ACRONYMS

FDIC- Federal Deposit Insurance Corporation

Introduction to Mortgage Banking Overview

Most people cannot afford to pay cash for a new home. Typically, they will seek out a mortgage loan from a lender. The lender funds the purchase of the new home, requiring the borrower to pledge the purchased property as security for the debt. This process, known as mortgage lending, involves a complex series of interrelated activities. Each activity is conducted in accordance with investor requirements and government regulations.  
  
This course covers the foundational concepts of mortgage lending. It introduces the "common sense" concepts of mortgage banking finance that are the background of all daily work that goes on in the business of mortgage lending. To provide this foundational understanding, the course will describe the basic business model of mortgage lending and explore how the business makes money, review the evolution of mortgage banking in the United States, identify the primary functions of mortgage banking, describe the major specialists in mortgage lending, and examine the role of regulation in the industry.

Objectives

Upon completion of this course, the learner should be able to:

* Describe the basic business model of mortgage lending.
* Outline the history of mortgage lending in the United States.
* Explain the function and goals of the major segments of the mortgage banking business.
* Discuss the major specialists in the mortgage lending industry.
* Provide an overview of the role of regulation in mortgage lending.

To understand the business of mortgage banking, we need to understand how and why lenders make mortgage loans. We know that lenders are in the business to make money, but how does this happen? Let's begin with a look at the very basics of how lending works as a business proposition.

# Business Proposition

How does one make money by lending it out? Profit is realized when a debt is repaid with interest.   
  
From this very simple question and answer come many of the key foundational concepts that form the basis of today's mortgage lending industry.  
  
**Consider:**

| **The primary risk of any lending transaction is borrower default.** | |
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| Much of the structure of the mortgage lending industry is built around managing that risk. The first step taken to mitigate risk is that the borrower pledges the property as collateral to secure the loan. If the borrower doesn't pay, they lose the home. This security helps reduce risk for the lender and makes lending a safer and more attractive business proposition. | |
| **Profit is realized as the debt is repaid.** |
| It takes a long time to pay back a large loan amount like those seen in real estate finance transactions, so realizing profit from interest payments is both an incremental and a long-term proposition. It takes a lot of money to finance the purchase of a property, so mortgage lending is a very capital-intensive proposition. |

# Obtaining Capital

By securing the debt with collateral, we've taken the first steps to mitigate risk, which answers one of the challenges posed. But how do you answer the challenges of realizing profit over, say, 30 years, and of obtaining large amounts of capital to lend?

**Example**  
  
Imagine a bank has $100,000 available to lend. The bank lends that to a good borrower and has every expectation that the borrower will repay every cent plus interest, in 30 years. Because it's a good loan, the bank can count on the income from the principal and interest payment every month. It's a good deal over the long term, but in the meantime, the bank has no access to the $100,000. What does the bank do when another good borrower comes for a loan?  
  
The answer is that the bank sells that loan to an investor and now has more capital. The investor gets the interest income that will be repaid monthly over the life of the loan, and the bank gets more capital immediately to make more loans and meet customers' needs. The lender makes a profit from the sale. The lender may decide to maintain the rights to service the loan on behalf of the investor. In exchange for servicing the loan (that is, performing loan administration duties such as collecting payments and providing customer service), the lender/servicer earns a fee from the investor throughout the life of the loan.  
  
This is a very simplified version of the process, but it describes the basic interaction between borrowers, lenders, and investors.

Some large mortgage banks that are [depository institutions](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

A financial institution (such as a savings bank, commercial bank, savings and loan association, or credit union) that is legally allowed to accept monetary deposits from consumers. Federal depository institutions are regulated by the Federal Deposit Insurance Corporation (FDIC).  
  
An example of a non-depository institution might be an independent mortgage bank. While licensed to lend, the mortgage bank cannot accept deposits.

 may have enough capital from deposits and servicing loans that they keep in their portfolio to fund loans almost exclusively from their own funds. Most smaller mortgage lenders use [warehouse lines](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

Warehouse lenders provide lines of credit, called warehouse lines, to mortgage lenders. The mortgage lender uses the credit extended in the warehouse line to create loans. Once the lender creates a loan and sells it to an investor, the mortgage lender replenishes the funds in the warehouse line so the lender can make new loans.  
  
Typically, the mortgage lender will have committed to sell an investor a certain number of loans before the loans are closed. The loans represent the business the lender expects to do that month. The lender will close and fund the loans using money from the warehouse lender, then deliver the loans to the investor and receive payment, which they will then use to repay the warehouse line.  
  
