



## Facilitating Loan Modification Using BPM

### Executive Summary

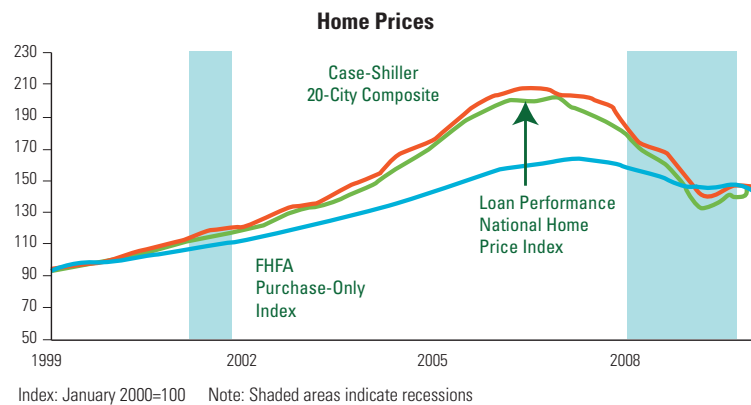
The ongoing real-estate mortgage crisis and the concomitant dramatic rise in delinquencies and foreclosures in the U.S. need no introduction today. The phenomenon that started in the middle of 2008 has had major adverse consequences on the banking and financial markets across the globe.

As depicted in Figure 1, the S&P/Case-Shiller Home Price Index in the U.S. real estate market reached a peak around 2006 before taking a sharp decline thereafter. This resulted in an abrupt loss in equity by home owners. Moreover, as adjustable rates began rising, loan refinancing became more and more difficult for home owners. The obvious

consequence of this has been the dramatic rise in mortgage payment delinquencies by home owners and subsequent foreclosures by servicers in historically high numbers. In 2008, more than two million homeowners received foreclosure filings, and the number rose to more than 2.8 million in 2009, while millions more are expected in 2010.

On the other hand, the number of home sales declined considerably, as shown in Figure 2 (next page). This made it more difficult for investors to retrieve their money, resulting in high REO (or real estate owned) for servicers. No one – including servicers, investors and home owners – is better off as a result of the entire debacle.

### Rise and Fall of Home Prices in the Last Decade<sup>1</sup>



Source: S&P/Case-Shiller Home Price Index; LP/Haver Analytics; FHFA.  
Figure 1

## Home Sale Slide<sup>1</sup>



Source: National Association of Realtors; Census Bureau. Figure 2

This white paper discusses the reasons why the current loan modification processing process is lagging behind the requirements of the mortgage industry and borrowers, as well as how the use of business process management (BPM) can help rectify many shortcomings by creating better operational efficiency for all parties.

### HAMP: An Overview

Responding to this crisis, the U.S. Treasury in February 2010 launched several home preservation initiatives under a single broad program called the MHA Program (Making Home Affordable Program). One of the constituents of MHA is HAMP

(Home Affordable Modification Program). HAMP is a \$75 billion program that includes \$50 billion from TARP (Troubled Asset Relief Program) for the modification of privately-owned mortgage loans.

Fundamentally, HAMP is an incentive provided to loan servicers (i.e., banks) to modify eligible mortgages to help limit the number of foreclosures. So far, this has not been imposed as a mandate; rather, it remains an option for servicers to exercise. The incentives provided to all stakeholders, (i.e., the servicer, the lender and the borrower) are covered in Figure 3.

### HAMP Incentives to all Stakeholders<sup>2</sup>

<b>Servicer Incentive Payments &amp; Pay-For-Success Fees</b>	Servicers will receive an upfront payment of \$1,000 for each permanent modification. They will also receive pay-for-success payments – as long as the borrower stays in the program – of up to \$1,000 each year for up to three years.
<b>Borrower Pay-for-Performance Success Payments</b>	Borrowers are eligible to receive a pay-for-performance success payment that goes straight toward reducing the principal balance on the mortgage loan, as long as the borrower is current on his or her monthly payments. Borrowers can receive up to \$1,000 in success payments each year for up to five years.
<b>Current Borrower One-Time Bonus Incentive</b>	One-time bonus incentive payments of \$1,500 to investors and \$500 to servicers will be provided for modifications made while a borrower is still current on mortgage payments but in danger of imminent default. The servicer will be required to maintain records and documentation evidencing that the trial-period payment arrangements were agreed to while the borrower was fewer than 30 days delinquent.
<b>Investor Incentive</b>	This compensation equals one half of the dollar difference of the borrower's monthly payment at 31% and the lesser of (i) what the borrower's monthly payment would be at 38% or (ii) what the borrower's pre-modification monthly payment was. This incentive lasts up to five years.

