Loan Administration Basics Overview

The mortgage banker can generate substantial income by servicing loans on behalf of investors. In this course, we will learn about the various functions of servicing and how loan servicing can be a valuable revenue-generating asset. We will also learn about the goals and structure of a loan administration division, the risk associated with loan servicing, and the regulatory environment.  
  
The course begins with a look at the major areas and goals of loan administration. We then look a little more closely at the major functional areas of a loan administration group: customer service, escrow administration, default administration, and mortgage accounting. Next we look at how a servicing asset is valued and traded. Finally, toward the end of the course, we review the major laws and regulations that affect loan administration.  
  
Note: The terms "loan administration" and "servicing" often are used interchangeably. Within the mortgage banking industry both terms describe the administrative and financial tasks associated with the daily management of closed mortgage loans. Regardless of how the function is titled within your organization, the loan administration function handles all activities related to the loan once the loan has been closed.

Objectives

Upon completion of this course, the learner should be able to:

* Define the four main objectives of loan administration and how these goals are achieved.
* Identify the main sources of revenue for servicers.
* Describe the typical structure and functions of a loan administration division.
* Describe the roles, responsibilities, and basic processes of the customer service department.
* Describe the roles, responsibilities, and basic processes of the escrow administration department.
* Describe the roles, responsibilities, and basic processes of the default administration department.
* Describe the roles, responsibilities, and basic processes of the mortgage administration department.
* Explain the critical concepts relating to the valuation and trading of servicing rights.
* Recall the important laws and regulations that impact loan servicing and what servicers must do to comply.

Goals of Loan Administration Overview

Loan administration processes are a vital part of any mortgage banking company, since the mortgage banker derives a large part of its income from the loan administration (servicing) operation in the form of servicing fees and other ancillary fees.

Mortgage loan administration involves all of the essential mortgage loan activities necessary to:

* Render the required service to the mortgagor in accordance with the terms of the mortgage agreement
* Protect the security of the investor
* Produce a profit for the mortgage company

Four Primary Objectives

The loan administration department has four primary objectives:

* Maximize profit
* Reduce risk due to mortgage servicing rights runoff
* Reduce risk due to payment defaults
* Serve the needs of borrowers, communities, and investors

Maximize Profit

Profit is the difference between gross revenues collected and costs paid. The mortgage banker can increase net servicing income profit by either increasing the revenue generated from servicing the loan, or reducing the cost of servicing.

Think About It

Think about what you know about loan administration. What are some ways that a servicer can [increase revenue](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Increase Revenue**

Internally, the servicer can increase revenue by doing such things as:

* Collecting and applying payments received from borrowers on a timely basis in order to maximize interest float
* Collecting late charge fees and other fees allowed by the mortgage agreement from the borrowers
* Earning investor incentive fees when offered by the investor
* Pursuing ancillary income opportunities, such as credit card fees, insurance premium commissions (credit life insurance), and other banking or financial services permitted
* Taking advantage of cross-sell opportunities, such as home equity loans, college tuition loans, and other products available for the lender to sell from its parent financial institution

 or [reduce costs](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Reduce Costs**

Internally, the servicer can reduce costs by doing such things as:

* Installing and maximizing new and efficient technology
* Providing employees with training and tools in order to increase their efficiency, effectiveness, and capacity
* Avoiding costly mistakes that can result in investor penalties, investor loan repurchase demands due to servicing errors, or law suits brought by borrowers
* Proactively working with borrowers to find solutions to payment defaults
* Outsourcing specific tasks where it is more economical to do so

? Click the links to read some possible solutions.

Reduce Risk Due to Mortgage Servicing Rights Runoff

When a mortgage banker makes a loan and sells it to an investor, the banker usually retains the mortgage servicing rights (MSR) and anticipates earning servicing fee income for the period of time it services the loan.  
  
The expectation of this future income is booked on the balance sheet as an asset. Each month, when the servicing fee is taken, the [balance sheet](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

A statement of financial position that shows the value of an entity at a point in time. It reflects assets and liabilities. The net outcome is generally regarded as the book value of the company.

 asset is reduced by that amount.  
  
Although most loans will have a long term (for example, a 30-year fixed rate loan will pay off in 30 years), the lender knows most loans will actually pay off sooner. It is typically called "prepayment" when a loan pays off before its term. (Click to read about [anticipated payoff](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Anticipated Payoff**  
  
The banker uses an anticipated "life-of-the-loan term" in accordance with guidance from their accounting division and external accounting firm to determine how much sooner it expects the loan to pay off.  
  
For example, the mortgage banker may expect that it will earn a total of $10,000 in servicing fees over a period of seven years (rather than the 30 years in the note). This $10,000 will be shown on the mortgage banker's balance sheet as an asset.

.) The predominate reason why loans pay off sooner than expected is because the borrowers have access to cheaper funds, for example, they may refinance to reduce their interest rate.  
  
If a loan pays off more quickly than expected, the mortgage banker must write off the remaining balance of the unearned servicing fees. This loss of future stream of income generated from the servicing rights is referred to as runoff. Mortgage bankers seek to protect themselves from losses due to MSR runoff.

Think About It

* The primary way mortgage bankers protect themselves from runoff risk is to purchase products that hedge their position against rapidly changing interest rates. Knowing what you know about runoff risk and loan administration, can you think of any other ways that mortgage lenders could reduce risk due to MSR runoff? [Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Answer**

In addition to purchasing products that hedge their position against rapidly changing interest rates, mortgage lenders reduce their risk of MSR runoff by:

* + Selling loans with higher runoff risk
  + Buying and servicing loans with less runoff risk
  + Encouraging borrowers to retain their loans by offering competitive streamlined refinancing
  + Earning the borrower's future business by providing top notch service on the existing loan
* Think about what you have just learned about MSR runoff. How is the servicer of a large servicing portfolio impacted if the prevailing interest rates drop? [Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

Reduce Risk Due to Payment Defaults

Although the mortgage banker may have sold the loan to an investor, it still retains some risk when a borrower defaults. Depending upon the terms of the loan sale to the investor, mortgage bankers may retain the following risks resulting from a payment default:

* The mortgage banker may have to advance P&I payments to the MBS investor on a regular schedule even if the borrower does not pay
* The mortgage banker may have to advance funds to pay property taxes and insurance premiums if there are insufficient funds in the borrower's escrow account
* A default may result in a foreclosure, which results in the write-off of remaining asset balances on the balance sheet
* The investor may impose penalties on the mortgage banker if the banker fails to mitigate the loss in accordance with the servicing agreement
* If the mortgage banker is forced to repurchase the loan, it will absorb the total cost of the foreclosure and any losses realized as a result of having to sell the property as a real estate owned (REO) property
* In some instances, the mortgage banker may agree to take on all risk of loss as part of the loan sale to the investor in return for an increased monthly servicing fee rate

Serve the Needs of Borrowers, Communities, and Investors

The mortgage banker is a corporate citizen. As such it is in the mortgage banker's best interests to serve the needs of the borrowers, communities, and investors. Experience has shown that those that forget this principle do not survive.

