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Loan Servicing: Current and Future Business Process Assessment

The most severe economic recession since the great depression dramatically impacted all sectors of the financial markets. The effect on the mortgage market and on loan servicers specifically, forced a paradigm shift in the business model. Large volumes of non-performing loans, multiple and complex loan modification programs, increased scrutiny and regulation and a heightened awareness by customers and the general public are the new reality.

A thorough review and assessment of loan servicer business operations is imperative and must address compensation, staffing and training, data management, compliance and reporting, default servicing improvement, technology infrastructure and effective application of software solutions.

Current State

Servicers are not the root cause of current problems, but they are an important part of the solution. The deluge of delinquencies and high volumes of foreclosure were unanticipated and unforeseen consequences of a housing bubble. Servicers weren't expecting it and their operating models weren't designed to handle it. The results are higher costs and lower productivity over the last 5 years.

Loan servicing is essentially two distinct business processes: transactional and administrative.

- Transactional processes: routine, standardized and generally referred to as reporting and remittance
- Have been readily automated and are scalable.
- Administrative processes: collections, foreclosure processing, REO disposition
- Requiring decisioning and 'hands-on' interaction.
- Have been more limited in automation and are not easily scalable

Since 2007, revenues are down and expenses are up. The Private Label RMBS market is essentially frozen. Hard costs are up. Delinquency rates are at four-to-five times historical levels. Fewer loans are being originated. Loan balances on the new loans tend to be lower. Demand for specialty servicers is at an all time high.

Servicing fees can range from 25bps to 50bps direct servicing costs can range from 15bps to 20 bps. Corporate allocations add 2-4 bps. Higher rates of servicer errors, Increased unreimbursed foreclosure and REO expenses, property inspection and preservation costs, and advances due to higher delinquency rates and longer foreclosure time lines put pressure on profitability.

Future State

Increased reliance on technology will require higher levels of expenditure. Future state will include national servicing standards, increased legal and legislative involvement, and changes to servicer compensation. Investors and rating agencies will stipulate more stringent requirements. Regulators will mandate compliance. Issuers and guarantors will implement performance metrics and fees and penalties for poor servicer performance.

Regulation will increase: Dodd-Frank and the Consumer Financial Protection Board regulations, FHFA Servicing Alignment Initiative (SAI) and GSE revised servicer performance metrics (STARS for FNMA and SSP for FHLMC). Changes include specific performance measures and monetary penalties for non-compliance, increased repurchase demands and limiting or in some cases terminating servicers.

Business Process Assessment

Costs and efficiencies will be achieved through refined and/or redesigned business processes. Servicers will employ new technology to leverage personnel and increase productivity. Emphasis will be on capability, capacity and cost. Individual recommendations should be documented and a formal implementation roadmap prepared and executed. An effective assessment supports recommendations to refine and redesign policies, processes and procedures, effectively manage staffing needs, enhance automation and leverage technology.

Servicers need to conduct a thorough business process and technology assessment:

- Identify areas of improvement to existing processes and systems
- Encompass all loan servicing functions
- Include all internal and external service providers and consumers
- Technology assessments should include software, hardware and personnel
- Focus on current high cost/high visibility issues for performing and non-performing loans

The business assessment process should constitute:

- Discovery- reviews existing policies and procedures
- Current State Assessment- a holistic view of all departments, systems and personnel
- Risk Assessment-specific risks are identified relative to each process
- Gap Analyses- differences or deficiencies between the desired state and current state
- Recommendations, and an Implementation Road Map

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