FINASTRA

Market Commentary

David Lykken discusses trends in mortgage lending and the rise of AI

Industry veteran David Lykken addresses questions about the challenges and opportunities community financial institutions face in the year ahead and how artificial intelligence will revolutionize the industry

"With the industry's focus on managing risk and generating returns, generative AI has the potential to drive marked improvements in employee productivity, operational efficiency, and customer experience."

Bill Borden
Corporate VP, Microsoft

Q: David, as you look ahead to 2025 and beyond, what are the significant trends you see impacting profitability for mortgage lenders?
A: One easy answer is that we need more volume. Period. Mortgage loan interest rates are still more than double what we saw only a few years ago, and the price of the average American home is up almost 70% since the start of COVID[1]. This means fewer people are putting their houses on the market and almost a whole generation of people are locked out of buying the home they need. On a historic basis, mortgage rates aren't really that bad and they will drift lower this year. But people who are holding 3% loans right now don't see it that way, and even if they can afford a higher rate, there isn't a lot of choice for move-up properties. So, if loan volume remains soft, lenders need to find ways to become more efficient and offer value-added services that borrowers find attractive. Artificial Intelligence (AI) is an important opportunity to make that happen.

Another trend to watch is the evolution of regulatory compliance. Rules keep changing and banks must demonstrate they have controls in place in order to avoid fines… sometimes very big fines.

About the author

David Lykken

David Lykken is a 51-year veteran of the mortgage industry, having owned and operated three mortgage banking companies, a software company, and a leading consulting and executive coaching firm. David is a regular contributor to widely syndicated television, radio and newspaper websites and distributes a weekly podcast featuring mortgage bankers and fintech leaders that reaches tens of thousands of industry professionals weekly.

To hear more from David, visit:
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1071 compliance is the most significant new rule in implementation, but there are more regulations on the horizon including CRA (Community Reinvestment Act) modernization – designed to increase access to credit for lower-income populations – alongside more stringent consumer protection laws, and stricter data privacy laws.

These challenges aside, I am very optimistic about the prospects for community financial institutions in the year ahead. Loan margins are going to improve, banks are developing more creative ways to attract customers, underwriting costs will be reduced, and financial institutions will be able to put more people in front of more customers which will result in more loans.

Again, AI will play an important role in making all of this happen, and banks that are slow to adopt new technology are going to quickly be left behind by more nimble competitors. I recently read research showing that 40% of community financial institutions are making AI a priority this year [2] which means that almost two-thirds had better be on the lookout!

Q: You say that AI promises to impact both the way community bank and credit union lenders operate and how they interact with borrowers. What do you see as its immediate benefits?

A: AI has actually been around for decades but used in very simple ways to answer inquiries and perform certain repetitive activities. What we're seeing now is an explosion in AI capability that is going to vastly improve lending processes. This isn't all going to happen at once, but momentum is building, and I have no doubt that AI will significantly enhance operational efficiency and customer experiences. Oh, and not forgetting, also revolutionize certain compliance responsibilities and reduce risk!

Let me give you an example. It might sound like a contradiction, but at least 90% of consumer loans will not require a human underwriter within the next 5 years, yet customers will enjoy a more personalized experience. Leveraging AI, community banks and credit unions will be able to efficiently analyze all types of customer data across thousands of borrowers to identify trends and preferences, enabling them to tailor their services and communication to individual needs, and make customers feel more valued and better understood. At the end of the day, people want their loans closed quickly and conveniently, and the FIs that figure out the ways to do that best are going to be the winners.

Q: You mentioned how AI will simplify regulatory compliance, which is a significant advantage for community financial institutions. What does that look like?
A: Demonstrating compliance with fair lending regulations is one of the biggest benefits AI will deliver, I believe. No matter how much we try to remove bias, it creeps into underwriting activities. Let's face it, we're all human and we all make mistakes.

But AI is programmed to eliminate any forms of bias and can help banks demonstrate their fair lending practices to regulators, and that they have rock-solid and fair underwriting processes. CRA and 1071 compliance are perfect examples where AI could add real value.

AI is geared to consistently and accurately assess huge amounts of data to identify problems and recommend solutions. When you use it to accelerate loan underwriting, you also gain the benefits of improved accuracy and fewer expensive error corrections, real-time transaction monitoring, better fraud detection and prevention, and verifiable transparency, all of which are regulatory priorities. AI really packs a huge punch.

