Success Stories on Loss Mitigation

An Executive Level White Paper

Authored by
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CMG Mortgage Insurance Company

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Executive Summary

This White Paper, based on a round-table discussion by members of the Mortgage Insight Panel, was created to share best practices and success stories on Loss Mitigation processes and procedures with Credit Union management.

We hope this information will help Credit Unions implement successful and efficient Loss Mitigation programs that preserve homeownership, reduce Credit Union losses, and support the community-oriented standards of the Credit Union movement.

Loss Mitigation plays a very important role in today's mortgage lending operations. As Credit Unions continue to evolve, so do the processes and procedures for a successful mortgage operation, from origination through loan administration and quality control. The ability to successfully mitigate losses is critical to Credit Union income. Early detection of default enables you to assist with member homeownership retention, allows you to avoid costly foreclosures and reduces REO costs.

Managing loan servicing in relation to the GSEs is essential in developing a framework that allows Credit Unions to be able to field a variety of workout options that can help delinquent members regain ground.

Identifying members in distress is a key task for Credit Unions who want to proactively reach out to their membership and provide an individualized approach to those facing delinquency. Helping your members to understand their options and being able to provide a holistic approach to their specific situations can only help strengthen the Credit Union's relationship with members.

Modification Basics offers a focused, practical overview of what a Credit Union should know about modifying a loan and when to choose the modification over a refinance. Regular scrutiny and analysis of the Credit Union mortgage loan portfolio is an important tool in the process.

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Introduction

The purpose of this White Paper is to provide relevant information to Credit Union management on how to establish successful loss mitigation strategies. You will hear from industry experts on their best practices when working with GSEs and servicing, choosing a sub-servicer, identifying members in distress, and modifying loans.

The White Paper is comprised of the following sections:

Section 1 - Establishing a Successful Loss Mitigation Department
Section 2 - Working with GSEs and Servicing
Section 3 – Identifying Members in Distress
Section 4 – Modification Basics

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Section 1
Establishing a Successful Loss Mitigation Department

Taking steps to establish a successful Loss Mitigation Department is crucial in developing and implementing a mortgage modification program. Mortgage modifications assist members experiencing financial hardships and other loss mitigation activities, such as short sales, deeds-in-lieu and foreclosures, help mitigate Credit Union losses.

Some key points to consider when building a successful Loss Mitigation Department:

- **Identify management and staff who are knowledgeable and demonstrate expertise in the various tasks and responsibilities associated with the collection activities and mortgage modification process.** If the Credit Union is an approved Seller/Servicer for Fannie Mae or Freddie Mac, the Loss Mitigation Department must have staff that are well-versed in secondary market servicing guidelines and private mortgage company requirements. In addition, they must demonstrate proficiency in understanding collection and loss mitigation policies and procedures.
- **Hire externally if necessary.** Depending on the size of the mortgage portfolio, complexity of the mortgage loan mix, and performance of the portfolio, it may be in the best interest of the Credit Union to hire experienced individuals from outside the organization.
- **Management and staff must demonstrate flexibility.** Mortgage modification solutions continue to evolve as Credit Unions make every effort to assist distressed members seeking to sustain their home. However, staff must also recognize when the best option for the member and the Credit Union is to move forward with other loss mitigation actions. Loss Mitigation Department management and staff must demonstrate flexibility in selecting a workout solution that is most likely to enable the member to resume making timely mortgage payments.
- **Adapt to changing loss mitigation environment.** We are experiencing frequent changes in the federal regulations and secondary market guidelines governing loss mitigation efforts and related activities. There are also the changing needs of members seeking assistance to consider. Management and staff in the Loss Mitigation Department must adapt and implement changes quickly to ensure compliance and to meet the needs of their membership.
- **Training.** It is imperative that management ensure all loss mitigation staff receive training on best practices for assessing hardship requests, due diligence in verifying documentation, determining the most viable work out solution, sound underwriting practices, accurate documentation preparation, and post-modification account monitoring.
- **Loss Mitigation and Mortgage Origination – Open lines of communication.** Loss Mitigation Department and Mortgage Origination management should have open lines of communication by working collaboratively in reviewing hardship cases. The goal is to identify drivers to mortgage loan delinquency and determine if changes should be made in front-end operations that will mitigate future credit risk.

