# DIGITAL LENDING:

## ARE YOU IN OR ARE YOU OUT?

PAUL C. KATZ, MANAGING DIRECTOR, HEAD OF BANK RELATIONS

### *EVERYONE HAS A PLAN 'TILL THEY GET PUNCHED IN THE MOUTH.*
### *—MIKE TYSON*

On some level, mortgage lending has been a fairly straightforward business line for community bankers. There have always been challenges associated with navigating cost, compliance, margins and cyclicality, but with a solid plan, community bankers have remained steady on their feet. However, the emergence of disruptive technology and savvy fintech competitors has many community banks unsettled.

In surveying the landscape, three community banks recently made a significant pivot: they got out of the mortgage business.

What was the trigger? Here's what one of the CEOs said in a public statement:

"We have been in the mortgage banking business for many years and have weathered unfavorable mortgage banking environments in the past. Unfortunately, the current poor operating environment is coupled with fundamental changes in the mortgage banking industry, such as more burdensome regulations, required investment in expensive technology, fierce competition, and razor thin profitability, to name a few."

The announcements straddled the American Bankers Association's Conference for Community Bankers in San Diego last month. They provided a timely backdrop for a panel hosted by Promontory MortgagePath: Digital Lending: Risks and Opportunities.

As part of the panel, the audience was polled on their current mortgage processes and the role technology plays, or should play, in enhancing the customer experience.

The answers demonstrate why digital transformation and alternative lending strategies are so top of mind.

> **On whether mortgages are a core product:** 64% said “yes”; 19% offer them as a “defensive” strategy; 14% don’t offer them; and 3% that do would like to exit the business.
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> **On whether their customers want a digital lending experience:** 56% said “yes”; 30% said “sometimes”; and 14% said “rarely/never”.
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> **On whether they currently deliver the digital experience their customers want:** 0% said “strongly agree”; 24% “agree”, 32% “neither agree nor disagree”, 37% “disagree”, and 8% “strongly disagree”.
>
> **On whether digital transformation is a priority:** 60% said it’s their “top priority; 34% ranked it as a priority behind others; 3% have completed the transformation; and 3% said they could compete “without it”.
>
> **On how they’re going digital:** 61% are planning on using “plug-and-play” third-party platforms; 26% via fintech partnerships; 10% using “other” strategies; and 3% building it using internal R&D.

These results provide insight into challenges community banks face in the residential lending space and suggest incentives to discontinue mortgage offerings or seek alternative solutions. None of the banks surveyed are utterly confident they currently offer customers a desirable digital lending experience. At the same time, more than half of banks polled say their customers are requesting a tech-enabled process.

So, why do only 60% consider digital transformation a top priority? With industry fluctuation, extensive compliance requirements, and tech-implementation costs, profitability isn’t always feasible, especially for smaller banks, who may not have a technology budget at all. This might begin to explain why the poll found more than a third of community banks aren’t proactively offering mortgages as a core product.

## AN INSIDE LOOK: BETTER EXPERIENCE, GREATER EFFICIENCY

Bryan Luke, president and chief operating officer of Hawaii National Bank, confirmed his customers want technology that can accelerate the lending process and let them be more engaged in it. Of particular interest, he said, is the ability to enter information online and upload documents outside of bank hours.

At the same time, Luke said there is a generational divide on the part of both customers and staffers when it comes to technological adoption. He also emphasized that digital mortgages face higher hurdles due to the complexity of the product and a myriad of compliance issues.

Despite these challenges, Luke said his bank is committed to digital transformation not only to improve the customer experience, but also to significantly increase efficiency and drive down cost.

## HIGHER COSTS MEET LOWER VOLUMES

The latest Mortgage Bankers Association data shows origination costs at more than $8,000 per loan—up from $5,000 just seven years ago.

In addition to grappling with the higher cost of production, Ken Janik, managing director for Promontory MortgagePath noted that community bankers are also facing a smaller origination market in 2019, stepped up activism by state regulators, and new competition from fintech entrants and mega lenders with large advertising budgets.

Community bankers will need to invest in new technology and/or alternative fulfillment solutions to meet changing borrower expectations, remain relevant and profitable and maintain compliance, he said. Banks should consider outsourcing options before discontinuing their lending operations entirely. Fulfillment services can enable banks to implement technology, manage and adhere to state regulations and ultimately, reduce their overall cost to produce a loan.

## SOLVING AND CREATING COMPLIANCE CHALLENGES

Colgate Selden, Promontory MortgagePath's head of regulation & compliance, argues digital processes can help demonstrate compliance and quality to regulators and investors. Not only do these systems capture perfected data, he said, but they function as a permanent record of what was provided and said; how the information was verified; what actions were taken and by whom; and finally, what factors led to the approval or denial decision.

Selden noted the transition from in-person borrower engagement to automated interactions has created some gray areas in terms of compliance. When does a click become an app, for example? How do you verify identity and confirm consent in a digital transaction? This, of course, is in addition to ongoing customer privacy, security, or fraud concerns.

The industry is still working through these issues. But the benefits will be worth it: Done right, digital lending can manufacture high-quality, compliant loans at a lower cost and a faster pace.

## DIGITAL LENDING: GETTING IN

Banks ready to realize these benefits by accelerating digital transformation should consider the following:

**Scenario planning exercises to gauge the impact of digital processes and competitors on market economics.**

**For banks considering a "partnership" approach, develop a digital platform strategy based on the size, structure and culture of your organization; as well as the current state of your legacy systems and processes.**

**Map the ideal customer journey and identify where digital solutions can improve the customer experience, enhance productivity and gain efficiencies.**

**Develop a set of in-depth questions for your prospective technology providers, including:**
- How is entry-point data and application workflow integrated and managed?
- How early in the process is high quality data captured and verified?
- How will the compliance functions protect against UDAAP, TRID and Fair Lending violations?

**How can you demonstrate to investors that their rules are being followed and the quality of the assets meets their standards?**

Fundamental changes to the mortgage industry don't have to force community banks out of the industry entirely to ensure overall profitability. When paired, digital mortgage and alternative solutions can create efficiencies, enhance the customer experience and address cost and compliance hurdles previously deemed unclearable.