THE DECLINE OF AMERIQUEST

A Case Study

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Executive Summary

In the subprime lending market, Ameriquest Mortgage Company is one of the leading lenders. It is widely known for its advertising slogan of "proud sponsor of the American dream." Yet in 2006, an investigation into unlawful mortgage lending practices and the subsequent $325 million multi-State settlement brought even more attention to this company.

What caused this lawsuit which brought irreparable damage to its reputation and financial loss for Ameriquest? This study focuses on the Information System Security management of the company. The study first introduces Ameriquest, and then briefly describes the lawsuit and settlement, and then discusses the IS security control in Ameriquest. The discussion will cover the internal control, external control, and technical controls of the company.

Profile of Ameriquest

Founded in 1979, Ameriquest is one of the United States' leading subprime lenders. It started as a bank - Long Beach Saving & Loan, in Orange County, California. In 1994, it was converted to a pure mortgage lender. In 1997, the retail part of the business was alienated from the business and renamed Ameriquest. In May, 2006, Ameriquest closes all of its retail offices, and opted to negotiate all future loans through brokers.

Ameriquest is best known for its subsidiary - Ameriquest Mortgage Company, which makes direct loans to customers. Its Argent Mortgage Company affiliate works in partnership with independent brokers. Today, Ameriquest has its headquarters in Orange County, California, and is comprised of over 250 branches, offering services in 46 states, with more than 12,000 employees. Other subsidiaries are Ameriquest Mortgage Securities, Long Beach Acceptance Corp., and Town & Country Credit.

As a privately owned company, Ameriquest primarily makes refinancing loans to existing homeowners who have less-than-perfect credit and insufficient income to qualify for conventional loans. Statistically, those with lower credit scores are more likely to default on a loan. Therefore, Ameriquest and other sub-prime lender charge these customer with higher interest rates than those that have good credit history.

Another thing that needs to be mentioned about Ameriquest is that it was among the first mortgage companies to use computers to search for prospective borrowers and also to speed up the loan process.

The Lawsuits and the Multi-State Settlement

Ameriquest, which was founded by Roland Arnall as Long Beach Savings in 1979, has faced a series of disputes over its lending practices with consumer activists, regulators and private litigants, dating back to 1996.

In 1996, Ameriquest was accusing of exploiting older, female and minority borrowers. According to the lawsuit, mortgage brokers and Ameriquest employees charged an additional fee of as much as 12% of the loan to these disadvantaged customers. The company paid three million dollar to settle the case.

In 2001, Ameriquest was investigated by the Federal Trade Commission. The company had to offer $360 million in low-cost loans to settle a predatory lending dispute with ACORN, a national coalition of community organizations.

The next lawsuit involving Ameriquest regards putting pressure on Connecticut customers early on to commit to refinancing. In January, 2004, the company settled this case by paying $603,552 of refunds, and an additional $500 to each borrower (totaling $62,000), as well as a $5,000 civil penalty to the State. More recently, the same problems surfaced again, but this time round the Department of Banking threatened to take away Ameriquest's license. This case is still pending.

On the 1st of August 2005, Ameriquest announced that it would set aside $325 million for contingencies for settling Attorney General investigations in 30 states, which is the second-largest State or Federal consumer protection settlement in American history. These lawsuits accused Ameriquest employees of: forging loan documents, pumping up appraisals, providing phony credit and employment histories, and of changing the terms of loans. The company was also accused of "bait- and-switch" tactics, in which borrowers discovered that Ameriquest provided inadequate disclosure of prepayment penalties, discount points and other loan terms; made unsolicited refinancing offers without adequate disclosure of prepayment penalties; improperly influenced and accepted inflated appraisals, and; misrepresented consumers' credit ratings and the availability and cost of future refinance loans.

The settlement does not constitute an admission of wrongdoing by Ameriquest. However, the mortgage lender agreed to establish new standards to prevent the alleged unfair and deceptive practices.

Under the agreement, **Ameriquest** is required to:

- Provide the same interest rates and discount points for similarly-situated consumers.
- Not pay incentives to sales personnel that include prepayment penalties or any other fees or charges on the mortgages.
- Provide full disclosure regarding interest rates, discount points, prepayment penalties, and other loan or refinancing terms.
- Overhaul its appraisal practices by: removing branch offices and sales personnel from the appraiser selection process, instituting an automated system to select appraisers from panels created in each State, limiting the company's ability to get second opinions on appraisals, and prohibiting Ameriquest employees from influencing appraisals.
- Not encourage prospective borrowers to mis-state income sources or income.
- Provide accurate, good faith estimates.
- Limit prepayment penalty periods on variable rate mortgages.
- Not engage in re-financing solicitations during the first 24 months of a loan, unless the borrower is considering refinancing.
- Use independent loan closers.
- Adopt policies to protect whistle-blowers and report improper conduct.

