



## The Rising Role of the Independent Mortgage Bank — Benefits and Policy Implications

Today, independent mortgage banks (IMBs) are the primary source of single-family mortgage credit, particularly for low- and moderate-income families. This paper examines recent developments driving the growth of the IMB segment, the enhanced regulatory climate in which they operate, and suggests policy recommendations designed to ensure stability in the housing finance system.



# The Rising Role of the Independent Mortgage Bank — Benefits and Policy Implications

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Since the 1870s, independent mortgage banks (IMBs) have played a vitally important role in the U.S. housing finance market. Early mortgage banking helped finance the country's agricultural expansion into the Midwest, and later helped to fund the nationwide shift to single-family housing as new urban markets sprouted farther west in the 1900s.<sup>1</sup> Put simply, mortgage banking connects those with local market knowledge, and loan origination and servicing skills, with those who have investment capital to fund home mortgages. It is as true today as it was in 1900.

In 2017, there were nearly 900 independent mortgage banks, according to Home Mortgage Disclosure Act (HMDA) data. Those companies accounted for 16% of all HMDA-reporting companies, but originated 54% of 1-4 family mortgages, up from 25% in 2008 at the depth of the Great Recession.

Recent news stories suggest that the rising role of independent mortgage banks in today's single-family mortgage market is a new phenomenon with potentially major policy implications. However, a more thorough review of both the history and the current state of the market suggests both points are overstated. Below, we review the IMB business model, the current role IMBs play in the market, and the enhanced regulatory structure under which IMBs operate today. MBA recognizes that the growth of the IMB market share raises policy questions, but we believe those should be measured and premised on a sound understanding of IMBs' important function in our housing finance system.

## THE INDEPENDENT MORTGAGE BANK BUSINESS MODEL

Independent mortgage banks are non-depository institutions that use a combination of their own cash (typically 2-5% of the loan amount), plus short-term borrowings, known as "warehouse lines," to fund individual mortgages. The warehouse lines are short-term credit facilities secured by the funded loans until the loans are sold to an investor — typically in one to three weeks. In today's market, the vast majority of IMBs' loans are sold to larger lenders ("aggregators") or directly to Fannie Mae or Freddie Mac (the GSEs), or issued as securities guaranteed by Ginnie Mae. Aggregators include banks and other financial institutions that either hold loans in their portfolios or sell into the agency market. While some IMBs sell into private-label securitizations, that market remains a fraction of its size prior

to the 2008 financial crisis, accounting for less than 5% of the \$1.6 trillion of home mortgage originations in 2018.

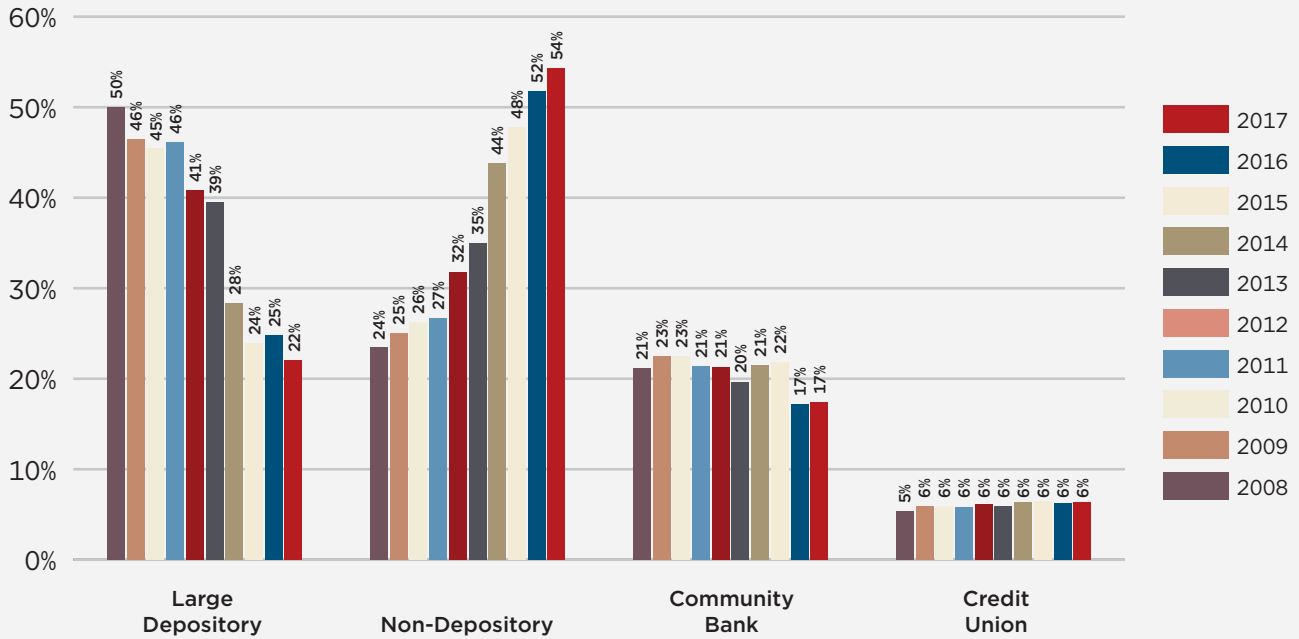
IMBs are typically "monoline" companies, predominantly focused on providing home mortgage financing, mortgage servicing, and other closely related services. They operate through all market cycles and across all delivery channels (retail, wholesale, and correspondent). Most IMBs are closely held private companies whose owners have made significant personal investments in technology and infrastructure — their success is tied to the success of the enterprise, providing "skin in the game" and strong incentives to manage the business for the long term. More recently, a few IMBs have grown large enough to secure backing from private equity firms, arrange larger and more sophisticated commercial financing facilities, and raise capital as publicly held companies.

