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THE DIGITAL AGE
Could Advancing Digital Strategies in the Marketplace Soon Render Originators Obsolete?
GOING VIRAL
The Evolution of Social Media Platforms is Creating a New Kind of Crisis for Housing Finance Professionals.

THE DIGITAL AGE

As advancing technology stimulates a boom in online lending, could digital strategies in the marketplace soon render originators obsolete?

By Chuck Green

Lately, it seems, consumers haven't exactly flocked to traditional lenders like they, well, traditionally have, according to experts. "We're probably seeing a destruction in traditional lending markets over the last couple of years," said Mark Willard, leader of the financial services practice at Market Strategies International, a market research consultant with an extensive background in consumer lending and eCommerce.

That undoing can be attributed to the fact that many consumers now are turning to online—or peer-to-peer lenders (P2P)—like Prosper, Lending Club, and Quicken Loans, particularly after feeling largely abandoned by their local bank or mortgage broker during the apex of the economic free-fall, Willard says. In P2P lending, of course, those seeking loans are matched with those who want to make them.

Through online borrowing and lending, borrowers generally obtain loans ranging from $1,000 to $25,000 that otherwise could be difficult or costly to obtain from traditional banks, while lenders fund such loans based on the promise of a capital return, reported the North American Securities Administration Association.

P2P lenders are reaching individuals who are retiring credit card debt and replacing it with three- or five-year amortizing loans, said Brendan Ross, president of Ross Asset Advisors, which specializes in private debt and P2P investing. "They're reducing their interest rate and setting a controlled, fixed payment. They're borrowing their way out of debt," Ross explained. "Hopefully, they won't ring up more."

P2P on the Uptrend

According to Peter Renton, editor and publisher of the *Social Lending Network*, a blog dedicated to P2P lending, with greater than 100 percent year-over-year growth, P2P lending is one of the fastest-growing investments. Industry volume now totals more than $50 million in new loans a month. During the Memorial Day weekend, total loan volume passed the $1 billion mark since the industry began back in 2006, Renton said.

James Taylor, CEO of Decision Management Solutions, which specializes in helping organizations build decision-making systems, said many local and regional originators are facing increasing competition for consumer and small business lending from national and online lenders, "which will force them to get more serious" about providing automated and online lending, as well as "push them" to pick up the pace in terms of the new product development and release cycle.

A trend to provide lending to more of the underbanked also is pushing banks to use a broader source of information for loan decisions rather than relying primarily on, for instance, credit bureau data, he believes.

Last month, the Federal Deposit Insurance Corporation released the results of its 2011 National Survey of Unbanked and Underbanked Households, the most comprehensive survey on the unbanked and underbanked in the U.S. The survey indicates that more than one in four U.S. households, or just more than 28 percent, either is unbanked or underbanked, a slight increase from the findings of the FDIC's 2009 inaugural survey. The survey is conducted every two years by the FDIC in partnership with the U.S. Census Bureau.

According to the survey, 821,000 more U.S. households have become unbanked since 2009, representing a 0.6 percentage-point increase. The FDIC reported that 8.2 percent of U.S. households are unbanked, representing one in 12 households in the nation, or nearly 10 million. Approximately 17 million adults live in unbanked households, while 20.1 percent of U.S. households are underbanked, accounting for one in five households, or 24 million households with 51 million adults.

Bricks-and-Mortar Benefits

Still, Taylor said borrowing remains something that some—"maybe many"—consumers are nervous about, which likely will persuade them to continue to prefer personal interaction provided by traditional lenders.

"The generation graduating from high school and college today is far more comfortable transacting over the Internet compared to older individuals who tend to be a little more suspicious about entering their personal data, such as their income and Social Security number, online," said Rich Alterman, SVP of business development at GDS Link, which provides risk management technology and consulting services. Younger people who have grown up with the internet are more comfortable sharing information through social platforms such as Facebook; they have a higher level of trust in these channels, Alterman says.

Even Willard acknowledged that trust equity built by many banks and lenders could give them a boost among at least some consumers.

While Annette Tirabasso, recently retired from Deloitte Consulting, said that, in the long term, online lenders could make originators obsolete, "Ideally, the originator's role should change to become more of a broad-based relationship banker—not a loan originator." She said the role of the latter requires a different skill set; instead of "selling loans," they'll need to be more educated about a wealth of products and better understand customer needs. "They'll move from a salesperson to a relationship person," she continued.

Netting Results

Even at that, though, banks and lenders must recognize the Internet is the "American way of life, and that usage has skyrocketed," age or income notwithstanding, Tirabasso explained. Furthermore, consumers are more comfortable with the Internet when applying for a loan, so making the loan application process less daunting would be to do it through the Internet, Tirabasso says. "That way, consumers can spend as much time as they want searching, researching, and exploring—not with a salesperson," she said.

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Besides the fact that it takes salespeople out of the equation, Willard says consumers prefer online banking because they don't have to sit in front of a loan officer and feel as if they're being evaluated, as they do with more traditional lending. They also consider online lending less invasive. "They convince themselves that they're just submitting [personal information] to some automated processing system, even though someone online is [evaluating the information]," he said. "But it doesn't feel that way to them, so it's less emotionally jarring."

Borrowers can complete the applications at home where their documents reside, says Victor Crain, senior partner at Crain Associates Research, which specializes in market research and forecasting. That makes the process much more convenient, he notes.