Ameriquest has already implemented several of these requirements, including appointing an independent monitor to oversee its compliance with the settlement terms. The Monitor will submit periodic compliance reports to the Attorneys General over the next five years.

Ameriquest IS Security Management

One year after the settlement, Ameriquest was left with both reputation damage and a huge financial loss. Last Spring, faced with declining subprime production and a changing retail landscape, Ameriquest Mortgage - once the nation's largest subprime lender - closed its entire retail branch network (229 locations), slashing 3,800 jobs in the process, only maintaining call centers in the retail channel.

The story of Ameriquest is a lesson for sub-prime lenders and is a good case study to consider, due to the unique nature of the business, and for understanding what is the best form of security governance. The settlement can provides a framework for new lending policies and standards that improve IS security for the whole industry.

In the following section, the study will discuss Ameriquest's IS security control from four perspectives: culture, internal control, external control and technical control.

Culture

High Pressure

"Sell, sell, sell" is the Focus of Ameriquest's corporate culture. This aggressive culture promoted the "anything-to-get-the-deal" mentality, which led to abuse.

According to interviews with former employees from Ameriquest, some managers would declare a "power hour" on some days, during which the salespeople were required to stand at their desk until they signed up a new client. One former employee said that ".... we were pushed to work 12 hour days, to never leave the office for lunch, and to work on Saturdays. Month ends were all about working until midnight just to get an approval for a loan that would be back-dated and closed the next day (in order for it to count for the current month)."

Mark Bomchill, who now works as a loan consultant for Plymouth, a Minnesota - based Allstate Residential Mortgage lender, typically processed two or three application for home loans each month before he worked in Ameriquest. After working for Ameriquest, he said that "It was so out of hand, I was juggling 10 to 15 new loans every month .... and there were guys in my office doing two or three times as many as I was. No one ever thought to question whether [the loan] was right for the customer or for the lender. It was just do the deal and to move on to the next."

Even though he and others in his office were closing more than 80 new loans every month, this wasn't enough to satisfy senior management. Managers often yelled at salespeople to make more calls and to find more customers.

When talking about high pressure in the office, people tend to remember the 2000 movie *Boiler Room*, starring Giovanni Ribisi and Vin Diesel. According to Lisa Taylor, a former loan agent in the Sacramento branch, the atmosphere at her office was very similar to that portrayed in the movie. One manager even used the film as a training model. "That was your homework…. watch *Boiler Room*", Taylor said in her statement.

Unethical Practice

The high-pressure sales culture was tactical. Ameriquest managers were required to promote a "do-anything-to-get-the-deal" mentality. Some managers even encouraged employees to "promise certain interest rates and fees, only to change these rates at the time of closure."

Unethical practice becomes a common phenomenon at Ameriquest. "It was just the atmosphere of the company. No one cared, as long as the volume kept growing", according to a former Ameriquest employee.

The unethical and even illegal environment pervaded into most of Ameriquest's sales office. Documents were altered to show higher incomes for applicants, and appraisers were encouraged to raise valuations on properties in order to make loans go through.

According to a former loan processor for Ameriquest, as well as to several State Attorneys General, individual Ameriquest loan agents routinely circumvented the company's loan processing system in order to approve loans and to inflate the fees and interest rates charged.

Early in 2007, statements were recorded in a class-action lawsuit at the U.S District Court of San Francisco, where it was said that "loan agents routinely witnessed, or participated in falsifying data that was then entered into the Ameriquest loan processing system".

Former Ameriquest employee Joseph Khaliq testified that some loan agents would "ask borrowers to sign blank documents. After the borrowers had left, employees would fill out the loan documents as they saw fit ... I [also] witnessed employees at the San Mateo branch forge borrowers' signatures on loan documents." He also said that Ameriquest loan agents would encourage borrowers to state a much higher income than they really earned, just to get their loan approved.