## EVOLVING MARKET DYNAMICS — IMBs GAIN MARKET SHARE WHEN BANKS PULL BACK

As noted, IMBs have been around for more than a century. Their share of home mortgage lending has ebbed and flowed with broader developments in the market. Historically, independent mortgage banks have focused their lending on mortgages guaranteed by the Federal Housing Administration (FHA) and Department of Veterans Affairs (VA) — so, when government lending volumes rise relative to conventional and jumbo volumes, IMB market share climbs. In addition, IMBs gain share when depository lenders pull back from the mortgage market. For example, when many banks reduced their mortgage lending following the Great Recession — based on a variety of factors such as compliance costs, regulatory and reputation risks, and better profit margins in other lines of business — IMBs stepped into the void. Some large depository lenders retreated not only

<sup>1</sup> For a full historical review of the history and growth of the mortgage banking business, see "Mortgage Banking in the United States: 1870 to 1940," Dr. Kenneth Snowden, Research Institute for Housing America, [https://www.mba.org/assets/Documents/Research/RIHA/86099\\_13129\\_RIHA\\_History\\_Paper.pdf](https://www.mba.org/assets/Documents/Research/RIHA/86099_13129_RIHA_History_Paper.pdf).

**CHART 1: SHARE OF ORIGINATIONS VOLUME (#) BY COMPANY TYPE**



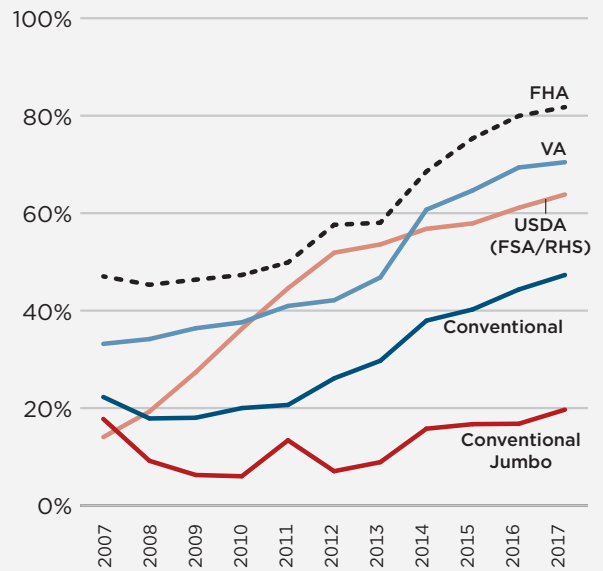
Source: Home Mortgage Disclosure Act (HMDA) data, 2008-2017

from government lending, but exited the mortgage market completely in the aftermath of the financial crisis.

As a result, since 2008, the IMB share of overall single-family origination volume (in units) climbed from 25% in 2008 to 54% in 2017 (CHART 1). In fact, by 2017, IMBs became the predominant lender segment in both purchase loans and refinances. In addition, since 2008, IMBs have gained significant market share in every loan type category – government (FHA, VA, and Rural Housing Service), conventional, and even jumbo. In 2017, IMBs accounted for more than 80% of FHA loans, 70% of VA loans, and 64% of RHS loans (all measured in units) (CHART 2).

