# Unintended Consequences

Back in 1993 I was SVP of Secondary Marketing for a large bank that had a reasonable amount of mortgage business originated through its vast retail bank branch network. I was also on the bank's acquisition team assigned to value servicing and mortgage banking assets. The bank had a problem, it had just applied with the regulators to purchase a regional bank after successfully negotiating and valuing the firm, however, our bank was deemed to have not enough low income and minority lending business to satisfy the regulators at the time. The bank opted for a chance to improve our performance over a one year timeframe so we could complete the important acquisition before another firm either bought them or someone bought us – back then it was a merger and acquisition market either you were growing through acquisitions or you were about to be acquired.

Amongst other measures implemented to solve the problem, the plan entailed hiring a group of loans officers primarily from the minority community, training them on mortgage loan origination process and policies at the time, and sending them into the closest branch to the underserved local markets that they were assigned. In addition, the bank priced loans for the targeted areas and borrowers with a 1 point better price than the normal. Unfortunately for the bank, the origination plan and other tactics didn't work. The new loan officers instead of working to serve the low income and minority communities they were hired to originate loans in, had targeted the more affluent communities and they were quite successful with normal mortgage loans. I called several of the new loan officers personally and asked them why they were not producing the types of loans the bank was after even after it had given the product a 1 point price advantage and the answer was simply: "Although Compton is my assigned area from by branch location in Inglewood, it is much more profitable for me to go after business in Manhattan Beach." A few calculations later I came to realize that the loan officers were capitalists; they had correctly figured out that they could generate more commissions from well-organized and relatively wealthy borrowers than they could from the lower income / minority borrowers who often needed additional help gathering the required documentation. This combination of quicker turn times, less work, and higher loan balances paved the way for the strategy's failure. Hence, they figured out that is was in their best interest to not originate loans in the areas assigned even with the 1 point pricing advantage.

Given this failure, (the bank did not receive approval for its acquisition) and the bleak prospects for acquiring another bank made it a prime acquisition target and it was later acquired a year later.

The reason this reflection down memory lane was presented was to demonstrate that the current LO compensation rules, and QM rules do more harm than good and have unintended consequences. Loan officers are not pursuing low income and minority business due to lower loan amounts and the increased difficulty of closing loans and instead are pursuing the greener pastures of higher to moderately well off borrowers. Given the choice to work half as hard on 8 loans a month with an average loan amount of $375,000 or 12 loans a month with an average loan amount of $200,000 what would you choose given that you make the same commission percentage on each loan?