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CHAPTER 3

Organization of Mortgage Loan Departments of Life Insurance Companies

THE principal difference among life insurance companies in the organization of their urban mortgage loan departments lies in the way they acquire new business. Some companies obtain all, or a major part, of their new loans through a system of branch offices; others acquire them mainly from outside correspondents. In discussing the organization of loan departments and the manner in which portfolios are administered it will be necessary, therefore, to describe these two general operating plans in some detail. First, however, differences in the size of company portfolios, and in the broad types of loans that compose them should be considered, since these have an important influence on lending organization, whether the branch office or correspondent system, or some combination of the two, is used.

Relation of Amount and Type of Investment to Lending Organization

There are differences in organizational plans and operating procedures, depending mainly on the size of the portfolio being handled, even among companies following one or the other of the principal methods of acquiring mortgages. Clearly, a company that holds no more than a half dozen mortgages, as is true of a large number of small insurance companies, will conduct its lending activities differently from one with an investment of $100 million or more in urban mortgages. In the first case, mortgage lending will be merged with the other investment activities of the company; in the second the lending will be conducted through a special department with highly specialized personnel.

Accordingly, in considering the problem of department organization, the wide differences existing in the size of company portfolios should be noted. As was indicated in Chapter 1, sixteen of the sixty-eight companies having total admitted assets of less than $1 million in 1945 held no mortgage loans and of the thirty-seven companies in this size class that reported separately on urban mortgages, twenty-one had less than $100,000 so invested. At the same time, of the twelve companies with total assets of $1 billion or more, seven had urban mortgage loan investments of from $100 million to $200 million.

In addition to the size of a company's portfolio, the types of loans composing the investment exert a powerful influence on lending organization. In this respect, also, companies vary widely. Data on the types of urban mortgages composing individual company portfolios were reported on special schedules mailed to all life companies in June 1946. Companies were asked to indicate how their loan portfolios were distributed, as of the end of 1945, among Federal Housing Administration and the so-called "conventional," that is, noninsured, loans and to distribute the latter according to the property securing the loan, whether of the one- to four-family, five or more family, or nonresidential type. On the basis of returns from sixty-eight companies (holding nearly two-thirds of the urban mortgages of all insurance companies) certain generalizations can be made on the relation between the size and the composition of an individual company's mortgage loan investment.

First, companies with loan portfolios of less than $20 million limit themselves, with but very few exceptions, mainly to FHA loans and to conventional loans on one- to four-family structures. Second, companies in this same size class show a strong tendency to concentrate their activities either in FHA or in conventional lending. Some companies have achieved a nearly equal division of lending activities between the insured and the noninsured spheres, but this balance is infrequent in this size class. Obviously, the organization of a company's lending activity is profoundly affected by the types of loans in which it specializes.

Third, concentration on nonresidential lending is mainly characteristic of companies with portfolios of $100 million and over, and in some portfolios of this size, nonresidential lending accounts for the great bulk of activity. Finally, there are a number of cases among companies with the largest portfolios ($100 million and over), and among those with portfolios of between $20 million and $100 million, in which a broad diversification of loan types has been achieved.

To summarize, individual companies vary all the way from those that lend exclusively, or nearly so, on small residential properties on an insured basis (most frequently the small portfolio companies) to those whose portfolios consist mainly of large loans on income-producing properties of the residential and commercial type (mostly companies with large loan investments). Between these two extremes there are other companies (mainly those with intermediate- and large-sized investments) that follow a policy of broad diversification. The administration of the mortgage loan portfolio, and particularly the extent to which mortgage lending is separated from other investment activities, will naturally be greatly affected by these differences in type of business.

Correspondent *versus* Branch Organization

The correspondent system of acquiring and servicing loans means that a life insurance company has arrangements with outside individuals, or companies, called "correspondents," whereby proposals for loans are brought to the loan department's attention. In the investment banking sense, it is an arrangement for "finding" new business. In performing this loan-originating function, the correspondent may assemble needed information, may assist in completing applications and other necessary papers, and may aid the insurance company in making its decision on a loan application. Beyond this, the correspondent may service all, or certain, of the approved loans. In this capacity he collects interest and principal payments and forwards them to the insurance company, prepares necessary reports on the larger income-producing properties, and makes occasional field inspections.