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**Answer**  
  
If interest rates fall dramatically, borrowers will refinance their loans in order to take advantage of the lower available rates. This will force loan servicers to write off remaining MSR balance sheet balances on loans that payoff existing loans through a refinance.

* Think about ways your organization strives to serve the needs of the [borrower](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Borrower**

Possible ways your organization may strive to serve the borrower include:

* + Simplifying communication
  + Displaying a customer service attitude
  + Performing its functions effectively and fairly
  + Increasing transparency

, [community](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Community**

Possible ways your organization may strive to serve the community include:

* + Preserving vacant properties held within the portfolio to reduce neighborhood blight
  + Participation in community charitable activities
  + Providing well paying jobs and opportunities
  + Providing financing for home purchases that are fair and meet the needs of the community
  + Assisting borrowers that are having a difficult time making their payments with programs customized to meet unique needs

, and [investor](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Investor**

Possible ways your organization may strive to serve the investor include:

* + Providing a fair rate of return on investments
  + Protecting the rights of the investor by fairly enforcing the terms of the note and mortgage instruments
  + Originating and delivering quality loans
  + Meeting all the terms of the servicing agreement

. Click the links to read some possible solutions.

The mortgage banker can increase net servicing income profit by either increasing the revenue generated from servicing the loan, or reducing the cost of servicing. To understand this concept, you need to understand where the mortgage banker makes money.

Servicing Fee Income

The servicing fee is a fee earned by a servicer for administering a loan for an investor. In many companies, the servicing fee income constitutes the mortgage banker's largest and most steady source of revenue.  
  
The servicer retains an agreed upon fraction of a percent of the payment collected each month. The fee is generally earned upon application the mortgage payment, and is deducted from the transmittal of the payment to the investor.  
  
Typically the servicing fee runs between .25% and .50% of the loan's unpaid principal balance at the time the payment was collected. An example of how the servicing fee is calculated is shown below.  
  
The monthly servicing fee declines over the life of the loan as the outstanding balance decreases. The fact that the servicing fees decline over time means that, at some point, the servicing fee for a loan will be less than the cost to service it.  
  
This declining service fee scenario points to a key principle of financial management in loan administration: *A loan servicing portfolio must constantly be fed with new loans to keep a profitable mix of loans*.

Servicing Fee Example

Assume the outstanding balance of a mortgage on January 1 is $100,000, and the loan administration fee is 3/8 of 1% (.375%) per month. The mortgage banker collects one payment. The monthly servicing fee would be computed as follows:

* $100,000 x .00375 = $375

Since only one payment is collected, divide this annual fee by 12:

* $375 / 12 = $31.25

In this example, the servicing fee earned by the servicer is $31.25. This amount is deducted from the payment sent to the investor.

# Float Revenue

Float is the number of days (or hours) that lenders have free use of money before having to pay it out to someone else (for example, the investor).  
  
Float revenue is interest earned on funds held for a period of time prior to having to disburse it. Float revenue can be earned on the P&I portion of the payment held from the time the payment was received from the borrower to the time it is remitted to the investor.  
  
Some investors allow the servicer to remit payments once a month. For example if the borrower makes the monthly payment on the 3rd of the month, and the servicer does not have to remit collected funds to the investor until the end of the month, the servicer can retain any interest earned on the held funds between the 3rd and the end of the month.  
  
Float revenue can also be earned on borrower escrow funds held for the payment of taxes and insurance. In some states, the mortgage banker is required to pass a portion of that float interest back to the borrower.  
  
While the amount of float interest earned incrementally on each loan is small, when multiplied over the number of loans in a large portfolio, the combined sum can be significant.

Other Revenue Sources

In addition to servicing fees, the servicer can generate additional sources of revenue such as the following:

* Late charges when a payment is received after the late charge accrual date
* Non-sufficient funds (NSF) fees when a borrower's check doesn't clear
* Profits from cross-selling products to existing borrowers
* [Investor-paid incentive fees](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Investor-Paid Incentive Fee**  
  
A fee paid by an investor to the servicer based upon performance. Generally, the servicer must outperform the investor's requirements in order to obtain the incentive fee.

Discovery Activity

Ask your supervisor what constitutes the three largest sources of revenue from the servicing of loans within your organization. Were servicing fee income, float revenue, and one of the other sources listed in the top three? Ask if it is possible to see a copy of the most recent [monthly income statement](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Monthly Income Statement**  
  
A financial statement produced on a monthly basis that shows the revenue and expenses of the entity for the reporting month. A positive number indicates the entity operated at a profit during the reporting period. A negative number indicates the entity operated at a loss for the reporting period.

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| **Area** | **Description** | **Sub Areas** |
| --- | --- | --- |
| **Customer Service** | * Provides the organization's corporate face and personality to the customer * Generally is the first to engage the borrower by providing welcome letters * Receives the bulk of customer inquiries * Handles routine servicing duties such as answering borrower questions and providing payoff statements * May assume loan set-up functions (in organizations without a specific loan set-up department) | * New loan setup * Call center payoffs * Special products |
| **Escrow Administration** | * Makes certain that the debits and credits to the borrower's escrow account are managed properly * Completes an annual analysis of the account to assure proper funds are on hand to pay real estate taxes and insurance premiums when due * Makes certain that the borrower provides evidence of the timely payment of taxes and insurance on non-escrowed accounts * May handle the release of insurance loss draft funds (in some companies) | * Tax * Insurance * Escrow analysis |
| **Default Administration** | * Traditionally becomes engaged after the borrower fails to make the mortgage payment on time * In progressive companies, uses sophisticated analytics to target borrowers that may be struggling * Works with willing borrowers to try to mitigate the loss to all parties by matching the borrower's circumstances to available loss mitigation programs * Where loss mitigation fails, manages the foreclosure process and sale of the acquired asset (portfolio lenders) | * Collections * Loss mitigation * Foreclosure * Bankruptcy * REO |
| **Mortgage Accounting** | * Responsible for applying mortgage payments, payoffs, and other remittances * Most likely responsible for investor focused activities, such as reconciling the investor portfolios, reconciling custodial investor accounts, remitting funds, and providing required reports | * Cashiering * Lockbox * Investor reporting and remittance |

Companies with smaller portfolios may bunch departments together, while companies with very large portfolios will have additional specialization with some departments focusing on specific loan products or investors.

Discovery Activity

Ask your supervisor to explain how your company may segment the loan administration activities differently than presented above. If available, compare your company's loan administration organization chart to the above.

New Loan Setup

Servicing begins on a new loan as soon as the loan closes. Normally, the mortgage banker transfers the loan from the loan origination system to the servicing system after the loan goes through a post closing audit review.  
  
