

Remote Check Funding: An Emerging Best Practice in Mortgage Closings

About This Whitepaper

Source Technologies provides integrated software and printing solutions for official check print management and control. We are the market leader in MICR-based payment solutions, with thousands of customer installs and tens-of-thousands of MICR printers deployed since 1990. We offer a suite of secure print management software products and a broad family of secure MICR printers, ranging from entry-level 35 ppm printers to multifunction printers (MFP), to high-speed workgroup printers offering 55 ppm.

We have produced this white paper for our customers, partners, and prospects to give them a deeper understanding of how MICR check printing solutions can improve the check issuance process for real estate closings, and other remote funding applications. It assumes at least rudimentary understanding of check issuance processes for real estate closings.

In this paper, we discuss the opportunities for commercial banks, title insurance companies, and mortgage lenders to capitalize on new technology and changes in the real estate market to offer better services to real estate attorneys and title companies. We also review how Source Technologies' solutions deliver capabilities to support best-practice disbursement management and fraud control.

Remote Check Funding: An Emerging Best Practice in Mortgage Closings

During the residential real estate boom of the last decade, the mortgage lending business grew considerably. With rising interest rates, a slowing economy, and potential increased regulatory scrutiny due to the sub-prime lending hangover, companies large and small are facing increasing competitive pressures.

Existing home sales continue to decline according to the National Association of Realtors®, and while levels are moderating, the real estate boom is clearly over. Wholesale and direct lenders, title insurance companies, plus thousands of title companies and real estate attorneys must develop new business practices that streamline core processes and cut costs. Survival and growth may depend on it.

Commercial bankers are also entering a new, more competitive phase. Following the acquisition wave and years of aggressive build-out, major US banks face pressure from their investors to improve efficiency ratios. Banks today must consolidate and improve operations, while at the same time capitalize on their market footprints to acquire new customers and grow deposits.

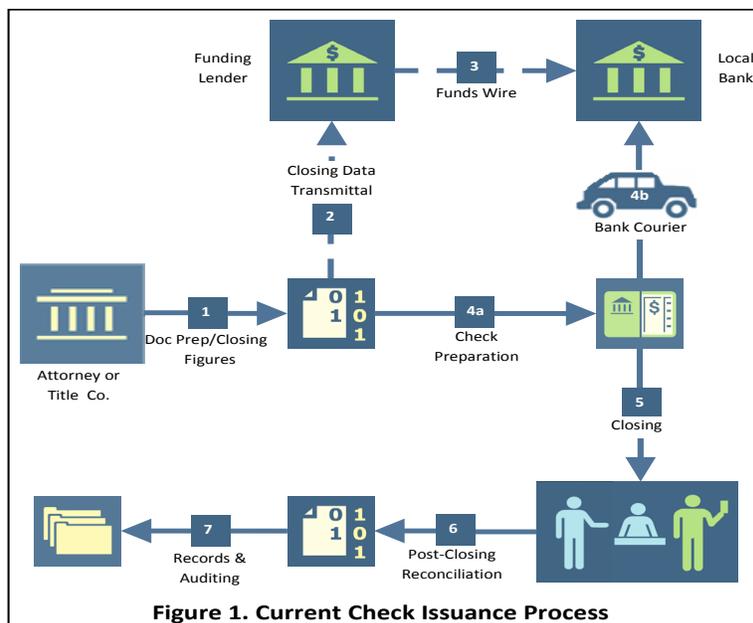
Smaller institutions, including community banks, regional banks, and credit unions must also play by new rules. Staying competitive and growing business is a function of how rapidly they can develop and offer new products and services to their markets.

For many years, major players in both industries have been investing in Internet technology in order to develop differentiated services for their partners and customers. These systems are web-based and typically provide document management and workflow tools that successfully reduce process time and eliminate postage and handling costs. Commercial bankers have gone a step further by offering online portals that let clients manage their accounts, process payments, and even deposit checks electronically.

The last capability—remote check deposit—raised the bar for commercial bankers by eliminating an extremely expensive activity and negating the need for banks to maintain physical operations near their clients. Recently, best-practice companies in mortgage lending, title insurance, and commercial banking have begun deploying the complement to this service—remote check funding, to gain a further advantage in the marketplace.

Remote check funding uses magnetic ink character recognition (MICR) laser printers and disbursement management software to allow lenders, commercial banks, title insurance companies, closing agents, and others to directly fund and print checks at the closing table in real-time, with complete visibility and control over the process.

