A Paperless World?

— by DYLAN HOWARD —

Here's what you need to know about the status of residential e-closings and e-mortgages today.

In the interest of lowering costs, increasing efficiency and providing consumers with additional information about their mortgage loans, several major mortgage industry players are studying the potential for moving forward from the typical paper-laden world of residential loan closings into a future that is virtually paper-free. ¶ In truth, paper-laden is a kind word for the standard residential mortgage closing. A standard closing can use as many as 460 separate pieces of paper. Closing documents are often presented to the borrower quickly, with short explanations given and dozens of signatures required. ¶ The dream of the electronic mortgage world involves a set of electronic documents, emailed to the borrower, who then has the opportunity to review them at his or her leisure. The documents are then signed electronically, avoiding the need for dozens of wrist-cramping signatures.

After execution, the documents are transferred electronically to the lender. The lender is then required to securely store the electronic promissory note in an appropriate system, or eVault. As the loan is transferred to the investor or subsequent lenders, the electronic note is transferred as well.

The critical loan documents are not executed on paper, and then scanned and electronically stored. They are created and executed—and live their entire lives—as bytes on a secure computer system.

In addition to streamlining the residential mortgage closing from the borrower's perspective, it is hoped that moving to an entirely electronic platform for mortgage origination and servicing will improve the mortgage industry in the following ways:

- It will prompt a significant reduction in cycle time for the residential mortgage closing process, which should lead to higher borrower satisfaction, increased productivity and lower costs.
- It will deliver increased data integrity, with the related ability to quickly and easily reuse the data throughout the mortgage closing process.
- It will facilitate easier and more consistent regulatory compliance, including the ability to perform automated quality checks throughout the life of the loan.

The electronic mortgage process as it exists today is the result of many years of work by industry insiders.

Studying the electronic mortgage process

Overall, a team established by Fannie Mae to study electronic mortgages announced that the electronic mortgage process could reduce the average 52-day period currently required to close a loan by a total of 30 days. According to the team, this could save the mortgage industry an average of approximately $1,100 per mortgage, or roughly $1 billion a year.

While the general process is similar to the standard pen-and-ink mortgage process, some of the terminology is different. Rather than a note holder holding the original "wet ink" note, the controller of the electronic mortgage documents maintains the authoritative copy of the transferable record, or eNote, in its eVault.

In order to qualify as a transferable record, the electronic note must otherwise qualify as a promissory note, the borrower must agree to the creation of the electronic note and there must be a reliable system to establish the official status of the record. The authoritative copy of the electronic note bears a tamper-evident seal that serves as a digital thumbprint, verifying execution by the actual borrower and distinguishing the authoritative copy from mere copies.

The electronic mortgage process as it exists today is the result of many years of work by industry insiders. In 1999, the mortgage industry established the Mortgage Industry Standards Maintenance Organization Inc. (MISMO®) in order to determine industrywide standards for electronic mortgages and for the maintenance of electronic mortgage data. MISMO is now supported by more than 150 industry organizations.

In 2000, Congress passed the Electronic Signatures in Global and National Commerce Act (E-SIGN), which paved the way for lenders to offer mortgages based on enforceable electronic signatures. Most states subsequently adopted the model Uniform Electronic Transactions Act (UETA), which was intended to achieve the same primary goal.

According to Fannie Mae, it purchased the first electronic mortgage on the secondary market in July 2000. Still, 14 years later, electronic mortgages remain extremely rare.

Fannie Mae recently announced that approximately 25,000 mortgage closings utilized electronic promissory notes last year—about 1 percent of all mortgages originated in the United States.

Early adopters of this technology tend to be smaller lenders and credit unions that contract with technology vendors. Larger mortgage lenders have been slower to adopt. Some lenders have developed hybrid electronic mortgages that include electronic notes but in which the remaining documents remain paper-based. Increasing the adoption of electronic mortgage technology is one stated goal of Fannie Mae, the Mortgage Bankers Association (MBA) and other major mortgage industry players.

MERS and e-mortgages

Reston, Virginia–based Mortgage Electronic Registration Systems Inc. (MERS) operates the MERS® System, a national electronic database designed to track changes in mortgage servicing rights and ownership interests in loans secured by residential real estate. In order to apply this model to electronic mortgages, and thus truly streamline the electronic mortgage process, MERS established the MERS eRegistry, a system of record identifying the owner and location of electronic promissory notes.

Much like the traditional MERS system, the original lender registers the electronic mortgage with MERS, and the MERS eRegistry then records the subsequent transfers of the electronic note from the originating lender to the investor, or to subsequent lenders. The eRegistry does not store the authoritative copy of the electronic note, but records the location of the authoritative copy.

The first electronic note was registered with the MERS eRegistry on July 23, 2004. By 2007, more than 1,700 electronic notes had been registered with MERS.