Establishing a successful loss mitigation department allows Credit Unions to provide valuable services to members experiencing financial hardships but who have a demonstrated willingness and ability to make timely mortgage modification payments. Guiding members through difficult financial challenges further demonstrates the Credit Union philosophy of providing value-added financial service to Credit Union members. Credit Unions with successful loss mitigation departments generally experience lower delinquency ratios and effectively mitigate credit losses.

Working with Subservicers

This section will briefly discuss when working with a subservicer may enhance your mortgage business, which criteria to consider when choosing a subservicer, and offers an example of how to structure your relationship with a subservicer.

When does it make sense to work with a subservicer? When cost and logistics out-pace your resources. *Is it more cost effective for you to complete subservicing in-house or to hire a service?* Be sure to consider all related costs, including dedicated staff, related overhead expenses, collections, compliance and reporting.

Below are more questions to help you determine if a subservicer is the right fit for your Credit Union:

- *What is the current profile of the sub servicer's customer base?*
- *What statistics demonstrate the sub-servicer's loss mitigation success?*
- *Does the subservicer show the ability to produce special reports for investors or other counterparties as required?*
- *Does the subservicer have separate teams for portfolio servicing vs. agency loans?*
- *Which functions does the subservicer outsource for efficiency and cost reduction?*
- *Who are the outsource vendors the subservicer contracts with? What is the vendor's operational performance level?*
- *Can the subservicer demonstrate the ability to effectively accept a bulk transfer? What is their track record?*

Answering these questions will help identify the track record of a subservicer's performance and help educate your staff on what will be required to establish a successful working relationship with the subservicer.

Structuring the Relationship

Dedicated staff and clear lines of communication are imperative in a successful business relationship. For example, a Credit Union dedicates a staff member in servicing to work with the subservicer representative and coordinate efforts with the collections supervisor, both staff members requesting information from the subservicer as needed. Members tend to be more comfortable talking to the Credit Union staff than the subservicers and are encouraged to contact the staff with questions or

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additional information. Credit Unions using subservicers follow Fannie Mae guidelines but allow some creativity for portfolio loans.

A subservicer can be a great help for those Credit Unions facing a sharp increase in mortgage volume. The subservicer will assure loan processing is compliant and accurate while freeing up valuable Credit Union staff resources to serve Credit Union members.

Section 2
Working with Government-Sponsored Enterprises (GSEs) and Servicing

Once you have established the foundation for your Servicing Department and your Credit Union's loss mitigation strategy, consider the following points when selling to the GSEs and addressing your Servicing Department needs.

If you would like to sell to Fannie Mae or Freddie Mac, you will need to be set up as an approved seller servicer. Your GSE representative will have detailed information on how to become an approved seller servicer. In addition, Fannie Mae's *Seller/Servicer Guide* is quite insightful and provides a valuable outline of collection responsibilities. These include:

- Accounting
- Collection Department
- Counseling
- Establishing guidelines for individual analysis on a loan-by-loan basis
- Instructions and control measures for sending out notices
- Management reviews

Freddie Mac suggests that you have an understanding of the following when performing your collection activities:

- Member's prior payment history
- Member's credit history
- Member's employment situation
- Member's reason for default
- Member's willingness and ability to pay
- Condition of the property
- Member's occupancy status

Fannie Mae offers a number of programs to help with sustaining homeownership. Both Fannie Mae and Freddie Mac can assist with risk assessment and provide guidance on loss mitigation techniques.

Useful Links:
Fannie Mae Workout –
http://www.efanniemae.com/sf/servicing/pdf/loanworkoutfactsheet.pdf
Freddie Mac -
http://www.freddiemac.com/service/factsheets/pdf/workout_incentive_program_374.pdf

Your Credit Union may want to consider offering the options listed in the following subsections.

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Foreclosure Prevention Resources

Workout Hierarchy

Fannie Mae's loan workout hierarchy requires that you first evaluate a member to determine if the Home Affordable Modification Program (HAMP) is appropriate. If HAMP is not appropriate, then consider other foreclosure prevention alternatives to resolve member delinquencies.

Home Affordable Modification Program (HAMP)

A servicer should first evaluate a member to determine if HAMP is appropriate. If it is not, the servicer should then determine whether the member is eligible for an alternative foreclosure prevention option based on whether the member is experiencing a temporary or permanent hardship.

