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Abstract: Offers a look at Ameriquest Capital Corp., a leading subprime mortgage lender in the U.S., based in California. Report that the company is owned by its only shareholder, Roland Arnall; Importance of advertising in Ameriquest's business strategy; Report that regulators are investigating Ameriquest's retail lending practices; Details of corporate strategy as described by Ameriquest executives; Comments of Aseem Mital, CEO of the umbrella group over Ameriquest's mortgage unit, on regulatory attention given to the company's activities.

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Under Scrutiny, Ameriquest Details Procedures

Despite its ubiquitous brand -- advertised everywhere from major league ballparks to this summer's Rolling Stones tour -- and its phenomenal growth since 2002, little is known about the inner workings of Ameriquest Capital Corp.

The nation's top subprime mortgage lender operates out of a 12-story high-rise in southern California, barely distinguishable from the others that dot Orange County's maze of freeways. Its sole shareholder is Roland Arnall, a Los Angeles billionaire who is reportedly in the running to become the next U.S.

ambassador to the Netherlands.

Until recently the highly secretive company relied largely on advertising to project its public image. Adam J. Bass, the senior executive vice president and Mr. Arnall's nephew, was the only executive who gave interviews. Those focused mainly on anti-predator legislation and the "best practices" his company has been promulgating since 2000, when it announced an agreement with the Association of Community Organizations for Reform Now.

But lately Ameriquest has been attracting unwanted attention. In March, American Banker reported that 25 attorneys general are investigating Ameriquest's retail lending practices. (Several more attorneys general have since joined the investigation.) And according to recent interviews with people involved, a potential settlement could top the record $484 million that Household International Inc. paid in 2002 to settle predatory lending allegations by regulators from all 50 states.

This month Ameriquest replaced its chief executive for the second time in a year.

To counter the allegations, the company's normally reticent executives -- many of whom had never spoken to the press -- agreed to give American Banker a glimpse of its procedures. In a series of interviews, they also laid out their volume-driven strategy, their take on the regulatory tussles, and their thoughts on going public.

STRATEGY

From 2001 to 2004, Ameriquest's mortgage production grew more than twelve-fold, to $82.7 billion, far surpassing the highest estimate of the subprime industry's growth in that period.

Most of the company's growth came from the wholesale unit, Argent Mortgage, which consistently undercuts the competition. Since December, when Scott Valentin, a Friedman, Billings, Ramsey & Co. Inc. analyst, began tracking average pricing on wholesale loans for a dozen major subprime lenders, Argent has consistently beaten the rest, by as much as 55 basis points.

Ameriquest says it stays competitive in wholesale lending in part by paying its account executives about 25 basis points less per loan than they could get elsewhere. The account executives make it up on volume, the company says.

"You pay your bills in dollars, not in basis points," said Aseem Mital, who recently became the CEO of ACC Capital Holdings, the umbrella company for the operating unit Ameriquest Mortgage Co. and Argent. (As the president of Ameriquest Capital, he had supervised Wayne Lee, the CEO of Ameriquest Mortgage, who abruptly resigned.) "Our people make more volume per employee than the rest of the industry, so even if they're getting less in basis points, in dollar terms they're making as much as the rest of the industry."

Jeff Gillis, Argent's executive vice president of operations, said it also hires inexperienced college-age workers, whom it trains in various functions. The program not only keeps costs low but also creates a bond between employees and the company, he said.

Argent gives salespeople the freedom to focus on sales, he said; the technology and back-office staff handle every other aspect of origination.

The undercutting has become increasingly acute in the last two quarters and caused competitors to complain. "They are clearly the aggressor," Countrywide Financial Corp.'s chairman and CEO, Angelo Mozilo, said in an April conference call.

Since mid-July 2001, Ameriquest has expanded its retail network by almost a third, to roughly 300 branches nationwide. Its call centers refer prospective borrowers to the branches and do not take applications, Mr. Mital said.

