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 continued growth of the IMB segment, explores the enhanced regulatory climate in which they operate, and suggests policy recommendations designed to ensure stability in the housing finance system.
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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.¹

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 2018, there were more than 900 independent mortgage banks, according to Home Mortgage Disclosure Act (HMDA) data. Those companies accounted for 18% of all HMDA-reporting companies, but originated 55% of 1–4 family mortgages, up from 24% in 2008 during the Great Recession.

Recent reports from academia, think tanks, and some regulators suggest that the rising role of independent mortgage banks in today’s single-family mortgage market is a new phenomenon with potentially significant systemic risk implications for the housing market or the broader economy. 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), 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 $2.1 trillion of home mortgage originations in 2019.

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, broker/wholesale, and correspondent). The majority of IMBs are closely held private companies whose owners have made significant personal investments in technology and infrastructure — their success is tied directly 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. By leveraging local market knowledge and relationships through their retail branch presence, IMBs tend to gain market share when the purchase market is strong and refinancing levels are lower. In addition, IMBs gain share when depository lenders pull back from the mortgage market. For example, when many banks

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reduced their mortgage lending following the Great Recession — based on a variety of factors such as compliance costs, regulatory and reputational risks, and better profit margins in other lines of business — IMBs stepped into the void. Large depository lenders pulled back sharply from the mortgage market (especially the FHA/VA market), and many community banks exited altogether due to excessive post-crisis regulatory cost burdens.

As a result, the IMB share of overall single-family origination volume (in units) climbed from 24% in 2008 to 55% in 2018 (Chart 1). By 2016, IMBs became the predominant lender segment in both purchase loans and refinances. IMBs have gained significant market share in every loan type category — government (FHA, VA, and Rural Housing Service), conventional, and even jumbo. In 2018, IMBs accounted for more than 82% of FHA loans, 68% of VA loans, and 66% 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 homebuyers obtained their financing from an IMB in 2018 (Chart 3). Further, independent mortgage banks originated more than 60% 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 2018 originated by IMBs was $251,000, compared to $288,000 for federally insured depositaries (Chart 5).
The expanded role of independent mortgage banks has strengthened our housing finance system by preserving and leveraging 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%. As of 2017, the top five lenders accounted for only 42% of originations. As a result, the mortgage market is exposed to far less concentration risk and more diverse business models.² 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.

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² Ginnie Mae 2017 Annual Report.
Most importantly, consumers were not consistently protected as regulation and supervision differed markedly by state and by the business model of the lender. Despite suggestions that they are less regulated, IMBs must comply with all of the same federal mortgage consumer protection rules that apply to depository institutions. And since passage of the Dodd-Frank Act, IMBs are now 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.

Today, independent mortgage banks are 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. Through its Vision 2020 plan, the CSBS continues to strengthen its supervisory framework and increase the frequency and rigor of state exams.

Just as states share supervisory information with each other, the CFPB and CSBS share information and coordinate supervisory activities. While the 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.

In addition to regulatory supervision by the states and the CFPB, IMBs are subject to rigorous 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. These steps allow IMBs to more easily obtain financing for their mortgage servicing rights (MSRs) or to sell them into a deep and liquid market. 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. The National Multistate Licensing System (NMLS) maintains up-to-date licensing information — including disciplinary actions — on nearly 600,000 loan originators employed by IMBs and other state-licensed mortgage lenders and brokers.

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3 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 several years have raised policy concerns — some appropriate, but many overblown — about the growth 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 concerns.

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 has been 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, between 1990 and 1995, the IMB market share grew from 35% to 56%, while the depositors’ share dropped from 65% to 44% over the same time period. 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 state and 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 levels, 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 pre-emption of some state laws. In fact, much of the market share shift was ceded by banks 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 responses 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. First and foremost, policymakers should assess the housing finance market holistically and evaluate those factors that have discouraged banks from participating more fully in the mortgage origination and servicing businesses.

