FEATURING

TRANSFER OF SERVICING (TOS) — A BATTLE-TESTED METHODOLOGY

STRATMOR INSIGHTS

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WELCOME

The dictionary defines relationship as "the state of being connected." At STRATMOR, we're all about the relationship — both with our clients and with our team. In fact, the theme of our recent company meeting was *Building Connections*. This month's lead article, authored by Senior Partner Michael Grad, is about Servicing relationships.

Michael's article illustrates that, in the context of Transfer of Servicing, our focus is the successful transfer of the relationship of the borrower, not the loan. Michael discusses STRATMOR's standardized approach to planning, executing and managing bulk Transfers of Servicing (TOS), noting a poorly executed TOS can significantly reduce servicing value, as dissatisfied borrowers are less likely to do repeat business. Because customer retention is now a factor in determining MSR value, bulk TOS need to be planned and managed with the greatest of discipline. If your company's plans include a TOS, this article is a must read.

Next, we connect a few of the dots in our *Mortgage Metrics Matters* section with a comparison of loan originator compensation and sales support at Banks versus Independent lenders. I think you may find the differences startling, especially with the bps compensation paid originators.

In *Speaking Borrower Satisfaction*, the Topic of the Month looks at how borrower attributes affect borrower satisfaction. Three borrower attributes are considered this month: gender, age and credit score. I, for one, was both surprised and pleased by the results. An additional six borrower attributes will be addressed in the August and September issues of *Insights*.

My final encouragement this month on building relationships is a plug for our 2017 STRATMOR Originator Census Survey. The data from this survey is sought out by many lenders as it provides valuable insights into retail and consumer direct loan originator production, age, turnover and tenure information as compared to peers. The more you can understand and measure the key attributes of your sales force, the better you will be able to proactively manage them and this, more than anything else, will improve the franchise value of your company. This survey is now open for participation. If you are interested, please CLICK HERE.

We hope this issue of *Insights* helps you in building connections with your colleagues and customers,

Lisa Springer, CEO

STRATMOR
INSIGHTS

IN THIS ISSUE

July, 2017

TRANSFER OF SERVICING (TOS) – A BATTLE-TESTED METHODOLOGY

By Michael Grad

Servicing is earning its stripes.

For many years, mortgage servicing operations have played a secondary role to sales and production operations in the organizational hierarchy of most mortgage lenders. Recently, industry focus has shifted as more lenders appreciate how a superior servicing operation — one that maintains a strong borrower relationship and delivers high borrower satisfaction — can enable lenders to charge lower interest rates, even if increased borrower satisfaction is the result of higher servicing costs.

The economic opportunities inherent in a superior servicing operation raise the stakes on the transfer of servicing to new providers and systems. STRATMOR's experience strongly underscores the need for a standardized TOS process and methodology that is tightly controlled.

The Big Picture of Mortgage Servicing Operations

In recent years, some of the industry's focus and spotlight has shifted to mortgage servicing operations and cost containment for a variety of reasons, including:

- **Increased scrutiny of a handful of servicing operations and practices by both state and federal regulatory authorities** including the CFPB, the OCC and the FDIC. Much of this increased scrutiny was born of the foreclosure abuses on the part of servicers that occurred during the mortgage industry melt-down the latter part of the last decade. Additionally, the CFPB has held servicers to elevated expectations for servicing transfers to minimize the impact on borrowers who, it's fair to say, have virtually no voice in such transfers.
For example, at a recent MBA Servicing Conference, CFPB's former deputy director Steven Antonakes noted that:

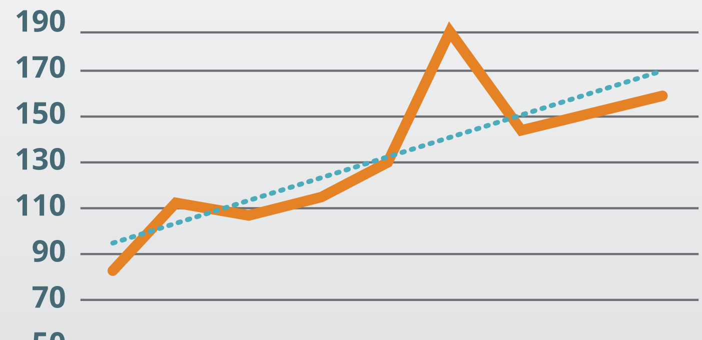
> [CFPB] will be paying "exceptionally close attention" to transfers ..." There will be no more shell games where the first servicer says the transfer ended all of its responsibility to consumers and the second servicer says it got a data dump missing critical documents."

