Answers for MBANewslink

Given by Dean Brown, CEO of Mortgage Capital Management

1. **Where do breakdowns typically occur in the mortgage pipeline?**

   The top breakdowns or issues for lenders are:

   - Those who do not use options when a pipeline source or renegotiation policy dictates that their use is necessary. Mortgage Capital Management (MCM) recommends the use of options as a hedge to protect against fallout and the volatility associated with a pipeline's potential renegotiations.
   - When they do not correctly price the mortgage up front when loans are locked in. For example, most lenders price their loans using an automated pricing service with some type of built in "best execution" that selects one investor using the loan level price adjustments (LLPAs) that apply to the loan on day one. In a significant number of cases, either the investor or the LLPAs to be applied to the loan are not correct at time of funding.
   - Loans that remain "In Process" status or "Approved" status for a long period of time and/or up until the expiration date of the loan. Data accuracy counts when hedging your mortgage pipeline….
   - Locks expiring without an extension, causing fallout. For many, extending a lock is not a priority until the last minute. This leads to the loan officer and borrower wanting and/or needing to extend the lock without re-locking at a rate and price equivalent to the worst of price plus the extension costs.
   - Creating duplicate loans in their loan tracking system without regard to the impact to their fallout calculations. Many companies allow branches or brokers to lock in loans without actually having the loan application in hand. The loan gets locked in with basic information and the loan file follows later to be completely entered in the loan origination system (LOS). We have discovered many instances where the loan was entered into the LOS a second time once the file was received. This results in a loan being locked twice and consequently, hedged twice. If this goes unchecked, the duplicate entries result in increased hedge costs because trades either have to be paired off or positions are mistakenly shorter for an extended period of time.

2. **How are lenders doing a better job of mitigating pipeline risk?**
   - The lenders who use option strategies, preferably mortgage backed securities puts and calls, have been successful at maintaining their margins, regardless of market volatility. Also, we have seen a great deal of success using Treasury puts and calls with a managed basis trade methodology.
   - Lenders also are better at using an all-in best execution strategy. For example, many lenders mistakenly employ an automated best execution strategy that is either vendor-provided or company-developed, wherein they price loans on a loan-level basis in order to achieve what they think will be the highest possible sales price for a loan (some vendors even forget to include fees). The more appropriate and profit-maximizing method involves calculating what the maximum price would be for the entire group of loans not just on a loan-level basis, but for the entire group of loans available for sale. For example, in order to

avoid a LLPA fee for a high balance loan, a lender may have to pool normal loan amount loans with a high balance loan in order to be with a 10% limit. The best price for all may be different from what the best price is individually. This is just one example, but the idea is that lenders should employ a goal programming method that takes more than just a simplistic individual loan review.

3. **Are the flood of new regulations and legislation helping or hindering lenders become more efficient?**

   Obviously, more regulation and legislation doesn't make anyone more efficient. However, lenders who are thriving and maintaining their margins have figured out how to comply and still make the process simple enough, or at least not too much more complicated than it had been in the past. The new requirements and compliance costs have also created a larger barrier to entry into the mortgage banking business, thereby enhancing potential margins.

4. **You started MCM 20 years ago, but have said that the genesis of the company started when you were in college. What was the event that triggered it?**

   In 1982, I was a college sophomore with an undeclared major. Interest rates for 30-year fixed rate conforming loans had risen from 11% to 16%, and my family's residential development/construction firm was struggling. Since lenders weren't offering commitments that would lock in loan rates for the length of time it took to build a home, the rapidly rising rates meant people who had contracted to build homes couldn't afford them once construction was finished. I began to research how a development company could hedge interest rates for its customers. I created a strategy using the newly formed market trading US Treasury bonds options on the Chicago Board of Trade (CBOT), and even wrote my senior thesis on the subject. After graduating from college, I joined the banking industry, helping my employer's mortgage division hedge mortgage pipeline risk. An MBA in finance followed, along with a rise through the ranks at several banks to senior vice president of secondary marketing at a large bank. Then, in 1994, I founded Mortgage Capital Management to help mortgage bankers become more profitable through the use of the best pipeline risk management tools and proven strategies available.

5. **How do you see your business evolving over the next few years?**

   MCM continue to grow and our software will evolve into more of a full-service technology platform providing secondary marketing systems in all forms. An example of this is something that we will be launching soon – Hedge Commander™ – that offers real-time pricing, lock-desk management, VAR hedge management, scenario analysis, tracking, goal-based best execution, and accounting interfaces all in one package delivered through the web. So basically more and more features as we strive to be better each day.