Chapter Objectives

- Identify historical events affecting today's mortgage industry.
- Contrast the primary mortgage market and secondary mortgage market.
- Identify entities involved in the primary mortgage market and the secondary market.
- Identify the regulatory agencies involved in mortgage lending.
- Discuss the seeds of the subprime mortgage crisis.

Brief History: Current Influences

- Political leaders and housing advocates
- Wall Street and investors
- Relaxed underwriting standards
- Unethical appraisers
- Unethical mortgage loan originators
- Over-reaching consumers
- No-doc mortgage products
Seeds of Today’s Mortgage Industry

- Early mortgage loans
  - Large down payment
  - Short-term
  - Balloon payment or refinance
- Federal Reserve Act of 1913
  - Created the Federal Reserve System
  - Allowed banks to make real estate loans
  - Implemented a system allowing government to influence interest rates
- Other legislation
  - Federal Home Loan Bank Act of 1932
  - Banking Act of 1933 (Glass-Steagall) created FDIC
  - National Housing Act of 1934 created FSLIC

Seeds of Today’s Mortgage Industry

- Federal Home Loan Banks
  - 12 regional cooperative banks
  - Expand credit opportunities
  - Privately owned by members
- Federal Housing Administration (FHA)
  - Created in 1934 to offer mortgage insurance
  - Innovator of mortgage products/terms
  - Part of Housing and Urban Development
  - Largest insurer of mortgage loans
- Government-Sponsored Enterprises (GSEs)
  - Established by Congress as financial intermediaries
  - Federal Home Loan Banks, Fannie Mae, Freddie Mac

Primary Mortgage Market

- Mortgage: Written instruments using real property to secure repayment of a debt
- Primary market: Borrowers and lenders come together to negotiate terms for mortgages
- Commercial banks: Variety of financial services
  - Historically demand deposits
  - Regulation now allows more low risk mortgage loans
- Savings and Loan Associations (thrifts): Specialize in savings deposits and mortgage loans
  - Traditionally major real estate lender; long-term, low-interest loans
  - S & L crisis of 1980s led to massive restructure
Other Primary Market Lenders

- Credit unions: Cooperative financial institutions owned and controlled by their members
- Finance companies: Specialize in making higher-risk loans at higher interest rates
- Mutual savings banks: State-chartered banks that are owned by depositors (thrifts)
- Portfolio lending strategy:
  - Financial institutions keep and service mortgage loans
  - Maintain as part of investment portfolios
  - Do not sell on the secondary market

Mortgage Banking Companies

- Mortgage banker: Company, individual, or entity that originates, processes, underwrites, closes/funds, and services mortgage loans
- Mortgage broker: Company or individual who, for a fee, places loans with lenders, but does not service such loans
  - Collect financial and other required information
  - Analyze income and debt for maximum mortgage amount
  - Explain available loan programs and loan process
  - Fill out loan application and provide required disclosures
  - Process loan file and submit to lenders
  - Assist borrower response and participate in closing

Secondary Mortgage Markets

- Private investors or government agencies that buy or sell real estate mortgages
- Established by federal government to moderate local real estate cycles
- Standardized loan criteria
- Purchased mortgage loans assembled into pools
- Mortgage-backed securities (MBS)
  - Debt obligations that represent claims to the cash flows (principal and interest) from pools of mortgage loans
  - Pass-through securities most common
### Secondary Market Participants

- **Federal National Mortgage Association (1938)**
  - Also known as FNMA or Fannie Mae
  - Largest investor in residential mortgages
  - Buys pools of conforming conventional, FHA, VA
  - Converts to guaranteed MBS
- **Government National Mortgage Association (1968)**
  - Also known as GNMA or Ginnie Mae
  - Pools federally insured/guaranteed loans; does not buy or sell
  - MSB carry full faith and credit of U.S. government
- **Federal Home Loan Mortgage Corporation (1970)**
  - Also known as FHLMC or Freddie Mac
  - Buys and pools, then actively sells MSB on open market
- **Fannie Mae and Freddie Mac**
  - GSEs under conservatorship of Federal Housing Finance Agency
  - Special authority to borrow from U.S. Treasury

### Secondary Market Standards

- Standardized underwriting criteria used to qualify borrowers and property
- Lenders conform in order to easily sell into secondary market
- Eliminates variations in loan quality, types of loans, and regional differences
- Create some confidence in quality of MBS
- Automated underwriting systems (AUS)
  - Streamline and standardize underwriting
  - Fannie Mae: Desktop Underwriter®
  - Freddie Mac: Loan Prospector®

