CAPCO

Market Study Report

CORRESPONDENT LENDING

Contributors:
Priya Merchant, Dan Mulberry, Eric Parrasch, Tommy Marshall, Bryce VanDiver

April 2016

Correspondent Lending Industry Study

This report analyzes those characteristics that help organizations succeed - and reveals how to bring industry best practices to your correspondent lending business model

The study took an end-to-end view across correspondent lending processes. The findings provide consistent, credible, industry best practices related to correspondent lending operations, performance and delivery. The study focused on areas such as market drivers, process efficiency, technology, data, risk management, and improvement metrics. The participants included a diverse range of respondents including correspondent aggregators, non-banks, Government Sponsored Entities (GSE) and technologists.

This report also captures alternative competitive approaches and emerging capabilities to transform your business, focusing on factors that contribute current-state optimization and lead to sustainable success. Thank you to everyone who participated in the study. We hope you find this report both enlightening and thought-provoking. We look forward to speaking to you further about our findings and the potential implications for your business.

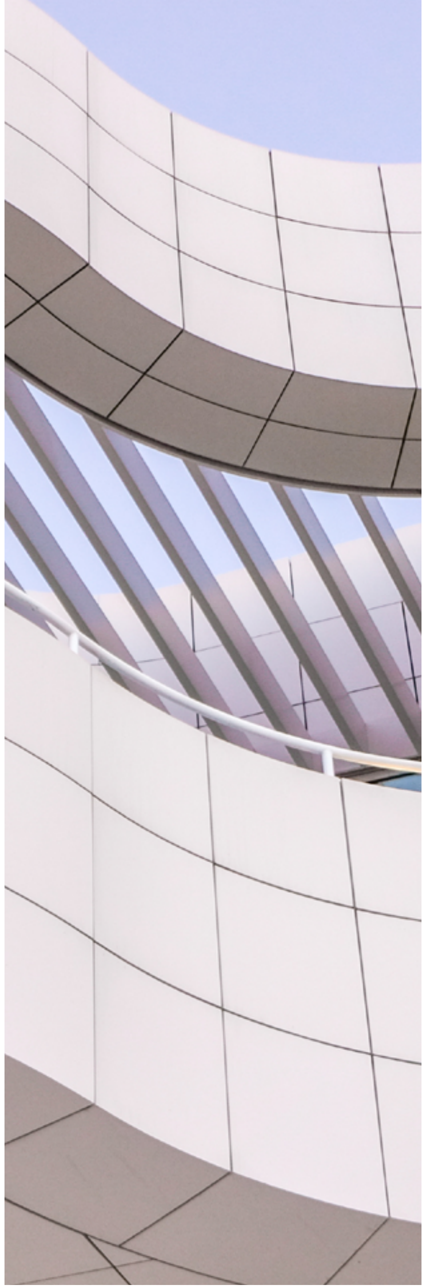


Table of Contents

01/ Executive Summary

STRATEGY & MARKET OUTLOOK

We determined that in many cases, sellers are configuring best execution pricing algorithms to penalize correspondents to some extent for delivery factors such as turn time and overlays, and this practice varies based on product. Some correspondent lenders are losing market share to the cash window with the top three reasons being cited as less inspection content, rep and warrant relief, and turn times. Co-Issuance is providing specific turn time advantages of less than seven days and the correspondents use different inspection criteria if they are not servicing the loan, focusing mainly on investor scalability and securitization requirements while expediting the process with compliance tools. Several correspondents were found to be reducing the upfront standard pre-purchase review.

OPERATIONS & PROCESS EFFICIENCY

To an extent, correspondents are using workflow automation to optimize efficiency and productivity. Suspense rates, error rates and submission rates appeared unaltered from workflow changes. There is some evidence in large-volume shops of significant re-engineering of the pre-purchase review to gain efficiency and productivity. Use of onshore and offshore teams was observed. A majority of correspondents use a two-person model of intake/reviewer, with a condition clearing bullpen. Easy vs. complex lanes are being utilized.

TECHNOLOGY & DATA

broader industry has not yet fully adopted more advanced use of data transmission, e-delivery, and Optical Character Recognition (OCR) to ingest physical file data and documents to automate elements of the manual inspection process. Machine learning / artificial intelligence is not being used. Additionally, due to system constraints, correspondents are not yet reharvesting standard lender data from external repositories or the Loan Origination System (LOS) to e-verify income, assets, compliance, etc., and eliminating/reducing manual re-verification.

Currently they are using data and analytics to inform the design of the content and criteria of targeted inspection.

MANAGING RISK & COMPLIANCE

In general, the market has reduced or eliminated loan review criteria with differences in the level of reduction based on loan type. Inspection content is fairly similar across the correspondents with exceptions around compliance and servicing setup data collection. Regulators scrutinize lenders differently. Unequivocally, bank depositories are at greater risk of large-scale recourse for assignment of liability by the Consumer Financial Protection Bureau (CFPB) and are therefore more conservative. They were investing more in post fund Quality Control (QC) & analytics teams in an effort to calibrate custom reviews for lenders based on performance.

CLIENT MANAGEMENT & MARKETING

Correspondents have simplified seller/servicer guides to be more in line with agency standards, and have reduced/eliminated proprietary overlays. They are offering lenders who produce verified manufacturing quality incentives in terms of customized and streamlined inspection processes and pricing advantages based on tenure, volume and quality. Correspondents provide greater support services to sellers that enable them to improve loan quality submission, clear conditions faster and turn their warehouse lines faster. They are reducing their prefunding operational processes (sometimes to 30-45 minutes) and performing a third party compliance check because as they lack the capacity to perform broader, deeper audit activities in a timely fashion. This results in an increasing tendency to rely on counter-party reps and warrants.

02/ About this Report

This report is based on the comparative study of correspondent organizations' operations across the country and provides wide-ranging insights into a rapidly evolving industry

In the scope of today's business world, a company's business strategy is incomplete if it does not consider its competition. This report is based on the comparative study of correspondent organizations' operations. It is specifically aimed at determining opportunities to incorporate or assimilate best practices for the purposes of continuous improvement. There are a number of benefits to correspondent aggregators from the findings of the study. These are largely centered on the insights the companies obtain by allowing them to identify opportunities in the marketplace. In turn, this helps them stay well ahead of the competition by being aware of their business challenges, and minimizing the risk of prioritizing certain business decision.

BENEFITS OF THIS REPORT

01

Facilitate measurement of capability maturity across peers

02

Provide insights into opportunities and the potential for impove-ment

03

Provide an independent, external comparison of operational performance against peer

04

Provide focus on capa-bilities that are critical to building strategic advantage

05

Provide objective basis for prioritization of operational initiatives

CLIENT MANAGEMENT & MARKETING

- Market Value Proposition
- Premiums for Mfg. Quality
- Seller Base & Product Focus
- Seller/Servicer Guidelines

MANAGING RISK & COMPLIANCE

- Compliance Philosophy
- Risk approach
- Statistical Sampling
- Regulation

TECHNOLOGY & DATA

- Emerging Technology & Innovation Adoption
- Data and Analytics
- Data Transmission

OPERATIONS & PROCESS EFFICIENCY

- Cycle Time
- Workforce Design
- Workflow & Engineering
- Conditions Management

METRICS

- Performance KPI
- Operational Efficiency
- Cost Per Loan
- Loans per Staff
- Others

STRATEGY & MARKET OUTLOOK

- Company Profile
- Strategy Outlook
- Future Growth

The comparative market study used a methodical approach to design and execution. A combination of information gathering methods were used as necessary such as secondary research and primary research. The primary research included peer market analysis (survey, site visit, telephone follow-up after site visit to clarify key points) and market trend analysis (exploring trends, capabilities, new opportunities and market potential). Specific firms were targeted for the study, and we had significant amount of participation both formally and informally. We established a set of key assumptions and probes for analysis to conduct the study and assess participants' relative strengths.