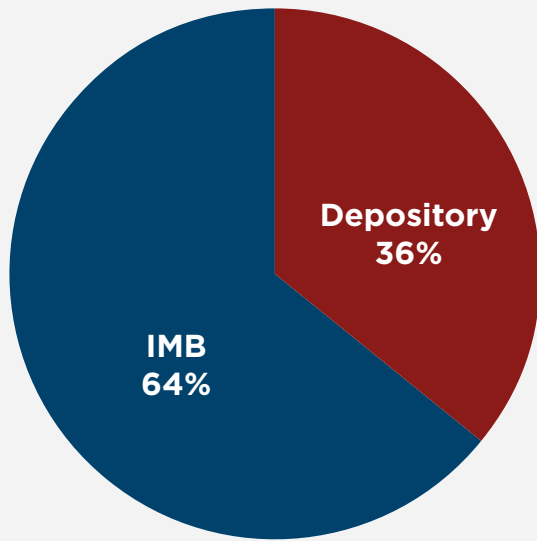
Given their market focus on government lending, it is not surprising that more than 64% of minority home buyers obtained their financing from an IMB in 2017 (CHART 3). Further, independent mortgage banks originated nearly 59% of all home purchase loans for low- and moderate-income borrowers (CHART 4). Finally, IMBs also tend to serve borrowers needing lower-balance loans. The average loan amount for home purchases in 2017 originated by IMBs was \$243,000, compared to \$280,000 for federally insured depositories (CHART 5).

**CHART 2: IMB SHARE OF ORIGINATIONS (#) BY LOAN TYPE**



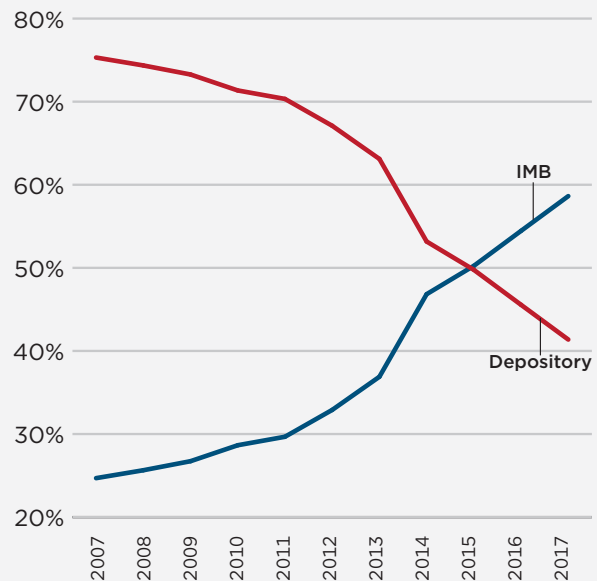
Source: Home Mortgage Disclosure Act (HMDA) data, 2007-2017

**CHART 3: SHARE OF HOME PURCHASE, OWNER-OCCUPIED ORIGINATIONS (#) TO MINORITY BORROWER BY COMPANY TYPE**



Source: Home Mortgage Disclosure Act (HMDA) data, 2007–2017

**CHART 4: SHARE OF LOW-TO-MODERATE-INCOME ORIGINATIONS (#) BY COMPANY TYPE**



Source: Home Mortgage Disclosure Act (HMDA) data, 2007–2017

The expanded role of independent mortgage banks has strengthened our housing finance system by bringing local market knowledge, diversifying risk across a larger number of lenders and servicers, and fostering greater competition and innovation. This is particularly true in the government lending market. In 2011, the five largest Ginnie Mae issuers accounted for more than three-quarters of single-family Ginnie issuance, and the top two lenders alone had 60 percent. Today, the top five lenders account for only 42 percent of originations. As a result, the mortgage market is exposed to far less concentration risk and more diverse business models.<sup>2</sup> Importantly, many of these new market leaders have been the leading innovators and investors in new technology.

### REGULATORY OVERSIGHT OF IMBs HAS STRENGTHENED SIGNIFICANTLY SINCE THE CRISIS

While IMBs’ role in the market has grown significantly over the past decade, the regulatory framework under which they operate has also been strengthened. Prior to the crisis, independent mortgage banks were licensed in some states, registered in others, and exempt from licensing in many. The supervisory framework for consumer protections was even more fragmented.

