

On the crest of a wave

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When JPMorgan Chase makes a technology announcement, the whole market jumps. That a mortgage lender the size of JPMorgan Chase is performing due diligence on Fiserv's MortgageServ mortgage servicing system as a probable replacement for its multiple legacy platforms is a 'twice in a decade' event, according to Kathleen Mikula, spokesperson for Fiserv's Lending Solutions division. It is also a sign that the mortgage servicing technology market may be picking up, and that servicing of home equity products is changing.

Conclusions from Mortech's 2005 study of mortgage technology support this. Mortgage lenders, flush after five great years, are investing enthusiastically in technology, with this year's spending expected to be eight per cent higher than 2004 to reach \$3.6 billion. With lenders predicted to bulk up servicing portfolios, servicing technology expenditures will leap up, too, in pursuit of what Mortech calls the 'Holy Grail' of automated process management.

Fidelity Information Services is the giant of mortgage servicing technology, with Fiserv Lending Solutions right behind it. Farther back are Fair Isaac, Harland Financial Solutions, and GCC Servicing Systems.

Much technology spending will go towards technology for servicing home equity products such as home equity loans and lines of credit, products that have surged in popularity in recent years and will surge more as higher interest rates quash the sustained refinancing boom and force lenders to look at other mortgage products.

The Federal Reserve reports \$881 billion in home equity loans outstanding in 2004, an 80 per cent increase from \$492 billion in 2000. Borrowings against home equity lines of credit grew at a 41.8 per cent rate in 2004 over 2003.

Home equity servicing has long been problematic for lenders. Back when home equity products were seen as simple products, benign offshoots of the first mortgage, lenders might service them on a consumer loan servicing system or even a credit card management system because of the revolving nature of home equity lines of credit.

But Dan Scheuble, chief information officer for Fidelity National Financial, the parent company of Fidelity Information Services, sees three drivers changing the old view of home equity servicing: the end of the refinancing boom; the maturity of the home equity line of credit as a product; and increasing risk. These three trends will drive the gradual consolidation of servicing platforms, such as what is happening at JPMorgan Chase, and the final placement of home equity line of credit servicing onto the mortgage servicing system.

'We regularly meet with the lending heads of large customers – we've had 80 meetings in the last

four-five months,' Scheuble explains. These lenders 'have five, seven, ten, twelve – any number of servicing platforms'. They are asking 'what should that look like' going forward. Ultimately, 'fewer platforms is better for quality and will reduce costs', and simplify operations considerably. Scheuble recommends that lenders 'use a consumer loan platform for auto loans, installment loans, maybe credit cards, and one platform for all real estate loans – first mortgages, B and C paper, [and] first-lien home equity loans'. Being a leading edge servicer means consolidating on to these two key servicing platforms.

Scheuble says that Fidelity can provide either option for servicing home equity lines of credit, because both its major servicing systems, one for mortgages (Mortgage Servicing Package - MSP) and one for consumer loans (ALS Servicing Manager), support the product.

Overall, though, home equity products are a 'big driver for customers' of Fidelity to invest in servicing technology. Interestingly, Scheuble notes that 'it is cheaper to service home equity lines of credit on a consumer loan system than on the mortgage servicing system'. But given the risk concerns, cheaper may not be better. Indeed, scrutiny by regulators is a factor. Scheuble points that out that 'many regulators want [home equity lines of credit] on a mortgage servicing system'. This reflects a general trend towards 'deeper processing' of home equity products, with demands being made for access to in-depth information by regulators, asset/liability managers, and other personnel.

Back in May, the regulators spoke: the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration together published credit risk management guidelines for home equity lending. These regulatory bodies were finding that, 'in many cases, institutions' credit risk management practices for home equity lending have not kept pace with the product's rapid growth and easing of underwriting standards'. These guidelines impact the loan servicing systems that process these wildly popular products and will drive further investment in portfolio credit risk management technology.

Servicers of home equity loans and lines of credit must have the following technologies under the guidelines:

- Segmenting and monitoring higher risk accounts for 'adverse changes'; includes periodic refreshing of credit scores, behavioral scoring of borrower characteristics, and periodic assessment of utilisation rates and payment patterns.
- Risk-based decisioning on the extension of credit on an existing home equity line of credit or other changes in the terms of the line of credit.
- Automated monitoring of values of collateral, i.e., the home.
- Automated monitoring of high loan-to-value (LTV) home equity loans or lines of credit.
- Annual credit reviews of home equity lines of credit to determine whether the line should be continued.
- Monitoring and controlling of over-limit accounts.
- Portfolio segmenting and segment analysis, including monitoring of segment limits, based on criteria such as, 'product type, credit risk score, DTI [debt-to-income ratio], LTV, property type, geographic area, collateral valuation method, lien position, size of credit

relative to prior liens, and documentation type’.