03/ Strategy and Market Outlook

We asked correspondents to describe the future outlook and priorities, channel growth strategy and how they planned to leverage operations as a competitive advantage

Correspondents are focused not just on driving efficiency, but also in re-imagining customer experiences, reshaping how work gets done, and even rewiring business models

TOP 3 FOCUS AREA

DEPOSITORIES	NON-DEPOSITORIES
1. RISK MITIGATION	1. DATA VALIDATION
2. DATA ACCURACY	2. INVESTOR COMPLIANCE
3. INVESTOR COMPLIANCE	3. MARKET SHARE

FUTURE OUTLOOK & FOCUS

Looking ahead, sentiment across the industry is positive, with the vast majority of correspondents predicting increases in revenue and profit for the coming year. Correspondents are focused not just on driving efficiency, but also on reimagining customer experiences, reshaping how work gets done, and even rewiring business models. Our study shows that organizations across the board have common business focus, directly linked to the core of their businesses. The firms (depositories and non-depositories) were unanimous in identifying the top three business focus areas: risk mitigation, data accuracy, and growth / market share.

A few other priorities that did not make the top three list are still significant. Standardization of compliance criteria was important for some. The standards need to be unified, harmonized, and agreed to across the enforcing entities to drive simplification without sacrificing the ability to manage risk. In addition, eLoans and overhauling old technology were enterprise priorities. These are critical building blocks that could impact the three top priorities so it is important to recognize them.

STRATEGY FOR GROWING MARKET SHARE

In a crowded market with limited volume, correspondents will need to offer more to sellers and remain focused on finding ways to bring additional value to business partners. Understanding sellers' needs will enable a firm to grow quickly and provide quality service.

5 WAYS TO ACHIEVE DIVERSIFICATION AND GROWTH WITHOUT COMPROMISING ON QUALITY AND RISK

The core tenets of the strategy for growth and differentiation in a crowded market

01

Managing and **growing client base** effectively remains fundamental to long-term success.

Deliver **outstanding client service.**

02

Competitively pricing products

03

Reduction/elimination of **overlays and ensuring** fast turn times. Be committed to continually improving in every area.

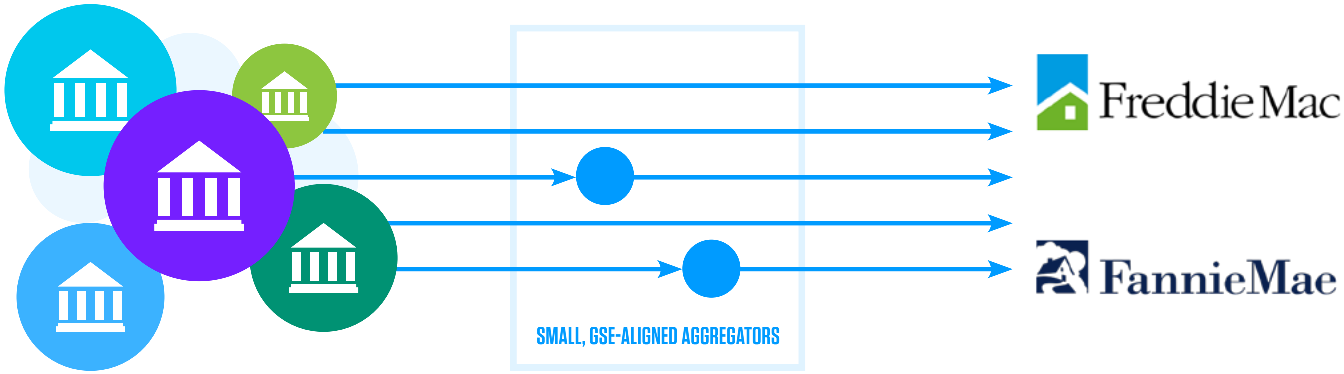
04

Achieve diversification while remaining focussed on core clients, by **offering more products and services**.

05

Utilize the **innovative technology** to reduce post-closing costs

Non-depositories appear to have the most focused and cultivated strategies for gaining market share. Since non-bank mortgage lenders rarely hold loans they do not require as much capital, which lowers their costs to lend and allows them to make their pricing more competitive. With the introduction of multi-lender swap by the Government Sponsored Enterprises (GSEs), smaller institutions and non-bank lenders now have access to the same securitization options that were typically reserved for larger more established lenders.



The direct-to-GSE model is driving the need for correspondent programs to alter operational processes, thereby ensuring they are structured to successfully compete with the GSEs.

Most depository institutions are clinging to status quo operational /organizational design, technology and standard operating procedures. They reported difficulty with ROI justification for unique investments in technology and innovation, and in many cases the correspondent channel is not as strategic a priority relative to retail and direct.

The study reinforces that there continues to be significant scope for correspondents to extend and diversify their service offerings. We encourage firms to leverage their strengths and become positioned to service the varied needs of a growing client base.

GSE CASH WINDOW IS WINNING MARKET SHARE

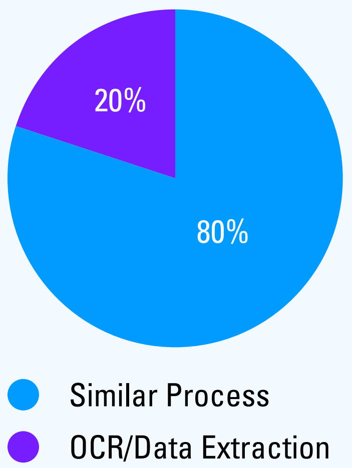
The correspondents, risks are being bypassed as sellers increasingly look to utilize the cash window. The continued growth of the cash window, particularly among small lenders, could lead to significant loss of business for correspondents.

The GSE cash window typically funds a loan in two days. The ability to fund a loan without suspense conditions - combined with the ability to clear warehouse lines faster - is causing a loss of market share for traditional aggregators. New entrants less concerned with regulatory scrutiny are aligning their strategies to compete with the GSEs and are gaining market share.

04/ Operations and Process Efficiency

We asked correspondents to demonstrate their business process design, process control frameworks, process innovations, operational constraints, people management and operational metrics

All the players are managing the cost of operations, while still looking for ways to optimize quality, efficiency and improve customer service. As an industry, they will have to lean on each other to find best practices.

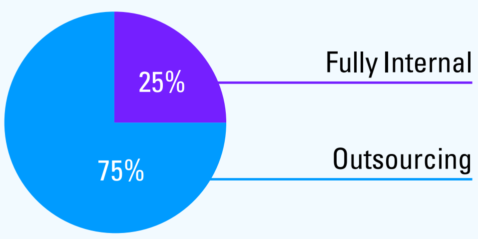


PROCESS DESIGN AND INSPECTION JOB TASK ANALYSIS

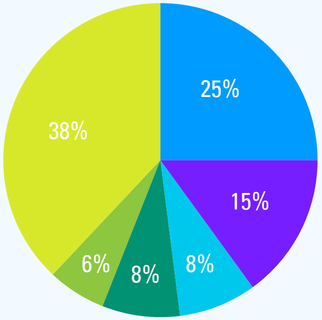
Nearly 80% of all participants are using similar processes- receiving, review, suspense clear, auxiliary, underwriting, and compliance. The checklists are organized differently, but the core review content is similar. Organization of criteria varies from Q&A format to open data field manual entry.

Inspection is organized by document chronologically or rules-based taxonomy; in either case, documents are scrolled and stare-and-compare dominates standard operating procedures. Some systems have hard stop triggers for defects. Others rely on a manual notation of real time findings. Still others run edits at completion (some in combination). Only 20% of all participants are using OCR and data extraction. However, none of them are fully automated. SLA objectives are fairly similar and actual results vary widely (see Operational Metrics information). On an average the initial review takes 24-96 hours, the time to review conditions is 24- 48 hours-, and the days to fund is seven.

Review capabilities of correspondents vary widely. 25% of the participants maintain internal capabilities for processing of same day initial review and posting conditions within 36 hours. 75% of the participants are using outsourcing for initial loan set up and data entry, complete review, and auxiliary under writing.



