

The LOS Market— The Battles Continue

It's been a long time since we've seen an article that goes through market share of the major loan origination system (LOS) firms in the third-party origination (TPO) space. This is a very sensitive subject and a great deal of controversy surrounds the topic. This column attempts to provide objective updated information and show general trends.

I'll start by saying this column reviews the market share numbers as determined by Wholesale Access, Columbia, Maryland. Wholesale Access provided its numbers to me exclusively for publication in *Mortgage Banking*. The surveys conducted by Wholesale Access took place every other year from 1998 to 2006.

The surveys primarily covered mortgage brokers and correspondents, defined as entities that either had no warehouse lines or used such for less than 50 percent of their loan volume. Using such a definition, many smaller "mortgage bankers" would fall into this category because it's common for firms closing even a small percentage of their loans in their own name to call themselves a mortgage banker.

Further, the market share numbers are based upon the total dollar amount of loans placed through each system. For the purpose of this column, I did not take into account the number of offices using each LOS—which can also be an important indicator of market share. While the differences are not dramatic, there would be some.

I noticed that in the past, an LOS such as Contour's The Loan Handler® (a product of Dublin, California-based Ellie Mae Inc.) would have a larger average customer, as counted by number of loans per year, than an LOS such as Byte (a product of Kirkland, Washington-based Byte Software) or Calyx Point® (a product of San Jose, California-based Calyx Software). Thus, some readers might feel market share by number of locations (which closely corre-

sponds to number of user licenses) is more important than market share by number of loans. For many in the industry, including settlement-service providers, wholesalers and other third parties, it would likely be the dollar volume that would be most important.

The volume of loans through an LOS also helps to quantify how much of the

parable applications.

A second major issue is that the more customers an LOS has, the more third-party firms will build supporting applications. The leaders will have virtually every financial services firm building interfaces (for flood certificates, appraisals, title policies, credit reports and much more).

Today's world of eCommerce dictates

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industry is actually using a particular LOS. Often, origination firms might own several LOSes but primarily will only use one. Because of this fact, licensed users as claimed by the LOS vendors can be a less reliable number.

I view these numbers from Wholesale Access as accurate, and have relied on them going back to the early 1990s. I personally believe they are the best numbers currently available, and have used them extensively in my current consulting practices as well as when I was president of Contour Software and chief strategy officer for Ellie Mae.

Why is market share important? The key reason is that the more clients an LOS firm has, the more money it can funnel into research and development (R&D). In the software industry, market share can sort of feed on itself. Just witness the success of Microsoft® Corporation and how difficult it can be for other parties to produce com-

parable applications such as an LOS require extensive support throughout any respective industry. This also becomes a tremendous barrier to entry for new LOS firms. Without a lot of users, third parties won't build connectivity—and users won't buy an LOS without a lot of connections already built (the proverbial Catch-22).

Figure 1 shows overall market share by product based on findings from the five separate Wholesale Access surveys from 1998 to 2006. We can see that Calyx has significantly increased its market share over this time period, and mostly at the expense of Byte, Contour, Genesis 2000® and others. However, Calyx appears to have maximized its market share at about 68 percent for now.

Ellie Mae, which owns Contour, Genesis and Encompass®, has seen the market share for the former two drop and the latter increase quickly. This is occurring because Ellie Mae has shifted all its bets to

Encompass, and will no longer offer the other two LOSes by March 2008. What has become apparent is that the broker market has really developed into a two-LOS marketplace.

We can see in Figure 1 that the third-place position went from a 15.2 percent market share in 1998 to a 6.7 percent market share in 2006.

Of particular importance, we have not seen a new LOS firm obtain noticeable market share among the segment of the origination business surveyed by Wholesale Access since Calyx was formed in 1991 (Ellie Mae acquired Contour and Genesis). Further, the leaders in the marketplace retained their leadership position regardless of massive changes in technology.

The introduction of Microsoft Windows® in the mid 1990s or the Internet-based application service provider (ASP) applications in the last 10 years appeared to have no impact on the entrenched firms. I would say that as technology changes, the major players tend to change as required to fit the needs of their customer base. New technologies do not seem to provide an open door to new competition, in my view. This runs counter to what we hear so often from the startup LOS firms attempting to gain a foothold in this market.

The Wholesale Access surveys also found that user satisfaction is at an all-time high among those polled. Survey respondents claiming to be “most satisfied” with their LOS increased from 50.5 percent in 1998 to 66.2 percent in 2006. I tend to think this increasing satisfaction could well be the result of the consolidation in the marketplace, which has allowed the leaders to invest significant dollars into refining their products. Certainly, the top LOS vendors have more money available to perfect their products. Secondly, over the

