The Rising Cost of Mortgage Compliance and Finding a Way to Profitability

Summary

The one thing that is unlikely to change in the Dodd-Frank era, is the rising costs of compliance. Therefore, the need of the hour for lenders is to develop a holistic approach to compliance management. In this ebook, we talk about the best practices that will help lenders to stop compliance costs from eating into their profits.

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EXPERT
Mortgage Assistance

Introduction

Mortgage originations are getting increasingly expensive. Most mortgage lenders view compliance and quality control to be the primary cost drivers of originations. And rightly so. An analysis of the previous five quarters shows that other than compliance, contributing costs for the most parts have remained consistent. Given that compliance is the new reality, and the costs related to compliance are likely to remain on the rise, arresting the increasing costs is the only available way for lenders to earn acceptable profit margins. To bring this about, they need to overhaul the existing compliance process from soup to nuts.

How Compliance is Pushing Up Costs

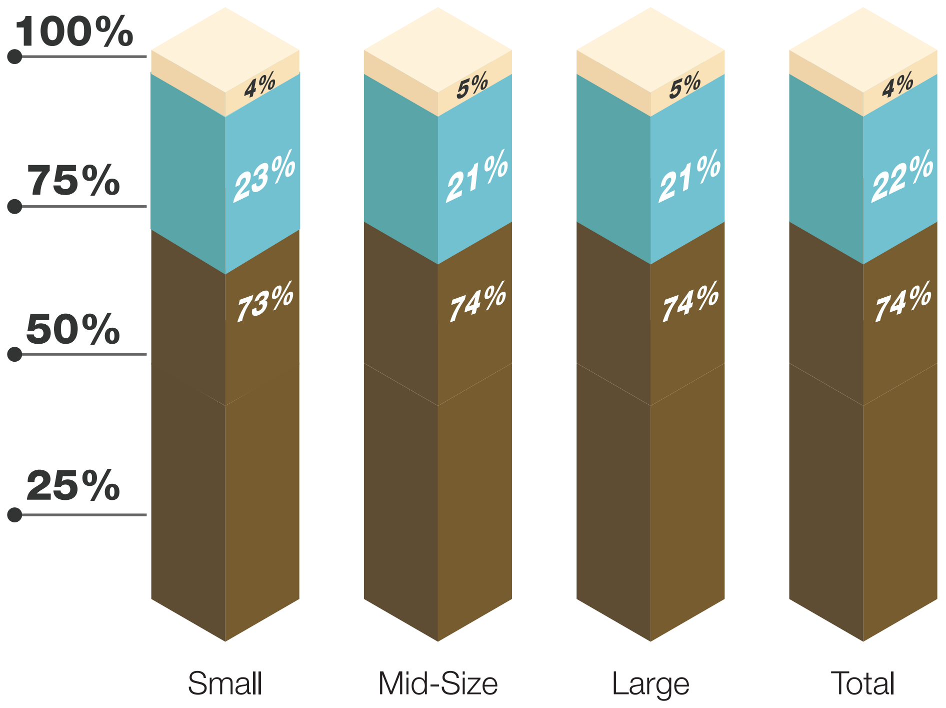
The cost of Dodd-Frank on Mortgage Institutions: $24 Billion in Compliance- related expenses and 61 million paperwork hours.

After the introduction of the Dodd-Frank Wall Street Reform and Consumer Protection Act the costs of compliance has orbited into the space.
The most obvious reasons being:

- The need to maintain expert resources to help businesses meet new compliance requirements. Sometimes the need to depend on both in-house and outsourced experts can be a double whammy.
- Continuous regulatory audits followed by the remediation process and the follow-up on remediation process. To top it, there is a need for federal and state-level audits which can increase expenses twofold for multistate lenders.
- Constant and meticulous monitoring of decentralized mortgage operations to ensure lending compliance or spot oversight involves substantial expenses.
- Increased regulatory scrutiny on business strategy comes with a hidden cost. Every question pertaining to business interests need to be pursued with compliance in mind which has a direct bearing on profits.

