

Improving the Odds: Making Workouts Work

BY CLAYTON BAKER

Mr. Baker, a financial services veteran in Ernst & Young's Consumer Finance Advisory Services practice, has more than 18 years of experience in mortgage and consumer lending. The views expressed herein are those of the author and do not necessarily reflect the views of Ernst & Young LLP.

Mortgage lenders and servicers continue to announce sweeping loan workout and modification programs. Fannie Mae recently unveiled a plan aimed at preventing foreclosures by streamlining the short-sales process. While these efforts have their place, institutions still need more effective methods for working consistently with tens of millions of borrowers in trouble.

Unfortunately, as new programs and approaches are introduced, many lenders and servicers still rely on old methods for dealing with mounting volume. They continue to throw bodies at the problem — hiring legions of staff to try to keep pace. With this influx of new hires, the premium on borrower contact higher than ever and a surge in schemes to “game” the system, executives must have the right tools available to enable front-line employees to maximize every interaction.

Lenders and servicers should look to several areas to ensure they are doing everything possible to achieve timely and successful resolutions. First, they must identify troubled borrowers and those likely to end up that way as soon as possible, through early intervention programs and processes. Second, they need nontraditional outreach methods for making contact with borrowers reluctant to communicate via standard channels. Third, they need systematic, technology-driven approaches to working with

POINT OF VIEW

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these borrowers in a way that channels them to the right options and reports the outcomes to management.

Many organizations are very proficient at pinpointing borrowers delinquent for 60 days or more and offering solutions, but they are not nearly as adept at early intervention. Servicers often prolong the inevitable by allowing borrowers to roll to later stages of delinquency, missing the opportunity to make the most of a valued contact before the situation deteriorates beyond repair. According to the Mortgage Bankers Association, residential delinquency rates were hovering around 7% at the end of the third quarter of 2008. This figure is almost certain to rise in 2009. These days, smart institutions augment traditional risk-scoring models, such as Early

Indicator, with more robust information, such as credit bureau data, FICO scores and geographic valuation indices, to create a richer profile of individual borrowers in their portfolios. This approach must be designed to cross various customer touch-points — telephone, Web and branch office — in order to be effective.

Many organizations are still searching for the proper strategies to deal with a borrower who is approaching but not yet in default. Some shops continue to rely on the historical adage on this, advising borrowers who call in with a hardship to “miss a payment before we can help you.” Protocols should be established to evaluate the financial circumstances and life events impacting such borrowers, and solutions that will identify steps to mitigate a potential calamity (i.e., foreclosure) should be in place long before it happens. A prudent start would be a formal process to evaluate the borrower's circumstances, to refer him or her to collections or a debt-counseling partner for assistance and to monitor the account for routine follow-up.

To maximize well-planned strategies for early intervention, mortgage lenders and servicers need to rethink the ways they contact borrowers, some of whom may be actively avoiding contact out of fear or embarrassment. Today, a traditional collections program finds and makes contact with about 20% of delinquent borrowers in any given month. The rest of the borrowers typically

roll over to the next phase of delinquency. In some institutions, one-third or more of the borrowers who reach the foreclosure stage have never had any contact with the lender.

But by moving collections toward non-traditional methods, lenders and servicers improve their chances for good outcomes. Some institutions have partnered with national and local nonprofit organizations that operate third-party outreach and counseling services to assist borrowers in trouble. The Hope Now alliance, for example, is a group of counseling agents, mortgage servicers, investors and other institutions that offer foreclosure plans to borrowers free of charge. One major lender has opened several dozen regional counseling offices and hired hundreds of loan counselors to review loans and help homeowners modify their mortgages. Other lenders are empowering legal and financial advisory professionals to assist lenders with resolving troubled mortgages.

Despite creative efforts, lenders and servicers are reaching only a small fraction of troubled borrowers with these new techniques. The vast majority of the work is still being conducted by traditional means — tens of millions of monthly telephone calls. Costs, of course, are rising quickly, and institutions have little choice but to conduct business this way. They do, however, have options in the approach they take to manage troubled borrowers through workouts. The key here is to ensure that the right solutions are presented to borrowers.

When a lender or servicer has correctly identified and successfully contacted a troubled borrower, it must have in place a comprehensive system for quickly analyzing the borrower's specific situation and integrating that borrower into a decision-support structure that effectively moves him or her through the loan workout or modification process. Too many organizations still rely on spreadsheets and notes stored in collections systems to negotiate with borrowers, making the process haphazard and cumbersome. What lenders and servicers

need — and regulators are clamoring for — is a system flexible enough to deploy program changes rapidly and help ensure adherence to regulatory guidelines in their efforts to modify loans and keep borrowers in their homes.

Such systems incorporate rules and workflow engines for consistency and accuracy — ensuring that, for example, the right workout plan is offered to the borrower, the correct documents are prepared in a timely manner, loan modifications are executed and investors are notified. This process often begins with employing borrower-segmentation analytics and risk-scoring guidelines that are tightly integrated with call centers and processing operations. Ideally, borrowers will call in and be routed through interactive voice response technology to an agent best suited to handle his or her case, based on such variables as geographic location, product or investor type and risk classification.

After borrowers are correctly routed, an effective decision-support system enables an organization to capture all necessary information: borrower financials, external data for validation (e.g., credit bureau triggers, property value data, market-level loss forecasts and carrying cost estimates). From there, the borrower's credit-worthiness, ability to pay, current equity position in the property and different loss outcomes should be compared dynamically and against investor guidelines (e.g., loss thresholds and current workout parameters) to determine the optimal solution for the borrower, lender and investor. By employing automated decision-making and dynamic scripting, lenders can help their employees — some of whom will be relatively new and inexperienced in loan workouts — navigate this decision tree in real time and guide borrowers toward their best solutions. For example, if a borrower's financials deem him or her ineligible for a repayment plan, the right tools should tell the lender what alternatives are available, be it refinancing through a Federal Housing Administration plan or some other option.

Indeed, with the constant proliferation of new workout programs, confusion is at an all-time high and execution is faltering. Rules and guidelines enable negotiators to get to the right answer, but the workflow required for fulfillment is more critical than ever. Whether a short sale, a modification or a repayment plan, documents, timelines and other parameters vary. Few institutions do an adequate job of managing the myriad options to ensure successful and timely execution. Even a simple mod or short sale can involve as many as a dozen parties, so coordination, oversight and communication are critical.

Even after a lender invests the time and money to perform remedial steps like financing arrearages, most borrowers simply cannot keep up. The reality is that nearly 60% of borrowers placed on repayment plans break them within eight months. Analytics and models must continuously advance to detect these risks as soon as possible and help the lender pinpoint the next best option.

Finally, any type of comprehensive solution would be incomplete without sufficient management reporting and scorecards to monitor and provide transparency to the process. These include tools that provide detailed assessments of the success (or otherwise) of outreach campaigns, analyze the performance of workout programs (recidivism rates and aggregate loss avoidance), measure fulfillment processing cycle times and pinpoint exceptions and root causes.

Minimizing or mitigating loan losses is just one of the benefits of improving the workout process. By thinking strategically about the entire decision-making process involved in workouts and modifications, institutions can effectively manage this unprecedented workload as well as lessen their risks going forward. Indeed, the organizations that find new ways to optimize this work will be much better positioned for success than their competitors when market conditions eventually improve.

