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October 3, 2005

Longing For The Golden Apple

Everyone wants to achieve the electronic mortgage, so what's the problem? Is the technology not there yet? Is adoption the issue? Are parts of the process still unclear?

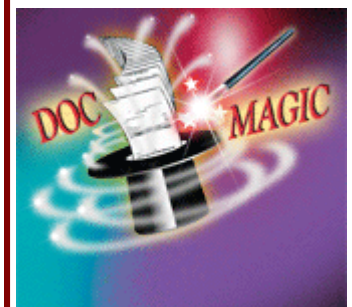
"The technology is definitely there," pointed out Bill Kelvie, CEO at Bethesda, Md.-based Overture and former CIO at Fannie Mae. "However, the usual barriers to adoption are there as well, particularly the lenders' concern that investors won't buy an e-mortgage and the investors not seeing the e-mortgage volume needed to make a big push in that direction." Nevertheless, he said, there has been progress: "Fannie Mae has a spec for e-mortgages, and there have been important steps in recording." He noted that the technology is ready "if you can call up all the needed parts of the process as services in a true service-oriented architecture."

Since nobody likes to store the paper, what's the real problem? "The reluctance is on the lender side," he stated, "because they want to know they can sell the note to the investor." However, a recent Electronic Mortgage Technology Newsletter poll showed that 42% of 55 respondents blamed investors for the lack of e-mortgage adoption, 36% blamed county recorders, 13% blamed a lack of new technology and only 9% blamed lenders.

A Fannie Mae spokesperson takes exception to blaming investors, pointing out that Fannie has been accepting e-mortgages for five years. "We did e-mortgages back in 2000 here at Fannie," explained Mark Oliphant, director of the e-mortgage program at Fannie Mae. "We purchased the first two in July of that year. Those two that we bought were completely paperless - including the deed. Over the years we've worked with numerous lenders and vendors to pilot e-mortgages.

"This has been a focal point for us for five years," he continued. "We translated pilots to production. We felt it was important to put a stake in the ground to let people know that we're ready to accept electronic mortgages. If I'm a lender and someone is asking me why there's a lack of e-mortgages done, I'd say as a lender that it's great that Fannie Mae is open for business, but I want to see that there are other choices."

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The logo for the Mortgage Quarterly Data Report. It features the word "Mortgage" in blue, "Quarterly" in orange, "Data" in orange, and "Report" in orange, all in a bold, sans-serif font. The text is set against a green background with a subtle pattern of diagonal lines.

Next to Fannie Mae, the largest investor is Freddie Mac and - to Mr. Oliphant's point - they still do not have e-mortgage standards to enable them to transact in a completely electronic fashion. "We've been talking about e-mortgages for what seems like forever," Freddie senior vice president/chief operation officer Mike May told our sister publication National Mortgage News. "The tech-savvy people thought we'd be doing e-mortgages before you know it but there are a lot of natural barriers that make e-mortgages difficult.

"As far as what we're doing, the industry has pushed us to decide what our standards around e-mortgages are," he pointed out. "We have a group that we've assembled to put that together. Right now we're going around the industry to see what's best and are in the process of building that out. We'll get it clear this year."

Mr. Kelvie said the mortgage industry indeed expects Fannie Mae and Freddie Mac to take the lead in making e-mortgages mainstream. "My guess is that the agencies will make a highway that others would use," he said. "Perhaps beyond that there will be a broader standard to conduct an e-mortgage as well. The Fannie Mae spec - I think - will be the thing that makes that movement a reality."

Standards Take Center Stage

But what is implied by Mr. Kelvie's observation is that until that "highway" is in place, adoption will be slow. Enter MISMO, MERS, SPERS, PRIA, and a host of other acronym-rich standards bodies that are active today helping to lay the groundwork.

Six years ago the Mortgage Industry Standards Maintenance Organization or MISMO as it is commonly known, was formed to focus on forming one XML dataset that encompasses every process in the lifecycle of a mortgage to make it possible for every party to speak the same language. Some headway was made this year when MISMO partnered with the Appraisal Institute to form a property dataset. Earlier in the year MISMO reached out to come up with an anti-fraud dataset as well.