In contrast, the branch office system is administered by company employees. Under this plan, company offices are established in selected cities, with responsibility for originating and servicing loans in a specified region. Although they may be located in the same quarters, the personnel responsible for lending activities operate independently of the insurance division.

In addition to the loans acquired through correspondents or branches, life insurance companies, like other types of mortgage lending institutions, also originate loans through their home office staffs and buy other loans from brokers or agents. The relationship of the latter to the insurance company is quite different from that of the loan correspondent, being of an *ad hoc* type, whereas the correspondent's relationship is expected to be continuous.

Often an insurance company acquires its loans exclusively through its home office staff and its system of correspondent relationships, or through its branch office system. To an increasing extent, however, companies are adopting a plan which is in effect a "cross" between the two arrangements. Under this system a company operates branches for its mortgage loan business and, in addition to loans acquired directly through these branches, others are acquired by each of the branches through local correspondents or brokers. In view of the widespread use of this combination plan, it will be interesting to discuss briefly the conditions which led to its adoption.

During the twenties, most of the larger insurance companies acquired their loans almost exclusively through correspondents who were remunerated for their services by a fee paid at the time of loan origination. In return, the correspondent was expected to service the loan while it was outstanding. This system worked satisfactorily as long as the volume of new loans was high, but when new loan volume declined after 1929, and almost stopped in 1932, the incomes of correspondents were sharply curtailed and many of them were unable to maintain the necessary staffs. As a result, insurance companies had either to subsidize the correspondents or to establish their own systems of loan servicing through branch offices. The problem was made more serious by an increasing proportion of delinquent loans and a rapidly mounting owned real estate account.

Various plans for remunerating correspondents were worked out. Agents were paid a flat monthly sum, depending on the number of mortgages being serviced, or fees were set at a percentage, often 5 percent, of collections. One estimate was that the payments would amount to about one-eighth of 1 percent on outstandings where income properties were concerned; presumably the rate would have been higher on smaller residential property loans.[1]

[1] This conforms in a general way with present levels of servicing fees, as indicated in Chapter 5, when account is taken of the differences in the general level of costs between the two periods.

After this depression experience, a number of the larger companies established their own branch systems. Sometimes this was accomplished quickly by directly employing certain correspondents. However, the shift to a branch office system was not so complete as in farm mortgage lending. In this field, almost all the insurance companies with large farm loan holdings now operate largely through branches.

The problem of selecting the most appropriate form of loan department organization is complicated by the fact that the merits of the two principal plans differ in the different phases of the lending cycle. In a period of active lending, when companies are aggressively acquiring new loans, there is naturally a high premium on the correspondent type of organization, especially in the field of large loans on income-producing properties. A branch organization is generally most effective when new lending is at a low ebb, since this is likely to be a time of relatively high loan delinquency and foreclosure. Under these conditions a company's primary interest is to maintain effective and continuous control over its mortgage investment, and this may ordinarily be accomplished most satisfactorily by company personnel. It is not surprising, therefore, that the recent rapid growth of urban mortgage lending has stimulated renewed interest in the correspondent system. Yet the lessons of the thirties have not been forgotten, which accounts for the maintenance by many companies of branch office systems.

Information on the extent to which the branch and correspondent systems were being used by insurance companies in the handling of their urban mortgage portfolios was assembled through a special schedule mailed to life insurance companies in 1946. Out of sixty-eight reporting companies, sixteen stated that they operated branches, and fifty-two indicated that their loans were acquired and serviced exclusively through correspondents and their own home office loan departments. Of the reporting companies operating branches, only two had extensive organizations. One had twenty-one branches and about five correspondents (exclusive of any *ad hoc* arrangements with other outside agents or brokers); the other had twenty-eight branches and about twenty correspondents. From these two cases, which represent the most extensive branch office systems among the responding companies, it appears that most of the business (possibly 80 percent) was acquired and serviced through salaried employees attached to the branches and the remainder through correspondents and other outside agents.[2] Of the remaining fourteen companies, seven had portfolios of $100 million or more and operated from two to ten branches, although the bulk of their business was acquired and serviced through correspondents. The other seven companies, with portfolios of from $20 million to $100 million, acquired and serviced a fairly high proportion—about 30 percent in a number of cases—through their home office mortgage departments. As would be expected, the companies with smallest portfolios depend most heavily on their home office staffs for the acquisition and servicing of loans.