In this channel, the price competition is less intense, but "retail is a price-driven model as well," he said. "If you're not offering a good price, you won't do any volume. Rate is a factor. There'll be certain products where the retail price might beat the wholesale price."

Retail employees earn commissions commensurate with their counterparts at other nonprime lenders, because, unlike Argent's account executives, they perform more of the functions a loan officer would typically handle at a mortgage brokerage, Mr. Mital said.

Ameriquest raised its public profile out of necessity. Before mid-2003, when the government tightened restrictions on which customers companies could contact with the do-not-call registry, it got in touch with prospects through telemarketing. However, faced with the elimination of its means of contacting consumers, it decided that the best way to attract them was television.

Kevin Morefield, the executive vice president of strategic planning, said Ameriquest's advertising, which began in 2001, has generated leads "monthly in the hundreds of thousands" for its retail branches. He also said that leads "have grown probably three- or fourfold" in the last year.

This growth has not been cheap. According to TNS Media Intelligence, Ameriquest had the biggest ad budget among mortgage companies last year, with $126 million; Argent came in eighth, with $18 million. Mr. Morefield said about a third of the marketing budget is branding-related, while the rest is purely lead generation.

Ameriquest's retail back office has a central location in Orange, while Argent has three processing centers, each in a different time zone. All four are organized in assembly-line fashion, which "speeds up the process" and provides efficiency, Mr. Mital said. Employees working on a smaller number of dedicated tasks tend to be easier to train and work faster, he said.

The workers are organized in groups of eight to 10, with each person performing a certain number of functions, such as data entry, underwriting, customer service, account management, and funding. Each team on the retail side handles loans from a fixed group of branches, while a wholesale processing team is assigned a specific group of brokers.

REGULATORY TROUBLES

In February -- two days before the Super Bowl, during which the company advertised heavily -- the Los Angeles Times reported that employees in its branch network and call centers had falsified borrowers' incomes and used bait-and-switch tactics.

Ameriquest disclosed the investigation by the attorneys general in a tersely worded bond filing a year ago, but few noticed it until American Banker reported it.

Iowa Attorney General Tom Miller, who heads the subprime lending task force of the nation's attorneys general, is leading the investigation into Ameriquest. This week he said the group would either settle with Ameriquest "soon" or sue it.

He said he did not "want to make any reference to where we might be on a number." But Connecticut Attorney General Richard Blumenthal said the $484 million Household settlement -- replete with major changes to the company's lending practices -- "could be a model" for what Ameriquest might have to pay.

The news of the investigation and the Times article led the Greenlining Institute, a prominent consumer group, to return a $100,000 donation from the company.

The regulatory worries do not end there.

A few years ago it was discovered that Ameriquest had resolicited Connecticut customers too soon for refinancing. In a Jan. 22, 2004, settlement with Connecticut Banking Commissioner John Burke, it agreed to pay $603,552 of refunds, an additional $500 to each borrower (totaling $62,000), and a $5,000 civil penalty to the state.

More recently the same problems surfaced again, and this time around the Department of Banking threatened to take away Ameriquest's license. The case is still pending.

Some state agencies, such as those in Georgia and Delaware, said they have not received many consumer complaints about the company. But Chuck Cross, a division director at Washington's Department of Financial Institutions, said the allegations in the Times article -- and the ones being investigated by the attorneys general -- were consistent with what he and other regulators have seen across the country.

Mr. Cross also said that even though his office has not produced a report on Ameriquest, the results from its last examination have been transferred to the department's enforcement division.

As of March 24, his office had collected 87 complaints against Ameriquest. Some dated back to 1997, but most were from the last few years. That compares with the 69 collected against Household, which HSBC Holdings PLC bought after the settlement. (Mr. Cross would not say if Washington was involved in the multistate investigation.)

Ameriquest is also in the midst of settling a four-state class action for about $50 million in a California court and has another case pending in Florida involving loans from that state and Illinois.

