A Web of Challenges

Servicers have to cope with ever-changing layers of state and federal regulations, and investor servicing guidelines.

By Ravi Ramanathan

Servicers today face an unprecedented volume of delinquent loans and foreclosures, which likely will build as more distressed homes emerge from the shadow inventory. They also must cope with ever-changing layers of state and federal regulations, and investor servicing guidelines, and the constantly shifting requirements of government programs. All of these factors have created a complex web of servicer policy and compliance challenges.

In addition to increased staffing levels to keep up with the volume surges, a new set of challenges has emerged for servicers: constant process adjustments to handle the investor and individual state-by-state level changes to regulations. Servicers must now also ensure that the decisions of their servicing associates who review the delinquent and distressed loans are consistently in line with their policy and procedural guidelines. Freestyle decision-making and experience-based interpretation of guidelines can leave servicers vulnerable to costly errors and reputational risk.

Banks are learning that origination and servicing compliance, prior to the subprime crisis, were largely related to document gathering processes. Generation of key documents, and the timely disclosure and execution of terms and notices, were the primary focus. This has now been layered with process-based compliance to ensure that the subjectivity of process decisions by bank employees is replaced with more objectivity. Furthermore, much of the compliance was based on a snapshot of loan file data. There is a real need to supplement document compliance with additional procedural associate compliance throughout the loan life cycle.

Complex Rules

Compliance in today's world is not black and white. Most of the servicing compliance challenges are not just based on timelines, but are also process- dependent. For example, the Treasury's Making Home Affordable Programs (HAMP, HAFA, 2MP) have gone through numerous major program changes as they have evolved. The GSEs have layered additional guidelines and updates to their servicing directives. The state, federal and regulatory guidelines also need to be accounted for. To further complicate matters, all of these regulations are subject to interpretation. The policies followed and the related actions that servicing associates take need to be customized based on several loan characteristics such as: the state the property is located in, whether or not the property is owner-occupied, property condition, Service members Civil Relief Act (SCRA) checks and the status of loan delinquency.

The increased scrutiny of servicer decisions by internal and external auditors has raised the bar for electronic documentation of the process trail, in addition to the document trail. It is no longer enough to establish compliance by referring to training guides and processing manuals-- loan level electronic documentation is required to prove beyond a reasonable doubt that the servicing associate followed the then prevailing policy.

Servicers must show they made a compliant decision during each step of the loss mitigation and foreclosure processes, as well as how and why they took each step. Was the Home Ownership Modification Program (HAMP) offered to the distressed borrower? Was there a reasonable attempt made to reach the customer? Were loan modification, short sale and deed-in- lieu workout options pursued and presented to the borrower prior to initiating a foreclosure? Servicers must show that they have exhausted all the possibilities of keeping a borrower in their home before moving to foreclosure. How do servicers show that they've done enough to satisfy all these requirements?

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The investor guidelines around critical servicing decisions leave a good deal of room for servicer and associate interpretation. These complex decisions need to be broken down into a series of simpler objective questions to eliminate the ambiguity for associates. A couple of examples illustrate this point:

1) What constitutes "Sufficient Customer Outreach"? Customer outreach functions involve a combination of calls, letters and face-to-face borrower contact attempts. The customer contact sufficiency check, combined with the definitions of non-cooperative borrower and non-responsive borrower, are as subjective as some of these activities get. The associate needs to be presented with a series of questions to collect data on contact attempts and the timing of the attempts. The data collected from these questions then need to be run through a decisioning process by a back end technology to determine whether the servicer made a sufficient effort to establish right party contact. Let's leave the discussion on the subjectivity around "Quality Right Party Contact" being proposed by the GSEs for another time.

2) What is the definition of an "Active Workout"? Most investor guidelines allow a servicer, via delegated authority, to postpone a foreclosure sale date if the borrower has a current active workout. The definition of what constitutes an active workout—as well as any exceptions that need to be noted for a waiver to this-- are critical when determining whether the foreclosure sale date postponement will be considered. In several states the only way to postpone a foreclosure sale date is to stop the entire foreclosure process and restart. This is not only costly but also results in substantially prolonged foreclosure timelines.