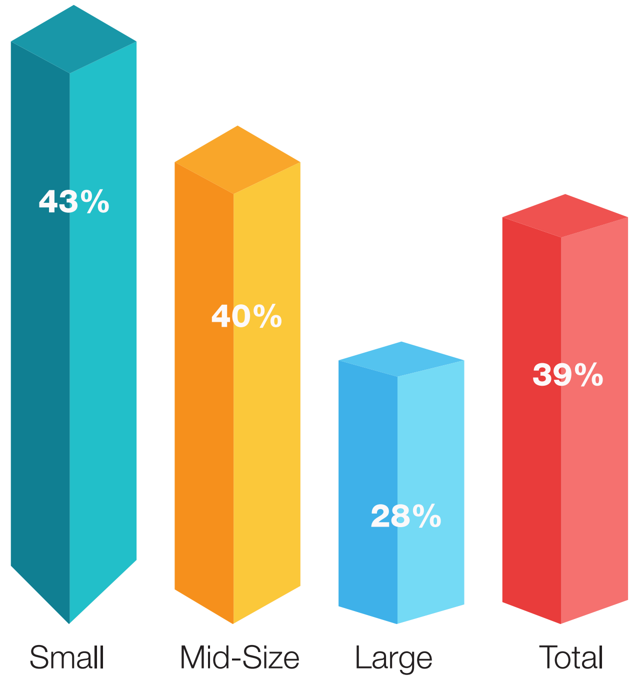
Annual compliance cost impacts on the credit union industry – 2016

$7.1 billion / 0.54% of assets.



Cost of Compliance By Expense Type

Percentage Increase in Compliance Cost Impact Since 2010



Yes, the Process is at Fault

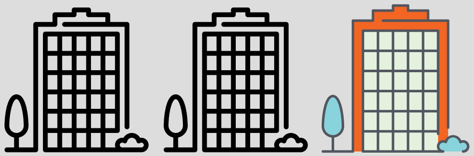
Mortgage lenders have always had a stand-offish approach to the operations elements of mortgage transactions – disclosure team, processing team, underwriting, closing and post-closing -- leaving the customer experience to the discretion of individual departments and some third party vendors (Title, Appraisal, HOI). Consequently, they have never bothered to ponder over questions like why are there multiple touch points for the borrower, why is data being entered several times, how to gain control over auditing issues, why are multiple technologies required for a single transaction, how to put data to good use, how to tap into the expertise of consultants etc. This has created large gaps in the process – big enough for compliance issues to rear its head and eat into the profits.

Regulatory compliance has pushed the production costs of each originated mortgage from $2,200 to $6,969: Mortgage Compliance Magazine

Compliance: Eating into Profits

1 OUT OF 3

firms spent a whole day tracking & analyzing regulatory changes in 2016



$1.7 BILLION

or 0.15% of assets has been the cost impact of regulatory complaince since 2010

2 OUT OF 3

firms spent more on hiring senior skilled staff.

70%

of compliance officers expect regulators to push more information over the next 12 months. MBA Survey

Set the Process Right to Restore Profitability

In the Dodd-Frank era, lenders can no longer afford to devote minimal time and thought to the transaction process. They need to focus sharply on variable costs, technology, scalability and strategic partnerships to stop expenses from going out of control. For instance, working with disparate vendors and technologies can lead to redundancy and inefficiency, causing costs to go up. However, if the lender insists on using technology and integrated processes, a lot of cost savings can be easily realized. In other words, decisions based upon strategic consideration and empirical evidence can help lenders find the best approaches to comply with regulations, execute them properly, establish controls, and monitor for compliance.

How to Set the Process Right

To set the process right, lenders need to have a holistic approach to compliance management. This will enhance process efficiencies and will lead to more cost savings. Some of these include:

HIRE AND USE CONSULTANTS THE RIGHT WAY:

In a compliance driven process, compliance consultancy must be embedded in a way each firm manages and deals with its customers. So always hire someone with sufficient experience in your type and size of business. This will help you effectively identify the flaws that might lead to compliance violations and at the same time help you improve processes and lead to cost savings.

Besides implementing and managing your compliance monitoring program, you should leverage the services of compliance specialists to provide appropriate training to your staff. From a cost cutting perspective, this can be extremely beneficial as a knowledgeable staff can solve most of your problems and help you truncate the expenses involved in having a full compliance service. Periodic training to refresh employee knowledge on key compliance concepts and new regulations can be extremely useful.