In addition, all nonbank financial activities are not the same. 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. Policy responses should not lump all nonbank concerns into the same bucket.

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

FACT: In the IMB business model, it is investors — not the IMBs themselves — that establish the credit standards to which the IMBs originate. 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. These programs, however, 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 — a broad measure of the credit box that covers government, conventional, and jumbo underwriting standards — 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 imminent risks to the taxpayer and systemic risk to the economy/financial system.

FACT: First, with respect to taxpayer exposure, it is important to recognize that the costs of the failure of an IMB are typically borne only by the IMBs’ owners. 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 bank depositors are made whole. If the FDIC’s Deposit Insurance Fund runs dry, the U.S. Treasury provides funds to protect depositors. After a crisis where FDIC reserves are drawn low or the taxpayer backstop is tapped, deposit insurance premiums are 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 if an IMB fails, but only in extreme cases of fraud or a severe economic crisis, and only after layers of private capital lose first. This private capital includes the value of MSRs, which can be pulled from a failing servicer and transferred to a new servicer by Ginnie Mae or the GSEs.
Systemic risk, when the failure of one or more financial institution causes a cascade of failures across the financial system due to falling asset prices and interconnected counterparty exposures, is fundamentally different than the risk of failure of a single lender. The banking system throughout history has been subject to panics and financial crises as a result of this contagion risk. Some concerns have been raised that the rising role of nonbank mortgage lenders will sow the seeds of a systemic risk event. This concern about systemic risk, however, appears to be significantly overstated, particularly considering the post-crisis changes in the market structure, the IMB regulatory framework, and the counterparty steps already being taken by Ginnie Mae and other key players.

Trends in the decades-long growth in nonbank lending were highlighted in a series of articles in the FDIC’s Third Quarter 2019 Quarterly Banking Profile. The FDIC highlights that aggregate loans to nonbank financial companies (including REITs, private equity, hedge funds, commercial real estate debt funds, as well as IMB warehouse lines) grew from $50 billion to more than $440 billion between 2010 and 2018. This amounts to only 5% of the total banking system’s balance sheet loans, and warehouse lending to IMBs represents only a small fraction of that total. Although banks provide critical warehouse financing to IMBs, at the current scale it is highly unlikely that the failure of one large IMB, or a spate of small IMB failures, could transmit risk to the broader banking system at a scale that could lead to a systemic crisis.

The Financial Stability Oversight Council (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 concern. FSOC has continued to monitor the sector each year thereafter. In 2019, FSOC conducted a deeper dive into the IMB role in the single-family housing finance market, reflecting continued share growth by IMBs and the lack of indicators that banks are returning to the mortgage market in a significant way.

Notably, FSOC highlighted the important role IMBs have played in the market during a decade of retrenchment by bank lenders. IMBs have not only served key market segments for low- and moderate-income and first-time buyers, they also provided greater competition and additional liquidity for mortgage servicing assets, and spearheaded the adoption of new technologies in the market. At the same time, the 2019 report raises concerns about the reliance of large IMBs on short-term funding from insured depositories, and the risk that these lines could be pulled quickly in a crisis.

It is important to remember that warehouse lines are over-collateralized, and the collateral is almost entirely government-backed or GSE-guaranteed loans. Warehouse lending today is a low-risk business, with the IMB having an equity position in the loans and deep, liquid markets into which the loans can be sold. The 2019 FSOC report recognizes this,

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noting that bank warehouse “exposures are somewhat limited in size and are well-secured by collateral.” Compared to the pre-crisis era, the vast majority of loans made by IMBs today 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. In addition, IMB exposure to repurchase risks for origination errors has been significantly reduced through reformed representations and warranties by the GSEs, greater coverage certainty under private mortgage insurer policies, and technology developments that strengthen the validity of the borrower and collateral data supporting underwriting decisions.