### Financial Institution Oversight

- **Federal Deposit Insurance Corporation (FDIC)**
  - Independent agency created by the Congress in 1933
  - Insures deposits in banks and thrift institutions
  - Examines, supervises financial institutions for safety, soundness, and consumer protection
- **Office of Thrift Supervision (OTS)**
  - Division of U.S. Dept. of Treasury established in 1989
  - Supervises, charters, regulates federal thrift institutions
- **Office of Comptroller of the Currency (OCC)**
  - Charters, regulates, supervises all National banks and federal branches/agencies of foreign banks
- **National Credit Union Administration (NCUA)**
  - Charters and supervises federal credit unions
Financial Institution Oversight

- Federal Financial Institutions Examination Council (FFIEC)
  - Prescribes uniform principles, standards, and report forms for examination of financial institutions
  - Makes recommendations to promote uniformity
- Federal Housing Finance Agency (FHFA)
  - Independent agency created in 2008
  - Broad powers and authority over secondary markets
  - Merges Federal Housing Finance Board and Office of Federal Housing Enterprise Oversight
- State banking authorities also regulate financial institutions operating in their states

Present Day Mortgage Lending

- Lender desire to shift risk led to secondary market emphasis
- Relaxed qualifying standards led to less safe mortgage-backed securities
- Risky loan products offered to subprime borrowers
- Impact of subprime crisis, credit crunch continues:
  - Limited financing available for jumbo loans
  - Most high-risk loan programs no longer available
  - Risk-based pricing
  - Tightening underwriting guidelines
  - Restricted availability of mortgage insurance

Reform and Consumer Protection

- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 signed into law July, 2010
  - Significant impact on all aspects of mortgage industry
  - Most changes phased in over next few years
- Most significant titles for mortgage industry:
  - Title X-Consumer Financial Protection Act
  - Title XIV-Mortgage Reform and Anti-Predatory Lending Act
Consumer Financial Protection Act
- Broad authority for rules and enforcement
- Creates independent Consumer Financial Protection Bureau (CFPB)
- Supervision, examination, and enforcement over:
  - All insured depository institutions and credit unions with assets over $10 billion
  - All non-depository institutions that broker, originate, or service mortgage loans
  - Any other provider of consumer services at their discretion, with some exceptions

CFPB Regulatory Authority
- Consolidates consumer protection responsibilities currently handled by:
  - Office of the Comptroller of the Currency
  - Office of Thrift Supervision
  - Federal Deposit Insurance Corporation
  - Federal Reserve
  - National Credit Union Administration
  - Department of Housing and Urban Development
  - Federal Trade Commission

CFPB Enforcement
- Investigates and conduct hearings on violations of most consumer protection laws
  - May issue a cease and desist order
  - May pursue civil action
  - Can refer criminal cases to DOJ
  - Must refer potential tax law violations to IRS
CFPB Structure

- Offices:
  - Office of Fair Lending and Equal Opportunity
  - Office of Financial Education
  - Office of Service Member Affairs
  - Office of Financial Protection for Older Americans
- Units:
  - Research Unit
  - Community Affairs Unit
  - Complaints Unit
- Consumer Advisory Board

Mortgage Reform

- Title XIV-Mortgage Reform and Anti-Predatory Lending Act
  - Establishes new minimum qualifying standards and defines a new category of “qualifying” loans
  - Requires verification/documentation of borrower’s ability to repay
  - Establishes penalties for irresponsible lending

Mortgage Reform: QRM

- Financial institutions that securitize mortgage loans
- Maintain at least 5% economic interest
- Qualified Residential Mortgage (QRM) exempt
  - LTV at least 20%
  - 28 / 36 qualifying ratio
  - Not currently 30+ days past due
  - Not 60+ days past due (24 months)
  - No bankruptcy, foreclosure, short sale, deed in lieu, state/federal judgment (36 months)
Key Term Review

- Demand Deposits
- Disintermediation
- Federal Home Loan Mortgage Corporation (Freddie Mac)
- Federal Housing Finance Agency (FHFA)
- Federal National Mortgage Association (Fannie Mae)
- Government National Mortgage Association (Ginnie Mae)
- Government-Sponsored Enterprise (GSE)
- Mortgage
- Mortgage-Backed Securities (MBS)
- Mortgage Banker
- Mortgage Broker
- Mortgage Loan Originator
- Primary Mortgage Market
- Secondary Mortgage Markets
- Securitization