Investors too, including the GSEs, provide additional oversight and requirements to servicers about financial soundness and operational performance. Indeed, investors can require the bulk transfer of servicing rights from the current servicer to another if the current servicer fails to meet financial strength requirements or otherwise performs poorly.

- **A dramatic increase in the direct unit cost of servicing a loan.** Partly a result of portfolio churning due to low interest rates but primarily a consequence of increased regulatory requirements and liabilities, e.g., TRID, unit servicing costs doubled from 2008 through 2016, resulting in material increases in loan prices. This is evident from the chart below in both the expense data (in orange) and the blue trend line.

Total Direct Servicing Expense ($/Loan)

MBA-STRATMOR Peer Group Roundtables Benchmarking Program
Lenders with Portfolio ≥$10B



	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Direct Servicing Expenses	83	114	109	117	134	192	147	155	163

MBA-STRATMOR Peer Group Roundtables Benchmarking Program (PGR) 2008 - 2016. ©STRATMOR Group, 2017.

- **Regulatory imbalances** between bank and non-bank servicers — some of which have been narrowed — have favored the accumulation of servicing rights by non-banks and the emergence of firms focused on investing capital in Mortgage Servicing Rights (MSR). Coupled with Basel III capital requirements, these imbalances have increased the size and frequency of bulk servicing transfers from bank to non-bank servicers.
- **Basel III capital requirements,** that have caused many banks to re-evaluate and, in most cases, reduce their accumulation of mortgage servicing rights. The Basel III rule limiting MSRs to 10 percent of a bank's common equity Tier 1 capital and requiring that MSR assets in excess of 10 percent be deducted from common equity have arguably reduced MSR assets on bank balance sheets from what they might otherwise be.
- **GSE fee parity across lenders and products,** which, since its introduction in 2009, has incented many smaller non-bank lenders to enter servicing and retain a portion of their originated MSRs. Before 2009, very large lenders were charged substantially lower GSE guarantee fees than what the GSEs charged smaller lenders.

The coupling of GSE fee parity with historically low interest rates made retention of servicing rights far more attractive to many mid-size and smaller lenders as a long term-strategy or a means to store economic value for a rainy day when higher rates returned and originations slowed. Typically, such new entrants would initially administer retained loans via sub-servicers both to speed their entry into servicing and to avoid up-front investments in servicing infrastructure.

Near-term, we expect an increase in bulk servicing transfers as some of these lenders bring their servicing in-house while others sell servicing rights both to realize market gains in portfolio value and offset potentially lower origination income because of higher interest rates.

While hardly a new insight, there is also greater recognition on the part of both lenders and regulators that borrowers ultimately bear the cost of servicing their loan. All other things being equal, higher unit servicing costs reduce the value of MSR assets and therefore production profit margins unless lenders charge higher mortgage interest rates (which they do).

In the October 2016 issue of STRATMOR Insights (click here to download), STRATMOR analyzed how customer retention affects the MSR value of servicing. While most analyses of MSR value are limited to the expected cash flows over the life of a single loan, STRATMOR's analysis of value calculates cash flows by considering the likelihood that the lender originates a new loan after the original loan pays-off., i.e. retains the customer.

STRATMOR's analysis showed that at customer retention rates of 50 to 75 percent — achievable for a superior performing lender — the economic value of an MSR could be 33 to 50 percent higher than its value calculated without regard to customer retention. For a conventional agency loan, this could

increase value by as much as 40 to 60 bps of the loan's principal balance, about $900 to $1,350 for a $225,000 conventional loan.

The implications for servicing transfers are:

- Customer retention can dramatically affect the economic value of an MSR and therefore the pricing of loans to borrowers.
- Borrower satisfaction with their current lender is a key driver of the likelihood that they will be retained by that lender for their next loan.
- While virtually all surveys of borrower satisfaction focus on the borrower's experience with the loan origination process, it is likely that a bad experience with the lender between loan boarding and payoff, i.e., a bad servicing experience, will sour the borrower and cause them to do their next loan elsewhere.
- Bulk transfers of servicing can establish whether both existing or new borrowers are favorably disposed towards doing repeat business with their lender. Indeed, in current markets, the target bulk-sale price sought by a seller will include customer retention assumptions for the buyer. Thus, if a bulk transfer of servicing is mismanaged, the value of the servicing will be decreased, possibly by a significant amount, and a buyer of servicing will likely wind up overpaying. For a lender transferring an existing owned servicing portfolio from a subservicer to an in-house platform or to a new subservicer, a mismanaged servicing transfer will have destroyed years of relationship value.