Temporary Hardship

For members expecting to overcome their financial hardship in a relatively short period of time, who anticipate making timely, future payments, and who plan to repay any arrearages over time, the preferred workout hierarchy is as follows:

- *Forbearance* – A temporary reduction or suspension of payments that must be immediately followed by an arrangement to cure the delinquency.
- *Repayment Plan* – An arrangement in which a member agrees to pay down past due amounts while still making regularly scheduled payments.
- *HomeSaver Advance™* – A monetary advance to cure a delinquent loan resulting in a separate unsecured loan for the arrearage amount.

Permanent Hardship

For members who have experienced a permanent or long-term/enduring financial hardship, foreclosure prevention alternatives should be considered in the following order:

- *Payment Reduction Plan™ (PRP)* – For a member who is not eligible for, or who does not meet the terms of HAMP, but has the willingness and ability to make reduced monthly payments of at least 70 percent of the member's contractual monthly payment.
- *Other Forbearance** – A temporary reduction or suspension of payments (subject to the limits of the governing MBS trust document under which that mortgage loan was pooled), which will culminate in a more permanent foreclosure prevention alternative, such as those listed below.

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*These mortgages may be bought out of pools and require further attention when loss mitigation efforts are involved. Risks include additional costs when the loan is being re-sold to a pool.

Once members are on a Payment Reduction Plan or other forbearance, the following options (along with any new programs that may become available) should be considered in the prescribed order:

- *Modification* – For mortgage loans that are ineligible for HAMP, such as non-owner-occupied property, this means any permanent change to the terms of a mortgage loan, including changes to the interest rate, loan balance, or loan term.
- *Pre-Foreclosure Sale* – For delinquent mortgage loans, the acceptance of a sales contract prior to a foreclosure sale resulting in a payoff of less than the total amount owed on the mortgage loan and release of the mortgage lien.
- *Deed-in-Lieu (DIL)* – For delinquent mortgage loans, the voluntary transfer of title from a borrower to the servicer to satisfy the mortgage loan and avoid foreclosure (also called a "voluntary conveyance").
- *Deed-for-Lease (D4L)* – For qualified members with properties transferred through DIL of foreclosure, D4L allows the execution of a lease agreement in conjunction with a DIL, allowing for borrowers/tenants to remain in the home.
- If there is mortgage insurance, the servicer must discuss with the provider and act in accordance with their agreement.

Fannie Mae has a comprehensive workout document that details the description of each of the loss mitigation options outlined above. (Please see workout link on page 8).

Best Practices Learned When Working with GSEs:

Because GSEs offer a national standard by which you can measure your results, using GSE guidelines may be of assistance in working with difficult members who may feel the guidelines are not being fairly applied.

Even if you are a portfolio lender, following GSE guidelines provides a basic framework from which to work. Many Credit Unions interviewed confirmed that they utilize this framework, as it assures consistency. This same framework can then function as the basis for variations. For such variations, best business practices warrant approval from your board and establishing a baseline.

Fannie Mae, Freddie Mac and the Mortgage Bankers Association all offer a number of classes and webinars to address the educational needs of Credit Union staff. These classes are an excellent source for fine-tuning your staff's skill sets within the various mortgage departments.

It is essential that your Credit Union understands the GSE accounting process and reporting requirements. These include reporting loan-level activity and establishing in-house policies for remitting funds due to the GSEs. Equally important are appropriate reconciliation procedures for internal accounting. Be sure to fully understand the roles and responsibilities of custodial accounts and setting up your remittance system.

Section 3
Identifying Members in Distress

One of the most significant keys to success in effectively managing mortgage collections is to take a proactive stance in implementing the innovative tools and techniques that will allow your staff to reach out to members who fall into the identified high-risk areas of your mortgage loan portfolio.

The economic environment in 2009-10 has proved challenging not only for members but Credit Unions as well. Credit Unions, however, are responsible mortgage lenders who actively seek ways to assist members who are experiencing financial challenges. Many of the tools and techniques Credit Unions are using today and which are outlined below will enable you to identify members in distress, *before* the member recognizes his or her financial distress.

This is because many members experiencing financial difficulties in today's economic environment have never previously encountered struggles in making their mortgage payment. Because they have never needed to ask for assistance with their mortgage payments, they are probably unaware of the short- and long-term solutions offered by their Credit Union that can assist them in regaining their financial standing and minimize the negative impact on their overall credit rating.

The following are some very useful tools and techniques to help Credit Union management effectively manage loan delinquency and mitigate Credit Union losses.

