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By Austin Kilgore

Is the Mortgage Industry Finally Getting Tough on Paper?

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"There's no way the borrower can sign anything incorrectly. So as soon as everything is signed digitally, we can fund that loan," said Jeff Bode (left), chief executive and owner of Mid America Mortgage, pictured with Michael Dunlap, Merchants Bank president and COO.

Jeff Bode is attempting something that's never been done before: run a mortgage lender that exclusively originates fully paperless, electronic mortgages.

It will take years for the chief executive and owner of Mid America Mortgage to fully realize this vision — if the ambitious plans can even be pulled off at all.

In the meantime, the independent mortgage banker, headquartered in the Dallas suburb of Addison, Texas, has been diligently establishing the framework for transforming its operation and expects to close its first loans with electronically-signed promissory notes in the spring, as well as use its platform to buy closed e-notes from other correspondent lenders.

"The technology is a little harder because you're actually reinventing things you've been doing for years and make it all electronic as opposed of paper," said Bode. "It's surprised me that it's been harder than I thought it would be. But we feel once we get that done, we can scale that with other lenders that can utilize our processes."

Like many lenders that originate e-mortgages, Mid America plans to fund a portion of its volume with its own capital. It has also partnered with Merchants Bank of Indiana to fund e-mortgages with a warehouse line of credit.

So-called e-warehouse originations drastically reduce the time it takes to sell a loan to the secondary market and replenish a line of credit. But their use has been muted by warehouse banks unwilling to forego their traditional interest income in exchange for higher per-loan fees and improved efficiency — a short-sighted view that Merchants Bank President and Chief Operating Officer Michael Dunlap said ignores the enhanced accuracy of digital loan documents and the security that comes with near-instantaneous delivery of the loan collateral to the warehouse bank after closing.

"To us, it's the relationship that we need to be there to be able to fund whatever path the mortgage banker wants to go down," said Dunlap. "For the mortgage banker there's still enough savings and a great customer experience to more than offset the fees going up and their spreads going down."

While Bode and Dunlap have modest expectations for the effect their efforts will have on the mortgage industry at large, parallel initiatives aimed at harnessing the efficiency and accountability of digital transactions reflect a renewed focus throughout the industry on using technology to improve consumers' borrowing experience.

Despite seemingly never-ending prognostications of widespread adoption of fully paperless mortgage originations, the e-mortgage movement has advanced in fits and starts. After federal legislation made electronic signatures legal in 2000, Fannie Mae and Freddie Mac began purchasing e-mortgages a few years later.

But those early efforts to build momentum for e-mortgages were soon stymied by the foreclosure crisis. And while adoption of e-signatures on documents like the initial disclosure package has steadily grown, adoption of fully electronic loan packages with e-notes continued to struggle.

Throughout this time, efforts to promote the benefits of e-mortgage were "all about e-notes and execution and what the industry could save itself on FedEx packages," said Chris Christensen, an attorney at Dallas law firm PiersonPatterson.

But that all changed in 2015, when the Consumer Financial Protection Bureau released the findings of its electronic closing pilot program.

The four-month study found borrowers who participated in an electronic closing process completed transactions faster and reported feeling better informed about the experience — even when the promissory note and mortgage/deed of trust were signed on paper.

The CFPB's study redefined what was really important in an electronic mortgage transaction, said Christensen.

"Now it's about the consumer experience and if you've got some e-stuff and some paper stuff, it's still a better experience than an entirely paper closing," he said. "We're in a very interesting period of time where the government is actually pushing us to the best business idea."

Another CFPB initiative further strengthens the case for providing consumers with electronic mortgage documents: the TILA/RESPA integrated disclosure rules.

Along with an overhaul to the format of the upfront and closing documents that lenders provide borrowers, originators must adhere to strict delivery and accuracy requirements. It is imperative for lenders to be able to maintain and prove their compliance with the requirements, and electronic documents that can be timestamped and tracked are far more effective than paper-based processes for adhering to TRID compliance.

Building off the industry efforts to implement TRID, Fannie Mae and Freddie Mac plan to start collecting data from the new Closing Disclosure form as early as the fourth quarter of this year. The government-sponsored enterprises plan to make submission of the data mandatory on all loans sold to the enterprises by the second quarter of 2017, further legitimizing the role that digital processes play throughout the mortgage industry.

"With TRID, where you can prove your compliance in an electronic world, it makes it a lot easier and you're a lot more apt to do it than be worried about doing something that regulators or other authoritative bodies aren't going to like," said Dunlap.

In the case of both TRID and the electronic closing pilot, the CFPB sought to empower consumers to have greater control and insight in their financial transactions, which in many ways, mirrors the increased engagement that consumers enjoy via social media and with other technology-driven products.