If the loan is not transferred automatically from the loan origination system to the servicing system, the first step in setting up the servicer's computer system is to enter key[borrower and loan information](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Borrower and Loan Information**

Borrower and loan information entered at loan setup includes:

* Borrower and co-borrower names
* Property and mailing address (if different)
* Borrower and co-borrower telephone number(s)
* Loan amount
* Payment amount
* Escrow set up amounts
* Payment due date
* Social Security number
* Interest rate
* Adjustable loan features
* Loan type

 as well as [investor information](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Investor Information**

Investor information entered at loan setup includes:

* Investor name
* Investor loan number
* Service fee rate
* MBS pool information
* Remittance information

.  
  
Incorrect setup information will cause a loss of borrower and investor confidence and potentially taint the long-term relationship with the parties.  
  
The original loan documents are shipped to a [document custodian](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Document Custodian**  
  
Usually a commercial bank that holds, for safekeeping, mortgages and related documents backing a mortgage-backed security. Custodians may be required to examine and certify documents.

 for safekeeping after they have been scanned. Images of the documents will be available to the loan servicer.  
  
The servicer initiates the contact by sending certain things to the borrower, including a payment booklet or an initial payment coupon (direct deposit authorization), a loan amortization schedule, and a welcome letter. The welcome letter explains how and when to make payments and how the mortgage banker will handle escrows for monthly property taxes and insurance. The borrower will also be notified of Internet access to account information and payment options, if available.  
  
This loan setup process is very similar in instances where the mortgage banker buys the servicing rights of an existing loan as part of a portfolio purchase.

Call Center

The customer service call center receives the majority of incoming calls from borrowers. The goal of the call center is to provide fast, courteous, and accurate responses to borrowers' questions.  
  
Receiving and handling incoming calls from borrowers increases the cost of servicing a loan; therefore, the customer service representative (CSR) strives to provide a complete answer to borrowers' questions on the first call.  
  
**Call Center Manager**  
  
One of the most important tasks of the customer service call center manager is to track the reasons why borrowers are calling in the first place. A common theme, such as a confusing welcome letter or payment coupon message, may be prompting calls. If the issue can be identified and rectified, the company will be able to reduce the cost of handling the incoming calls, while also eliminating a source of frustration for the borrowers.  
  
In some instances, the [voice response unit (VRU)](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Voice Response Unit**  
  
A communication system designed to provide automated answers to commonly asked questions. The voice response unit (VRU) responds to caller-entered digits or speech recognition in much the same way that a conventional computer responds to keystrokes or clicks of a mouse. When the VRU is integrated with database computers, callers can interact with databases to check current information such as unpaid principal balances, last payment received date, and next payment due date.

 can be modified to include an automated message to callers so they can obtain their answer without having to speak to an actual CSR, or a message can be placed on the company's web site under the frequently asked questions (FAQ) section.  
  
**Call Center Reports**  
  
The call center manager must balance department efficiency with the effectiveness of delivering quality service. In order to achieve this mix, he or she will run a series of reports to track key [performance indicators](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Key Performance Indicators**

Key performance indicators of a customer service department include:

* Time to answer an incoming call
* Hold times
* Percentage of calls abandoned
* Customer selected paths within the VRU
* Volume of calls and time of day calls are received
* Call duration at the CSR level
* Number of calls per CSR
* Call reason codes at the CSR level
* Call resolution codes at the CSR level
* Percentage of calls transferred at the CSR level
* How much time CSRs are signed into the system to receive calls

.  
  
Some companies will ask callers if they are willing to participate in post-call survey. This provides the manager with an additional set of reports in order to gage the effectiveness of the staff. Companies may also randomly listen in on calls or record calls for training purposes provided the customers are informed of this beforehand.

Discovery Activity

Ask your supervisor for a list of the top five reasons why borrowers contact your company's call center. If possible, ask to see the report of top reasons. Keep in mind the primary reasons may change based upon time of the year (such as year-end statements) or pursuant to a particular event (such as a bulk loan transfer).  
  
Click to read a list of [possible answers](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Possible Answers**  
  
Some of the most common reasons that borrowers contact a call center include questions about:

* Fees charged such as a late charge fee
* Payment changes due to escrow analysis
* Payment changes due to an ARM adjustment
* Where to send tax bills
* Making insurance policy changes

Calls also often come in with requests for:

* Year-end tax statements showing mortgage interest paid the prior year
* A copy of a loan document or paid tax/insurance bill
* Information about other services offered by the organization

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Payoffs and Assumptions

Many companies will merge the [loan payoff](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Loan Payoff**  
  
A loan payoff occurs when a borrower pays all outstanding principal, accrued interest, accrued fees (such as late charges), and any escrow advances the servicer may have made on the borrower's behalf.

 and [loan assumption](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Loan Assumption**  
  
The substitution of one borrower with another. Typically, mortgage agreements prohibit such a transfer without the prior approval of the lender.

 functions into the customer service group since they are borrower-facing activities. They also view it as an opportunity to retain the borrower as a customer.

The payoff process includes:

* Taking the request (either directly or through the VRU)
* Producing the statement
* Answering any questions from the borrower (or the borrower's confirmed representative) about the payoff quote
* Obtaining original custodial documents
* Reconciling incoming payoff checks
* Issuing the [loan satisfaction](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Loan Satisfaction**  
  
A document recorded within the county in which a property is located that releases the lender's lien on a property. State law governs when the loan satisfaction must be provided to the borrower in response to the full tender of all amounts due and owing. Failure by the lender to meet the statutory release requirements can carry significant penalties.

 in accordance with statutory requirements.

In infrequent cases when the loan documents allow the mortgage loan to be assumed by a new party (through loan assumption), the process follows many of the same steps in the loan payoff process. It differs in that the loan remains in the portfolio with a new party responsible for making future payments.

# Special Products

Special products can include loans with unique characteristics such as adjustable rate loans, unique loan types (such as FHA 203K loans, multifamily loans, or small commercial loans), loans to specific borrowers, or loans marked for special handling.  
  
Adjustable rate loans require additional handling in the form of making the necessary adjustments to the system, producing the appropriate and required notifications to the borrowers, and being prepared to assist borrowers with any questions they may have.  
  
Some organizations have certain borrowers for whom they wish to provide additional personalized services. This may be based upon the borrower's relationship with the organization, the amount of the loan, or other factors. The organization will often assign their most experienced CSRs to this specialized group.  
  
Some loans will fall into a special handling category. These are often loans where the organization may feel there is additional risk. Examples may be cases with pending litigation, cases that had previously involved servicing errors, or borrowers that have been identified as needing additional assistance.

# Escrow Administration Overview

Provided the mortgage instrument permits, the lender may collect an amount each month, from the borrower, in order to pay taxes and insurance premiums when they become due. This is to prevent the lender from losing its security interest to either a tax sale or an uninsured loss. Funds collected are held in a custodial "escrow" account.  
  
