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Exploring Return on Automation

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On Their MINDS

Loan Quality, Compliance Top Issues

Roundtable participants from left: Vladimir Bien-Aime, John Coester, Steve DeBlasio and Dain Ehring

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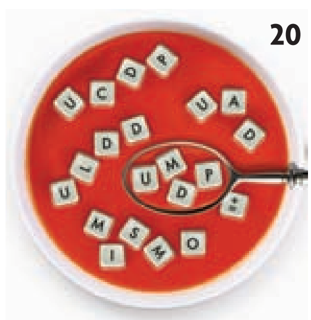

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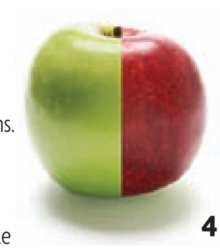


Inside

Going It Alone

In a competitive field, vendors aspire to best-of-breed status.

Following 2007's housing market crash, the industry has witnessed the disappearance of one independent mortgage technology provider after another. It seems as though the fortunate ones have been acquired by larger firms beefing up to compete in an increasingly consolidated marketplace.

But what of the tech vendors that still compete for "best-of-breed" standing in the mortgage space? How do they manage to survive, let alone thrive?

Certainly some entrepreneurial vendors have been around long enough to possess a book of business that lets them operate on recurring fee income. And as the market contracts further, we will see new firms launch after large companies lay off talented veterans unwilling to go find jobs in other industries.

Furthermore, some nimble vendors doubtlessly will garner new business by being first to offer technology tools that help mortgage lenders deal with particular production challenges and regulatory issues.

By Scott Kersnar

Though the continuing stagnation in mortgage originations inevitably will force more independent vendors to find acquirers or close their doors, a sampling of six firms—Coester Appraisal Group, Doc Systems Inc. (DocMagic), MortgageFlex, Optimal Blue, Precision Risk Management Services and VirPack—all reported being able to operate successfully on a stand-alone basis. Obviously all six have been affected by the downturn to some degree, but all said they have been able to make ends meet. Some even said they've increased revenue.

But PRMS boasts that its product leverages the Microsoft .Net framework and requires little IT support, while easily integrating into loan origination systems.

"QRM works very well and has a substantial client base on the high end of the market," said Demster. "However, with lenders focused on pipeline and operational risk, I feel that PRMS will consistently offer a significantly higher competitive advantage. At the end of the day, PRMS allows its customers to consistently maximize profitability on their trades without requiring users to be a Houdini to get answers from their systems."

"Risk-management solutions do not have to be fully integrated into an LOS to perform well."

Dave Demster, PRMS

PRMS is a strategic partner to veteran LOS provider MortgageFlex of Jacksonville, Fla. What makes MortgageFlex Systems a best-of-breed player in the LOS space, said president and CEO Lester Dominic, is that it develops its product in response to demand and does that more carefully than rivals do. He cited the fact that MortgageFlex did a complete rewrite of its code into Microsoft .Net at a cost of some $10 million.

"They not only spent a lot of money rewriting the code for their new system, they took a lot of time and did it right," said Bob Phelps, business applications manager for Irvine, Calif.-based Standard Pacific Mortgage.

A former MortgageFlex user, Standard Pacific jumped to Morvision and Mortgage Cadence to leverage newer technology, but returned to the MortgageFlex fold after they finished the .Net rewrite. Phelps said that rewrite made integrations easier to enable compliance. "I think one of the strong points for any vendor has to be that they partner with us rather than saying, 'this is the way we built our system, take it or leave it.'"

So what must an independent firm do to compete as a best-of-breed provider?

"For most people," said Dave Demster, director of business development for Precision Risk Management Systems, "best-of-breed suggests that a product or service provides comprehensive functionality, is offered in a modern and intuitive technology, easily integrates with external systems and generally speaking, provides a greater ROI than other offerings in the specified space."

"Certainly," he added, "incorporated into the ROI analysis, there is the assumption that industry-knowledgeable people will develop and support the product to stay ahead of competitive offerings and support its clients."

Little Rock, Ark.-based PRMS is a newer company in the industry and has to compete with larger, established risk-management firms like Quantitative Risk Management, which has offices on three different continents.

Functioning on a stand-alone basis is not a handicap for PRMS, he said, "Risk-management solutions do not have to be fully integrated into an LOS to perform well. In effect, the risk management solution overlays the LOS system and provides analytics and decisions derived from LOS data. it doesn't appear to a lender that he has ever left the LOS to get to the risk management functionality. A .Net platform makes this fairly straightforward."

