Mortgage Banking – Profitability
Program

Examination Objectives

To measure the profitability of the thrift's mortgage banking operations in order to determine if they are sufficient to justify the relatively high risks of the operation.

To determine if the salaries paid to the mortgage banking personnel are excessive or inadequate.

To determine the effect of the subsidiary and affiliate mortgage operations on the profitability and safety of the parent thrift.

Examination Procedures

Perform the following examination steps to ensure that the mortgage banking activities are profitable and not a drain on the thrift. Those steps that do not apply may be omitted; however, a notation should be made as to why they do not apply.

Level I

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1. Determine what type of mortgage banking operation the thrift is operating: (1) creating an off-balance sheet servicing portfolio (OMSR) and recording servicing fees as received; (2) creating an off-balance sheet servicing portfolio and capitalizing ESFR; (3) selling mortgages with servicing released; (4) buying or using table funding to create servicing (PMSR); or (5) a combination of these strategies.

2. Review the previous report of examination and all mortgage banking operation-related exceptions noted and determine if management has taken appropriate corrective action.

3. Gather all profitability tracking reports prepared by the thrift that distinguish mortgage banking revenues and expenses. Compare these specific revenues and expenses to the latest MBA Cost Study (available for internal use from OTS Regional Offices).

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4. Separate origination costs into fixed and variable in order to determine the ability of the thrift to reduce overhead expenses (salary and premises) if originations decline sharply.

5. Review the salaries and other compensation of the mortgage banking personnel to the average costs shown in the MBA Cost Study and other surveys. Then determine whether:

- The mortgage banking personnel have greater compensation than others in the mortgage banking industry;
- The compensation of mortgage banking personnel is tied to performance, avoidance of risk, and long-term profitability as well as volume;
- The number and cost of mortgage banking personnel can be varied according to cyclical needs;
- Annual bonuses and total compensation of executive management are tied to long-term profitability; and
- Total mortgage banking compensation is reviewed by the thrift or an outside group to make sure that it is comparable to the mortgage banking industry.

6. Determine the relationships of the mortgage banking subsidiaries or affiliates with the parent thrift. Assess whether those operations are permitted under OTS regulations and § 23A and 23B of the Federal Reserve Act. Assess whether:

- Their operations are practically and visibly separate as well as legally separate;
- All transactions are covered by written agreements and are at market comparable prices and terms;
- The thrift is not providing any guarantees or other forms of credit support; and

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- The mortgage banking operation is not dumping mortgages into the thrift's portfolio that it cannot sell into the secondary market without losses.

7. Calculate the overall benefit/expense of the subsidiary to the thrift using market prices:

   - Determine the yield for the funds invested; and
   - Determine if that yield is adequate for the risks taken by the thrift both from its initial investment and from continuing operations.

8. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

Level II

9. Measure the reports from the mortgage banking operation of the thrift against the appropriate OTS mortgage banking reports with particular attention to the expense coverage ratio (mortgage banking income to G&A) and the off-balance sheet value of servicing report. Then determine:

   - The rough percentage of the thrift's operations that are related to mortgage banking;
   - The percentage of the mortgage banking operation to the thrift's overall profitability/losses;
   - The other core income of the thrift;
   - The yield on mortgage banking activity for the funds invested;
   - If mortgages are originated for sale to correspondents, the profitability and dangers to the thrift;
   - The other significant risks of the thrift's mortgage banking operation; and

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- Whether the total profits versus total risks are appropriate for the core earnings and capital level of the thrift.

10. Ensure that the Objectives of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

Examiner's Summary, Recommendations, and Comments

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