Training alone will not eliminate the risks associated with servicing loans. It's also important that servicing associates are taking the right steps in the right sequence consistently over the life of the loan, with no gaps. The reliance over policy and procedure documents, process cheat sheets and laminates has to be minimized.

For consistent and effective procedural compliance, servicers must employ a new operational framework. Technology can facilitate a more qualitative process-based compliance by turning those process steps into auditable questions or decisions that each associate needs to make. Each of the steps and the decisions made are then documented to ensure consistency, fairness and accuracy. In essence, this means turning a qualitative process into a quantitative one.

Collaboration between bank policymakers and risk and default servicing departments is needed to ensure that rules are clearly defined. These rules need to be centrally stored and enforced within a technology that allows for decentralized global deployment of rule sets, and ensures consistent, unbiased enforcement across all servicing departments.

Technology solutions are required to track key decision points in servicing delinquent loans. They help establish that the proper decisions were made by all departments. Software systems can also give servicers peace of mind that proper sequences were followed with all the third parties involved in servicing distressed loans, such as property preservation and short sale vendors, broker price opinions and foreclosure attorneys.

The interpretation of subjective decisions by servicers to provide the borrowers with the appropriate amount of time to respond and provide documentation on critical servicing guidelines prior to moving a customer to foreclosure will have a significant impact on portfolio performance. It may not be the story everyone wants to hear, but the challenge is to manage the timelines and find a balance that accommodates the customer, investor, and regulator expectations and obligations. It's a balancing act that technology can help with by enforcing consistent policy application and customer treatment across an entire servicing operation.

Technology can enable servicers to efficiently move through and manage their inventory, while at the same time ensuring each customer is treated consistent and fairly. Severely delinquent loans need special servicing compared to newly delinquent loans. To complicate matters further, many of the loans are the result of acquisitions, and it's often unclear which steps were taken. The conservative approach is to start from the beginning with borrower outreach and communication. By then, guidelines may have changed, new information is required from borrowers, and borrower situations may have changed. The constant state of change requires more training on new policies and creates opportunities for missteps by servicers.

Servicing technologies have historically been plagued with an inertia to change. Making changes to a servicing system is expensive and typically involves a long implementation time period. With the advancement of technology and cloud-based computing, servicers now have options to embrace new software that is far cheaper and has substantially shorter implementation times.

Software options are available where the entire software and server infrastructure is accessible from the "cloud" via a web-browser. The Software is delivered as a Service (SaaS) in a utility-style model. The systems now allow for storage and retrieval of documents, minimizing the need for paper-based processing. Many of the systems support bi-directional servicing system integration to eliminate the information timing gap on receiving current loan information necessary to complete loan reviews, and push updates back to the servicing system.

The solutions not only allow servicers with qualitative process compliance by turning each step in the default servicing process into auditable decisions, but also stores all of that to ensure consistency, fairness, and accuracy. The decisions made on each loan by each associate are documented for quality control review, investor forensic audits, and portfolio analytics. That audit trail makes it easy to demonstrate compliance to auditors, investors, and oversight bodies.

Embracing a technology-driven path to process compliance has a key strategic benefit for servicing operations. The technology activity and process data repository expands the customer value proposition through the operational analytics opportunities. The first stage of the implementation allows the servicer to focus in on process conformance and compliance. The data collected on each step of the process can be mined and analyzed to identify intelligent metrics around state, investor, and other loan parameters. This allows servicers to identify and drive process and policy changes through their organization. Leveraging third-party market and economic data combined with transactional data collected through operational technology can empower servicing management with business intelligence analytics.

Today's servicers are constantly challenged to keep up with evolving regulations and investor guidelines. The latest process-based technology solutions not only enable servicers to manage day- to-day compliance and process changes, but allows them to be agile. Managing timelines and finding the right balance that accommodates customers, investors, and regulators is critical. Without a technological framework, servicers would be hard-pressed to respond quickly to meet new regulatory and compliance changes. And using the right technology—one that offers process-based compliance—can make all the difference. ❖

About The Author

Ravi Ramanathan serves as president and chief executive officer of DecisonReady, a provider of end-to-end policy and process compliance solutions for default servicing, and is responsible for the company's strategic vision. The company has reviewed for leading servicers more than two million delinquent residential mortgage loans for loss mitigation, and for foreclosure process and policy compliance. DecisionReady was founded in 2010.