disciplines should perform the reviews. External vendors with specific subject-matter expertise in certain defined areas (such as property valuation or property inspection) may be utilized as appropriate and deemed necessary in order to supplement staff knowledge and experience levels.

Key Performance Indicators

In addition to this in-depth approach, metrics—which drive servicer performance—should be analyzed on a regular basis to identify existing issues and related trends. If a servicer has not developed an appropriate and robust set of metrics and key performance indicators (KPIs), it becomes challenging for them to control, manage, and improve the business effectively.

Default management and other key operational data should be collected monthly and reviewed regularly to identify emerging trends and proactive corrective measures, as appropriate, to help improve performance. It is critical that surveillance professionals periodically validate the metrics and information provided. In some cases, surveillance professionals will need to partner with servicers to develop and expand key metrics.

While actual field audit reviews provide a solid “point-in-time” assessment of a servicer’s performance, the ongoing review and analysis of metrics and KPIs offer a consistent view into how well a servicer performs. Leading indicators designed to identify process improvement opportunities should comprise many of the metrics utilized. Critical trends—such as delinquency roll-rates, cash flow velocities, loan modification and foreclosure timelines, recidivism rates, and REO disposition timelines—can be identified early with corrective measures taken proactively that may help curtail delinquencies and reduce losses.

For certain metrics, some servicers have begun to establish standards against which they measure performance and progress, such as cash flow velocities, REO turn-times, and customer service call abandonment rates. Where standards did not previously exist, many servicers now collaborate with surveillance professionals and implement benchmarks and self-surveillance routines; these self-monitoring routines help servicers continuously optimize performance as well as provide bond holders (wherein serviced assets are the underlying collateral) with added assurances that appropriate steps are taken to maximize collateral performance.

An analysis of KPIs and the identification of certain adverse trends should lead to the root causes of performance. For example, excessive customer service inquiries, customer disputes, and aged payment applications may mask a true underlying problem (i.e., untimely follow-up relating to loan modification processing and other loss mitigation activities, borrower confusion over payment transmittals caused by servicing transfer issues, or false delinquencies due to the improper and untimely application of borrower payments). All these factors may inhibit asset performance and lead to increased loan-level losses and loss severities. Servicing surveillance professionals should work closely with servicers to analyze root causes and identify and implement corrective actions where necessary.

Loan Boarding, Critical Processes

Most asset performance problems begin up-front with incomplete or incorrect boarding, either from new originations or from servicing transfers, so loan boarding should be a major focus. Servicing surveillance organizations should have a resource intimately familiar with and knowledgeable about the loan boarding process.

Specific areas of focus should include timing and completeness of data received; the completeness of data, such as borrower contact

numbers, entered into the servicing system; and the amount of time it takes to board new loans to the underlying servicing system. Loan boarding is often overlooked when analyzing the cause behind loan delinquencies, yet gathering information correctly at the beginning of the process is critical in helping minimize problems that occur later and may potentially lead to losses.

Other critical servicing processes that should be reviewed include primary mortgage insurance processing, customer service, customer disputes, lien release and satisfaction processing, tax administration, flood insurance processing, hazard insurance processing, force-placed insurance, and other processing routines relating to escrow.

Best Practices

Prior experience and interactions with a variety of servicing organizations make it clear that surveillance professionals should be well versed in a variety of best-practice servicing standards. These standards should be shared openly with servicers, so processing routines can be enhanced with an end goal of optimizing asset performance. These practices should identify the most effective processes and strategies across the industry and should be continually updated and revised, so they remain state of the art.

Best practices should cover a wide variety of key servicing functions, including (but not limited) to:

- » Loan boarding (standards around welcome calls, hello letters, data integrity and data completeness, loan activation timelines, adjustable-rate mortgage data sampling requirements, and formalization of a feedback loop to origination and underwriting personnel regarding deficiency trends and specific issues identified)
- » Customer service (abandonment rates, average speed of answer, and response timeliness associated with written borrower complaints and disputes)
- » Billing (timeliness of statement transmittals along with content and clarity of borrower statements)
- » Investor reporting (standards for posting cash, reconciliation standards, and associated timeliness)
- » Collections (call frequency stratified by product and borrower credit rating, use of the auto-dialer vs. manual calling campaigns, and use of language line services)
- » Delinquency (cash flow velocity, delinquency roll-rates, and transfer process to loss mitigation staff)
- » Borrower contact (performance of door knocks, use of skip tracing, and right party contact)

- » Loss mitigation (stop advance decision requirements, resolution rate standards, follow-up timeliness for loan modification requests, modification recidivism rates, and the use of other loss mitigation options including forbearance, repayment plans, deeds-in-lieu, short sales, cash-for-keys, borrower counseling, and term extensions)
- » Property inspections (timelines and frequency in accordance with delinquency and stated investor guidelines, performance of door knocks, use of skip tracing, and responsiveness to FEMA-declared disasters)
- » Foreclosure timelines (standards for judicial vs. non-judicial states, adherence to GSE guidelines, and processes to ensure appropriate borrower concurrence and authorization)
- » Bankruptcy (timeliness associated with development and filing of bankruptcy plans as well as motion for relief and proof of claim filing standards)
- » REO (eviction standards, average days on market, and portfolio agings)

The preceding list touches on just a handful of areas that should be covered by best practices. Implementation of servicing best practices will enable servicers to continually improve their operations while increasing overall awareness of the servicing process and actions to aid in the reduction of loss severities.

Effective servicer surveillance has been and will continue to be a critical ingredient in the mix of elements necessary to achieve compliance with CFPB and other regulatory guidelines while at the same time maximizing asset performance. In today's marketplace, more than ever, it is essential for servicers to adhere to the highest level of servicing standards.

Servicing surveillance is essential and should be integrally woven into the fabric of any successful firm—whether it is an investor, bank, monoline insurer, private mortgage insurer, GSE, rating agency, or other regulatory body or pertinent third party. When implemented properly, surveillance can ensure residential mortgage servicing organizations run more efficiently and effectively, thereby yielding greater compliance, improved performance, more active management, mitigation of risks, and an overall reduction in loss severities.

Vincent Spoto has more than 25 years' experience in the financial services sector. He is currently a partner and managing director at RRMS Advisors, where he provides advisory and consulting services relating to servicer surveillance, risk management, compliance monitoring, default management, and asset disposition. 

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LEGAL LEAGUE 100 SERVICER SUMMIT

SEPTEMBER 9, 2013
HILTON ANATOLE, DALLAS, TEXAS

HOSTED CONCURRENTLY WITH THE FIVE STAR CONFERENCE AND EXPO



KEYNOTE SPEAKER:
DAVID L. MOSKOWITZ

EVP, Deputy General Counsel
at Wells Fargo & Company

The Legal League 100 Servicer Summit will once again host a private audience of lenders, servicers, regulators, GSEs, and members of the Legal League 100 for open-forum roundtables and private networking on September 9, in a private location of the Hilton-Anatole.

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