



white paper series
risk management

Big Bank Lending:
Tactical to Strategic Technology Selection

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Introduction

This paper will address how lenders' technology selections can become strategic, rather than merely tactical decisions. In particular, the paper describes an inside/outside the firewall solution that enables banks to tie their internal lending operations (loan origination and underwriting) to a distributed platform that includes Web-based (extranet) service portals.

Financial institutions are re-engineering production systems, reducing costs, and growing market share. The most pressing issue for many lenders is to adopt the latest, most sophisticated technology in order to reduce costs and improve processes. Newer technology is designed to Web-enable certain aspects of lending. The trouble is, many institutions have been stung in recent years by making the mistake of implementing a separate, distinct Internet strategy as a separate business channel rather than as part of an integrated business solution.

The challenge for banks is to develop a streamlined process that harnesses the power of the Internet, while at the same time leveraging their existing distributed networks. Banks are looking to reconfigure systems, along with operational processes, to take advantage of the Internet as an optimal venue for commercial exchange—such as vendor procurement. The newest generation of software for new e-finance processes often ties together loan origination and underwriting systems, customer data, and loan product and service tracking. All authorized departments within the financial institution are able to access, process and communicate with what appears to the individual user as a single system.

This is generally accomplished using various middleware effectively, the glue that binds together the various, disparate systems. The tactical aim is for knowledge and process to be shared within the bank by anyone whom it might benefit. The ultimate goal is a seamless system with standardized business rules¹. The benefits in terms of profitability and efficiency are observed throughout the bank. Until now, however, despite many large banks' concentration of lending activity in the area of real estate, the integration of the systems has not included the real property assets themselves.

Big Bank Lending: Real Estate Collateral Management in the Origination Process

Of the two main ingredients needed to produce a loan, the borrower and the collateral, the emphasis has historically been on the borrower—his or her credit worthiness, and therefore, propensity to repay the loan. Though real estate can typically comprise as much as 70 to 80 percent of a bank's exposure, the real estate asset itself is very often ignored except during origination or foreclosure, when appraisals are deemed necessary. Advances made in the consumer credit arena with respect to credit tracking and analysis, and the advent of merged credit reports have propelled the underwriting and origination processes far ahead of the collateral side of the equation. A tremendous need exists for a solution that brings the real estate collateral—and all information associated with that asset—to the forefront.

Despite the loosening of intra-institutional restraints resulting from the advent of the Internet, many financial institutions still rely heavily on paper-based processes. However, more institutions are shifting to electronic processes and capitalizing upon emerging Web applications. Financial services players are, for the most part, focusing on prepackaged e-process solutions targeted to loan origination and underwriting. CIOs are also looking at technology that can balance automating document-centric, back-office operations with the adoption of online customer service solutions. IT executives are under

1. "Business Rules" refers to the decision-making parameters that the bank defines for each step of the lending process. For instance, one series of the business rules established during the loan origination phase is the banded spectrum of credit scores and borrower-estimated property values that will determine the type of loan and associated interest rate that the lender can offer to a borrower.

enormous pressure to invest in the foundation for future Web infrastructure while improving automated paper-based processes in the near term, without wasting time or resources. Achieving scalability is of central concern for the deployment of any of these solutions.

Operations executives and CIOs are attempting to create the paperless office. One short-term goal has been to simply get paper documents into images such as PDF 2 files. As a strategic consideration, institutions would be better served by a datacentric approach—essentially, getting rid of the paper while securing and aggregating the data that resides in the documents themselves. Cost-justification is easy—the institution is currently incurring the costs of paper, humans to process the paper, delayed processing time, sequential processing, and lost interest.