Companies not operating branches naturally divide their mortgage lending between correspondents (or other outside agents) and their home office mortgage department. Some nonbranch companies, predominantly those with mortgage loan portfolios amounting to less than $5 million, do not use the services of correspondents. All loan acquisitions, and all servicing of outstanding balances, are handled by their home office staffs. Of course, this type of organization limits the scope of the lending, particularly since the insurance company, unlike the savings bank, commercial bank, or savings and loan association, does not aggressively pursue new business through direct advertising. The home office staff ordinarily has a more or less passive attitude and, consequently, a large volume of loans can be built up only through correspondents or branch personnel.

Regarding the proportion of mortgage loans of nonbranch companies handled through correspondents and other outside agents, the tabulations covering 1945 operations show that sixteen out of twenty-nine respondent nonbranch companies with loan portfolios of less than $5 million, and fifteen out of twenty-one nonbranch companies

[2] It is difficult to estimate these proportions, though it is easy to distinguish at the extremes between loans acquired through full-fledged corrrespondents having an established and continuing relationship with the company, and loans handled from origination through servicing by branch office personnel. It is not easy, however, to draw a line that clearly separates the two in all cases. Thus, some loans were acquired by branches from outside agents, who served only as brokers and did not necessarily have a continuing relationship with the company. Ordinarily, these agents merely sold loans singly or in groups, at a premium over their face amount and, unlike the correspondent, did not service loans on a continuing basis. In view of the difficulty of distinguishing between the two, the percentages expressing the distribution of loan acquisitions between correspondents and branches should be viewed only as rough approximations.

with portfolios of $5 million and over, acquired 70 percent or more [3] of their mortgage loans through loan correspondents. Of these same companies, eleven with small, and nine with large, portfolios had 70 percent or more of their mortgage loan balances serviced through loan correspondents. Other companies reported smaller proportions of their business taken care of in this way. As indicated above, nearly half of the small portfolio companies handled their entire loan origination and servicing functions through their home offices.

The situation was roughly similar in 1946, except that a somewhat larger proportion of companies with portfolios of $5 million and over depended on correspondents for the origination and servicing of 70 percent or more of their mortgage loans. This shift bears out the contention that the dependence of lending agencies on outside agents is highest during periods of loan expansion. The wish to build up new loan volume during periods of expansion, as well as to have a closely controlled and dependable organization for servicing loans during periods of contraction, has motivated companies to adopt the joint correspondent-branch type of system.

Aside from the question of branch *versus* correspondent organization, there are no striking differences in the setup and administration of insurance company mortgage lending activities. All companies, except those with very small portfolios, supervise operations through home office mortgage loan departments, generally separate divisions under the direction of a principal officer.[4]

The organization of these departments varies among companies but the differences are more in matters of detail than in broad policy and plan of organization. Each department includes the following principal functions: (1) formulation of broad mortgage investment

[3] No company reported that all of its loans were serviced by outside agents, but four out of twenty-one companies with mortgage investments of $5 million or more reported that all of their loans were acquired through correspondents or other outside agents. In general, the proportion of loans serviced by correspondents is the same as the proportion of loans acquired through outside agents. However, the number of correspondents servicing loans at a given time will generally be larger than the number of correspondents from whom loans have been purchased in the preceding year, since loan servicing is a continuing activity while loan origination is intermittent.