In a 2004 case, Idanel Bonaparte received a loan for $108,000 from an Ameriquest branch in Tampa, Florida. Her financial assets included a 401(k) account worth $25,456.53. A month later, Linda Hubbard refinanced her home with a $211,000 loan from Ameriquest. Her application also included a 401(k) account with the exact same $25,456.53 balance. Furthermore, two months later, Romy Hodge refinanced her house with a $75,000 loan and, much to her surprise, she too, was credited with a 401(k) account that had a balance of exactly $25,456.53. Hubbard and Hodge did not provide this information - it just recycled legitimate loan agent financial documents to get loans approved**.**

Internal Control

Corporate Structure

For the last several years, interest rates hit historically low levels and, as a result, more and more people jumped into the real estate market without careful consideration. In such a hot real estate environment, those with a damaged credit record seek help from subprime mortgage companies. Understandably, Ameriquest expanded rapidly during this period.

When Ameriquest was first founded, it undertook all business from its branch network. Leads came in from connections with local real estate agents, or were distributed from a centralized group.

To speed up loan processing and improve efficiency, the company was organized in an assembly-line fashion. The company's central retail back office was located in Orance, CA and it also had processing centers located in Sacramento, a Chicago suburb of Schaumburg, Ill., and also in Arizona, and Connecticut.

In 2006, the company announced to close all its network of retail branches, and adopted a new, centralized retail lending model to quickly adjust to the mortgage market's ups and downs and to operate more efficiently.

The top management thought that a centralized structure would make it easier to train employees, balance workflow and expand. During an interview, Aseem Mital, ACC Capital Holdings' chief executive said, "In the past, when loan demand was especially high at one branch, Ameriquest would refer prospects to a nearby one. You may have had one branch underutilized, but in a center like this, you have more balance". He also said that the operation center would operate at 80% capacity, so it could ramp up if necessary.

Another benefit, according to the top management, was to easily comply with the company's multi-State settlement. In a centralized system, less authority would have been given to loan officers.

Verification of Data

The process of celebrating a mortgage loan (also called the loan cycle) has five distinct steps: application, loan processing, loan underwriting, loan closing, and loan servicing. Simply put, during the application process the applicant provides basic information and then during the loan processing stage, detailed information about the borrower is collected and verified, followed by the transaction itself. Based on the information gathered during the first stage, the loan underwriting stage determines the risk for the lender. If the loan is approved, then the loan goes to the closing stage, and finally to servicing.

These steps and processes, if carried out properly, with proper supervision and documentation, can ensure data integrity. However, in some of the cases detailed in the class-action suits that Ameriquest recently settled, many of the appropriate checks and balances appear to have been ignored.

At discussed earlier, during the application and loan processing stage, borrowers are encouraged to “inflated their income” in order to gain the loan and the loan salesperson routinely falsified data, which was then entered into the Ameriquest loan processing system.

At the underwriting stage, the application is passed along for review by the underwriter. In the past, both the loan application and supporting documents such as W-2s, bank statements, 401(k) statements and other financial records were kept together in one file for review. However, after Ameriquest adopted an automation system, at the beginning of the loan cycle the loan agent entered all documentation electronically.

This should not have been a problem, if the underwriter was able to access the file and verify its correctness and reasonability. However, in some cases, the underwriter was merely reviewing the data entered into the system by the loan agent, and was not double-checking the actual physical documents.

Independency of Responsibility

In March 20, 2006, Jimmy and Florence Grice sued Ameriquest and appraiser Rick Hyatt for $1.1 million in Henderson County, Tennessee. They accused Ameriquest and the appraiser of conspiring to inflate the value of their properties. ." He (the appraiser) said that our house's price was double what it was worth. It was properly appraised for $67,500, and yet it was originally appraised for $130,000 by Ameriquest." The couple said that the inflated appraisal was predetermined, in order that the Grices could obtain a refinancing loan of $110,500, at a 1.784% interest rate.

The Grices’ case was not the first one, and will not be the last case that sues Ameriquest’s appraisal practice. In Ameriquest, the loan officers would apply high pressure on the appraiser to generate house values that would enable loans to be accepted.

Before the multi-State settlement, branch staff had the authority to order appraisals for customers. Ameriquest centralized appraisals after it closed its retail branch network. The company uses a "preferred panel" of licensed appraisers with at least five years' experience. All appraisals were submitted electronically, in a portable document format, in order that "none of the data could be manipulated." The appraisals were "run through a series of rules to make sure" that the appraiser was using the correct comparable sales, and only about 30% of appraisals were reviewed by in-house appraisers prior to funding. Furthermore, salespeople have "no influence" on the appraiser panel's makeup.

