Citicorp's mortgage unit is bankrupt

Efforts to "grow" its way out of trouble by increasing speculative activities have proved disastrous.

Citicorp's home mortgage subsidiary has operated in such an "unsafe and unsound" manner that it is virtually bankrupt, according to a secret report by the Comptroller of the Currency, which was leaked to the *Wall Street Journal* and the *New York Times*.

The report, dated Aug. 18, found that the unit, Citicorp Mortgage, Inc., had negative capital of $80 million at the end of 1991, and that, despite an injection of $172 million in capital during the first half of 1992, the unit had equity capital of only $14 million on June 30, backing a mortgage portfolio of $24 billion.

The report paints a picture of an operation which was so desperate for short-term profits that it made loans which had virtually no chance of being repaid. "Historically, the mortgage banking credit culture focused almost exclusively on volume, sacrificing quality and saleability," the report said. "In an effort to become the nation's largest mortgage lender, Citicorp offered liberal non-traditional products, priced above the market." By offering loans with limited verification and minimal documentation, the comptroller found, Citicorp "attracted higher credit risk borrowers."

In other words, Citicorp was a haven for borrowers who had difficulty getting loans elsewhere and were willing to pay the bank a higher fee for their money.

The report excoriates Citicorp's management, saying that "mortgage banking activities have been inadequately supervised" and that "the board and management have neglected their responsibilities to correct identified problems and ensure that mortgage banking activities are conducted in a safe and sound manner." The report found that "Citicorp still struggles with basic mortgage banking operations" and that "management failed to correct major deficiencies cited in [comptroller] examinations and reports dating back to 1988." There are "serious issues warranting the attention of senior management" in "virtually all functional areas" of the mortgage operation, it found.

The comptroller's examiners, in checking the paperwork on mortgages issued by Citicorp, found "an inordinate number of missing documents" in the files. In addition, the comptroller's report found that Citicorp Mortgage had made errors in the escrow accounts of fully 25% of all the mortgages issued by the bank during January and February 1992. Escrow accounts involve a portion of the mortgage payments held by the bank to pay insurance and real estate taxes on the properties covered by the loans. The bank has reportedly promised to make corrections where necessary.

Overall, the report found, "inadequate supervison of this high-risk culture resulted in unsafe and unsound underwriting."

One consequence of Citicorp's mad rush into home mortgages, is that its mortgage servicing portfolio, the largest in the country, has a delinquency rate almost twice the mortgage sector's average, with the percentage of loans 90 days or more past due almost four times average. Some 12.74% of all loans are delinquent, the study found, a figure far higher than the 5% Citicorp reported at the end of the second quarter.

The behavior of Citicorp's mortgage unit was so outrageous that the Federal Home Loan Mortgage Corp., commonly known as Freddie Mac, refused in March to renew a contract for the purchase of mortgage loans from the bank. At the end of 1990, Freddie Mac had taken the unusual step of requiring that Citicorp "scrub" loans it wanted to sell to the agency. To "scrub" a loan, means to completely repeat a review of all the borrowers' qualifications, making sure that all documents are in order and that they meet the necessary credit standards.

The extraordinary move by Freddie Mac strikes at the heart of Citicorp's mortgage strategy, which is based upon collecting fees for servicing mortgages—collecting the payments from the homeowners and paying the taxes and insurance on the properties—rather than earning a profit from the mortgage loans themselves. Citicorp has the largest mortgage-servicing portfolio in the U.S., from which it earns considerable fee income.

Citicorp's strategy of making and selling as many loans as possible in order to maximize its fee income was devastated by Freddie Mac's move. According to the *Inside Mortgage Finance* newsletter, Citicorp issued only $4.5 billion in new mortgages in the first half of 1992, dropping it to 12th among U.S. mortgage lenders. As recently as 1989, it had been first.

In another setback to Citicorp, the General Services Administration has temporarily suspended the bank from bidding on government contracts, because the bank's Diners Club division had provided illegal gifts to a former GSA official. The government holds 750,000 Diners Club charge cards.