Most importantly, consumers were not consistently protected as regulation and supervision differed markedly by state and by the business model of the lender. Today, IMBs must comply with all of the same federal mortgage consumer protection rules that apply to depository institutions. Compliance with these consumer rules is subject not only to state supervision and enforcement (more below), but also to comprehensive supervision by the Consumer Financial Protection Bureau (CFPB), which has examination, investigative, and enforcement authority over IMB lending practices and consumer compliance.

Independent mortgage banks are now subject to licensing and supervision in every state in which they do business. The Conference of State Bank Supervisors (CSBS) significantly stepped up its role in nonbank supervision even before the crisis reached its peak. Under the auspices of the CSBS, IMBs now submit quarterly financial data and annual lending data to their state regulators. CSBS has also worked with state regulators to substantially enhance the frequency and rigor of state onsite examination programs for IMBs, including the use of multistate exams for larger IMBs. Through the use of the Nationwide Multistate Licensing System, the CSBS has developed methods for state regulators to easily share critical information about licensed entities, allowing states to coordinate supervision and track issues — bad actors and/or struggling companies — from state to state.

<sup>2</sup> Ginnie Mae 2017 Annual Report

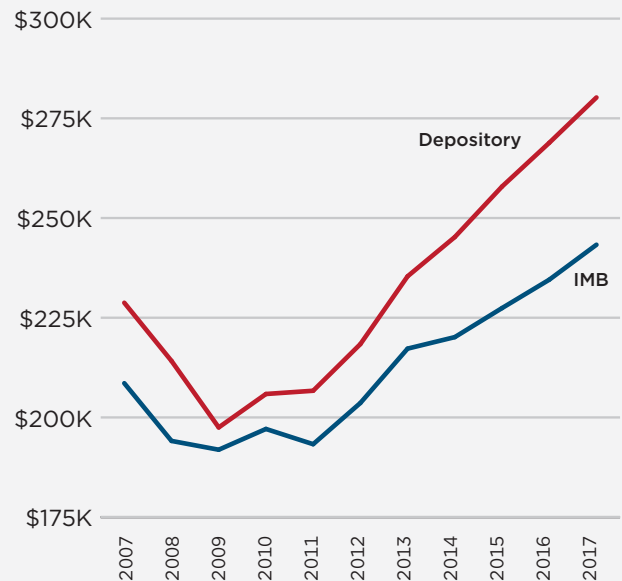




Just as states share supervisory information with each other, the CFPB and CSBS share information and coordinate supervisory activities.<sup>3</sup> While CFPB’s mortgage examination program is focused on larger IMBs, some multistate exams are conducted jointly with the CFPB and the states. The CFPB also examines many smaller IMBs, which are selected based on a variety of factors, including information from state regulators.

Finally, in addition to regulatory supervision by the states and the CFPB, IMBs are subject to counterparty oversight by Fannie Mae, Freddie Mac, Ginnie Mae, and FHA. Each agency/enterprise establishes minimum net worth and liquidity requirements for all approved lenders and servicers, and routinely monitors their performance. In the wake of the crisis, minimum capital and liquidity standards were increased substantially, and in 2015, Fannie Mae, Freddie Mac, and Ginnie Mae worked together to further strengthen the standards. Warehouse lenders also closely monitor IMBs for counterparty risk, as they will look to the independent mortgage banker and the underlying collateral to get repaid in the event of a default. Finally, independent mortgage banks are the only mortgage lending business model where all individual loan originators employed by the company are licensed and subject to continuing education requirements in each state in which they originate loans.

**CHART 5: AVERAGE HOME PURCHASE SIZE BY COMPANY TYPE**



Source: Home Mortgage Disclosure Act (HMDA) data, 2007–2017

<sup>3</sup> See <https://www.csbs.org/cooperative-agreements> for all of CSBS’s MOUs and cooperative agreements between the states and the CFPB.



## POLICY IMPLICATIONS OF RISING IMB MARKET SHARE

Such a shift in market share in any sector of the economy generates policy concerns, and even more so in financial services because of the potential for broader economic implications. Not surprisingly, a number of academics, think tanks, and regulators over the past year have raised policy concerns — some appropriate, but many overblown — about the rise of IMBs in the single-family housing finance market. Given the vital role IMBs play in serving middle- and working-class families seeking homeownership, any policy assessment of the issue requires a clear-eyed understanding of the housing finance system, not an overreaction based on unfounded fears.