- Stress testing of key portfolio segments.
- Reporting and analysis of ‘production and portfolio trends by product, loan structure, originator channel, credit score, LTV, DTI, lien position, documentation type, market, and property type; delinquency and loss distribution trends by product and originator channel with some accompanying analysis of significant underwriting characteristics (such as credit score, LTV, DTI); vintage tracking; the performance of third party originators (brokers and correspondents); and market trends by geographic area and property type to identify areas of rapidly appreciating or depreciating housing values’.

Scheuble notes that for users of Fidelity’s MSP, these regulatory guidelines are a ‘non-event’. MSP ‘maintains all core data for this reporting’ and has the access tools, particularly the Passport analysis and reporting system. Passport is a browser-based reporting system with analytical tools that works with a relational database version of the mortgage servicing data housed in MSP. Scheuble feels that these guidelines ‘play into [Fidelity’s] strengths’. ‘We have an interface into every risk management tool’ on the market. He believes that many consumer loan servicing systems do not have these capabilities for sound credit risk management of home equity lines of credit.

Scheuble believes that securitisation will end up a bigger factor for home equity product servicing than credit risk. Lenders want a ‘big switch to be flipped’ to securitise some pools of loans. That ‘switch’ can then be flipped off to change back to regular servicing of home equity lines of credit. ‘Asset/liability managers are demanding this.’ Fidelity’s MSP is undergoing a major revamp called ‘MSP Magnified’. ‘Re-architecting is ongoing. The state-of-the-art is VSAM/COBOL – it’s venerable, runs efficiently.’ But the ‘long-term goal is to go to a thin-client, internet-based world – Websphere, Java, DB2. The main driver is the need for integrated workflow and rules-based technology. Users want to change business rules for a new product today and get it into production in a week.’ Fidelity will also add web services technology for better connectivity to delivery channels and third party vendors, in a further drive to automate servicing processes as much as possible.

Fidelity is making a \$60 million incremental investment in the project, which will take three-to-five years. The revamping is a ‘customer-selected function-by-function migration’, with ‘no major conversion’. Several beta tests are occurring, starting with debt collections functionality.

Fidelity just enhanced home equity servicing functionality late in 2004, adding the abilities to access a home equity line of credit with a credit card, put a hold on the account when a withdrawal is anticipated, and create five sub-accounts for a single line of credit. Fidelity has continued to enhance this functionality in 2005.

Additionally, Fidelity is investing in the integration between MSP and its consumer loan servicing system, ALS Servicing Manager. ‘We have several projects – one in production – with an integration layer called Express that can pull together information from behind the scenes [from both ALS Servicing Manager and MSP] to get a view of the overall customer relationship.’ ‘Integration is the biggest thing going on’ at Fidelity.

Fiserv’s MortgageServ, the major competitor for MSP, also boasts strong home equity servicing functionality, much of which came out in May 2004, in the software’s largest release ever, at the request of numerous customers. Even more recently, Fiserv announced credit card access to home equity credit lines serviced on MortgageServ. Since MortgageServ is real-time, balance

adjustments are made instantaneously, providing risk management. GMAC Mortgage services its home equity products on MortgageServ, as do many other mortgage companies, according to BenchMark Consulting International.

Servicers can also turn to a wide array of specialist vendors to add risk management functionality to the servicing platform. For example, Cogent Economics' ServicingQC software applies quality control analytics to mortgage servicing using an optimised statistical sample so that servicers can 'hone into areas where [the servicer] may need servicing improvement', according to Kaan Etem of Cogent Economics. Another vendor, Strategic Analytics, offers LookAhead software for portfolio stress testing and forecasting of portfolio metrics, including those reflecting credit risk.

Research by Jeff Lebowitz of Mortech, though, shows a 'digital divide' in mortgage servicing between the large servicers using MSP or MortgageServ and the smaller services. 'Only the top 70 firms are well-schooled' in analysis of mortgage servicing portfolios. There is 'a growing disparity between the knowledge of the larger and smaller lenders' regarding the portfolios they service, with smaller servicers relying on more informal methods. The solution will be 'software as a service', i.e., outsourced services that give smaller servicers access to the necessary analytical tools for good credit risk management.