Yield Book Mortgage Research

Responsible Servicing behavior metrics and scores: Loan churn

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Responsible behavior in a servicing context is the practice of extending fair and reasonable terms to borrowers throughout the life of the loan in the regular servicing processes; to facilitate the measurement of and highlight the extent of potentially predatory practices within a deal or market segment, quantitative-based metrics have been developed.

Loans issued and then passed to the three different Government Sponsored Enterprises (GSEs) (GNMA, FNMA, and FHLMC) have been considered as separate universes, due to the different eligibility requirements. In this research, we focus on loans originated after the Great Financial Crisis (GFC) within the Ginnie Mae universe.

Overview of Methodology

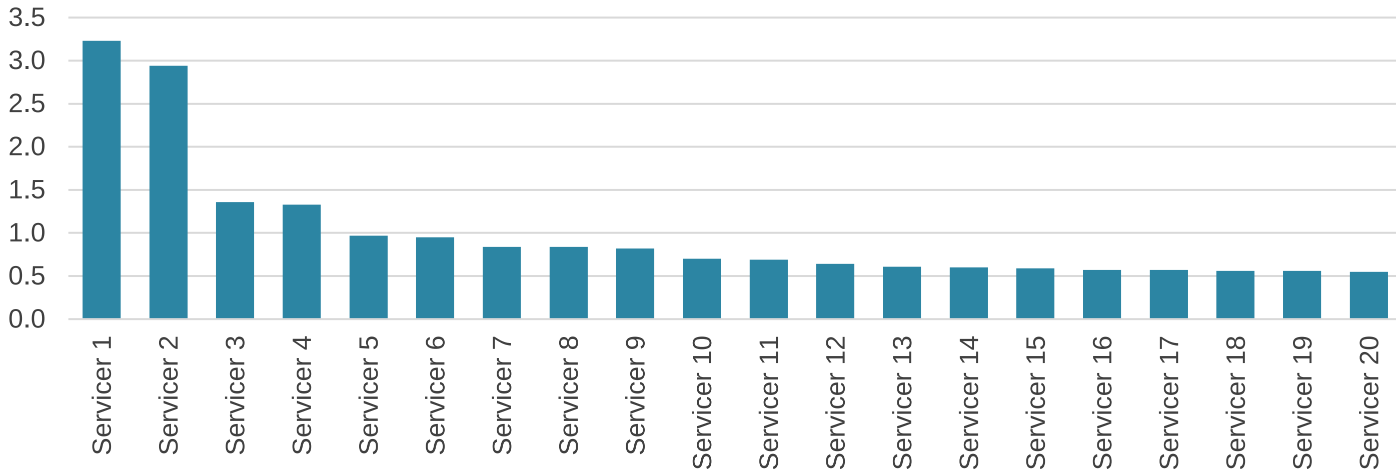
Refinancing is an important tool for borrowers to maintain control over long-term debt, and the charging of fees by the servicer for administrative processes is standard and justly applied. However, loan churn is understood to be the process of encouraging borrowers to refinance repeatedly in a short time frame since the origination of their loan with little benefit to the borrower, with the servicer benefiting from these administrative fees at each refinance – this forms one of the metrics within the Responsible Servicing theme of Yield Book's ESG Framework.

Servicers engaging in these practices have been detected through monthly analysis of servicing activity within the Ginnie Mae universe over 2016 to 2018, covering some 4 million individual loans, with some interesting cases emerging. We observe those servicers displaying high proportions of recently-issued loans refinancing within a short time span, across their entire serviced universe. While market conditions are of course a key reason that refinancing may be particularly high in any particular month, we can observe relative behavior between peers, and find outliers.

Results

Figure 1 shows the average rates of refinancing for 200,000 young loans across 2016-2018, showing large deviations in expected rates per servicer.