Let's start by addressing several of the unfounded or exaggerated concerns:

### )] MYTH: IMB market share growth is new and unprecedented.

**FACT:** As noted previously, the IMB business model is time tested for over 140 years. The market share garnered by IMBs shifts in response to other market developments, such as the share of government lending and the appetite of banks for mortgage risk. The latter is particularly important. Bank interest in the mortgage business is driven by a multitude of factors, with a critical one being the relative return compared to that of other banking services. When banks pull back from mortgage origination and servicing, it is monoline IMBs that stand ready to fill that gap, effectively serving as a countercyclical force.

The current phenomenon is not new. For example, in 1995 the IMB market share reached 56%, up from just 35% in 1990, while depositories' share dropped from 65% to 44% over the same time period.<sup>4</sup> What is different from 1995 is that today's IMBs operate in a far more regulated environment, with routine exams, data reporting, and coordination among the states and with federal regulators. Counterparty standards imposed by the GSEs are also significantly more robust than those in the 1990s.

### )] MYTH: Unregulated IMBs are part of the risky "shadow" financial system where nonbanks are taking market share from regulated institutions.

**FACT:** First, as outlined in detail above, IMBs are subject to the same consumer-facing regulations promulgated by the CFPB as any other mortgage lender. They are regulated at the state and federal level, and are subject to rigorous counterparty oversight by FHA, Ginnie Mae, the GSEs, and warehouse lenders. This regulatory scrutiny and market discipline address not only compliance with consumer protection laws, but also financial assessments of capital and liquidity by counterparties with strong incentives to protect their own interests.

Second, this argument suggests that market share was unfairly "taken" by IMBs. In fact, depositories today continue to have some noteworthy advantages over their IMB counterparts — low-cost federally insured deposits, access to the Federal Reserve Discount Window and the payments system, access to Federal Home Loan Bank (FHLB) advances, and preemption of many state laws.<sup>5</sup> In fact, much of the market share shift was ceded by banks, many of which pulled back from the mortgage market due to a combination of important factors:

- Heightened regulatory risk from critical bank examiners, or overzealous consumer compliance enforcement by state and federal regulators;
- Excessive reputational risk arising from enforcement actions and litigation;
- Uncertainty related to the use of the False Claims Act to penalize FHA lenders for immaterial underwriting defects, or aggressive buyback demands from the GSEs;
- Punitively high capital standards on mortgage servicing activities; and
- Better returns in other lines of business.

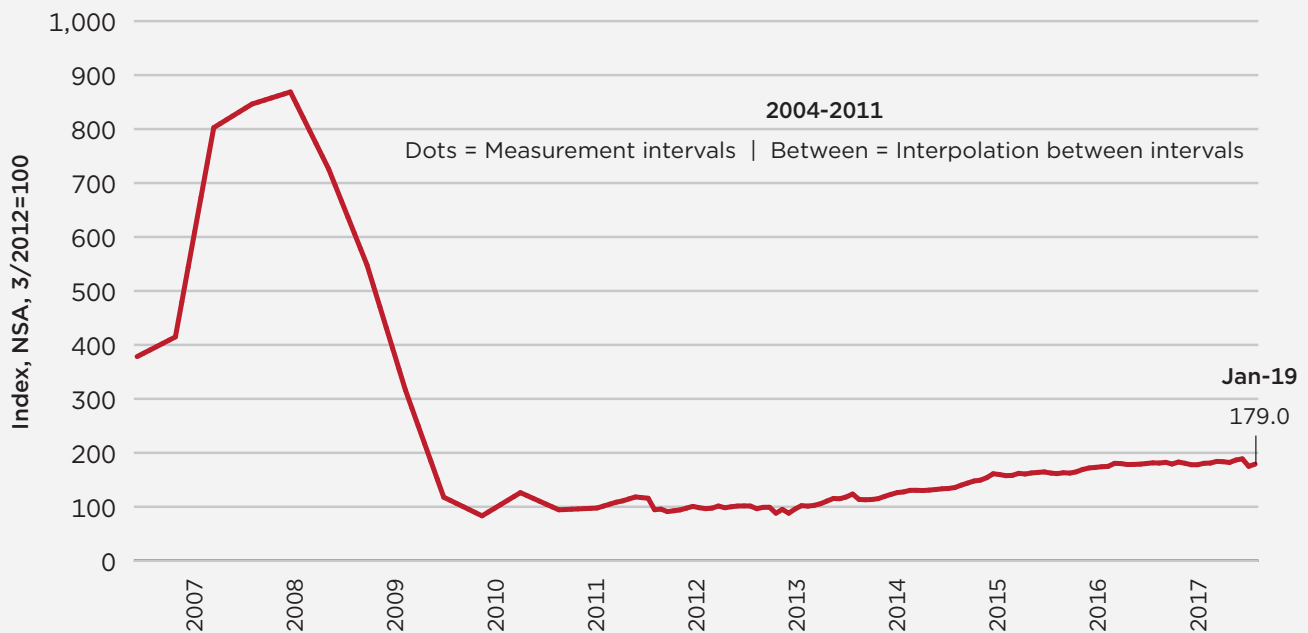
Policy reactions that seek to force market share away from IMBs offer no guarantee that banks will come back or that they will serve the same market segments as IMBs. In fact, such a move could undermine housing markets, not keep them stable.