The escrow administration department is responsible for the management of the borrower's escrow account.

Escrow Analysis

The lender must complete an annual analysis of the borrower's escrow account to determine if there is a projected [surplus](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Escrow Surplus**  
  
A surplus means the lender is holding more escrow funds than are projected to be needed. If the surplus is greater than $50, it is generally refunded to the borrower. If the surplus is less than $50, it is either refunded to the borrower or applied against the next computation period.

 or [shortage](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Escrow Shortage**  
  
An escrow shortage means that the lender did not collect sufficient funds to pay projected taxes and insurance. This may happen if tax bills or insurance premiums are increased. Servicers will generally permit the borrowers to make up shortages over the next 12 payments. This is called "spreading the shortage."

 of funds available for the payment of insurance premiums and taxes.  
  
The escrow analysis is based upon estimated real estate taxes and the insurance premium amount. The analysis must be completed in accordance with the [Real Estate Settlement Procedures Act](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Real Estate Settlement Procedures Act (RESPA)**  
  
RESPA regulates the initial and annual escrow analysis and escrow statements. It allows the lender to maintain a two-month cushion to offset unanticipated increases in the tax or insurance bills. This two-month cushion also shields the borrower from large unanticipated payment increases.

, statutory requirements, and the mortgage instrument.

Annual Escrow Statement

An annual escrow statement must be provided to the borrower within 30 days of the completion of the computational year (generally based upon when real estate taxes are due).

The annual escrow statement must contain the following information in a manner that is easily understood:

* Previous years' monthly mortgage payment amount
* Amount of payment being deposited to escrow monthly during the prior computation period
* Total cumulative amount deposited to the account during the prior computation period
* Breakdown of disbursements from the escrow account during the prior computation period
* Estimated disbursements for the upcoming computation period
* Description of any shortage or surplus along with options for settling such shortage
* New monthly escrow payment amount
* Interest earned on the held escrow balances

# Escrow Example

In the following simplified example, both taxes and the hazard insurance disbursements are scheduled for 12/31. The computation year begins with the January payment. There are no other disbursements projected. The account is non-interest bearing. There is no escrow surplus or shortage from the prior computation period.

| Projected Tax Amount | $2,000 |
| --- | --- |
| Projected Insurance Premium: | $500 |
| **Total Projected Debits:** | **$2,500** |
|  |  |
| 1/12th of Projected Debits: | $208.33 |
| Two Month Cushion: | $416.66 |
|  |  |
| **Total Allowable Escrow:** | **$2,917** |
| 1/12th of Total Allowable: | $243.08 |

In this example, the borrower's monthly escrow deposit would be $243.08.

Real estate taxing authorities assess an [ad valorem tax](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Ad Valorem Tax**  
  
A tax based upon the value of the real estate. It is generally based upon a percentage of the assessed value.

 on properties in order to fund local education and infrastructure needs required by the community. The taxing authority's lien interest is virtually always superior to the mortgage lien. Therefore, if a tax bill goes unpaid, the taxing authority may foreclose its lien and defeat the lien of the mortgage lender.  
  
If this happens, both the borrower and the lender's interest in the property are liquidated. This places a high duty on the servicer to assure that taxes are paid timely, and the lender's lien position is protected.  
  
If the lender is collecting escrow deposits from the borrower, the lender will pay the taxes on behalf of the borrower from the escrow custodial account. If the loan is a non-escrow loan, the servicer will follow up to make certain the tax bills have been paid directly by the borrower.

Think About It

The payment of real estate taxes can be extremely difficult for lenders. Can you think of any reasons why it is so difficult for lenders to manage tax payments and how lenders can handle this? Click to read some [possible answers](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Possible Answers**

The payment of real estate taxes can be extremely difficult for lenders for a number of reasons, including:

* Mortgage companies servicing loans on a national basis may have to work with thousands of different taxing authorities
* There can be multiple taxing authorities for one property (state, city, county, borough, township, utility, or village)
* Each taxing authority may have different due dates, installment variations, penalties for late payment, and may offer different discounts for early payment
* To further complicate the process, some taxing authorities will only send tax bills to the borrowers, so in these areas, servicers have to obtain bills individually from each borrower

For most national mortgage companies, the task of obtaining tax bills from this multitude of sources is outsourced to companies that specialize in obtaining tax bills. These companies are known as tax service providers. The cost of the tax service is collected at the time of loan closing and is generally paid from the borrower's funds.

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If the lender is not escrowing for the payment of taxes, why should it spend time following up to make certain the tax bill has been paid?[Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

Areas of Default Administration

The default administration group is responsible for the mitigation of loss resulting from a borrower default. The typical breakout of the default administration department is:

* Collections
* Loss mitigation
* Foreclosure
* Post-sale claims

Often the default administration department will also be responsible for the sale of the real estate owned (REO) property. However, since this is no longer considered loan administration (since the loan no longer exists), a discussion of REO is not included here.

# Collections

The collections department will generally have the first contact with a borrower who is experiencing a problem making payment. This is, many times, the most important communication with the borrower, since it will establish a trust relationship with the borrower and permit the servicer to address the problem with the borrower while it may still be manageable.  
  
More often than not, the first contact with the borrower will be initiated by the servicer. Depending upon the investor requirements and the borrower's payment habits, this first attempt to reach the borrower will generally happen between the third day of [delinquency](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Delinquency**  
  
Failure of a borrower to make timely payments under a loan agreement. The loan becomes delinquent the day after the due date. For instance, if the payment due date is the first day of the month, the delinquency date is the second day of the month.

 and the 17th day of delinquency.

The methods and tools the collection department uses to attempt to contact the borrower includes:

* Collection notices
* Collection letters
* Telephone calls
* Skip tracing
* Visits to the property

The first attempt to reach the borrower will most likely be by telephone. Calls will be systematically queued to the collections staff based upon predefined variables such as the borrower’s payment history, credit scores (such as the [FICO score](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**FICO Score**  
  
The best-known and most widely used credit scoring model in the United States, the FICO score is calculated statistically, with information from a consumer's credit files. The score takes into consideration payment histories, credit utilization, credit history, and recent credit application searches.  
  
For more information about the FICO credit score, visit:<http://www.myfico.com/CreditEducation/articles/>.

), loan age, and other variables.  
  
For instance, if the system detects that the borrower has established a pattern of always paying five days after the due date, the account will probably not be queued for a telephone call until after the fifth day of delinquency. This allows the servicer to focus efforts on cases that may be experiencing a new and unique problem.

# Think About It

Most collection professionals feel that the telephone contact provides the best balance of cost efficiency and effectiveness since it allows for two-way communication and often results in a planned resolution. The downside of the telephone approach is that the call attempt is often unsuccessful in reaching the borrower.  
  
