



## Laurentian Bank Plunges ~8% After Internal Audit Discovers Mortgage Documentation Issues: Time to Sell?

### Description

**Laurentian Bank** ([TSX:LB](#)) plunged nearly 8% in a single trading session following news that an internal audit discovered “identified documentation issues and client misrepresentations” in a handful of mortgages that were sold. The \$89 million worth of “compromised” mortgages represented approximately 5% of total mortgages, which were sold to a third-party buyer that remains unknown.

The unfortunate news was revealed by Laurentian in its annual report released on Tuesday, so the incident appears to be an honest mistake and nothing like the **Home Capital Group Inc.** debacle that happened earlier in the year.

“No employees were implicated in any misrepresentations, and the documentation issues appear to have been unintentional,” said Laurentian.

As an investor, it’s notoriously difficult to tell what insiders were really thinking when large accounting issues occur. Fortunately, in Laurentian’s case, the issue was spotted in an internal audit, so that likely rules out a management team that’s acting in an immoral manner.

Although the “misrepresentations and documentation issues” appear to be accidental, the incompetence of management is also nothing to get too excited about if you’re thinking about bottom fishing after a decline, which I believe will continue over the coming weeks.

### Where there’s smoke, there’s usually fire

With companies that are conducting fraudulent activities, the first sign of problems is usually just the tip of the iceberg, but in the case of Laurentian, no fraud appears to have taken place; however, the honest mistake will lead to a larger audit, which could reveal that the issues dig a lot deeper than originally anticipated.

Laurentian plans to conduct “an in-depth review of the mortgages originated in its branch network that have been sold to the third party,” which could reveal an estimated \$124 million in “compromised” mortgages. There’s no way to know if these numbers are conservative or not, so we’ll just have to wait

and see what the audit will reveal. If it shows more than \$124 million in additional “problem” loans, shares of Laurentian could be heading for another plunge.

In an age where white-collar fraud is disturbingly high, it’s important to remember that large-scale honest mistakes are still possible. It’s unfortunate, but fortunately for investors, it’ll likely be short-term pain that will pass in time.

### Bottom line

I’ve never been a huge fan of investing in Canada’s smaller, regional banks. The Big Five banks are safer, and the yields are in the same ballpark, so I see no reason why the average investor would opt for such a bank [unless it’s trading at a significant discount to its bigger brothers](#).

Laurentian’s valuation is [in line with its peers](#), even after the 7.89% plunge. I’d recommend sticking on the sidelines, because not only could the issues be deeper, but I think the company may have lost credibility with its investors after such an embarrassing mistake.

As Warren Buffett once said, “It takes 20 years to build a reputation and five minutes to ruin it.” Many investors may be heading for the Big Five after learning about Laurentian’s unpleasant surprise.

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