Policymakers are rightly concerned that overly restrictive regulation of banks can push activity outside of the banking system. Unfortunately, this concern has been expressed vaguely with respect to "nonbanks," a catch-all category that sometimes is meant to include IMBs, but may more likely be focused on non-mortgage activities by hedge funds and other investment vehicles.

4 Housing Statistics of the U.S., Patrick Simmons, Editor, 1997 Bernan Press

5 These benefits do come with significant costs in the form of more burdensome regulation with respect to safety and soundness and other controls.

CHART 6: MORTGAGE CREDIT AVAILABILITY INDEX (NSA, 3/2012 = 100) EXPANDED HISTORICAL SERIES



Source: MBA, Powered by Ellie Mae's AllRegs® Market Clarity®

» **MYTH:** IMBs originate high-risk mortgages that threaten a return to pre-crisis days.

**FACT:** Because of their focus on the FHA, VA, and RHS programs, IMBs do originate loans that on average have lower credit scores and higher loan-to-value and debt-to-income ratios. However, these programs are designed to serve core populations that are the foundation of middle-class homeownership and wealth building. These agencies, not the IMBs, control the credit box, and there is little evidence of a return to the excessively layered risks that characterized the pre-crisis period. For example, while MBA's credit availability index has shown modest expansion in recent years, it remains well below the levels reached at the peak in 2006 (CHART 6).

Further, IMBs are subject to the same limits and restrictions on high-risk mortgage products as depository institutions (and even greater restrictions in those states that have enacted laws that go beyond the CFPB's rules). The CFPB's ability-to-repay and Qualified Mortgage (QM) requirements, Loan Originator Compensation and anti-steering rules, and fair lending and servicing requirements all apply equally to IMBs. Negatively amortizing adjustable-rate loans; loans with prepayment penalties; stated-income loans; and no-income, no-job, no-assets (NINJA) loans all represent high-risk products that have been largely eradicated from the market for banks and nonbanks alike.

» **MYTH:** IMBs pose taxpayer risks and systemic risk to the economy / financial system.

**FACT:** First, IMBs do not pose a risk to taxpayers in the same manner that banks do. Banks accept deposits, which are subject to federally provided insurance. In the event of a bank failure, the Federal Deposit Insurance Corporation (FDIC) ensures that depositors are made whole. If the FDIC's Deposit Insurance Fund runs dry, the U.S. Treasury provides funds to protect depositors. After the crisis, deposit insurance premiums were increased to replenish the Fund. IMBs, on the other hand, do not accept federally insured deposits and have no government backstop. If they fail, the owners of the company lose their entire investment. IMB counterparties, including governmental entities like Ginnie Mae, may face the risk of losses, but only in extreme cases of fraud or a severe economic crisis, and only after layers of private capital lose first.

Systemic risk occurs when the failure of one institution causes a cascade of failures across the financial system due to falling asset prices and counterparty exposures. The banking system throughout history has been subject to panics and financial crises as a result of this contagion. Even though banks provide warehouse financing to IMBs, it is unlikely that the failure of a warehouse customer could lead to a systemic crisis involving the entire banking system. Warehouse lines are short-term facilities secured by collateral, with the IMB having an equity position in the loans and a strong incentive to sell the loans



into the secondary market. Even at the depth of the Great Recession, well-run warehouse bankers stayed in the market and provided sufficient liquidity for IMBs from 2008–2010. Moreover, in today’s market, the vast majority of loans made by IMBs are high-quality loans eligible for sale into deep, liquid markets, making it unlikely that warehouse lenders will be saddled with large volumes of unsalable collateral.

