SECONDARY MARKETING EXECUTIVE®

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Increase Your Profitability Through Effective Hedging

Studying fallout patterns and implementing other plans can help create a roadmap to profitability. The role of senior managers is critical.

By Greg Crosby

Secondary marketing teams are now taking a closer look at hedging options as an effective tool to increase their competitiveness in the marketplace. In terms of overall risk, hedging has been compared to playing the stock market by some people and even experienced secondary marketing teams generally agree that doing it well can be a challenge.

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However, there are some basic tips that a team can consider when looking for ways to be more profitable through hedging, including tracking fallout tendencies and taking advantage of early delivery price bonuses.

All secondary marketing teams can benefit by tracking fallout tendencies of loans to better understand the risks of hedging. Fallout, or when a loan fails to close, is a significant source of risk. Tracking the causes of fallout helps secondary marketing teams to better appreciate the strengths and weaknesses in the market that determine profitability.

Currently, there is a serious lack of intellectual study on fallout risks, and secondary marketing teams have to develop their own academic resources, such as fallout tracking reports. These reports are an analysis of case studies of previous loans that are used to evaluate factors contributing to fallout. Fallout tracking reports are roadmaps to profitability to teams willing to devote the time and resources to developing them.

To create fallout tracking reports, loans are first divided by closing behaviors (why borrowers decide to take out loans.) Examples of these behaviors could include whether a loan is for refinancing or for a couple purchasing their first house.

Loans with the same closing behaviors often share the same fallout risks, making closing behaviors a key to being able to anticipate the strengths and weaknesses of various loans. Fallout tracking reports look at each closing behavior as a separate category and provide a clearer picture of the fallout tendencies of each.

Next, a set of rules for each closing behavior category is developed to compare past fallout or pull-through tendencies. These rules define success or failure for loans and cover circumstances such as the denial of a loan or a shift in the market that impacts loans in the pipeline. The rules are used to analyze case studies of past loans to capture the relevant history and determine which factors contributed to the profitability or loss of the loans in each category.

The final step is to use the data for each category to create closing ratio tables or charts, which demonstrate the relationship between interest rates and profitability, and exposure reports, which show the impact of interest rates on loan prices.

This information is then used to plot the tendencies of each category and can act as an instructional tool or a guide to help secondary marketing teams hedge the scenarios that cause fallout and strive to take

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advantage of the positive conditions that can offer increased profitability.

The early delivery bonus

One way for secondary marketing teams to be more successful that is sometimes overlooked is to consider taking advantage of the early delivery price bonus, which is an increase in the price lenders receive for delivering loans prior to the normal settlement date.

Frequently, the bonus can earn an additional 3/8 of a point for every 30 days the loan is submitted before the scheduled delivery date. If secondary marketing teams can achieve the earlier date, the opportunity for enhanced profits is there. However, meeting this earlier date can be a challenge, especially if a team is dealing with large numbers of loans at that time.

At first, the challenges to achieving the earlier delivery date may seem daunting, but there are a number of ways secondary marketing teams can boost their ability to meet this goal. To alleviate some of the timing pressures associated with the bonus, they can work to enhance their company's organizational capabilities to process loans.

A team's ability to meet the forward delivery date is directly linked to how organized it is and how fast it can process loans. In many cases, reducing the workload of staff who may have too many additional duties or using the latest labor-saving software to better manage workloads is enough to help a company be more capable of achieving the early delivery option.

Secondary marketing teams also need to address the issues that can place a loan in "suspense," which can completely undermine the profitability of a team. The most efficient way to prevent having loans fall into suspense is simply to make sure there are no title errors or missing paperwork. Using the audit function that is part of any popular secondary marketing software is one of the most effective ways of minimizing "suspense" issues.

Bringing it all together

For secondary marketing teams, the best ways to increased profitability are to educate its members on fallout tendencies, understand when to exploit early delivery price bonus options and be ready and able to take advantage of them.

The role of senior managers in implementing these ideas is crucial. Management will need to review the ways the team does business and evaluate potential changes that will enable the team to more effectively meet early delivery dates and conduct the necessary research to prepare reports tracking fallout tendencies.

After the team has been reorganized to streamline the way it processes loans through the pipeline and the necessary research has been done to track fallout, team members must become familiar with new ways of doing business. Retraining may have to be done periodically to keep team members up-to-date on the latest conclusions about fallout tendencies or to develop new internal systems to help the team continue to meet early delivery dates.

These tips about tracking fallout tendencies and pushing to meet early delivery dates are tools that reveal missed opportunities and demonstrate ways to take advantage of them. Although missed opportunities do not show up on an annual report, they are as much a loss to the lender as buying too high or selling too low. With a solid commitment to researching, planning and reorganizing, most secondary marketing teams avoid missing opportunities and boost their profitability. SME