Are Your Hedging Skills (or Lack thereof) Leaving Money on the Table?

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Secondary mortgage market professional are always under pressure. They are faced with a multitude of difficult tasks including managing the pipeline, guarding against losses and trying to exploit profit opportunities where none seem to exist. All the while, they’re facing fierce competition and managing scarce or dwindling resources. One thing most realize is that they’re foregoing proven profit opportunities because they’re not actively involved in efficient pipeline hedging activities.

To add to the pressure, few practical options exist for pipeline managers beyond leaving their money on the table, and that is to ‘farm out’ the process. The process of having a third party handle the pipeline not only requires them to relinquish control of their pipeline management, it is expensive. Additionally, the ‘black box’ approach provides results that provide no more insight or understanding of the process than they have now.

While most executives want to engage in pipeline hedging, they often cite a lack of experience, practice and knowledge of techniques as their reason for not doing so. Additionally, they mention their desire to expand their understanding of what these practices entail, the level of complexity and the resource commitment required to succeed. Some under- or overestimate the difficulty of staring and maintaining a hedging program and some find that even with the capable software tools that are available, the learning curve and resource commitment will outweigh the benefit.

However, there is a new option that pipeline managers can exploit in order to increase profits. It is one that combines advanced technology and education with a business mentoring approach to pipeline management. This option not only helps managers enhance their skills and advance their understanding of the process, it helps them make informed decisions going forward and, most importantly, it allows them to remain in control of their pipeline.

Finding a comprehensive program on specific areas such as hedging and related secondary practices takes research in and of itself. It is imperative that pipeline managers find the right program. A few tips are offered as to what to look for in a mentoring program. This general outline will help managers in their search in order to maximize the results and impact on their operation.

First, the providers of these programs must have the right mix of expertise and experience in the industry. They must have a firm grasp of proven processes as well as knowledge of the essential technology to help educate and as well as execute best secondary marketing risk practices.

The program should offer a stair-step approach that builds up the skill level that best suits the individual as well as the organization. For example, the program should provide course tracks for managers to become more proficient as traders, as well as tracks that help establish a more comprehensive enterprise approach to pricing, hedging and market execution.

Offerings should include tailored courses to high-level executives such as the CEO, CFO or President who want to understand more about how their organization is managing its secondary marketing risk. These course tracks also help offer a measure of protection for secondary operations when managers leave or retire.

These programs should be tailored to the varying levels of experience each individual within an organization possesses, including beginner, intermediate and advanced.

For example, beginner-level mentoring might include the important differences between hedging and fulfilling forward commitments, as well as key drivers of a mark to market and also how to compute a hedge ratio and set a hedge position.

For intermediate-level mentoring, something in the realm of determining the cost of existing closing ratio factors, calculating the most cost effective pull-through curve and tips on how to better interpret market position exposure report. This level would also include actual trading simulations as well.

Advanced-level mentoring and training should have students crafting risk and pricing policies that work hand in hand to minimize negative fluctuations in earnings, maximize the profit realized from pricing, hedging and best execution activities. Their training should include enterprise-wide simulations that result in a best-practices manual for their entire organization.

The takeaways from these types of educational programs are many. For the individuals at the beginning levels of the business and for other important indirect stakeholders, these programs increase practical abilities and theoretical understanding of the mortgage pipeline risk management discipline and how it integrates into the overarching mortgage banking profit management process.

When these programs have been completed, the secondary manager should then be empowered to effectively conduct mortgage pipeline risk management activities and to clearly plan, communicate, execute and coordinate risk management activities in concert with pricing, best execution selection and mortgage pool delivery activities.

They should reach a level of acumen needed to craft a solid, comprehensive risk management policy that benefits from insights into how models, reporting and market analysis impact risk exposure. The policy will embrace management's ability to utilize models and feedback to optimize performance while limiting risk. They should also become adept at coordinating outcomes with best execution, pooling and pricing activities, to the degree that the combined operating performance of the organization will reflect favorably when compared to its peers.

These types of education programs work best when comprehensive technology is employed to help secondary manager and their organizations. The best type of technology is software that is comprehensive and provides a high-level of clarity and transparency as opposed to a 'black-box' system where the ability for user to see how results were derived doesn't exist. The software should provide multiple hedging approaches allowing managers to view exposure in different contexts as well as the flexibility to view market exposure from a vantage point that fits their risk policy.

And finally, the software should have the necessary reporting tools that allow managers to convey their derived strategies to other stakeholders within their operation.

Secondary managers can achieve their goals of maximizing profits, expanding their understanding and achieving better control of their pipelines by taking advantage of comprehensive programs that offer technology, education and business mentoring.

By employing these, they can craft an effective hedging policy and better manage their operation. The results are likely to produce better returns and a more advantageous position in the marketplace.

About the Author

Gregory Crosby serves as president of PowerSeller Solutions LLC. He has served as a chief financial officer, with both commercial banks and investment securities brokerage firms, led financial research and trading for a commodity trading pool operator and has served as an adviser and board member to companies ranging from service providers and product distributors to financial conduits. Greg joined ASC in 1997 and brought his risk management and best execution systems to help complete the PowerSeller Secondary Marketing Software Suite. Now its own entity, PowerSeller Solutions LLC is a leading Secondary Marketing and Pipeline Risk Management software and service provider.

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