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RENEWALS AND RETENTIONS

Mortgage Lenders Focus on Plugging the Leaks

ISG

INTRODUCTION

A changing economic landscape is driving mortgage lenders to reassess their business strategies. With the writing of a large volume of quality new loans becoming an increasing challenge, lenders are placing more emphasis on reducing attrition of their existing portfolio.

This shift in priorities is driving significant changes in sales and operational strategies. Specifically, top performers are differentiating customer treatment throughout the mortgage sales cycle, and exploring the potential to rebalance the internal and outsourced shares of processing and servicing.

This white paper examines how mortgage lenders are refining their sales and operational improvement strategies with respect to mortgage renewals and retentions.

A SLOW-FILLING BATHTUB

Traditionally, lenders have relied on high new inflows to meet their Mortgages under Administration (MuA) targets. As a result, they've had little motivation to manage leakage of servicing revenues and lost units. Today, with new purchase volumes showing slower rates of growth and net re-financings declining dramatically, the "bathtub" of mortgage assets isn't filling so quickly.

In this low-growth environment, banks must develop a more clearly defined and aggressive approach to retain valued customers and thereby reduce the attrition or outflow rate of MuA.

This strategic shift is manifest at a high level in executives' re-apportioning the shares of target MuA growth generated, reducing that generated by acquisition on the one hand, and increasing the share from improved retention on the other. A renewal rate increase of 160 bps at end-of-term (EoT) could have a $1 billion MuA impact. Coupled with improved retention processes, the cumulative impact could be upwards of 7 percent of acquisition costs.

ATTRITION DRIVERS AND IMPACT

Generally speaking, high rates of portfolio attrition reflect the combination of a strategy that treats all customers the same, coupled with inadequate operational processes. More specifically, the impact of these two factors on attrition can be understood through an analysis of drivers that include:

1. Channel of Origin.
2. Initial On-boarding.
3. Mortgage Type.
4. Customer Rate.
5. Product Features and Benefits.
6. Operational Capacity & Alignment with Renewal Demand.

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KNOW YOUR CUSTOMER

The importance of the adage, "know your customer," is particularly appropriate to portfolio attrition. While business introduced through a third party broker or financial advisor provides an institution with "new to group" home-buying customers, sourcing through this channel of origin has its risks. If systems and process don't properly align offers with opportunity (informed by account transactions and mortgage renewal history), value may be unnecessarily lost.

With generally diminishing customer loyalty, the need to anchor the relationship immediately upon completion is also important. The on-boarding process needs to be transparent across channel by all sales roles, and should include system flags that identify gaps or instances of disputed client relationships, as clarity on who ultimately "owns" the client is vital.

Delays or defective procedures at this stage have lasting consequences – among them missed cross-sells during the critical 30-day post-completion window of opportunity, where research shows new customers have a greater propensity to consider additional financial services.

Certain customer segments are particularly price- and time-sensitive, while others are less so. Fixed-rate customers across a broad term spectrum, unsurprisingly, are less likely to defect than variable rate customers. However, as maturity approaches, customers who have secured a notably aggressive rate will include a subset of rate shoppers, especially if the relationship is limited to the one product. Proactively identifying these customers is imperative, to ensure that escalations and additional price incentives are invested in the right relationships with true long-term potential. Similarly, if those capabilities aren't in place, the renewal process may involve arduous delays and pricing escalations, resulting in a negative experience for a customer the bank wishes to retain.

Other mortgage customers require certain product features such as offsets, payment flexibility, or a combination of different home equity lines of credit. These segments should be identified and flagged by payment history and linkage of accounts. Current information on product features, benefits, and competitive positioning can re-position renewal conversations away from solely a price focus.

As competitive pressures shrink mortgage margins, many lenders are pressed to accurately assess attrition risk and the prepayment component of Mortgages under Administration.

Adequate servicing capacity and alignment, including clear delineation of responsibilities, is essential. Otherwise, competitive renewal offers may be missed by agents who circumvent customer files and cherry-pick large deals from the at-renewal maturity schedule. To address this problem, portfolio managers need to ensure agent availability as well as a balance between agent target units and value of mortgage files/business retained. Retention and renewal targets should therefore include percentages of EoT portfolio rather than just a dollar value.