As you can imagine, managing the flow of money and loans to maintain a healthy cycle is critical to mortgage lenders.  
  
The graphic below shows the basic steps for a mortgage lender who relies on a warehouse line to fund loans.

 and sales of loans on the secondary market to maintain a flow of capital.

# Mortgage Lender as Financial Intermediary

At the most basic level, the mortgage lender plays the role of a financial intermediary — connecting borrowers seeking financing for a[mortgage](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

An agreement between a borrower, known as the mortgagor, and a lender, known as the mortgagee, in which the borrower conveys an interest in a property to the lender as security for a loan. The loan is evidenced by a document called a mortgage note or note. In some states a deed of trust is used in place of a mortgage as the security instrument.

 loan (in the primary market) with investors who have money to lend (in the secondary market). This connection gives rise to the many complex processes and functions that make up the real estate finance industry.

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# How Does It Work?

If a borrower has a sufficient down payment, meets all credit requirements, and selects a property that supports the value of the loan, he or she will be granted a loan to fund a home purchase. While this is essentially the way it works today, it is only because there are entities or individuals willing to invest their money in mortgage lending.  
  
Investors are presented with alternative ways to invest their money, such as bonds, stocks, certificates of deposit, commodities, and an almost endless list of other options. The mortgage banker attracts capital to the real estate financing market by responding to the demands of the potential investor, while bringing investment funds to the borrowers who need them to finance their homes.

Interest Rates

One of the critical items both borrowers and investors are concerned with is interest rate. The interest rate dictates how much the borrower will have to pay for the use of the money and how much money the investor will make for its risk and investment.

Role of Interest Rates

Let's explore the role and impact of interest rates and what it means for the mortgage lender's business.   
  
Periods of economic turmoil and fluctuating interest rates generally create inverse ups and downs in the mortgage industry. As market rates decline, mortgage applications rise; conversely, as market interest rates rise, the number of mortgage applications decline.

This happens for a variety of reasons:

* Borrowers are better able to afford the monthly payments of principal and interest when the interest rate is low.
* When interest rates are low, buyers can afford to purchase more expensive houses due to the lower payment.
* When interest rates decline, current borrowers are able to refinance existing loans to a lower rate.

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History of Mortgage Banking Overview

The mortgage lending industry as we know it today has developed in response to two fundamental challenges:

* How do you manage risk of default?
* How do you obtain capital to sustain the lending cycle and keep credit available?

Let's look at the history of mortgage lending in the United States to better understand how it has evolved to meet these challenges.

The Early Years

Early Mortgage Banking

Mortgage banking has always served the function of connecting sources of capital to the borrowers who need it. The westward expansion of the United States is a prime example of a situation where mortgage banking helped borrowers living in [capital-poor](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

A geographic area of the country where the need for funds is greater than the funds available.  
  
During the early period of immigration of European settlers into the Western United States, such areas included states such as Texas, Oklahoma, Arizona, New Mexico, and California.  
  
Many of the new settlers had large dreams and small bank accounts (if any at all).

 areas attract financing from investors residing in [capital-rich](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

A geographic area of the country where there are sufficient funds available to fill the needs of all qualifying borrowers. This included such areas as the Northeastern United States.  
  
Mortgage bankers made the flow of funds possible by selling loans they made to cash poor Western settlers to investors back East. This enabled the settlers to realize their dreams of purchasing land and materials.

 areas of the country.

Rise of Local Lenders

In the early part of the twentieth century, most mortgage lending was done by [local banks and savings and loan associations](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

**Local Banks and Savings and Loan Associations**  
  
The establishment of the two-way flow of funds between capital-rich and capital-poor areas made more money available. As loan payments (including interest on the funds loaned) were passed back to the lenders, there was more money to lend to new borrowers.  
  
Eventually, local banks and savings and loans became established to fill a large portion of the lending needs. These institutions specialized in taking in deposits and making mortgage loans.  
  
These banks or associations would lend money locally, often to members and depositors of the association, and retain the mortgage loan on their books.

 or by [building and loan associations](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

These associations originated in England and came to the United States in the early nineteenth century.  
  
Building and loans were established originally for working-class people who wanted to buy homes but did not have access to banks. A group of people would deposit their savings into an association, and then as the association gained enough money, it would finance mortgages for its members.  
  
Unlike banks, building and loan associations made their investments based primarily on the interests of their members, rather than investing for the greatest return and security. Associations also tended to serve small groups or communities and did not offer many of the services banks did.  
  
