The Impact of Automated Underwriting Systems

We are currently in the midst off seeing automated underwriting technology permeate the industry. Many of us have been waiting years to see this happen. While everyone believes it's a good trend, most don't really understand all of the benefits and where it's all going. Most importantly, we all need to understand it's true impact on the originator.

Many different companies are providing automated underwriting systems. Currently, the two most popular systems are Loan Prospector by Freddie Mac and Desktop Underwriter by Fannie Mae. This review will concentrate on these two systems but you can expect other systems will become widely available in the future. Additionally, both systems have many similarities as they relate to their impact on the originator.

The most important impact is streamlined processing as it affects every part of the industry. For the loan officer it often means less documentation requirements from the consumer although it's crucial that the requested documents are collected. The fact that up-front document requirements are determined by these systems is why it's so important to use these systems at the point of sale. Processors can reduce their workload by up to 60%. This means processors can handle many more loans and the loans move through processing much faster. Even wholesalers and the loan servicer see significant efficiency gains as the paper loan files are much smaller. Underwriters, file clerks and storage areas also see less paperwork, which reduces their costs.

Another significant advantage is that they can replace pre-qualification tools when used at the point of sale. They will help the loan officer determine if the borrower does qualify and not just for Fannie Mae and Freddie Mac accepted loans. They do offer some ability to underwrite FHA, VA, Jumbo and sub-prime loans. Nothing's greater than being able to give the borrower a tentative thumbs up to their loan. However, loan officers must use real caution in this area. Just because you receive an approval from an automated underwriting system is not enough to provide the consumer with a loan confirmation. Both the loan officer and the consumer most know that it's only an indication of an acceptance and many things can change during the processing and underwriting stages.

One of the areas that does cause frequent problems is the old computer term "garbage in garbage out" (GIGO). When using these systems it's easy to tell the system what you think it wants to see. Loan officers will find that their data will be checked by several parties and changed. The more accurate the loan officer is at the beginning, the more likely the decision will be correct and the happier the loan processors and underwriters will be.

Because entering the correct data is so crucial, it's the one area where training is absolutely required. Many different parties are providing training in many different formats. Of course the best training is always one on one, and users should be stepped through their first loan. These systems require a lot of data entry and it's important to know not only what data must be entered but also how to do so with the system that your mortgage operation uses. Most of the time, loan officers are using a loan origination system that is interfaced to Desktop Underwriter or Loan Prospector. Different systems require different training because data is entered in different ways. For this reason, training should be provided on the system that you plan to use. Many mortgage companies have tried to implement one system or the other and sometimes have not been successful. The need for good training is crucial. Additionally, not all loan origination software vendors offer interfaces to both Desktop Underwriter and Loan Prospector. This has, in part, been responsible for the death of more than a few such vendors who weren't able to create these interfaces. If the system you use doesn't have these interfaces, then you have little choice but to purchase a system that does.

Appraisals also get a streamlining effect as both systems allow for alternatives to the traditional full appraisal. This can lower the cost to the consumer and speed up the process. It also means less time coordinating the appraisal function and reviewing the resulting appraisal documentation.

For consumers, the advantages are many and include: less documentation required, faster processing time, better knowledge about loan approval up front, lowered loan related costs, they work closer with the loan officer about underwriting issues rather than the loan underwriter, and faster underwriting and closing.

For wholesalers, the use of automated underwriting systems by mortgage brokers is tantalizing. It offers many advantages that include: reduced data entry costs since the broker enters the data; reduced loan fallout since the broker knows with more certainty what loans the wholesaler would accept; reduced loan documentation which reduces underwriting time and QC work; faster underwriting time since most of the work has already been completed; better quality loans because of the work the broker has already completed; and finally, it can enhance their relationship with their brokers. While wholesalers are having some difficulty rolling these systems out to their brokers, it clearly is in their best interest to have them used.

Wholesalers do face a couple of problems. First, they ideally want their loans to remain fungible between Fannie Mae and Freddie Mac so that the loan can be sold to either as the secondary marketing department determines. This is problematic since documentation requirements and loan approvals are different for both systems. Wholesalers must then either slot the loans to one agency or make additional requirements of the broker so that both agencies would accept the loan. This issue is no different than brokers wanting the same capability, to have a loan approval that many wholesalers will accept, like they previously had with traditional methods. The second problem is rolling these systems out. It's expensive and very resource intensive for wholesalers. They must add staff to provide on-site training, add technical support staff for questions, install the required communication systems, train internal staff, define new procedures, etc.

Today, both systems can be accessed on the Internet through 3rd party vendors. Eventually, I expect the Internet will become the primary method for accessing both systems. These systems will have an impact on the industry as loans become cheaper to produce. In the next few years, we'll see processors and loan officers handling twice the volume as this technology eliminates so much of the paperwork required with traditional methods. These systems could also help usher in risk based pricing where each loan will receive it's own interest rate. If your firm hasn't begun to take advantage of these systems then 1999 is the year to start.