'Code' Not Yet Cracked

Ultimately, whether banks and lenders are paying heed to the escalating popularity of online lending might be another question. Tirabasso conducted a study, Deloitte's "The Silver Lining in Online Lending," to capture practices by lenders and to test how consumers react to those practices and how banks can benefit from satisfying customers. She found a gap between what consumers are looking for and what online lending capabilities lenders offer.

For his part, while Willard thinks banks and lenders are doing more to engage consumers online, he says their efforts have fallen short. That might be partly because of residual resentment consumers have for traditional lenders for rejecting their loan requests, he speculates. Further, Willard believes that while major banks want to, by in large, they haven't the "cracked the code" as far as how to most effectively provide online lending to consumers.

"It's not really [a] programmatic [issue] as much as it is execution. Their websites aren't particularly well engineered; you still have to fight through the clutter of what's often a very messy kind of website environment, or of a consumer website environment that's trying to do too many things," Willard said.

Adds Tirabasso: Banks need websites with a clean design and intuitive navigation. Among other things, they also should include educational resources—or tools to help them choose the right product—and pre-filled applications to allow the user to save information so they don't feel pressed for time and compelled to complete the process all at once.

Online Apps Set for Takeoff

According to a 2010 study called Online Lending: The New Reality, by Lieberman Research Group, a market research organization serving business-to-business and consumer markets, and Mortgagebot, which provides integrated point-of-sale solutions for mortgage applications from every business channel, among major transactions under way in the adoption of online mortgage-lending technology, 71 percent of bank executives believe that, at some point, they'll need to offer a smart online mortgage application.

Additionally, mortgage application volume from the online channel will grow dramatically. By 2013, banks expect their online allocation volume to grow from 4 percent to 13 percent—a 225 percent increase. Further, of lenders that have adopted or are planning to adopt smart, online, consumer direct lending technology, up to 61 percent say they're primarily doing so to better serve borrowers.

Wells Fargo declined to comment for this article, while Bank of America and JPMorgan Chase didn't respond to a request for a response.

Cautious Optimism Recommended

On another front, John Breyault preached caution among consumers opting for online lending. "If they're purely online, they might not be regulated by [a] state's banking regulator, which could limit [a consumer's] options in the case of a dispute," he emphasized. Additionally, consumers need to do their due diligence, regardless of whether they're working with a traditional brick-and-mortar lender or an online lender, says John Breyhault, VP of public policy, telecommunications, and fraud at the National Consumers League.

Not only that, Breyault said newer services like Prosper and Lending Club might be difficult for the average consumer to understand. P2P lending is regulated by the SEC as a sale of securities, and since these P2P lenders were required to register with the SEC, default rates have dropped. This is encouraging, but are these tools that average consumers will be able to use effectively either as a borrower or an investor?

Prosper CMO Brad Lensing said that investing and loan servicing activities on the Prosper marketplace are subject to state and federal regulation. Loans originated through the Prosper marketplace are made by WebBank, a Utah-chartered Industrial Bank, which is regulated by the Utah Department of Financial Institutions and the FDIC.

In any event, when it comes to online lending, Tirabasso speaks from personal experience. She borrowed money for a home loan online through a major bank last year, which she called "easy and hassle-free." She closed the loan from her laptop via a web conference with a closer and attorney. In the meantime, she "received lots of communication—phone calls to check email, email statuses—like my own personal assistant to remind me of steps." She only was required to authenticate her identity online, execute limited power of attorney, and view and agree to loan documents online with a closer and attorney.

Nevertheless, Taylor's expectations for the ability of traditional lenders to engage consumers online isn't exactly off the charts. "Are they doing enough? Not much!" he said. "They need to both automate their decision-making, so that they can give real-time responses, and provide the kind of online assistance that helps consumers make the right decision and be confident that they have done so. Having a Facebook page is no substitute."

Lending's Online Leaders

Meet today's dominant technology providers.

Peer-to-peer (P2P) lending, matching those who want to borrow money with those interested in lending it, seems to be finding a place among a burgeoning number of consumers.

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Prosper is among the leading P2P lenders. During the past six years, more than $400 million in personal loans have crossed its platform, Lensing says.

Borrowers seek Prosper loans to help pay down high-interest-rate debt, fund a small business, or even start a home improvement project, Lensing notes. They receive competitive fixed rates on loans up to $25,000. Investors also get unprecedented access to a large and historically profitable alternative asset class: consumer loans.

In 2011, 11,231 loans totaling $75.2 million in loan proceeds were originated through Prosper's platform. This year, to date (through September 30), through its platform, the lender has originated 15,129 loans totaling $116.2 million, Lensing says.

He indicated Prosper is meeting a distinct need in the market. "Prosper and peer-to-peer lending as a whole have grown significantly to meet the needs of both borrowers and lenders. Through efficiencies gained through technology on Prosper's platform, credit-worthy borrowers receive competitive fixed rates, while investors on the platform receive access to short-duration predictable high-yield income."

Since its 2006 launch, more than $406 million in loans have been generated on the Prosper platform, Lensing says.

Borrowers and investors have both been affected by the debt crisis. Borrowers are faced with limited consumer credit options, while investors have seen low returns and high volatility on traditional asset classes. With Prosper, borrowers benefit by having access to credit with competitive rates, and investors benefit with predictable returns that show a low correlation to other asset classes.

Neither Lending Club nor Quicken Loans would comment.

According to the latest company statistics on Lending Club's website, as of October 10, the club had funded loans totaling $935,315,475.

Quicken Loans closed a record $30 billion in home loan volume in 2011, its website states.