

Leveraging Analytics in Mortgage Loss-Mitigation Strategies

WITH THE CREDIT CRUNCH WREAKING HAVOC in pre-collections and collections departments across the country, loss-mitigation-and-recovery professionals are asking, “What’s next?” Unfortunately, there appears to be no break in the storm, and the number of delinquencies and foreclosures is expected to remain high as adjustable rate mortgages (ARMs) continue to reset through 2012 (see Page 74). That being said, the use of advanced analytics may allow banks and mortgage lenders to mitigate the impact on their balance sheets while helping to keep borrowers in their homes.

Current Market Environment for Mortgage Lenders

Aggressive subprime lending practices have led to millions of loans teetering on the edge of foreclosure. Some of the lenders facing the biggest challenges relied on shortsighted strategies, such as originating loans with high loan-to-value ratios, employing minimal documentation, and offering interest-only mortgages. The colorful terminology used to describe some of these practices includes:

- ▶ NINJA loans—loans made to borrowers with **No** verification of their **IN**come, **J**obs, or **A**ssets;
- ▶ Liar loans—loans made to borrowers with better credit scores who were able to seriously exaggerate their income because the lenders did little or nothing to verify their income.

With secondary market interest and access to capital markets all but dried up, mortgage lenders have been forced to keep the vast majority of their 2007 loan originations on their books. As the number of delinquencies and foreclosures rises, mortgage lenders and banks are struggling with how to triage delinquent loans in order to stem the tide of charge-offs hitting their balance sheets. With multiple functions to coordinate (i.e., recovery, loss mitigation, foreclosure, property acquired through foreclosure, and bankruptcy), the task is daunting indeed.

The pre-collections professional focused on loss mitigation is currently busier than ever as the number of loan files moving from “current” to 30, 60, or even 90 days past due continues to grow. With the stack of loan files reaching the top of the cubicle wall, he or she has the difficult task of deciding which loans to attack and in what order. Pick from the top

KEVIN BINGHAM is a principal at Deloitte Consulting LLP in Hartford, Conn., chairperson of the Academy’s Medical Malpractice Subcommittee, and an official Academy spokesperson.

FRANK ZIZZAMIA is a director at Deloitte Consulting LLP in Hartford and founder of its advanced quantitative services practice.

DAVID SISKO is a director at Deloitte & Touche in Charlotte, N.C., and practice leader of default management.

MICHAEL GREENE is a senior consultant at Deloitte Consulting in Boston and a member of the advanced quantitative services practice.





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Joe Gilbert

Winklevoss Technologies, LLC

Two Greenwich Office Park

Greenwich, CT 06831

Voice: 203-861-5530

Fax: 203-861-5531

www.winklevoss.com/wintech

sales@winklevoss.com

Mortgage-Loss Triage

- ▶ **LOWEST FORECLOSURE RISK—Hold out from treatment. These accounts will self-cure.**
- ▶ **LOW-TO-MEDIUM RISK—Use a dialer campaign. Automated contact of these accounts will lead to some returns without incurring the heavy expense of employing the most experienced professionals.**
- ▶ **MEDIUM-TO-HIGH RISK—Utilize the most experienced professionals for manual calls in order to remedy these accounts. The focus should truly rest here.**
- ▶ **HIGHEST FORECLOSURE RISK (i.e., least likely to cure)—Proceed with foreclosure process, freeing up resources to focus on those accounts that can be saved.**

ward on the loans to other functions for processing.

Unfortunately, the easy-to-spot loans may be only a small fraction of the actual delinquent loans being reviewed on a daily basis. Combine that with the fact that the vast majority of people handling troubled loans have been hired in the past 12 months, and you get a sense of the serious challenge facing mortgage lenders and banks.

A Critical Juncture

Pre-collections loss-mitigation departments are at a critical juncture. They can continue doing business as usual, using a simple set of rules applied uniformly across their loan portfolio to offer treatment strategies to their borrowers. Or they can choose to move away from their current resource-intensive and expertise-neutral approach by leveraging advanced analytics to enhance their process in two ways:

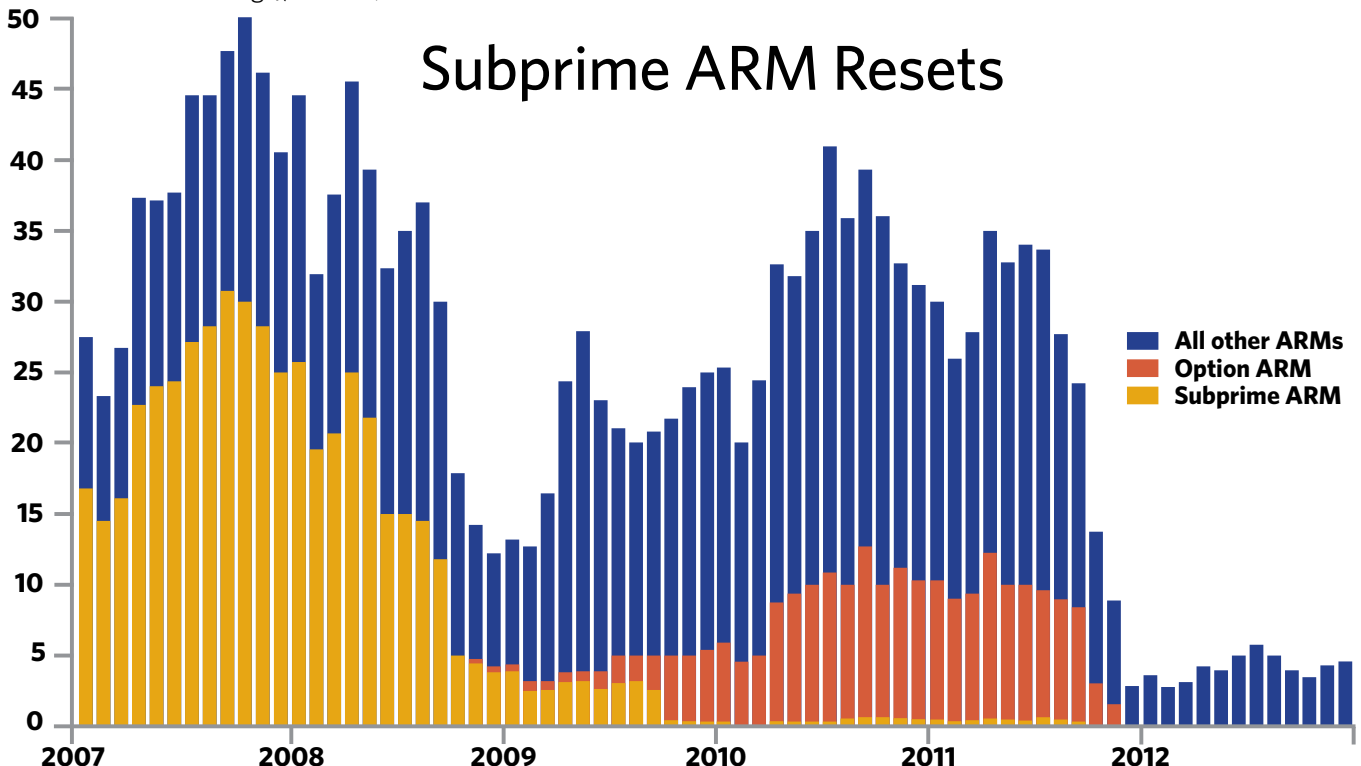
- ▶ Employ advanced analytics to identify overdue loans that should be triaged using optimal resources and treatment strategies;
- ▶ Use predictive analytics to identify current loans that have the propensity to become overdue in the next 90 days.

of the pile? Pick from today's loans or the pile from three days ago? Or pick in alphabetical order, hoping borrowers closer to the beginning of the alphabet will be more likely to keep their promises to pay?

A seasoned professional may be able to quickly spot the obvious loans that are

going to self-cure; in other words, spot the borrower who is likely to remit the amount owed. He or she may also know from experience that a few of these loans are already too far gone to be saved. Rather than spend valuable time trying to call these borrowers, the professional will for-

Amount of ARMs billing (\$ Billions)



