The Mortgage Professional

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Avoiding the Wholesale "Dump and Run"
The "Dumbing Down" of the Loan Officer

The embrace of the huge profit potential of the ALT-A and non-prime loan business among mortgage companies has had unintended consequences which costs companies more than they realize in lost profits and time. The result, the further erosion of credit analysis and qualifying skills of loan officers, reduces the significance of the role of the originator. In addition, it contributes to the accidental application of predatory lending practices.

How it Happens

The wholesale non-prime business' primary sales focus is to get originators to submit applications for a pre-qualification. The originator faxes a 1003 and credit report to the wholesaler to get a credit grade and indicative rate. The wholesale representative then grades the loan and "stips it out," adding the standard documentation requirements as a condition of pre-qualification. The originator, in turn, contacts the borrower to obtain the requested documentation from the borrower. When the originator follows this process, the wholesale representative enjoys a position of inordinate power in this role, controlling the loan from the minute it arrives. On the face of it, there is nothing different in this process from what a loan officer does with a retail client, so what is the problem?

Problem 1: The Wholesaler's Control

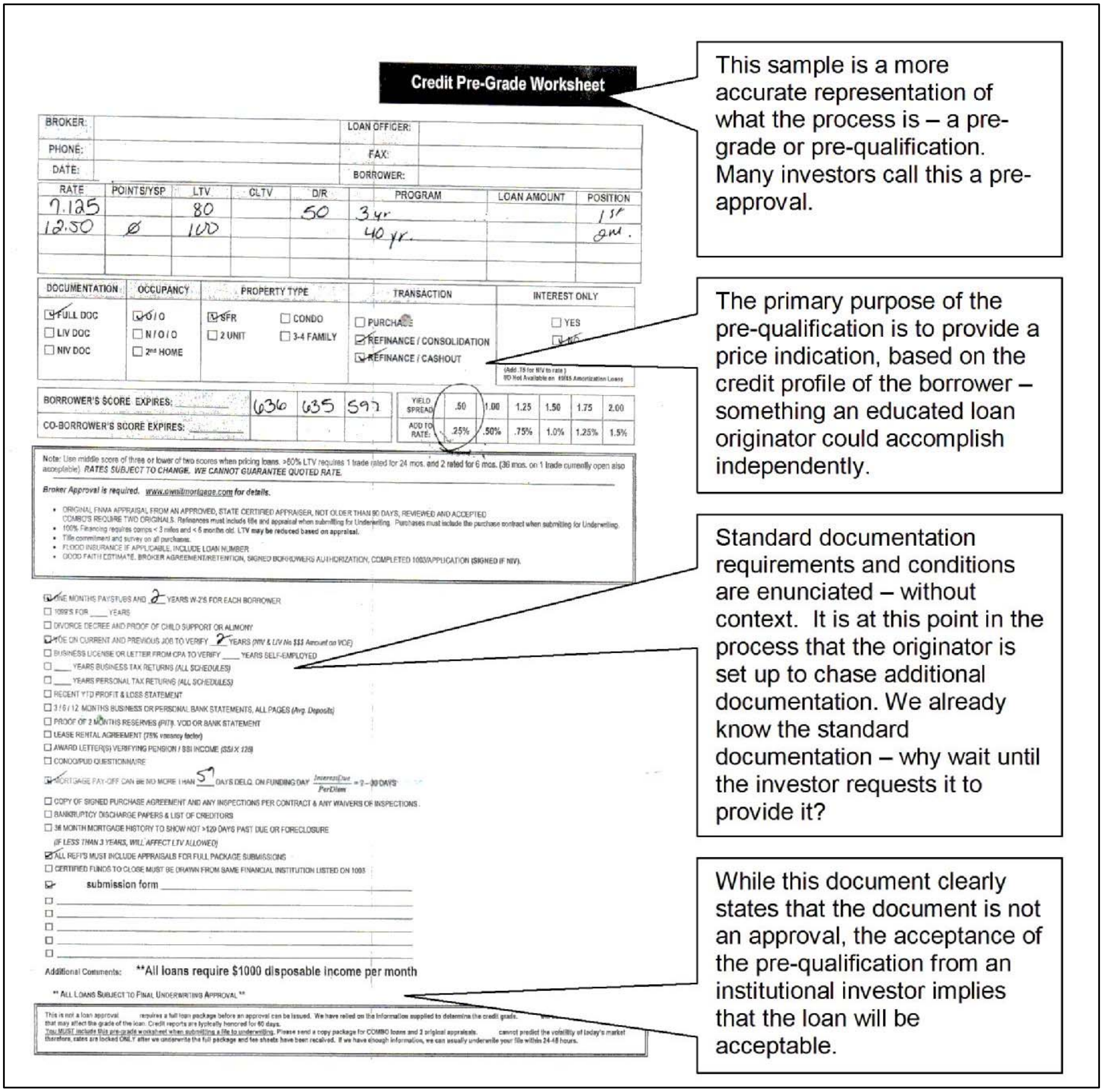
The position of certainty – that is, "don't worry, I'll get this loan done" – occupied by the wholesaler naturally impairs the loan officer's motivation to represent the borrower's best interests. "The loan is done, and I can go on to the next deal." This means that the first representative who gives a positive answer on the loan will likely control that loan for the remainder of the process, whether or not it is the best transaction for the borrower. This tends to create a situation where the loan officer is at the mercy of the wholesale representative. The wholesale representative is usually insulated from conversations with the borrower, so it is the loan officer who bears the brunt of effort getting redundant or additional documentation, answering questions and explaining circumstances that would not necessarily be favorable. Ultimately, when there is a limited amount of time in the process, there is no accountability on the part of the wholesaler if the terms of the loan change at the end of the process due to circumstances beyond his or her control. The loan officer is, again, in the position of selling the wholesaler's transaction to the borrower.

