Managing Risk

An Alternative to Servicing Your Loan Portfolio

By David J. Miller Jr.

Many credit unions today wrestle with enterprise risk management, focusing a considerable amount of time and resources on managing operational risk, balancing it with the delivery of exceptional member service, while still being profitable.

If those three objectives are high on your to-do list, you might consider engaging a third party to handle the heavy lifting associated with servicing your loan portfolio. They can assist you in achieving those objectives. So, it might prove worthwhile to invest some time looking into a partnership with a subservicer to see how they can help you.

The subservicing industry has grown from a small, relatively select group of users to a widely accepted form of servicing for a broad cross-section of financial services participants. Historically, credit unions have been holders of the mortgage servicing right (MSR) with some retaining the MSR when they sell their loans to Fannie Mae, Freddie Mac or Ginnie Mae.

Over the last few years, we have seen dramatic shifts in this business with many credit unions engaging in secondary marketing activities. As a result, subservicing has become an accepted form of managing loan servicing activity and has become an alternative to in-house servicing operations.

> There are numerous reasons to consider subservicing as an alternative to an in-house servicing operation. The most challenging is compliance.

WHAT IS SUBSERVICING?

Subservicing is the outsourcing of traditional administrative loan servicing activities to a third party for a fee. The portfolio can be serviced on a private label basis with the servicing branded to provide a high-quality, consistent member experience.

Subservicers handle all of the traditional servicing activities, from the loan closing through payoff, foreclosure or sale of servicing. They manage the core servicing activities including member service, default administration, accounting and investor reporting, and integration with your in-house systems. And, of course, they will manage compliance and regulatory issues on your behalf.

The subservicer typically also provides access to loan data, delivery of industry standard and customized reports and support of management reporting needs. Perhaps most importantly, the subservicer will provide 24/7 member support and be able to measure and deliver the results through call statistics, turnaround times, performance measures, and high-quality contacts with the member.

In sum, while you have entrusted the daily operational activity and the responsibility of servicing performance to a third party, you continue to own the servicing rights and the member relationship while retaining the rewards and benefits associated with the servicing asset.

Despite the fact that you have outsourced the servicing asset, you are still obligated for the performance of the servicing activities. In order to administer your responsibility, you will need to develop a strong oversight program to assure that the servicing is being performed in accordance with all applicable requirements, as well as in accordance with your business strategy.

BENEFITS OF SUBSERVICING

There are numerous reasons to consider subservicing as an alternative to an in-house servicing operation. But let's start with perhaps the most challenging consideration today—compliance.

In today's environment, the compliance and regulatory landscape has become increasingly complex, with increasingly frequent updates and changes. Moreover, the costs for non-compliance have risen dramatically with higher penalties and compensatory fines being imposed by the different regulatory authorities and mortgage agencies.

Can you keep up with the ever-changing compliance and investor requirements without hiring a small army of specialists in your operation? They would need to review changes, determine operational and technical impact, build solutions, and then test to assure that you will be in compliance by the due date. It's certainly a daunting task.

A relationship with a subservicing partner that has broad expertise can help you achieve these objectives, assuring that your loans are serviced in compliance with all state and federal regulatory parties, GSE, investor and all insuring entity guidelines and requirements, while delivering a process that is built on best practices.

In your long-term business planning cycle, you focus on strategic goals and actions necessary to manage and control costs while retaining flexibility in your operations. Subservicing allows you to lock down your servicing costs while retaining the flexibility to better manage portfolio volume changes and address compliance-related business requirements.

IN-HOUSE VS. OUTSOURCED COSTS

Typically, working with an established subservicing company will be more cost-effective than trying to retrofit your existing servicing platform to the changing requirements. The costs for the required servicing technology, trained staff, different support systems and compliance monitoring make it difficult to be cost-competitive without servicing at least 150,000 loans.

Using a subservicer enables you to adjust your volumes more easily in response to changing market conditions and secondary market pricing opportunities, without having to support the fixed costs for an in-house servicing operation. Taken all together, subservicing can be a cost-effective alternative given the resource constraints that you face.

Subservicing also allows you to offer new products to your members and expand your services. By working with an experienced subservicer with a strong staff and technology, your credit union can offer a wider range of fixed-rate and adjustable-rate loan programs, provide various types of conventional and government loans and better serve your member base. You will also be able to access specialized housing agency and other financing programs without having to develop and support the required servicing for these different products internally.

SUPPORT FOR SELLING STRATEGIES

Best execution – isn't that what it's all about? Many credit unions today who are servicing in-house follow past practice, putting the loans on their balance sheet rather than exploring a broader delivery into the secondary market. And while there are clearly investment considerations, their execution is tied to a specific delivery method because of either a systems limitation or limited servicing knowledge tied to their investor reporting capabilities.

A good subservicer will provide the flexibility to support all of your selling strategies as well as supporting your business as you look for best execution for your new originations.

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David J. Miller Jr. is Executive Vice President and Business Development Director at Cenlar FSB, a leading loan servicing provider for more than 40 years. You can reach him at dmiller@cenlar.com.