

Making Mortgage Modifications Work

January 2010

REAL ANSWERS. REAL FAST.

The Premier Consultancy in Credit, Collections, and Risk Management

Introduction

Bridgeforce is pleased to augment its Strategy Brief series with several issues designed specifically to assist mortgage holders and servicers in evaluating their strategic and operational approach for managing credit losses and control issues during this time of unprecedented delinquency and foreclosures.

This first issue focuses on quick hit solutions for improving loan modification, pull-through and stick rates – which Bridgeforce has identified through “in the trenches” experiences while evaluating client operations and defining advanced loan workout and treatment solutions.

It's All Over the News: Loan Modifications Aren't Working as Planned

Low pull-through and trial modification success rates are plaguing the Treasury Department's Home Affordable Modification Program (HAMP). All too many executives, politicians and reporters are quick to point fingers at the culprits, but identifying a sole responsible entity is not an easy target. Unfortunately, pointing fingers and assigning blame will provide little benefit to financial institutions, homeowners, or government agencies that are all desperate to get the nation's mortgage woes clearly focused in the rear view mirror.

Through Bridgeforce's research and analysis of this complex problem in our hands-on work with clients, we have narrowed down four key challenges that are impacting the ability for mortgage holders and servicers to treat distressed real estate customers:

Four Key Challenges with Treating Distressed Real Estate Customers

1. Addressing HAMP Qualification Criteria Deficiencies - Many customers in need of assistance are not qualifying under HAMP guidelines. At the same time we are finding that even some that do qualify probably shouldn't. You won't hear as much in the press about the high HAMP re-default rates, but it is a serious problem for mortgage holders who bear the losses. A major contributing factor is the lack of consideration of a customer's true ability to pay (e.g. cash flow and backend DTI) when qualifying for a HAMP modification. In too many cases HAMP is simply not the best solution – specifically in situations where the customer still has a negative cash flow and/or a high backend DTI after the HAMP modification. This occurs because the **HAMP modification provides limited ability to influence the resolution of the customer's overall debt structure to improve affordability – which in turn leads to higher re-default rates than would be the case if the customer's entire debt structure were taken into account in designing the solution.**

As an Example: A customer may qualify for HAMP and have their mortgage payment reduced by as much as 50% and still have a negative cash flow with a backend DTI greater than 75%, since debts other than the mortgage are not taken into consideration in the HAMP approval process. Clearly this customer, regardless of the fact that they're

HAMP-qualified, is on a path to failure and loss for the mortgage holder. The incentive payments provided by the government come nowhere near the losses that will be incurred (not to mention the costs wasted on a doomed trial-modification process).

- 2. Treating HAMP Non-Qualifiers** - So much attention has been paid to the minority (e.g. HAMP) that many of the troubled borrowers who don't qualify for HAMP are falling into the foreclosure process before truly understanding all of the options available. The good news is there are many other NPV-viable treatments that can be leveraged and in fact, they are significantly out numbering HAMP modifications. Unfortunately, many mortgage holders and servicers are not yet offering a robust set of internal programs, which will continue to be a key driver for stabilizing the real estate market. Notwithstanding, when implementing more robust internal programs, care must be given to properly balance the risk/reward tradeoff and ensure that the proper monitoring processes, policies and controls are established.
- 3. Managing Conversion Rates** - A primary challenge in managing HAMP continues to be converting customers on trial mods into permanent mods, and similarly, in moving non-HAMP modifications all the way through the process to closure. Customers feel servicers are dropping the ball, and servicers are blaming customers for not following through with the necessary documentation/verification requirements under the program. In our experience, we feel both parties are right. Surprisingly, one of the largest obstacles we find impeding the success of treatments overall has been the management and execution of critical communications / workflows -- while this may seem straightforward, we find that most of the industry has simply been unable to smoothly integrate the required changes into their current processes. Not only does the sheer volume of cases create a staffing and process management problem (given the historically low base with which servicers and lenders have always dealt), but the added complexity of managing different programs concurrently with this new staff has proven a daunting challenge.
- 4. Closing the Communications/Workflow Technology Gaps** - The shortcomings of the HAMP program and complexity of the process are further exacerbated by the fact that there is a significant gap in automation and communications / workflow management in the real estate vertical to deal with the end-to-end management of distressed customer treatments. In our experience, we have found that successful execution of treatments requires a flexible decision support tool applied up front in the customer management process, coupled with an advanced communications / workflow management solution; a system that can simultaneously manage customer contact strategies and the workflows associated with the collection and verification of the correct number and version of multiple documents / forms per process. In addition to ensuring success both during the trial period and beyond, communications / workflow management solutions are required to support the critical ongoing customer management needs of these rapidly growing portfolios.