There is significant relationship value at stake when a large servicing portfolio is transferred from one platform to another. Given the points above and the current regulatory environment, leaders of servicing operations must establish a TOS process and methodology of transferring a borrower relationship in addition to the borrower's loan data. It is critical to assure that such transfers are expertly performed in all their complexity.

Stratmor's Bulk TOS Process and Methodology

STRATMOR's servicing experience strongly underscores the need for a standardized transfer of servicing (TOS) process and supporting methodology that is tightly controlled. Whether the business justification for a bulk TOS is the purchase of a servicing portfolio, bringing a subserviced portfolio in-house or moving a subserviced portfolio to a new subservicer, the planning, organization and execution of the TOS consists of similar functions. The same processes, analyses, work tasks and management practices and activities do not need to be reinvented. Adopting a battle-tested TOS process and methodology addresses the multitude of variables, including loan volume, loan types, investors, the internal resources of the servicing transferor and transferee, the desired borrower experience and regulatory commitments. With this latter thought in mind, the remainder of this In-Focus article presents the overview of battle-tested STRATMOR Transfer of Servicing Methodology.

In-Focus

TRANSFER OF SERVICING (TOS) — A BATTLE-TESTED METHODOLOGY

Process Overview

The chart below summarizes the STRATMOR TOS process in seven sequential stages and seven parallel work streams. All stages of the process are supported by cross-functional teams — typically seven to ten — staffed by team members of both the servicing transferor and transferee working in parallel under the overall guidance and direction of a transferee led PMO and supporting Transfer Command Center (TCC). On a daily basis, the PMO/TCC governs, guides, tracks, coordinates and integrates the efforts of the collective cross-functional teams. Critical to the TOS success is the disciplined and data-intensive planning and preparation. Central to a TOS launch is establishing a Program Management Office (PMO) and governance structure.

TOS PROJECT STAGES						
TOS Analysis & Design	TOS Solution Definition	Transfer Preparation & Development	Test Planning – Test Plans & Cases	Testing	Servicing Transfer Rollout	Post-Transfer Evaluation & Monitoring
PARALLEL WORK STREAMS (PMO)						
Servicing Operations						
Transfer Command Center						
Borrower Impact						
Finance						
Compliance/legal/risk						
IT Development						
User Acceptance						

TOS Analysis and Design

This up-front stage involves three key activities. First, conducting due diligence and discovery of both the transferor and transferee servicers to establish their current capabilities, strengths and weaknesses; in effect, to define the current operational state. Second, defining how the servicing transfer will be rolled out; how the total servicing portfolio will be broken down into discrete transfers plus the boarding of newly originated loans. Third, defining the scope, major tasks, timeline and key milestones of the TOS project along with identification of key implementation assumptions and risks. Borrower relationship touchpoints are also identified in this stage — points in the TOS process where borrowers will/may have communications with the servicer — along with any supporting IT components or supplemental work streams.

TOS Solution Definition

In this second stage, the transferee target state for the TOS and ongoing servicing operations is defined in terms of business requirements, including the data conversion approach and requirements for people, processes and technology. The differences, or gaps, between the current state and the transferee target state defines the requirements for development of a TOS Implementation workplan and roadmap, the major output of this stage.

Transfer Preparation and Development

Preparing for a servicing transfer involves the development of detailed written transfer instructions. These explicit instructions detail how the transferee servicing system should be configured to best receive the loan data, the specifications for both internal and external interfaces, training and staffing plans, Command Center protocols, and the routines and reporting for governing subsequent stages of the TOS.

Test Planning – Plans and Test Cases

Test plans and cases are critical to assuring a successful TOS. Consistent with the TOS design, the test plan will define the specific types of transfers to be tested, e.g., performing FNMA loans, what will be measured, including the borrower's experience, what the expected results are and how the resulting servicing data will be validated and accepted as proof that the transfer was successful. The test plan will also involve the development of a TOS dashboard for tracking the progress of actual transfers.

Testing

Testing involves both execution of tests with test data and trial conversions of actual loans. Testing also serves as a live training ground for end-user personnel, providing the basis for finalizing TOS policies and procedures, and allowing for final user acceptance and sign-off.

