The Evolution of Internet-Based Mortgage Lending

By: Rob Chrisman | Thu, Jun 23 2011, 10:13 AM

[I am on vacation, and my access to e-mail is sporadic and not timely. In my place are daily commentaries from a series of very knowledgeable mortgage industry people with different backgrounds, and they have been given very little direction about what to write about. **The second is below**. Our views may or may not coincide, but I thank them for their time in volunteering and helping out.]

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Internet Lending Begins

Just a little over fifteen years ago the **Statement of Policy Regarding Computer Loan Origination System** was published in the Federal Registrar. From the HUD website: "This Statement of Policy sets forth the Department's interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) and its implementing regulations with regard to the applicability of RESPA to payments for services from certain computer systems, frequently called CLOs, used by settlement service providers in connection with the origination of mortgage loans or the provision of other settlement services covered by RESPA."

This HUD "Statement of Policy" set the tone for consumer-direct business sourcing on the Internet. Up to that point, only a handful of small, visionary mortgage companies had been attempting to use the web in the same way other industries were by getting "free" advertising and leads. Their model was to get leads from your site, cut commission splits, take apps, process, and deliver closed loans in a manner that cut operational costs. It was the Dot.Com promise-and the Dot.Com Bust.

CLO

In 1996 HUD changed its interpretation of the anti-kickback provisions written into Sections 8A & B of RESPA with regard to "CLOs" (Computerized Loan Origination Systems). In going beyond the "qualified CLO" of 1994, HUD opened the door to entrepreneurs who chose, rather than to be mortgage lenders themselves, to be online marketers of consumer mortgage "opportunities". The key was that these market operators could earn their fees if everyone acted within HUD-delineated restrictions which included lender-neutral, multi-lender platforms with standardized CLO fees. A perfect history of this period can be found in the October, 1994 issue of ***Mortgage Banking*** in an article by Phil Shulman.

Business Model

The Internet can be a place where a mortgage lender can disintermediate its advertising agency and outsell its salespeople by going directly to the public with its message. Since 1996 the internet has allowed mortgage lenders to leave the brunt of its consumer-based marketing efforts to web professionals. They simply buy leads under CLO rules and maintain or build pipeline volumes while controlling marketing expense and cutting commissions.

Early Examples

Two obvious examples of this dichotomy are E-LOAN and LendingTree. Janina Pawlowski and Chris Larsen were Silicon Valley whiz kids who clearly early saw where the Web was going, but they saw it too soon and got caught up in that Dot.Com mind set that told us "E-Commerce is here! The old world is gone forever!" E-LOAN was such a well crafted solution-why didn't it work? Because its value proposition was lost in the medium, it was ahead of its time. It tried to attract borrowers with the internet, to the internet, to explain why you should get a mortgage on the internet.

Success on a Big Scale

LendingTree's model worked though. TV ads pushed viewers to get up and go to their computers to submit personal information so banks could compete for their loan. It was an irresistible offer for many. Lenders could even set efficiency filters for quality and location. When combined with falling rates and a growing list of lending products, LendingTree allowed lenders (like us) to expand from single market referral based companies to multi-state internet call centers. Lendingtree's "long form" lead became the standard, and is still unmatched

online.

Lead Gen Grows

Several competitors sprang up, most notable LowerMyBills. The "short form" lead became the favorite of the larger call center lenders. Cheaper and in much larger quantities, these lenders grew with the expansion of HELOC's, 125%, Alt-A and Subprime.

The Model Starts to Change

The original "long" and "short" form placed contact with the consumer before a price was ready to be quoted. Today, with fewer mortgage products available, increases in consumer empowerment, and better technology, more lead generators are quoting offers before they contact the consumer. Zillow, Google, and iCanBuy are examples. Bankrate has employed that model for some time now. The consumer sees the price then chooses to contact or be contacted by the lender.

Goods/Bads of New Model

Lenders like the quality of leads but quantity can be an issue. A bigger issue with this "price before contact" is the "price". How do you get noticed? Well, low ball pricing usually. We would like to think that the internet has matured enough where lenders that "lure" consumer with price won't survive. Recent L.O. compensation reforms have kicked some of these low-ballers in the teeth as company margins need to be set and can't vary (much). Time will tell but from what we can see - companies that deliver a fair price and have customer service scores to back it up will come out the winners. Quicken Loans comes to mind here.

Future

The empowered Web 2.0 consumer and future borrowers (your kids and grandkids) will have more and more opportunity to check on and select a lender prior to initiating contact. A nice website with company managed testimonials is no longer enough. Websites that allow consumers to "rate" lenders and loan officers will become more common. Yelp and epinions are examples. However it's accomplished, getting a borrower in the door and to the closing table will forever involve some sort of cost of sale, and the development of some sort of customer relationship.

Editor's note:

Higher capital requirements? Not so fast...Myron Scholes, a Nobel Prize-winning quantitative analyst, said subjecting major banks to higher capital requirements could make financial markets more volatile. "If you restrict or require more capital of banks, what will happen is that they have to wait until the deviations [in price] get larger before they intermediate, because they have to make a return on the capital they are employing," Scholes said. "As intermediary services stop, markets then become more chaotic."

For a smattering of large investor news, Bank of America issued disaster declarations for Vermont and Massachusettes, as well as updates for Oklahoma and Kentucky. The company also came out with a merger of Bank of America, N.A. and BAC Home Loans Servicing, along with issuing a product clarification on the flood insurance requirements for condominiums. GMAC released their July Client Development Calendar. Chase announced requirements for correspondents in connection with the SAFE Act, specifically to assist correspondents in complying with those requirements by noting common mistakes to avoid when submitting loan files to Chase and to offer guidance to ensure proper documentation is in the loan file at the time of funding submission.

Yesterday's FOMC news was...not much. Overall the FOMC statement was in line with expectations, and we find the 10-yr still sitting around 2.96%. Housing news has been mixed lately, as we all know, and even "mixed" might be an optimistic term. Overall "the housing sector continues to be depressed" - as the FOMC statement so succinctly put it. Even apps yesterday showed a drop of about 7% during last week. **READ MORE**

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