Source:<http://www.encyclopedia.chicagohistory.org/pages/1746.html>

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Early Mortgage Servicers

Early investors (located primarily in the capital-rich East) were not inclined to want to deal directly with Western borrowers due to distance and unfamiliarity. So, the mortgage banker agreed to collect the payments from the borrowers and pass them on to the investors. This became known as "servicing" the loan.

Early Loan Terms

A typical loan term would be fairly short — three to seven years — with a balloon payment due at the end. Often the loan terms allowed the borrowers to pay interest only. When the loan matured, the borrower would either have to pay off the loan or refinance it at the then-current interest rate.  
  
The banks and associations made profits by charging an interest rate to borrowers that was larger than the rate they paid to their depositors. This worked fine as long as the banks and associations had funds on deposit. Yet it was a finely tuned arrangement that required a steady stream of willing depositors, dependable borrowers, continued growth, confidence in the bank or association, and relatively stable interest rates. The timeline below features a snapshot of key periods that shaped the mortgage lending industry as we know it today.

Early History

* [Pre-WW I](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)
* [Post-WW I](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)
* [1929-1933](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)
* [Post-WW II](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

|  | **Before World War I**, the need for greater credit in the agricultural sector became a crucial national issue as commodity prices and farmland values fell.  The federal government established new institutions and policies to meet that credit crunch: changes that significantly aided a growing farm mortgage banking business. |
| --- | --- |
|  | **After World War I**, the extensive urban development boom of the "Roaring Twenties" came into full swing.  Mortgage bond houses grew rapidly with the demand. Securities dealers began arranging financing for highly speculative new construction. | |

|  | **1929-1933.**The long boom of the 1920s came to an abrupt end after the stock market crash of October 1929.  Output and employment steadily fell.  By 1933, the field of private housing had suffered an almost complete collapse. |
| --- | --- |
|  | **Post-WW II.**Congress's creation of the Federal Housing Administration (FHA) in 1934 launched a revolution in housing finance. FHA programs reduced the investment risk for lenders.  WWII veterans returned home to communities where very few homes were for sale. Thanks to FHA and other government initiatives, housing starts quadrupled to half a million units by 1946 and more than 1.5 million new units by 1950. | |

The creation of the Federal Housing Administration (FHA) and the introduction of the [30-year fixed-rate mortgage](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)

**30-Year Fixed-Rate Mortgage**  
  
As much as we think of the 30-year fixed-rate mortgage as a standard and traditional loan product, it's actually unusual; in fact, in many countries outside the United States, fixed-rate mortgages are not available, or are only available for shorter terms.  
  
Prior to the New Deal, a set loan term was a new concept that made taking out a mortgage loan much safer for the borrower. Mortgages had been primarily of the "balloon" variety, similar in concept to an auto lease. In addition, many loans had a "call" provision that allowed the bank to demand immediate payment at any time, regardless of how many years were left on the loan. If borrowers could not refinance, they would lose their home to the bank in a foreclosure.  
  
The FHA introduced a new concept in banking, a loan which had a fixed period of time, called a term, during which a fixed amount of principal and a fixed or variable amount of interest would be paid back in full. This new "fully amortizing" loan was a significant innovation in banking and contributed greatly to the growth of homeownership in the United States.

 revolutionized mortgage lending in the United States and helped make the American Dream possible. Also as part of the New Deal, Fannie Mae was created to bolster the secondary market for home loans, with the same aim of supporting mortgage lending and making credit more widely available. Throughout the 20th century, government has played a significant role in shaping the mortgage lending industry in the United States in order to support homeownership and its pivotal role in the economy.