Servicing Transfer Rollout

Immediately following final user acceptance sign-off, the actual transfer of the servicing portfolio will start and rigorously follow the approved TOS methodology and workplan. Using the transfer dashboard, each transfer will be monitored by the Transfer Command Center.

Post-Transfer Evaluation and Monitoring

Post-transfer evaluation and monitoring is conducted and managed by the Transfer Command Center. Each transfer is monitored constantly with respect to such key metrics as borrower calls, payment errors and complaints. While these metrics develop over time for each transfer, early results may be indicative of systemic problems or work load assumptions that may call for additional metrics or fine tuning of both processes and the transfer schedule.

Upon completion of all transfers, a comprehensive post-transfer evaluation is conducted to assess the effectiveness of the total transfer on key performance metrics and with an eye towards (a) remediating any process problems in future transfers and (b), taking follow up actions that may be appropriate to mitigate potential relationship and reputational damage with those borrowers who experienced problems and filed complaints.

Assessing Success

STRATMOR's methodology for TOS projects pinpoints that success:

- Requires a top-down positioning of the borrower relationship value and TOS methodology (people, process and technology).
- Defines a shared understanding of the end-to-end TOS operational target state and IT architecture around which to fashion the solution and inform design and transfer decisions.
- Engages upstream and downstream functional areas, integrates critical borrower and internal hand-offs (sales, fulfillment, servicing, secondary, capital markets) and documents high level, end-to-end requirements.
- Performs the level of business process documentation, requirements definition and cultural/employee readiness necessary to deliver a solution that meets business needs.
- Coordinates work streams across multiple parallel and inter-dependent TOS functional teams via a robust program management capability and infrastructure.

At the end of the day, a TOS project using the STRATMOR TOS Methodology is a borrower centric, fact-based and disciplined servicing transfer as perceived by the transferor servicer, the transferee and, most importantly, the borrower.

From the borrower's perspective, a smooth transfer should result in no interruption of service during the boarding period, e.g., receipt of payments, payment of taxes and insurance, customer service, etc., or errors regarding monthly payment amounts — principal, interest and escrow amounts — that would prompt borrower inquiries and complaints.

A Thumbnail Case Study

STRATMOR's TOS Methodology for TOS was recently put to the test at a top-tier lender involved in the transfer of hundreds of thousands of loans from one subservicer to another. In this large bulk transfer, STRATMOR supported the lender's executive steering committee and day-to-day oversight of PMO and Command Center.

For every Key Performance Indicator, the results of this TOS project were outstanding, with all indicators exceeding the targets established early-on in the project. Most impressive, out of the hundreds of thousands of loans involved in the transfer, under 200 borrower complaints were registered, corresponding to an extraordinarily low complaint rate of less than one percent.

Lender KPI	Borrower Result
Borrower Communications	1+M borrower communications with < 1% error rate
Borrower Contacts	Approximately 150k calls handled, exceeding service level goals at 99%
Borrower Complaints	A <1% error complaint rate
Payment Processing	Approximately 500k payments processed with <1% error rate

LEARN MORE

For more information about STRATMOR's Transfer of Servicing (TOS) Consulting Services, contact Sr. Partner Michael Grad at michael.grad@stratmorgroup.com.

LOAN OFFICER MARKETING AND PROSPECTING

Determining compensation amounts and structure is fundamental to ensuring that your organization hires and retains the best talent while simultaneously controlling costs and justifying compensation to your stakeholders. This month's issue explores one aspect of loan officer compensation — the LO's marketing and prospecting activities.

About the Survey

Since 2010, STRATMOR Compensation Connection has been providing lenders with valuable insights into what mortgage lenders are paying for critical positions and how compensation is structured. This survey explores not only on what loan officers, processors, underwriters and key executives are being paid, but also analyzes their compensation structure.

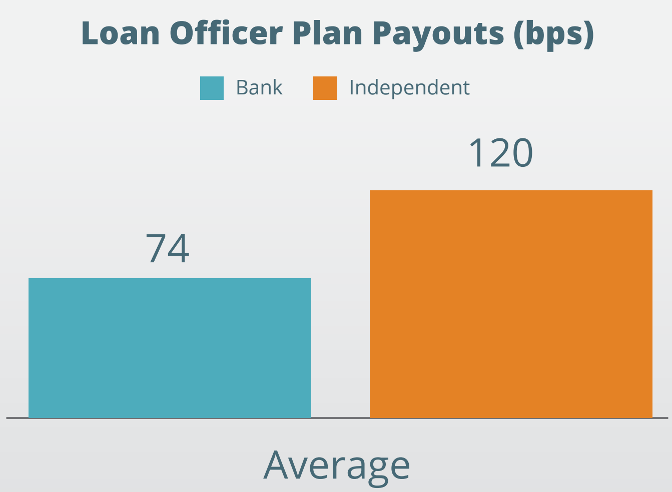
The survey is offered in modules to allow lenders to choose their level of participation:

- Executive Management
- Retail Sales (Head of Production to Loan Officers)
- Consumer Direct Sales
- Fulfillment (All Channels)
- Production Support

The following are select results from the survey.