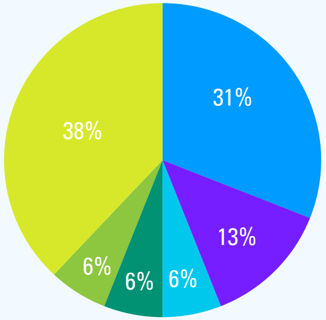
EXAMPLE FILE #1



28 DOCUMENTS CHECKED
100 DATA ELEMENTS REVIEWED

- Closing Documents
- FHA/VA/USDA Docs
- Appraisals
- Initial Disclosures
- Credit Documents
- Other (23 Documents)

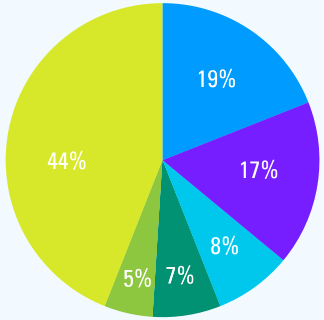
EXAMPLE FILE #2



24 DOCUMENTS CHECKED
144 DATA ELEMENTS REVIEWED

- HUD1 Statement
- Note
- Notice of Right to Cancel
- TIL Disclosure
- Payment Letter
- Other (19 Documents)

EXAMPLE FILE #3



29 DOCUMENTS CHECKED
132 DATA ELEMENTS REVIEWED

- Deed of Trust
- Note
- Power of Attorney
- HUD1 Statement
- Homeowner Disc.
- Other (24 Documents)

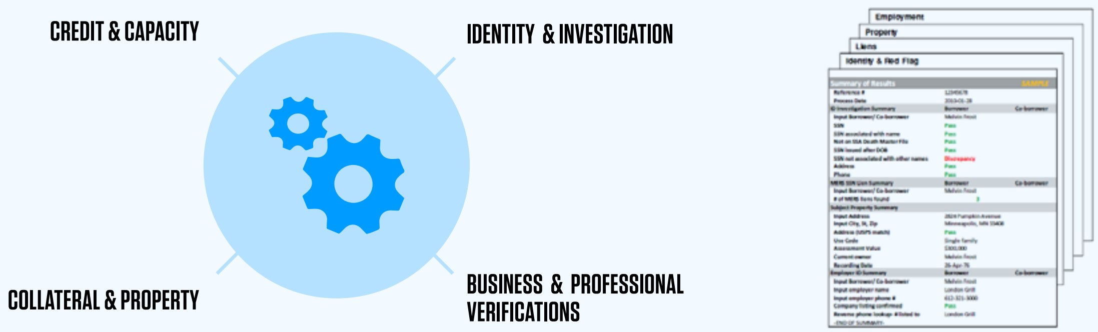
INSPECTION JOB TASK ANALYSIS

All the participants derive their workflow from an inspection criteria checklist, with the majority adapting it into a system Business Process Management (BPM) model. Some correspondents are still using a checklist only model. The critera for the checklist is open field text, data entry, while some is built off question/response triggers. The workflows drive off document stacking order, collecting all data relevant to each document, while others drive off of factor analysis (credit, collateral, note, compliance) going back and forth between documents. Some of the correspondents have adopted advanced OCR and data extraction in order to distill checklist content review to missing, exception or red flag reviews only (balance auto populating and self-editing against rules engine).

EXTENT OF REVIEW

Some of the file reviews looked at significantly fewer data elements and had some form of data extraction or automation. Review content/depth varies based on client needs and area of review. Many of the edits and validations are automated based on customized rules and exception process. 40-63% of the data elements reviewed in each sample are taken from the note and one other document.

Independent verification to decide with confidence



ABILITY TO REPAY / COMPLIANCE TARGET REVIEW SCALE

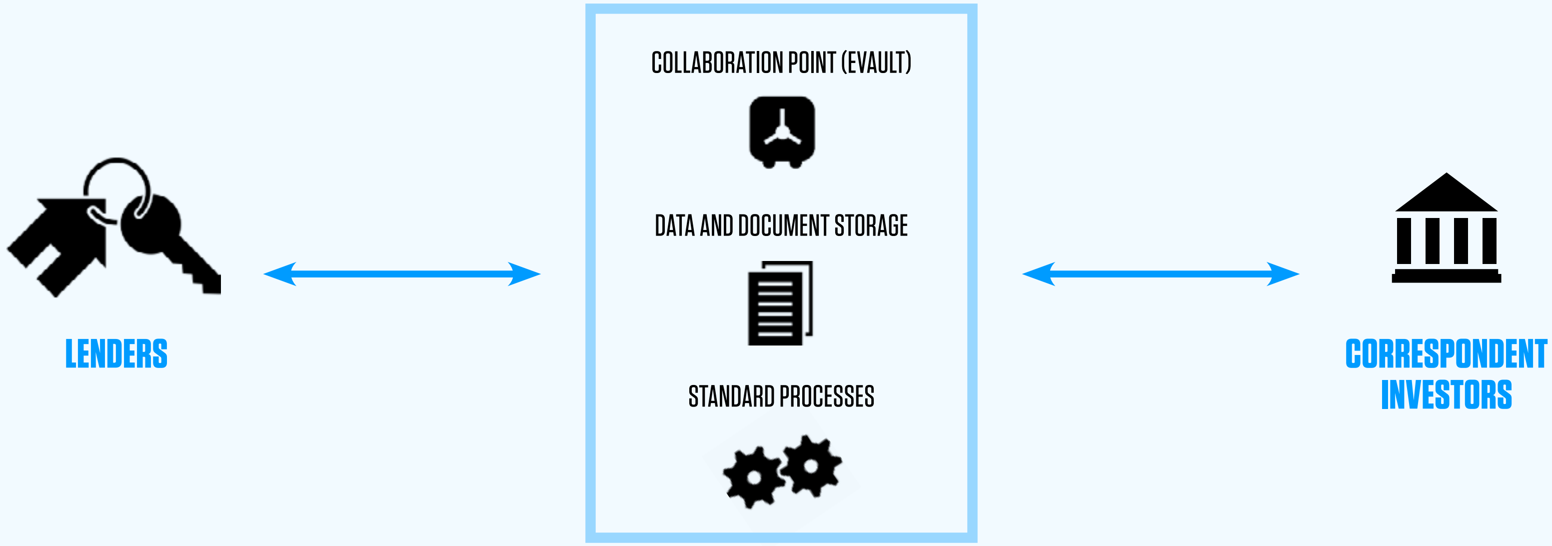
10% of participants have dissected the pre purchase review into four teams that run in parallel to create scale and reduce training. 40% of participants are emphatic that scale and capacity trump cost efficiency and are willing to carry expense of flex capacity. 60% of participants have created senior Underwriting (UW) call centers dedicated to helping clients remediate defects. The trend is to move away from first in first out (FIFO) and towards dedicated account support teams for pre-purchase review and conditions. Underwriting remains separate from pre-purchase review teams.

PROCESS INNOVATION

DATA CERTIFICATION "MIDDLEWARE" APPLICATION

Loan processors and underwriter have to order services – such as income verification, fraud, and compliance reviews from various disparate systems wasting time and compromising data integrity.

The transferable due diligence model is increasingly being utilized by non-lenders, but lenders subject to regulatory audits and penalties claim the risk remains high to adopt. The "middleware" process is being leveraged by an insurance firm to sell loan level repurchase insurance to lenders. We observed at least 20% of the firms were passing data through a "middleware" vendor who performs data and document validation and compliance verification, and then passes a standard data format to the correspondent.



eVault is an industry-changing innovation that enables the company to provide certification, safekeeping and status reporting for electronically created and signed mortgage documents.

USE OF INDUSTRY UTILITIES PRE-CLOSE AND PRE-FUND

Currently there are process inefficiencies when a loan moves through the value chain. The top quality issue is incomplete files and incorrect and/ or missing documentation for loans.

Correspondents remain convinced that re-harvesting source data is an intelligent option, but it is not protected under GSE seller servicer contracts.

There has been discussion but limited traction on access to pre-close data for correspondents to enable co-underwriting or inspection.

There is increased use of third party compliance and collateral review automation software to screen and approve compliance requirements. However, some larger lenders maintain that they must continue to leverage internally designed inspection processes for collateral and compliance. Use of GSE pre-purchase certainty tools is not being endorsed by some participants.

DISTRIBUTING A CORRESPONDENT OPEN SOURCES UTILITY FOR PURCHASE CERTAINTY

Given the broad array of highly specialized functions that occur in the loan life cycle, the most efficient approach to fulfillment is to ensure that the core competencies and skillsets are leveraged across the industry using specialized internal or external resources and services.