How Do We Resolve These Key Challenges?

Although solutions exist today that can greatly help manage the complexity of assessing treatment eligibility, maximizing customer contact, and operating controlled workflow processes, many mortgage holders and servicers have not yet invested in the technologies needed to effectively support HAMP or other modification treatments. Most of the more recent investments we have seen, have, unfortunately, centered on extending the existing systematic lending approval technology used for loan acquisitions, which falls far short of providing an optimal solution for several reasons:

- Trying to modify these technologies is usually more expensive and done as a band-aid solution that compromises support of the HAMP modification guidelines and other modification strategies.
- These solutions tend to be monolithic (like the loan origination systems that begat them) when the current need is for a much more agile, re-configurable capability that can adjust with the challenges presented in these changing times; and
- These solutions do nothing to streamline and manage the communications / workflows associated with high volumes of loan modifications in process.

Viable, Affordable Solutions That Work Today

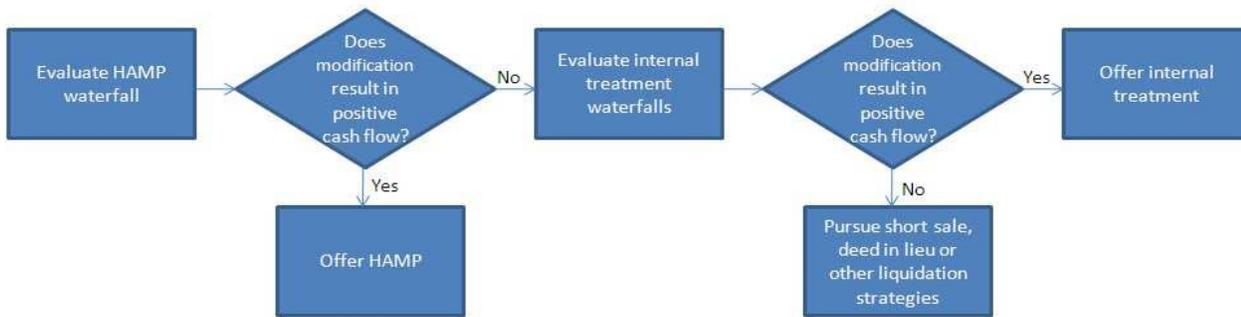
Fortunately, Bridgeforce has defined robust solutions that are implementable within as little as 30-60 days for most mortgage holders / servicers to meet the key challenges described above.

- 1. Addressing the HAMP Qualification Criteria Deficiencies** - To address this key challenge, we need to clearly understand how to compensate for the HAMP program ignoring a customer's ability to pay. Unless your company or your customer specifically requires that you offer a treatment through HAMP (and if they do, see below), there is no federal requirement that prevents filtering out accounts with high probabilities of re-default in order to determine a better solution.

To make this determination, use the following waterfall decision process:

- 1) Does HAMP result in a positive cash flow -- if not
- 2) Do any of my available internal treatments result in positive cash flow – if not
- 3) Could creditor payment concessions through use of a consumer credit counseling service, coupled with internal treatment, get the customer to a positive cash flow – if not
- 4) Timely liquidation is likely the best alternative to protect asset value and losses

Evaluate HAMP vs. Internal Treatments



Note: Some lenders/investors require HAMP to be offered regardless of the impacts to increased losses.

In the case where you are REQUIRED to offer a HAMP treatment to all qualified borrowers: Remember that some additional flexibility in qualifying customers for HAMP is provided under the Treasury Department's supplemental directive 09-01: *"Servicers having at least a \$40 billion servicing book will have the option to create a version of the NPV calculator that uses a set of cure rates and re-default rates estimated based on the experience of their own portfolios, taking into consideration, if feasible, current LTV, current monthly mortgage payment, current credit score, delinquency status and other loan or borrower attributes."*

This directive allows you the flexibility to, at a minimum, engage risk and analytical resources to determine more realistic re-default rates rather than the non-realistic 40% rate baked into the Treasury department's NVP guidelines. This will immediately lower the number of HAMP eligible customers because many will not be NPV viable with more realistic re-default rates. From there, we must do all we can to ensure pull-through for the HAMP offers we have made (see points 3 - 4 below).