Second, the Financial Stability Oversight Council (FSOC) has not identified the IMB sector as a systemic risk. FSOC first noted the rising share of IMBs in origination and servicing markets in its 2014 annual report. In that report, FSOC recommended that state regulators work together with the CFPB and FHFA to ensure strong oversight, but did not designate this issue as a systemic risk. FSOC has continued to monitor the sector each year thereafter. The 2018 annual report’s assessment of the mortgage market highlights the fact that residential mortgage credit standards (measured by average credit scores) and loan performance (measured by 90-plus day delinquencies) remain strong, even in the face of three major hurricanes in 2017.<sup>6</sup> None of the annual reports from 2014 to 2018 cite IMBs as a systemic threat, with only one recommendation focused on enhanced monitoring — which is reflected by the enhanced oversight

and coordination between CSBS and federal agencies noted above. The most recent FSOC annual report recommends that federal and state regulators continue to coordinate closely to “enhance data integrity, quality, and consistency, and to identify and address gaps in data collected on these activities.”

A recent academic paper<sup>7</sup> published by the Brookings Institution attempts to stir public concern about the rising role of non-bank mortgage lenders by suggesting that the recent market share gains by IMBs will sow the seeds of the next systemic risk event. The systemic risk premise of the Brookings study of IMBs appears significantly overstated. As noted previously, the vast majority of IMBs are small, privately held companies. The largest IMB in 2017 (Quicken Loans) originated an estimated \$86 billion in mortgages with a market share of less than 5%. The next five largest IMBs combined account for an 8% share.<sup>8</sup> Compared to 2006, just before the crisis, the three largest mortgage lenders — all banks — accounted for more than \$950 billion in mortgages for a 35% market share.<sup>9</sup> Similar trends exist for mortgage servicing markets — significant growth in IMB share, but much lower levels of market concentration than observed in the pre-crisis market.

6 Financial Stability Oversight Council 2018 Annual Report, pages 32–33

7 Kim, You Suk, Steven M. Laufer, Karen Pence, Richard Stanton, and Nancy Wallace. 2018. “Liquidity crises in the mortgage market.” BPEA Conference Draft, Spring.

8 Housing Wire, February 23, 2018, <https://www.housingwire.com/articles/42600-top-mortgage-lenders-see-originations-drop-in-2017>, and MBA data on total mortgage originations in 2017

9 Industrial Organization of the U.S. Residential Mortgage Market; U.C. Berkeley, [http://faculty.haas.berkeley.edu/walden/HaasWebpage/18\\_mortgageio.pdf](http://faculty.haas.berkeley.edu/walden/HaasWebpage/18_mortgageio.pdf)



Not only were pre-crisis markets highly concentrated, they included high volumes of very risky mortgage products. So, while IMB market shares have risen significantly, the concentration risk is sharply lower, and the credit risk profile of those loans is dramatically improved. While these are trends that should be monitored (and are being monitored), they do not suggest an emerging systemic risk to the economy. And as privately held institutions without government backing, IMBs do not pose direct risk to the taxpayer.

The systemic risk arguments presented by the authors of the Brookings study rest primarily on concerns about IMB reliance on warehouse lending, and their need for liquidity during a downturn to sustain servicing advances as delinquencies rise. These are important issues that raise policy concerns (discussed below), but do not rise to systemic concern. During the 2008 financial crisis, warehouse lending contracted substantially, and IMBs were put at a competitive disadvantage. This could occur again in a substantial downturn, but would be a consequence, *not a source*, of systemic risk. In other words, in a future liquidity crisis, while some IMBs could be a *casualty*, they are highly unlikely to be the *cause*.

## RECOMMENDATIONS TO ENHANCE THE STABILITY OF THE HOUSING FINANCE MARKET

As previously noted, the expanded role of independent mortgage banks has strengthened our housing finance system by bringing local market knowledge, diversifying risk across a larger number of lenders and servicers, and fostering greater competition and innovation. We recognize, however, that this shift brings new risks that need to be monitored and mitigated. However, in light of the central role IMBs play in serving middle- and working-class families seeking homeownership, policy responses must focus on addressing specific shortcomings, not reacting to unfounded fears.