Figure 3

There are also stringent eligibility criteria that borrowers must meet in order to qualify for HAMP. A snapshot of these criteria is depicted in Figure 4. Most of these criteria mandate the need for substantial document submission and subsequent approval processes to be considered eligible for a successful loan modification.

Despite its allure to both servicers and borrowers, the number of loans undergoing active modifications has been much lower than expected. A snapshot of loan modifications at various stages is provided in Figure 5.

A deep dive into the real-life loan modification landscape reveals a huge gap between the stated

objective and the realized goal from the permanent modification count standpoint. The most interesting observation is the striking contrast between the percentages of HAMP trial modifications as part of the overall loan modification target (close to 70%), as compared with the completed loan modification count as part of initiated trial modifications (less than 25%). Many of the industry's largest players are showing even lower completion figures:- Bank of America (12%), J.P. Morgan Chase (16%), CitiMortgage (19%) and Wells Fargo Bank (21%). These developments provide substantial evidence for the lack of proper IT-enabled solutions with advanced workflow automation, decisioning and market responsiveness capabilities to support the huge volumes of

### HAMP Eligibility Criteria<sup>3</sup>

Loans originated on or before January 1, 2009.
First-lien loans on owner-occupied properties with unpaid principal balance up to \$729,750.
Higher limits allowed for owner-occupied properties with 2-4 units.
All servicers for loans owned or guaranteed by Fannie Mae and Freddie Mac are required to participate; additional servicers are strongly encouraged to participate.
The current principal, interest, property taxes and homeowner's insurance payments are costing the borrower(s) over 31% of their gross monthly household income.
All borrowers must fully document income, including signed IRS 4506-T, proof of income (i.e. ,paystubs or tax returns) and must sign an affidavit of financial hardship.
Property owner occupancy status will be verified through borrower credit report and other documentation; no investor-owned, vacant or condemned properties.
Incentives to lenders and servicers to modify at-risk borrowers who have not yet missed payments, when the servicer determines that the borrower is at imminent risk of default.
Modifications can start from now until December 31, 2012; loans can be modified only once under the program.

Figure 4

### HAMP Modification Status Distribution<sup>4</sup>

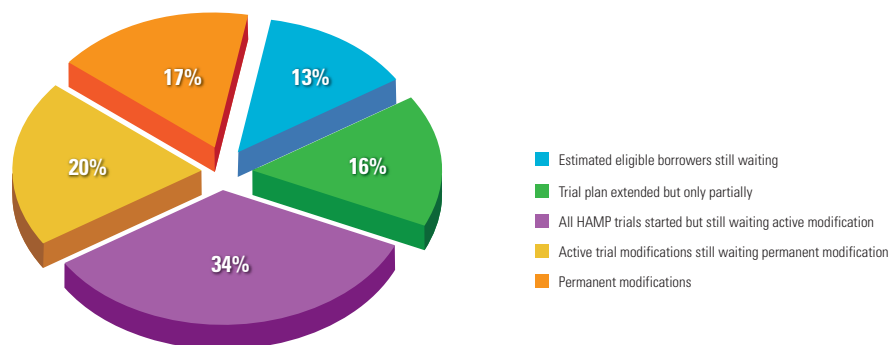


Figure 5

mortgage modifications that require extensive, document-intensive processing and multiple levels of approvals.

The following section showcases the application of business process management (BPM) suites for streamlining the loan modification process by obviating process inefficiencies.

