Neil Fraser

Brandon Perry

TACKLING INDUSTRY CHANGE

Paul Wetzel

Michael Riddle

Executive Roundtable

We are gradually morphing to a more next-generation mortgage process and some say it's about time. Lenders are notoriously slow to embrace change. So, why are things different this time? There are so many new outside factors that are forcing lenders to evolve. To discuss how change is impacting the mortgage industry we gathered a panel of experts that includes: Paul Wetzel, EVP, Product at Mortgage Cadence.; Michael L. Riddle, the Managing Director at Mortgage Resources Group, LLC.; Neil Fraser, Director of US Operations at Paradatec, a mortgage OCR technology; and Brandon Perry, President at TTP Enterprises, a leading CRM firm. Here's how they see the future of mortgage lending:

Q: How have recent mortgage technology vendor M&As changed the mortgage industry?

NEIL FRASER: It is common, and often a natural progression in many industries that they start out fragmented and consolidate as they mature. The purported advantages to consolidation can include: economies of scale, more resources for research and development, and better marketing and market reach.

Paradatec monitors the M&A activity of companies that we know well. The reality of consolidation, in many cases is very different from expectations. Just like in other verticals.

The consolidations we see appear to be aimed at allowing the larger mortgage technology providers to become one-stop shops for all things tech and to move that technology further down the food chain to smaller banks and credit unions.

But M&A is a risky approach. Some recent consolidations have led to organizational confusion, and a general loss of focus.

Ultimately they find that the organizations' cultures have little in common, and the perceived synergies between the two companies are illusive. In fact, in some cases we have seen this mistake repeated multiple times over several short years. Generally, a great deal of marketing hype follows such consolidations. So, the goal of increased marketing reach is often realized, but is only short term. However, the reality is that the loss of focus can be devastating to both their clients and employees.

We believe these risks are common in the case where unique and significant differentiators make a particular technology company's products and services clearly superior. For a technology vendor in this position, there are many potential disadvantages to consolidation. In the recent past we believe we have been witnessing the negative results of some of these mergers, especially in our niche of advanced OCR technology for the mortgage industry.

Paradatec has historically made its living by licensing our sophisticated mortgage OCR solutions to some of the largest banks and lenders in the country through OEM relationships with larger partners. Our solutions traditionally were only used in very large lenders. The net effect of the consolidation of the last few years is that our current and future re-sellers are able to leverage very sophisticated OCR technology to smaller organizations that never could support such platforms themselves.

Fintech has been an underinvested segment and lenders' interest in spending to improve digital outcomes is driving investment into mortgage technology.

—Paul Wetzel, Mortgage Cadence

PAUL WETZEL: Leading vendors are looking to add to their product offerings and/or customer base with acquisitions. Where the reason for the acquisition is augmenting the product offering, this can frequently be a faster time to market versus building the functionality natively. Having said this, acquisitions are not always guaranteed to be successful. Considerations like cultural fit of new teams vs. the acquirer, and compatibility of technology stacks are two key considerations among many others.

MICHAEL L. RIDDLE: I think it depends on whom you talk to and which specific companies that you are referring to. In some instances, larger technology providers have acquired smaller providers for a specific technology, market niche or just to gain market share. Traditionally, these types of M&A don't always work out because there isn't synergy between the technology platforms, corporate cultures don't mesh, and customer bases don't align.

However, when the right companies merge, ones that have a shared vision for the future, corporate cultures that align, technology platforms that easily integrate, and where the sum is greater than its individual parts, there can be significant advantages for industry participants. This type of merger or acquisition has the power to disrupt an industry.

Speaking from experience, the second example is what has transpired with our new merger. MRG has formed a partnership with Asurity Technologies (Asurity) that brings together Treliant Solutions, LLC, Risk Management Solutions, Inc. (RMS) and Mortgage Resources Group, LLC (MRG) into an integrated best-in-class compliance platform.