Q **How many bps is an average Loan Officer paid?**

A **Based on the results of our latest study, the average Loan Officer was paid 101 bps on production in 2016. However, the results vary dramatically for Loan Officers at Bank Owned/Affiliated mortgage companies versus Independent mortgage companies.**

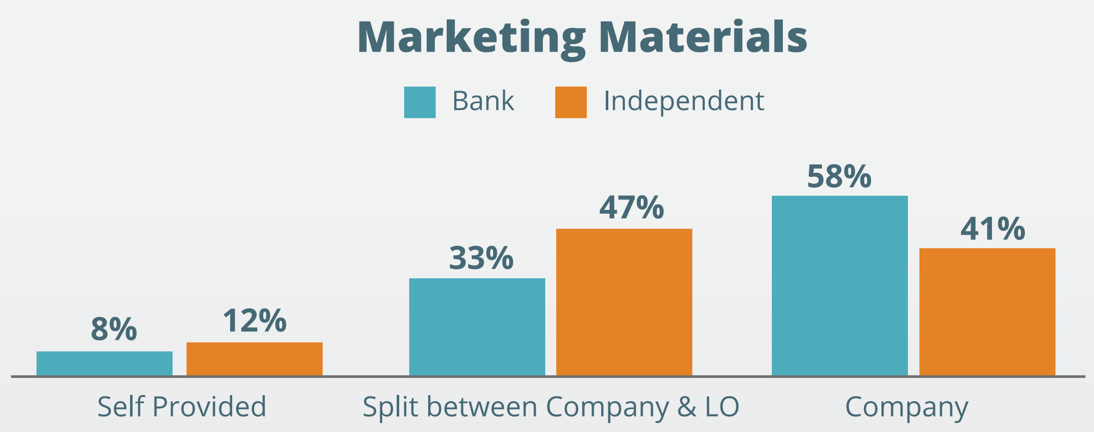


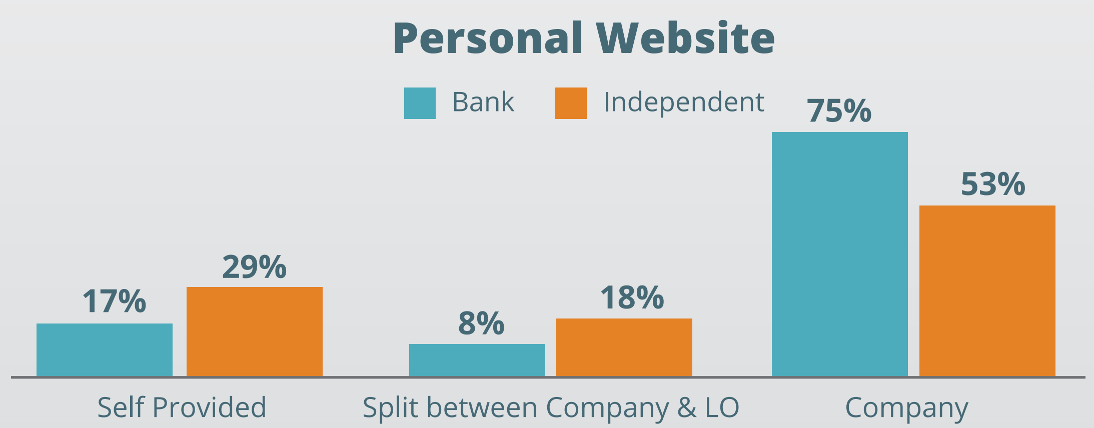
- The average for Bank Owned/Affiliated mortgage companies was 74 bps versus 120 bps for the Independents. This represents a gap of 46 bps, a result that is consistent with the results from past years.
- While Bank LOs averaged one less loan per month than Independent Originators, the lower payouts are not simply the result of lower productivity.
- Bank Owned/Affiliated companies provide their Loan Officers ("Gatherers") with brand recognition and referrals through their bank household base.
- The Independents require their Loan Officers ("Hunters") to self-source all of their business. In that light, we can think of the additional bps paid LOs by Independents as compensation for their marketing and prospecting efforts ("hunting").

