The Digital Revolution: A Giant Leap for the Mortgage Industry

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Executive Summary

The mortgage industry digital transformation can be broken down into two phases. Phase one concentrated primarily on developing front-end applications to improve the borrower experience. Now in phase two, focus has shifted to digital closings (eClosing), benefiting lenders with technologically driven operational and capital efficiency gains.

As digital continues to revolutionize mortgage processes, members of the ecosystem need to develop a clear understanding of what this entails. This document provides an all-you-need-to-know overview of:

• Key components in the digital mortgage process
• Industry use cases
• Legal parameters and enforceability
• The current state of industry acceptance
• The importance of scale in adoption
The inherent complexity of mortgage processes is due to the sheer number of parties and steps required for each transaction. Fortunately, digital mortgages are enabling a remarkable transformation in the way homes are purchased. According to Fannie Mae, “An eMortgage is a mortgage loan where the critical loan documentation, specifically the promissory note (eNote), is created electronically, executed electronically, transferred electronically, and ultimately stored electronically.”  

Here are the key components of the digital mortgage process:

**eNote:**

The electronic promissory note, or eNote, is often viewed as the most important element of a digital mortgage. Its validity is critical to a successful sale into the secondary market and the holders’ ability to legally enforce the eNote.

In a white paper by Buckley Sandler, the benefits of the eNote to mortgage ecosystem participants are highlighted, stating:

“eNotes confer clear and demonstrated benefits on both the mortgage industry and consumers through improved convenience, quality control and transaction speed. Among other benefits, an eNote:

- May be transferred from one holder to another nearly instantaneously;
- Is less expensive to create and transmit than a paper promissory note;
- May be effectively protected against undetected alterations; and
- If managed in a properly designed information processing system, eliminates uncertainty concerning the identity of the current person entitled to enforce the eNote, and when that person first became entitled to enforce.”

Key Components of a Digital Mortgage

**eVault:**
Once the eNote is created and executed, it needs to be managed as a negotiable instrument. Using an electronic vault, authorized users can perform key actions against the eNote such as registration, eDelivery, transfer, and life of loan events.

Additionally, the eVault that is designated as the location for a given note holds the authoritative copy, or ‘electronic original’. The eVault also allows for verification, authentication and audibility of the eNotes it contains, and puts control in the hands of mortgage originators, warehouse lenders, investors, servicers, and custodians to manage their electronic assets.

**Digital Closings (eClosings):**
Digital closings, or ‘eClosings’, encapsulate the actual settlement and closing process and include the documents necessary to execute the mortgage as well as supporting documentation. A digital closing doesn’t necessarily mean all documents are signed electronically. In fact, for certain loan programs or geographic locations, a hybrid approach may be the only option currently available. Digital closings streamline the home buying experience and offer quicker turnaround times, better data quality, faster liquidity, and improved efficiency. This occurs through a secure electronic environment where some or all of the closing documents are executed and accessed online.³

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Hybrid vs Full Digital Closing

While a full digital closing involves signing all documents electronically, another option is a hybrid closing. In a hybrid close, only a portion of the documents are signed electronically. This approach can be used to achieve scale and enable a large portion of the benefits of a full digital transformation. The hybrid close can start with an eNote, which can be signed in every state across the country and is accepted for purchase by the government-sponsored enterprises (GSEs). Beyond the eNote, lender documents from loan origination and document preparation platforms that don’t require notarization can easily be incorporated.

Furthermore, adding eNotary capabilities to a solution, where permitted by law, enables critical documents such as the mortgage/deed of trust to be electronically signed and notarized. Finally, additional title and real estate documents can also be brought into the digital closing room to provide the most complete solution.
Processes at Work: Fannie Mae Use Case

Requirements

Fannie Mae selected its next generation eVault with the goal of advancing the digital mortgage revolution and removing obstacles to adoption through a modern, secure and scalable platform. The GSE opted to move away from its proprietary system to ensure it could scale to meet future demand. “The hosted platform is more robust and has a larger set of capabilities, so this change is really a key piece in ensuring that our own internal technology is ready to support larger volumes,” explained Mike Cafferky, Product Manager, Digital Products at Fannie Mae.