"In terms of MISMO adoption, we're seeing a lot of traction around the data standards," explained Gabe Minton, vice president of industry technology at the Mortgage Bankers Association, Washington. "On the e-mortgage side there's a lot of development going on. For example, Fannie Mae released their updated e-mortgage standards that include MISMO. Freddie is expected to update their guidelines by the end of the year. They're mobilizing.

"The GSEs are important because you have to have the investors to buy the loan product before people rush to create it," he reported. "Countrywide and Wells Fargo are also now very engaged in e-mortgages and are very active in MISMO. We have a long way to go still. However, we've come a long way in defining an end-to-end solution. The technology is there but gluing that technology together

and deciding who to invest in still has to be figured out. The mechanisms are in place and the standards are coming into place."

So what's to come from MISMO in the near future to continue to move the ball forward? "We'll have an updated MISMO eMortgage I-Guide at the annual likely," answered Mr. Minton. "There's still plenty of work to do and we're not at a mainstream level of adoption."

He said MISMO now has a new hire to act as a full-time resource on MISMO compliance. "Rest assured that MISMO compliance will be moving forward with more steam now," he pointed out.

"By the end of this year going into next year we'll tackle e-mortgage compliance, but I want to get some data certifications under our belt first," Mr. Minton concluded. "We'll also address data quality as well."

The Role of MERS

Data aside, there has to be a body to standardize ownership of the electronic note. Enter Vienna, Va.-based Mortgage Electronic Registration System or MERS.

The MERS eRegistry reports the status of all loans, including beneficial interests, servicing and subservicing arrangements. The benefit of MERS is clear because assignments of the note are eliminated, no correction costs or tracking costs are incurred and there is one deed of trust or mortgage form for all transactions.

In terms of MERS traction, Decision One Mortgage of Charlotte, N.C., a member of the HSBC Group, registered the 30 millionth loan on the MERS System in April of this year. Thirty million loans represent more than a 35% increase in the number of loans registered on the MERS System in just one year.

"The MERS eRegistry is the means to determine who owns the note," explained Carson Mullen, EVP for the customer division of MERS. "The MBA and Fannie and Freddie have endorsed MERS. It's the central point of the e-mortgage. A lot of us have been thinking about this in terms of when is this e-mortgage going to happen, but now it is happening.

"We built this e-registry to make sure the facility was available," he continued. "The largest lenders in the country will be using it by 2006. In fact, we see 2006 as a pivotal year in the move toward the e-mortgage."

Getting County Recorders Online

At the end of the mortgage process the note has to be recorded on the county level. The issue with e-recording is that only a select number of counties are electronic and there is no national standard - meaning that each county has their own method. Currently the Property Records Industry Association, Washington, or PRIA, is working with

MISMO to standardize this space and help recorders make the transition.

"We've been trying to get a handle on which counties have been trying to do some form of e-recording," said Carmen Bramante, a PRIA director. "There are probably over 70 counties that are doing some model of e-recording, which is an increase of between 20 and 30 additional counties over last year's count. So, it is moving along.

"From a county recorder's perspective, e-recording has been accepted for a while now and they're more excited about implementation," he speculated. "Typically you hear from the lenders that things aren't moving fast enough on the recorder side for them to do a complete electronic closing package, but the other side is that there are 70 counties out there doing it today and there are less than the fingers on my hand of lenders that are doing electronic transactions for closing.

"MISMO and PRIA are working to standardize the needed data and the structure around that data," Mr. Bramante added. "It's not a federal standard per se, but it is working toward having one way to conduct e-recording. We're all working toward one standard. There will always be local and state laws about how real estate is conducted that even in the electronic world the system of record would have to capture the business rules around that property and the finance of that transaction. We just can't get away from the laws on the local and state level."

There is a proposal before MISMO and the Residential Technology Committee of the MBA to look at MERS being the option to further e-recording because county recorders have questions about deciding if the e-note is the legal and binding note. MERS is that today for e-registering and there is a proposal to have them do the same for e-recording.

The idea is to create a log so MERS can point to who originated and owns the note. If you're going to register an e-note to a county it should be with the same organization that you trust to determine the legal pointer for your docs, some would say. Countrywide is pushing this idea currently as a way to further e-recording. Countrywide, for one, has said that everybody including the servicer, the recorder, the closing agent and everybody that has to attach a process to certify that note should have a directory that will track the note through all those processes.