Real Estate Collateral Management in the Origination Process

With respect to existing structural costs, the basic process is for institutions to take an application, process the application, and underwrite the loan. So far, much institutional time has been spent on how to improve the application process, including how to reduce loan commissions using alternative loan channels such as the Web. Heretofore, Web strategies have spent heavily on new lead-generation and generating business directly from consumers via the Internet. Very few institutional resources have been focused on how to reduce costs of processing and underwriting components, yet there are significant costs associated with the back office aspects of loan origination. Financial institutions have learned how to process loans efficiently by controlling documentation, communication, and processing—however, much of the required loan documentation is provided by third-party vendors. As a result, the institution faces several dilemmas, to wit:

- How to close the loan as fast as possible—recognizing that much of the slowdown in mortgage processing occurs with vendor procurement.
- How to minimize total application, processing, and underwriting costs—several studies have documented that third-party services add significant costs to loan origination.
- How to select best value documentation and compliance products for a specific loan—part of the institution’s documentation process is to determine the best valuation product for a given loan type. For example, which is the best collateral product for a given credit score in a given market area?
- How to select the best value vendor for given documentation and compliance products—given the best value product, which vendor is best suited to provide this product to the bank?
- How to interact with selected vendors—once the best value vendor is selected, everyone at the institution must be able to communicate with each vendor. This communication must be tied to the order and report to allow decision makers to follow all correspondence.
- How to process incoming reports from vendors—once reports are received from third party vendors, collaboration must occur inside the financial institution in order to process the loan. This collaboration must occur simultaneously within the bank and may also involve additional collaboration with the vendor.
- How to get data for decision-making extracted from vendors’ reports—from an operations perspective, the goal is to extract data from vendors’ reports to update loan processing systems. At the same time, lenders desire to extract data to construct data warehouses for future uses.
- How to re-use this data for future decisions including portfolio monitoring—once loan processing is complete, loan level data is very valuable. Financial institutions have the need to re-use this data for multiple reasons as well as to share it with other departments.

Our solutions allow vendors to deliver and to send their products/solutions to a server accessible to all areas of the bank via the bank's intranet. At the same time, data can be extracted from vendor reports to update processing systems on a real-time basis, saving dollars, eliminating re-keying, and providing better information about loan status.

Back-Office Focus

Recognizing that it takes two numbers to make a secured loan: a credit number on the borrower and a collateral number on the property, we have tied our vision to the collateral side of the real estate lending equation. We fully understand the time-consuming and encumbered loan origination process that can be especially tied up by the slow, paper-based delivery of multiple reports by the variety of vendors who are involved in the course of a loan transaction. We develop e-finance fulfillment solutions to automate and streamline the loan origination process, while at the same time minimizing the margin for error within the process—all of which correspond to reduced costs, faster decisions and strategic opportunities.

Communication Network

CMS (Collateral Management System[®]) works within an institution's intranet to create an internal network for collateral communication and collaboration, allowing loan officers, processors, originators, and other authorized bank personnel to communicate internally and relate their communications to the work product under consideration. Collaboration can be real-time, at pre-specified times, or at the user's convenience. Bank personnel are also able to communicate/collaborate with a vendor, and vendors needing to communicate with one another can do so as well—such as a fee appraiser communicating with a fee review appraiser. One customer justified the cost of the bank's system on this feature alone. Approximately 90 percent of the phone calls between loan officers, processors, staff appraisers, reviewers, and fee appraisers at this institution were eliminated. Implementing the CMS produced substantial time-savings for this client, in addition to hard dollar savings.

Simultaneous Processing

Most loan applications involve sequential processing—one step must be completed before the next begins. However, if an institution adopts simultaneous processing, multiple steps are completed at once, speeding loan processing and funding, a huge time saver for the bank. With FNC Pipes solutions, collaboration allows for simultaneous processing. A processor, underwriter, loan officer, and appraisal reviewer can look at the same document, collaborate, and solve any problems or potential problems quickly. The nested communications ability of the CMS makes such collaboration possible. Anyone authorized to access the system can communicate with anyone else.

