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THE CHANGING SHAPE OF THE **C**redit Reporting Industry

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THE CREDIT REPORTING INDUSTRY HAS CHANGED DRAMATICALLY IN RECENT YEARS.

Not that long ago, it took days to prepare a credit report. First the report would be manually prepared on a typewriter, then sent by courier to the mortgage lender for review. But then technology came on the scene.

In the late 1980s and early 1990s, credit agencies developed technologies to instantly merge credit data from the national repositories into a single, comprehensive report. But even then, order and delivery were achieved by fax and snail mail.

Eventually companies brought dedicated printers and modems into the lender's office to instantly deliver completed reports, saving days in processing time.

To further enhance the order and delivery process, progressive companies developed software that allowed the lender to order as well as receive a merged credit report in seconds instead of hours or days. Companies such as Salisbury, Maryland-based Credit Plus Inc. developed the means to interface a lender's loan origination software with its credit reporting platform, eliminating the need to rekey information.

With the introduction and widespread adoption of automated underwriting came the demise of the residential mortgage credit report (RMCR). Lenders no longer needed the additional information and verifications contained within an RMCR. All that lenders required was a triple-merged in-file with credit scores to make an underwriting decision, ultimately saving valuable time and money.

New technology, industry consolidation and challenges presented by pending reform of the Real Estate Settlement Procedures Act (RESPA) all are reshaping the business of credit reporting.

Today many credit agencies offer credit reporting and other crucial services through a single, comprehensive platform available on the Web. Of all of these changes, several advantages stand out as particularly noteworthy. Topping the list is the speed at which mortgage professionals can now obtain credit information. What used to take days now takes seconds.

The exponential growth of automated services has led to a streamlining of lending operations to a degree not imagined just a few years ago. In the late 1990s, more and more credit information providers began adding items such as flood reports, appraisals and tax return reports to their product and service mix.

This article looks in detail at the changing face of the credit reporting industry—much of it brought about by technological developments. It also examines the roles consolidation and bundling of settlement services under the Real Estate Settlement Procedures Act (RESPA) could play in further transforming the business.

Rapid changes

From eliminating huge paper trails and weeklong lag times to eliminating many traditional jobs, the streamlining of the lending industry has been staggering. You can find evidence of this all around. In June, Howard Beales, director of the Federal Trade Commission's (FTC's) Bureau of Consumer Protection, testified about the Fair Credit Reporting Act (FCRA) before the Financial Institutions and Consumer Credit Subcommittee of the House Financial Services Committee. Beales noted how the modernization of credit reporting has played a key role in providing American consumers rapid access to consumer credit.

While credit reports are much more a part of the front end of loan servicing than a true settlement service, their evolution and regulation weigh heavily on the settlement service industry.

With credit becoming even more important in the successful quest for home financing, consumers are bombarded with advertisements that offer fast, easy access to their credit reports and solutions to their credit woes. In addition to streamlining business operations, technology has helped consumers make significant gains in accessing their credit ratings.

Some products now let mortgage professionals show their clients a glimpse at their credit future and provide assistance with how to improve a troubled score. For example, in the past year my company, Credit Plus, released a product called ScoreWizard®. This Web application helps mortgage bankers, independent brokers and large, national lenders educate their customers. It also helps them tap into the market of would-be borrowers whose credit ratings might otherwise prevent them from getting a loan. Ultimately, ScoreWizard helps these potential borrowers reach their target credit score more quickly and easily than through traditional means.

The product offers four features that let mortgage profes-

sionals evaluate a potential borrower's credit file, predict the impact certain actions could have on the credit score and improve the score. The key innovation has been the "What-If Simulator." This lets the broker or mortgage banker edit the credit report and see how actions such as adding or removing accounts, changing balances and correcting errors and omissions could effect a consumer's credit score. This process can greatly reduce the time and money often wasted on failed loan applications.

Technology has helped in many other areas to improve and speed the loan origination process.

Flood reports are now provided instantly and with much more reliable flood zone determinations than ever before. This is primarily due to databases, which have become significantly more thorough and extensive. Most systems are tied directly to credit ordering and other bundled portals for one-step ordering.