Smart About SMART Docs

Beyond standardizing the data, the registering of the note and the recording of the note, the loan package itself has to be standardized. This is where a SMART Doc comes into play. At present there are eight levels of SMART Docs and - generally speaking - awareness about what the term and each level means is low, but it doesn't have to be, according to Tim Anderson, executive vice president at

Edina, Minn.-based Dexma.

"There are varying degrees of SMART Docs," he said. "A SMART Doc can be just the ability to extract the source data from the LOS on a document and a subsequent PDF or image of that doc, which could be MI, title, credit or a full loan closing package. From there you wrap it in a secure XML digital signature to maintain the integrity of the data and the docs. That's doable today with many systems.

"The big pickup is getting the data and the docs in the same transmission through a secure delivery," Mr. Anderson pointed out. "If bankers were looking into vendors that could offer this there would be a huge benefit because they wouldn't have to reconcile the data - because it happens at a different time and place - with the document - which also happens at a different time and place.

"So, if you could really trust the data, think of the benefit," he continued. "The situation now is such that you have an LOS that takes the data through a process, then you take images of the documents that are either PDF, TIF, XHTML, etc., and add them to the mix, but if I could coordinate that to get the data and the docs at the same time through a trusted SMART Doc delivery that electronically validates all the contents for you, there's a huge pickup there."

What's the difference between the levels of SMART Docs and how does a lender decide which to adopt? "A level one SMART Doc is self validating between the data and the documents," answered Mr. Anderson.

"Through the process of generating that SMART Doc it validates itself," he pointed out. "The problem is that it's hard to develop a level one. As a result, you have these varying levels of SMART Docs where the data and docs aren't one, they're two in a single wrapping.

"People need to become familiar with the different levels, how they're generated and decide which one they're comfortable accepting," he concluded. "Most bankers haven't gone through the validation process to really look at SMART Docs. The law supports all eight variations of SMART Docs, it's just a question of which level they decide they're going to adopt."

However, it's difficult to familiarize yourself with a moving target. New levels of SMART Docs are being identified as new adoption opportunities are identified. Nonetheless, while tackling the levels may seem cumbersome, Ruth Thompson, was actively involved with MISMO well before the introduction of the e-mortgage workgroup and is president and CEO of document automation vendor Desert Document Services, Tempe, Ariz., said SMART Docs can be broken down into three broad categories of capability: "First, there's the transferable record - SMART Doc level one and SMART Doc level seven - which is data and

viewable data bound together, easily and verifiable." She said these are used for notes and security instruments.

"Second, you have levels that include the document with data, but no verifiable linkage from data to viewable data," Ms. Thompson stated. "This is useful for things like electronic image transfers - for example, delivery to an investor, loan-level data plus supporting docs as images, or for due diligence. Last is XML or the image, "typically for data only-type applications," she explained.

Desert Docs as a company interviewed lenders to see how e-mortgages fit within their IT roadmaps. "Their input led us to focus on maximizing operational efficiencies by managing and deploying loan products into the business process in a way that supports paper, paperless, and e-mortgages out of the same channel," she said. Desert Docs' solutions can deliver printable outputs in either XHTML or PDF formats and SMART Doc level one, SMART Doc level seven or some combination of these as needed by the lender.

Ms. Thompson said she believes strongly in the process and that the SMART Doc doesn't have to be a foreign concept. "By partnering with a solution provider capable of providing multiple levels of SMART Doc output formats at any point in the loan production and delivery process a lender can use SMART Docs today," she said. "In the end, this will allow lenders to maximize their current IT system investments while taking advantage of all of the benefits of their current level of SMART Doc standards adoption. As lenders move closer to e-mortgages, they will already have a solution in place that can accept all levels of SMART Doc standards without requiring reworking their IT systems."

An Interim Solution

Even if a lender doesn't want to go the whole nine yards, imaging provides a baby-step approach to SMART Docs - and the e-mortgage - adoption that is doable today.

"Imaging is an important part of today's mortgage document solution, but it's not about the image," said Ms. Thompson. "Imaging will become the 'de facto custodial service' because the value of the imaging system is (1) indexing and (2) retrieval. These capabilities will be part of the foundation for moving into the future with e-mortgages.

"However, image-based workflow systems require solution partners that are able to provide loan product management, deployment and delivery management, and integrate with image workflow technology in order to manage the complexity and provide the data validation necessary to prepare the correct documents and link them to their meta data," she concluded.

