

THE UBIQUITY OF IMB REGULATION

*Regulatory Creep Harms Small and Mid-sized IMBs -
and the Consumers These Small Businesses Serve*

IMB Consolidation = Less Competition, Higher Rates, Fewer Choices

Regulatory Creep is Not Justified by Taxpayer or Systemic Risk

**A CHLA Report Rebutting the Myths that
IMBs are Not Adequately Regulated or
Pose Systemic or Taxpayer Risk**

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THE MYTH: IMBs are Risky and are Unregulated

A cottage industry has sprung up in recent years in Washington dedicated to propagating myths that IMBs represent a significant financial, taxpayer, or systemic risk and that IMBs are not adequately regulated.

Bank executives warn lawmakers of lending risk among nonbanks.

[9/21/22] "JP Morgan Chase CEO Jaime Dimon said the migration of mortgage lending outside the banking sector carries risk, especially during an economic downturn. *It is riskier because the smaller companies cannot finance and advance funds to securitizations when there's a crisis.*"

*** This is the same bank that received \$25 billion in TARP bailout funds during the 2008 crisis - necessitated by irresponsible securitizations by Wall Street Banks that blew up the economy.**

*** This is the same bank that retreated from mortgage loans as soon as COVID hit: "Homebuyers seeking a mortgage through JPMorgan must now have a credit score of at least 700 and must put down 20 percent of the total purchase price. The bank said it is shifting focus to refinances."**

Liquidity crises in the mortgage market. Brookings Report

[3/9/18] Assertion: *"The Ginnie Mae servicing model, for example, assumes that nonbank servicers will have the resources to absorb a substantial share of credit losses before the government steps in, yet it is not clear that the sector has the capacity to absorb those losses, or that the existing prudential standards are sufficient to ensure the nonbanks' viability in a stress scenario."*

*** This claim betrays a complete and total lack of understanding about Ginnie Mae risk. Ginnie Mae securities are backed by federally insured loans (FHA, VA) - not by non-bank capital.**

*** Ginnie Mae itself acknowledges their main concern is servicers making advances, not losses.**

*** CHLA's January 2018 Ginnie Mae Report and 2022 IMB Report both explain that Ginnie Mae makes billions a year in profits, didn't even post a loss in 2008, and has limited financial risk.**

Risks of nonbank mortgage sellers and servicers revisited. Op-ed

[7/29/21] This opinion piece draws on work from MBA's Research Institute for Housing America, to conclude that *"the risk of nonbanks was significantly higher than that of depositories."*

*** Conclusion is based on a finding that IMBs have higher 90+ day delinquency rates than banks - ignoring the fact that this is mainly because IMBs serve more underserved borrowers than banks.**

*** This piece falsely equates liquidity issues with loss risk, failing to identify specific loss risks.**

*** It ignores the fact that IMBs predominately originate government backed loans (FHA, VA, RHS, GSE), which have strict loan underwriting standards and record capital levels at this time.**

Non-bank lenders are the biggest risk to the system right now. Jim Cramer

[11/28/18]. *"There are many non-bank institutions making home loans that could collapse in value. Worse, if those lenders can skirt regulations meant for big banks with similar lines of business and make loans without documentation or money down, that could be a serious problem. . . . We know there's been little or no regulation of these guys. I'm not crying wolf."*

*** This claim that non-bank mortgage lenders can skirt regulations meant for big banks is absurd.**

*** Such speculation ignores basic realities - like QM rules prohibiting no doc loans and the fact that IMBs predominately originate FHA and GSE loans, with strict understanding standards.**

The need for nonbank regulation is a consensus issue for the Fed.

[11/28/18]. This American Banker story headlines Federal Reserve concerns about "nonbanks." [11/28/18]. This American Banker story headlines Federal Reserve concerns about "nonbanks."

*** But if you look past the headlines, people like Fed Vice Chairman Michael Barr are focused mostly on unregulated areas like crypto, hedge funds, and private equity firms, as well as SIFIs.**

*** Purveyors of the "IMBs are Risky" myth - who often have a hidden agenda - bootstrap these generalized concerns about unregulated non-banks to falsely attack highly regulated IMBs.**