Figure 1. Young loan refinancing rates per servicer over 2016-2018

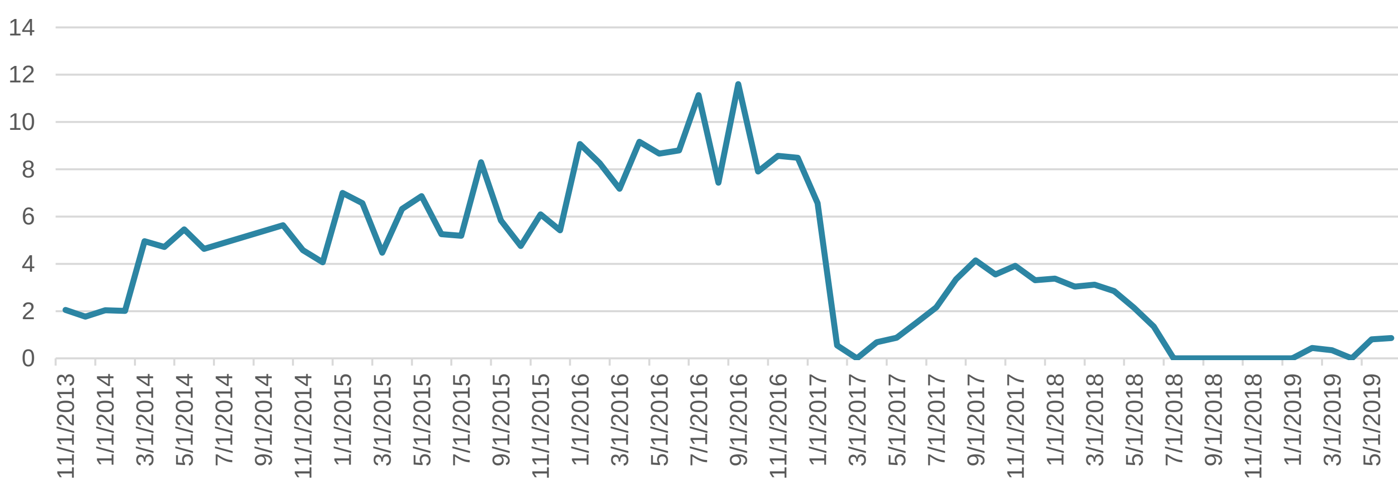


Source: Yield Book

To explore this behavior in depth, we analyzed behavior month by month per servicer, with some interesting cases emerging.

NewDay Financial was observed to maintain high relative rates of refinancing of young loans throughout 2016-2018, peaking in September 2016. This behavior was detected by Ginnie Mae in late 2017, ultimately leading to their expulsion from their Veteran Affairs (VA) programs alongside Nations Lending. Although rates started decreasing to 2 or 3% by mid-2018, the servicer remained in the top 20 rates for many following months.

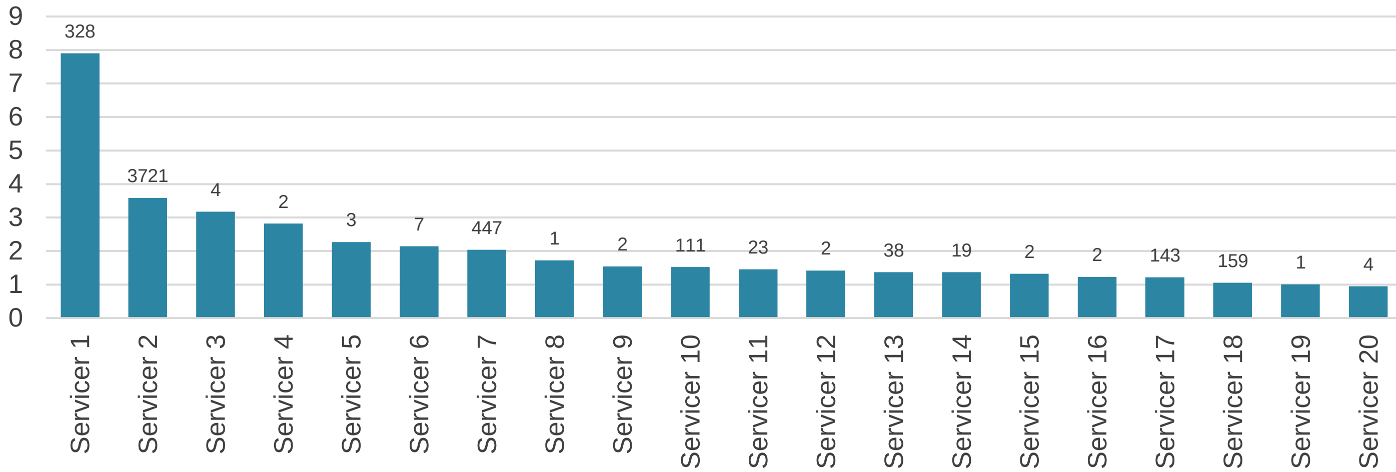
Figure 2. Monthly young loan refinancing rates for NewDay Financial



Source: Yield Book

Also part of this behavior is Freedom Home Mortgage Corp, occurring from late 2016 to early 2017. While dwarfed by the rate from NewDay Financial, we observe a high rate and number of young refinanced loans relative to the market, signaling potential behavior issues.

Figure 3. Servicers with 20 highest refinancing rates of young loans in October 2016



Source: Yield Book

Conclusion

Loan churn – as a recognized indicator of irresponsible and potentially predatory behavior – has been observed in various contexts and verified by known historical events and actions taken by Ginnie Mae. While supervisory regimes have been tightened since for VA programmes, the approach outlined above can be extended to behaviors under other GSEs and other programmes within Ginnie Mae too, and can help detect these issues in a timely manner.

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