While the systemic risk import of IMBs' larger role in today's mortgage market is overstated, there are some common-sense policy solutions that could add security and stability to the IMB sector at little cost to the taxpayer. Additional policy steps should also focus on making the origination and servicing of mortgages an attractive and stable market for any lender — bank or nonbank — that wants to devote investment capital to supporting homeownership.

Our housing finance system is strongest when the sources of capital are diverse, and risk-taking is predicated on stable loan products and sustainable underwriting. MBA recommends policymakers consider the following:

- Ensure that QM standards, as well as GSE and FHA/VA lending standards, remain focused on creditworthy borrowers and safe products. Ensuring sustainable, high-quality lending through these standards remains the best way to mitigate systemic risk arising from the housing finance market, as well as for insulating the market from external shocks.
  - Grant IMBs eligibility for the FHLB system, as access to FHLB advances (e.g., collateralized by MSR or servicing advances) will further strengthen the liquidity positions of IMBs while maintaining the FHLBs' core mission of supporting institutions that are demonstrably committed to housing finance. This would provide IMBs access to longer-term, stable sources of liquidity to supplement short-term warehouse financing.
  - Provide the government housing finance programs (FHA, VA, USDA, and Ginnie Mae) with the funding and resources needed to conduct thorough counterparty oversight, as well as to identify and respond to emerging risks. Enhancements to counterparty standards should be risk-focused, transparent and based on the size and complexity of the organization.
  - Ensure the mortgage servicing compensation regimes of the GSEs and Ginnie Mae preserve and support a deep and liquid market for mortgage servicing rights for servicers of all sizes and business models.
  - Further improve the value and liquidity of Ginnie Mae mortgage servicing rights (MSRs) by continuing to explore options discussed in the Ginnie Mae 2020 white paper,<sup>10</sup> including:
    - + Continued enhancements to the Ginnie Mae Acknowledgment Agreement to facilitate MSR financing and provide IMBs additional liquidity options;
- + Allowing direct MSR ownership by a wider range of institutions; and
  - + Allowing loan-level servicing transfers (i.e., allowing servicers to “split pools”), which Ginnie Mae believes could encourage more institutions to invest in Ginnie servicing.
- Standardize the servicing requirements at the government guarantors and clarify the nature of the liability that participation in their programs entails. This would increase the value of the MSRs on government loans and thus the “reserve” liquidity of all those that service them.
  - Make the mortgage market more attractive to banking institutions by:
    - + Reducing the punitive capital treatment of MSRs under U.S. bank capital rules that keep many banks from growing their mortgage operations; and
    - + Fixing the FHA False Claims Act enforcement that has driven many banks from the FHA program. Increasing bank participation in the government mortgage market also helps IMBs by supporting a deep liquid market for MSRs.

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<sup>10</sup> Ginnie Mae 2020: Roadmap for Sustaining Low-cost Homeownership, June 2018; [https://www.ginniemae.gov/newsroom/publications/Documents/ginniemae\\_2020.pdf](https://www.ginniemae.gov/newsroom/publications/Documents/ginniemae_2020.pdf)

## CONCLUSION

Independent mortgage banks have played a vital role in both our past and present housing finance systems. Over the past decade, IMBs have become the primary source of mortgage credit for the most critical sectors of the housing market — first-time buyers, working families and minority households. When measured against the bank market share in 2010 — a cyclical peak — the growth in IMB share sparks alarm in some quarters, but a longer-term perspective demonstrates that these market share shifts are not uncommon and are driven by a number of complex factors. While MBA recognizes that the growth of the IMB market share raises policy questions, we believe those should be measured and premised on a sound understanding of IMBs' important function in our housing finance system.

Importantly, regulatory arbitrage is not a primary driver here, as the post-crisis regulatory regime for IMBs has become quite robust, a process that began in the states even before the crisis in 2008. As policymakers assess the state of the housing finance system, they should avoid steps designed to “force” market share away from IMBs. Instead, MBA urges a focus on measures that will make the origination and servicing of mortgages an attractive and stable market for any lender — bank or nonbank — that wants to devote investment capital to supporting sustainable homeownership. We outline a number of such recommendations herein.





**MBA<sup>®</sup>**

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