"Our consumer expectations are now set by Google. So if I go to a bank and don't have a Google-like experience, I'm upset," said Christensen. "If we don't really care about the consumer and take our traditional view of the consumer — which has been, 'These are your loan terms and be happy for them, sorry if you don't fit in the credit box, you're out' — then we're going to get disintermediated. And there's a lot of money pouring into Silicon Valley to disintermediate established mortgage players."

E-Warehouse Efficiency

An underlying driver of Mid America Mortgage's e-note strategy is a desire to improve its internal operations and control costs, particularly for loans that are funded on its warehouse lines of credit.

The e-closing process has various automated checks to ensure borrowers completely and accurately execute as aspects of the transaction, including the note and mortgage.

"There's no way the borrower can sign anything incorrectly. So as soon as everything is signed digitally, we can fund that loan," said Bode. "We no longer have to scramble through and look and see if they truly see if they signed the note or see if the notarization on the security agreement was correct."

"It's a lot faster process and we think everybody involved in the process will appreciate a quicker funding at the closing table," he added.

In a traditional paper closing of a mortgage funded with a warehouse line of credit, loan documents are physically moved between the various parties of the transaction — oftentimes across multiple state lines — in a process that can take as long as 20 days or more. But with an e-note, each of those handoffs happen electronically in a matter of minutes.

"As a warehouse lender we still have our role in the world but instead of making a net interest income over a turn time of 20 days, you make it so the loan turns in days. So you charge a fee to cover your costs and generate a profit," said Dunlap.

As a result, warehouse lines are replenished faster, allowing lenders to originate more volume with the same amount of capital, or alternatively, originate the same volume with a smaller line of credit.

That also creates an opportunity for warehouse banks to provide lines of credit to a larger pool of mortgage lenders.

"If you have a $100 million line, but you trade your loans so much quicker you only need a $15 million line, that creates a more competitive landscape where someone like Merchants Bank of Indiana can fund with the larger banks like Bank of America, Barclays and Wells Fargo," said Dunlap.

In addition to Merchants Bank, Bode has assembled a cadre of partners and resources to establish Mid America's e-note platform.

Mortgage Machine Services, a sister company to Mid America that Bode also owns, provides the lender with a fully customized loan origination system, while the electronic document, signature and vaulting technologies it has implemented are provided by DocMagic. Mid America will sell its e-notes to Fannie servicing-retained, and its portfolio is subserviced by LoanCare, a division of ServiceLink.

For its part, Merchants Bank, based in Carmel, Ind., uses Arclight Financial, a vendor that specializes in electronic transaction processing for warehouse mortgage lending. The company provides due diligence reviews of both paper and e-note mortgages submitted for funding on Merchants Bank's credit lines. And in addition to its e-warehouse lines of credit, Merchants Bank originates its own e-notes.

Evolving the E-Vault

After Mid America sells its e-notes to Fannie Mae, the loans are stored on an electronic vault, a storage system that securely holds the official digital records of an e-mortgage.

Fannie Mae developed its own e-vault in the early 2000s, and as technology and business practices have evolved, the agency is now evaluating its options for updating the vault.

"We've recognized that there does some to be renewed momentum across our customer base and interest in making e-mortgage really happen," said Cindy McKissock, Fannie Mae vice president of business initiatives.

"Our e-vault is aged. The technology needs to be upgraded, it needs to be replaced with a different solution, whether that's with our own internal build of an e-vault, a purchase of an e-vault technology, pushing e-vault out to the custodians," she added. "We're looking at all of those and we haven't really narrowed in on one specific approach."

As part of that process, Fannie Mae is evaluating how changes to its e-vault policy may potentially encourage broader e-mortgage adoption. Also involved in the discussions are document custodians, who perform certifications of both paper and e-note mortgages that Fannie Mae acquires.

Simultaneously, but separate from the e-vault updating project, Fannie Mae and Freddie Mac have been given a mandate to take a closer look at the e-mortgage environment by their regulator, the Federal Housing Finance Agency.

In its recently released 2016 GSE Scorecard, Fannie and Freddie have been directed to: "assess and, as appropriate, implement strategies to improve the lending industry's ability to originate and deliver e-mortgages to the enterprises."

"That's a game-changer because literally, the only thing the agencies do is what's on their FHFA scorecard," said Christensen.

Still, it's unclear whether the GSEs alone can encourage broader acceptance of e-mortgages by aggregators and other warehouse banks, said Bode.

"I think the aggregators have to lose market share to somebody who's doing e-notes before they're going to step in and start taking e-notes themselves," he said. "But once they do, they'll be involved."