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U.S. Loosens Reins, but Mortgage Lenders Want More Slack

By Peter Eavis
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The government, in recent days, has been giving one set of bankers nearly everything they want.

In this case, the lucky lenders are mortgage bankers, who for months had pressed federal agencies to loosen regulations on the home loan market. The regulators, eager to increase the flow of housing credit, seemed happy to make the adjustments. Just this week, they relaxed agreements that help shield taxpayers from losses on bad mortgages, and they watered down a regulation that aimed to set safe standards for home loans.

The government is in a tight spot. Some six years after the financial crisis, thousands of apparently creditworthy borrowers are being shut out of the housing market because they cannot get mortgages. From the authorities' perspective, it may be worth throwing the mortgage bankers a bone if it helps open up the market to deserving households. And regulators stress that they are doing so in a careful way.

"We know that access to credit remains tight for many borrowers, and we are also working to address this issue in a responsible and thoughtful manner," Melvin L. Watt, director of the Federal Housing Finance Agency, said on Monday.

Bankers assert that, over all, mortgage regulation has tightened significantly since the financial crisis of 2008. And they add that the changes made this week by regulators help stop the pendulum from swinging too far toward overregulation.

"This is absolutely the most conservative framework ever in the history of this country," David H. Stevens, president of the Mortgage Bankers Association, said. "What has happened in the last weeks shouldn't be reflected as going easy on the mortgage industry."

Still, the regulators' mortgage concessions are at odds with the broader thrust of the financial system overhaul that started after the crisis. In areas not directly related to mortgages, the agencies have sometimes adopted rules that were tougher than initially expected. Capital requirements, for instance, have become more stringent, and the final version of the Volcker Rule, which aims to keep banks from gambling with depositors' money, ended up stricter than its first draft.

But in crucial ways, the rules on mortgage lending have become more lenient.

This week, for instance, after fierce industry criticism, regulators weakened a provision of the Dodd-Frank Act of 2010 that governs how banks sell mortgages.

When banks make home loans, they package them into bonds, which they then sell to investors. In the years leading up to the crisis, banks sold substandard mortgages to investors, who later took enormous losses on them. To help keep that from happening again, Dodd-Frank required banks to hold on to a small portion of the loans they sold.

But the legislation had an important exemption: Lenders would not need to retain mortgages that had a low risk of default. The act assigned regulators the task of defining a low-risk mortgage. In the first draft of the so-called risk retention rule, the regulators said that such a loan would, among other things, have a down payment of at least 20 percent. But after mortgage bankers and other groups asserted that this could restrict credit, the down-payment requirement was left out of the rule completed this week.

“The opposition for that proposal was so intense. It came from all corners,” said Daniel M. Gallagher Jr., one of two Securities and Exchange commissioners who voted against the rule on Wednesday. “They were opposed to what we thought were prudent lending standards before the subprime crisis.” The commission passed the rule 3 to 2.

Mr. Gallagher said that there was a lot of political pressure against a rule that required down payments for the exempt mortgages. “We got letters from both parties telling us to go with the gutted rule,” he said. “But I don’t view this as political. It’s about good policy and what’s good for the taxpayers.”

The victory of the mortgage bankers over down-payment requirements did not surprise some housing finance analysts. Over the years, they say, the bankers have benefited from a broad alliance with homebuilders, real estate agents, consumer advocates and investors.

“That was really what won the battle for mortgage bankers,” Mark A. Calabria, of the libertarian-leaning Cato Institute, said in an email.

In recent years, mortgage lending has become quite profitable for banks as borrowers have taken advantage of low interest rates to refinance. At the same time, it has become a lower-risk business for banks because most home loans these days carry a government guarantee of repayment. As a result, if the borrower defaults, the taxpayer, not the bank that made the loan, takes the hit.

The banks have paid dearly for loans made before the crisis. Fannie Mae and Freddie Mac, the government mortgage giants that guarantee home loans, have demanded that banks buy back billions of dollars of precrisis loans, mostly defaulted on, that fell short of agreed-on standards. Also, law enforcement agencies have pressed the big banks into multibillion-dollar settlements over selling subpar loans.

To avoid having to buy back large amounts of loans again, the banks say that they now place demands on prospective borrowers that are even stricter than what the government requires on the loans it buys. To calm the banks, the regulators on Monday loosened the terms governing when Fannie Mae and Freddie Mac can demand that banks buy back loans.

But some housing specialists do not see why the government made that concession. To avoid buying back loans, they say, the banks could just do a better job of extending mortgages that meet the standards that they and Fannie and Freddie have agreed on.

“It’s remarkable the way lenders say it’s been too harsh on them to buy back loans, rather than say, ‘We should make better loans,’ ” said Thomas J. Adams, a partner at the law firm Paykin, Krieg & Adams who specializes in mortgage securities. “The overwhelming evidence is that they are not very good at their business.”