Importantly, the scrutiny has not affected Ameriquest's bond prices. According to Andrea Miller, an analyst at Bear, Stearns & Co., the spreads on Ameriquest's three-year ARM-backed securities against the one-month London interbank offered rate loosened by only 3 basis points from late February to mid-June, to 23 basis points. Subprime asset-backeds over all widened by the same amount during that period, to 22 basis points.

CONTROLS

Mr. Mital sounded frustrated by the flak his company is getting.

"There were instances [of abuse], and we dealt with those right away," he said. If "somebody bends the rules, we get rid of those people and immediately go back and … [find out] if there was any customer" who had been treated unfairly. "We're not about … having an aggressive sales culture."

He also admitted, though indirectly, that Ameriquest's lending was not foolproof. "We can't design the perfect system in a human-oriented process."

Tom Noto, Ameriquest's general counsel, said it prefers to settle cases where it identifies loan problems it has committed, and sometimes it is the first to identify the problems.

"We prefer informal resolutions," he said. "Basically, if you see a problem, what's the point of going to the mat in court? You try to reach a reasonable resolution."

His company's approach is "to look at the merits of the case and, if things didn't go according to our procedure, step up to the plate and address it," Mr. Noto said. "You try to run a zero-defect business. Not everybody can do that, and when you don't, you step up."

Two of the practices the attorneys general are investigating involve stated-income loans and appraisals.

Renne Deane, an executive vice president, oversees Ameriquest's due diligence, credit issues, and investor relations. For stated-income loans, she said, it has the applicants fill their incomes on a 1003 form and then "write a letter in their own handwriting stating that they make X amount of dollars per month or per year, and whatever specific job that is."

The company then applies a "reasonability test" to determine whether the stated income makes sense for the job and the region where the person lives, she said.

Ameriquest began making interest-only loans in March after "looking very hard at the product," Ms. Deane said. It makes the loans with only five-year interest-only periods, to avoid payment shock, and it requires a minimum FICO score of 620 or 700, depending on the loan. It also limits the loans to 20% of its production.

According to figures provided by the company, stated-income loans fell to 11% of retail production last year, from a high of 19% in 2003. Limited-documentation loans increased 4 percentage points, to 13% of retail originations; full-doc loans rose by the same amount, to 76%.

But the trend at Argent has been the opposite. The percentage of stated-income loans has doubled since 2001, to more than one third of wholesale production last year. Mr. Mital said the difference is a function of what brokers are selling, not of what his company is emphasizing.

"We can't drive that per se; we price … [stated and full-doc loans] just about the same" between channels, he said.

Ameriquest tends to introduce products through its retail channel first, Mr. Mital said. "Whenever you introduce something very new to you, the whole process is much more controllable on the retail side."

Ms. Deane said the company uses a "preferred panel" of licensed appraisers with at least five years' experience. They submit all their appraisals electronically, in the portable document format, so that "none of the data can be manipulated." The appraisals are "run through a series of rules to make sure" the appraiser is using the correct comparable sales, and about 30% of appraisals are reviewed by in-house appraisers prior to funding.

Further, salespeople have "no influence" on the appraiser panel's makeup, she said.

A quality assurance unit goes back and audits "up to 10% of Ameriquest production" after funding, Ms. Deane said. Securitizers kick less than 5% of its loans out of pools because of appraisal problems.

ADJUSTMENTS

It's clear Ameriquest wants to spend more time cozying up to customers and employees. Mr. Mital is shifting its growth strategy somewhat.

"Growth is not just about volume, but growing in customer satisfaction, how we serve communities, and keep our employees engaged and happy," he said.

To this end, a spokesman said, Ameriquest is looking at its compensation structure for originators to make sure it provides "incentives that support our best practices."

According to Mr. Mital, it not only will expand its "best practices" guidelines and try to further automate the mortgage process, but it also will focus more on customer service and keeping its employees happy.

Part of this will be by automating decision-making and providing more imaging technology to employees, which should speed up the mortgage process and "improve the flow of paperwork," he said. "Every three months we make an incremental jump. We've already added quite a few imaging capabilities to our branches."