Q **Do Banks provide different levels of sales support than Independents?**

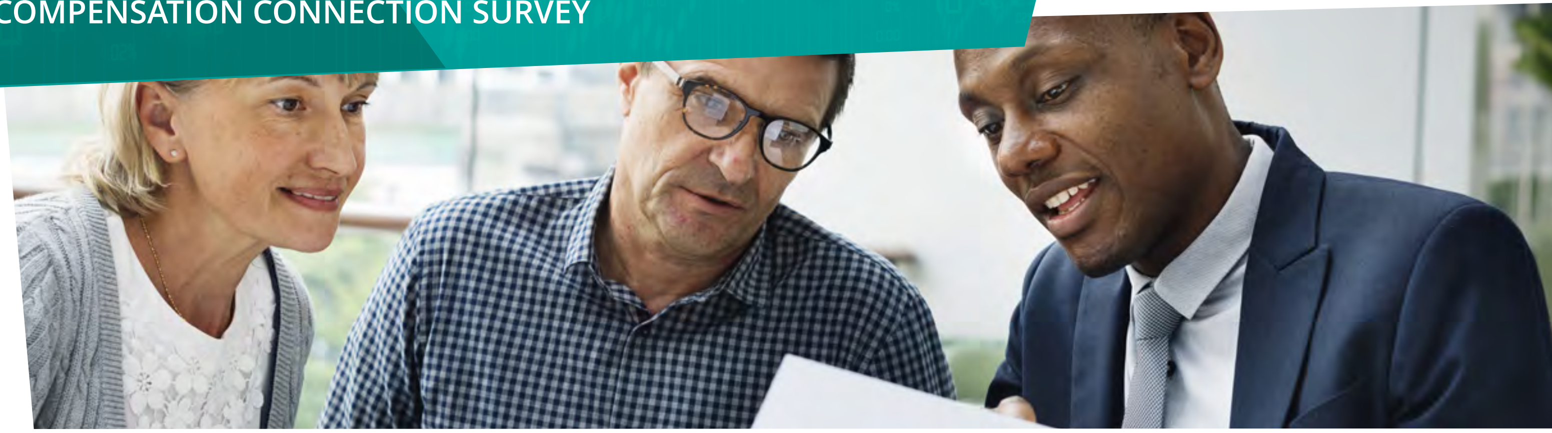
A **In this year's study, we asked lenders to report on the level of sales support that is provided to their Loan Officers. The survey asked whether Marketing materials, a personal website, CRM and outside sales training are provided and paid for by the LO, the company or split between the two.**

We see from the charts below that the Bank Owned/Affiliated mortgage companies are more likely than the Independents to full provide marketing materials and a personal websites to the Loan Officers.





STRATMOR Compensation Connection Survey, 2017. ©STRATMOR Group, 2017.



- Fifty-eight percent of the Bank Owned/Affiliated mortgage companies provide marketing materials to their Loan Officers versus only 41 percent of the Independents. Further, Independents are more likely to split the cost of marketing materials with the Loan Officer.
- The results are more pronounced for Loan Officer personal websites. Seventy-five percent of the Bank Owned/Affiliated mortgage companies fully provide this sales support tool to their Loan Officers.
- Just over half (53 percent) of the Independents cover the full cost of a Loan Officer personal website.

More Marketing Support Could Mean Less Commission

While not the primary driver in differences in compensation plan payouts, the greater marketing support provided by Banks to their LOs is certainly a factor in allowing them to pay lower commissions than the Independents. Providing these tools to their Loan Officers negates the need for the Loan Officer to pay for sales support tools.

PARTICIPATE IN THE SURVEY NOW

The Compensation Connection Survey is now open for participation. If you are interested in participating, click here.

