The Asteroid is Coming for the Paper Mortgage

Blockchain, AI and Other Tech Advances Promise to Make the Old Ways of Doing Business Extinct

By Robert Greenberg

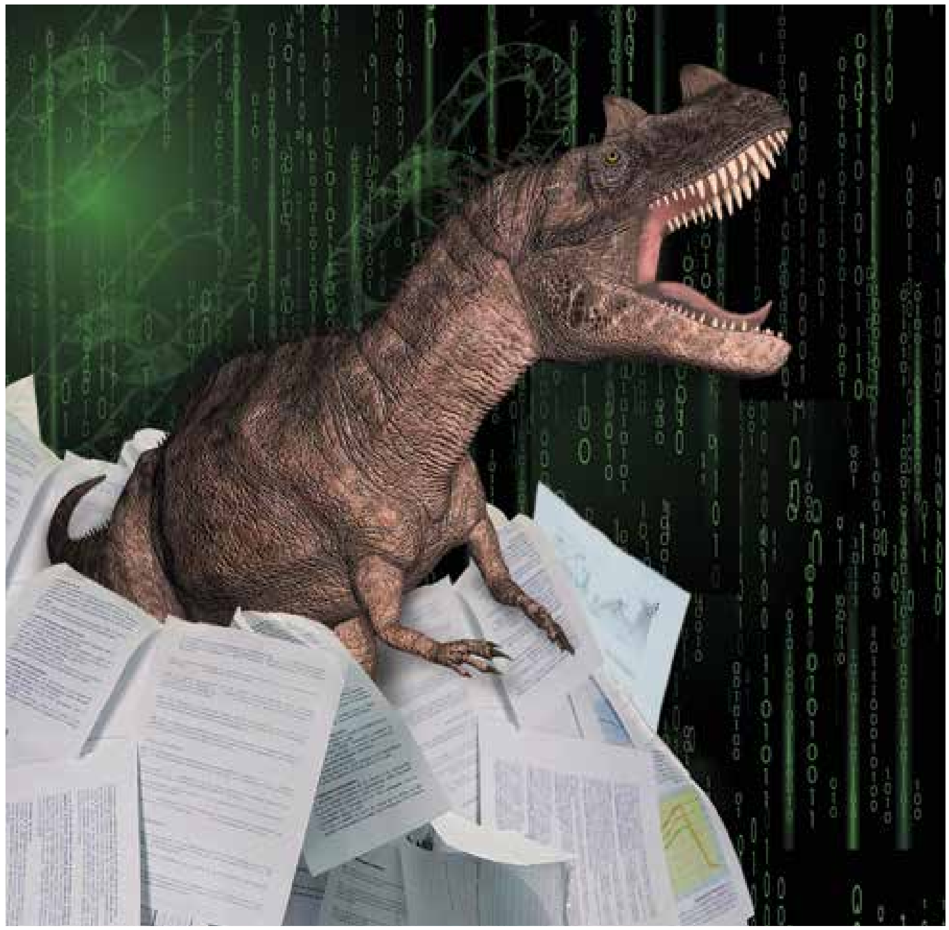

Photo illustration by Paula Douglass

The paper mortgage isn't dead quite yet, but it is heading toward life support as advances in digital technology drive change across all industries, including mortgage origination. It took a long time to get to this point, and no one is looking to resuscitate the paper process. Mortgage originators have been talking about mortgage automation and technology for 20 years without completely closing the deal.

This speed of change appears to be quickening, however, even for an industry that has traditionally lagged behind others on technological advancements. The mortgage industry has Amazon, social media, the Great Recession and tech-savvy millennials to thank for the rapid pace of innovation over the last decade.

This speed of change also is notable in a recent J.D. Power study that shows 43 percent of mortgage clients reported applying for a mortgage digitally in 2017, up from 28 percent in 2016.

While digital mortgage applications are on the rise, eClosings remain exceedingly rare. Once the loan reaches the closing table, the industry goes back to pen and paper. Mortgage industry eClosings have been so rare, in fact, that each time a company does one, it still generates media coverage.

When United Wholesale Mortgage (UWM) completed a virtual closing in July 2017 — deemed the first for the industry — it produced a media buzz, as did UWM President and CEO Mat Ishbia's bold prediction at the time that the majority of closings will be done this way by the end of 2019.

Paper slog

With eClosings and eNotarizations still a novelty, it remains to be seen whether clients — and originators — will fully embrace an end-to-end digital solution, although the inclination is certainly present. Here's how it worked just a decade ago for most homebuyers and originators. The prospective homebuyers would fill out a paper application and

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gather supporting documents. These would typically include paper copies of pay stubs, two years of W-2s, their most recent tax return, a couple of months' worth of bank statements and a signed permission form to allow the lender to pull the prospective borrowers' credit reports.