Both Fannie Mae and Freddie Mac require electronic mortgage originators to register with and use the MERS eRegistry.

E-mortgages and the GSEs

Many of the standard practices and procedures in the residential mortgage industry are essentially enforced by the government-sponsored enterprises (GSEs)—Fannie Mae and Freddie Mac—which purchase the majority of residential mortgage loans and set the standards for the loans they are willing and able to purchase.

Both Freddie Mac and Fannie Mae have declared their support for the electronic mortgage movement, and both organizations actively purchase electronic mortgages. In addition, both have issued electronic mortgage guidelines to provide assistance to potential electronic mortgage originators and servicers.

Pursuant to these guidelines, electronic mortgage originators must maintain an eVault that is compatible with the MERS eRegistry, supports industry standard documents and provides for multiple, secure methods of eNote delivery. Electronic mortgage originators must also utilize firewalls and other security controls to safeguard against malware, protect borrower's sensitive information and verify document integrity.

Electronic mortgage servicers are subject to the GSEs' standard servicing requirements. In addition, servicers must be able to update MERS' eRegistry to record changes to the status of the mortgage loan, including payoffs, or loan modifications. If the borrower defaults and the servicer must foreclose, Fannie Mae at least requires special loss-mitigation procedures.

CFPB pilot project

Although there has been a steady industrywide push in support of electronic mortgages over the past 15 years, the phenomenon got a potential boost from the Consumer Financial Protection Bureau (CFPB), which recently announced it would make a special effort to evaluate the benefits of electronic closings.

Noting that the residential mortgage origination process is often "fraught with anxiety" for consumers, CFPB Director Richard Cordray announced an upcoming pilot project that would assess how electronic closings could streamline the closing process and ease the concerns and frustrations of borrowers.

According to an April 23, 2014, news release, the CFPB hopes that electronic closings will help address what the CFPB sees as the major "pain points" in the closing process. These include the limited time consumers may have to review the closing documents, the volume of necessary paperwork and the complexity of many closing documents.

Specifically, the CFPB stated its intent to study the following:

- Methods for improving customer understanding of the closing process, including by providing educational materials such as document summaries, term definitions and process explanations;
- Means for incentivizing borrower engagement by early document review; and
- The benefits from electronic closings for improving efficiencies, including avoiding both surprises at the closing table as well as unnecessary bottlenecks.

The CFPB believes that electronic closings—and by extension, electronic mortgages as a whole—have not been more widely adopted as a result of misinformation about the feasibility and legality of conducting electronic closings. The CFPB also cited concerns that electronic closings may actually increase the risk to consumers by reducing their engagement in the closing process. The pilot project is reportedly designed to evaluate and address these issues.

Lenders interested in participating in the pilot project must partner with a technology vendor and submit a joint proposal. The proposed projects must meet minimum guidelines for functionality, including a secure software solution for storing and transferring documents and data, the ability to audit and the ability to mask sensitive data fields.

To date, the CFPB has announced the following participants:

- ***Vendors*—**Accenture Mortgage Cadence, DocMagic Inc., eLynx, Pavaso Inc. and PiersonPatterson LLP.
- ***Creditors*—**Blanco National Bank, BECU, Franklin First Financial Ltd., Flagstar Bank, Mountain America Credit Union, Sierra Pacific Mortgage and Universal American Mortgage Co.

The CFPB highlighted the pilot project as an important part of its Know Before You Owe mortgage initiative. The highest-profile aspect of that initiative to date is a new disclosure rule issued by the CFPB in November 2013. The rule requires mortgage lenders to provide two new mortgage disclosure forms: a Loan Estimate and a new Closing Disclosure, which must be provided to consumers at least three days prior to closing. This new rule is slated to take effect in August 2015.

Many industry participants believe it is only a matter of time before e-closings and e-mortgages are the rule rather than the exception.

Both with the pilot project and the broader initiative, it is clear that the CFPB expects the mortgage origination and closing process to evolve in order to address what the bureau sees as failure to properly serve consumers. Whether the CFPB decides that evolution requires the regular use of an electronic closing and mortgage platform remains to be seen.

Only a matter of time

While adoption of electronic processes for residential mortgages has been slow, many industry participants believe the cost savings and compliance benefits ensure it is only a matter of time before e-closings and e-mortgages are the rule rather than the exception.

In an effort to generate ideas to increase the use and acceptance of electronic mortgages, Fannie Mae established what it called an Innovation Challenge team in 2013, consisting of a Fannie Mae executive sponsor, a staff-level assistant and industry representatives. After studying the issue, the team announced its belief that electronic mortgages could become much more prevalent in the next two to three years.

The largest hurdle to date may well be a borrowing public worried by recent headlines about computer hackers breaching reportedly secure systems and stealing sensitive personal and financial information. Industry insiders insist that an electronic mortgage world will be at least as safe as the current paper world. As a wise man once said, the only constant is change. **MB**

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