As experienced by early adopters, remote check funding is a significant departure from current check issuance processes. It offers tangible financial benefits to everyone in the closing process, often paying back the capital investment in about a year. The balance of this white paper compares the typical process in use today versus remote check funding. It also examines the benefits and risks of this emerging best practice, and reviews current and potential opportunities for its application.



Current Check Issuance Processes

Figure 1 presents a simplified diagram of the typical check issuance process for a real estate closing. The closing agent (title company or attorney) manages the process among seller, buyer, and lender by preparing documentation, facilitating funding of the loan, preparing payoff checks, and scheduling and conducting the closing. An average closing will require a dozen or more checks. These include business checks written on the agent's operating or escrow accounts and, for some payees, certified checks drawn on the agent's bank. For certified checks, the agent requests the various checks, which are then produced at the bank and must be picked up or couriered to the closing location.

Closings are often rescheduled for a variety of reasons. The buyer or seller may have last-minute conflicts. There may be a delay in completing home repairs or addressing other issues related to the sale. Overly-optimistic attempts by the parties to accelerate the closing or problems with contingent transactions may also force a rescheduling.

Rescheduling closings penalize all parties involved. Because most payoff amounts change daily, rescheduling at the last minute requires that the agent redo virtually the entire process, including document preparation and voiding/reissuing checks—a very costly activity. Additionally, rescheduling may occur after loan funds have been wired to the closing agent's bank. This is a significant problem for lenders because any delay at this point cuts into their float, thus reducing profits. It also introduces a fraud risk.

Occasionally, discrepancies may occur at the closing table. This could require the closing agent to void and reissue checks or, in rare instances, reschedule the closing.

The lifecycle for checks in the closing process ends with any needed post closing bookkeeping and reconciliation, plus proper maintenance of records, thus making them readily available for auditing by the closing agent's accountant and affiliated title insurance companies. This is a mostly manual activity, and is viewed simply as a cost of doing business.

Best-Practice Closings: The Remote Check Funding Process

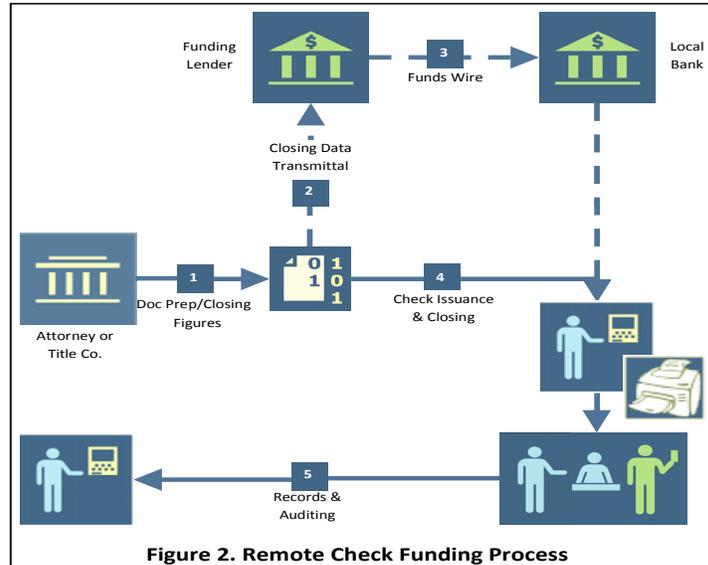


Figure 2 presents the remote check funding process. The overall business process remains essentially the same; the closing agent (title company or attorney) manages the process among seller, buyer, and lender, and document preparation/loan facilitation steps are unchanged. However, there are two major differences versus traditional check issuance.

First, there is no check preparation per se. The closing agent sets up check requests for the various payees in the disbursement management system, including all variable information: payee name, amount, and memo, plus the account numbers from which the funds will be drawn. Checks are not printed until all parties are at the closing table, all remaining issues have been resolved, and the parties are ready to complete the transaction.

At this point, the agent prints the checks from the disbursement management system on MICR-enabled laser printers. These printers function exactly as normal laser printers except they typically have specialized security functions.

They also use specially-formulated magnetic ink character recognition (MICR) toner which allows the agent to print the checks on blank check stock instead of pre-printed checks. Today's MICR printers printing on blank stock can duplicate practically any feature of an offset-printed check, including custom information such as the branch address, the MICR line, logos, barcodes, and signatures. This provides several benefits:

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- Because blank check stock allows all static information as well as payee information to be printed, checks can be issued from an unlimited number of accounts. Agents no longer need to keep track of several different checkbooks for their closing activities. A single type of blank stock is utilized in the printer. The disbursement management system allows users to create and use an unlimited number of different layouts for their accounts, including logos and other graphical elements.
- Blank stock effectively eliminates official check fraud for the agent. There is no preprinted stock to pilfer, so there is no need to secure checkbooks. And because checks are printed on-demand at the point of closing, the opportunity to duplicate a prepped closing check on the office copier is also eliminated.
- Blank stock is significantly less expensive than preprinted checks. And because there are no check books to maintain, Agents no longer waste money throwing out checks that have become obsolete because of new office coordinates or account changes.