More cautionary is the fact that loan officer's reliance on wholesale representatives discourages them from learning a program's detailed internal underwriting guidelines. When presented with a problem, they cannot effectively challenge the finding. Wholesalers contribute to this ignorance by refusing to provide their actual underwriting guidelines and forcing loan originators to rely on sell sheets and highlights for guidance.

Many states legally mandate that a loan originator cannot accept a loan from a borrower if the loan originator does not know whether the borrower will receive a loan. How can the loan officer make this determination if he or she is relying on the wholesale investor's pre-qualification?

Problem 2: The Pre-Approval

The verbiage “Pre-Approval” has become substituted for what it is – a “Pre-Qualification.” A Pre-Approval, in the context it is used today, means “Approved subject to Approval.” Really – it’s a “Pre-Qualification” until it is a “Loan Commitment.” Unfortunately, many loan officers don’t focus on this blatant distinction. They tell their borrower that the loan is approved and use it as leverage to advance the application. This results in an obvious question from the borrower when the transaction ends up not proceeding as planned – “I thought you said the loan was approved.” There have been many cases in which borrowers have followed a loan process only to learn that there was no approval. The consequences often are; having to close later, at a higher rate, with a lower loan amount or with a different program.



Many states are now regulating the use of the word “Pre-Approval” to mean that the borrower must in fact apply and be accepted prior to being “Pre-Approved.”

For the loan officer, the use of the "pre-qualification as pre-approval" system costs him or her money. If all he or she knows about pre-qualification is "give me your name, social security number and address," the loan officer does not have any tool for developing a trusting rapport with the borrower. Only the most desperate borrowers will end up with this loan officer.

Problem 3: Predatory Practices

Non-Prime loans are already viewed with a jaundiced eye by regulators because borrowers who can least afford to pay higher rates are most often offered these loans exclusively. Some predatory practices are a by-product of the Non-Prime wholesale process:

Bait and Switch – Initially offering a more attractive product and changing the terms at the end of the process is a problem created by the "Pre-Qualification as Pre-Approval" process.
Lending without Regard to Repayment Ability – Wholesalers may encourage loan officers to submit loans as "Stated" income, or change the process from a Reduced Documentation process to a No-Qualifier process without consulting the loan officer in an effort to facilitate the approval. As we know there are many ways to get the loan approved, but should we?

Problem 4: Faulty System

The process of submitting a loan for a pre-qualification from a non-prime lender is no different that submitting a loan to automated underwriting through DU or LP. The approval is really no better than the documentation submitted to support it. The difficulty is that many companies do not force loan officers to take complete applications in advance. As a consequence, individuals – loan officers, processors, managers – spend a lot of time trying to obtain documentation that does not exist or is insufficient. These documentation problems would be revealed immediately with a complete application.

