Servicing's Pain Points

BY JOHN GUZZO

Historic changes are occurring in the servicing business.

Not least among the many changes that have occurred in the U.S. housing market over the last few years has been a permanent shift in the way lenders and servicers communicate with borrowers. ■ As a result of unprecedented volumes of delinquent loans and the subsequent surge of stringent regulations, mortgage servicers have recognized the need to streamline processes, enhance technological capabilities and outsource certain functions in order to maintain compliance and remain competitive. ■ Mortgage technology vendors and outsourcers offering solutions that provide better quality control, promote process efficiencies, facilitate borrower communication and improve regulatory compliance are the vendors most in demand by investors and acquirers. As investors and acquirers take a long-term view in assessing acquisition opportunities, it has become clear that the market views these solutions as fulfilling a more permanent need in the industry.

There's a reason consumer satisfaction has dropped

Overall satisfaction with primary mortgage servicers is down considerably. This decline can be attributed in large part to the growing number of frustrated homeowners who originated their mortgages during the peak of the housing boom.

According to Westlake Village, California–based J.D. Power and Associates' 2011 *U.S. Primary Mortgage Servicer Satisfaction Study*sm, consumer satisfaction with primary servicers fell across the board.

The "mortgage servicing experience" study measured four areas: billing and payment processing, escrow account administration, website and phone contact.

The survey indicated that, on a relative basis, there is still minimal servicer/borrower contact due primarily to inadequate staffing levels. The study also concluded that additional contact with borrowers shapes their individual perceptions and emotional behavior, ultimately affecting borrowers' satisfaction level. Understandably, if loan information is not received by borrowers in a timely and accurate manner, the servicer's customer satisfaction ratings inevitably suffer. There is a growing need for more frequent communication with borrowers.

Since 2007, the pace of technology innovation in the servicing sector has begun to accelerate.

It is apparent that technology innovation in the mortgage servicing industry was fairly stagnant over the past few decades—at least when compared with the originations sector. Despite the massive run-up of consumer debt through 2007, the servicing side of the market remained mostly unchanged.

Between 1985 and 2007, outstanding household debt in the United States grew from approximately 60 percent of annual disposable income to more than 125 percent, primarily because of increased mortgage debt. The Great Recession caused consumers to be more cautious with spending, but debt levels taken as a whole are still near their historical highs.

The path to overcoming the breakdown in communication

Since 2007, the pace of technology innovation in the servicing sector has begun to accelerate. Scalable technologies—such as those that support electronic document delivery and record-keeping in compliance with today's regulations—are in demand by lenders, servicers and subservicers.

The mortgage servicing industry is experiencing greater demand for more targeted and frequent borrower communication, including email, text messaging and more complex print/mail offerings. Innovations have aided lenders and debt servicers in the ability to obtain, store and transfer data about consumers and their debts. New database technologies are improving the ability of debt servicers to assemble disparate pieces of information about consumers, making it easier and more cost-efficient to locate and contact consumers (i.e., borrowers).

Additionally, the emergence of electronic payment technologies and systems is providing consumers with a multitude of new options for paying their debts. In an effort to obtain payment and keep up with the large increase in borrower communication methods, many lenders and servicers have outsourced their collection departments to companies that specialize in facilitating the billing and payment process.

When licensing technology or subscribing to third-party technology is not an option, outsourcing business processes has become a viable solution and growing trend.

Unprecedented levels of distressed loans

Numerous congressional committee hearings have attempted to address the widespread problems facing the mortgage industry, with the greatest emphasis being placed on the shortage of automated processes used in mortgage servicing and foreclosure.

Major concerns were initially raised after servicers struggled to keep up with the significant surge in mortgage defaults.

According to the Government Accountability Office (GAO), by the end of 2010, approximately 4.6 percent of the 50 million first-lien mortgages outstanding were in some stage of foreclosure. For comparative purposes, 1 percent of mortgages were in foreclosure in the first quarter of 2006.

The backlog of pending foreclosures continues to build, and the clash between state regulators advocating consumer rights and trade organizations vouching for the mortgage industry is resulting in an influx of regulatory compliance mandates.

These regulations directly affect standard lending and servicing processes that now need to be reconsidered. For example, in certain cases, servicers must provide written notice to delinquent borrowers, or those under imminent default, within five days (instead of 20 days) of their assignment. New processes and higher-quality automation are required to effectively address foreclosure, loss-mitigation and loan-modification activities.

Most servicers have not completely streamlined their documentation process, so they continue to experience processing delays with their loss-mitigation and foreclosure filings. It is estimated that approximately 1 million foreclosure actions that should have taken place in 2011 will now happen in 2012, or even later. These processing delays will further challenge servicers' operational ability to comply with regulations in a timely manner.

Furthermore, the Dodd-Frank Wall Street Reform and Consumer Protection Act has imposed various regulatory challenges. The Consumer Financial Protection Bureau (CFPB) is perhaps the most widely discussed aspect of Dodd-Frank. The monitoring and enforcement agency was created under Title X of the bill and started its work as an independent agency in July 2011.

As part of the CFPB's broad mandate, its examiners are beginning to review copies of monthly statements, consumer payment records and bills from vendors documenting any services related to loan accounts.