THE REALITY: IMBs Are Heavily Regulated

FINANCIAL REGULATION OF IMBs

- 1. Financial Supervision by every state an IMB does business in.** IMBs are licensed in every state they do business. Each state establishes its own IMB financial requirements, bonding requirements, financial supervision, and exam and enforcement authority.
- 2. Fannie Mae and Freddie Mac Seller/Servicers - Financial Requirements.** All Fannie/ Freddie IMB seller-servicers must meet the following minimum financial requirements:
 - (1) **Net worth:** \$2.5 million + 35 BP of Ginnie servicing +25 PB of other servicing.
 - (2) **Capital Ratio:** Tangible Net Worth/Total Assets greater than 6%.
 - (3) **Liquidity:** Servicing: 10 BP of Ginnie Mae servicing + 7 BP of GSE scheduled servicing + 3.5 PB of GSE actual & other servicing. Origination: 50 BP of loans Held for Sale plus Pipeline loans with Interest Rate Lock Commitments after Fallout Adjustments.
- 3. Fannie Mae/Freddie Mac - Financial Accountability for Faulty Loan Underwriting.**

The GSEs constantly audit deliveries of loans from IMBs and require the re-purchase of loans that do not meet sound underwriting standards - even if the loan is performing.

In today's environment, lenders often take losses of 25% and more on loan repurchases.
- 4. Ginnie Mae Issuers - Net worth and Liquidity Requirements.** All approved Ginnie Mae IMB issuers must meet the following minimum financial requirements
 - (1) **Net worth:** \$2.5 million + 35 BP of Ginnie servicing +25 PB of other servicing.
 - (2) **Liquidity:** Servicing: 10 BP of Ginnie servicing + 7 BP of GSE scheduled servicing + 3.5 PB of GSE servicing and non-agency servicing. Origination: 50 BP of loans held for sale plus rate lock commitments.
 - (3) **Risk-based Capital Requirement.** Risk weighting - principally 250% of Gross MSRs (not > Adjusted Net Worth)
- 5. FHA Origination - Financial Requirements.** All FHA loan originators must have, at all times, a minimum adjusted net worth of \$1 million, plus 1% of the total FHA volume over \$25 million, up to a maximum required net worth of \$2.5mm, plus \$200,000 in liquid assets,
- 6. FHA Financial, Operational, Loan Scrutiny.** All FHA loan originators are subject to
 - (1) a Quality Control (QC) Plan, approved by FHA, (2) Individualized loan (PETR) reviews, (3) FHA audits of FHA loans, with HUD IG audit authority, (4) Credit Watch, under which loan default performance must be within reasonable numerical bands.
- 7. FHA - Financial Accountability for Faulty Loan Underwriting.** FHA requires lenders to indemnify loans that don't meet FHA underwriting standards. FHA can also levy fines against lenders that have a record of multiple and significant violations.
- 8. Financial Scrutiny by Warehouse Lenders.** Though not technically regulation, this is one of the most powerful forces exerting market-based financial scrutiny and accountability regarding an IMB's financial health and capability as a going concern.

The financial requirements above are tailored to IMBs' role in originating these federal agency mortgage loan programs. IMBs pose no direct taxpayer risk.

Owners of IMB put their own net worth at risk. IMBs are subject to financial scrutiny by warehouse lenders and are licensed and regulated by every state they lend in.

CONSUMER REGULATION OF IMBs

- **CFPB Supervision and Enforcement Authority.** The Consumer Financial Protection Bureau has supervisory and enforcement authority over all IMBs, no matter how small.
- **SAFE Act licensing requirements for all IMB loan originators (LOs).** Every IMB LO is required to: (1) complete 20 hours of pre-licensing courses (2) pass the SAFE Act test (3) pass an **independent** background test (4) do 8 hours continuing education annually.
- **Nationwide Multistate Licensing System (NMLS).** All IMBs are required to submit a quarterly Mortgage Call report and annually report their agency and court orders.
- **Dodd-Frank (“DF”) and Other Federal Mortgage Rules.** *Unlike most non-bank financial products, mortgages are subject to numerous product-specific federal consumer protection rules:*
 1. **Ability to Repay/QM** [Sec. 1411 of DF]. *Prohibits no doc loans/requires an ability to repay.*
 2. **No Steering Incentives/LO Comp** [Sec. 1402 of DF]. *Bars variations in LO compensation, in order to prevent steering of borrowers to predatory loans or loans with less favorable loan terms.*
 3. **RESPA Sec. 8.** *Bars kickbacks, referrals, or unearned fees in conjunction with a mortgage loan.*
 4. **TRID.** *Requires extensive loan disclosures at application, which generally cap loan fees.*
 5. **No Arbitration.** [Sec. 1414 of DF]. *Prohibits arbitration or other limits on consumer legal rights.*
 6. **Prepayment Penalty Ban** [Sec. 1414 of DF]. *Bans most mortgage prepayment penalties.*
 7. **Adjustable Rate Mortgage (ARM) Disclosures** [Sec. 1418 of DF]. *Mandated ARM disclosures.*
 8. **Servicing requirements** [Sec. 1414 of DF]. *Escrow rules and other servicing requirements.*
 9. **RESPA/TILA disclosures.** *Extensive mortgage loan consumer disclosure requirements.*
 10. **HOEPA/High Cost Mortgages.** *Additional consumer protections for “high cost mortgages.”*
 11. **Equal Credit Opportunity Act (ECOA).** *No discrimination except for ability to repay.*
 12. **HMDA.** *Annually mandated statistical loan level disclosures for a lender’s mortgage loans.*
 13. **Servicemembers’ Civil Relief Act.** *Extra protections given to servicemembers regarding their financial transactions, in recognition of their service member responsibilities.*
- **Loss Mitigation requirements: FHA, VA, RHS, and Fannie/Freddie loans.** IMBs predominately originate federal agency mortgage loans, which require extensive loss mitigation actions for borrowers that default. During COVID, Congress also mandated a forbearance option only for these programs, allowing loan non-payments without penalty.
- **States.** States approve and regulate siting of IMB offices, mandate privacy protections for borrower financial information, and have cybersecurity requirements. Many state mortgage consumer protection laws go well beyond federal mortgage rules listed above.
- **Community Reinvestment Act for IMBs in Massachusetts, New York, and Illinois.** These states have adopted laws modeled after the bank federal Community Reinvestment Act (CRA), with exams and enforcement mechanisms regarding mortgage performance.
- **FTC Privacy Protections:** (1) CAN-SPAM Act, (2) Do Not Call (Telephone Consumer Protection Act or TCPA), and (3) CLBA Information Security, Privacy Notice.

