Default Mortgage Servicing Simplified

A unified servicing platform can be a valuable tool in dealing with increased regulations and eroding profit margins.

Executive Summary

In the aftermath of the financial crisis of 2008, the U.S. mortgage industry reeled under an unprecedented level of defaults followed by increased regulations. As a result, default mortgage servicing came under scrutiny. Since 2008, default servicing has been subjected to government mandated programs (HAMP, HARP, etc.), settlements, frequent regulations, GSE policy and procedure updates, etc. The industry has largely been in fire-fighting mode, struggling to keep up with new regulatory and policy moves. This has resulted in inefficient processes, a large number of disparate systems/technologies/rules and maintenance overheads. These, in turn, have eroded profit margins at a time when revenue opportunities are dwindling.

It is time for the servicing industry to take a long-term view of default servicing and the regulatory environment. They must streamline, automate and integrate operational processes to create a single platform for default servicing.

In this paper, we discuss the current regulatory environment and the challenges faced by servicers. We propose a conceptual approach to address these challenges by leveraging a unified default servicing platform.

Overview

Default mortgage servicing consists of servicing subprocesses such as loss mitigation, deed-in-lieu, short sale, bankruptcy, pre-foreclosure, foreclosure and real estate owned (REO). These subprocesses provide lenders and borrowers with the best options to mitigate risk.

These subprocesses are linked by complex rules and at times more than one subprocess can be active concurrently. For example, bankruptcy and loss mitigation might be in play at the same time. Also, under the prevailing regulations, foreclosure cannot be initiated while the borrower is undergoing loss mitigation.

Regulatory Environment

Default servicing is subject to regulation by various agencies, laws and justice systems. The key agencies that govern the mortgage industry are the U.S. Department of Housing & Urban Development (HUD), the Federal Housing Finance Agency (FHFA), the Federal Housing Administration (FHA), the Consumer Finance Protection Bureau (CFPB), the Federal Reserve, the U.S. Treasury, the Office of Thrift Supervision (OTS), the Office of Comptroller of Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), state regulatory agencies, insurance regulatory agencies and government-sponsored enterprises (GSEs). The key regulations are the Consumer Finance Protection Bureau (CFPB), the Real Estate Settlement Procedures Act (RESPA), the Truth-In-Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), the Home Mortgage Disclosure Act (HMDA), the Fair Debt Collection Practices Act (FDCPA), the Fair Credit Reporting Act (FCRA), state-specific foreclosure rules and the bankruptcy court system.
The recent regulatory changes have been driven by the need to protect consumer interests and to tackle the loss of borrower confidence, predatory lending practices and the lack of adequate information available to borrowers.

The current regulatory environment poses several challenges for the servicing of default mortgages, including interdependent and conflicting/overlapping regulations, frequent updates and increased operational and compliance costs.

Some of the examples of interdependent or conflicting regulations are highlighted below.

- CFPB and bankruptcy courts both regulate servicer response for borrowers during bankruptcy.
- Conflicting federal regulations and statewide regulations governing foreclosure practices (differing timelines and processes).
- Dual-tracking restrictions allowing only one loss mitigation workout (the process to cure loan delinquency and thus minimize losses) at a time, forcing servicers to accurately monitor loss mitigation workout plans.
- Foreclosure must be halted in light of new or pending loan modification documents received or in the event of a bankruptcy filing by the borrower.
- Conflicting information, format and mailing requirements for various borrower communications such as Adjustable Rate Mortgage (ARM) letters, event notification letters, monthly billing and escrow statements.

- CFPB guidelines requiring prompt credit of partial monthly payments versus bankruptcy guidelines requiring Trustee funds to be kept in a suspense account till one full payment can be applied.

The GSE’s guidelines, state regulations and investor guidelines increase the complexity and interdependency of the processes supporting the various regulations.

**Operational Challenges**

Traditionally, various default subprocesses have been mutually independent, served by relatively isolated operations/support groups. Consequently, the IT infrastructure and applications developed in silos. However, the housing crisis resulted in higher interdependency among operational areas. This, in turn, demanded a comprehensive view of the borrower’s status.