|  |  |
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| Pre-World War I | Before World War I, the need for greater credit in the agricultural sector became a crucial national issue as commodity prices and farmland values fell. The federal government established new institutions and policies to meet that credit crunch — changes that significantly aided a growing farm mortgage banking business. |
| Post-World War I | After World War I, the extensive urban development boom of the roaring twenties came into full swing. Mortgage bond houses grew rapidly with the demand. Securities dealers began arranging financing for highly speculative new construction. |
| Stock Market Crash | The stock market crash in 1929 lead to high unemployment, retarded growth, economic uncertainty, and a loss of confidence in the local banks and associations.  As depositors grew anxious about the situation, they began to withdraw their money from the institutions. This left the banks and associations short of funds and unable to refinance the existing mortgage loans when they became due. Hence, when a borrower's loan became due, he or she could no longer roll it over since the lending institutions no longer had the funds available. The lender would be forced to call the loan due.  Since the borrowers would most likely not have sufficient funds to pay the loan off in its entirety, the bank or association would be forced to foreclose. It is important to note that these were borrowers that may have never missed a payment during the term of the loan. Predictably, this situation led to a surge in foreclosures. |
| Post World War II – A Period of Growth | With the return of hundreds of thousands of veterans from World War II and the Korean War, coupled with a growing economy, the housing market thrived. While mortgage bankers originated and sold loans to investors in the secondary market, savings and loan associations tended to retain the mortgage and derive their profit from the interest spread between what they paid depositors and the interest rates earned on the mortgage loans. As long as interest rates remained relatively stable, this arrangement worked fine.  In order to attract more funds to the housing finance market, in 1968, Ginnie Mae issued its first[mortgage-backed security](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)  Mortgage-backed securities are investment instruments backed by mortgage loans as security. Ownership is evidenced by an undivided interest in mortgages or deeds of trust. Income from the underlying mortgages is used to pay principal and interest on the securities.  Investors soon preferred this type of investment in mortgage finance, since it didn't require them to take possession of documents, and the investment could trade in a manner similar to stocks.  **Liquidity characteristic of MBS**  MBS provide enhanced liquidity — the ability of an asset to be converted into cash quickly. For instance, a U.S. Savings Bond has more liquidity than real estate property owned.  **Pass-through characteristic of MBS**  MBS have a pass-through characteristic — a feature that requires the mortgage loan servicer to pass through all principal and interest payments due to the security holder in accordance with the amortization schedule, whether or not those payments have been collected from the borrower.  If the borrower fails to make timely payment, the mortgage banker must advance the funds to the investor. If the borrower eventually defaults, the mortgage banker bears any losses. Mortgage bankers embraced the securitization of mortgages because it opened up an entirely new class of investors.  . Mortgage bankers derived their main source of income from [servicing fees](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)  A fee paid by an investor to the servicer of a mortgage loan. The fee is generally earned upon application of the mortgage payment, and deducted from the transmittal of the payment to the investor. Service fees are generally based upon the unpaid principal balance of the loan at the time the payment was collected.  . |
| The Collapse of the Thrifts | The savings and loan industry (also known as thrift institutions) failed to adapt to this new form of mortgage finance and continued to hold onto many of their mortgages, relying on depositors to produce new sources of funds. In the mid-1970s, as interest rates rose, depositors demanded an increase on the interest rate the associations paid on deposits. The thrift associations were unable to match the rates offered by money markets since the mortgage loans they held in their portfolios had fixed rates of interest.  As a result, the thrifts experienced a mass exodus of depositors known as disintermediation — the withdrawal of funds from a financial institution in order to invest them directly. Eventually the thrift industry virtually collapsed. |
| Subprime Period | Starting in the late 1990s, many traditional mortgage lending institutions added subprime lending to their mix of products. The term "subprime" generally pertains to the credit rating of a borrower. It indicates the borrower's credit score threshold for the loan is lower than the customary score required in order to obtain a loan. It may also refer to a loan wherein the borrower is unable to provide standard forms of documentation to evidence income.  Subprime lending encompassed not only less strict underwriting criteria, but also introduced new loan products, such as negative amortization, low introductory (teaser) rates that would reset to higher rates after initial fixed period of months or years, interest-only features, low (or no) down-payment requirements, and other perilous features. In many instances, underwriting restraints were relaxed to allow marginal loans to be funded. New companies emerged that focused primarily on the subprime customer.  **Think About It**  In what ways do you think this situation was a win-win for lenders, servicers, investors, borrowers and politicians?Click the link to learn more:[A Win-Win Situation](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)  **A Win-Win Situation**   * Lenderswere able to sell their loans at a higher price since the loans carried a higher interest rate. * Servicerswere able to obtain a few extra basis points in servicing fees, hypothetically to offset the cost of additional services this market required. * Investorswere able to obtain a higher yield on their investments. * Borrowers, previously shut out of homeownership due to poor credit, a lack of a down-payment, or marginal income, were now able to obtain financing in return for agreeing to pay a higher rate of interest. * Politicianswere able to take credit for encouraging lenders to broaden the pool of home buyers to segments of the population that could not qualify for traditional financing.   Except for a few warning voices concerned with the housing bubble, many people — borrowers, lenders and investors alike — shared the overly optimistic belief that housing prices would continually rise and that borrowers could refinance out of onerous rates, for example, when a low introductory rate or interest-only period ended and payments rose.  When property values began to decline, borrowers and lenders were stuck. Borrowers could not make the [new high payment](http://education.mbaeducation.org/courses/1/DL2_011010/content/_169556_1/index.html)  **Adjustable-Rate Mortgage vs. Teaser Rates and Interest-Only Features**  Many people erroneously blame the adjustable-rate feature for higher rates of default and foreclosure in the housing crisis. However, interest rates have declined since 2005, so payments on adjustable-rate mortgages have accordingly decreased. The adjustable-rate feature was not the problem.  The problem was that adjustable-rate mortgages were often combined with other features, such as teaser rates (low introductory rates or payments) or interest-only features. These loans gave the borrower low initial payments, but then "reset" (after an agreed upon period of months or years) to the full interest rate and payment. Mortgage loans products with extremely low introductory rates or interest-only options often resulted in payment shock at reset and payments that were higher than the borrower could reasonably afford.  , nor could they sell or refinance due to the depreciated value of the property. The inevitable result was default and foreclosure.  As subprime foreclosures spread, investors who had invested in securities back by them panicked. Their sudden withdrawal from the secondary market caused capital for mortgage lending to disappear and the credit markets to freeze, culminating in the financial disaster of 2008.  Many of the mortgage bankers engaged in subprime lending suffered losses fatal to their organization. By 2010, the subprime market had all but disappeared. In its place, lenders returned to the more traditional mortgage loans requiring reasonable down-payments, high borrower credit scores, and sensible underwriting restraints. |
| Crisis and Recovery | The years that followed the financial crisis of 2008-2010 saw deep and far reaching change in the mortgage banking industry as well as in the economy as a whole. The collapse of organizations due to repurchase, default, foreclosure, and fraud in mortgage lending impacted almost all major arenas of the industry.   The most visible changes were a result of new legislation as the regulators sought to craft regulations designed to protect consumers and prevent future breakdowns in the financial markets. Much of the responsibility for the creation and enforcement of regulation was transferred to the newly formed Consumer Financial Protection Bureau (CFPB) called for by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These regulatory enhancements have created greater protections for consumers and transparency in the process; however the impact on the originators, servicers, and investors of mortgage loans has been a significant increase in the cost to originate and service mortgages as well as an exponential increase in the risk.  The increased legal and regulatory risk led to a tightening in the credit markets making it harder for consumers to qualify for financing, resulting in a growth in the rental housing market.   In addition to the revolution in the regulatory environment the mortgage industry experienced drastic advancements in technology enabling much of the process from origination through closing, trading of loans on the secondary marketing, and servicing of mortgages to occur electronically. This has allowed the process to be easier for consumers and the mortgage industry to adopt to unprecedented levels of change in processes and compliance standards which eminated during this period. |