Q: Tell us more about how automated underwriting translates to higher profitability for community financial institutions.
A: I almost don't know where to start because the opportunities are so vast! With respect to consumer mortgages, while the loan servicing function is very efficient, it costs roughly $7,000 to $9,000 to book the average loan[3]. From commissions to document management to decisioning to closing, AI can dramatically reduce that expense and free up your staff to pursue more and better opportunities. I know of one mortgage lender that has aggressively adopted automation for the past 20 years and now reports that its cost to underwrite and close a loan is closer to $185.

That's truly incredible. From application to closing, virtually every step is driven by AI-enhanced processes.

It will also help level the playing field with independent non-bank mortgage companies, who have adopted technologies faster than banks and have less of a regulatory drag. Banks and credit unions pull through 68% of loans from application to closing, while IMCs pull through closer to 73%... that adds up to a lot of foregone loans that banks should rightfully be closing.

Plus, mortgage companies close loans on average as much as 30 days faster than community financial institutions[4], so anything that accelerates that process, even by a few days, is a necessity. AI is one of the most important –, probably the most important -– underwriting revolution transforming banking now and in the future.

AI works 24/7 to elevate customer support, provide answers and advice, guide customers through the application process, accelerate gathering documents such as credit reports and employment history and financial records, and ensure everything is done accurately the first time. It never sleeps, never takes a lunch break, and never runs out to Starbucks for a latte. AI takes over a lot of routine tasks so your staff can work on more complex decisions and nuanced opportunities.

And it can vastly increase the number and speed of prospecting touches, punching out thousands of emails to thousands of qualified borrowers in minutes rather than weeks.

I work with a lot of financial institutions, and AI is part of virtually every conversation I have… I'm a believer and you should be, too.

Rate of AI adoption by community banks by size (2020-2024)

25%

Small Community Banks (Assets <$1B): Adoption rate increased from 5% in 2020 to 25% in 2024.

35%

Medium Community Banks (Assets $1B-$10B): Adoption rate grew from 10% in 2020 to 35% in 2024.

50%

Large Community Banks (Assets >$10B): Adoption rate rose from 15% in 2020 to 50% in 2024.

Source: The Financial Brand, December 2024

Q: Does AI mean that financial institutions will need fewer employees?

A: This is always the elephant in the room. While it's true that banks can reduce underwriting expenses through automation, that only covers half of the equation.

Successful banks will shift analytics and data management to automation and will also create more loan volume by adding people to activities that require the human touch and where they are more strategic in nature. People do business with people they trust, and when your team spends more energy explaining, reassuring and helping customers understand their mortgage and personal loans, you'll earn more business. Long-term, profitable business.

AI will transform employee roles, so staff will now focus on complex, higher-value tasks where a computer, no matter how sophisticated, offers no advantage. And by driving growth, financial institutions may in fact need *more* employees and create new avenues for career advancement. AI is a win-win for customers and banks alike.

In big cities and smaller communities, banking is changing. Many institutions are going back, even in small ways, to a community square model, where the bank branch is a meeting place. AI operates mainly in the background, so employees become front and center in the sales process. AI helps tee up opportunities, but your teams will always be the closers.

Q: Before financial institutions embrace AI, what are the risks they need to consider?

A: Let me start by saying that virtually all banks and credit unions already use some form of AI, although they may not even realize it. Whether it's a website chatbot, a rate comparison calculator or a workflow automation tool, bankers and customers have become comfortable with these first iterations of the technology. But moving towards a fuller implementation of AI requires banks to have a game plan for any potential risks. I see two categories of risk that must be understood and quantified:

1. **The customer experience.** People are more comfortable interacting with technology when it is empathetic, conversational, and warm. This is not easy to accomplish, but AI is evolving to mimic the touch and feel of real human interaction. But trust, which is a bedrock foundation necessary to close deals, is best developed with real-time human interaction. Institutions will need to consider what they may be sacrificing by minimizing any of the human touches.
2. **The bank experience.** AI suffers from garbage in/garbage out logic, so distorted inputs lead to distorted outputs which might include bad loans, regulatory implications, and cybersecurity concerns. AI isn't a stand-alone solution; it requires controls, oversight and buttoned-down implementations. Institutions must ensure they're committing appropriately to their implementation and usage of AI to deliver the right results.

There's another risk you must consider when evaluating AI tools: the risk of doing nothing. As I said earlier, AI has arrived and financial institutions that don't begin to adopt concepts will very quickly be reduced to second tier status.

Please remember, AI is as much about empowering your staff to work on higher value opportunities as it is about reducing costs and automating certain functions.

And with two-thirds of community financial institutions not even considering AI this year, you've got a golden opportunity. Seize it!

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