SERVICING MANAGEMENT®

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Financial Literacy Helps Servicers

It's important to convince borrowers that you are in a position to help them remedy issues with delinquency and default.

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The music is slow and ominous. There is a picture of a bare wooden floor in the middle of the room. The camera pans slowly to show more of the room. The announcer is about 65 years old with a crisp, deep and engaging voice. The voice has grown raspy with wisdom and experience, carrying a solution to a serious problem.

"The fear of losing it all is deeper than reality," he states.

The music continues to play, and a pair of legs and feet wearing khaki pants and penny loafers appears and begins to pace slowly across the empty room.

"You don't have to lose your home. There are Chapter 13 bankruptcy laws to protect your home and family from foreclosure and allow you to make a fresh start."

By this time, a little girl is shown sitting on a stoop leading to the door. She is an adorable six-year-old, clutching her teddy bear tightly. She is sad and reaches up to grab her father's outstretched hand. He is wearing a wedding ring and pulls her to her feet for the slow walk out of the door.

"Call today for a free consultation." The door shuts, and the music ends.

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This commercial is only 30 seconds long, but it delivers a powerful and persuasive inference to the public several times a day: bankruptcy will stop foreclosure against a homeowner; the family room will be empty; the furniture will be set out on the street; bankruptcy is a fresh start and the only solution to the problem with that nasty lender.

A quick look through the yellow pages will show the use of such phrases as "consumer protection" and "stop harassing creditors" associated with bankruptcy advertisements. Why should this be important to a loan servicer or service provider?

Because your emerging market is now educated to believe that they can depend on bankruptcy to stop your collection efforts, and they feel that it is the best financial option available to them.

Bankruptcy-literate

Borrowers are bankruptcy-literate. They understand what it does, how much it will cost and who can help them do it. While there is a well-known side effect - a tarnished credit report - it beats getting put out on the street by a harassing creditor.

Law firms that represent consumers in such cases have latched on to a relatively inexpensive message delivery vehicle and have successfully grabbed the attention of the consumer in a big way. Their message is not complicated, it is not very long, it does not take great resources to explain itself, and it is certainly cost-effective for the volume of business it generates. There is no secret that it has significantly contributed to the record levels of consumer bankruptcies filed over the past several years - and will likely continue to do so in the foreseeable future.

BusinessWeek reports that overall mortgage originations could fall 36.5% in 2004 and by an additional 28% in 2005. Even an optimistic organization like the Mortgage

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Bankers Association has predicted that volume will drop off in both 2004 and 2005, albeit at a slower pace than other media outlets report.

The emerging low- to moderate-income market and subprime borrowers with poor credit histories made a whopping 70% increase in borrowing for the first quarter of 2004, totaling $105.6 billion. Many of these loans are adjustable-rate mortgages and hold potentially large, long-term gains.

However, as interest rates rise, the delinquency and default fallout is expected to be huge. These borrowers are usually the first affected by an economic downturn, the last to recover from one, have limited financial resources, and usually lack the crisis management and financial literacy skills to avoid default through effective communication with their lenders.

The loan servicing industry has correctly identified this segment of the market as the one which requires more resources to manage. The subprime industry has made great strides in its collections and loss mitigation efforts, and many companies have developed a type of fast-track system for foreclosure and REO disposition.

The early-and-often approach has been preached by the industry for several years now, and it has become a standard practice of sorts. It stands to reason that higher success rates could be obtained if lenders spent more of their resources taking preemptive action with high-risk accounts.

Loss mitigation tools

What would happen if a borrower was exposed to loss mitigation tools as an alternative to bankruptcy and foreclosure early in the collection process? Given the choice between bankruptcy and a 1% loan modification, what borrower would willingly pay $1,000 to $1,500 to file a Chapter 13 bankruptcy? Why wouldn't a lender want to collect that $1,000 as an incentive to offer the modification?

These are questions which often puzzle me and many other industry professionals. Prudent servicers realize that they are in competition for some borrowers' limited financial resources. Loan servicers might want to consider exposing more borrowers to lower-cost solutions that can help solve default and delinquency.

Whenever organizations like ours interview a new client facing foreclosure - and after his bankruptcy has been dismissed - we always ask why he didn't request a loan modification or repayment plan from the lender prior to filing? The answer is all too often, "What is that? I have never heard of loss mitigation, nor have I ever thought that I would qualify."

Clearly, these borrowers filed bankruptcy because they have received positive information about it through targeted media and print sources.

Benefits of intervention

Conversely, many evidently did not receive any effective information concerning the benefits and rewards of loss mitigation. Failure by a lender/servicer to educate its borrowers about alternatives to foreclosure creates a lose-lose situation for both the borrower and lender.

As service providers, the decision must be made to compete for the "first right" to use the borrower's financial resources for the benefit of all. Bankruptcy attorneys, investors and other creditors are spending millions of dollars on educating borrowers to believe that their expertise, products and solutions are better than those of the lenders.

It is important to note that these solutions are often presented to the defaulting borrower well before the property becomes a foreclosure and an REO loss. The information presented is often misleading, incomplete and sometimes fraudulent. Bad information deprives the lender of its expertise and credibility within the foreclosure process.

Borrowers lose because they often become victims to scams that deprive them of a legitimate opportunity to save their homes from foreclosure. They are also forced to turn to bankruptcy, even though they may be eligible for more prudent options, such as modifications or repayment plans that will not destroy their credit.

So, educate your borrowers about loss mitigation, forbearance plans, partial claims and loan modifications. Assume that it will not take thousands of dollars and an expensive, six-month campaign to convince the average borrower that your solutions are much better and more affordable than bankruptcy or third-party assistance. SM