Mortgage default servicing currently faces the following key challenges:

- **Disjointed operational teams** resulting in overlapping/missed procedures and regulations (e.g., a foreclosure notice being sent to a borrower who has recently filed for bankruptcy).
- **Multiple systems/applications** for default subprocesses resulting in higher IT maintenance costs (usually separate loss mitigation, REO, bankruptcy, recovery and foreclosure applications).
- **High coordination efforts** (large number of operational reports/procedures/touch points to achieve cross-functional coordination).
- **Limited automation opportunities.**
- **Absence of a unified view of portfolio** (multiple segment reports need to be reconciled/merged).

These challenges have resulted in significant overheads and margin erosion for default servicing, requiring servicers to rethink their default processes and the underlying applications enabling those processes.

**An Integrated Platform**

The changing regulatory environment and operational challenges faced by mortgage servicers in default servicing warrants careful consideration of existing operational processes and IT infrastructure. Lenders must consider an integrated platform that adequately links the various subprocesses.
The key features of such a unified default servicing platform would be as follows:

- Linked/unified subprocesses.
- Linear (one active process at a time).
- Configurable (different case types).
- Flexible (rules-driven).
- Compliant.
- Analytics (cross-functional reports).
- Integrated (linked upstream/downstream).

Figure 2 depicts indicative building blocks and a functional view of a unified default servicing platform.

The approach toward this end state could vary depending on the servicer’s existing IT application landscape, operational processes, portfolio composition, etc. Based on these key factors and additional considerations, servicers need to create a long-term IT roadmap for consolidation and transition. Figure 3 weighs the considerations involved in creating a unified default servicing platform.

**Pros and Cons of a Unified Default Servicing Platform**

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<tr>
<th>Advantages</th>
<th>Disadvantages</th>
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<td>- Increased regulatory compliance, minimize cross-functional gaps &amp; consistent regulatory reporting.</td>
<td>- Large application, challenge in terms of maintenance.</td>
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<td>- Increased responsiveness to regulatory changes/updates.</td>
<td>- Conversion/transition costs from existing systems to new platform.</td>
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<td>- Centralized repository for rules acts as &quot;True Source.&quot;</td>
<td>- Complex user access management with multiple operational groups.</td>
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<td>- Linear, well-integrated workflow; one process owner per loan.</td>
<td>- Higher initial development and training costs.</td>
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<td>- Lower cost of compliance.</td>
<td>- Process-specific changes could impact other process areas.</td>
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<td>- Facilitate audits/litigation support.</td>
<td>- Large number of integration points to accommodate multiple external applications like attorney, legal, marketplace, etc.</td>
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<td>- Increased operational efficiencies.</td>
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<td>- Reduce long-term IT costs.</td>
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<td>- Helps in cross-skilling the servicing teams.</td>
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Additionally, there are various determinations that are to be made as part of a long-term strategy. These include build versus buy, in house versus hosted, fixed versus transaction-based cost structure, etc. Some of the build-versus-buy considerations are depicted in Figure 4.

**Conclusion**

A unified default servicing system would increase coordination among various default subprocesses, allow an organization to respond to regulatory changes in a comprehensive manner and eliminate various gaps/pitfalls. The implementation of such a platform would transform the operational underpinnings of default servicing toward more efficient, coordinated, streamlined, flexible and interoperable units. The implementation approach could customize an existing off-the-shelf product or expand/build upon in-house application infrastructure. The transition from existing systems could be carried out in phases (based on subprocesses and/or age/time basis) to mitigate operational risks.

A unified default servicing platform has the potential to eliminate significant inefficiencies. The applicability of such a solution for an individual servicer would depend on the scale of default operations, their current IT infrastructure, the operational cost structure and key operational/regulatory concerns faced by the organization. A careful evaluation would help weigh the pros and cons, build-versus-buy and cost-benefit analysis for each servicer, allowing it (if applicable) to build a long-term default technology roadmap and leverage the strengths of the unified default servicing platform and recent technological trends.
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