In addition to delivering legally defensible compliance expertise, in-depth compliance insights with state-of-the-art technology to document mortgage transactions, we can now also provide HMDA, CRA, Fair Lending, and Redlining solutions. This provides our clients with a significantly more comprehensive compliance solution.

BRANDON PERRY: The mortgage technology vendor space seems to be mirroring the mortgage industry in regards to M&A activity. With the mortgage lender M&A activity, the competitive landscape with technology vendors is extremely high. Smaller boutique vendors are strategically acquired by larger well-funded looking to expand or enhance their product offerings. The current trend is for the larger vendors to serve as one-stop shops for mortgage lenders. This is good news for the mortgage industry as it nicely sets the table for further innovation by start ups or boutique technology vendors looking to plug the holes left by the larger players.

Q: How has new regulation changed the mortgage industry?

NEIL FRASER: Regulation equates to reporting in order to attain measurement and control. As regulation has increased in this market, the need for originators and services to quickly extract meaningful content from their loan files to support such regulatory demands has increased as well.

The Paradatec solution can assist with data gathering for many regulatory events, but one that's especially burdensome in terms of executive liability is the Fed's Comprehensive Capital Analysis and Review (CCAR). The CCAR is an assessment of the capital adequacy of thirty-four large U.S. bank holding companies and was introduced as part of the Dodd-Frank Act. The effects of the Dodd-Frank Act in general are widespread and relatively well known. CCAR is focused on, evaluating capital adequacy even under stressful conditions. Reporting for CCAR came through the FR Y-14M forms in June 2012 which support a dictionary of around 250 data fields to be collected and presented to the Fed.

One of the early effects of CCAR 14-M reporting has been that large lenders have taken extra responsibility for the accuracy of data presented to the Fed for their loans. That includes loans originated via the correspondent channel or acquired otherwise. For Paradatec, as a specialist in automatically reading mortgage documents via Optical Character Recognition (OCR), this presented an opportunity to provide automated audit of LOS data vs actual scanned images of original paperwork in order for entities to comply. For 2017 CFOs of CCAR entities are obliged to attest that, not only is their CCAR 14-M data is "materially correct to the best of their knowledge" but also to "the effectiveness of internal controls and include those practices necessary to provide reasonable assurance as to the accuracy of these data". In other words "I've checked all my data". This is a big task especially for banks that acquire loans they did not originate. CCAR entities are effectively now required to check all their loan paperwork vs LOS data and attest that they match. That's a huge undertaking without sophisticated OCR technology.

Compliance becomes more difficult each day, as a cascade of new disclosure and lending requirements are imposed by federal, state and local regulators.

—Michael L. Riddle, Mortgage Resources Group, LLC

MICHAEL L. RIDDLE: The regulatory environment for today's mortgage lender has become exceedingly complex. Compliance becomes more difficult each day, as a cascade of new disclosure and lending requirements are imposed by federal, state and local regulators.

With this avalanche of regulation, it is becoming very difficult for mortgage lenders to gauge whether their internal compliance systems are functioning properly and whether the continuing cost, in both human and financial terms, of adopting and maintaining adequate regulatory controls, can be sustained in a volatile origination market.

Lenders, in order to cope with these added regulatory compliance risks, are faced with an immediate and compelling need to re-evaluate and upgrade the capacity of their internal systems to recognize and incorporate mandated regulatory changes. Static document systems and templates simply will not suffice to keep you compliant. To ensure compliance, mortgage disclosure and documents systems need to be dynamically constructed.

At the same time, the absolute risk of non-compliance has become intolerable. Audits by regulators and investors alike are now commonplace and fines, penalties, and loan repurchase demands are escalating. As tough new regulatory standards increase the scope and absolute number of loans that must be evaluated carefully for compliance, investors have become acutely aware that several regulatory changes impose liability on the purchase of a mortgage loan for compliance errors made by its originator. It is no surprise that investors are increasingly demanding, prior to funding a loan purchase, that originators provide loan specific data in an electronic format complete enough to permit comprehensive automated compliance reviews on each loan to be purchased.