THE REALITY: More Regulation of Small & Mid-sized IMBs is Not Justified by the Minimal Risk They Pose

IMB critics argue IMBs are not subject to the same safety and soundness regulation banks are.

There is a simple reason for this. Unlike banks, IMBs do not have access to FDIC-insured, taxpayer-backed deposits - or to FHLB advances - or to cheap Fed discount window funds.

*** If an IMB that does not service loans suddenly goes out of business, there is no impact. * If a small or mid-sized IMB that services loans goes out of business, there is a limited advance impact for Ginnie Mae and Fannie and Freddie - but no systemic or taxpayer risk.**

*** IMB taxpayer and systemic risks are limited to only the very largest servicers.**

IMB critics are constantly spinning myths about the allegedly great risks that IMBs pose - and are constantly being proven wrong when actual crises occur. COVID was a good example.

IMBs are now facing a profoundly challenging market environment, caused by 50% mortgage volume declines in large part caused by a doubling of mortgage rates in 2022. Yet, the taxpayer and systemic crises predicted by the "IMBs are risky" crowd have not occurred - because their doomsaying is based on a complete lack of understanding of the IMB business model.

IMBs originate mortgage loans and rarely hold them in portfolio, instead securitizing them or selling to aggregators. This is completely different from 2008, when Wall Street Banks held huge mortgage portfolios on their books, whose decline decimated their financials and the economy.

Yes - some IMBs have gone out of business, and some have merged. But the main impact has been that IMBs have had to reduce costs to right size expenses with reduced revenues. There has been no taxpayer risk. There has been no systemic risk. There has been no consumer risk.

This limited IMB risk was explained in detail in CHLA's [October 2022 IMB Report](#) [EXCERPT]:

"Smaller IMBs Are Better Placed than Large IMBs To Weather Challenges. Some IMBs will go out of business, but early signs are the larger IMBs are more at risk. Large IMBs with portfolio holdings or a non-QM loan focus have more risk than smaller IMBs. And, a number of larger IMBs went public, creating shareholder pressure to meet earnings expectations, making downsizing harder.

"Financial Risks to IMBs Are Limited. The basic IMB business model is to originate federally backed mortgages (FHA/VA/RHS/GSE). This largely insulates IMBs from any impact of higher mortgage loan defaults or foreclosures - unlike bank portfolio lenders or Private Label Securities participants.

No Taxpayer Risk from an IMB Loan Originator Failure. The IMB business model means there is no real taxpayer impact of an IMB loan originator going out of business (if the IMB is not servicing loans). The only real impact is fewer mortgage lenders around to originate new mortgage loans.

Taxpayer Risk from Smaller IMB Servicer Failures is Miniscule. If Ginnie Mae issuer/servicers go out of business, Ginnie's risk of loss is extremely low, since their guarantee is backed by federally insured loans (FHA/VA/RHS). Ginnie Mae might have to transfer an issuer's MSR portfolio - but historically it has been relatively easy to transfer portfolios of smaller issuers with little or no cost. The risk to Fannie and Freddie of IMBs going out of business is even lower, since many IMB seller-servicers have been selling loans through the cash window, reducing advance responsibilities."