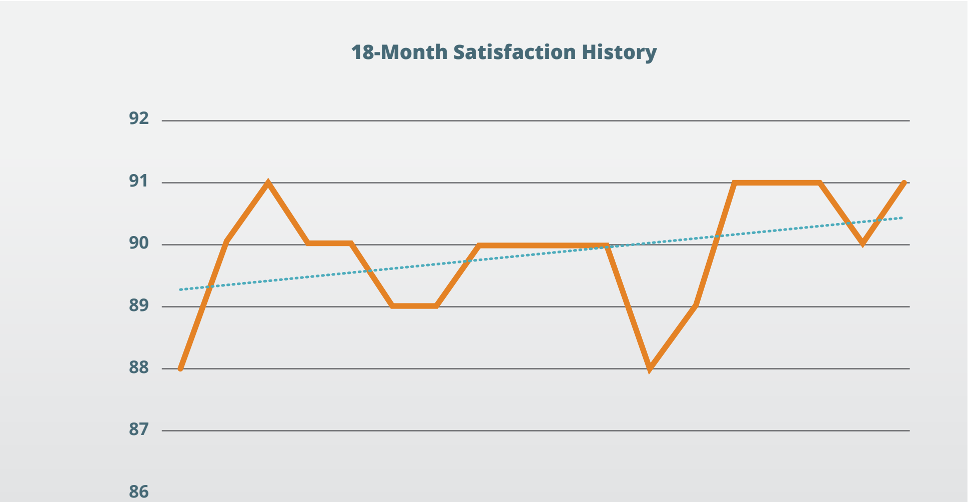
Speaking Borrower Satisfaction

OVERVIEW

Each month's edition of *STRATMOR Insights* includes a *Speaking Borrower Satisfaction* section containing a National Borrower Satisfaction Index plus a Topic of The Month based on data collected by STRATMOR's *MortgageSAT Borrower Satisfaction Program*.

National Borrower Satisfaction Index

For this July 2017 edition of STRATMOR Insights, the National Borrower Satisfaction Index chart below displays the Total Borrower Satisfaction Score for MortgageSAT participating lenders over an 18-month look-back period — formerly just a 12-month look back — starting the look-back with the June 2017 satisfaction score.



	Jan, 2016	Feb, 2016	Mar, 2016	Apr, 2016	May, 2016	Jun, 2016	July, 2016	Aug, 2016	Sept, 2016	Oct, 2016	Nov, 2016	Dec, 2016	Jan, 2017	Feb, 2017	Mar, 2017	Apr, 2017	May, 2017	Jun, 2017
Satisfaction	89	89	89	89	89	89	89	89	89	89	89	89	89	89	89	89	89	89

MortgageSAT, June 2017 ©STRATMOR Group, 2017.

Borrower Satisfaction Improves During Peak Volume

As we can see from the chart, the satisfaction score during the peak home purchase/finance months in 2016 (March through July) dropped from 91 in March to 89 in June. This fall-off reflects the increased volume — in particular, purchase volume — that must be handled by back office personnel during these months, resulting in more processing errors and delays.

However, except for May 2017, in which satisfaction dropped to 90, satisfaction for MortgageSAT lenders during the 2017 peak

Speaking Borrower Satisfaction

WHAT BORROWER ATTRIBUTES AFFECT SATISFACTION? —PART I

volume season has held up surprisingly well at a score of 91, despite a 28 percent increase in second quarter 2017 origination volume projected by the MBA in its May 2017 Mortgage Finance Forecast (including a 50 percent projected increase in purchase originations). And, as indicated by the dashed "trend-line," MortgageSAT lenders are steadily improving their average satisfaction score.

Making Borrower Satisfaction a Key Performance Metric

This suggests that when lenders make borrower satisfaction a key performance metric, service levels rise. Indeed, since MortgageSAT allows lenders to measure satisfaction by branch and back-office units, these units will begin to compete to achieve the highest satisfaction scores. Further, as Senior Partner Garth Graham discussed in his June *Insights* In-Focus featured article, "The Seven Commandments for Achieving Borrower Satisfaction," there are common sense origination practices to significantly improve borrower satisfaction — practices that are well-understood by MortgageSAT lenders.

TOPIC OF THE MONTH — WHAT BORROWER ATTRIBUTES AFFECT SATISFACTION? — PART I

We've all probably heard opinions expressed that borrower attributes — such as gender, age, income and credit (FICO) score — play a role in how a borrower is treated. To the extent that such opinions have systemic validity, we might therefore expect borrower satisfaction to vary significantly across borrower attributes. But to be fair, such variations may also reflect different expectations on the part of different segments of borrowers; for example, that wealthier borrowers expect better service. Fortunately, MortgageSAT results allow us to look at borrower satisfaction both in absolute terms and relative to expectations.

This month's Topic of the Month is the first of a three-part series that considers satisfaction versus various borrower attributes. This month: satisfaction versus gender, age and credit (FICO) score.