What are some of the inherent advantages and disadvantages of using the telephone as a collection tool compared to a letter or notice? Click the links to read suggested [advantages](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Advantages of the Telephone as a Collection Tool**

Some advantages of the telephone as a collection tool over a letter or notice include the following:

* It demands immediate attention of the borrower
* It shows the seriousness of the situation
* It personalizes the relationship
* It allows the collector to determine the reason for the delinquency
* It allows the collector to better fit a solution to the borrower's situation
* It can result in a promise to pay from the borrower

 and [disadvantages](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Disadvantages of the Telephone as a Collection Tool**

Some disadvantages of the telephone as a collection tool over a letter or notice include the following:

* High percentage of attempts failing to reach the borrower
* Difficulty in confirming the identity of the person on the phone
* Inability to gage the surroundings of the borrower or the condition of the property
* Can alienate the borrower

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# Loss Mitigation

A borrower may experience a situation that prevents him or her from remitting the mortgage payment. The options available to the servicer depend upon the following "situational" variables:

* The severity of the problem
* The duration of the situation
* The willingness of the borrower to pay
* The ability of the borrower to pay

In addition to the above "situational" considerations, the servicer's options may be restricted or enhanced based upon:

* Investor requirements
* Loan features (adjustable rate, fixed rate, balloon, etc.)
* The value of the property
* The loan type (FHA, VA, conventional insured, conventional uninsured, etc.)

Depending upon the borrower's willingness and ability to pay, the servicer will select either a retention option (designed to keep the borrower in the property) or a liquidation option (designed to permit all parties exit the loan with the smallest possible loss).

| **Option** | **Description** |
| --- | --- |
| Temporary Indulgence | * Gives the borrower a short grace period (usually no more than 30 days) to repay all past-due installments at once. * Generally not written. |
| Forbearance | * Reduces or suspends the borrower's monthly payment(s) for a specified period. * May be offered by itself or in combination with other foreclosure prevention alternatives, such as a repayment plan. * Must be written, and generally should not last longer than six months without special investor authorization. |
| Repayment Plan | * Allows a borrower to repay missed payments over a defined and agreed upon period of time. * The borrower commits, in writing, to pay a full payment, plus a portion of the missed payments until all the missed payments are repaid. * A typical repayment plan might call for a borrower to make up for two missed payments by agreeing to pay one and a half payments per month for a period of four months. |
| Loan Modification | * Modifies the terms of the original mortgage note. * Typically strives to reduce the borrower's payment in order to address a long-term or permanent change in the borrower’s ability to pay. * The reduction in the payment can be accomplished through a partial reduction in the loan balance, the extension of the terms of the note, a reduction of the interest rate, or some combination of all. * The investor has to pre-approve a loan modification. * Generally requires that the loan be repurchased from any mortgage-backed security. |
| Partial Loan Reduction | * Allows the borrower to retain the property and allows the lender to reduce its loss. * A portion of the unpaid balance is "forgiven," and the remaining balance is re-amortized to produce a lower payment. * Most likely deployed if the value of the property has significantly fallen. * Generally, has to be pre-approved by the investor. |

# Loss Mitigation Disposition Options

Liquidation loss mitigation options require the borrower to forfeit ownership in the property in return for a full or partial forgiveness of the remaining unpaid debt. The two primary liquidation options are described in the table below.

| **Option** | **Description** |
| --- | --- |
| Deed-in-lieu | * Occurs when the mortgagor voluntarily conveys title to the investor via deed. * Allows the lender to avoid the cost and delays of a foreclosure, and the borrower is able to obtain a release from the debt. |
| Short sale (preforeclosure sale) | * Occurs when the net proceeds from the sale of the property are insufficient to pay off the loan and the investor is willing to accept an amount that is less than the full pay off amount in order control the loss. * The investor specifies an amount it is willing to accept as a pay off. * The borrower sells the property. * The remaining unpaid balance is often forgiven. * The amount the investor is willing to accept is most likely based upon the value of the property less anticipated marketing costs. |

Foreclosure

Foreclosure is the legal process of seizing ownership rights to the property pledged as security for the loan. The laws controlling the action are statutory (dictated by the state). Therefore, the process in each state is different.  
  
In some states, such as Texas and Georgia, the statutory process is quick — usually less than 60 days. In states such as New York and Pennsylvania, the process can take up to two years.  
  
The two primary forms of foreclosure are described in the table below.

| **Foreclosure Type** | **Process** | **Typical Duration** |
| --- | --- | --- |
| Judicial | * The lender files a complaint stating the nature of the default. * After service of the complaint upon the borrower, a hearing is set wherein the parties are given their day in court to present their arguments. * If the lender prevails, the court will issue a judgment in favor of the lender. The borrower will be given a short time to pay off the judgment. If the borrower fails to do so, the property will be auctioned off to the highest bidder. The lender will recover all, or a portion, of the remaining debt from the proceeds of the foreclosure sale. * In many instances, the lender is the highest bidder at the auction. In this case, the lender will acquire the property, which it will then attempt to sell to recover their outstanding debt. | * Since a judicial action must take place in the court, the duration of the action will be subject to the court's schedule. * Typically takes from six months to two years to complete. |
| Non-Judicial | * The lender only needs to notify the borrower of the foreclosure, and publishes the foreclosure sale in accordance with the terms of the deed of trust and the statutory requirements. * As with a judicial sale, the lender will recover all or a portion of the remaining debt from the proceeds of the foreclosure sale, or the later sale of the acquired property. | * Typically takes from two months to up to six months. |

Discovery Activity

Ask your supervisor if they can give you an estimate of the loss your company absorbs on each foreclosure. The loss may have to be segmented by loan type and investor.

# Foreclosure Property Maintenance

During the foreclosure, the prudent servicer will inspect the property at least once a month in order to ascertain the occupancy status and condition of the property. If the property becomes abandoned, the servicer must take appropriate action to preserve and maintain the property.

These actions may include the following:

* Secure unlocked doors and broken windows
* Winterize the property to prevent freeze damage to the plumbing and fixtures
* Maintain the outside appearance of the property including cutting grass, trimming bushes, removing debris, and removing snow
* Make temporary repairs such as patching a leaky roof to prevent further damage to the property
* Removing toxic and combustible items

# Think About It

Why is it likely that a judicial foreclosure would result in a larger loss to the servicer than a non-judicial foreclosure? [Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

Foreclosure Post-Sale Claims

Upon completion of the foreclosure, the servicer may file a claim with the private mortgage insurer, the FHA (for FHA-insured loans), and/or the investor. Depending upon the loan type and servicing agreements, the servicer will be able to recover all or a portion of the following:

* P&I advances to the MBS investor
* T&I advances to the taxing authorities and insurance carriers
* Foreclosure attorney fees and costs
* Property preservation costs

The servicer will generally not be able to recover the following:

* Servicing fees on missed payments
* Accrued but unpaid late fees
* The lost value of the future stream of servicing fees on future payments
* Administrative costs of managing the default activities
* Municipal fines due to failure to care for the property

The severity of the loss to the servicer will vary based upon the loan type, unpaid balance, duration of the foreclosure, servicing agreement violations, and servicing agreement provisions.