Automated valuation models (AVMs) seem to offer new capabilities with each passing week. AVMs provide efficient and effective tools to value residential property. AVMs cover residential properties nationwide and offer confidence scores, multiple model results, recent sales information and advanced search capabilities. Some companies are now using multiple AVM products in a specific sequence to ensure a "hit" on the property value, meaning they retrieve a usable value on the subject property from the AVM.

Tax-return verification reports (TRVs) compare the income-related lines of the tax return that are provided by the borrower with the same lines on file at the Internal Revenue Service (IRS), and they highlight any variations in an easy-to-read report. TRVs are derived from data obtained directly from the tax returns retained in IRS files.

This data can be obtained on any individuals or businesses that have authorized the release of this information in connection with an application for credit of a similar consideration. Not only do TRVs help reduce fraud, but these days they're available in less than 72 hours or they're free.

The processes for obtaining appraisals and title insurance also have been greatly accelerated. A particularly exciting new product on the scene is the mortgage loan report (MLR). The MLR is a less-costly alternative to the typical \$150-to-\$250 title search, which can quickly add up after several searches. It identifies mortgage-secured liens as currently reported on the borrower's credit report, and includes a place for borrowers to add any other lien holders not listed in the report (affidavit). The whole process culminates in a 30-second reporting time, versus the traditional three-to-four-day wait. Additionally, the MLR is guaranteed and backed by errors and omissions (E&O) insurance.

Another notable innovation is the equity report, which is designed for use with equity, refinance and debt-consolidation loans. This report presents the essential elements of creditworthiness, property value and flood data with the MLR that identifies existing secured mortgage loans.

Through an electronic provider network (EPN) such as Spokane, Washington-based Synergistic Software System Inc.'s SharperLending™ (www.sharperlending.com), the reports are sold by members of the network, such as credit information companies. This allows the reports to be

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ordered from a single source and makes them available within minutes, enabling the user to take the documents right to the closing table. This unique, new equity product featuring the MLR offers a 30-second decision at half the price of commonly used products. It's becoming one of the faster-growing product offerings in the industry.

Technology trends

Manipulation of data and the innovative use of the Internet have been crucial in advancing credit information and settlement services. The ability to enter different accounts, balances and timelines and analyze different scenarios enables originators to pinpoint which financial areas to focus on so that more borrowers can qualify for loans.

The credit reporting sector is now seeing innovations that improve everything from consumer access and control of credit status to the speed and ease with which lending personnel can obtain and analyze credit information.

An example of technology designed for speed is application service provider (ASP) plug-ins for electronic credit data transmission, which allow mortgage professionals to automate credit-based decisions and close their transactions more quickly and efficiently.

These plug-ins allow lenders to integrate credit reporting into their own loan origination systems instead of relying on a supplier's system, and allow for custom credit decisioning and underwriting that isn't otherwise readily available. They also take advantage of the cost-effectiveness of Internet technology, allowing users to access credit data from Experian, Equifax Inc. and TransUnion LLC.

Tools like this allow brokers and lenders to use data collected on their Web sites to automatically pull credit reports, import data into their back-office systems and make automated decisions.

On the consumer side, similar technologies also exist for companies that do not host their own Web site. Service providers can build a private-labeled Web page for a lender that collects data from a consumer wanting to apply for a mortgage loan, pulls the credit report, e-mails the originator that a new application has been made and references the credit report number for the originator to review. It can even add a free credit score analysis as a value-added service. The user also has the option of charging the consumer for the report or being billed later.

Meanwhile, many companies are banking on bundled services as the next big service model in the loan origination business, giving rise to EPNs. These networks create a single platform for the order, delivery and management of all mortgage services.

They also provide a generous number of vendors to choose from, with the ability to easily add custom vendors. For example, a lender's local appraiser can be added to the system instead of relying on a company with which it has no previous relationship.

In addition, EPNs can allow for custom decisioning. For example, the user can set a default credit score from a credit repository at 620. Once the credit report is pulled, if the score is 620 or more, the user can instruct the application to automatically pull an AVM. If no record is available from the

first AVM provider, another AVM will automatically be pulled from a different provider until a record is found.

