Is Technology to Blame for Lost Loans?

We've all witnessed a lot of changes in the industry since the introduction of automated underwriting systems (AUS). Without question, there have been many advantages and cost reductions for the industry as a whole. Still, with the introduction of any new technology, there can be unintended consequences.

In the late 1990s Fannie Mae actively promoted Desktop Underwriter® (DU) and its sister, Desktop Originator® (DO), and Freddie Mac actively promoted Loan Prospector® (LP). These systems were widely adopted by both their customers and mortgage brokers. Today the vast majority of conforming loans are underwritten by these two systems. Consumers can now walk into almost any mortgage origination company, apply for a conforming loan and expect to have their loan underwritten efficiently by one of these systems. Of course, not all borrowers are approved, and when the loan is referred for manual underwriting by DU or LP because it does not appear to meet the standards for automated approval, the borrower then could end up being moved to a nonprime loan with a higher rate. While everyone in the industry accepts this as standard practice, could a change actually increase our loan production?

Note that in the previous scenario, the borrower's loan is underwritten by *one* of the systems. While technically it's feasible that the borrower can have his or her loan reviewed by both systems, it rarely occurs in general practice. Although I'm sure there are some loan originators out there that will use both systems, I have yet to come across any. Both Fannie Mae and Freddie Mac will frequently advertise to their customers how they will accept loans that the other government-sponsored enterprise (GSE) won't. In fact, it's a fairly strong promotional practice to emphasize how many more consumers would be approved over the competing GSE's AUS.

The reality is, there are a significant number of consumers who would be accepted by one GSE's AUS and not the other. We can accept that with all the borrowers referred and then declined by one of the GSEs' AUS, there's a significant percentage of loans that would be accepted by the other. We don't know what this percentage is, since no study has ever been commissioned. But given the millions of loans underwritten by the AUSes, an educated guess would be that tens of thousands of loans could fall into this category. Of these loans, we can expect that a significant percentage of borrowers may not have qualified for subprime loans for the home they were seeking. Or the borrower may be applying with a mortgage banker that does not originate any subprime loans at all. These loans are then typically lost business.

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If we wish to correct this technology-related problem, we need to see why it occurs. Why is it that mortgage originators don't automatically allow both systems to evaluate every potential loan? There are several reasons for this.

- There is an economic factor at work, since both DU and LP have a cost related to their use. Prior to the AUSes, underwriting was effectively free to the mortgage originator. Mortgage originators now save money when only one system is used.
- Each of these systems is somewhat difficult to use, and requires some training. Both GSEs have made strides to make the systems easier to use, but they are complex systems dealing with complex financial analysis. For the mortgage originator, it requires extra effort and training to use both systems. Both systems have entirely different user interfaces and differing underwriting feedback.
- In recent years the GSEs have entered into primary supplier agreements, whereas the mortgage company primarily uses just one of the GSEs' loan products and related AUS. For most mortgage companies, the mortgage originator is not given the option of using both AUSes.
- There is no system widely available to the industry that allows the mortgage originator to seamlessly use multiple AUSes for a single price.

Prior to the introduction of the AUSes, the common practice in the industry was that each loan was packaged in such a way that either GSE could purchase it. It was typically left to the secondary marketing department to determine at the last minute which GSE it would sell its loans to. As the AUSes were introduced, one could wonder if they were used to help control the loan origination channels. Conforming loans are now slotted to one GSE or the other at the point of sale. The secondary marketing departments largely have lost the ability to, in essence, place a given loan to the lowest bidder.

In the late 1990s and soon after the AUSes were introduced, there were at least a half-dozen companies that attempted to provide the industry with a great solution. The basic ideas proposed were to build a single Web site that a mortgage originator would use. This single site would then automatically submit the loan to both LP and DU, as well as to several other industry-leading AUSes that were widely used at that time. The originator would be given a single low price, only one credit report would be pulled and there would be only one user interface to learn. In addition, these systems would create a competitive environment that could be beneficial to the consumer.

Both GSEs declined to allow their AUSes to be used in such a system and they haven't allowed such a system to be developed to date, according to my knowledge. It's my belief that the GSEs should publish their AUS decisioning algorithms as open standards just as they did prior to the existence of AUSes. In such a case, many independent businesses could build a super-AUS that would be cost-competitive and comprehensive.

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If we had open AUS standards, the industry could evolve to help ensure that every possible loan application taken could be approved. With the Internet and today's technologies, every consumer could be evaluated by several or even dozens of different AUSes. They could know instantly what lenders and GSEs would be willing to purchase their loan. Such a system would be similar to the airline industry (and most industries), where single Web sites can provide pricing for many airlines.

There's no question that AUSes are doing a better job today at ensuring that the maximum number of loans are approved, as compared with manual underwriting. However, there are still areas that need improvement. As our industry approaches what could be the largest refinance bust ever, we need to ensure that every possible loan that can be approved is approved. Since all of the technology exists today to create a better system, there's no excuse not to move forward.

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