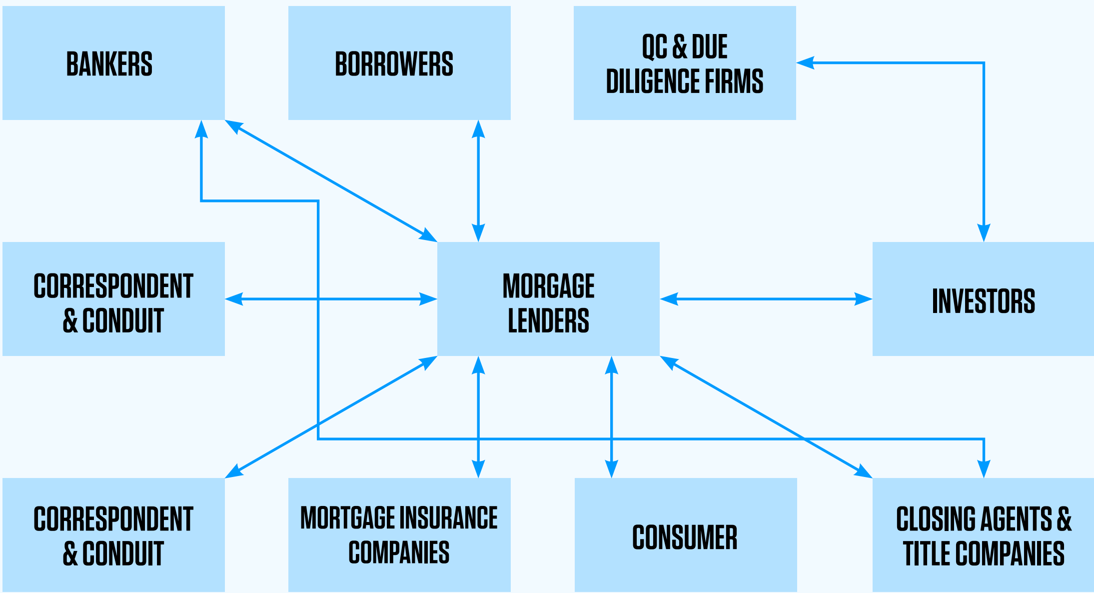
Distributed component manufacturing will benefit the industry by pushing the most specialized components of the manufacturing process to the lenders and their suppliers. This allows the use of the best suited tools and services for these sub-processes, reduces the need to double check data, provides a stable counterparty risk profile and improves overall loan quality.

One of the participants of the study is committing $20M to create a next generation LOS that will tie sellers to their back end.

BUSINESS RULES LOGIC AND AUTOMATION

Only 20% of participants are using rules logic to create a dynamic ”next task up” concept. 30% of the participants are significantly investing in “just right processing” models where the inspection is a derivative of lender profile, loan file attributes and accumulated risk models. There is little evidence of statistical process control in operations.

Distributed manufacturing pushes specialized components to lenders and their suppliers

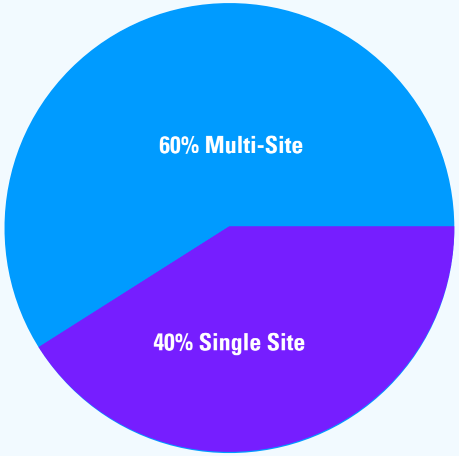


OPERATIONAL CONSTRAINTS

CRITERION	COMMENTS	LOW	MEDIUM	HIGH
Scalability	100% reported capacity constraints in 2015-16. Training cycle time remains a challenge; because of the document recognition factor and TILA-RESPA Integrated Disclosure (TRID)		●	
Turnover	Many correspondents reported burnout and boredom due to the manual operational nature of the work	●		
Manufacturing Defect / Seller Negligence	Transmission errors from document upload remain too high and create tension Correspondents reported that 87% of all defects are rebutted and attributed to manual error rates	●		
Productivity	All peers report a 50% degradation in UW productivity since 2012. Lenders admit that data entry errors and missing images account for too high a percentage of suspense conditions. There is high level of frustration over the lack of industry standardization around TRID requirements, lack of re-usage, re-harvesting of UW, compliance, collateral and Know Your Customer (KYC) done during origination			●
Queue Management	No real time loan level status and inability to "auto" clear certain conditions upon upload creates backlog Large volume of data entry creates internal manufacturing defects		●	
Correspondent Standardization	Variance in overlays versus correspondents underwriting specifically to agency guidelines frustrates sellers Some lenders believe they have a different level of institutional responsibility in the current environment			●
Technology & Complexity	Much easier for smaller, less complex organizations to adopt "appliance software" without the enterprise governance		●	

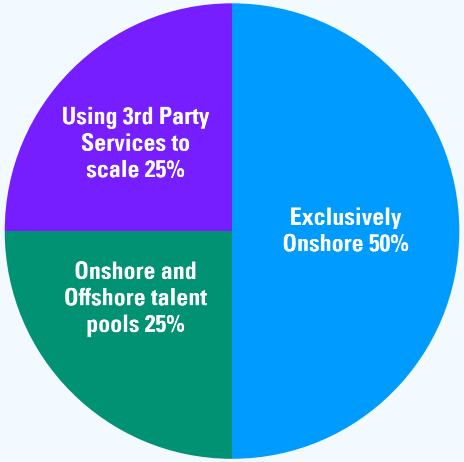
PEOPLE, TALENT & MOBILIZATION

Production geographies



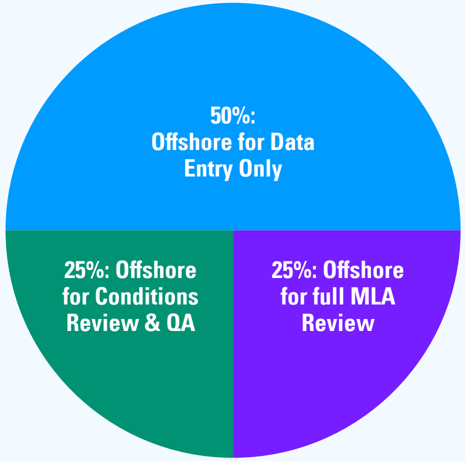
- 40% of participants using singular US site only
- 60% of participants with multiple sites

Outsourcing & process efficiency



- 50% of participants are exclusively onshore
- 25% of participants with onshore and offshore talent pools
- 25% of participants using BPO 3rd party to scale - TCS, WiPro, Sutherland, ISGN, Accenture, Clayton, Scienna, MRN, Digital Risk

Process area offshored



- 50% of participants use offshore teams for data entry only
- 25% of participants use offshore for full Mortgage Loan Approval (MLA) review
- 25% of participants use offshore for conditions review and internal QA

TRAINING CYCLE TIMES

Training and ramp cycle times reported: 2-10 week range for classroom and 4-12 week range for on the job training certification.