PAUL WETZEL: New regulations and GSE requirements have pushed technology providers to look for creative ways to address both the ongoing release of requirements themselves but also what kind of technology upgrades might be necessary to better accommodate the strong likelihood that this level of change will continue for years to come. While new regulations must always be accommodated as a priority, customers will not tolerate regulation support being the focal point of a technology vendor's roadmap. Leading vendors always need to be upgrading their technology platforms and better accommodating the ongoing drumbeat of regulation is one key driver for this. The pressure of regulation is also a key driver for ongoing consolidation of mortgage technology vendors as some vendors will look to exit the market by selling their business vs. investing to upgrade their technology per the above.

BRANDON PERRY: With the heightened awareness of compliance with new regulation in the mortgage industry, many lenders have paused delivery and implementation of solutions, which drive new business. I've mentioned "compliance doesn't matter" quite often in the past couple of years and it still holds true today. While compliance can't be ignored, lenders must not fall into the trap of hyper-sensitivity to rules and regulations and then completely ignore the basic need to grow your business. The most successful lenders have been able to find a nice balance between regulation and business growth.

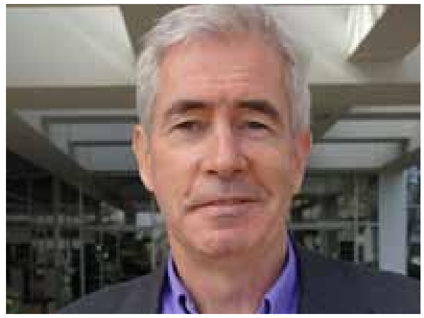
Q: How has talk of and interest in the digital mortgage changed the mortgage industry?

NEIL FRASER: In this era where smartphone and tablet usage permeates nearly all of life, it only seems logical that the purchase of a home would eventually move in that direction as well. This certainly creates a situation where the loan package can be moved electronically at no cost, rather than printed (multiple times, most likely) and physically moved between geographies. Therefore, in-transit time and cost can be reduced, which is great for the market.

At the same time, we don't believe the digital mortgage negates the need for certain underlying technologies, including OCR. While a borrower may be able to upload PDF copies of their paystubs and bank statements, as an example, the data must still be gleaned from those documents as part of the underwriting process. Without the aid of sophisticated OCR such as that provided by Paradatec, that gleaning process remains a manual process, even though the mortgage is "digital".

Organizations looking to embrace the 'digital mortgage' concept should look to not only eliminate the paper that exists in their process today, but also lean-out their business processes with the aid of technology so the per-loan processing costs can be reduced.

BRANDON PERRY: I believe much of the interest and talk of digital mortgage rose from the ashes of the constantly fluctuation regulatory environment. With the birth of compliance as a new cost center in most lenders, the pressure to absorb these new expenses must be released. I previously mentioned the importance of new business growth, but pressure can be released internally by finding ways to more efficiently process loans. Mortgage executives challenging their current processes helped pave the way to embrace technology allowing for digital mortgage. One of the biggest challenges with digital mortgage is information security. With the ever-growing list of data breaches, cyber security will never be more important to the mortgage industry as we enter the digital mortgage world. The nature of the extremely sensitive information held by mortgage lenders makes them prime targets for cyber attacks.



M&A is a risky approach. Some recent consolidations have led to organizational confusion, and a general loss of focus.

—Neil Fraser, Paradatec

PAUL WETZEL: Core concepts related to digital mortgages of course are not new but there is certainly growing interest in these topics over the past couple years and that is a very good thing for the mortgage industry. Fintech has been an underinvested segment and lenders' interest in spending to improve digital outcomes is driving investment into mortgage technology. When executed correctly by a vendor, digital mortgage becomes a menu of options open to each lender that improve borrower experience, speed time to close and staff efficiency, and increase the transparency and security of the transaction. This will help both the lenders top line and bottom line as well as improving their standing in the industry.