# Cash Processing

The mortgage servicer may process the mortgage payments in-house, through a [bank lockbox](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Bank Lockbox**  
  
Typically a service offered by commercial banks that simplifies the servicer's collection and application of mortgage payments. The address to the lock box is generally displayed to the borrower as a post office box that directs payments to the commercial bank.

, or through a preapproved automated debit of the borrower's banking account.  
  
Mortgagors can also make payments via the Internet where they authorize an [automated clearing house (ACH)](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Automated Clearing House**  
  
An electronic network for processing financial transactions on a large-scale basis. The automated clearing house (ACH) is governed by the National Electronic Payment Association (NACHA), which represents approximately 11,000 financial institutions with oversight by the Federal Reserve.

 payment. The borrower can initiate the transaction, or the servicer can initiate in the event the borrower authorized a recurring debit.  
  
Click to read the typical [cash processing process](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Cash Processing Process**

The typical process will follow the steps below:

* The payment and payment coupon is received by the mortgage company. Payments received prior to a defined cut-off time are posted that day. During month end or late charge accrual days, the processing time may be extended.
* If the payment amount matches the coupon amount, the payment is applied to a general cash receipt custodial clearing account. If the payment amount does not match the coupon amount (within a small pre-prescribed tolerance limit, usually not exceeding $10) the payment is flagged for special handling.
* The general cash receipt custodial clearing account is reconciled and the funds are applied to the individual mortgagors' accounts. The daily bank deposit amount is reconciled to the amount applied to the servicing system.
* The P&I portion of the payment is systematically transferred to the investor's custodial account; the tax and insurance (T&I) portion of the payment is transferred to the borrower's escrow custodial account.
* The funds are held in the appropriate custodial accounts until disbursed.

.  
  
Payoff funds received are forwarded to the payoff department for handling.

# Discovery Activity

Ask your supervisor if your organization processes the majority of payments received from borrowers in house, through a lock box, or as a preapproved debit.

# Investor Accounting

The investor holds the servicer responsible for the accuracy of all data and for meeting the various reporting and remitting deadlines. Investors may impose interest, fees, or penalties for noncompliance. Most servicing contracts provide specific authorities allowing the investor to pull the servicing of their loans if the servicer consistently fails to report and/or remit timely and accurately.  
  
The investor accounting function involves the following primary duties:

* [Custodial Accounts](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)
* [Balances](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)
* [Remit Funds](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)
* [Remit Fees](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)
* [Reports](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Reconcile Custodial Accounts**  
  
The mortgage servicer holds funds collected from the borrowers on behalf of the investor from the date of payment receipt until the scheduled remittance date. These funds are held in a custodial account.   
  
A custodial account can be similar to a typical bank checking or savings account. The primary difference is that in a custodial account, the funds are held on behalf of another entity. An example of a custodial account is where the mortgage servicer holds escrow funds on behalf of the borrower. The funds belong to the borrower, but the servicer is authorized, by the borrower, to make certain disbursements for real estate taxes and insurance premiums from the account.  
  
The debits and credits occurring within the account must be reconciled on a regular basis. Investors will periodically audit the custodial accounts, and servicers must explain all entries and the remaining balance.

**Reconcile Loan Balances and Security Balances**  
  
As payments are received, the unpaid loan balance is reduced by the principal portion of the payment. Trial balance reports are run by the servicer to make certain that the amortizing unpaid loan balances contained on the system match against the outstanding loan balances shown by the investor.  
  
If loans have been placed in mortgage-backed securities (MBS), the servicer must also run a report to assure that the consolidated unpaid balances of the loans making up the pool balance to the remaining outstanding amount of the MBS pool.  
  
If the loan balances exceed the remaining balance of the MBS, the pool is deemed to be over-collateralized. If the MBS balance is higher than the collective balances of the individual loans, the pool is deemed to be under-collateralized.  
  
The servicer is responsible for funding any under-collateralized pools.

**Remit P & I Funds to the Investors**  
  
The servicer must remit principal and interest (P&I) funds to the investor in accordance with the remittance schedule in the servicing agreement.

Agreements vary between investors and the way the loan was sold. The three most common forms of remittance schedules are:

* **Actual/actual** – A remittance style wherein the servicer remits, to the investor on a predefined schedule, actual interest collected and actual principal collected from the borrower. Under this remittance style, the servicer is not required to advance its own funds if the borrower fails to make a payment. This type of remittance style is used on whole loan sales.
* **Scheduled/actual** – Under this remittance style, the servicer must remit to the investor on a predefined schedule the amount of interest scheduled to be paid by the borrower, whether or not it has been collected from the borrower, along with any actual principal collected.
* **Scheduled/scheduled** – Under this remittance style, the servicer must remit to the investor on a predefined schedule, all scheduled interest and all scheduled principal due whether or not it is paid by the borrower. If the borrower fails to pay, the servicer must advance its own funds. This is the remittance method favored by holders of mortgage-backed securities.

For example, if the loan was sold as a whole loan, the investor may require actual collected payments be electronically remitted the next day. In some instances, the servicer will report amounts collected, and the investor will initiate an ACH draft on the holding account based upon the report. Still other investors prefer a monthly remittance. This type of remittance of funds actually collected is often referred to as actual/actual Remittance. The two "actuals" refer to actual principal and actual interest collected.  
  
If a loan has been placed in a mortgage-backed security (MBS), the servicer will generally remit following the scheduled/scheduled remittance style once a month on a specific date. In addition to any scheduled payments remitted, the servicer will also remit any unscheduled P&I collected from the borrower. Unscheduled collections include instances where the borrower may have made an additional principal payment or loan payoffs.

**Remit Guarantee Fees**  
  
Mortgage-backed securities are often guaranteed by a private entity, by Fannie Mae or Freddie Mac, or by Ginnie Mae. The servicer pays a monthly guarantee fee on loans placed in the MBS pool.  
  
The guarantee fee generally runs between .15% to .5% of the unpaid principal balance of the loan.  
  
If a default occurs which forces the servicer to liquidate the loan, depending upon guarantee fee options selected, the servicer may be able to file a claim with the guarantor agency/company to collect back all P&I payments it advanced during the delinquency.  
  
The investor accounting department remits the cumulative guarantee fees to the guarantor. In most instances this occurs through an ACH draft initiated by the guarantor. Therefore, in practice, the guarantor provides the servicer with a report of the amount of the draft a day prior to the draft. The servicer reconciles the report and moves the funds to a designated clearing account.  
  
**Example**  
  
Imagine a loan with an unpaid principal balance of $100,000. The guarantee fee is .25%.  
  
The servicer would pay a guarantee fee of $20.83 ($100,000 x .25% / 12).  
  
