

# Searching For Reliable Mortgage Data In The High-Tech Maze

**Streamlining high-tech operations will result in a rich data harvest.**

By David Parker

The present crisis in mortgage lending, unprecedented in its scope and continuing repercussions, is already unleashing an accelerating wave of technological development in response to the great pressures and opportunities that are transpiring. Think of this new period of innovation as "Mortgage 2.0" - a time when internal enterprise need, government regulation and market opportunities intersect to drive change and permanently alter the lending landscape.

One area in which some of the most significant change is occurring is in the loan manufacturing process, with mortgage banks leading the charge to improve the quality of the loans they originate and sell into the secondary market and to develop automated tracking mechanisms that continually document who owns which loans.

In some respects, mortgage banks are simply intermediaries in the mortgage process - they match the people that need a mortgage with investors that desire to fund the loan. But they are receiving a disproportionate amount of the negative attention and forthcoming disciplinary action associated with managing this process. And many are finding that the systems they have in place now are hindering their ability to respond to today's challenges and to prepare for business in a new world tomorrow.

The challenge that the industry faces with legacy systems and processes - with some systems installed more than a decade ago - is a lack of transparency in the data and in the process that goes into manufacturing a loan. The Internet-based platforms and technologies that comprise Mortgage 2.0 are uniquely designed to address these issues.



Mortgage banks that move quickly to adopt these so-called cloud solutions will not only improve the transparency of their manufacturing processes, but gain a competitive advantage in selling their loans into the secondary market, setting themselves up to be the leaders in the Mortgage 2.0 era.

But this change requires more than a reallocation of IT resources and a streamlining of workflow processes. It requires a transformation in philosophy that embraces a new way of doing business - a philosophy that embraces open collaboration and the sharing of information across the organization's different functions and roles. And it requires both management and those who integrate and use the system to trust its integrity.

### **Trust, but verify**

The process of selling, originating and processing loans has become significantly more efficient over the past 10 years, yet the old caveat still applies: garbage in, garbage out. And for most lenders, the accuracy of loan files still has a long way to go. Software can ensure that the loans originated meet investor guidelines and that the risk, as it is understood, is reflected in how the loan is priced.

But if inaccurate or incomplete data goes in, the resulting picture will be incomplete or misleading. This can lead to the ill-advised bundling of loan types and the consequent mis-rating and pricing of the resulting tranches. Consequently, the whole secondary market is thrown off, creating a situation where even those with sound judgment and ethics are not equipped to make good decisions.

The challenges the market faces today are to improve the overall level

of data reliability and to develop a system of checks and balances in which the secondary market assumes the basic validity of data while still having mechanisms in place to audit loan portfolios upon occasion. Systems developed over the last 20 years rely predominantly on the information gleaned from borrowers and originators to feed loan manufacturing.

Even third-party data can be modified as part of the sales process. This system worked well for many years, but eventually led to a fundamental problem that is all too clear in these post-boom times: an overreliance on the data provided from parties with a vested interest in the outcome of the underwriting decision.

Addressing this challenge requires a fundamental re-engineering of the loan manufacturing process, starting with an admission of the obvious: The data, and sometimes even the documentation provided by the borrower and originator, are not always 100% accurate. Mortgage industry analyst Craig Focardi of the TowerGroup has stated that typical loan files contain between 25 and 50 different documents from multiple sources, in multiple data formats.

Lenders collect these different documents from more than 10 various external sources, and consequently, the typical loan file contains an average of 200 pages of paper. Given the complexity of the process, the system sets itself up for a high rate of error. In short, lenders need to take advantage of today's lower volumes to move quickly to improve the efficiency of their systems and to adopt an approach in which the underlying premise is predicated on the idea to trust, but verify.

### ***In the cloud***

Because Mortgage 2.0 is based on extensible technology that resides in the Internet "cloud," it allows lenders to easily broaden the community of vendors from which they draw information for a specific loan, including multiple third parties with no interest in the outcome of the transaction. A "benchmark record" can then be established to give lenders a loan file that can be compared with the da-

ta supplied by the borrower and the originator.

