

# Adapting Automated Underwriting To Fit Today's Market

*The industry has changed, and this high-tech solution has evolved to better serve the current environment.*

By Joe Bowerbank

**D**uring the subprime and Alt-A days, proprietary in-house automated underwriting systems (AUS) were a must-have for mortgage bankers. Typically, lenders purchased expensive AUS whereby they were responsible for hosting and managing the business rules behind underwriting manuals.

Maintaining guidelines and pricing was entirely left up to lenders. This meant that several business analysts had to be on staff to make constant changes to business rules.

Once the market shifted toward only A-paper borrowers, however, the role of the AUS changed. The systems used during the subprime era were designed to evaluate the complexities and granularities of a subprime borrower's creditworthiness.

But the secondary market's appetite for anything other than conventional, conforming loans came to a swift halt. Investors began requiring lenders to use Fannie Mae's Desktop Underwriter (DU) or Freddie Mac's Loan Prospector (LP) AUS as conditions to accept loans for purchase.

Subsequent to the mortgage meltdown, lenders were left in a financially challenged position to restructure operations, production, technology models and every other functional area across the board. Cost cutting became king in order to sustain the business and weather the storm. Lenders had no choice but to bear expensive per-application fees on loans

submitted to government-sponsored enterprise (GSE) AU engines for approval and investor purchase.

In late December 2008, interest rates dropped to historic lows, and the mortgage market began to enjoy a mini-refi boom. Lenders started adding staff to accommodate the market's upswing, but amid unpredictable market conditions, lenders still needed to keep cost control at the forefront of expansion.

With that in mind, lenders sought additional methods and tools to operate efficiently and cost-effectively. Technology is one avenue by which to achieve this.

Software as a service (SaaS) gained momentum virtually overnight, because it was less expensive, easy to implement and had a low total cost of ownership. Lenders predominantly began to use the SaaS model in the loan origination system (LOS) and product and pricing engine (PPE) arenas. In particular, PPEs became popular because lenders could use these low-cost engines as simple pre-qualification product finders and then use DU/LP to underwrite loans.



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The problem, however, lies in the costs associated with the number of applications sent through GSE-operated AUS. In an incredibly tough, profit-pinched market, this quickly adds up and hurts the bottom line. Consequently, the industry's loan approval paradigm has again begun to shift.

## **AUS as a deal filter**

Many lenders empower their loan officers with the discretion to use DU/LP at the point of sale (POS) as a means to check if deals will work. Pulling DU/LP at the POS and then having to again pull it in the back office to satisfy investor conditions doubles the cost to originate and sell loans. This results in lenders' spending thousands of unnecessary dollars each month in order to capture business at the POS.

This pain point has created the need to utilize proprietary AUS. An AUS houses and mirrors each investor's underwriting manual and corresponding pricing. Hence, lenders are turning to proprietary AUS as a POS "deal filter" to check if deals will work before incurring unnecessary transaction fees. So, if a lender's in-house AUS renders a conditional underwriting pre-approval at the POS, it only needs to pull DU/LP on the back end to satisfy investor requirements.

In late 2007, consulting firm CC Pace published a white paper entitled "The Future of Automated Underwriting"

ing." In the white paper, the firm's research concluded that companies should emphasize the AUS as their key operating platform.

The firm further stated that AUS provide the best way to balance efficiency with loan quality and to establish consistency and control. In addition, research also determined that "an AUS carries the same weight as a human underwriter's decision."

In essence, an AUS answers the questions, "Is this loan approved?" and "What do I have to do?" In contrast, a PPE delivers a result (typically using stated borrower information) that does not pull and evaluate credit.

### **AUS integrations**

Up-front cost savings is only one advantage of utilizing an AUS in today's market. Equally important are integrations with other platforms. To gain the maximum benefit of using an AUS, integrations must exist with GSE-operated AUS, the Federal Housing Administration's (FHA) TOTAL Scorecard platform and back-office LOS. These integrations are paramount in order to gain efficiencies, maximize profitability, elevate service and realize return on investment.

As an example, an AUS that is tightly integrated with an LOS allows loan officers and brokers to pre-qualify, price and underwrite loans at the POS without ever having to leave the application with which they are accustomed to working. The 1003, pricing, loan details and underwriting conditions automatically appear within the LOS. When an underwriter clears a condition, it moves to the loan officer's or broker's pipeline. This fluid, bidirectional integration of disparate systems offers real-time visibility and provides faster turn times.

The current business environment obviously has lenders looking for ways to do more with less. Whether it's wholesale, retail or consumer direct lending, mortgage bankers are aggressively pursuing growth opportunities.

However, growing existing channels or launching new channels re-

quires more staff to support them. An AUS helps lenders avoid having to hire more underwriters when volume picks up or a new channel is launched.

As an example, let's assume lender XYZ has a retail channel that is doing roughly \$30 million a month in volume and growing by about 10% each month. The lender's underwriters are already resource-constrained, and the owner also has a mandate to launch a new wholesale channel.

In order to do this, more underwriters would have to be hired and trained. However, using an in-house AUS moves the onus of underwriting to the POS for loan officers and brokers.

As a result, the bulk of the decisioning and underwriting process is completed at the POS, with files then being sent to underwriting for quality control. This allows underwriters to increase productivity without adding more staff, as they are able to become highly efficient reviewers.

### **Secondary market issues**

A proprietary AUS is also effective in making secondary marketing departments more profitable. There are a couple of ways lenders accomplish this, depending on secondary marketing strategy.

If lenders are utilizing best efforts as their execution model, off-the-shelf investor products are usually private-labeled, whereby loan officers see only the best investor price for a particular program, and then lock the loan. Secondary marketing later re-decisions the individual loan or bulk-decisions the entire locked loan pipeline to determine to which investor to sell the loan(s). This prevents a laborious, time-consuming burden of having to visit each investor's Web site to attain pricing and eligibility.

If the lender wishes to use a more sophisticated secondary marketing strategy that involves mandatory, bulk or co-issues, then custom guidelines and custom pricing are generally needed. Lenders are able to place their own overlays on top of investor

guidelines and add their own custom pricing.

In turn, the lender is able to offer "blended guidelines" to originators at the POS. For instance, let's say XYZ lender does business with five investors. The advantage of blending guidelines is to show originators only a single set of programs and pricing to choose from. This increases the secondary desk's flexibility to fill different investor pools that best fit their execution strategy.

Whichever secondary strategy you use, AUS drive improved profitability both at the POS and in secondary marketing.

Our industry has clearly gone through many changes and experienced significant retrenchment. After the market crashed, lenders scrambled to harness just enough technology to get by. Automated underwriting systems as we once knew them died in a resource-constrained climate with new loan-approval needs.

However, with an upswing in volume, the in-house proprietary AUS again has a role in mortgage banking. Generally, the more sophisticated mortgage banker that is focused on aggressively growing its volume is an ideal candidate for utilizing a proprietary in-house AUS. On the other hand, brokers and smaller mortgage bankers are typically better suited to utilize a PPE that returns a pre-qualification and price.

Many organizations often start with a PPE and later graduate to the functionality of an AUS. This type of comprehensive decision management and underwriting platform, coupled with seamless integrations with GSE AUS, FHA TOTAL Scorecard and LOS, helps lenders reach lending efficiency, profitability and cost cutting as it relates to pricing, underwriting, processing, fulfillment and secondary marketing.

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