Solution

Fannie Mae’s eVault provides a seamless, safe, and worry-free process. By utilizing eOriginal’s hosted solution, Fannie Mae has accelerated deployment and greatly reduced costs for ongoing support efforts. The solution delivers advanced integration to the MERS® eRegistry and improved flexibility as digital mortgage technology continues to evolve.

Results

“Borrower expectations about the ease and speed of the mortgage experience are changing, resulting in lenders seeking competitive advantages by offering a comprehensive digital mortgage experience. With this launch, our new eVault will make it even easier to securely and efficiently deliver eNotes to Fannie Mae,” the GSE stated in an August 2017 announcement.

Fannie Mae holds the largest collection of eNotes in the U.S., totalling in the hundreds of thousands. To ensure a smooth migration to their new eVault, eOriginal’s automated processes reviewed the validity of the tamper seal and internal structures related to compliance, such as the holographic or text signature, of each migrated eNote to account for variances that existed over the large number of legacy eNotes. Additionally, Fannie Mae and MERSCORP Holdings jointly ran quality control checks against other technology solution providers to ensure the proper creation, execution, and delivery of future eNotes.

The eNote Evolves

In 2016, Fannie Mae and Freddie Mac conducted an industry survey to understand the perceived barriers to eMortgage adoption. Respondents noted that one issue was the fact that three different systems were required to produce documents: One to produce the Closing Disclosure in an electronic form; one to create the eNote in the complicated SMARTDoc 1.02 format; and another to create on paper.

Additionally, one of the key takeaways was that a “lack of consistent and uniform set of processes/policies forces the industry to adopt different closing processes depending on the market and that is a major hindrance for adoption.”

In response to these obstacles, the GSEs and MISMO® developed a new eNote standard; version 3.0. The 1.02 format, a combination of HTML and XML, made it difficult for larger document preparation platforms to create. The new version format combines XML with PDF, which offers document preparation providers a more user-friendly alternative. From an implementation perspective, the new format was tested with technology providers early in 2018. The goal now is to require the delivery of the new eNote format in early 2019.

As we see a push for real digital transformation with participants in the mortgage ecosystem increasingly seeking ways to maximize the benefits of a digital transformation, the focus today is on the closing process, the wider adoption of the eNote, and moving away from aging legacy systems.

North Carolina Catalyzes Change

In 2017, North Carolina began a state-wide eClosing pilot project which brought together all sectors of the mortgage industry, including lenders, closing attorneys, title agents, secondary market investors, and technology providers to overcome any final barriers to the use of eMortgages in the state.

“The biggest challenge that we are facing currently is widespread adoption,” said Ozie Stallworth, director of electronic notarization and notary enforcement at the North Carolina Department of the Secretary of the State. “We believe however, with a successful implementation of the pilot program, more and more within the mortgage industry will look to take advantage of the benefits that eClosing affords lenders, attorneys, settlement service providers, consumers and everyone that touches the mortgage closing process.”

In addition, an Electronic Mortgage Closing Advisory Committee has been formed to help its Secretary of State transition the electronic mortgage pilot program to a state-wide eMortgage closing initiative. The program will focus on developing an eClosing best practices document and encourage mortgage stakeholders to engage in the eClosing process in North Carolina and beyond.

Legal Enforceability

In the past, lack of understanding around legal parameters, enforceability and transferability of eNotes impacted widespread adoption. However, continued market acceptance and case law regarding validity and enforceability have proved to be extremely encouraging and play a major role in mortgage’s digital revolution. Better data, enhanced compliance, and improved processes are key components when it comes to creating an asset that can be moved digitally through the secondary market, and innovative technology is key to meeting these needs. Additionally, the Buckley Sandler white paper (2017) drills down on the eNote, stating: “The mortgage industry is now poised to truly move towards the digital transformation of the full mortgage loan, including all segments of the mortgage lifecycle, including application and initial disclosure delivery, closing, notarization, recording and securitization.”