"Within the last year you're seeing a big push to image the whole loan folder and the concept of e-mortgages has

driven that sentiment," added Mr. Anderson. "People at least need to get that static document to electronic form. That's the big push.

"On the servicing side they want to be able to service that loan electronically and now imaging is being pushed to the point-of-sale to process and close the loan," he pointed out. "It's the path toward the acceptance of a complete SMART Doc. The value of Fannie saying that we want to get to an e-mortgage and will accept it as legal and binding combined with the value of MISMO is driving it.

"This is a major evolution because at least we're getting away from a static document to getting it in electronic form, and the next evolution that you'll see over the next two to three years is being able to sync the data and the image into a true SMART Doc implementation," said Mr. Anderson. "Taking dumb docs and making them into dumb paper images does have some pickup because now you can at least manage the paper better, but it doesn't allow the lender to make the process more efficient because you're processing images the same way you did paper."

The Final Step to Adoption

"In order to make e-mortgages a reality the industry has to take a second look at their architecture," said Brian Fitzpatrick president at integration vendor WellFound Decade Corp., Jacksonville, Fla. "The way to get to an e-mortgage is to have a bunch of systems collaborating in real time. The only way this is going to happen is if they have the right architecture.

"Of course standards are very important to the industry as a whole," he noted. "However, standards aren't going to make it happen. In order to make it happen, data has to come out of legacy systems and get them to collaborate using MISMO. It's all about having the right architecture in place to make that happen."

The literal "final step" in the e-mortgage process involves automating the closing table, which means adopting electronic signatures. While the idea of a click sign may be foreign now, many see it as being the norm in the not-so-distant future.

"We've taken the Silanis signature engine and turned it into an ASP model," said Michael Pelfrey, vice president at eLynx, Cincinnati. "When we first rolled it out three years ago we knew we were ahead of the ballgame, but did not know how slow it would be to get folks to the table. U-SIGN continues to be the e-signature platform that we're using, but the difference today is that we have lenders in production.

"Going forward, you'll start seeing people leveraging the fact that they offer the borrower freedom of choice," he continued. "They'll tell the borrower, 'We'll do business the way you want to do business with us.' This is going to shift the landscape."

Why has adoption taken so long? "Prior, the industry was strained trying to keep up with massive volume," answered Mr. Pelfrey. "We've picked up six or seven lenders just in the last couple of months simply because they are now able to pick these products up. Today we have two customers pushing to do a hybrid e-closing."

Lenders like Navy Federal Credit Union, Vienna, Va., are there today and encourage others to experience the benefits that an e-mortgage can bring. Navy Federal is currently using electronic signatures to close loans electronically, and is one of a dozen selling these e-mortgages to Fannie Mae.

"Five years ago the e-mortgage was a glimmer in someone's eye," noted Molly McCormack, associate vice president of projects and compliance at Navy Federal. "Over the past five years the new e-signature laws have come into play. The awareness of e-signatures has increased and there is also awareness that this is the way the industry is going.

"We are closing mortgages using an electronic signatures today," she said. "When a borrower closes electronically with us they go online and click sign everything except the deed of trust. From there we wrap security around it and everything is electronically delivered to Fannie Mae.

"However, I'm not sure if we'll ever be 100% lights out because borrowers will always want to talk to someone," concluded Ms. McCormack.

The Wall Street Factor

Another factor that may prompt greater e-mortgage adoption is if Wall Street Investors step up and accept e-mortgages.

Right now, Fannie Mae is the biggest investor pushing e-mortgages, but if others jumped onboard lenders would have more choices and a bigger incentive to go electronic.

According to a recent Electronic Mortgage Technology Newsletter poll, 68% of 40 respondents believe Wall Street Investors will be stepping up.

"Wall Street Investors will come to the market looking for quality data," said Roger Gudobba, senior principal at VMP Mortgage Solutions Inc., Fraser, Mich. "Sarbanes-Oxley was passed because company data was misleading. It's the data that's driving it. The only way to get there is to have e-mortgages and some level of SMART Docs.

"It's great that the Mortgage Bankers Association has come out to support e-mortgages. Also, players like Wells Fargo and Countrywide have stepped up and are very interested as well," he concluded. "In the end, competition will drive e-mortgage adoption."

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