Like all the others interviewed, Demster said it is essential that best-of-breed providers add value in terms of flexibility as well as improved ROI in their product offerings. In 2009, Tulsa, Okla.-based Gateway Mortgage decided to stop outsourcing risk management to Compass Analytics in favor of licensing PRMS software to bring trading and risk management in-house. "I know that we made more money by doing that," said Gateway president Kevin Stitt.

MortgageFlex's selective strategy for integrating and performing with other vendors and services was "a huge factor" in picking them, Phelps said.

"We don't want an LOS company that jumps on every bandwagon that comes along," he said. "We want to be able to rely on our LOS vendor to help us pick the other vendors we need. By the same token we want them to listen to us when we have a vendor."

For example, MortgageFlex interfaced with fraud detection vendor Interthinx when Standard Pacific requested it.

A recurring theme for best-of-breed vendors is they have to know their corner of the industry well enough to provide technology and services that move the ball forward in ways that rivals don't.

For example, Plano, Texas-based product and pricing engine provider Optimal Blue was founded by people who earlier developed one PPE and saw a chance to go to the next level.

In a feature on mergers and acquisitions in the March edition of *Mortgage Technology*, industry observer Jeff Lebowitz suggested all the PPE vendors should merge into one entity, perhaps under the QRM banner, to increase their bargaining power with larger lenders and thereby their chances of survival.

Given the challenges of the current market, is every small entrepreneurial player hoping to be an acquisition target for megavendors like CoreLogic, Wolters Kluwer and Lender Processing Services?

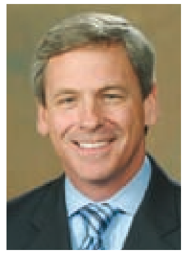
"That's not always the case," said Optimal Blue co-CEO Larry Huff. He pointed out that the market Optimal Blue serves is "everybody outside the top five banks," representing the megabanks' purchase criteria to the lenders and brokers.

"As a nimble, privately held enterprise, we are able to respond quickly to changes in the marketplace," he said. "This flexibility has allowed us to keep up with the incredible pace of change the industry has endured during the course of the past year."

Can a PPE perform for a lender as effectively on a stand-alone basis as one that's permanently integrated into an LOS? The jury is still out on the recent purchase of Loan-Score Decisioning Systems by Calyx Software. One lender, an Encompass360 user that currently uses Optimal Blue, said it would be watching the performance of the Mortgage Pricing Systems' PPE that Ellie Mae just acquired because the lender would rather have the PPE integrated into its LOS.

"If I were a lender, I would say that as well," said Huff, acknowledging that the test of Optimal Blue's value as a best-of-breed provider in that instance will be whether it proves to be sufficiently "more sophisticated and more comprehensive" than Ellie Mae's integrated PPE. "Our job is to innovate and add value in areas that competitors can't."

In addition to PPE tech, Optimal Blue offers secondary marketing functionality to automate best-fit product searching and enable centralized locking, best execution and rate sheet generation.



"As a nimble, privately held enterprise, we are able to respond quickly to changes in the marketplace."

Larry Huff, Optimal Blue

In the past year, the company has launched two new offerings: a change-request feature to configure workflow rules for changes like lock extensions and interest rate changes on locked loans, and the first phase of loan officer compensation functionality.

Like Vienna, Va.-based e-delivery specialist VirPack, Optimal Blue has beefed up its product offerings with workflow to streamline its piece of a lender's operations and address quality-assurance and compliance needs.

"Their LO compensation feature is really based on best practices that they got by seeking advice from us and other users, from administration down to loan officers," said Brent Duhaime, executive vice president at Plano, Texas-based LeaderOne Financial. "They made it very easy to be compliant. LO compensation is a super-big change coming and they have assisted in making that change pretty easy."

He said the change request feature was another "outstanding" example of Optimal Blue's ability to respond to the needs of its clients. "A good working relationship is as important as the technology or anything else, Duhaime said. "They are above vendor status with us; they are more of a business partner."

Some executives at smaller firms note that acquisition is a survival strategy for acquirers as well as potential acquirees. "The larger companies want to acquire the smaller ones because they are more in touch with their customers," said Brian Coester, CEO of Rockville, Md.-based Coester Appraisal Group.

Founded in 1970 and boasting a database of over 39,000 appraisers with an average of 14 years of experience, Coester Appraisal Group serves smaller, regional lenders that compete by offering superior customer service themselves and "look for the competitive advantage a smaller vendor can offer them," Coester said.

He added larger vendors are unlikely to offer leading-edge technology or rapid response to market conditions.