The financial cost of time wasted on loans that do not close is difficult to quantify. If less than 40% of completely processed pre-qualifications result in a closing, the man-hours required to close one loan are 237% higher than in the prime business. Couple this with the fact that loan officers who only collect social security numbers in their pre-qualification efforts do not convert as many prospects into borrowers. The borrowers who do convert require substantially more time to process because retrieving documentation is a reactive process requiring numerous review and re-review actions.

What to Do

These scenarios are in no way an indictment of the non-prime business, which performs a vital function in providing financing to non-standard borrowers. It is a matter of education of the loan officer, and creating a culture of managing the process instead of the process managing us.

Valerie Frank, broker-owner of Preservation Mortgage in Warrenton, VA, is an example of how to proactively originate non-prime loans efficiently. As a pre-2000 veteran of the mortgage business, she knew how to produce effectively with a reduced support staff. Her first step was to hire and train new loan officers, instead of recruiting seasoned loan officers. "I can't take the chance that someone who has learned poor practices in another office will come in and try and change the way we want to do business. It only takes one incident to infect the whole office." She trains the new loan officers at her "Preservation University" to do it her way. "Instead of just asking for a social security number, I spend a lot of time up front with a borrower, investigating their background and talking about what they are trying to do. When I decide to take a loan, it's going to close." She converts almost all of her prospects who are eligible for financing because "I get to develop trust and rapport with them while I am pre-qualifying them."

She also understands that she has to package every loan as if it was a FNMA/FHLMC loan. "I do a lot of prime loans. The documentation really doesn't change that much from "A" to "non-prime." She also notes that FNMA's EA programs are competing with sub-prime lenders in aggressive approvals. "The pricing is better. The process is more consistent and it is faster." As a testament to the efficiency of her model, she has 15 loan officers and only one processor.

The Lesson

The profitability of sub-prime loans conceals much of the inefficiency in the system. The difference between prime loan originators, whose processors can manage upwards of 150 loans, and sub-prime originators, who can process between 25 and 30, is in the system. In sub-prime, we treat every loan as if it were unique, when in fact the outcome and process is the same. The company that controls the process will enjoy increased efficiency and profitability.

Wholesale lenders define the market. They use the relative inexperience and ignorance of the broker or originator to control the process – some parts of which are unorthodox and may be illegal. There are wholesale representatives who refuse to give originators copies of the investor's underwriting guidelines. The only reason for withholding this information is to reinforce the originator's reliance on the wholesaler. This also results in inefficiency as the originator struggles to manage a borrower's expectations AND respond to the investor's documentation requirements long after the borrower has submitted the application.

The Solution

From management down, mortgage broker and mortgage banker firms must become aware of the problem and commit to developing a process flow that eliminates these pressures. In our experience, we have been able to identify problems and inefficiencies in a company's operations by documenting the current flow and seeing where the problem areas are. Then we structure a process solution.

With respect to the Sub-Prime lending quandary, we already know where the problems are, and we take the following steps to correct them:

1.) Institute "Defined **Complete** Application", to be taken in before the loan is submitted for underwriting – including all commonly requested loan documents – income, asset and credit.
2.) Assemble Loan Plan Specifications Matrix for top programs – with underwriting guidelines – and selective review and approval of wholesale representatives. All originators, but particularly new loan originators, should be required to use only approved investors.
3.) Institute Processing Flow identifying the specific steps that must be followed by EVERY party in order to deliver excellent customer service.

Companies that can increase their efficiency are more profitable. In turn, higher profits allow the company to be more competitive in the marketplace and provide borrowers with more favorable terms.

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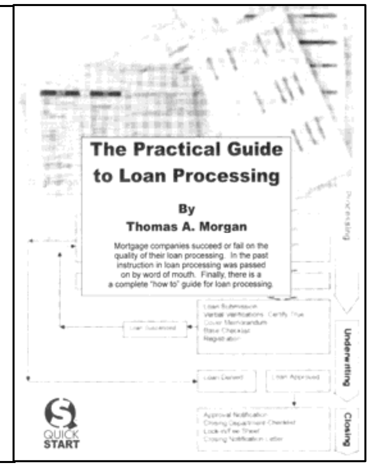

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