Position "Collections" in your advertising and print collateral, and on your website, as a resource for members who might need assistance with their finances.

Positively promote your Mortgage Collections Department as a resource to your membership. What, a "positive" image for collecting delinquent mortgage loans? *Yes!* Work with your Marketing Department to develop an aggressive, multi-channel marketing campaign to promote the idea that your Credit Union's Mortgage Collectors are ready, willing, and able to work with members experiencing financial challenges.

To be successful, you have to put yourself in your member's shoes. Create self-service channels that will enable the member to maintain some degree of anonymity as he or she researches what solutions may be available from your Credit Union. However, make sure to provide contact information, such as a phone number or e-mail address, so that when they do decide to openly approach your Credit Union for assistance, they have the information they need right at their fingertips.

Some Credit Unions have added the functionality to their websites that allow a member to "chat" with a Credit Union employee. In today's technological world, many of our members prefer e-mailing and texting to phone calls, so "chatting" online is a viable opportunity for members to contact our mortgage collectors. Your Marketing team will be instrumental in determining whether this option will be well-received by your membership.

Review and revise your delinquency letters to incorporate positive wording that encourages members to contact your staff. Remind your audience that Credit Union staff are readily available to help and equipped with financial solutions that may relieve homeowners' financial distress. Consider having the assigned collector or mortgage workout specialist send a hardship package to any member who is delinquent 30 days or more and who has not been available by phone.

Take a bold step and rename your Collections Department. Consider changing the name of the department to "Payment Assistance" or something that has a more positive connotation to encourage members to call.

Keep an eye on the Community

Generally layoffs in the community are publicized in advance of the actual occurrence. Use your community liaisons to gain awareness of cutbacks that may be affecting a large portion of your membership now or in the future. Offer to run workshops that assist that segment at their place of business or in a community center in order to help them prepare for this difficult time. You will gain their respect and cooperation far ahead of any other creditors to whom they may be obligated.

Maximize the relationships between the Branch Network, Call Center, Servicing areas and any other departments that have member contact. Educate employees throughout the Credit Union to identify the warning signs of a member that may be in distress. If "trusted advisors" throughout the organization guide their members to see the department as a resource rather than a payment recovery operation, you are likely to gain access to more members earlier in the process.

In many areas of the United States, home values have significantly declined. Some members may recognize their homes are "underwater" and, even though they have always paid their mortgage payments on time, are considering walking away or withholding payments until the lender is willing to reduce their mortgage rate.

Some members have tuned into WIFM (*What's In It For Me?*) – so they have chosen or, worse yet, been *advised* to become "strategic defaulters." There has been an advertising explosion by "white knight" companies and attorneys that offer members a myriad of solutions to modify their current mortgage, save a home from foreclosure, and even erase debts. Make sure your staff is well informed of the techniques these companies and attorneys employ so they can properly inform members of the pitfalls and potential negative impact to their credit ratings.

Recommend Reputable Financial Counseling Agencies

If your Credit Union does not employ certified financial counselors or have a partnership with a reputable financial counseling firm, reach out to your community to forge relationships with reputable financial counseling agencies.

As a word of caution, refrain from advertising or promoting Credit Union staff as "counselors," because on October 1, 2009, there was a regulatory change to the Truth-in-Lending Act (Reg Z) that prohibits

lenders from using the word "counselor" unless the individual involved is a certified financial counselor. If you have implemented a Mortgage Hardship Program, you may consider as a long-term solution to require Credit Union staff working with members to become certified financial counselors. Many community colleges have continuing education programs that provide affordable online or in-class courses to complete the educational requirements to become a certified financial counselor.

Because you often have a financial relationship with your members, you have access to information that many mortgage lenders do not have. How is that an advantage? You have the advantage of reviewing a member's spending patterns when he or she has a checking account with your Credit Union. It is extremely difficult for a member to change spending patterns because of the social and psychological effect on the member and his or her family. There are financial counseling agencies that provide family support groups to help make transitions when a family has experienced a significant decrease in their income.

Look at the entire financial situation and provide solutions that will help improve the overall financial position of the member, not just the mortgage. With the introduction of HAMP, your staff may only be focusing on the housing-to-income ratio. Look at solutions for other loans the member may have with your Credit Union that may help to lower their overall debt-to-income ratio. This sends members a message that you care, that you're looking at the situation holistically, and are willing to work with them on long-term solutions that will put them on the road to financial recovery.