PEOPLE MANAGEMENT

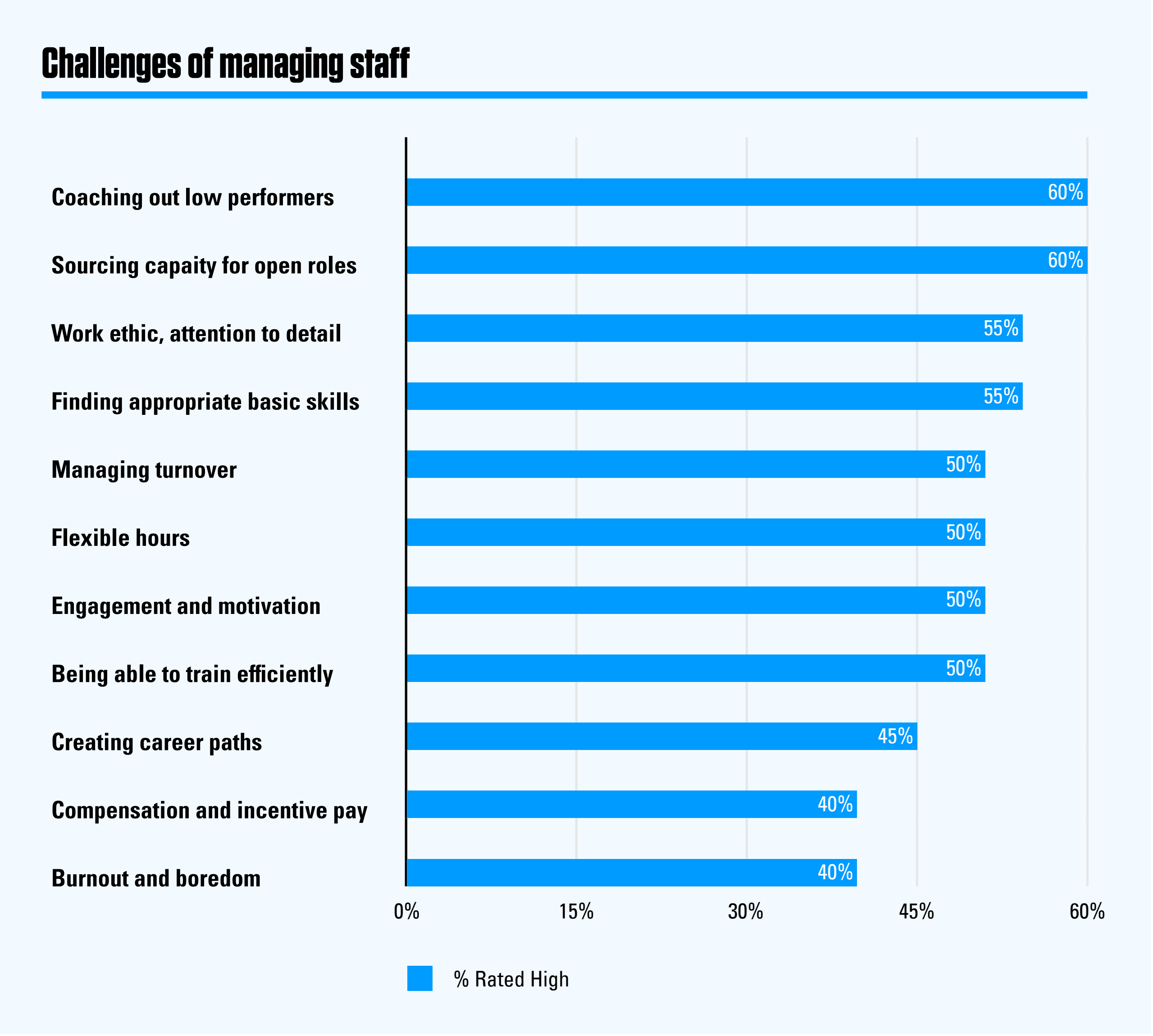
We ranked the feedback from peers regarding which aspects of managing human capital were causing the greatest challenges to operations.

CHALLENGES OF MANAGING STAFF

Finding skilled staff - 60% of participants suggested they are now recruiting for core competencies, transferable skills and personality characteristics rather than mortgage domain experience. Several are using training academies to teach document recognition and overall process, then using correspondent training as a step in to other roles.

Boredom and fatigue were also mentioned as key challenges. By moving to client account teams, some peers are uniting back office teams with sales to create a shared sense of goals and objectives

Industry growth and strong competition for skilled staff have kept wages buoyant for underwriters. They are earning over $75-100k per year with incentives and quality premiums. DE underwriters are in highest demand given the credit profile in the market. Almost 50% of clients said they would increase prior-approval underwriting services if they could staff the roles.



OPERATIONAL METRICS

We asked correspondents to share current run rate metrics for comparative KPIs to create some perspective on market range.

METRICS	RUN RATE LOW	RUN RATE HIGH
FTE	62	412
COST PER LOAN	$135	$450
LOAN PER STAFF	18	43
INITIAL REVIEW SLA	1	5
DELIVERY TO FUND: ACTUAL	2.8	18.7
PERCENTAGE OF LOANS SUSPENDED	40%	92%
AVERAGE NUMBER OF CONDITIONS PER LOAN	1.2	6+

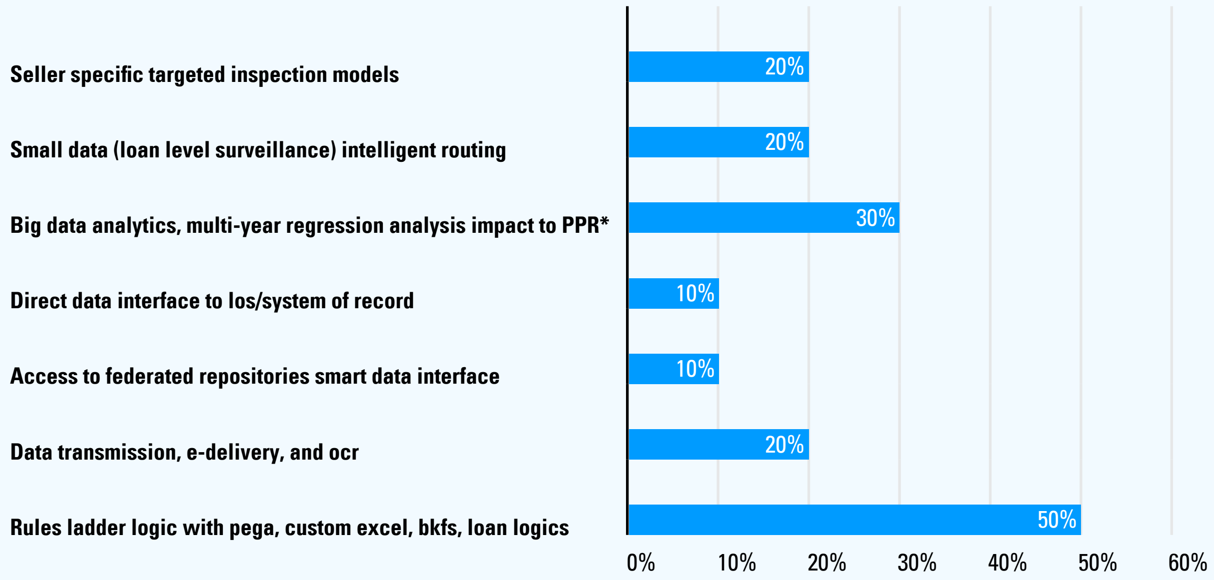
05/ Technology and Data

We asked correspondents to demonstrate how they were utilizing advanced data and analytics, statistical modelling to optimize their pre funding review, adopting new technologies and the core technology systems being used

Correspondents' current technology need is for a robust, easy-to use web platform that incorporates innovative technology for flexible delivery options. They also need streamlined purchase processes for fast funding, as well as streamlined quality assurance reviews to mitigate risk

INCORPORATING ADVANCED DATA & ANALYTICS

Currently, correspondents are using advanced data and analytics ranging from 10 - 50% across different use cases. There is 50% usage of "rules ladder logic with Pega, Custom Excel, Black Knight Financial Services (BKFS), Loan Logics" among the correspondents. The correspondents are not leveraging seller e-verification records, multi-factor analysis, machine learning, artificial intelligence and robotics.



*Pre-Purchase Review

DYNAMIC INSPECTION PROCESSES

Nearly 40% of firms who participated in the study have incorporated "intelligent design" into their inspection process. Correspondents complete offshore data and document verification and then route loan for additional inquiry based on a risk/ complexity score.

30% of the participants have significantly truncated inspection criteria based on accumulated counter-party risk rating developed through detailed, product-specific longitudinal risk profiles of sellers.