Major consolidation

Another prominent trend in the credit information industry is consolidation. In the past two to three years, small credit bureaus have been disappearing faster than the first cold beer at the 19th hole. Many smaller entities are in a particularly tough situation, because they're often charged disproportionately large fees by their vendors because of the smaller volumes they typically run.

That's where consolidation is coming into play. Some mid- to large-size companies are diversifying by offering a wider variety of products and services by partnering and forming other strategic relationships. Others—those who can afford to—are buying entire companies outright. An example is Santa Barbara, California-based Fidelity National Information Solutions Inc.'s (FNIS') acquisition of Walnut Creek, California-based Appraisal Enhancement Services (AES). In any case, if you don't continue to generate innovation, all you have to compete on is price.

Savvy credit bureaus will find the key to success will be in how they implement any consolidation moves. You can't simply make acquisitions, cut staff to almost nothing and expect that part of the business to generate the same revenue as before. Firms looking to consolidate need to be sure their choices fit within a solid survival strategy.

The next year or so will be especially tough on the mortgage industry as a whole, as interest rates rise again. The Mortgage Bankers Association (MBA) is predicting that mortgage volume will decline by 43 percent in 2004, mostly attributable to an expected drop-off in refinancing activity. In fact, it's quite possible that in that time period we could see the credit industry consolidate from about 100 into as few as 10 to 20 bureaus across the United States, with virtually none of the small or mid-size credit bureaus we have today.

RESPA implications

On another front entirely, some changes are afoot on the regulatory horizon that have implications for the credit industry as well. If proposed changes to RESPA are adopted as final rules by the Department of Housing and Urban Development (HUD), we'll see some likely winners and losers. Just take a look at the issues surrounding the possible offering of guaranteed third-party settlement service fees in a package offered to consumers.

The initial proposed Guaranteed Mortgage Package (GMP) as outlined by HUD in late July last year would offer one guaranteed price for all lender and third-party charges needed to complete a loan. As this goes to print, HUD had not yet decided whether to issue a final rule incorporating industry comments on the proposed rule, or follow another course of action.

But if we presume adoption of something like the initial

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proposal, the largest credit bureaus could gain a tremendous advantage over small to midsize bureaus. This is because of the number of third-party enterprises the large companies already own.

Combining and "packaging" settlement services is seen as potentially providing added value for consumers. But in my view, this may simply prove too costly for a vast majority of existing settlement service providers to offer. If the industry adopts a standard price for bundled settlement services—say, \$300—many companies will have difficulty conforming because they can't predict how much time and effort will be needed to service each particular loan application.

Each situation is different, and the amount of required service varies too widely—especially with credit, where it's not known initially how much work will be needed on a credit report to get the loan approved. How much should be charged? What's a fair price? Setting a standard uniform price will result in some customers underpaying and some overpaying.

Given these possibilities and the struggle many companies are now grappling with, what specific steps are credit and settlement service providers taking to ensure their future survival?

Some firms, especially those focused on credit information services, are lobbying to have credit reports excluded from the closing portion of the proposed RESPA rule's guaranteed mortgage package. Why? First, because credit

reports are by far the least expensive portion of fee-based loan application services and could easily be subject to artificial rate hikes by companies that fear getting burned by having to bundle service packages, in my view. And second, credit is used for establishing loan eligibility, not as a back-end item of the loan process.

Some are also adopting business strategies such as consolidating services or purchasing additional entities that will help them round out their internal resource pool. Or, particularly for small bureaus that don't become part of a larger company, creating different pricing structures will also be key to their survival.

A possible dual package was being considered by HUD at press time. Although opposed by some in the industry, including the Mortgage Bankers Association (MBA), the idea would be to split the guaranteed mortgage package in two, with one package including title charges, government recording and transfer charges, property surveys and pest inspections. The other package would include loan origination costs such as credit reports and appraisals.

This is a time for all players in the industry to do some serious soul-searching. Major changes are on the horizon that have serious implications for many players. How it all turns out, only time will tell. **MB**

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