2. Treating HAMP Non-qualifiers - Restricting homeowner assistance predominantly to government-supported programs will ultimately lead to higher losses than would be the case if other internal options are strongly considered. Customers are looking for guidance to find the best alternative for them -- which in some cases includes liquidation. The good news here is the wide array of options that are available for designing win-win alternatives to help customers stay in their homes and preserve asset value. This includes the ability to apply greater influence on having customers address the larger issue of affordability through the use of credit counseling. While in many cases such a course will require the customer to make some life style changes, it is a critical component to customer stick rates. One of the largest obstacles facing the borrower is hopelessness to affect their ability to stay in their home – the combination of an aggressive modification along with reality-grounded counseling and education about how to sensibly deal with the other debt obligations goes the farthest toward lighting the ray of hope necessary to keep customers engaged.

To treat HAMP non-qualifiers, we recommend the following guardrails in the design and offering of internal treatments:

- Be aggressive in creating affordable alternatives but mindful of long term revenue loss
 - This can be easily accomplished with creativity, strong NPV modeling and a flexible decision support tool. A good decision support tool will consider a customer's hardship duration and match it with the most appropriate treatment. Treating a customer for 5 years when they only need 12 months of assistance is overkill. But, conversely, under-treating an account that truly needs 5 years of assistance merely delays losses. A good decision support tool, applied up-front in early customer interactions, will also help avoid inappropriate judgmental selection by loss mitigation analysts who can often be easily influenced by lucrative incentive plans.
- Avoid any perception of offering treatments that are postponing losses – Ensure there is documented demonstration of the homeowner's affordability and willingness to repay with every treatment
- Create consistency in communication and in application of treatment criteria across platforms and channels. Servicers may be using different criteria and oversight guidelines than those used on your internally managed portfolios
- Control - Close adherence to internally approved program offerings, document storage and retention are important (just as they are central to HAMP modifications).

Measuring the success of your internal treatments:

- Success should be measured by program attractiveness to homeowners, ability to reduce credit losses and foreclosures, long term return on assets, re-default rates, and subsequent need for additional treatments.
- Another key factor contributing to program success will be the ability to market your offerings with a consistent message through all customer touch points, and through high quality consistent education of call center associates.
 - Armed with the right infrastructure, mortgage holders and servicers will have far greater flexibility and speed-to-market with internally developed programs.
 - We always recommend leveraging industry best practices as a quick implementation starting point while ensuring profitability and control.

3 & 4. Managing Conversion Rates and Closing Communications/Workflow Technology Gaps -

The process starts with determining the appropriate treatment by determining a customer's true financial condition on initial contact. If they appear to be eligible for HAMP, there then needs to be systemic way to efficiently follow up for completed documents by the required due dates. If they do not qualify for a HAMP treatment, determining if (and which) internal treatments should be recommended is best accomplished during the same initial contact.