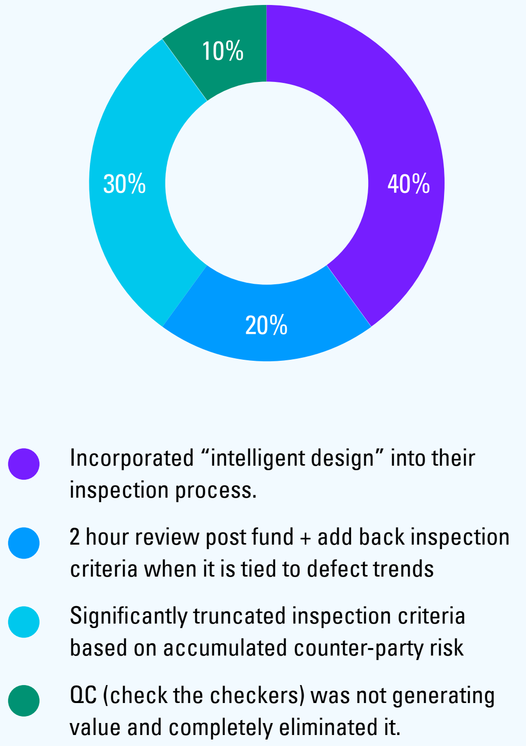
20% of the participants maintain post -fund-review on each client and only add back inspection criteria when it is tied to defect trends that exceed normal variation and Upper Control Limits/Lower Control Limits (UCL/LCL) control ranges.

10% of the participants have completely eliminated the 5-10% operational QC (check the checkers) after they determined through data analysis and analytics that the cost of QC was not generating value.

ELECTRONIC DELIVERY / DIGITAL TRANSMISSION

We observed one relevant case that involved the transmission of data and documents to a third party data aggregator who performed 100% inspection, then forwarded pre-defined data format back to the aggregator.

Document inspection process



CORE TECHNOLOGY & PROCESSING SYSTEMS

SCOPE AND INTENSITY OF TECHNOLOGY INVESTMENTS

Only 20% of participants reported future plans to migrate from legacy systems within the next 12 months. Significant research into technology interfaces versus “rip and replace” strategies.

There is a significant appetite for an industry standard regarding imaging, data capture, compliance, and investor purchase certainty. Only one bank and several non-banks reported that their technology created a competitive advantage in terms of speed, accuracy and scale. Most of the participants made self-deprecating remarks regarding the ability of their technology to create a competitive advantage.

TYPES OF SYSTEM

Correspondents’ systems range from excel to more automated systems for reviews. 20% of participants are using only an Excel QA process 30% of participants are using third party black box systems to ship data and return images and a structured data set from which they execute their inspection.

Correspondent system breakdown

10%

lender built a custom PEGA application to drive an “intuitive” review process

20%

lenders using only an Excel QA process

30%

lenders using third party Black Box systems to ship data and return images and a structured data set from which they execute their inspection

10% of participants have built a custom PEGA Workflow Application (PEGA) application to drive an “intuitive” review process including (Lakewood, Unifi, BKFS, Scienna, Loan Logics, Mortgage Cadence, DataTrac). 10% of participants reported converting to a new LOS this year; disappointed that promised features not delivering (third party data integration, OCR, data uploading).
30% of participants are using third party.

LOW ADOPTION AND RISE OF INTEREST IN UTILITIES

Several lenders are conducting investigations on IBM/Watson/Cognitive Processing and e-delivery. These remain a priority but have a small percentage of adoption. Due to budget constraints, more than half of correspondent aggregators showed interest in leveraging utilities to integrate with their core system.

INTEGRATION WITH SELLER SYSTEMS

There was intense discussion about LOS systems integration, including e-delivery of origination data. It remains a roadmap priority.

06/ Managing Risk and Compliance

We asked correspondents to describe their compliance philosophy, rate their appetite for risk, loan level criteria, sampling technique, impact of TRID and approach to overlays relative to the industry

Given the shifting regulatory environment of the industry, not only do correspondents need to have an adaptable and robust compliance process and infrastructure, but they also need to make compliance a part of the core culture of the organization. Compliance has become a top priority for most correspondents.

PHILOSPHY RELATIVE TO BROADER MARKET

We found variances based on type of institution, participation in regulatory surveillance, tenure and bank vs. non-bank. GSE and service aggregators have a deeper respect for counter-party re-purchase obligations. Banks are much more skeptical. There is general acceptance toward deep QC for initial lender sign ups: 100% QC for 10% or up to 30 initial loans. There was dissenting opinion on ongoing counter party monitoring, ranging from one loan per month, to 0-15% total sample, to highly specific measurement of prioritized areas of concern and defects only.

REVIEWS AND ADJUSTMENTS OF CONTROLS

Banks tend to retain controls longer; non-banks trend toward allowing clients a lighter inspection based on net worth, tenure with investor, historical repurchase and rolling 90-day quality trends.

LOAN ACCEPTANCE CRITERIA RELATIVE TO COMPETITIVE THREATS

60/40 split: 60% of participants are willing to assume a greater level of responsibility around managing counter party risk with proprietary rules and controls. 40% of participants are much more comfortable inspecting to a "lowest common denominator depending on their negotiated investor criteria."

There was more due diligence on bulk delivery versus whole loan delivery. 30% of lenders have implemented a counter party "Rating System" for scoring risk profiles. The specific front-end inspection and back-end QC sampling that is deployed is based on the overall risk rating. 50% of the participants are very conservative, applying a universal pre-purchase review (standard 45-90 minute inspection) plus a tailored form of additional credit, compliance and collateral based on loan level attributes, red flags, or post funding portfolio QC trends).

OVERLAYS AND CREDIT SAMPLING TECHNIQUES

80% of participants described very similar post-funding sampling (5-10%) with fairly standard defect matrices. 20% of the participants are experimenting heavily with 100% loan level data extraction against expanded post-funding & targeted QA/QC/due diligence.

OVERLAYS

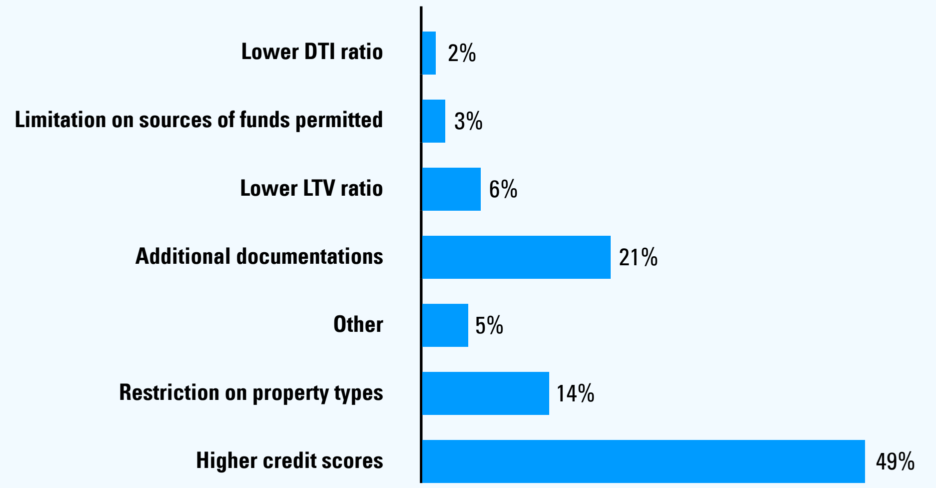
Stricter mortgage underwriting criteria above the guidelines set by investors (such as the GSEs) are being applied on a limited basis. Larger and mid-sized lenders and correspondents are more likely to apply overlays.

Most correspondents (64%) say that credit overlays are applied on a limited basis on 20% or less of their loan originations. Only 24% of participants reported applying overlays across the board (more than 90% of their loan originations).

The most common type of overlay applied is higher credit scores (49%), followed by additional documentation requirements (21%).

The primary reasons for overlays are to reduce default risks and repurchase risks.

Overlays



TRID

TRID is still a relevant problem. It continues to impose a heavy compliance burden and causes dissatisfaction through delayed closings and increased fees and costs. Banks are still struggling to comply with the Consumer Financial Protection Bureau's 2015 TRID, according to an American Bankers Association[1] Survey.

- More than 75% of participants said loan closings are being delayed as a result of TRID. On average, a delay of eight days was reported with responses ranging from one to 20 days.
- An overwhelming 93% claim uploading and loan processing times have increased as a result of TRID implementation.
- Some of the offerings banks have eliminated include construction loans, adjustable rate mortgages, home equity loans and/or payment frequency options as the rule does not provide adequate compliance direction.
- 25% of respondents have increased the total cost to the consumer to obtain a loan
- About 50% of participants claim they have/will have to hire additional staff to comply with the TRID rule

[1]. ABA. The American Bankers Association 2016 TILA-RESPA Integrated Disclosure (TRID) Survey. 17 Feb 2016.