Case law for paperless mortgage is also catching up: “Two separate court decisions have recently set the precedent that electronically signed promissory notes secured by real property (eNotes) are legally enforceable by lenders. These decisions address many concerns held by investors about buying eNotes and suggest further clarity may have to come from case law as the digital mortgage industry matures.”

In addition, the Consumer Financial Bureau’s TILA-RESPA integrated disclosure rule (TRID) requires lenders to keep an electronic audit trail of all mortgage-associated documentation for regulatory audits. As a result, lenders that have not yet made the transition to digital are now forced to maintain hybrid systems, incurring more time, money, and staffing to guarantee compliance.

Furthermore, to paraphrase a key point made by Carolina Banker magazine: A large advantage of digital mortgage is the ability to easily retain and store records and produce audit logs. Every eSignature is logged in real time and the reports generated become an important tool in showing good faith compliance. Additionally, electronic documents are of higher legibility, and staff time and operating costs are reduced as scanning and other responsibilities are diminished.⁹

The benefits of digital mortgage aren’t limited to the closing process. Post-closing, going digital can have a demonstrable effect on loan quality and subsequently improve investor confidence.

Investors play an integral role in maintaining a robust secondary market and are the engines driving today’s digital financial ecosystems. Technology can be used to verify the authenticity of the eNote and provide an online platform through which assets can be properly tracked and transferred. This ‘certainty’ is critical to funding and overall valuation, especially for organizations that securitize, pool or pledge assets in the secondary market.

In opinion piece published in the National Mortgage News, Terry Sundh, CEO of TRK Connection, writes, “When loan documentation is created, executed, transferred and store digitally, it is nearly impossible to misplace that documentation, thus exponentially increasing the likelihood of delivering a complete loan file.”

In addition to digital benefits during closing, Sundh writes: “From a lender perspective, the essential documents are already in electronic form and are thereby ready much sooner for sales to investors, which can translate into more money per transaction as investors pay a premium for such speed.”
Looking to the Future: The Importance of Scale

The concept of scale refers to the ability to accommodate growth. There is no question that legacy systems need to be replaced with digital platforms and that adoption is key. However, in today’s burgeoning digital mortgage ecosystem, scalability includes tailoring a solution to the lender and building what is currently possible. While adoption has been slow, there is no avoiding a digital future or the current drive for systems to evolve and work together to provide information that can be used in real-time and with complete confidence.

Scaling the eNote
Confidence in the eNote is bolstered by the knowledge that:

- It is being purchased by industry leaders such as Fannie Mae and Freddie Mac
- It’s allowed to be executed and is recognized in every jurisdiction
- It is easily incorporated into the closing process
- It comes immediately into the possession of the lender upon execution
- Servicing actions are completed within the eVault
- It is delivered into the secondary market and funded within days
- An eNote is the foundational of a full digital closing strategy
Looking to the Future: The Importance of Scale

Scale does not always mean trying to reach 100 percent in an ecosystem that is still embracing its new reality. Incredible operational benefits and accelerated access to capital are achieved using various approaches, including the hybrid model. However, return on investment in technology and operational changes are only realized if implemented in high volume. Today, vendors have carved a path to big electronic volume thanks to alignment of technology, product mix, warehouse, servicing, and investors. When this is achieved at scale, the true benefits come to fruition.

One thing is certain; as we look to the future and continued proliferation, commitment to digital best practices and standards that safeguard participants within the mortgage ecosystem remains essential.
About eOriginal

eOriginal guarantees trusted transactions of digital financial assets for all parties from the borrower to the secondary market. We create a ‘digital original’ document that combines all the legal and enforcement rights of a paper contract with the capital and operational efficiency of digitization. Our proven network provides the confidence, visibility and compliance lenders and buyers need by providing certainty in how these assets are maintained.

As a pioneer in the space, we are a trusted partner for digital lending transformation and management by major financial institutions, leading law firms and credit ratings agencies. For more information, visit www.eoriginal.com.

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