Ginnie Mae and FHFA are absolutely right to be focused on establishing net worth and liquidity standards that are designed to ensure that issuers and seller/servicers can perform their program obligations to act as a banker to defaulted borrowers by making required advances. But the level of these standards should balance that objective with consumer access to credit considerations.

THE REALITY: IMBs are Subject to Significantly Greater Consumer Protections than Banks Are

- CFPB has supervisory authority over 100% of all IMBs.

In contrast 98% of banks (< \$10 billion in assets) are **exempt** from CFPB supervision.

- **Every licensed IMB loan originator (LO) must: (1) complete 20 hours of SAFE Act pre-licensing courses, (2) pass an independent background check, (3) pass the SAFE Act test, and (4) complete 8 hours of continuing education each year.**

In contrast, bank loan originators are **exempt** from all these qualifications requirements.

In fact, thousands of registered bank LOs have actually **failed** the SAFE Act test.

- **IMBs are required to carry out loan modifications, partial claims, and other loss mitigation actions, and were mandated to offer forbearance during COVID** - because they predominately originate FHA, RHS, VA, Fannie Mae, Freddie Mac loans. Congress also mandated a COVID borrower forbearance option for **only** these loans.

In contrast, banks acting as portfolio lenders (as well as non-agency MBS loans) have no such requirements. Notably their performance in the 2008 housing crisis was abysmal.

- Note: all other federal consumer protections generally apply equally to IMBs and banks.

THE REALITY: Excessive Regulation of IMBs Exacerbates Consolidation - Hurting Consumers

- Smaller IMBs lack the loan volume economies of scale to absorb the compliance burdens of analyzing and complying with the proliferation of regulations being imposed on IMBs.
- Many small closely held IMBs are reassessing whether they want to take on liability risks associated with a growing regulatory burden and are increasingly opting to sell their firm.
- If IMB critics succeed in convincing federal policy makers to add even more unnecessary financial and regulatory burdens, this would exacerbate other factors already driving smaller IMBs out of business or causing them to sell to larger mortgage lenders.
- **Increases in mortgage market concentration are bad for consumers.**
- **Reduced competition = fewer consumer choices and higher mortgage rates and fees.**
- **CHLA is asking regulators to use a cost benefit test when considering regulation of IMBs (and particularly smaller IMBs): Balance added costs and resulting industry concentration against incremental financial or consumer protection benefits.**
- **Small business streamlining is critical: Regulations and compliance burdens should be streamlined for smaller IMBs - in the same way they are for smaller banks.**

Appendix:

New IMB Requirements Implemented or Proposed in Just the last 2 Years

RECENTLY IMPLEMENTED

GINNIE MAE

- New Risk-based Capital Requirements and heightened net worth and liquidity requirements were adopted by Ginnie Mae in October 2022

FANNIE MAE and FREDDIE MAC

- New origination liquidity requirements and heightened net worth and liquidity requirements were adopted by FHFA in October 2022

STATES

- New York adopted a CRA law in November 2021, which would apply to IMBs.
- Illinois adopted a CRA law in March 2021, which would apply to IMBs.

FTC

- The FTC Safeguards Rule requires non-bank financial institutions to develop and maintain a comprehensive security program to keep their customers' information safe. The law becomes effective 6/9/23.

PROPOSED OR SUGGESTED

CONFERENCE OF STATE BANK SUPERVISORS (CSBS)

- The CSBS adopted [Model State Regulatory Prudential Standards for Nonbank Mortgage Servicers](#) in July 2021. CSBS is encouraging all 50 states to adopt these model standards.

CONSUMER FINANCIAL PROTECTION BUREAU (CFPB)

- The CFPB has a pending [Proposed Rule](#) to create a Registry of IMB Offenders, which creates reporting requirements redundant with what is currently required by the NMLS.
- The CFPB has a pending [Proposed Rule](#) to require all non-banks to submit all form contracts which limit consumer legal rights, which is unnecessary for IMBs, since mortgage lenders are barred from using arbitration or other similar limiting provisions.

FEDERAL HOUSING FINANCE AGENCY (FHFA)

- FHFA's February 2022 draft of its [2022 - 2026 Strategic Plan](#) suggested FHFA might explore asking Congress for authority to specifically examine nonbank servicers. This suggestion was ultimately dropped in the final plan released in April 2022, but it signals a possible expansion of the number of agencies that could examine IMBs.