SHIFT TOWARDS INTERNAL-AUDITING:

Adjusting to the additional cost of audits without subtracting the costs from your bottom-line is a pipe dream. An easy and bold way out is to shift the bulk of your auditing efforts in-house and use outsourced resources to do component based task. This will make it easier for you to train and retain people with auditing skills, have complete control over the entire auditing process and be proactive and quick in preparing for audits. An overall control on associated risks, existing trouble-spots, control mechanisms and reporting capabilities always serves as an early warning system to identify and remediate issues on a timely basis. Given that federal and state level audits can involve huge remediation costs, having an early warning system brought in by a robust internal control mechanism can lead to considerable cost savings. To bolster the internal-audit mechanism, lenders can leverage technology, which can help them audit loan terms and view risk levels at each point in the loan lifecycle.

The good part of establishing an internal audit function is that it does not involve huge expenses. The function can be internal, but just as easily co-sourced or out-sourced.

Non-qualified mortgage loans fell from 14 percent in 2015 to 9 percent in 2016 due to heightened regulatory requirements - ABA Survey

Why Compliance is Pushing Up Costs

Lack of in-house compliance skills

51%

Need for additional processes for compliance needs

51%

Compliance activities associated with business function outsourcing

20%

How to Set the Process Right

PUT DATA TO OPTIMUM USE:

Superior data helps in establishing risk-free operations that can keep costs down to the point of sufficient profit on per-loan basis. It helps originators to acquire the intelligence needed to better understand where to originate, what type of loans to sell, how to improve close ratios, turn times and so on. To put data to good use, lenders need to have the right mechanism to capture, validate, store, and analyze data.

Technology is a big enabler in this regard and can be used to extract high quality data from loan documents. It helps to unite disparate corporate data into one resource, harnesses it as a single source of company truth, and leverage it to achieve the strategic goals. To encourage data-utilization among lenders, Freddie Mac has added a business intelligence tool to its Loan Advisor Suite which pulls out data from all of Loan Advisor Suite's applications into a simple snapshot that lenders can use to manufacture high quality mortgages and monitor transaction data.

FOCUS ON A RULE-COMPLIANT BUSINESS STRATEGY

A business strategy that is more customer centric always helps a business to be in the good books of the regulatory authority. While focusing on market place is primary to businesses growth, encouraging it at the cost of providing the right value to the customer can prove to be too costly. For instance, if borrowers are looking for mortgage products that would remain consumer friendly when interest rates go up, you should cater to this specific need, overlooking the greater business need to sell more mortgages by fudging, hiding or exaggerating facts. A business strategy that balances business growth with customer requirement is less suspect in the eyes of the compliance board and effectively keeps litigations at bay. To ensure this, lenders need to provide consumers with clear information during and after the point of sale, give them the right advice taking the customer's circumstances into account, provide products as consumers expect them to perform, and do not put up unreasonable post-sales barriers to change products, switch provider etc.

Increase in staff time spent on regulatory activities since 2010

91%

JPMorgan employed 4,000 additional compliance staff in 2013 and spent an extra $1bn on controls.

Deutsche's 2014 results included €1.3bn in extra regulatory-related spending

Half of **Citigroups** $3.4bn efficiency savings were consumed by regulatory and compliance activities.

In 2013 **HSBC** inducted 3,000 more compliance staff, increasing compliance employees to more than 5,000.

UBS spent SFr900m ($946m) on regulatory demands in 2014.

Conclusion

If compliance requirement is a game-changer, industry players need a game-changing solution to remain profitable. The solution must take into account the strategic reboot needed in the origination process. It may not necessarily mean re-inventing the wheel, but must involve working with partners and vendors committed to and accountable for efficiency, choosing the right technology to integrate partners and cover larger swaths of the transaction and overseeing the transaction as it moves from disclosures through processing, underwriting and closing.

Expert Mortgage Assistance (EMA), a division of the Flatworld Solutions group, commits itself to making mortgage process outsourcing faster, easier, better and more economical than ever before. We have over 10 years of experience in providing support services to blue-chip financial institutions in the areas of mortgage processing, underwriting, closing, post-closing and title services. Today we serve more than 200 financial institutions of all sizes, including two of the world's largest top-tier mortgage lenders.

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