As competitive pressures shrink mortgage margins, many lenders are pressed to accurately assess attrition risk and the prepayment component of MuA. Miscalculating attrition has a negative impact on an offering's actual profitability, in terms of reduced interest income as well as higher cost to acquire replacement business, as the unit cost differential to acquire new business compared to retaining existing business is typically over 25 percent.

Executives should review the end-to-end mortgage value chain and evaluate how their processes affect the risk of attrition.

REDUCING PORTFOLIO ATTRITION

At renewal, many institutions are still treating all customers the same, regardless of relationship history. While regulatory constraints narrow an institution's options, some points of differentiation and areas of flexibility still exist. Executives should review the end-to-end mortgage value chain and evaluate how their processes affect the risk of attrition.

Another consideration is whether the sales targeting process favors third-party introduced (TPI) business, and if so, whether procedures and policies are in place to counter the risk of these loans leaking away at renewal. The importance of clarity around customer ownership, discussed earlier, is relevant here.

Portfolio attrition rates can be improved through marketing and sales collaboration aimed at developing powerful analytical tools. Top-quartile performers in retention typically conduct regular reviews of internal attrition models to ensure that at least 70 percent of portfolio flows can be satisfactorily accounted for. Specialized modeling software and specific techniques can support these efforts.

A "national attrition model" can prioritize new-to-group loans and combine this segment with mortgage, bank, and demographic data such as, for example, large dollar amounts outstanding, low LTV, extended amortization period, variable rate, no loan accounts with the FI, and urban singles. In addition, the model can overlay value potential based on prior experience.

The attrition model also helps a lender identify and segment different categories of customers, and pursue them accordingly. Banks need to differentiate their customer treatment throughout the mortgage lifecycle to reflect known attrition drivers such as acquisition channel, previous renewal history, and key relationship factors. This allows for a more nuanced matching of value of the customer relationship to the bank's initial renewal/retention offer. For example, new-to-group customers – first-time buyers in particular or first-time renewers – should receive personalized service by experienced branch staff for their first renewal, rather than a perfunctory call from the phone channel. Less-valued customers (rate shoppers who are serial revolvers at renewal) should receive less attractive offers and less attention.

From a process perspective, effective management and reporting of renewals documentation (including metrics around mailings, returns, follow-ups, and contacts) is proven to reduce attrition rates.

Similarly, renewal calling programs should be segmented. Rather than contacting all customers at 120 days, agents' customer connect plans should prioritize the most "at risk" elements of the portfolio.

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Today, few retail banks are sufficiently discriminatory, either in initial renewal offers or in the escalation process. Where rate escalations show more than 65 percent approval, the considerable management effort that is likely being tied up unnecessarily can be systematized. Delays resulting from cumbersome manual escalations also detract from the customer experience and allow many valued customers to slip away. Similarly, renewing customers can be encouraged into "stickier" products by differentiating pricing between, for example, VR open and VR closed to favor the latter.

Another potential issue is increased churn as the unintended consequence of an over-emphasis on the sales component of MuA. Prompting for re-finances at renewal results in loans that may have a lower margin than the existing business.

Clearly defined targets and incentives for different sales channels with correct unit and value weighting/ contribution for specific products is therefore critical, as is sufficient visibility to monitor activity by file/customer across channels. Otherwise branch, phone, and third-party/ specialist agent channels can end up competing for the same mortgage customer, resulting in inefficiency and, often, negative customer experiences.

Alerts should be built in to management information systems, with minimum amounts set considerably higher than HELOC thresholds. In addition, relative shares and average values of each should be product-tracked per agent.

Retail bank strategies focused on higher retention profiles also raise a series of operational implications; specifically, the impact of growing volumes of refinancing transactions on total back office workload and productivity. Executive management's focus on the level of mortgage funds under administration can lead to an underestimation of the additional effort required to process discharges relating to re-refinances. MuA should be considered in the context of unit growth and profitability.

The "new normal" of doing more with less, in the context of the current mortgage market, creates an imperative for operational improvement. ISG analyses of back office servicing operations (that include Renewals and Retentions process modeling) in the Retail Banking sector consistently identify significant opportunities to improve efficiency and profitability and reduce cycle times.

Optimizing renewals and retentions processes has traditionally been a low priority among retail banks. But in today's environment, neglecting it is a luxury that banks can no longer afford.

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