Informative Research

HOW TO STAY COMPLIANT AND SAVE MONEY IN SPITE OF RISING COSTS AND SECURITY RISKS

INTRODUCTION

Success in mortgage loan origination is all about the numbers. One critical metric is the cost to originate a loan, which saw a record high in the first quarter of 2017 when total loan production expenses reached $8,887 per loan.[1] That cost moderated in the second quarter but rose again in the third to $8,060 per loan, according to the Mortgage Bankers Association.

Another important factor is mortgage loan volume, which has been negatively affected by the shortage of available housing inventory across the country, shutting out many potential borrowers.

"For the third year in a row, the nationwide inventory shortage is likely to continue to hinder sales and increase prices," Nela Richardson, chief economist at Redfin, wrote in December 2017. "We expect small increases in inventory at the high end of the market by yearend. Starter-home inventory has not increased meaningfully since 2011, and we don't expect it to increase at all next year."[2]

Rising interest rates are also a concern for lenders, with experts predicting four rate hikes in 2018 and two more in 2019.3 The effect of those interest rates on borrower's buying power can be dramatic, with every 1% increase in the interest rate decreasing a borrower's purchasing power by as much as 9 to 11%.4 That decrease could result in lower average loan amounts as borrowers try to stay within budget.

Still, with pent-up housing demand and a strong economic outlook for 2018, lenders have ample opportunities to grow their business, with one expert estimating $1.1 to $1.2 trillion in purchase originations over the next couple of years — the highest levels since 2006 and 2007.[3]

So how can lenders position themselves to capitalize on the opportunity while keeping costs in check? One solution is to drive costs down by bundling origination services with one provider. Bundling makes compliance easier and can improve the borrower's closing experience while saving money in the process. And that cost saving can be significant.

THE RISKS OF CHOOSING THE WRONG VENDOR

The rising cost to originate loans is largely a result of increased regulations as lenders shore up back-office processes for verification and quality assurance.5 Lenders have turned to outside companies with specific areas of expertise to help streamline their processes, but the compliance risk of using multiple vendors has risen exponentially since the implementation of Dodd-Frank in 2010.

The Consumer Financial Protection Bureau (CFPB) has made it clear that a critical part of their oversight of banks and non-banks is monitoring the performance of third-party service providers. Since 2012, when the CFPB first notified financial institutions that their vendor relationships would be under scrutiny,[6] the bureau has continued to expand its examination of service providers.[7]

Exhibit 1

In order to properly manage vendors, the CFPB requires lenders to:

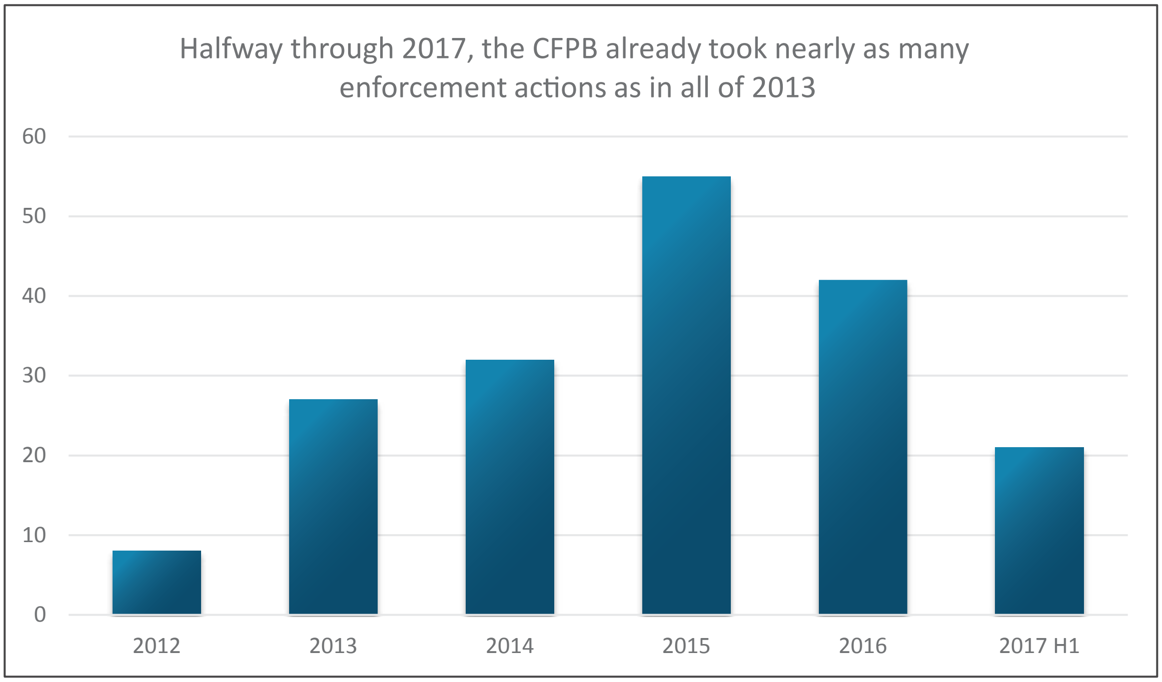
1. Conduct thorough due diligence of service providers
2. Review service providers' compliance policies, procedures, internal controls, and training materials
3. Include clear compliance expectations in service provider contracts as well as appropriate and enforceable consequences for non-compliance
4. Regularly monitor service providers for compliance
5. Take prompt and appropriate action for non-compliance, up to and including termination of contracts