Depending on the deployment model (see below) and system setup, check printing may be immediate, it may first automatically verify that account funds are available, or it may require approval before printing, either by someone within the agent organization or the agent's bank. More advanced systems allow this "disbursement decision-flow" to be configured based on the requestor, payee class, item type, amount, or other criteria.

For example, a staff person may set up checks in the system, but only the closing attorney can authorize the printing. Or, when the system is deployed and managed by the agent's bank, certified checks may require approval by the bank before printing.

This system of checks and balances allows process steps to be distributed among the right people. Separating the check request from the actual printing allows amounts to change right up to the last minute, with final approval and issuance taking place at the closing table in real-time. The result is more flexibility for the agent, significant streamlining of the check issuance process, and greater overall visibility and control.

The other major process change is in the post-closing aspects of the check lifecycle. Because all information about a check is automatically logged in the disbursement management system (including request, approval, print data, etc.), manual bookkeeping and reconciliation activity is minimized. Historical information may also be maintained indefinitely, allowing for easy reporting and auditing. More advanced systems allow authorized users to view data via secure web access. This allows trusted partners, such as accountants, title insurance companies, and bankers, to research items or conduct audits online as needed.

These post-closing capabilities can save closing agents and their partners significant time and money by eliminating many manual activities. And by allowing greater information sharing, they also reduce fraud risk and promote greater collaboration.

Deployment Models and Benefits

Remote check funding can be deployed and managed in four basic ways, described below. In each case, the benefits will differ for the various parties.

Commercial Bank Deployment

In this model, the bank deploys and manages the remote check funding system as a managed software service, similar to other online tools. The system is server based and closing agents access it via a secure web browser. Secure MICR printers are tied into the system as either network-connected clients or PC-attached printers. The bank may allow printing of certified checks in addition to company checks drawn on the agent's account (see "disbursement decision-flow" above).

Benefits:

- **Banks** - By offering this service, banks gain a considerable competitive advantage in acquiring and retaining title companies and attorneys as commercial clients. Given the significant size of escrow funds involved, banks looking to boost commercial deposits can benefit tremendously.

Depending on how the commercial relationship is structured, a bank may also gain additional float generated by debiting the agent's account upon issuance of the check instead of at presentment. Another potential advantage is the ability to serve clients regardless of their location. If the bank supports remote certified check printing as described above, there is no need for an agent to be within driving distance of a branch.

Finally, while the focus of this paper is remote check funding for real estate closings, this capability is a value-added service for any commercial client managing several checking accounts or issuing checks in a number of locations. In addition to the benefits delineated above for closing agents, the system can allow businesses to gain centralized visibility and control check issuance in retail stores, branch offices, et cetera.

- **Closing Agents** -Title companies and closing attorneys enjoy all of the benefits described earlier, including eliminating the use and cost of multiple preprinted check books, thus streamlining the check issuance process, and reducing official check fraud risk. They also benefit from reduced manual reconciliation and record keeping.
- **Lenders** - The bank deployment model maximizes lenders' float by reducing the rescheduling of closings. Also, depending on how the commercial relationship is structured, the agent may grant lenders' view-only access to transaction status and check history information.
- **Title Insurance Companies** - Insurers can also benefit from view-only access to historical data. While they are not involved directly in the transaction, the ability to remotely research and audit checks written for title insurance allows them to streamline their processes and minimize check fraud related to sold policies.

Lender Deployment

Many direct and wholesale lenders today are extending their supply chains in order to gain more control over their product offering. This includes offering value-added services to closing agents, including commercial banking services.

The lender deployment model is similar to the commercial bank model, except the lender acts as the commercial bank, effectively supplanting the bank in the supply chain. As part of a full-service banking relationship with closing agents, the lender's "commercial banking" arm deploys and manages the remote check funding system as a managed software service.

As with the commercial bank model, the system is server based and closing agents access it via a secure web browser. Secure MICR printers are tied into the system as either network-connected clients or PC-attached printers. The lender may allow printing of certified checks in addition to company checks drawn on the agent's account.

