Fairbanks' Problems Could Reshape MBS, Fitch Says

The fallout from problems at one of the subprime market's largest servicers, Fairbanks Capital Corp., could be significant, analysts at rating agency Fitch have warned.

In fact, in a recent teleconference, the rating agency said that servicers should expect the cost of doing business to rise considerably while loss severities on securitized pools of subprime mortgages could notch upward.

"It's an industry-wide problem," said Diane Pendley, a managing director at Fitch during the June 23 teleconference, which focused on the rating agency's recent downgrade of Fairbanks' servicer rating.

The subprime market's third largest servicer with a portfolio that totaled $41.02 billion at the end of March, Fairbanks has been in the spotlight recently because of allegations that it mismanaged borrower payments, charged bogus fees, and acted too aggressively in collecting and foreclosing on delinquent loans.

A new management team at Fairbanks has promised to implement changes that will make the company more responsive to borrowers and less focused on aggressive loss mitigation techniques – including a "dual tracking" strategy in which foreclosure proceedings are started at an early stage of delinquency even as workouts are being explored.

Pendley believes that Fairbanks' problems mark a paradigm shift for servicers, which are likely to find their business practices under increased scrutiny in the months ahead.

"Any servicer that worked under that type of system is at risk to have those kinds of problems in their portfolio, if they have not taken the time and the effort to research their procedures, change them to have a consumer slant and they are not addressing disputes as a priority," she warned.

In practice, that's likely to mean that servicers will have to make big changes in their customer service policies, adding more staff and technology to monitor and record phone calls, increasing the amount of time that is spent talking to borrowers, and stepping up training around customer service issues. While necessary, those changes will increase the cost of servicing, Pendley said.

But the more marked impact could come on the MBS front. One of the key changes that Fairbanks has made is to move back - from the current 62nd day to the 87th day of delinquency – the point at which loans are referred to foreclosure. Fairbanks is also implementing a foreclosure review process, which is expected to add 1 to 3 days to the process.

Those changes, which are likely to take place at other servicers as well, could have a measurable impact on future securitization deals.

"We have to factor in that the landscape has changed and timelines may extend across the board.

Feds Probe ABFS's Servicing

The Department of Justice has issued subpoenas for the files of certain loans made by American Business Financial Services.

In a filing with the Securities and Exchange Commission, the Bala Cynwyd, PA, based lender said it is cooperating with a DOJ probe into its loss mitigation practices.

The DOJ investigation marks the second time this year that the issue of forbearance has shown up on the radar screen of federal regulators. In March, the SEC announced a settlement with Household International. The agency charged that Household used undisclosed restructuring and forbearance agreements to make its delinquency numbers appear more favorable.

In the ABFS case, the DOJ wants information on loans made between May 1, 2000, and the same date this year in which ABFS opted for forbearance instead of foreclosure. The government also wants information on ABFS's management of delinquent, non-performing, and defaulted loans and REOs and on agreements to sell or securitize loans – including the reps and warranties it makes to investors.

In an amended 10-Q filed with the SEC, ABFS reported that 5.73 percent of its home-equity loans were 30 days or more past due at the end of March, down from 6.01 percent three months earlier. Meanwhile, some 11.10 percent of ABFS's portfolio of "business purpose" loans – business loans secured by the equity in the proprietor's home – were 30 days or more past due.

Loans in forbearance accounted for 4.89 percent, or $84.75 million, of ABFS' total managed portfolio at the end of March, the company's 10-Q shows.

As a result, loss severities should increase," said Scott Seewald, a senior director in Fitch's RMBS rating group.

Seewald said Fitch is close to completing a review of 91 rated subprime securitizations serviced by Fairbanks. While many of those are seasoned deals or transactions that have been downgraded in the past, Seewald warned that some deals won't escape the review unscathed. "There will be rating actions going forward," Seewald said.

While he declined to talk specifically about the characteristics of deals that are likely to be downgraded, Seewald noted that servicers generally have less impact on seasoned deals than on "more current transactions where it remains to be seen how they are going to perform." ✦

Tar Heel Law Not Hurting Borrowers, UNC Study Finds

North Carolina's attempt to crack down on abusive lending hasn't hurt credit availability, a new report by researchers at the University of North Carolina suggests.

"There is no scarcity of credit," said Michael Stegman, director of UNC's Center for Community Capitalism, at a press briefing on an analysis that is being billed as the first independent assessment of credit availability in the Tar Heel state, though it was funded largely through a grant by the North Carolina-based Coalition for Responsible Lending.

Passed in 1999, North Carolina's anti-abuse law was the first to restrict or prohibit such loan terms as credit life insurance, balloon payments, and prepayment penalties on high-cost loans. As the debate over predatory lending has heated up in recent months, the law has become a test case for both industry and advocacy groups seeking to bolster their agendas.

In an industry-supported study released last year, researchers at Georgetown University's Credit Research Center found subprime lending in North Carolina dropped 14 percent between the fourth quarter of 1999 and the second quarter of 2000, when the first phase of the law took effect. That study, based on an analysis of some 300,000 loans generated by nine large subprime companies, found that the falloff in credit access was most significant among borrowers at the lower end of the income spectrum.

But UNC's researchers questioned those findings. In fact, their analysis of 3.3 million loans in a database licensed from research firm LoanPerformance found that first lien subprime purchase money originations rose 43 percent during a seven-quarter period after the second phase of the law took effect in July 2000. Loans to borrowers with FICO scores of 580 or less increased by 31 percent during the post-law period, a rate consistent with both neighboring states and the national average.

And while the number of subprime refinance loans dropped by 20 percent in North Carolina compared to 3 percent nationally after the law was passed, Stegman said the drop points to the "weeding out" of bad loans.

Significantly, the study found that subprime borrowers in North Carolina did not have to pay higher prices for credit as a result of the law – a trend that would likely occur if loans were hard to come by. While rates in the state did rise – by 33 basis points – after the law was enacted, they grew more slowly than the national 40 basis point average.

The UNC study also found that the number of subprime loans with prepayment penalties fell 72.3 percent after the law took effect, while such loans grew at a 19.7 percent clip nationally. Similarly, balloon payment mortgages fell 53.1 percent in North Carolina, compared to 15.7 percent for the entire U.S.

While supporters of the North Carolina law hailed the study as evidence that the statute has done its job, industry groups took a wait-and-see approach.

The American Financial Services Association said the study deserves – and will get – "careful consideration." But the trade group also reiterated its belief that "overly restrictive measures on mortgage lending impede credit to needy borrowers."

"We advocate education, rather than new legislation, as the most effective means to reduce lending abuses," AFSA said.

Meanwhile, Wright Andrews, executive director of the Coalition for Fair and Affordable Lending, suggested the continued focus on the North Carolina law misses significant changes that have occurred on the legislative front since it was enacted.