Depending on the homebuyer's situation, they might be asked for more documents, such as a letter explaining any large deposits into their bank account, a divorce decree and property settlement, their most recent retirement account statement or a letter from their boss verifying employment. It felt like slogging through "War and Peace" (all 1,225 pages) for both the consumer and the mortgage originator who had to check off that each document had been received and uploaded into the loan-origination system.

In the wake of the 2008 financial crisis and the regulations that followed, mortgage loan files by circa 2013 had ballooned to 500 pages, according to the Mortgage Bankers Association. This is up from just about 100 pages pre-crisis.

Now, imagine that some of that paperwork gets misfiled or doesn't get uploaded properly. If that happens, the borrower gets asked to supply some of the same documents again. Missing documents from loan-modification files in the aftermath of the housing crash were a massive embarrassment for the industry, causing serious processing errors and even wrongful foreclosures.

Finally, when closing day arrives under a paper process — and paper closings are still the norm — the homebuyer sits down in the title insurance office, is handed a pen, and is asked to sign about 20 documents. Through it all, this historical paper-based mortgage process was slow, cumbersome and lacked integrated, computerized data analysis for good risk management.

Filling the void

With a nod to the vintage Virginia Slims ad campaign, the mortgage market, likewise, can claim to have come a long way with its move into digital mortgage platforms. To date, much of the market's focus has been on the front-end digital-application process. The industry saw significant movement on this front in the wake of the financial crisis as innovative startups came in to fill a void left by big banks that tamped down on residential mortgage lending as they sought to deal with bad loans on their books.

At the end of last year, about 10 years out from the crisis, Bank of America still had nearly $11 billion in credit-impaired mortgages left from buying Countrywide Financial, according to Reuters. As of the same date, JPMorgan Chase & Co. still had roughly $30.5 billion worth of their $89 billion in bad loans.

As big banks put the brakes on residential mortgages, alternative lenders seized the opportunity to address the unmet demand. They employed technology to make mortgage credit available in a manner that was faster, smarter and more consumer-friendly.

These alternative lenders have had success. The U.S. market served by nonbank digital lenders has grown rapidly, to about $35 billion in 2016, a 22 percent increase over the year before, according to a 2017 University of Cambridge Judge Business School report on alternative finance. In just a few short years, these alternative lenders have gained clout as they've introduced intricate underwriting algorithms and expanded data analytics and improved risk management via sophisticated online platforms.

Regulatory sandboxes

The march toward further innovation is well at hand. This past July, the U.S. Department of Treasury released a report on nonbank financial institutions and fintechs (financial technology companies) calling for a financial system that creates economic opportunities and fosters innovation. The 222-page report offers a peek into what the Trump administration views as the future of mortgage finance.

"The use of data, the speed of communication, the proliferation of mobile devices and applications, and the expansion of information flow all have broken down barriers to entry for a wide range of startups and other technology-based companies that are now competing or partnering with traditional providers in nearly every aspect of the financial services industry," the report says.

The increasing scale of technology-enabled competitors — some of which are attracting an abundance of capital — has raised the stakes for traditional bank and nonbank originators who see the need to innovate more rapidly to regain market share. Data analytics and artificial intelligence (AI) are among the top investment areas for financial companies, according to a PricewaterhouseCoopers report last year.

Other reports estimate that by 2030, AI technologies could increase North American gross domestic product (GDP) by $3.7 trillion and global GDP in $15.7 trillion. Financial institutions are now looking to AI to cut costs, boost returns and improve risk management.

The Trump administration also has called for the establishment of "sandboxes" to provide regulatory relief to foster further innovation in the financial sector. New technologies, such as predictive data analytics, AI and blockchain could potentially qualify for regulatory sandbox treatment.

When it comes to blockchain, many in the mortgage industry are still figuring out what it is and what it can do, although early indications are that it is highly relevant to mortgage finance. Blockchain technology allows an originator to record and track transactions in real-time in a decentralized, tamper-proof database called a ledger where everyone with permission to access the ledger knows about the transaction. The technology certainly has implications for how financial institutions track and maintain records.

Blockchain promises to provide the checks and balances that lenders require to ensure an authoritative digital copy of the loan documents exists and resides in the possession of the lender or holder. In an age where

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loans are transferred regularly to investors, as is the case in peer-to-peer lending, blockchain offers secure chain-of-custody and ownership proof of electronic documents. Other potential uses also are being explored.

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The mortgage industry is just scraping the surface on how blockchain, AI and other technologies can be used to revolutionize the mortgage industry. In just the past five years, we've seen tremendous strides. More innovation and adoption will take time, but this is the direction the industry is headed.

Blockchain, AI, and automation are here to stay and will advance the mortgage market into something that is unrecognizable from the industry's current state. For those trying to figure it out, whether in a regulatory sandbox or an innovation lab, this is one of the most exciting times to be in the mortgage industry. ■

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