07/ Client Management and Marketing

We asked correspondents to share the specific tactics they were using to drive higher sales, client loyalty, promote preferred “brand identity” and provide seller services

Client-dedicated support teams, flexibility and a seamless support process are the keys to success for correspondents. The in-house operations team and dedicated client teams offer complete client integration training and customizable support.

SALES AND COMPETITION

INCENTIVE TECHNIQUE AND TACTICS

50% of the correspondents reported that they had developed some form of incentive system for sellers that produce consistent quality.

PERCEPTIONS OF INSTITUTIONAL BIAS AND CFPB INEQUITY

All respondents believe that their size and scale in the market contribute to whether sellers view them as “agile” and “flexible”. Everyone acknowledged consent order participants and larger banks have far less regulatory forgiveness and felt that those retaining servicing carry an extra burden of assignee liability and have to get it right in pre-funding.

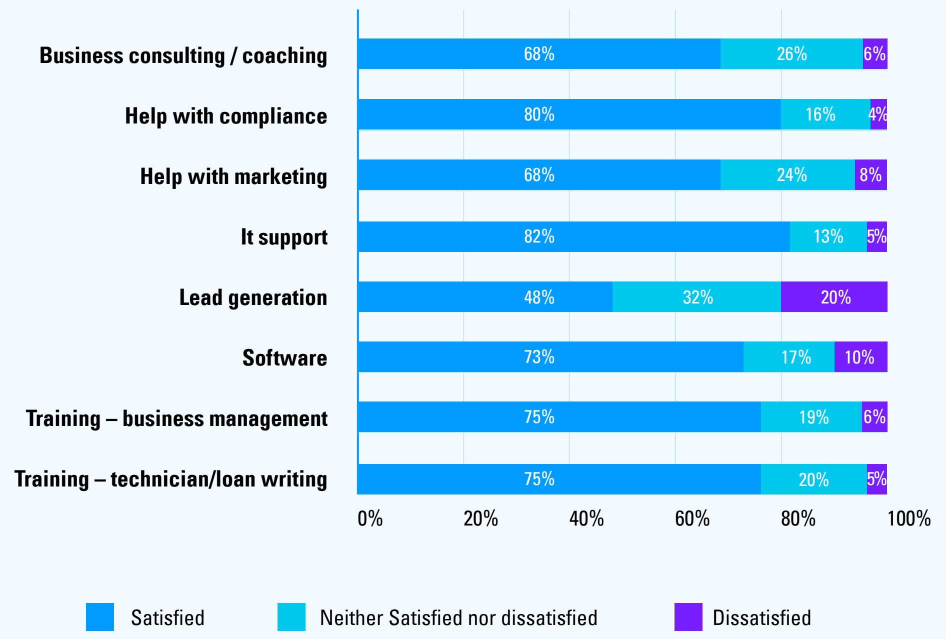
BALANCING SPEED OVER CERTAINTY

It is notable that of the bank depository participants, only one felt they needed to exceed their targeted SLAs for initial review and funding; benchmarks set by GSEs and rising servicing aggregators only seen as a threat if published SLAs are not met.

PRICING AND HEDGING ADVERSE SELECTION

Third party best execution services adjust pricing for turnaround time but claim the adjustment criteria is coming from sellers.

Support services for sellers



SPECIAL SUPPORT SERVICE FOR SELLERS

Overall, sellers are satisfied with the service they receive from correspondent aggregators, especially for core business functions. There are some key areas where sellers would be pleased to receive a greater level of support.

In particular, a number of sellers see business consulting, coaching, and training technicians /-loan writing generation as an important need that could be better supported, with fewer than half of all firms satisfied with their current service. Yet there are significant differences between correspondents, reflecting the varying value propositions offered by aggregators.

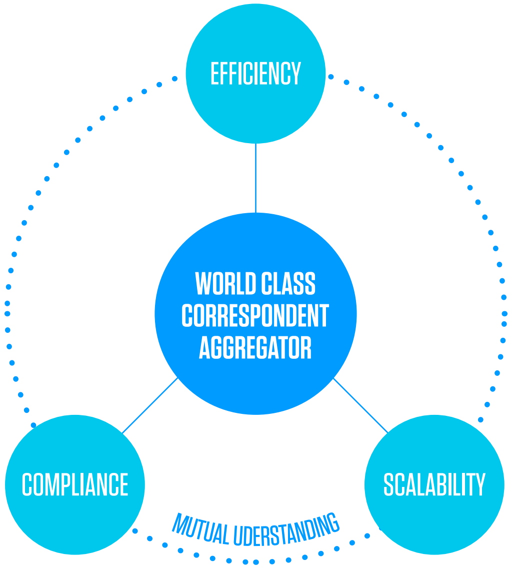
The correspondents have started providing greater support services to sellers that enables them to improve loan quality submission, clear conditions faster and turn their warehouse lines faster. Examples of services being provide are:

- Eligibility Review to ensure non-agency loans are purchased (Expanded tier 1/tier 2 and jumbo products).
- Seller web guideline & helpdesk: Provide a credit specific resources when sellers want to get in touch for a) UW guidelines b) definition and application of overlays c) resolve complex conditions.
- Provide detailed TRID insights and guidance.
- Share a QC scorecard, but longitudinal data, trends, causal patterns and covariance data is not shared.
- Organize teams to be client or regionally focused in order to develop working relationships and synergy.
- A few non-depositories sponsor client workshops quarterly with breakouts for training and trends annualy.

08/ Recommendations for change

Correspondents today need to start thinking of themselves as part of an ecosystem, not industry – they are operating in an environment where industry boundaries are blurring, replaced by forces within their ecosystem of partners, customers, and even competitors. Internal company goals and external competitive pressures are now dictating priorities, and for correspondents, it is critical that the flexibility exists to adapt business models and strategies when the market dictates change.

Several strategies have emerged that provide indications of where certain firms are heading: there is certainly no "one size fits all" approach to success. Several new entrants and growing companies are using disruptive methods to bring value to the consumer. We provide several recommendations for change that will enable the success of the correspondents business.



01.

CORRESPONDENTS MUST LOOK TO BLEND VARIOUS KEY FACTORS TO BE OPTIMALLY EFFICIENT

With ongoing compliance concerns such as TRID and other financial regulations, it is critical for correspondent aggregators to have best-in-class compliance. The mortgage industry is highly cyclical, and adaptability and scalability are vital concepts. Being able to scale to meet changing market conditions will drive efficiency as fixed costs become variable. Understanding the balance between maintaining compliance while operating at maximum efficiency (thereby reducing costs) will be essential for correspondents in today's market.

DATA EXTRACTION & VALIDATION
Documents converted to data and verified data intake

E-DELIVERY & UNIFORM DATA SETS
Loan files in fully electronic form using standard formats

BIG DATA AND ANALYTICS
Meaningful insights from exponential data growth

MACHINE LEARNING & ARTIFICIAL INTELLIGENCE
Training software to recognize data and apply business rules automation

CLOUD
Access to advanced technology and services in the cloud

EMORTGAGE
Paperless mortgages with eDocs and eSignatures

PORTABLE COMPLIANCE
Transferrable third-party certification of conformity to laws, rules and regulations

SOPHISTICATED RULES ENGINE
Advanced configuration of work routing, processes, automated edits, alerts, etc. to drive efficient work flow

Correspondents have to challenge their existing process to reach 48 hours and align delivery to match GSE's.

02.

CORRESPONDENT AGGREGATORS MUST LOOK TO LEAPFROG MORTGAGE TECHNOLOGY

Today's mortgage technology must leapfrog over legacy systems that no longer meet the industry needs to catch up with the current state of the industry. Regulatory burdens, demographic shifts, and big data have spurred participants to deploy innovative technologies to best address evolving business and consumer needs. We believe there is a wealth of untapped potential in the market, and many of the firms are seizing this opportunity to drive business progress.

03.