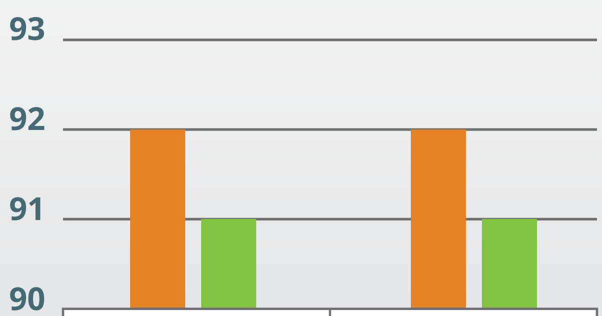
Speaking Borrower Satisfaction

WHAT BORROWER ATTRIBUTES AFFECT SATISFACTION? —PART I

Q **Do men and women experience different satisfaction regarding their mortgage origination experience?**

A **No! Based on roughly 48,000 survey responses covering 2017 YTD, men and women report virtually identical overall satisfaction (92). Similarly, their satisfaction compared to expectations (91) is also identical. Note that satisfaction compared to expectations is lower than the overall satisfaction score, indicating that although overall satisfaction was relatively high, it fell slightly short of expectations.**

Satisfaction vs. Gender



	Male	Female
Overall satisfaction	92	92
Compared to expectations	91	91

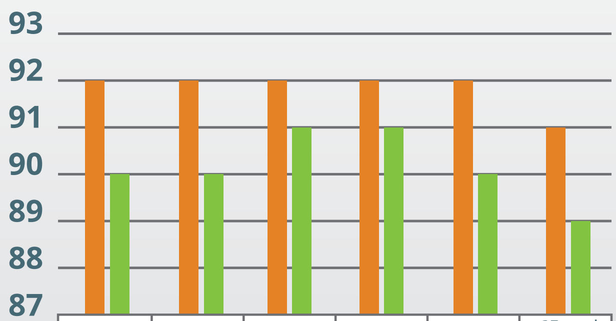
Speaking Borrower Satisfaction

WHAT BORROWER ATTRIBUTES AFFECT SATISFACTION? —PART I

Q: Does satisfaction vary with age?

A: No, except slightly for borrowers over 65. Younger age segments reported identical overall satisfaction scores of 92 compared to 91 for the 65 and older segment.

Satisfaction vs. Age



	18-24	25-34	35-44	45-54	55-64	65 and older
Overall satisfaction	92	92	92	92	92	91
Compared to expectations	90	90	91	91	90	89

Speaking Borrower Satisfaction

WHAT BORROWER ATTRIBUTES AFFECT SATISFACTION? —PART I

Q

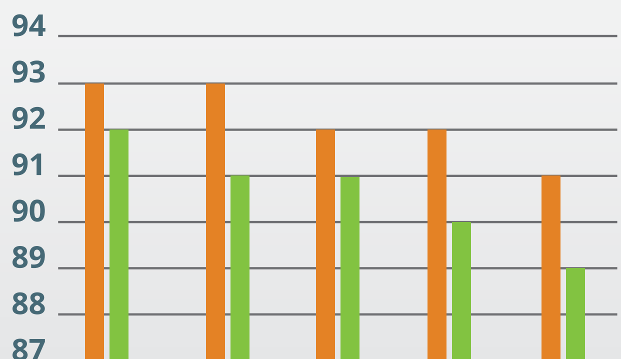
Q: Does satisfaction vary with credit (FICO) score?

A

Slightly. Borrowers with FICO scores equal to or less than 680 reported overall satisfaction of 93 compared to 92 for borrowers with FICO scores of 681 to 760 and 91 for borrowers with a FICO score greater than 760.

While other borrower attributes need to be considered (and will be in future *Insights* Issues), the above results suggest that mortgage lenders treat all borrowers much the same, resulting in borrower satisfaction scores that do not vary materially based on borrower attributes. One must keep in mind, however, that MortgageSAT results consider only those borrowers whose loans have closed. Borrowers who withdrew their application because they felt mistreated or were unhappy with the service they received are not reflected in the results.

Satisfaction vs. Credit Score



	620 or less	621-680	681-720	721-760	Greater than 760
Overall satisfaction	93	93	92	92	91
Compared to expectations	92	91	91	90	89

MortgageSAT, June 2017 ©STRATMOR Group, 2017.

If you are interested in learning more about STRATMOR's *MortgageSAT Borrower Satisfaction Program*, click here. Or reach out directly to Mike Seminari, Director of MortgageSAT, at 614.284.4030 or mike.seminari@stratmorgroup.com

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