The differences in the two records are calculated, and the variances that exceed certain predetermined thresholds are highlighted. By forcing this reconciliation by building it into the system, contradictions in data points that may have been overlooked in a traditional origination will have to be explained going forward.

The benchmark record monitors which data elements are being used to process the deal and the reason for their selection. The decisions are all recorded and persist in an electronic file that can be shared with investors and the people responsible for analyzing risk. While the cost per loan manufactured increases with this approach - primarily as a result of additional purchases of third-party data - this cost should be offset by the willingness of investors to pay more for the resulting higher levels of quality, transparency and accountability. The exact pricing of these Mortgage 2.0 advantages will be determined by the marketplace on a case-by-case basis.

Mortgage 2.0 is not a destination unto itself, but rather, a milepost on the way to true "cloud computing," in which resources reside in the Internet cloud and the network becomes the computer. This provides an extraordinary level of flexibility to adapt loan products and data collection to changes in customer demand, regulatory requirements or the underwriting demands of the secondary market.

Moving toward this networked approach lets participants in the mortgage manufacturing and securitization process participate in ways previously unimaginable. In several cases that we have seen implemented, technology enables investors to create custom loan manufacturing plans that lenders can then follow to originate mortgages.

Today, investors can define the underwriting guidelines only. Stepping into the cloud gives them the ability to influence the nature of the loans in a more dynamic way, much earlier in the origination process.

Investors can require that a benchmark record be created as part of the loan manufacturing process, and

perhaps even determine how comprehensive the documentation should be. If investors see the greatest risk score in borrower information, they can opt to make the benchmark record more comprehensive relative to the borrower and lighter on collateral value information.

By effectively moving the role of the investor upstream in the origination process, the lender introduces a much higher level of transparency. As a significant corollary benefit, lenders will also have to put into place the scalable and flexible infrastructure to more rapidly bring new products to market.

Everyone now agrees that transparency is good, but there is not yet a consensus on how it should be valued. As the adoption of benchmark records from lenders becomes more widespread, investors will need to determine how much they are willing to pay for information on the loans they plan to acquire. This need not be an arbitrary process; if transparency has value to market participants, that will quickly be reflected in the pricing in the secondary market, as securities created using the more transparent loans trade at a premium.

As benchmark records gain traction as a vehicle for addressing the challenges of borrowers and originators providing inaccurate and incomplete information, attention will next shift to safeguarding the sources of data used to create these files, with the goal of ensuring that the problem isn't just being shifted to the data service companies. Risk analysts, lenders and investors will need to have a thorough understanding of the data service utilized in creating the record.

But instead of waiting for events to shake confidence in data services providers (which happened with borrower- and originator-supplied data), the industry needs to create a rigorous certification process for these companies that will provide safeguards and ensure confidence.

Many of the criteria are obvious: How often are data refreshed for the various elements? What is the origin of data for performing refreshes? What are the processes and procedures in place when data elements are found to be inaccurate? Other

criteria are not so obvious until the benchmark record scoring has been in place for some time. But in a cloud-based system, editing or adding criteria becomes a routine update versus a re-engineering project.

This is not to say that cloud technology and Mortgage 2.0 processes must entirely replace all existing vendor systems. While there is a need to foster an environment where data companies compete, it is equally important to make sure that only best-of-breed companies are allowed to enter the ring so that when benchmark records are published, the integrity of the record is never in doubt.

Fortunately, the adoption of the benchmark record will not require trading out of existing systems. In fact, it can be used parallel to other systems, and can be made available to ratings agencies and investors as a software as a service offering, where parts of existing systems or particular point solutions that are no longer relevant can be replaced by Internet-based modules.

Again, the flexibility of the new cloud systems allows multiple configurations and accommodates incremental changes without the accompanying capital expenditures characteristic of modifying or replacing aging internal

systems. Establishing and certifying benchmark records has the potential to create a virtuous circle of information sharing.

With the participation of all the major stakeholders and working from a Mortgage 2.0 platform, such a system could be up and running quickly, bringing a whole new level of agility and reliability, and renewed trust, to all phases of the lending process. **SME**

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*David Parker is director of business development at Dorado Systems, San Mateo, Calif. He can be reached at (650) 227-7300.*