Dealing with a "Bad Apple"

Ameriquest alleged that it was "a nationwide lender and our goal is to continue to lead the industry through best practices and to provide superior products and services". The company's top management stated that "We hold ourselves to the highest standards and ethical practices, and do not tolerate unethical or improper behavior by our employees or by our vendors."

The company stated that it actively monitors employees for fraud or misrepresentation, and that it immediately terminates those who fail to comply. New employees were required to take an ethics test during their orientation training. Appraisals were monitored by a centralized appraisal department, and Ameriquest said that they were reviewed by an automated process.

Mr. Mital said in an interview: "There were instances [of abuse], and we dealt with those right away. If somebody bends the rules, then we get rid of those people and immediately go back and ... [find out] if there was any customer who had been treated unfairly. "

The top management said that they preferred informal resolutions. "Basically, if you see a problem, what's the point of resolving the matter in court? You try to reach a reasonable resolution."

In 2004, company launched an anonymous whistle-blower policy to help it identify quicker when employees were not doing the right thing. Under this policy, the independent loan closer was to provider a written report both to designated Ameriquest Party senior management, and also to the Monitor during the compliance monitoring period, If he or she discovered any unfair, deceptive, misleading or unlawful behavior by any Ameriquest employee in connection with any loan, or if the Closer failed to report such misconduct, then Ameriquest should take disciplinary action against the Independent Loan Closer, including the temporary or permanent removal of their name from the list of approved Independent Loan Closers.

Internal Auditing and Monitoring

One of Ameriquest's loans was called a "stated income" loan. For this product, the borrowers just had to declare their income. The product is originally designed for highly-paid-professionals whose incomes fluctuate. However, this product was used by Ameriquest loan officers to push up borrowers' income.

The applicants just needed to declare their income on the application and write a letter in their own handwriting stating their income and job. Renne Deane, an Executive Vice President, who was in charge of Ameriquest's due diligence, credit issues, and investor relations said that the company applies a "reasonability test" to determine reasonableness and accuracy of input. A quality assurance unit then went back and audited "up to 10% of Ameriquest production" after funding. Securitizers refused less than 5% of the loans out of pools on account of appraisal problems.

External Control

The mortgage industry is regulated by State Banking and Finance Agencies throughout the United States. Most States require mortgage lenders to be licensed. The well-known laws and regulations include the Home Mortgage Disclosure Act (HMDA), the Truth in Lending Act, and Fair Credit Reporting.

The usual procedure is that consumers file complaints to the Department of Banking (or other banking agencies) about certain unethical or unfair practices. The agency then reviews such a case, and decides whether to investigate the business involved. If the result proves wrongdoings, then the company will be liable a penalty, which could include the suspension of its license.

From 2000 to 2004, consumers filed 134 lending complaints against Ameriquest to the California Department of Corporations. An investigation was instigated to verify these charges.

In Washington's Department of Financial Institutions, allegations were investigated by the Attorney General, and the outcome was transferred to the Department's enforcement division.

In the San Francisco civil suit, Ameriquest was charged with failing to make the required disclosures to borrowers, with falsifying borrowers' income amounts on loan applications and with saddling borrowers with bigger payments than they could afford.

In Connecticut, from 2005 to 2007, 179 customers accused Ameriquest of excessive financial charges and $670,000 was paid out in refunds and penalties to settle these cases.

According to the DOB, in 2003 and early 2004, Ameriquest re-financed 16 mortgages and charged prepaid finance fees that were aggregated with the prepaid finance charges imposed in previous financing, and "within two years of the current refinancing, this exceeded either $2,000, or 5% of the principal amount of the initial loan."

In late January, 2004, Ameriquest settled with the State on these allegations, and agreed to the sanctions and to paying a civil penalty. However, the DOB noticed that after the initial settlement, Ameriquest funded yet another 38 loans with prepaid financial charges in excess of 5% of the principal loan amount.

In December, 2014, a letter was sent to Ameriquest. In this letter, Ameriquest was required to “show compliance with all lawful requirements as a condition for the retention of its first and secondary mortgage lender/broker licenses." However, once again, Ameriquest failed to comply with the requirement. As a result, the State revoked Ameriquest’s license to fund loans.

Furthermore, in May, 2006, Connecticut Department of Banking proposed that 24 lending licenses held by Ameriquest and a subsidiary should not be renewed, which meant that Ameriquest had to stop offering loans in Connecticut. The company also faced more than $5.5 million in additional penalties.