Summary

1. Mortgages are written instruments using real property to secure repayment of a debt.
   - Federal Reserve Act of 1913
     - Created Federal Reserve, established a charter for banks to make real estate loans, set up a way to influence interest rates
   - National Housing Act of 1934
     - Created the Federal Housing Administration (FHA) to insure banks against losses for defaults on home loans
   - 12 Federal Home Loan Banks (FHL Banks)
     - Established in 1932 as regional cooperative banks
   - The Federal National Mortgage Association
     - Created in 1938 as the first secondary market to address the problem of uneven supply of money for mortgage loans (also called Fannie Mae)

2. Primary market
   - Lenders making mortgage loans to borrowers
   - Includes commercial banks, savings and loans (S & Ls), savings and mutual savings banks, and mortgage companies:
     - Mortgage bankers may originate/fund/service loans
     - Mortgage brokers place loans with lenders
3. Secondary Market
   - Private investors and government entities buying and selling mortgages
   - Moderate local real estate cycles and standardize loan criteria
     - Fannie Mae, largest investor buying and selling mortgage-backed securities (MBS)
     - Freddie Mac issues MBS to investors
     - Ginnie Mae guarantees MBS for government insured or guaranteed loans

4. Oversight of the mortgage industry:
   - Federal Deposit Insurance Corporation (FDIC) insures deposits and examines and supervises financial institutions
   - Office of Thrift Supervision (OTS) supervises, charters, regulates federal thrift institutions
   - Office of Comptroller of Currency (OCC) charters, regulates, and supervises all National banks
   - National Credit Union Administration (NCUA) charters and supervises federal credit unions
   - Federal Financial Institutions Examination Council (FFIEC) prescribes uniform principles, standards, and make recommendations
   - Federal Housing Finance Agency (FHFA) legal and regulatory authority over the secondary mortgage markets

5. Subprime mortgage crisis led to:
   - Tighter qualification standards
   - New laws related to predatory lending
   - Fewer higher risk loan programs
   - More difficulties in obtaining financing
6. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
   - Significant overhaul of the nation’s financial laws
   - Title X-Consumer Protection Act creates a new Bureau of Consumer Financial Protection within the Federal Reserve that consolidates broad regulatory authority
   - Title XIV-Mortgage Reform and Anti-Predatory Lending Act addresses abusive lending practices
Chapter 1 Quiz

1. Which is NOT a function of the secondary markets?
   A. moderate effects of local real estate cycles
   B. provide lenders with money to make more loans
   C. serve as a depository for consumer assets
   D. standardize underwriting guidelines

Chapter 1 Quiz

2. The Consumer Financial Protection Bureau was created by the
   A. Federal Reserve Act.
   C. National Housing Act.
   D. Dodd-Frank Wall Street Reform and Consumer Protection Act.

Chapter 1 Quiz

3. Which agency is conservator of Fannie Mae and Freddie Mac?
   A. Department of Housing and Urban Development
   B. Federal Housing Administration
   C. Federal Housing Finance Agency
   D. Office of Federal Housing Enterprise Oversight
Chapter 1 Quiz

4. Which is the largest secondary market participant?
   A. Federal Home Loan Mortgage Corporation
   B. Federal Housing Administration
   C. Federal National Mortgage Association
   D. Government National Mortgage Association

Chapter 1 Quiz

5. Mortgage brokers
   A. act as intermediaries between borrowers and lenders.
   B. originate and service mortgage loans.
   C. provide funding for mortgage loans.
   D. underwrite mortgage loans.

Chapter 1 Quiz

6. What was established in 1932 as a cooperative to finance housing in local communities?
   A. Federal Home Loan Mortgage Corporation
   B. Federal Home Loan Banks
   C. Federal Housing Finance Agency
   D. Government National Mortgage Association
Chapter 1 Quiz

7. Which is NOT a primary lender for residential properties?
   A. commercial banks
   B. insurance companies
   C. mortgage companies
   D. savings and loan associations

8. Which statement about Ginnie Mae is TRUE?
   A. Ginnie Mae buys loans from commercial banks and mortgage companies.
   B. Ginnie Mae is a government-sponsored enterprise.
   C. Ginnie Mae is a participant in the primary market.
   D. Ginnie Mae sells mortgage-backed securities.