### Addressing Process Pain Points Using BPM

- **Lagged response to loan modification program updates/changes:** One of the major challenges deterring the successful adoption of the loan modification programs is the high frequency of regulatory and prescribed mandates by the government and other watchdogs. The monolithic applications infrastructure of most financial services companies struggles to keep pace with these changes on a regular basis, resulting in a loss of interest or dissipation of effort. This is precisely where a BPM solution can potentially create significant business value through faster adaptation to market changes and better responsiveness. Most of the standard BPM tools offer features such as delegation of business rules to appropriate business user groups, leading to the capture of changes “on-the fly.” This can result in better market adaptability and enhanced operational productivity.

significant business value through faster adaptation to market changes and better responsiveness. Most of the standard BPM tools offer features such as delegation of business rules to appropriate business user groups, leading to the capture of changes “on-the fly.” This can result in better market adaptability and enhanced operational productivity.

- **Manual validation:** The pre-qualification step of the solicitation phase involves preliminary data capture and validation, followed by systemic evaluation of the borrower’s eligibility. However, the high volume of requests restricts the manual validation process to a bare minimum, in terms of quality of information screened upfront. Additionally, the time-consuming nature of the process results in poor operational productivity. A BPM solution that serves as the orches-

tration layer across existing legacy systems can facilitate seamless integration to ensure automated validation of borrower credentials with better quality of information, along with faster turnaround.

tration layer across existing legacy systems can facilitate seamless integration to ensure automated validation of borrower credentials with better quality of information, along with faster turnaround. This is possible by obviating the need for frequent application switch-overs in order to extract various types of data from different systems, as well as replacing multiple human system interfaces with a standardized one, thus leading to a substantial increase in operational productivity.

- **Deployment of limited resources for servicing unsustainable modifications:** The active pursuit by the U.S. government of the HAMP program through lucrative incentives and other measures has caused servicers to push through loans into trial modifications in huge numbers. Unfortunately, a significant portion of such trial modifications do not get converted into permanent modifications.
- **In such cases, borrowers face a double adverse impact because of two factors:** First, their monthly installment is increased again to the pre-modification level, and then the difference in installment between the pre-modification amount and the trial modification amount gets accrued as a payable amount. This worsens the condition of such borrowers who are pushed further toward foreclosure. At the same time, the situation is no better for servicers/investors because of the increased probability of delinquency, which has adverse financial implications.
  - > The above phenomenon clearly points to the need for performing proper and proactive screening of borrowers, based on complicated logic involving income and loan attributes to ensure that only eligible borrowers make the cut. This can be facilitated using a solution offering strong business rule engine capabilities, along with predictive analytics features. Additionally, most BPM suites offer robust process modeling features to ensure that proper process analysis is performed to optimize the selection criteria.
  - > Such tools can be leveraged to evaluate and classify imminent defaulters and offer trial plans accordingly to suit their needs and ensure successful closure of loan modification programs. Additionally, this type of proactive analysis can potentially obviate the risk of strategic default<sup>5</sup> (financially stable borrowers willfully defaulting on mort-

A deep dive into the real-life loan modification landscape reveals a huge gap between the stated objective and the realized goal from the permanent modification count standpoint.

A BPM solution that serves as the orchestration layer across existing legacy systems can facilitate seamless integration to ensure automated validation of borrower credentials with better quality of information, along with faster turnaround.

gage payments due to the contagion effect of a rising number of defaulters in the same neighborhood) to a considerable extent.

- **Reduced operational effectiveness due to suboptimal task routing:** The typical loan modification process involves a multitude of users from various departments (i.e., collections, intake, relationship management, quality control, etc.) to work on a particular request, either sequentially or in collaboration. These scenarios demand an extremely efficient routing mechanism to minimize the wait time and ensure effective resolution. This can be facilitated using features such as skill-based routing, easy task assignment and real-time collaborative capabilities that come standard with many BPM suites.
- **Manual document chasing:** One of the primary reasons behind the huge accumulation of loan modification applications at the trial plan stage is the lack of timely availability of necessary documentation with verified content. The current procedure of ad hoc follow-up through manual mode has proved ineffective so far, resulting in huge volumes of trial modification plans being rendered invalid midway through the process. This clearly establishes the need for seamless interfacing with document management systems that can be leveraged using agent-driven features for an automated check on pending customer documents; service level agreement-triggered, systemic follow-up through automated customer correspondence; and systemic information interchange with third parties for title search artifacts, credit bureau reports, broker price opinion documents, flood insurance papers, etc. Standard BPM suites offer pre-built integration wizards that can be easily configured and triggered based on complex business rules and hence can be used as an effective tool to provide the above-mentioned functionality.
- **Effort duplication due to redundant manual intervention across disparate technologies:** More often than not, due to disparate IT systems across various lines of businesses, end users are required to manually enter the same or at least similar data involving borrower income, loan detail, credit information, etc. in different formats in various applications. While on the one hand, such procedures can potentially