MICHAEL L. RIDDLE: The first thing that comes to mind is the user experience. All the talk of the digital mortgage has changed borrower expectations. Since that now famous Super Bowl Ad that launched Rocket Mortgage and borrowers expectations, consumers demand technology that delivers a quick and simple user experience that matches the type of every day experience that they have on the Internet with the likes of Google, Apple and Amazon.

This has forced the industry to focus attention on delivering a dynamic and mobile digital experience. Many companies have invested heavily in technology and on being able to provide the types of tools consumers are look for on the front end. But what lenders must realize is the fact that to truly deliver on the digital experience the entire mortgage process needs to be streamlined not just the point of sale.

This includes compliantly documenting each and every financial transaction digitally. To be able to maintain a competitive edge in the digital age requires an understanding of data-security, technical capability, industry experience, compliance insights, legal expertise, matched with seamlessly integrated systems and robust data interfaces to actually streamline the lending process while delivering on the digital mortgage experience.

Q: Lastly, how do you see the mortgage industry and the mortgage process of the future evolving as a result of these and other big changes?

PAUL WETZEL: It's an exciting time to be in the mortgage industry with respect to how technology can be used to dramatically improve outcomes. Lenders should be pressing their mortgage technology vendor partners for their view and strategies related to the above. Healthy vendors who plan to not just survive but thrive need to be active in the M&A space, have new a creative ways to accommodate ongoing regulation, and established but growing digital mortgage capabilities. Seismic shifts like the end of paper won't happen overnight for the industry but they won't happen at all leading lenders being willing to be front runners and we're starting to see more lenders being willing to be just that.

MICHAEL L. RIDDLE: As mentioned earlier, the regulatory environment has become exceedingly complex, and I don't see that changing anytime soon. That will continue to put pressure on lenders to comply, which will highlight the need for an advance compliance ecosystem— One that is comprehensive, can track, monitor and provide real time insights for all of a lenders compliance needs.

In addition, borrower expectations will continue to push the envelope on delivering the digital mortgage experience that today's borrower demands. That requires the right balance of advanced technology, deep mortgage expertise, legal insights, industry integrations, with the ability to constantly evolve.

BRANDON PERRY: We've become a culture accustomed to instant gratification with nearly everything in our daily routine. Rather than heading to the store, how about same day delivery? We're upset when a website has a two second delay loading. I've heard

The next big competitive environment is time. I believe the time to pre-approval, approval and closing in the next few years will be fractional to the current process timeline of today.

—Brandon Perry, TTP Enterprises

countless radio commercials from car dealers touting how fast they get you in and out when buying a car. We are kidding ourselves if we believe obtaining a mortgage is the only exception. The next big competitive environment is time. I believe the time to pre-approval, approval and closing in the next few years will be fractional to the current process timeline of today.

NEIL FRASER: This industry is experiencing an evolution through the aid of technology like many others before. While the regulatory requirements will certainly control what the experience looks like for the consumer, automation within the process will continue to expand…the increasing per-loan processing costs dictate as much. Industry leaders such as Amazon and Orbitz have made the self-service model albeit in other segments, much less daunting, and the speed at which transactions can be completed has decreased significantly through this evolution. While the magnitude of the buying decision for a home is obviously much greater than that of buying an airplane ticket or a box of diapers, the consumer has become comfortable with online transactions to the point that a paper-bound process is viewed as slow and stodgy.

The process will continue to evolve, both due to competitive pressures as well as consumer-driven expectations. But, like a lot of the other 'digital transformations' that have occurred, we believe the mortgage market will be "both…and" situation, as in both paper and digital, rather than an exclusively digital model, at least for the foreseeable future. Until the entire consumer community is ready to embrace a digital-only approach, paper will continue to be a part of the process, and therefore vendors that automate paper reading will continue to add value. ❖