Take Advantage of Portfolio Analysis- In-house or Third Party Solutions

Historically, Credit Unions have enjoyed the loyalty of their members over any other debtors that they have been obligated to. In this environment, that loyalty may not be as apparent, especially if you have moved from a SEG-based environment to a community field of membership. Credit Unions have also experienced unprecedented growth in lending and a larger share of the market than ever before. It is no longer possible to know your members by name, in every instance, as well as their current financial situation.

Your Credit Union may have the expertise and resources internally to develop and implement portfolio analytic solutions to identify and monitor at-risk accounts. To be effective, in-house analytic solutions will require data that must be obtained from external service providers, such as credit scores, bankruptcy navigator scores, credit report attributes, and valuation solutions. A cost-benefit analysis should be completed to determine the benefits of developing in-house portfolio analytic solutions, as opposed to seeking out third-party service providers.

Developing an effective in-house analytic solution may be a viable solution; however, if your Credit Union does not have expertise and resources, there are multiple third-party vendors that offer portfolio review and can provide valuable insight to your operation. Bankruptcy indicators for the Visa portfolio can be a great help in establishing your outreach program in that area. Analysis that determines current equity positions on your first and second liens can provide a valuable benefit as well.

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Third-party portfolio analytic solutions can provide valuable information that in-house programs generally cannot utilize, such as national, regional, local, and/or peer trends, interpretation of the data and the pairing of findings with effective solutions, lift rates by obtaining specific borrower credit attributes, and historical trending of the success rates associated with modification solutions.

The frequency of completing portfolio analysis must be established to effectively trend the data and track the success of tools, techniques, and resources implemented to manage the risk in the mortgage loan portfolio. As Credit Union professionals, you are knowledgeable about the local economic environment and therefore should determine how often the data must be updated to analyze the mortgage portfolio. The objective is to have the ability to make a difference well in advance of the bankruptcy notice or the foreclosure judgment that shows up in your Inbox.

When you complete or receive your portfolio analysis, determining what the data means and charting a course of action is critical. You must have dedicated resources that are empowered to develop and implement a formalized credit management strategy.

Expand your resources to engage a cross-section of Credit Union staff in developing this strategy, as they are often the best source for innovative ideas and solutions. Remain focused on the long-term goal, which is to manage your mortgage portfolio by proactively providing financial solutions that will help members in danger of losing their home to foreclosure.

Your Credit Union staff should be recommending financial solutions that will be accepted by the member as allowing them to improve their financial conditions and minimize any negative impact on their credit ratings. Credit Unions that are successful will build member loyalty, while simultaneously minimizing mortgage delinquency and mitigating Credit Union losses.

Section 4
Modification Basics

When considering possible modifications, the best strategy is to keep it very simple. The following questions should be answered:

1. *Can the member support the payments on the house?* Fannie Mae's 31% ratio for housing expense is an appropriate guideline.
2. *Can the member support other monthly obligations?* Review paystubs to see what the actual net pay is and identify the disposable income after all monthly expenses are paid.
3. *What is the current value and condition of the property?* There are several methods, varying in cost, which can assist in this determination.

For all modification requests, members should provide the following information:

1. Documentation of current incomes, paystubs, tax returns, copies of unemployment information or other sources of income. These files need much more extensive review than a new file. Unemployment needs to be considered and acceptable appraised values will vary from traditional standards.
2. A hardship letter that explains the current situation needs to be documented. Determinations regarding the actual hardship and the likelihood of the cure, as opposed to a "temporary Band-Aid®," need to be made.
3. Budget counseling from an accredited source is required. Face to face counseling vs. a telephone interview is preferred.
4. A credit report should be obtained to confirm the information.

Once this information is received, a recommendation can be made. Fannie Mae has an automated system that provides a recommendation. If it is positive, the process can continue and the property value should be determined. Zillow.com is one method that can be used to determine values. Information should also be obtained on the status of the taxes and insurance if there is no escrow associated with the loan.

In the instance of severely delinquent loans, more than 120 days past due, refinancing is often a better option, enabling the Credit Union to get current title coverage and a new appraisal. A portfolio program currently in use is a 3/1 ARM that has up to a 40-year amortization, and escrows are required.

For loans that are current, investor guidelines need to take precedence in considering a modification over a refinance.

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