Since the outstanding loan balance generally declines each month, the guarantee fee also declines.

**Provide Investors with Required Reports**The investor accounting department will also be responsible for providing reports required by the investor regarding the portfolio. With few exceptions, the reports are system generated. However, the investor accounting department is charged with making certain that the reports are produced as scheduled and reconciled.

The potential menu of reports is voluminous. However, here are few that are likely to be found in all servicer/investor relationships:

* Monthly custodial account and trail balance reconciliation reports
* MBS pool-to-security balance reconciliation reports
* Remittance reports
* Account status code reports
* Loan activity reports

# Think About It

Is it possible for a servicer to make float income from servicing loans under the scheduled/scheduled remittance style? [Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

# Valuation and Trading Overview

Once a mortgage banker separates the value of servicing from a loan, the market treats the servicing like any other financial asset that can be bought and sold. The purpose of selling servicing may be to restructure a portfolio, to recognize income, or to generate cash for operations. As with any valuation, a mortgage banker finds that valuing servicing is part art and part science.

# Determining the Value of the Mortgage Servicing Rights

The value of mortgage servicing is simply the present value of the [after-tax cash flows](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**After-Tax Cash Flows**The cash flow remaining after deduction of an allowance for taxes attributable to that income.

 generated by a loan portfolio over its expected life. This value depends on some assumptions and the actual characteristics of a particular portfolio.

The steps for assessing the servicing portfolio's value are as follows:

* Stratify the portfolio (separate the loans) into homogeneous (similar) segments. Some typical groupings include investor, [coupon rate](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Coupon Rate**  
  
The annual interest rate on a debt. The coupon rate on a mortgage is the contract rate stated in the mortgage note. The coupon rate on a mortgage security is the rate stated on the face of the security, not the rate of the mortgages in the pool backing the security.

, loan type, location, original loan maturity dates, and remittance cycle.

* Project servicing income, costs, and prepayments.
* Calculate the cash flow remaining after deducting the expenses and taxes on this income.
* Calculate the net present value (NPV) of the future revenue streams of income.

# Think About It

Think about what you know about how servicers make money. What are some of the servicer's most important income elements? [Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

**Answer**  
  
The servicer's most important income elements are described in the table below.

| **Income Element** | **Description** |
| --- | --- |
| Servicing fee | The agreed upon fee paid by the investor to the servicer for administering the loan or security. Servicing fees are expressed as a percentage of the loan. The standard fee for conventional loan servicing is generally 25 basis points or .25 (¼) of 1% of the loan amount. |
| Excess servicing fees | Any fees the servicer receives in excess of the standard servicing fee. |
| Float income | Interest earned during the time between the receipt of borrowers' principal and interest payments and remittance of those funds to investors. |
| Escrow earnings | Interest earned during the time between the receipt of borrowers' T&I payments and remittance of those funds to the taxing authority and insurance carrier. In some states, a portion of earned interest must be credited back to the mortgagor. |
| Ancillary income | Income from products sold to mortgage loan customers, such as bank credit card fees, insurance premium commissions (credit life insurance), and other related charges. |
| Fee income | Ancillary fees such as late charges, document fees, NSF fees, etc. |

The relative importance of these valuation elements changes over time due to the changing characteristics of the portfolio.

Now think about how the servicing fees are calculated. How does the relative importance of servicing fees as an income element change over time? [Answer](http://education.mbaeducation.org/courses/1/DL2_011014/content/_172523_1/index.html)

Types of Servicing Sales

Servicing sales are of two general broad types:

| **Type** | **Description** |
| --- | --- |
| Servicing released sales | The sale of individual loans at, or near, the time of origination. These loan sales are generally made to companies that intend to resell the loan to an investor, or place the loan in a mortgage-backed security. |
| Servicing bulk sales | The sale of loans as blocks of existing servicing portfolios. |

Each servicer will decide on its approach to retaining or selling servicing rights based upon:

* Current circumstances
* Expertise
* Anticipation of interest rate trends
* Financial model

Some lenders may decide that the cost and risk of servicing loans is beyond their appetite, and will decide to sell all loans servicing released at time of closing or shortly thereafter. Other lenders may choose to retain certain types of loans that they feel comfortable servicing, and sell all others servicing released.  
  
Companies with large existing servicing portfolios are able to benefit from the economy of scale. Studies consistently show that companies with large portfolios are generally able to service loans in a more cost efficient manner than companies with small portfolios. These large servicing shops are often unable to keep the portfolio size needed to gain the economy of scale efficiencies intact through internal loan production alone. They are most likely to supplement their own production with servicing purchases.

Discovery Activity

Ask your supervisor or manager what your company's strategy is regarding the sale or purchase of servicing.

Market Trends

The value of servicing portfolios is significantly influenced by the anticipation of interest rates. The value of servicing, assuming all else is equal, will generally run in the same direction of anticipated interest rate projections. When interest rates are projected to rise over the next few years, the value of servicing will also rise. When interest rates are projected to fall, the value of servicing will also fall.

Other external factors that can influence the trend of servicing values include:

* Anticipated rising inflation (which would contribute to a rise in interest rates)
* Economic perils such as higher unemployment or property depreciation that could result in higher delinquencies
* The imposition of new laws and regulations that could drive up the cost of servicing or increase the risk

# Regulators

In 2010, Title X of The Dodd-Frank Wall Street and Consumer Protection Act established The Consumer Finance Protection Bureau (CFPB). This act empowered the CFPB with broad authority over financial enterprises including mortgage servicing. Its purpose is to enforce rules and regulations, perform audits, and collect consumer complaints about financial dealings, including mortgage servicing.  
  
In addition to the Consumer Finance Protection Bureau, the Office of the Comptroller of the Currency (OCC) regulates the mortgage lending and servicing activities of all national banks and federal thrifts engaged in mortgage lending and servicing.  
  
Ask your supervisor or manager if your company is regulated by the OCC. If it is not, ask which regulatory agency oversees your company, and pay a visit to their website to learn more about their mission. Use these links to learn more about the objectives of the [CFPB](http://www.consumerfinance.gov/) and the[OCC](http://www.occ.treas.gov/).

**Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)**  
  
Dodd-Frank established the Consumer Finance Protection Bureau (CFPB) to enforce specific servicing practices. In January 2013, the CFPB released its proposed 2013 Real Estate Settlement Procedures Act (Regulation X) and Truth-in-Lending Act (Regulation Z) Mortgage Servicing Final Rules.

In summary, the rules require:

* Clear and concise monthly mortgage statements to borrowers showing payment application breakdowns, recent transaction history, and information about the next payment due
* Notifications regarding adjustable rate payment changes
* Servicers to provide notice and pricing to borrowers before force-placing insurance coverage
* A reduced timeframe for providing responses to borrowers

The CFPB website provides provides excellent resources to inform lenders about regulations and to help them comply. To find more detail about the Mortgage Servicing Final Rules, please visit the CFPB's [website](http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/).  
  