The mortgage market is also far less concentrated than it was leading up to the financial crisis. As noted previously, the vast majority of IMBs are small, privately held companies. The largest IMB in 2018 (Quicken Loans) originated an estimated $80 billion in mortgages with a market share just over 5%. The next five largest IMBs combined account for less than a 10% share.\(^8\) 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.\(^9\) 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.

The systemic risk concerns evaluated by FSOC rest primarily on IMBs’ reliance on warehouse lending, and their need for liquidity during a downturn to sustain servicing advances as delinquencies rise. The IMB experience in 2008 may provide a good gauge of the potential risk of banks pulling warehouse lines en masse. At the depth of the Great Recession, many banks shuttered their warehouse lending operations, particularly those banks that were exposed to IMBs with large subprime operations and high volumes of unsalable loans and heavy repurchase obligations. Despite this challenging environment, enough well-run warehouse bankers stayed in the market and provided sufficient liquidity for IMBs to support a recovering market, including a 33% spike in single-family mortgage volume between 2008 and 2009, when mortgage originations increased from $1.5 trillion to $2.0 trillion. Although federal policy options to provide support for the warehouse market were explored, none were ultimately needed. Market innovations to speed warehouse turn times and new entrants to warehouse lending supported both a growing market and a growing market share for IMBs. Although a significant pull-back of warehouse lending could occur again in a substantial economic downturn, it would more likely be a consequence, not a source, of systemic event risk.

\(^8\) MBA Databook of Residential Mortgage Originations: 2018.
RECOMMENDATIONS TO ENHANCE THE STABILITY OF THE HOUSING FINANCE MARKET

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. At the same time, we recognize that this shift brings new risks that need to be monitored and mitigated. Considering the central role IMBs play in serving middle- and working-class families seeking homeownership, it is critically important that policy responses focus on addressing specific shortcomings, not reacting to unfounded fears.

While the systemic risk implications of IMBs’ larger role in today’s mortgage market are overstated by many market observers, there are some common-sense policy solutions that could add security and stability to the IMB sector with little exposure 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 and to insulate the market from external shocks.

- Allow well-managed IMBs that meet appropriate financial benchmarks to join the FHLB system, as access to FHLB advances (e.g., collateralized by MSRs or servicing advances) will further strengthen the liquidity positions of IMBs while enhancing the FHLBs’ core mission of supporting institutions committed to housing finance. This would provide IMBs access to longer-term, stable sources of liquidity to support advance obligations and to supplement short-term warehouse financing, particularly if the banking system curtails warehouse capacity due to a financial market stress event.

- Further improve the liquidity and value of Ginnie Mae MSRs by continuing to explore options discussed in the Ginnie Mae 2020 white paper, 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 will encourage more institutions to invest in Ginnie Mae servicing.

- Standardize the servicing requirements at the government guarantors (FHA, VA, and RHS,) and align them to the greatest extent possible with GSE servicing and loan-modification standards. This would increase the value of the MSRs on government loans and thus the “reserve” liquidity of all those that service them. Specific FHA servicing reforms should include:
  - Adopting a single foreclosure timeline and making curtailment of advances proportional;
  - Expanding the Claims Without Conveyance of Title program; and
  - Eliminating costly anachronisms like the “face-to-face” meeting requirement for delinquent borrowers.

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  - Expanding the Claims Without Conveyance of Title program; and
  - Eliminating costly anachronisms like the “face-to-face” meeting requirement for delinquent borrowers.
• 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.

• Make the mortgage market more attractive to banking institutions by:
  + Reducing the still-punitive capital treatment of MSRs under U.S. bank capital rules that keep many banks from growing their mortgage operations;
  + Ensuring better alignment between the federal banking regulators and CFPB on supervisory approaches to mortgage consumer protection rules in order to ensure consistent consumer protections market-wide and a level playing field for all market participants; and
  + Faithfully implementing the recently completed False Claims Act reforms to increase FHA lender certainty and attract more banks to the FHA program.

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 causes concern 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 coordinated 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.