elevate the risk of errors in manual entries, they can also cause data redundancies and erroneous data references, in addition to the inefficiency of wasted time and effort. This is a direct fallout of the lack of integration among various systems. A BPM tool can add significant value by providing a common platform for enabling various existing systems to talk to each other in a coherent way. The other benefit is the timely availability of existing information to obviate the need for repeatedly collecting the same data from either the customer or manually extracting it from one of multiple systems, which leads to reduced operational productivity.

**A BPM tool can add significant value by providing a common platform for enabling various existing systems to talk to each other in a coherent way.**

### Looking Ahead

The current state of the HAMP program clearly suggests the need for major introspection and analysis to improve the rate of permanent loan modifications and ensure the success of this important initiative. As evident from the aforesaid analysis, proper IT support is among the overarching needs to attain a more acceptable rate of completed mortgage modifications. As a first step toward embarking on such an initiative, organizations must prepare a focused BPM business case to ensure proper buy-in from senior management. This can be the stepping stone for subsequent adoption of BPM to address various pain points of the existing loan modification process. Furthermore, the widely accepted and recommended phased approach for embracing BPM will enable organizations to clearly prioritize specific pain areas and ensure maximum lift in the shortest possible time to generate significant ROI. Initial success can then be showcased to ensure holistic involvement from an enterprise-wide perspective.

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## Footnotes

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## About the Authors

*Anirban Mukherjee is a Senior BPM Consultant with Cognizant Business Consulting. He has six-plus years of experience with a wide range of projects, including BPM roadmap layout, business process analysis and vendor evaluation.*

*Mukherjee has been actively involved in the preparation of multiple BPM business cases pertaining to various stages of the loan modification program for facilitating senior management buy-in. He holds a Master's in Business Management with specialization in finance and can be reached at [Anirban-7.Mukherjee-7@cognizant.com](mailto:Anirban-7.Mukherjee-7@cognizant.com).*

*Kinjal Sengupta is an Associate Consultant with Cognizant Business Consulting and has worked in BPM software development. He is currently engaged as a Business Analyst with a leading Swiss bank, working on business process analysis and requirement gathering. He has supported Mukherjee in the preparation of BPM business cases pertaining to loan modification programs.*

*Sengupta holds a post-graduate diploma in Computer-Aided Management with specialization in finance and can be reached at [Kinjal.Sengupta@cognizant.com](mailto:Kinjal.Sengupta@cognizant.com).*

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### World Headquarters

500 Frank W. Burr Blvd.  
Teaneck, NJ 07666 USA  
Phone: +1 201 801 0233  
Fax: +1 201 801 0243  
Toll Free: +1 888 937 3277  
Email: [inquiry@cognizant.com](mailto:inquiry@cognizant.com)

### European Headquarters

Haymarket House  
28-29 Haymarket  
London SW1Y 4SP UK  
Phone: +44 (0) 20 7321 4888  
Fax: +44 (0) 20 7321 4890  
Email: [infouk@cognizant.com](mailto:infouk@cognizant.com)

### India Operations Headquarters

#5/535, Old Mahabalipuram Road  
Okkiyam Pettai, Thoraipakkam  
Chennai, 600 096 India  
Phone: +91 (0) 44 4209 6000  
Fax: +91 (0) 44 4209 6060  
Email: [inquiryindia@cognizant.com](mailto:inquiryindia@cognizant.com)