Other important CFPB work to implement the Dodd-Frank Act in 2013 included revised Escrow Requirements under the Truth-in-Lending Act (Regulation Z) and the 2013 HOEPA Rule. The CFPB website provides an important overview of the rules issued thus far to implement the Dodd-Frank Act along with compliance guides and videos to explain the changes and help lenders comply:<http://www.consumerfinance.gov/regulatory-implementation/>

**Fair Credit Reporting Act (FCRA)**  
  
FCRA was enacted in 1970 in response to mistakes made by credit reporting agencies. The Act requires that credit information be reported accurately. Creditors are prohibited from reporting information they know, or have reason to know is false or inaccurate.

Willful violations of the Fair Credit Reporting Act allow homeowners to recover damages in three ways:

* Actual damages between $100 and $1,000 for each violation of the Act
* Any punitive damages that the courts may award to the foreclosure victims
* Homeowners are entitled to attorney fees and the costs of any legal action they bring against the lender for violations of the FCRA

For more information about FCRA, visit the FTC's FCRA page at: <http://www.ftc.gov/os/statutes/fcrajump.shtm>

**Fair Debt Collection Practices Act (FDCPA)**  
  
FDCPA was enacted in 1978 to address abusive practices in debt collection. It provides borrowers with an avenue for disputing and obtaining debt information in order to ensure the information is accurate. The Act also controls times when creditors may call, and prevents certain other activities such as contacting the borrower at their place of employment. The Act also requires creditors acting as collectors to provide a disclosure statement to the borrower.

FDCPA prohibits abusive practices in the collection of payments, including mortgage payments. FDCPA imposes specific restraints on third-party collectors. The following is a partial list:

* Limits times when borrowers may be called to between the hours of 8:00 a.m. to 9:00 p.m. local time.
* Requires a notification to borrowers of their rights to dispute the debt.
* Requires collectors not call the borrower at their place of employment if so requested by the borrower.
* Requires the collector to cease collection activity (other than litigation) if the borrower provides a written demand to cease communication.
* Prohibits any misrepresentation by the collector regarding the debt, consequences of failure to make payment, or identity of the collector (such as claiming to an attorney or law official).
* Restricts abusive, profane, or threatening language used in an attempt to collect the debt.
* Prohibits the reporting of false information to credit reporting agencies.

For more information about FDCPA, visit: [http://www.ftc.gov/os/statutes/fdcpajump.shtm.](http://www.ftc.gov/os/statutes/fdcpajump.shtm)

Homeowners Protection Act of 1998 (PMI Act)  
  
Requires the mortgage servicer to cancel private mortgage insurance automatically once the homeowner’s equity position reaches 22% of the value of the property.  
  
More information about private mortgage insurance cancellation (and the PMI Act) can be found on the CFPB's website at:<http://www.consumerfinance.gov/askcfpb/202/when-can-i-remove-private-mortgage-pmi-insurance-from-my-loan.html>

**Protecting Tenants at Foreclosure Act (PTFA)**  
  
PTFA protects tenants from eviction because of foreclosure on the properties they occupy.  
  
The tenant protection provisions apply in the case of any foreclosure on a "federally related mortgage loan" or on any dwelling or residential real property. The Act provides that the successful bidder at the foreclosure, including the lender, takes title to a house upon foreclosure, subject to the rights of any bona fide tenant and will need to comply with certain notice requirements. An exception is if the successful bidder intends to personally occupy the property.  
  
To read more about PTFA, visit: <http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/ptfa.pdf>.

**Real Estate Settlement Procedures Act (RESPA)**  
  
RESPA exerts specific servicing rules as it relates to the transfer of servicing rights, responding to borrower requests, and the analysis of escrow accounts.

If the mortgage permits the lender to establish an escrow account, the servicers must provide the borrower(s) with the following two items on a regular basis.

* **Escrow Analysis.** A periodic examination of escrow accounts to determine if current monthly deposits will provide sufficient funds to pay taxes, insurance and other escrowed bills when due.
* **Escrow Statement.** A detailed account showing when the servicer paid the property tax and hazard insurance, and the amount paid for each. It must include funds remaining in the escrow account and projects future requirements. The annual escrow statement mailing may include a new supply of payment coupons reflecting any change in the escrow payment and the Form 1098 detailing the amount of interest paid for federal income tax purposes.

Section 6 of RESPA requires that loan servicers acknowledge a borrower's qualified written request for information within 20 business days of receipt of the request, and provide a response within 60 business days.  
  
RESPA requires that servicers provide written notice if the borrower's loan is being transferred to another servicer. It also prohibits a servicer from treating a payment as delinquent if it is mistakenly sent, by the borrower, to the previous servicer within 60 days of the transfer.

**Servicemembers Civil Relief Act (SCRA)**  
SCRA was enacted to protect members of the service that are on active duty and have had their income materially impacted by their activation. Mortgage lenders may not foreclose, or seize property for a failure to pay a mortgage debt, while a service member is on active duty without the approval of a court. In a court proceeding, the lender would be required to show that the service member's ability to repay the debt was not affected by his or her military service. The Act also provides for a maximum interest rate of 6% to be assessed while the borrower is protected, and allows the borrower a period of time to repay any missed principal and/or interest after their discharge from duty.  
  
For more information about SCRA, visit: <http://www.benefits.va.gov/homeloans/scra.asp>.

**Truth-in-Lending Act (TILA)**

**Truth-in-Lending Act (TILA)**  
  
Mortgage servicers are required by the Truth-in-Lending Act to notify a borrower at least 25 days prior to changes in the interest rate and/or payment amount pursuant to an adjustable rate mortgage. An adjustment to the interest rate with or without a corresponding adjustment to the payment for an adjustable rate mortgage is an event requiring Truth-in-Lending disclosures to be provided to the borrower.  
  
The notice must include the adjusted payment amount, the adjusted interest rate, and the index used to compute the new interest rate.rik

State and Local Laws that Impact Loan Administration

In addition to the above Federal acts, the states (statutory) and local authorities also impose controls the loan servicer must adhere.

These include statutory laws:

* Foreclosure laws which impose specific requirements upon the servicer as it relates to completing foreclosures
* Mortgage servicing licensing laws that require parties engaged in the practice of servicing mortgage loans to obtain state licenses
* FDCPA regulations that go beyond the Federal FDCPA provisions
* Mandated borrower mediation as a pre-condition to commencing foreclosure
* Required payment of interest on lender held T&I escrows
* Restrictions on prepayment penalties
* Requirements regarding record retention

There are also municipal ordinances:

* Regarding the preservation and protection of vacant properties
* Requiring foreclosures and/or vacant properties be registered with the municipality

In some ways these state and local regulations put a greater burden on servicers than the federal regulations because there are so many potential governing authorities, and the laws and ordinances are not always clearly defined and evenly enforced.