Benefits:

- **Lenders** - As with the commercial bank model, lenders offering remote check funding to title companies and attorneys as commercial clients are able to capture closing agents' escrow funds—a significant new source of revenue for stand-alone lenders. Additionally, lenders are able to better manage the delivery of their products and services to the end-consumer. This cuts costs and improves the customer experience, leading to a competitive advantage.

As with the commercial bank model, a lender may gain additional float generated by debiting the agent's account upon issuance of the check instead of at presentment. Further, because new loan funds are transferred to the lender's commercial banking arm prior to closing instead of another bank, the lender effectively retains the funds—and float—until closing.

- **Closing Agents** - Title companies and closing attorneys enjoy all of the benefits described earlier, including eliminating the use and cost of multiple preprinted check books, thus streamlining the check issuance process, and reducing official check fraud risk. They also benefit from reduced manual reconciliation and record keeping.

- **Title Insurance Companies** - Depending on how the commercial relationship is structured, insurers may be granted view-only access to historical data. While they are not involved directly in the transaction, the ability to remotely research and audit checks written for title insurance allows them to streamline their processes and minimize check fraud related to sold policies.

Title Insurance Company Deployment

In this model, the title insurance company deploys the remote check printing system as a managed service. This is typically just part of a related suite of software licenses to agents for a modest monthly fee.

The system is server based and closing agents access it via a secure web browser. Secure MICR printers are tied into the system as either network-connected clients or PC-attached printers. In this model, there is no direct link to an agent's commercial accounts.

Benefits:

- **Title Insurance Companies** - Differentiating their products in a competitive market is an ever-present challenge for title insurance companies. Anything that helps them stand out with closing agents allows them to grow and retain their market share.

As with the commercial bank model, lenders offering remote check funding to title companies and attorneys as commercial clients are able to capture closing agents' escrow funds—a significant new source of revenue for stand-alone lenders. Additionally, lenders are able to better manage the delivery of their products and services to the end-consumer. This cuts costs and improves the customer experience, leading to a competitive advantage.

As with the commercial bank model, a lender may gain additional float generated by debiting the agent's account upon issuance of the check instead of at presentment. Further, because new loan funds are transferred to the lender's commercial banking arm prior to closing instead of another bank, the lender effectively retains the funds—and float—until closing.

Finally, the ability to remotely research and audit checks written for title insurance allows them to streamline their underwriting processes and minimize check fraud related to sold policies. This benefit cannot be underestimated.

- **Closing Agents** - Title companies and closing attorneys enjoy all of the benefits described earlier, including eliminating the use and cost of multiple preprinted check books, thus streamlining the check issuance process, and reducing official check fraud risk. They also benefit from reduced manual reconciliation and record keeping.
- **Banks and Lenders** - These parties do not benefit directly from this model, however, the system may allow for banks and lenders to remotely research and audit check history for closings they are involved in.

Closing Agent Deployment

Finally, title companies and real estate attorneys may choose to deploy a remote check funding system themselves. This model works well whether automating one location or a network of branch offices. In this model, the closing agent deploys the software on a PC for a single office setup or on a web server for a multi-office implementation. In either setup, users access the system via a web browser. Secure MICR printers are tied into the system as either network-connected clients or PC-attached printers.

Benefits:

- **Closing Agents** - Title companies and closing attorneys enjoy all of the benefits described in the previous section, including eliminating the use and cost of multiple preprinted checkbooks, thus streamlining the check issuance process, and reducing official check fraud risk. They also benefit from reduced manual reconciliation and record keeping. The payback for this type of deployment is typically 12 to 14 months.
- **Banks, Lenders, Title Insurance Companies** - As with other models, the closing agent may choose to grant trusted partners access to historical data. Once again, the ability to remotely research and audit check issuance helps these partners work more closely with the title agent and streamline their overall processes. For title insurance companies in particular, online auditing is a powerful tool for minimizing check fraud related to sold policies.

New Tools, New Risks

Despite its benefits, remote check funding employs new technology that can bring new risks, some with serious consequences. When reviewing available technology for a remote check funding system, keep these potential issues in mind:

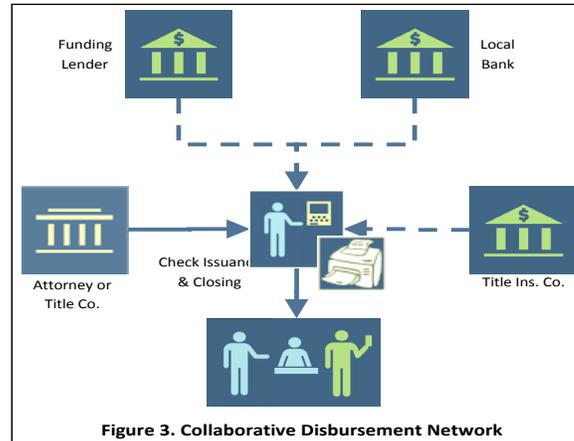


Figure 3. Collaborative Disbursement Network

- **Print stream eavesdropping** - Hi-tech thieves can potentially capture check information as the print stream travels through a corporate or public network. For maximum protection, ensure that the disbursement management system encrypts all data from the requesting agent through any approval process, all the way to the printer for decryption—not the local network server or PC to which a printer is attached.
- **Client and printer spoofing** - Fraudsters can potentially log into a system from an unauthorized computer or location. Worse yet, they could hijack the print stream by redirecting it to another printer on the network and abscond with checks well before the breach is uncovered. This can be prevented by the disbursement management system restricting access to registered IP addresses and firmware serial numbers on both the printers and client PCs.
- **Distributed-print disconnect** - When either the requestor or approver is not local to the MICR printer, the local party can claim that the check did not print properly and request a reprint, potentially walking off with a perfect duplicate check. Regardless of deployment model, ensure that the printers “talk back” to the disbursement management system. Such bi-directional communication should not only confirm successful printing, but should also support full control and status of the printer.

- **Toner swapping** - Best-in-class systems mate the toner cartridge with the printer via an RF microchip. Removing and locking away the cartridge prevents the printer from being used with another cartridge for check printing, giving branch managers additional security over the official check process.
- **Static processes** - As with any system that requires good security to function, complacency is a lurking threat. A full featured disbursement management system manages password, approval cycle, and encryption key shelf life, plus session time-out. These features enforce the highest levels of access control and security.

To learn more about the security and efficiency benefits of best-in-class disbursement hardware and software, please read Source Technologies' white paper, MICR Printing Technology: Automating Official Check Issuance.

Other Opportunities

As stated in the introduction, best-practice companies in mortgage lending, title insurance and commercial banking have begun deploying remote check funding systems to cut their costs and gain competitive advantage in their respective markets. However, as more companies deploy remote check funding, it will go from being a competitive advantage, to a baseline requirement, and eventually, to being just part of the "plumbing". Over time, this plumbing may evolve into a collaborative disbursement network, similar in function to electronic data interchange (EDI) systems in use for decades.

A collaborative disbursement network would allow parties to dynamically extend appropriate information sharing and control as needed among trusted partners, based on a standard technology framework. For example, a closing agent could extend transaction visibility to a new title insurance company or wholesale lender. Since information sharing leads to faster decision-making, greater efficiency, and less risk, agents may be in a position to bargain for better business terms with these partners based on greater transaction visibility.

It would also support alternative closing process workflows. For example, today, loan funds are wired into a closing agent's account, and the agent draws funds from this account among others in the closing process. Under a network model, the funding lender would simply provide electronic approval for the disbursement; the agent would issue/print the check directly from the lender's account while printing other checks from the agent's operating or escrow accounts. This would eliminate wire transfers and conserve float for the lender.

While industry-wide technology standards to accomplish this are far in the future, the opportunity to establish one's own network exists today. Several major market players have already deployed their own remote check funding networks and are leveraging them to significant advantage. As these companies extend access to more customers and partners, the need to link networks will inevitably drive technical standards. This will allow for very dynamic networks, varied network structures, differentiated service offerings and ultimately, an even more advanced best-practice model for mortgage closings.

About Source Technologies

Founded in 1986, Charlotte, N.C.-based Source Technologies provides integrated solutions for controlling financial transactions and other secure business processes within the financial services industry and FORTUNE 1000 companies. Clients include several of the top 10 banks and many of the world's largest securities companies.

Source Technologies' value proposition goes well beyond hardware and software. As thought leaders in the field of paper and electronic disbursements, we ensure delivery of successful solutions by providing:

- Deep domain expertise in the flexible design and delivery of back-office and customer-facing applications in a variety of banking and retail environments.
- Over 20 years of software implementation, API/Host integration, logistics fulfillment, installation, and customer service to hundreds of large and mid-size banks, Fortune 1000 companies, federal and state governments, and other clients.
- Extensive ASC X9AB committee work in setting check and Image Replacement Document printing and processing standards.
- Packaged solutions for secure, real-time management of MICR laser checks, electronic disbursements, and other sensitive documents on-demand, with centralized approval and process control.
- Print platforms with virtually unlimited scalability and advanced control features for high-volume environments, including thread management and load balancing.

To learn more about Source Technologies' Secure Print solutions, visit Sourcetech.com.