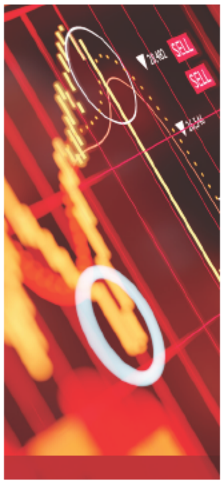
The Case for an Independent COVID-19 Servicing Review



Servicing of consumer finance loans has been an "in-person" activity historically, with the ability to physically wave a hand or raise a flag and have a supervisor walk over to assist with a particularly nettlesome customer issue. Moreover, handoffs between different servicing groups—particularly bankruptcy, collections, and collateral recovery (foreclosure/repossessions)—have always been an area for heightened risk and often the root cause for operational and compliance breakdowns.

But this risk was mitigated when a member of the other department shared some physical proximity. Therefore, there is an increased likelihood for operations that have worked well to not perform at the same level now, especially considering new CARES Act and state law requirements.

Many banks and finance companies moved to a virtual work-from-home regime in mid-March, which as of this writing has extended for more than a third of the year. Moreover, with COVID-19 cases well above where daily rates were tracking when the initial March/April closures went into effect, remote work could continue into 2021. Some servicers have indicated that more than of 90 percent of their workforces are still remote, and many banks do not expect employees to return to offices until sometime in the winter or even next year.

Remote work will naturally cause inherent operational risk to increase measurably, which coupled with the new regulations could be exponential. Thus, consumer finance entities would be well advised to perform enhanced operational due diligence to determine if processing breaks are arising from the current work-from-home environment, which was overlaid with new compliance requirements covering a range of activities, including:

- forbearance
- fee and penalty waivers
- other loss-mitigation activities
- credit reporting
- foreclosure moratoriums
- eviction moratoriums

These new regulations were stood-up in record time from a remote setting, at a point in the cycle where servicing staff-load levels were at a natural trough. Servicing teams performed heroically by working around the clock for weeks to help ensure that institutions were compliant.

Now that the reality of an extended stay-at-home situation is settling in, it would be prudent to examine whether what was built is working as intended and can function in a robust manner over an extended period. Even though there were no major process breaks in the first few months, certain metrics may be flashing warning signs. Therefore, interim protocols that were designed for a stay-at-home period initially thought to be six to nine weeks may not be sustainable for another six to nine months.

Although an institution's second-line-of-defense compliance group and third-line-of-defense internal audit groups normally would be tasked with assessing the robustness of this new operating environment, there are some key reasons why they may not be best for the current COVID-19 situation.

One key factor is that the practically overnight mobilization effort and lower point-in-cycle staffing levels required many companies to deploy individuals from the second and third lines to assist in standing up these new processes. Therefore, these individuals may not be the best placed to review and assess the new operation, since they were involved in its creation.

Another reason for looking to an outside vendor to assist in reviewing the current state is to benefit from their informal benchmarking of your operations to other similar companies. Since vendors are performing other reviews, they will know where to look for problem areas and can point out where your operations exceed peers or where there is room for improvement.

Likewise, testing remote operations is not as straightforward as having an internal on-site review. Vendors who routinely perform servicer due diligence or outsourced loan testing have key competencies related to conducting reviews from afar. They can deploy:

- off-the-shelf checklists
- testing platforms
- analytics and other review tools that will give an institution a more comprehensive view into its current state environment

This experience and know-how should be leveraged. A vendor will be able to dig deeper quicker to uncover key risk areas.

Although federal regulators have generally been more lenient in recent examinations and enforcement activities, there is no guarantee that this situation will continue. Servicers should recall how the 2008 financial crisis gave rise to the Independent Foreclosure Reviews. Since this is an election year, a less "servicer-friendly" administration could be in place in fewer than six months. Similarly, states will have massive budget holes and will look to find revenue from every available source. Financial institutions have always been an easy target for fines and penalties.

The current environment is hard enough and filled with constant daily challenges; the last thing a financial institution wants is to be positioned as a poster child for poor implementation of the CARES Act. Therefore, institutions should proactively look to mitigate this potential reputational and compliance risk by assessing more fully and objectively what is in place currently and determine whether it is sufficiently robust to continue for another six to nine months of additional remote work. So, just like with the actual disease, an ounce of prevention is worth well more than a pound of cure when it comes to COVID-19 servicing!

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