Settlement Service Automation—Looking at the Landscape

SETTLEMENT SERVICES IS A MULTIBILlion-dollar industry with little idea of how its products will be delivered in the years to come. While we can't go so far as to say they are clueless, we can say they are placing their bets in a lot of different areas. Companies like Fidelity National Financial, Santa Barbara, California; LandAmerica Financial Group Inc., Richmond, Virginia; and The First American Corporation, Santa Ana, California, are all watching the landscape and trying to decide how their products will be delivered in the future and who else will be involved in that process. Products such as title insurance, credit reports, appraisals, flood certificates, etc., have to flow from these settlement service vendors (SSVs) to mortgage origination companies. The future presents real challenges, and missing the boat could eventually create large swings in market share for these dominant players.

Furthermore, the numerous delivery channels vary widely in terms of profitability for these firms. Today their products are widely distributed to tens of thousands of customers. This could all change as technological innovation could funnel much of their business through a few electronic channels. We must also throw into the mix the Real Estate Settlement Procedures Act (RESPA) changes calling for packages of these products. We can look at each opportunity and only make guesses as to which will be successful. The only thing that's certain is that we have a long way to go before we'll know the outcome.

Electronic networks

Over the last few years, several electronic networks have been established, such as Santa Ana, California–based FNIS', Houston-based Stewart Title Co.'s and Richmond, Virginia–based LandAmerica Financial Group Inc.'s RealEC Technologies™; Pleasanton, California–based Ellie Mae Inc.'s ePASS® (electronic processing and submission system); Milwaukee-based Mortgage Guaranty Insurance Corporation's (MGIC's) eMagic™; and West Palm Beach, Florida–based Ocwen Technology Xchange® Inc.'s (OTX's) REALTrans®. These technology firms have found some success by electronically connecting mortgage origination companies with the settlement service vendors. It's a complex environment, and each of these firms has a slightly different niche. They earn their fees by charging the SSVs a small fee for each product delivered. They add value by moving the data to/from the SSV's host computers with those of the mortgage originator.

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One thing has become clear: The data must tightly integrate with the loan origination systems (LOSes) that the mortgage origination companies use. The SSVs require dozens of data elements that exist in the LOS, and hundreds of data elements should be passed back to the LOS. In addition, a constant stream of status information must also move back and forth. For this reason, the four technology vendors mentioned here have expended a lot of effort to integrate with as many LOSes as possible. Ellie Mae went so far as to buy two leading LOSes to insure a tight integration and to keep out the competition. Because the electronic networks rely on the LOS for so much of their solution, it becomes a business plan weakness.

LOS vendors

The top LOS vendors have been around for a dozen or more years, and have created sizable customer bases. Many systems handle more than 1 million loans per year, and thus have considerable aggregation capabilities. Most LOS vendors consider the transaction revenue opportunity as their Holy Grail. It's a way for significant profits to be generated through the electronic transactions that come from the SSVs.

For the electronic networks, LOSes can be a significant competitor. For example, several LOSes have established direct connections with the SSVs, effectively cutting out the electronic networks. The LOSes with the largest loan volumes flowing through their software solutions have a significant advantage over their smaller competitors. Perhaps the smaller LOS vendors will be more reliant on the electronic networks as the LOS vendors are less able to justify the significant research and development (R&D) expenses required to build the SSV connections. For the SSVs, both the LOSes and electronic networks have the impact of adding expenses while aggregating volumes.

The future threat for the SSVs is if the LOSes and electronic networks someday actually begin to purchase the SSVs' products on behalf of their customers. In essence, a buying co-op could be created to obtain better pricing from the SSVs through the aggregated volume.

Large lenders

The SSVs are motivated to keep a direct relationship with as many of their customers as possible. There's a threat that continued inroads from these other solutions might risk high-margin direct delivery with their best customers. While it's not realistic for the SSVs to establish direct connections with the smaller mortgage originators, they are feverishly working to establish and maintain connections with the largest mortgage origination companies (the larger lenders).

About one-third of the SSVs' volume comes from the top 25 lenders in the industry, so each SSV is committed to direct electronic connections. On the other hand, large lenders appreciate multiple SSVs tying into their computer systems and maintaining an ability to choose different SSVs as desired.

The large lenders are also eyeing increased profitability that could come from handling SSVs' products in a different manner. Today it's the borrowers who are actually paying for the SSVs' products, but this all changes under the newer RESPA rules that allow for the bundling of the SSVs' products into a single loan package. Already, several large lenders have announced a fully packaged loan product that includes all of the SSVs' products. This could result in the lenders prepurchasing large volumes of the SSVs' products, which they then resell. This method could further reduce the margins for the SSVs.

GSEs

The big wild card right now is what the government-sponsored enterprises (GSEs) might do. Both Fannie Mae and Freddie Mac have automated underwriting systems (AUSes) that are already tightly integrated into the LOSes. Further, they handle (or aggregate) huge volumes of loans—certainly more than any other entity. Both firms hunger to increase profitability and see fertile grounds in the area of handling settlement services through their respective AUSes. Imagine the buying power the GSEs would have if they handled all the settlement service products and earned fees on each transaction.

Already Fannie Mae and Freddie Mac have started down this path with credit reports, and Freddie Mac recently began promoting an automated appraisal product. The opportunity exists to easily add $100 or more of profit on each loan handled by the AUSes. The SSVs do fear the GSEs because of their power and position in the marketplace. At the same time, if they refuse to work with the GSEs, they stand a chance of being cut out of the new frontier (or almost as bad, being last to the party). The LOSes, electronic networks and large lenders all have similar fears about the GSEs. Political pressure is probably the best defense the SSVs have with the GSEs.

The SSVs are seeing their landscape change rapidly. Threats to their margins are coming from all areas. Further, where their revenues come from are increasingly becoming consolidated. A few customers with large volumes might be less profitable than tens of thousands of customers with small volumes.

Still, where there's change, there's also opportunity. The need for the SSVs products isn't going away, and each is working hard to leverage technology to increase its market share. The SSV with strong products, political savvy and—perhaps most importantly—the right technology decisions could become the real winner.

Scott Cooley is an independent mortgage technology consultant, analyst and author based in Los Gatos, California. He can be reached at scottmcooley@hotmail.com.