

# News

## TPG assists lenders with selling scratch and dent loans

### FEATURE

The mortgage lending landscape is changing — the market is contracting, margins are thinning and fraud is on the rise. Investors are already reporting an increase in repurchases.

As repurchase requests rise, lenders are struggling to make sure they are not losing the money they earned last year. Understandably, they want to keep their profits as intact as possible, and they will be looking for more sophisticated and more efficient ways of responding to repurchase requests without having to buy loans back.

As such, lenders may look to rid themselves of loans with mistakes when the loans don't make it through the original sale to their intended investors. Or, lenders may have already been required to repurchase these loans and are looking for another purchaser of them. Historically, as repurchases rise, so do scratch and dent loans.

The question remains, however, whether there exists an appetite for these scratch and dent loans. Surprisingly, the market for scratch and dents remains very strong overall, said representatives from a scratch and dent services company. Yet, they said,

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**— Arthur Prieston,  
TPG Chairman**

potential investors and their appetite change from month to month.

“Scratch and dent loans can be a useful way for lenders to get these mistake loans off their books,” said TPG Chairman Arthur Prieston. “Yet lenders must make sure they not only have a buyer for the loans, but the right buyer who will offer the best combination of price, service and dependability. The Prieston Group can assist clients in this process, helping to make selling of these loans a smoother experience.”

With a volume-driven industry such as ours, mistakes will occur. Commonly referred to as scratch and dent loans, these mistakes may happen for a variety of reasons. Some mistakes may be small, such as missed ratios or guideline requirements. Others, however, may be much more serious, including first payment defaults, valuation discrepancies and even fraud.

**Steve Cohen**, who works with scratch and dents, agreed that a wide range of reasons exist for a loan becoming a scratch and dent. Some loans may simply have small underwriting or documentation errors or the appraisal may have been too aggres-

sive, making the loan-to-value ratio too high. Others are loans that have defaulted or have been found to contain fraud.

Yet no matter the mistake, too many of these scratch and dent loans can be detrimental to a lender's business, making it imperative that they deal with such loans right away. In fact, **Mr. Cohen** estimates that about 2 percent of all originations may fall into the scratch and dent bucket for one reason or another. That number could even be as high as 5 percent.

Once a lender has decided to rid itself of scratch and dent loans, the process of selling them begins. The first step is finding interested buyers, which generally involves compiling the loan data and distributing it to potential interested parties. From there, potential buyers submit indicative bids, which are strong indications of the amounts buyers are willing to pay.

Once an indicative bid has been accepted, the buyer conducts due diligence on the loan (or pool of loans) and a final price is agreed upon. Assuming the loan information lenders submit is accurate, the indicative price can be close to the final price.

For larger lenders, the process can be fairly routine. Many of those companies have a capital markets desk and a trader devoted solely to scratch and dents. The next tier of lenders below the large ones, however, may find themselves unsure of how to handle scratch and dents.

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“They’re so busy getting their good loans sold that when they do have this fallout, they need a little help,” Mr. Cohen said.

That’s where TPG can help out. For TPG clients, the company can be a valuable resource in dealing with scratch and dent loans. In fact, TPG can assist lenders with scratch and dent loans in a number of ways — even if the reason the loan is being sold as a scratch and dent is not fraud related.

First, when a lender is TPG Approved, so are its loans. This approval, and the accompanying insurance, acts as an enhancement to the value of the loan being sold as a scratch and dent loan — regardless of whether the loan contains fraud. For example, if the loan didn’t have TPG’s insurance covering it, it might plausibly sell for 90 cents on the dollar. With the insurance, a loan that has the insurance, but is not an accepted TPG claim might see its selling price increased because the insurance carries value with it.

Second, if a loan is the subject of a repurchase request due to fraud and the claim has been accepted by TPG, our relationship with the lender automatically adds value by way of the assignment of proceeds. In other words, if a loan contains fraud and is sold as a scratch and dent, the buyer of the loan can receive the insurance proceeds, including any money TPG collects on behalf of the loan. The buyer may accept a lower selling price upfront, but it will receive all proceeds from the insurance and loss mitigation efforts.

Lastly, if a scratch and dent buyer is not interested in the insurance, TPG can work with the seller and buyer to work out a negotiated settlement that benefits all parties involved.

With the market’s current direction, TPG’s assistance will be even more critical. Not only is fraud on the rise in these changing conditions, but repurchases are increasing as well. In fact, some investors are now having their QC departments reviewing files with even more scrutiny to find any reason to put a loan back.

“There’s a lot of it out there and we don’t see it slowing down,” Mr. Cohen said. “The floodgates are open and these smaller lenders are going to need help managing the process.”

This increase in repurchases is a direct result of a tightening market, and an action that directly impacts lenders, especially those on the smaller side.

“They never know when someone’s going to tap them on the shoulder and say, ‘You still want to sell loans to us? You’ve got a million dollars in loans you need to buy back,’” Mr. Cohen said.

Despite the challenges, selling scratch and dent loans can help mitigate the cost and risks associated with doing business in a contracting market. The Prieston Group’s assistance helps mitigate this risk even further. ■