

Financial Services

Subservicer Oversight in 2021

Are you prepared?



2020 was a volatile year that saw financial institutions in the consumer and commercial lending space exposed to significant operational risk. This risk was multiplied for the financial institutions that relied on third-party subservicers, as these firms had to consider not only their own risk profile but that of the third parties servicing their portfolio and engaging with their borrowers.

Financial institutions had to manage through a global pandemic that caused high unemployment and a stock market crash, followed by fluctuating rates, new regulations, growing cyber-risk exposure, and historic economic recovery requirements.

These events brought several challenges to third-party oversight teams, especially maintaining the ability to conduct business in the manner they were accustomed. Many financial institutions struggled with:



Inability to conduct onsite assessments.



Adapting to remote oversight model.



Obtaining necessary data and documentation needed to perform oversight activities .

While financial institutions may have been inclined to deprioritize third-party oversight in the face of the business disruption observed in 2020, it is vital that financial institutions in 2021 remain vigilant in their oversight responsibilities. With many Americans still economically burdened, cyber threats on the rise, new regulations coming from the Coronavirus Aid, Relief, and Economic Security Act, and new Consumer Financial Protection Bureau leadership, third-party oversight will be a key issue for regulators to focus on in 2021!

In this article we'll explore key risks facing third-party oversight teams in 2021, and some mitigation strategies to help prepare you to appropriately manage risk in this evolving landscape.

1. CFPB Blog; The Bureau is taking much-needed action to protect consumers, particularly the most economically vulnerable, David Uejio, January 28, 2021

Subservicer Oversight: Key Risks



COVID-19-Related Loss Mitigation Activities

As the COVID-19 pandemic continues to put strain on the US economy, third-party servicers will feel the downstream impacts. This pressure is seen clearly in the mortgage subservicing market, where the economic effects of the pandemic have resulted in millions of borrowers taking up forbearance in 2020, putting immense pressure on third-party subservicers.

To consider: In July, these subservicers will need to begin taking action to support their borrowers as they begin rolling off their forbearance plans and foreclosure moratoriums are lifted. Systems will need to be adapted and staff will need to be hired and trained to cope with the anticipated volume of borrowers needing loss mitigation options as they plan how to become current again.



Capacity

Third-party servicers are experiencing capacity issues as a result of:

1. Customer Call Volumes—as customers navigate difficult life situations.
2. Remote Work Environment—requiring operations and technology enhancements to support the mobile work structure.
3. Regulatory Changes—a slew of new requirements coming in and requiring time-consuming system enhancements.
4. Elevated Delinquency Volumes—requiring outreach on forbearance options, credit reporting adjustments, and fee waiver conversations.

To consider: These capacity pressures are expected to remain elevated through 2021 and should be a top priority for oversight groups as these constraints often increase regulatory risk as compliance obligations are deprioritized in lieu of front-end business requirements.



Business Disruption

The post-COVID operating environment has strained third-party service providers' technology infrastructure due to the increased reliance on mobile and remote systems. As a result, there is heightened risk for business disruption, cybersecurity breaches, and compromised data that elevates the financial and reputational risk of the financial institution contracting with them.

To consider: Oversight teams should be mindful of these factors when assessing the risk and impact of a potential business disruption:

1. Does the third-party subservicer perform a critical function on your behalf?
2. Does the third-party subservicer have an appropriate contingency plan in place?
3. Does the third-party subservicer have adequate staff in place to support the changing business needs?
4. Does the third-party subservicer have the necessary policies, procedures, and training materials available to employees, specifically on high risk areas such as IT security and Business Continuity/Disaster Recovery responsibilities?
5. Does the third-party subservicer have offshore operations?
 - Rapid changes to global working conditions may require companies to quickly shift functions to onshore resources.

Subservicer Oversight: Mitigation Strategies



Technology & Automation

1. Review automation tools and logic.
2. Review change management and development operations.
3. Analyze the timeline for implementing and testing regulatory changes to automation code.
4. Evaluate manual processes that run the risk of experiencing increased error volumes, and monitor the subservicers' remediation plans (automated controls and/or capacity building).



Metrics

Monitor subservicer operational metrics, including but not limited to:

1. Average speed to answer.
2. Abandonment rate.
3. Number of calls answered.
4. Average satisfaction rating.
5. Number of loans in foreclosure per employee.

Identify negative trends in metrics and act quickly to have the subservicer implement corrective action plans before significant processing errors occur.



Ongoing Monitoring

1. Increase the frequency and sample sizes of quality-control reviews performed, especially for a third-party subservicer with manual controls and automated control logic.
2. Adjust test plans to ensure there is a diligent review of compliance with all (old and new) regulatory obligations.
3. Escalate exceptions in test results and any audit findings to support quick remediation action.
4. Perform ongoing risk-assessment for critical third parties.
5. Continue to review Service Level Agreements and update contractual obligations as deemed necessary.



Operations

1. Review the third-party subservicers' capacity in high-volume areas where there is increased risk for operational errors.
2. Review internal capacity to ensure it's sufficient to perform thorough audits and compliance control testing.
3. Confirm the third party has adequate policies, procedures, and training resources in place for employees. Especially for those performing critical business processes.
4. Review the third-parties' Business Continuity and Disaster Recovery plans, in addition to your own, for effective recovery time objectives and remediation plans.







How Guidehouse Can Help

With heightened regulatory oversight, numerous regulations to adhere to, and a multitude of business stressors, it is prudent that third-party subservicer oversight be prioritized in 2021. Measures should be put in place to ensure risks are mitigated swiftly.

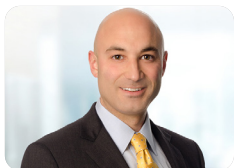
Guidehouse is actively working with industry leaders to mitigate these risks now. We are conducting assessments, documentation reviews, and leveraging new automated testing for COVID loss mitigation and other operational metrics.

As you prepare to navigate this complex subservicer oversight landscape, whether it is in preparing for forbearance exits, refreshing your business continuity plan, or conducting testing to assess your subservicers' risks and controls, we at Guidehouse are here to help.

We have helped financial institutions drive the effectiveness of subservicer oversight across a wide range of functions including:

	Third-Party Oversight Assessments: Perform in-depth third-party subservicer oversight assessments, including documentation reviews, risk assessments, and testing.
	Portfolio Reviews: Perform an assessment of the portfolio to analyze processes, determine any areas of exposure, and reduce risk.
	IT Due Diligence: Perform an assessment of the IT infrastructure in place to identify and help close any gaps that your third-party subservicer may be exposed to.
	Policy and Procedure Analysis: Define and document processes that will support operations and identify risk, decreasing exposure for the company and their third-party subservicers.
	Business Continuity Planning: Review and assess business continuity programs to ensure there is adequate planning in the event of a disaster.
	Control Reviews: Perform a review of all controls in place, plus current and upcoming regulatory changes, to ensure compliance with applicable rules and regulations.

Authors



Christopher Sicuranza
Partner and Head of the Banking,
Insurance & Capital Markets Practice
csicuranza@guidehouse.com



Mark Tuggle
Director
Financial Services
mark.tuggle@guidehouse.com



Patrick DellaValle
Director
Financial Services
patrick.dellavalle@guidehouse.com



Eleanor Gass
Senior Consultant
Financial Services
egass@guidehouse.com

 guidehouse.com/financialservices

 linkedin.com/showcase/guidehouse-financial-services

 twitter.com/GuidehouseFSAC

About Guidehouse

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