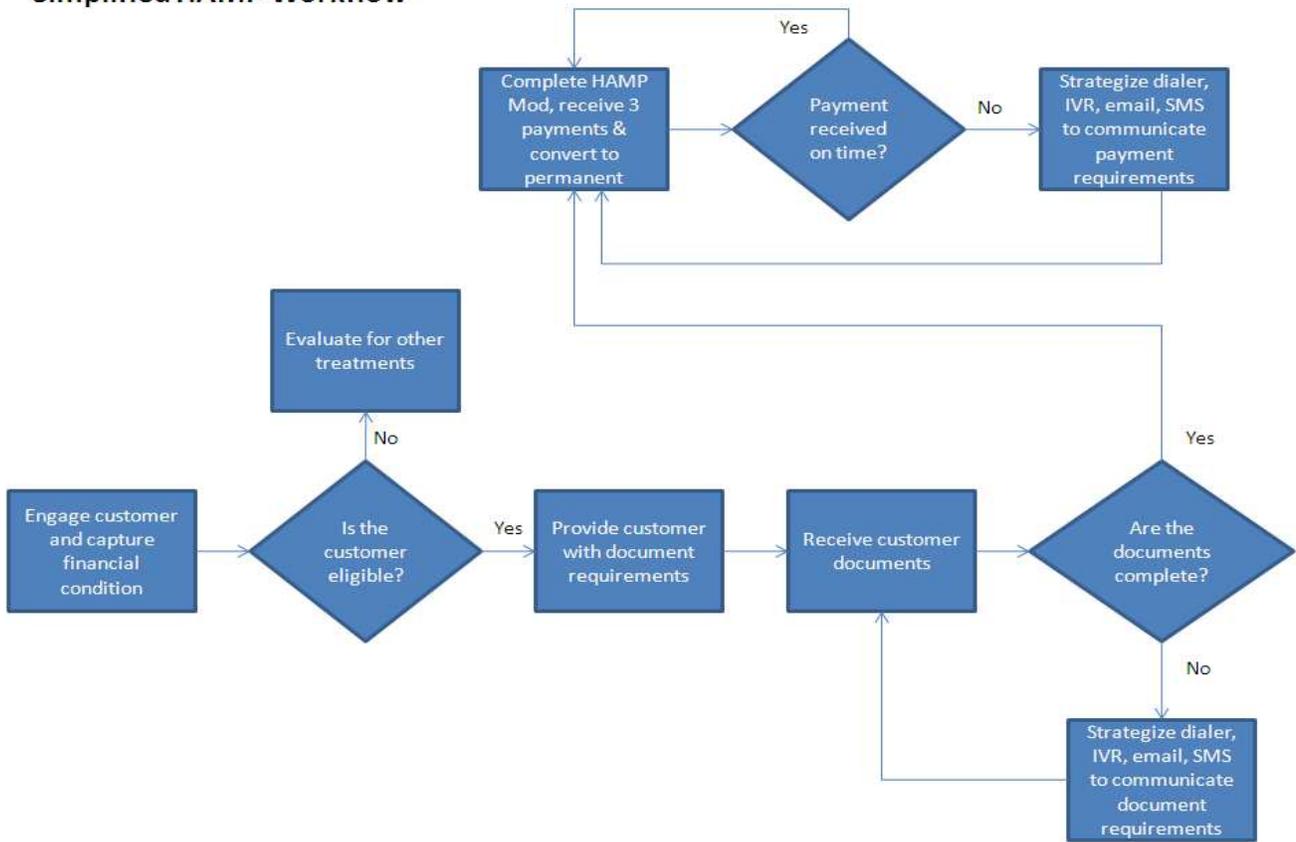
- A comprehensive decisioning tool for agents that allows for the complexity of both HAMP and internal treatments is a necessary first step. In addition to creating a very efficient triage function, such a tool enforces consistency of offer, treatment

and educational message being conveyed to the borrower. This consistency not only reduces the incidence of inappropriate offers but also helps build customer loyalty by ensuring that all borrowers receive the best opportunity you can provide.

- An advanced communications / workflow engine is imperative to the collection of this critical information. As underwriters review the customer information and determine missing or invalid data, or if customers simply do not respond within allowable timeframes, the game of aggressive follow-up must commence. To win this game, we need to employ all of the communication channels at our disposal. This includes unattended IVR messaging, dialer campaigns, letters, emails and text messages. An advanced workflow-driven system that knows the exact documents, timing and escalation strategies to engage will maximize customer contact and pull-through rates for each type of modification, HAMP or internal treatment.
- In addition to automated communication strategies, an advanced technology solution should also provide a web portal option for customers. Customers can use this portal to submit a formal request for treatment, review the current status and next steps of their treatment request, and then set-up and track automated payments for their approved treatment – all of which will improve pull-through rates and cut down on unnecessary status call volume. The most comprehensive online solutions we've encountered can also provide the first contact eligibility screening by taking the customer through an online eligibility survey, determining HAMP or other treatment eligibility, and providing detailed instructions on how to fulfill the treatment requests (i.e. which documents are required, by when, how to provide them, etc.).
- Often, the next challenge is guiding customers through the trial modification payment process. A best-in-class technology solution will monitor the status of payments, send reminders utilizing multiple communication channels, execute escalation strategies when payments are late, and proactively identify milestone contact review points for customers -- especially as they get close to returning to their previous payment amount. Although this sounds simple, we have found it is often difficult to create and execute these types of automated strategies unless an organization is leveraging a technology solution that was explicitly designed for this purpose. Too many times, leveraging the existing systemic loan approval logic leaves the organization unprepared for managing the volume and complexity of workflow steps envisioned above.