All these individual State investigations finally led to a multi-State settlement. One element of the Ameriquest settlement particularly addressed the external control of the appointment of an independent monitor and compliance committee for a period of five years. The independent monitor was to oversee Ameriquest’s compliance with the settlement terms and was given broad authority to examine Ameriquest’s lending operations, including its access to documents and personnel. The Monitor then had to submit periodic compliance reports to the Attorneys General during the next five years. Ameriquest had to pay the Monitor’s costs.

Technical Control

The Empower System

In the mortgage industry, software systems are used by mortgage brokers to weed out applicants with a bad financial background and to fulfill sales quotas. Most mortgage companies uses automated mortgage software to increase loan processing speed.

The system used in Ameriquest is Empower. According to the developer, 24 of the top 100 lenders in the U.S. use some version of the system, including Accredited Home Lenders Holding Co. in San Diego; Fieldstone Investment Corp. in Columbia, Md., and; National City Corp. in Cleveland.

Ameriquest identified about 50 steps in a loan cycle where people had to physically handle documents and verify information. The Empower system allowed Ameriquest to automate about 30 of those steps.

However, speed came with a cost. There was a lack of queries by the system for support documentation. Manual loan processing typically requires key financial documents to be attached to the loan application all the way through the application. From application through to processing, underwriting and closing, different employees in different department each handle the physical copies of W-2 reports and paycheck stubs. “There was ample opportunity to even accidentally notice discrepancies in the financial study work provided.” a former Ameriquest employee said.

A lack of verification mechanism leads to an increased possibility of faulty business practices. With all the data managed electronically, employees at each stage of the loan cycle rely solely on the authenticity of the information provided by the Empower system. "The idea is that once the data is entered, it can be used again and again electronically without being touched or reviewed by others as the loan is processed." Ameriquest management called this “no-touch funding”. Once the income data and other supporting data are entered into the system, there is no routine in the system to question the entries, or to ensure its correctness and integrity.

This situation put no restraint on Ameriquest employees. Some loan agents and processors just changed the income field as they wanted to ensure that a loan would pass through the system without a problem. Therefore, many borrowers were approved for loans that would not otherwise have been approved at a higher annual interest rate.

"Ameriquest agents would use the software to qualify people for loans that they weren't qualified for in the first place, and were always two or three percentage points higher than they would have paid elsewhere," said a former Ameriquest employee who worked at an Ameriquest branch in Florida, who spoke on the condition of anonymity. "It was a standard operating procedure."

The SNAP System

In 2002, Ameriquest began to implement a new software system called SNAP for Sales Navigation and Accelerated Production in an attempt to seek greater control over how loan data was configured and managed in its system.

According to Ameriquest, the new system overlapped with Empower at the front end of the loan origination process, and it included a complete product and pricing engine that allowed agents to adjust rates and fees.

The web-based SNAP system added new safeguards such as standardized pricing and automated checks for appraisals for the loan cycle. It incorporated rules for the loan pricing into software and limited the ability of sales representatives to arbitrarily raise interest rates or points. Ameriquest hoped to use this program to enforce "fair and uniform loan pricing, to validate appraisals and to enforce the distribution of legally required disclosure document to consumers".

"SNAP does everything that Empower doesn't," Ameriquest management said. It does more than merely recording loan applications. It can also help salespeople track contacts and sales leads, and selects the right loan product for the customers.

Empower remained the dominant system in Ameriquest's underwriting department, while sales offices primarily used SNAP.

Summary

No mortgage loan is approved without a processor; and no processor makes a loan without running the applicant's personal and financial background. The mortgage industry is a human-oriented business. We cannot design the perfect system in a human-oriented process.

Ameriquest learned a hard lesson through this multi-state settlement. Ameriquest adopted a very progressive stance, focusing on "sell, sell, sell…", which forced salespersons to proceed without thinking about "what best suits the customer". The company's IS security system failed to provide a control mechanism, either internal or external, to monitor or disciple its employees. The technical control system just facilitated employees' wrong-doings. In the end external regulators had to be involved to solve the problem.

It is really hard to say that just one factor caused the failure and that a tragedy happened in the case of Ameriquest Mortgage Company. The multi-State settlement provides a wealth of useful and insightful suggestions and solutions for the mortgage industry, which also provides a foundation for other industries to examine closely.

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