This is entirely unique within the marketplace. Other providers focus on suppliers (for example, appraisers). In such a model, a Web site is developed where buyers (banks) can procure services from appraisers, and appraisers deliver documents to the bank. These alternative systems are principally focused on delivering documents. They are simply procurement systems—our solutions comprise much more functionality and so, are fundamentally different.

We deliver both documents and data—as in data warehouses and data marts. One core difference between our solution and a simple procurement system is that the procurement system merely gets the product/solution to the bank. The bank must have an internal network to manage the document and/or communicate with vendors once the document arrives. As only one person can communicate with a given vendor at any time, there is no collaboration within the system, nor is there the advantage of simultaneous processing, both of which would greatly benefit the institution. The rewards gained from these two functionalities alone make our solutions superior to other products or solutions on the market.

Front-End Origination Analytics

Our solutions integrate with any and all bank systems, legacy or otherwise. As a result, we have the ability to automate many of the decision rules for collateral processing. For example, a bank may have multiple loan products that require different types of collateral documents. At the same time, most institutions have compensating factors allowing different types of collateral documentation for differences in credit factors. FNC has built a matrix into CMS, allowing a bank to input product type once, credit score once. We build a decision rule that allows for compensating balances in real time. The practical benefit to the bank is the consistent application of its business rules, and the cost savings from the automation of the entire process.

Additionally, CMS is designed to order the best value collateral product from the best value vendor. The bank defines the best value product for a given set of financial characteristics, as well as the best value vendor for a given area/product. How is the best value vendor determined? Is it based on turn time, lowest fee, quality? We provide the bank with a screen to determine these criteria based on its own internal assessments. Through advancements in neural technology, we also track all vendors and provides real-time feedback on each vendor, updating the CMS for future job assignments.

Back-End Origination Analytics

When a bank receives a report from a vendor, the CMS opens the report, extracts the data, and can then subject the data to a set of rules devised by the client institution. While appraisal software vendors (ASVs) can do this to their own forms using a set of appraisal rules, they must apply this function through the software itself (a CD distribution problem). We can apply bank specific rules as well as market-based rules. Finally, because our solutions are Web enabled, banks can make changes to rules easily and enact them throughout the bank's network with a simple adjustment to the server(s). The next time a user logs in after a rule change, the new rules will be applied, again representing a huge savings to the bank with but a quick change in the bank's operating requirements.

Big Bank Lending: Conclusion

High-volume lenders face a number of challenges as they transform their loan production processes from manual to digital methods. Before selecting, adopting and advancing a particular technology solution, consideration should be given to what the organization is trying to achieve and with what priority. As presented in this paper, there are a host of tactical operations concerns that may prompt an institution's decision to scrutinize its processes and ultimately adopt new technology. To review, these may include:

- Enhancing overall operational efficiency
- Minimizing application, underwriting and processing costs
- Establishing or refining operational standards
- Stabilizing the processor (or appraisal manager) headcount over up- and down-cycles
- Reducing upfront switching costs associated with changing vendors
- Introducing performance metrics
- Selecting vendors
- Improving communications and interaction with vendors
- Processing incoming reports
- Abstracting and archiving data

Again, these are largely operations issues. But high-volume lenders should assess their technology with respect to planned or proposed strategic actions as well. For instance, a merger with or the acquisition of another bank would benefit from the very same scalable, electronic platform implemented to integrate loan origination, vendor management and underwriting systems for operations. Additional strategies contemplated from time to time may include whether to:

- Enter/exit a particular line of business
- Contract/expand wholesale lending operations
- Contract/expand retail operations

Strategic decisions carry far greater risk/reward than day-to-day lending operations decisions. Most times, the difference between a successful strategic decision and a failed one lies in its execution. In this age of industry consolidation, a question that a loan officer, chief credit officer or chief appraiser might ask him or herself is, "If my bank were to acquire another, or to be acquired, would our current systems help or hinder the success of that event?" The answer to that question may lend more urgency to the need to inspect current systems and operations than may have been previously recognized.