Setting up comprehensive audit trails would show how information set out in affidavits—the amount of indebtedness, fees, penalties, etc.—is linked to servicers' internal records at the time the affidavits are executed. Unfortunately, many servicer foreclosure-governance processes and audit trails are unable to adequately handle the current historic levels of default. This shortcoming means these servicers' setups could be insufficient to manage and control the operational, compliance, legal and reputational risks associated with an increasing volume of loss mitigation and foreclosures.

The call for reform

Historically, servicing platforms were primarily designed as accounting systems for receiving funds and calculating loan and principal balances, which generally worked fine when dealing with low default rates.

Over the last several decades leading up to 2007, most private mortgage technology innovation had focused on the origination side. But as a result of the credit crisis, there is now more emphasis on servicing automation than in the past.

Accordingly, many servicers are in the process of updating or replacing outdated legacy systems, and considering third-party technology and outsourcing solutions.

The Federal Reserve System, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) completed an extensive review of 14 federally regulated mortgage servicers in the fourth quarter of 2010. The foreclosure policies, practices and systems of these large servicers were examined, and the findings of the review were submitted to Congress.

The preliminary assessment revealed significant weaknesses in foreclosure-governance practices, foreclosure-documentation processes, and oversight and monitoring of third-party law firms and other vendors. Indeed, these underlying factors all contributed to the numerous problems associated with mortgage servicing and foreclosure practices.

The review also revealed a need for significant improvement in controls.

The agencies issued enforcement actions by consent against the 14 mortgage servicers in April 2011. These actions, the agencies believe, will ensure the servicers' processes are fully compliant with all applicable laws and that customers are treated fairly.

The stipulations require communications to be timely, appropriate and designed to avoid borrower confusion. They also mention how "reasonable and good-faith" efforts should be made when engaging in loss-mitigation and foreclosure-prevention for delinquent loans.

Establishing a single point of contact (SPOC) is essential for servicers to achieve a reduction in foreclosure filings.

In February 2012, the federal government and 49 state attorneys general announced a $25 billion settlement with five of the nation's largest bank mortgage servicers. Although the deal excludes mortgages owned by Fannie Mae or Freddie Mac, it incorporates an overhaul of the five banks' mortgage servicing practices, indicating the government's ongoing interest in long-term reform.

The sustained high level of "shadow inventory," or seriously delinquent loans that have not yet gone into foreclosure, is a continuing concern. This reality represents an ongoing opportunity for providers of servicing technology and outsourced solutions.

High levels of shadow inventory tend to increase the need for lender/borrower communication. Servicers generally argue that developing greater communication during the default-resolution process is a vital component for reducing the number of foreclosures nationwide. By creating an effective mode of communication between the servicer and borrower during the foreclosure process, servicers will be taking an important step in better managing their foreclosure filings.

The need for single point of contact

Establishing a single point of contact (SPOC) is essential for servicers to achieve a reduction in foreclosure filings. Robust communication portals help strengthen communication and quicken the pace of mortgage modifications and/or other loss-mitigation efforts for the servicer, while allowing the customer to receive improved service.

The Treasury Department issued Supplemental Directive 11-04 in May 2011, which mandates that servicers of non-GSE mortgages establish dedicated resources for communicating with borrowers and assign SPOC relationship managers. Many mortgage servicers do not have the requisite technology, infrastructure or personnel to implement SPOC. Therefore, upgrades in technology and infrastructure are a necessity. Industry sources also indicate the top 35 mortgage servicers could add nearly 30,000 full-time employees in order to handle SPOC requirements.

Providers of integrated borrower communications solutions, offering emails, text messages, e-bills, and automated print and mail capabilities, however, could alleviate the strain on servicers while still providing the personalized attention to consumers that is required by SPOC. These types of solutions would help eliminate incremental costs and deliver personalized outreach, hence routing communications to the right agent, incorporating borrower communication preferences and delivering sensitive information at the right time.

A servicer communication portal, for example, serving as a single data repository for customer communications sent to borrowers, would allow multiple areas within the servicer's organization (such as customer service, collections and default) to review all communications. Absent such a portal, communication between the servicer and borrower can tend to be disorganized and spread across the servicer's organization, which has proven hard to track and manage.

Servicers have a strong incentive to record all of their interactions in a centralized location, as each servicer is being required to have clear and comprehensive internal written policies for the identification and solicitation of borrowers. This would allow servicers to better verify their compliance with increasingly complex regulatory mandates.

By having a hub that centralizes the communication chain, servicers would reduce the time and expense of managing the interaction that occurs between them and the borrower, and borrowers would be more satisfied with the level of service they receive, ultimately reducing a major pain point in the mortgage industry.

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The shifting landscape

Amid this shifting landscape, there are several significant industry drivers impacting the evolution of mortgage technology. These drivers include restoring consumer confidence, decreasing the volume of delinquent loans, stabilizing the debt markets and adhering to new regulatory guidelines.

Key solutions that respond most directly to these industry drivers are:

- Integrated borrower communications offerings;
- Compliant eDocument delivery, closing and storage;
- Outsourced print and mail capabilities; and
- Other solutions that streamline processes and promote regulatory compliance.

Mortgage vendors and outsourcers that provide the aforementioned key solutions are the ones most in demand by investors and acquirers.

There has never been a greater need for lenders and servicers to quickly innovate as a means of remaining competitive. They are primarily doing so by licensing or subscribing to third-party technology, and outsourcing to third-party providers. As a result, many mortgage technology vendors and outsourcers that offer these solutions are growing revenue and increasing market share, thus capturing the attention of both strategic and private equity acquirers. **MB**

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