Ms. Deane said that last year, at Mr. Lee's behest, she consolidated quality control, post-funding, appraisal, and other "high-risk" functions, so "we could get much quicker visibility on positive or negative trends."

It is also making consumer-friendly changes to the types of loans it offers. Ameriquest began making prime loans in December through a pilot test with Freddie Mac, and Argent will follow suit eventually.

This is being done to increase the percentage of applications that end up being funded, Ms. Deane said.

The company's pull-through rate is only 10%, "so we're taking many more applications than we're actually pulling through… because we don't have products to offer them, so our goal is to be able to offer all products to all borrowers," she said.

So far Ameriquest has made about $48 million of loans through the pilot test, including about $10 million in April, Ms. Deane said. For now it sells them to Freddie on a servicing-released basis, because it cannot yet service them profitably.

Beyond the consumer-friendly aspect -- lower rates -- Mr. Mital said that the move into prime loans would help his company generate more home purchase loans, which are more plentiful than refis when rates are rising.

Mr. Noto said that last fall Ameriquest instituted an anonymous whistle-blower policy to help it identify more quickly when employees are not doing the right thing.

GROWING PAINS?

Ameriquest keeps the servicing rights on most of the loans it makes, and according to Jane Johnson, its head of servicing, the portfolio has doubled in the last two and a half to three years. At the end of last year it stood at $81.5 billion.

Last month the rating agency Fitch Inc. raised Ameriquest's servicer grade but also expressed concerns about the expansion.

Kathleen Tillwitz, a Fitch analyst, wrote in a report that it is unclear how well and how quickly Ameriquest can get its new Schaumburg, Ill., servicing center up to speed to handle continuing growth. She is also concerned that, with the percentage of adjustable-rate loans in the servicing portfolio rising to about 70% this year, the company will have problems with defaults when rates rise.

Ms. Johnson said it opened the Schaumburg center in February and another in Rancho Cucamonga, Calif., in November 2003 to complement its main operation in Orange because it anticipated rapid growth three years ago.

Additionally, "we hire 60 to 90 days ahead of the curve in several of our areas," including "customer care" representatives, she said.

Ameriquest's three servicing centers operate in a "blended environment," which means that they handle calls from all over the country, so the company can shift calls to another center if one or more temporarily shuts down, Ms. Johnson said.

She said she wants the customer service employees to be more "flexible" than they typically are in the industry. Example: unlike many other servicers, Ameriquest does not have its customer service staff read from scripts.

Helping borrowers work out their payment problems has become more important as subprime servicers have come under scrutiny. Ameriquest's "home retention" department, which tries to work out problem loans, has boosted its head count over 350% in the past year, to 275, and the department expects to have 375 employees by yearend.

"We don't want to refer these things to foreclosure, so we have to have enough people in place to talk to every single person that calls," Ms. Johnson said.

Ameriquest is also "just now getting into the modification world," in which it alters a delinquent loan in ways such as by reducing its interest rate. It started making loan modifications in April, and a "few dozen" loans are in the process of being modified, she said.

Mr. Mital acknowledged that Ameriquest has considered going public, but he said that probably will not happen anytime soon.

"As one of the largest private [mortgage] companies, we like to keep our options open and are prepared to take advantage of capital markets opportunities," he said.

However, "there is no significant need for capital in the way we run our business today," Mr. Mital said. "We see a lot of the REITs that went out are still trading below their IPO price. Our securitization model continues to be strong. … It's better to be lean and efficient than to go raise capital because someone's willing to give it to you."

Not to mention that for now his company clearly has other pressing issues.

Price Leader
Ameriquest's wholesale unit, Argent Mortgage, consistently undercuts rivals

GRAPH: Price Leader: A-quality two-year ARMs

GRAPH: Price Leader: B-quality two-year ARMs

PHOTO (COLOR): Perspective: Mital says his company dealt with instances of abuse quickly.

PHOTO (COLOR): Noto says a "reasonable resolution" is better than "going to the mat in court."

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By Erick Bergquist

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