[4] The degree to which an insurance company centralizes its mortgage lending activities in a special department varies directly with the size of the company and with the size of its mortgage investment. However, even those companies with large mortgage investments differ in the extent to which the loan department utilizes facilities of other specialized divisions of the company, such as the legal department, the accounting department, etc. As will be seen in Chapter 5, this difference in company policy presents one of the major difficulties in making estimates of lending costs.

policies; (2) supervision of home office, branch, and correspondent personnel and operations; (3) consideration of all loan applications and formulation of recommendations for action by the company's finance committee; (4) maintenance of adequate records on all closed loans, including a record of payments of interest and principal and the necessary insurance and tax accounts; and (5) operation, when needed, of a real estate management department.

Handling Mortgage Loans

It would be impossible within the scope of this chapter to trace all of the steps taken in handling even a single type of mortgage loan, but in order to clarify some of the problems of measuring lending costs and of deriving the rates of foreclosure and loss, the main steps are outlined in this section. While there are differences among companies, depending mainly on the way in which they are organized to acquire and service loans and the type of loans made, a proposed loan brought formally to the attention of the home office department consists of the following documents: (*a*) a loan application made out by the borrower, which gives detailed information on the property and states the desired terms of the loan; [5] (*b*) a report on the loan prepared by the company's correspondent, agent, or branch or home office employee, which gives an appraisal and incorporates a recommendation for finance committee action; (*c*) a legal description of the property; and (*d*) photographs. Naturally, the record varies a good deal with the type of property involved. Essentially, however, the data presented give facts about the property, the neighborhood, and the borrower necessary for satisfactory completion of the risk-rating function.

Insured loans made on small residential properties are the simplest type. Here risk-rating virtually disappears and the concern of the lending agency is merely to see that the proposal qualifies under the rules of eligibility set down by the insuring or guaranteeing agency. Contrast this with a conventional, that is, noninsured loan on an office building, hotel, suburban shopping center, or apartment building. A careful analysis must give assurance that the lien can be satisfactorily established; that the property will produce sufficient income, even under straitened conditions, to meet the mortgage pay-

[5] An individual's application for a home mortgage will now generally include information about his income, employment, assets and liabilities, etc. However, the lender's preoccupation with the physical security means that most of the data refer to the property. This was even more marked in earlier years.

ments; that the property has been fairly valued; that the loan-to-value ratio and amortization provisions will give the lender an adequate margin of collateral value over the loan balance at all times; and that the interest rate, and such terms of the loan as length of contract and prepayment privileges, make the investment attractive from the viewpoint of handling costs and net return relative to the return available on other uses of the company's funds. Here we have every element of the risk-rating process.[6]

When all available facts pertinent to a given loan proposal have been reviewed, and when the officer in charge has determined that the loan should be made on the stipulated or revised terms, a recommendation to this effect is made to the finance committee, or to such other subcommittee of the company's directors as is charged with the responsibility for approving loans. If the loan is approved, all the legal papers are prepared and the loan is closed. The disbursement of funds follows immediately, and the necessary accounting records are then prepared. These records consist of an accounting card (now invariably a separate ledger card, which is, in some companies, processed in part by punch-card tabulating equipment) on which are recorded all payments of interest and principal, payments on insurance and taxes,[7] and notations concerning delinquency, loan contract modification, etc. From this record can be prepared periodic reports on new loans made, repayments on principal, interest and other income, delinquencies, foreclosures and real estate owned—the essential facts for the management of a mortgage portfolio.

Management of the owned real estate account is, of course, a separate element of company organization. Its problems are no different from those of real estate management by any other type of agency, except that the insurance company may be inclined to take a detached position, and generally has the property managed, on contract, by some outside agency.

[6] The risk-rating problem varies greatly from one type of property to another. There are excellent handbooks that deal with the process in great detail, particularly with the ever-changing problems of property appraisal.

[7] One of the notable lessons of the mortgage debacle of the early thirties was that the mortgagor could, to his advantage as well as that of the mortgagee, pay property insurance premiums and taxes through the latter. This avoids the unpleasant and generally unprofitable incident of foreclosing property on which taxes are long delinquent, or property destruction without adequate insurance coverage. Furthermore, the lender is more alert to trouble, since insurance or tax delinquency is frequently a forerunner of mortgage delinquency.