"It's harder for a CoreLogic to move. They're more interested in the long term," Coester said. "I could make a policy change overnight and the next day everyone in the company would understand it. At CoreLogic it might take a year for a major new policy to be implemented."

We also have a competitive advantage in technology," he added. "There's nothing a CoreLogic would add."

It Better Be About Compliance

To crown a king of the independent mortgage technology firms these days, it's hard to look past Document Systems Inc., more commonly known as DocMagic. Founded in 1988, over the years the company has built dominant market share among mortgage document providers.

CEO and president Dominic Iannitti can remember trying to create "the closest thing possible to a WYSIWYG-type application before graphical user interfaces had been developed."

Today, the company maintains a library of over 100,000 documents currently used in mortgage transactions.

DocMagic's revenue is currently growing at a double-digit pace, Iannitti said. He attributed "easily 40%" of the increase to the thinning out of the doc prep herd, as the assets of companies like Guardian Mortgage Documents and Online Documents have been acquired by other companies.

Though he is known as a fierce competitor, Iannitti told *Mortgage Technology* that "we don't have a war mentality. Our strategy is to redirect our product-development efforts to what our clients need before they know what those needs are."

An example is e-disclosures. While DocMagic is widely considered to offer an affordable product, Iannitti said "competing on price is not our first choice," though the company offers volume-based pricing for some larger customers. If, as estimated, DocMagic's doc prep market share may be as high as 60%, he attributes that to their iron-clad compliance guarantees, supported by a rules-based auditing engine, "which takes a fraction of a second to determine whether there is an issue."

All observers interviewed agree that currently, compliance is the single most important motive that mortgage lenders all have for making technology purchases. DocMagic claims a larger compliance staff than any other doc prep firm, "as large or larger than ComplianceEase," Iannitti said. Though compliance companies are not DocMagic's direct competitors, "we have some customers that use us just for compliance," he added.

Even so, there are no magic bullets for compliance. "Given today's unsettled regulatory picture, no one person has the answer to anything," said Patricia de Holczer, lending compliance manager for Little Falls, Minn.-based Home Savings of America. "RESPA 2010 was a huge change for the entire industry, specifically on loan officer compensation and YSPs."

She said the ability to have an open conversation with DocMagic's compliance department is crucial: "Being able to rep and warrant that your docs are always compliant is important, of course. But being willing to discuss, being willing to challenge and be challenged in an ongoing conversation, that is the factor that counts most in a vendor relationship today. We get that with DocMagic."

While regulatory compliance has become more burdensome, the mortgage market has also declined, leaving investors less likely to impose onerous delivery requirements on correspondents.

Like VirPack, DocMagic is among the doc vendors that offer barcoding. VirPack offers e-delivery of documents to purchasers like Winston-Salem, N.C.-based bank BB&T for its purchase reviews.

"VirPack has a proven history as an e-delivery innovator for the mortgage industry," said Phil Lamm, correspondent lending manager at BB&T.

"We worked hand-in-hand to develop a proof of concept, test it and ultimately bring it to market, and we are absolutely thrilled with the end result which enables a streamlined solution for both the BB&T team and our clients," he added.

"Our strategy is to redirect our product-development efforts to what our clients need before they know what those needs are."

Dominic Iannitti, DocMagic

Nevertheless, Michael Coar, the president and CEO of VirPack, predicts that while the disappearance of Countrywide Home Loans put a crimp in demand for indexed loan delivery to investors, the need for maintaining an audit trail and curbing buybacks will continue to make indexed delivery attractive to mortgage investors.

Because indexed delivery automates confirmation that document sets are complete, the efficiencies, savings and quality assurance are compelling.

VirPack uses barcodes to automate indexing, said Coar, "because barcodes are one of the easiest and most accurate means to uniquely identify a document. That's why they are on virtually anything that you ever buy and also used to annotate things such as model number and serial numbers."

He added that barcoding is "a hundred times" less expensive than implementing optical character recognition technology.

Like DocMagic, VirPack claims that it has expanded while other independents technology vendors have languished under the weight of the housing and financial crises.

"In the two worst years on record, '08 and '09, we grew more than 40% each year," Coar said, adding that VirPack again projects double-digit growth this year.

"While best-of-breed providers would certainly be natural acquisition targets regardless of the market climate, " said Coar, "being independent offers the opportunity to leverage integration opportunities, often among vendors who might otherwise compete against each other."

But "this is a delicate dance," for vendors to manage, he acknowledged.

Meanwhile, the large technology aggregators hear overtures every day from the independent firms grown tired of that dance.