FEVERPITCHED / DREAMSTIME



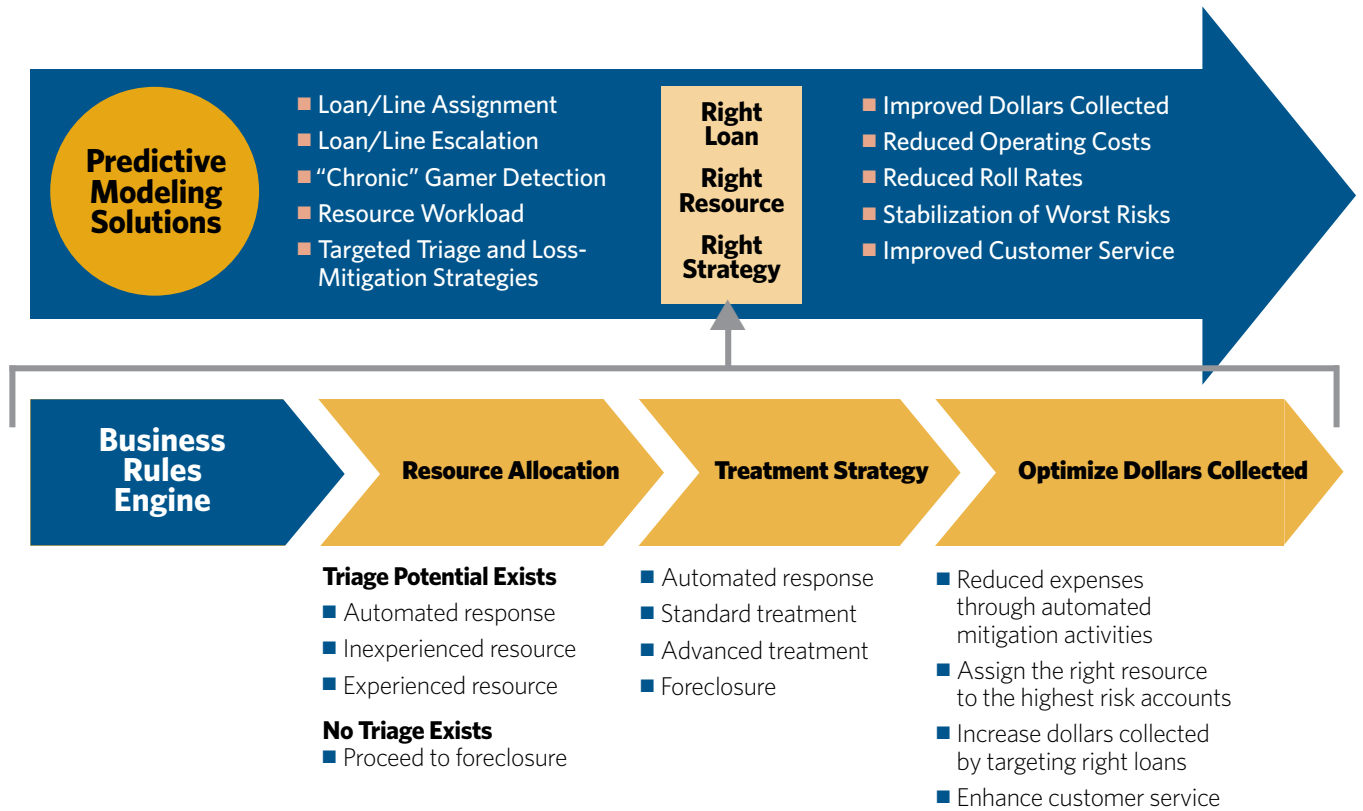
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Stated another way, advanced analytics can be used to put out current fires and, more importantly, to anticipate where future fires might arise in order to allow the mortgage lender to get ahead of the delinquency and foreclosure curve.

Advanced analytics uses nontraditional data elements from multiple sources that can help lenders prioritize treatment actions for delinquent loans while at the same time monitoring current loans for early warning signs of trouble. External data include information such as housing price indicators, foreclosure rates, labor/employment histories, demographics, customer lifestyle, and other behavioral data that help to segment the pool of loans and identify the propensity of each one to move toward foreclosure.

Once a pre-collections professional knows how to stratify delinquent loans using advanced analytics, he or she is better positioned to take action and remedy troubled accounts that have the

highest willingness and ability to pay. A risk-intelligent strategy allows for the assignment of the right resources to the right loan with the right treatment strategy. For example, experienced individuals can be assigned to handle high-risk loans that will require extensive loss-mitigation discussions over the phone. Those with less experience or who are more familiar communicating without direct interaction (e.g., by e-mail, letter, etc.) can be used for loans with a high probability of self-curing.

Predictive analytics leads the pre-collections professional to the right accounts for triage and treatment. Although the number of delinquent accounts hasn't changed, the stack of accounts assigned for review decreases dramatically. What was once a daunting and manual task becomes a manageable and automated process allowing him or her to focus on the loans that actually can be saved. Stated another way, advanced analytics

helps place the right loans on the top of the stack.

At a higher level, individuals have loans assigned to them based on their skill level, historical success rate (e.g., right party connections, promises taken, promises kept, etc.), and current workload. The most experienced professionals are assigned the most difficult cases, where their skills are best utilized from a customer-service and dollars-at-risk perspective.

At this critical juncture in our country's history, we think it is vital that actuaries, statisticians, and loss-mitigation experts continue working together on enhancing the pre-collections and collections process. With so many delinquencies and foreclosures on the horizon, we must act now. By using advanced analytics and business rules to assign the right resources to the right loans with the right treatment strategy, we strongly believe we can help thousands of Americans keep their homes.