These requirements make it easy to understand how consolidating vendor services would immediately benefit lenders, reducing the number of companies they have to oversee in this way. This is especially true in light of the enforcement actions the CFPB has taken to make their point, which amounted to $525 million in settlements in just the first nine months it started looking at vendor relationships.[8]

The pace of regulatory requirements — and the nuances of what regulators are looking for —makes it hard for lenders to adjust. As A McKinsey report noted in 2013: "Through these actions, and others, the nature of the due diligence firms are required to conduct is expanding well beyond the traditional assessments for supplier, operational, and IT security risks. The rules have not changed entirely, but the emphasis has. Regulators are sensitive to other risks, such as strategic and reputational risks, that even smaller third parties can create for customers, and are critical of firms' processes for monitoring these risks."[8]

And the CFPB is only one of the regulators scrutinizing vendors as part of their oversight. The Office of the Comptroller of the Currency identified vendor management as a key risk in its Semiannual Risk Assessment for fall 2017. "The number, nature, and complexity of third-party relationships continue to expand, increasing risk management challenges for banks. Financial technology companies providing innovative financial products and services introduce opportunities, as well as potential risk, for banks."[9]

Exhibit 1



Source: CFPB

THE BENEFITS OF BUNDLING

Clearly, regulatory oversight of third-party vendors is here to stay, but lenders can effectively manage their risk by consolidating services and vendors. And choosing the right vendor is now more critical than ever.

Informative Research (IR) has been serving the lending and insurance industry since 1946, developing the first-ever Tri-Merge Credit Report in 1994. Today, IR is an industry leader in using technology to improve the loan process, delivering a complete set of services for originators – from prospect acquisition and credit solutions to verification services and portfolio management. These solutions can be ordered separately, but lenders will see the most savings by bundling services. Bundles are completely customizable, so lenders can pick and choose the products and services that are right for them. IR has partnered with some of the best companies in the industry, pulling data from 10 different sources to offer the depth lenders need, but with tremendous savings.

Depending on the bundle and the client, lenders partnering with IR save anywhere between 30% and 85% on out-of-pocket loan costs.

Bundling doesn't just save lenders money, however. By consolidating vendors, lenders see immediate compliance benefits too, helping them avoid any extra hassle. IR has three major security certifications: PCI, EI3PA, and SOC2, something no other company in the industry has been able to do.10 In fact, IR has achieved a 100% compliance rating on more than 200 control points within the Report on Compliance (RoC), exceeding industry-wide compliance and security standards. This means that lenders get robust data from diverse sources without the risk of relying on different vendors.

CASE STUDY

IR has worked with more than 3,000 mortgage companies, banks and lenders to deploy innovative technology solutions for a better loan process. One recent company, a regional lender ranked in the top 600, realized significant benefits and process efficiencies from working with IR.

This specific client was battling multiple issues impacting its profitability, cost of doing business, and efficiencies. The reality of being in a purchase market meant that the cost of producing a loan was increasing every quarter. In addition, the client had a large percentage of potential customers fall out at the time of the initial credit pull, as well as after the process had started. Faced with fewer customers, higher costs to close, and efficiency issues adding to that cost, this company approached IR for help. The first step IR took was to review their lending practices, beginning with how prospects were discovered. IR performed an analysis of all the products and services they utilized and evaluated its loan process, considering its investor partners as well.

IR developed a three-pronged solution to help this client:

1. **Save on prequalifying prospects**
2. **Offer a spend-effective strategy**
3. **Impact efficiencies**

The first part of IR's solution addressed how the lender developed prospects and converted them into mortgage-ready borrowers. Before proposing a firm offer of credit to applicants, the client utilized SoftQual to pull a soft inquiry of their credit along with a mortgage FICO© score to match them to the right loan option instantly. And since it was a soft pull, the client can save up to 62% on out-of-pocket costs for qualifying borrowers.

Next, IR created a credit and verification bundle for the client that included:

Credit Bundle

TriMerge Credit Reports, FICO Scores, Bureau Fraud Products, FACTA Surcharges, Re-Issues, LOS fees, Risk-Based Pricing Notice (RBPN), OFAC, Credit Assure, Derogatory and Inquiry letter.

Verification Bundle

PreClose Credit Report, Tradeline updates/ Conference call fees, Enhanced Fraud Solution, 4506T, SSN Verification, Lien and Judgment Report, and Flood.

By initiating the credit and verification bundle pricing strategy, the client was able to project actual spend per customer and improve process efficiencies by doing so.

- The disclosure process was simplified due to only two fees being associated with services utilized
- The funding process was simplified due to including all services being contained in two fees per borrower
- The accounts payable process was simplified due to a condensed invoice with only two fees per borrower

The client was extremely satisfied with the performance of the credit/verification bundle, experiencing an upfront credit spend savings and complete control on the remaining spend per loan. The client is re-disclosing less, has become more efficient in correlating fees prior to loan funding, and has seen a dramatic improvement in the accounts payable process due to all services being included within a single invoice and only two line items per borrower.

By using the credit bundle, the company saw 36% annual savings at $79,860. With the verification bundle, the client estimated a positive impact on P&L of $200,000 per year.

The client not only saved money, they also increased borrower satisfaction with less fallout at both the initial and final stages of the process.

CONCLUSION

Although the current economic environment poses some challenges for lenders, it also provides an equal number of opportunities, if they are positioned and willing to take them. Partnering with a trusted company to bundle origination services is a smart strategy to cut costs without cutting quality, allowing lenders to expand loan volume and increase homeownership while minimizing compliance risks.

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