Below is a high level diagram for determining HAMP eligibility and optimizing customer contacts and workflow management.

Simplified HAMP Workflow



Leveraging industry expertise and best practices, Bridgeforce has developed a complete solution to address the key challenges discussed in this Strategy Brief. The automated solution was developed in partnership with Bridgeforce's sister company, Collections Marketing Center (CMC). It leverages the FlexCollectSM technology platform, which fully supports and optimizes management and communication strategies for mortgage holders and servicers. The complete solution can be implemented in as little as 30-60 days. In that time, our solution has eliminated manual backlog, increased throughput of existing staff, and accelerated the decision process enabling our clients to manage this new challenge effectively and efficiently.

Key functional capabilities of the solution include:

- o A branded web portal that can guide customers through the evaluation process to determine eligibility (for HAMP as well as internal modifications); the web portal will also allow customers to view the status of their modification and ultimately manage their modified loan.

- The ability for loan modification agents to gather the same information and conduct a real-time evaluation of eligibility and capture the result of the customer conversation.
- Both of the above are based on an advanced decision-support treatment engine that allows for not only the HAMP waterfall and NPV evaluation, but other types of treatments as well (for the 60% of customers who do not initially qualify for HAMP).
- A full-channel communication strategy and deployment engine that is able to evaluate customer status against defined timelines and execute on these strategies using agent manual calls, dialer-driven campaigns, IVR, email, letter and SMS channels as needed to guide customers through the entire fulfillment process.
- An underwriter/agent workstation that manages and executes complex workflows to feed accounts at various stages to the appropriate group(s) for next actions.
- Exception based queue management that allows time based activities to be escalated and visible to management for timely resolution.
- Multi-document tracking at the customer level eliminates re-work and miscommunications that often arise.
- A central repository of all customer interactions, communications across channels, and a view to all provided forms and documents via comprehensive tracking reports.

In addition to the technical components above, the complete Bridgeforce Solution includes:

- Program set-up and management
- Definition of most effective treatment policies
- Program marketing communication design assistance
- Agent treatment tool setup
- Operational process definition and documentation
- Agent training
- Outsourced call center / loan mod processing agents (if required)
- Operational oversight and management

Conclusion

Timely solutions for improving the volume and success of loan modification, pull-through and stick rates are required for reducing credit losses and foreclosures. Bridgeforce has seen a significant opportunity to improve both the efficiency and effectiveness of most loss mitigation processes in use today, due in part to the short lead time that was available when designing solutions to help stem the rapid rise in real estate defaults. In some cases, long-overdue investments in technology are now actually required to bring these changes to fruition. The good news is that investments like this are usually quick to pay dividends given the impact of converting distressed mortgages to performing assets. Assistance is also available when guidance or temporary resources are needed to meet accelerated timelines.

By leveraging proven technology, strategies and industry best practices, Bridgeforce has been able to help mortgage holders and servicers make quick changes to improve system

infrastructure, processes, program offerings and controls. Simultaneously addressing all areas touched on in this Strategy Brief may seem somewhat overwhelming, but in fact, we have assisted many clients in completely re-engineering their workflows and treatments in as little as 30-60 days when needed.

We hope you have found this Strategy Brief useful and invite your feedback on both this issue as well as the **Future Strategy Brief Topics Under Consideration** listed below.

Bridgeforce welcomes the opportunity to further discuss any aspect of this position paper with you, as well as its implications to your business.

For more information, please contact:

John Savage, Chief Technology Officer: Mobile 302.897.2598

Steve Stark, Senior Program Manager: Mobile 302.345.2997

155 Stanton Christiana Road * Newark * DE * 19702

* office: 302.325.7100 * fax: 302.325.7109

www.bridgeforce.com

Future Strategy Brief Topics Under Consideration

1. Minimizing revenue losses on second lien portfolios
2. Strategies for improving collection rates and modification referral volume
3. Effective risk management and mitigation on outsourced portfolios
4. Recovery strategies
5. Portfolio acquisition and interim servicing
6. Portfolio growth and HELOC line management