REDUCE/SIMPLIFY CREDIT UNDERWRITING AND LOAN DELIVERY IN LINE WITH GSE

The GSE cash window typically funds a loan in two days. The ability to fund a loan without suspense conditions -- combined with the ability to clear warehouse lines faster -- is causing a loss of market share for traditional aggregators. Correspondents should challenge the existing process to reach 48 hours and aligning delivery to match GSEs.

04.

DEVELOP A MORE FLEXIBLE, DYNAMIC, RESPONSIVE WORKFORCE DELIVERY MODEL

For long-term growth, organizations will need to scale foundational capacity via outsourcing to meet demand surges and take advantage of time zones and geography. The mortgage industry is cyclical in nature. Industry events - such as rate rallies - cause increases in volume that require production capacity for loan review. Most organizations are unable to scale quickly.

One large correspondent and two medium correspondents have successfully leveraged outsourcing to reduce their costs and scale their operations.

05.

DECREASE THE SCOPE, CRITERIA, AND SUSPENSE FACTORS FROM THE PRE-PURCHASE REVIEW AND MAKE IT EASIER AND FASTER TO CLEAR LOANS INITIALLY

Consider stripping back all pre-purchase controls that are not directly required to validate transaction legality and compliance.

06.

INCREASE POST-FUNDING SAMPLING USING STATISTICAL SAMPLING METHODS

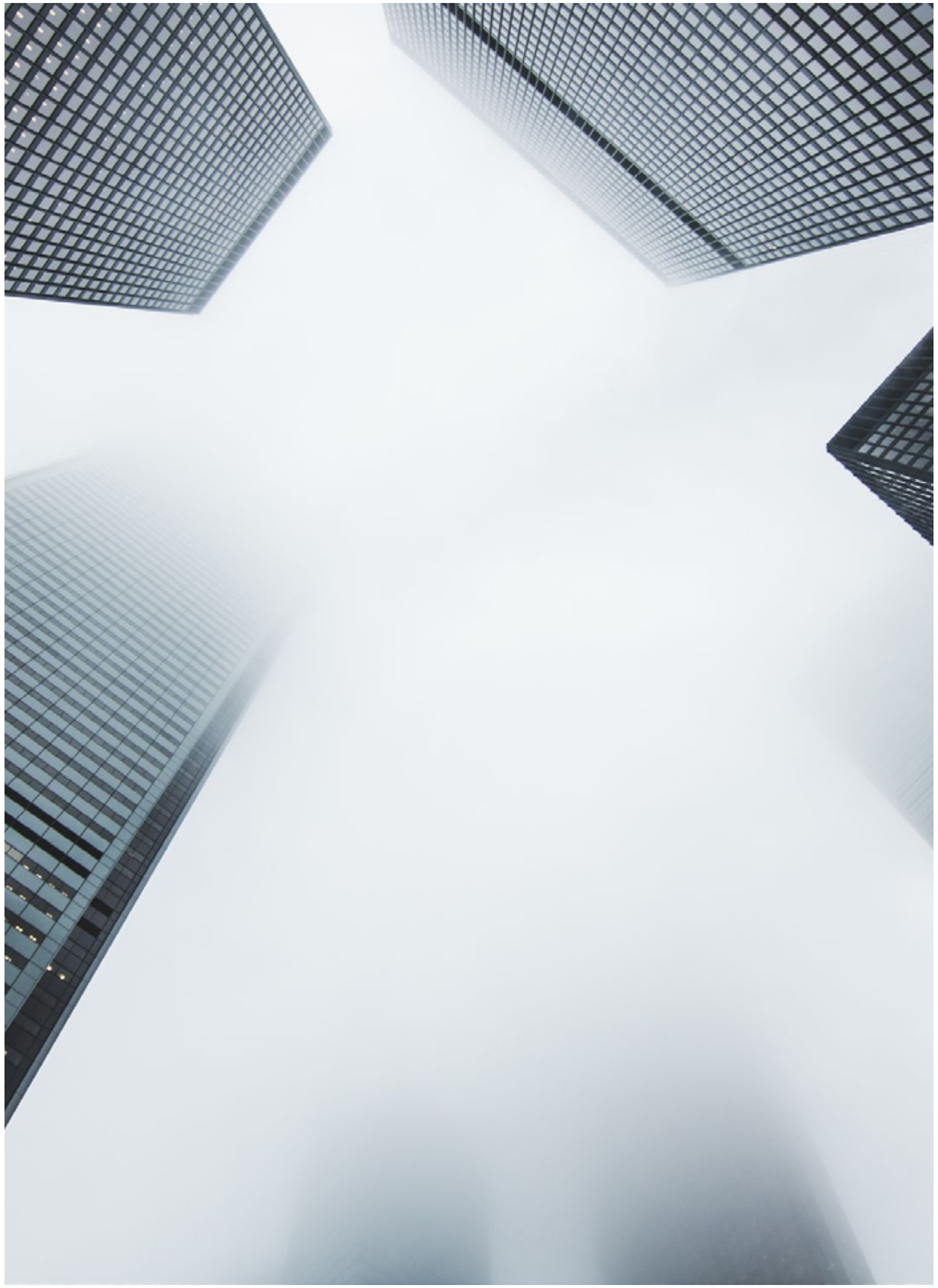
While decreasing the pre-purchase review effort, there should be an effort to increase post-funding sampling using a statistical sample method to collect data. Analysis of this data can provide feedback to the pre-purchase review process to create more targeted review methods for clients based on their risk profile- this approach may reduce friction on clients who factor in price increases for excessive overlays.

07.

ENHANCE THE LEVEL OF AUTOMATION, DATA EXTRACTION, AND MACHINE PROCESSING OF DATA

Gaining speed and accuracy to stay competitive is a matter of using the right document imaging and management system. Rather than having an operator inspect, identify, and name each loan document that comes into your company, you can automate this time-intensive activity while improving your company's overall accuracy. Monitoring the elapsed time that loans spend in this first stage is important to improving a company's overall speed and accuracy.

Correspondent need to go beyond OCR. They must be able to recognize most 260+ standard mortgage documents; leverage technology to automatically name, sort, and file documents to the correct loan folder, thereby determining what's missing and minimize "stare and compare" - to extract data automatically.



DISCOVER HOW WE CAN HELP YOU OUTPERFORM YOUR INDUSTRY PEERS

These insights may prompt you to consider if you need to change any of your business practices and strategies to maximize profitability and growth opportunities.

Capco can work with you to help you capitalize on insights in this reports, adding value with ideas and expertise to create stronger and more resilient correspondent businesses.

If you would like to discuss this report, please contact us.

Contributors Biography

TOMMY MARSHALL

Tommy is a partner in the banking practice at Capco. He has spent 18 years focusing on operational strategy, marketing and home lending. Tommy is currently playing a role in the evolution of digital financial services across the enterprise and the re-engineering of capabilities at some of the worlds' largest financial institutions

BRYCE VANDIVER

Bryce VanDiver is a Managing Principal with over 13 years of management consulting experience working with clients, from strategy to implementation, in complex improvement initiatives. His payments and consumer lending experience spans multiple products and technology platforms. Bryce is a proven team builder who has achieved success in the implementation of target operating models, business case design and business transformation programs, while helping to his client achieve their business goals.

DAN MULBERRY

Dan is a Managing Principal and housing finance expert at Capco. He has extensive experience with a top-tier lender in operations, business and technology strategy, platform delivery and management. He has also held positions in a variety of capital markets functions including secondary marketing, agency/investor relationship management, structured finance and portfolio management. Dan is known in the mortgage industry as a leader in ecommerce and excels at revolutionizing mortgage operations through leveraging innovative technologies.

PRIYA MERCHANT

Priya is a Principal Consultant in the banking & wealth management practice at Capco. She has hands-on leadership in wealth & investment management, lending and capital markets industry. Priya has worked with many of the top global institutions, leading a broad array of transformation ranging from strategy to execution, focused on business and technology operating models, data and digital technologies. With a passion for emerging technologies and trends, she helps businesses visualize the future and leads them towards it.

ERIC PARRASCH

Eric is a consultant in the banking and payments practice at Capco, with experience delivering and executing strategic projects for financial firms across a number of business areas including payments, lending and capital markets. Eric holds a Masters in Business Management from the University of Edinburgh.

CAPCO.COM