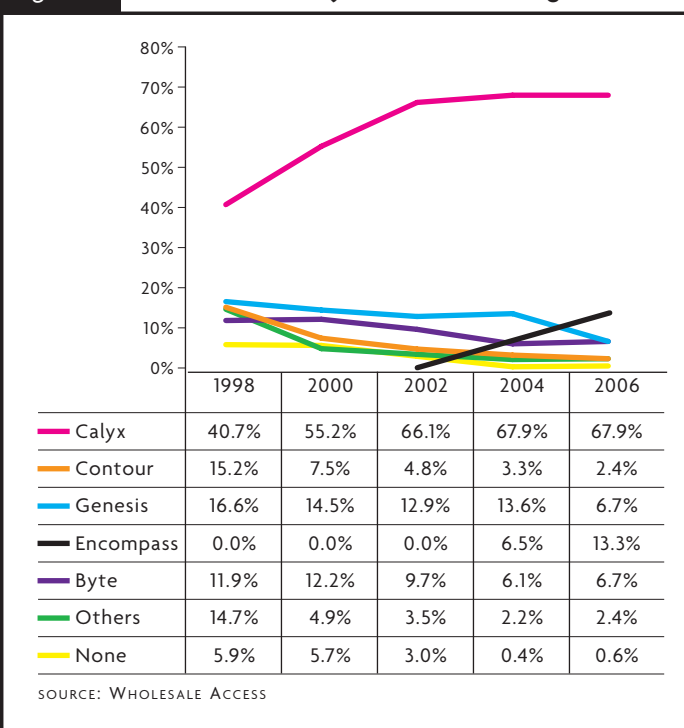
years, the products mature and become more refined.

Figure 2 measures user satisfaction by LOS. This is the most difficult chart to analyze. For example, how can Contour and Genesis, as products no longer being enhanced, have such a high user satisfaction in 2006? My interpretation is that when a product is being phased out, only the most satisfied users will keep using that product for as long as they can. Thus, the ratings become skewed toward clients

that want to keep holding on.

Calyx has the most consistent user satisfaction, which shows the maturity of the product. Newer products such as Encompass, which was just coming out in 2004, might find lower satisfaction because the product itself hasn't fully matured. More recent findings in surveys about user satisfaction with Encompass will likely yield a more accurate measure of the product's standing in the industry.

Figure 1 Market Share by LOS for TPO Segment



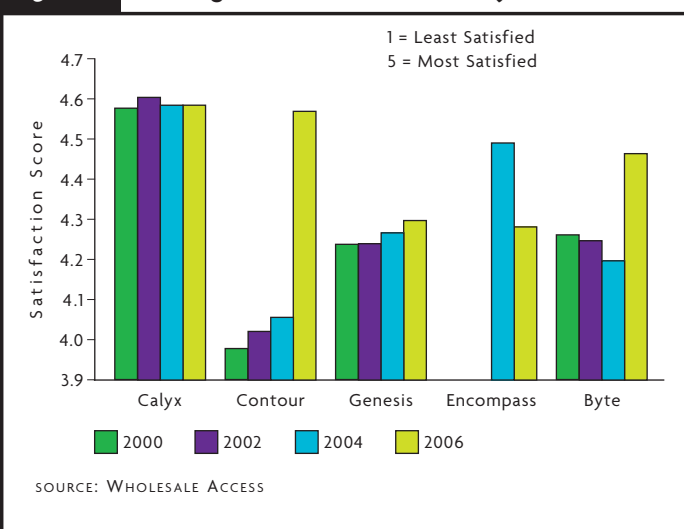
My perspective

I find it interesting that Calyx has flatlined at a very high level of market share since 2002, according to the Wholesale Access findings. I believe there is a percentage of the market (even among brokers) that look for feature sets not available from the primary supplier. A market leader must attempt to provide solutions that are best for the majority of the target market.

In our industry, mortgage origination firms can be different based upon the products they originate, where they obtain their leads, the type of consumer they work with and so on. These differences can cause some of them to seek solutions from vendors that better support very specific needs. In short, a leader can't be all things to all users. It is difficult to say if Calyx can move above 70 percent market share. I do suspect there is a market-driven ceiling someplace.

Ellie Mae has a unique history, as it rolled up two major LOS vendors and then brought to market a new LOS. From my perspective, we really need to combine the market share of all three of the LOSes to find their trend and actual market share. If we combine Contour, Genesis and Encompass into a single number, we get 31.8 percent for 1998, 22 percent for 2000, 17.7 percent for 2002, 23.4 percent for 2004 and 22.4 percent for 2006.

Figure 2 Average Satisfaction Score by LOS



These numbers, I believe, show that Encompass has been making up for the market share being lost by Contour and Genesis. Overall, the way I read the numbers, Ellie Mae's market share is about the same as it was in 2000, around the time when Ellie Mae acquired Genesis (2000) and Contour (2001). It does take years for an LOS to mature and become refined. Encompass will be the product to watch as it hits its stride.

Another interesting question is this: Is there room for more than two LOSes in the mortgage broker market? I think this is a difficult question to answer, as clearly the trend is consolidation with Calyx and Ellie Mae continuing to dominate the space. Combined, they now have more than 90 percent of the market.

This makes it a challenge for other LOSes. It's difficult to know if these two could get to a combined 95 percent market share, but I don't see both getting to 100 percent. I think there will always be a place for additional LOSes that serve specific niches. These underdogs will be challenged, but they serve an important role.

Calyx and Ellie Mae now have a responsibility they didn't have during their formative years. Being the leaders in the industry for the most important technology application now requires them to consider their role in a broader context. Like a Microsoft, what they do (or don't do) for the industry becomes crucial. The industry becomes beholden to them in significant ways. They now have a responsibility to make significant technology enhancements for the betterment of us all.

The battle will continue between Calyx and Ellie Mae. I see no reason why either firm can't adjust its market share numbers vis-à-vis the other. It's clearly the biggest battle in the mortgage technology space. In the end, it's the users that win as these two players constantly strive to outdo one another. This will be the battle to watch in the years to come.

I welcome feedback to this article, which may be e-mailed to scooley@scooley.com.

Scott Cooley is an independent mortgage technology consultant, analyst and author based in Los Gatos, California. He can be found at www.scooley.com.

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