How Mortgage Banking Works Overview

With the exception of large depository institutions, mortgage bankers are inherently thinly capitalized institutions. They do not have large sums of cash on their balance sheet, nor is that their objective.  
  
The goal of a mortgage banker is to make the loan to a borrower, and then make a profit from it. Once a loan is created, the lender can hold the loan in its portfolio, or (more often) it can sell the loan to an investor on the secondary market.  
  
In most cases, mortgage lenders seek to sell the loan to an investor as quickly as possible. Having sold the loan to an investor, the mortgage banker retrieves the money and can recycle it with another loan. The goal is to do this over and over again. With each transaction the mortgage banker may make a small profit. The lender also creates an asset on its balance sheet in the form of a stream of future income earned from servicing the loan for the investor.

In many aspects, a mortgage banking company works in a similar fashion to many other industries. Products are:

* Designed and developed (with intent to attract customers)
* Marketed, sold, and serviced

Within the mortgage banking firm, these are completed by the following major functional areas:

* Loan production
* Funding, warehousing, and shipping
* Secondary marketing
* Loan administration

Mortgage banking is a cyclical process in which each of its major functions affects the other. We will start by exploring a four-part model of mortgage banking, examining how each function fits into the overall process.

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# Introduction to Mortgage Banking

# Functions of Mortgage Lending

| **Function**  **Loan Production** | **Description**  Loan production is the creation of new mortgage loans. The term "production" refers to the process of producing loans that are consistent with the product design set by the investor.  Loan production involves coordination with every other mortgage banking department to ensure that the mortgage banker can sell the loan in the secondary market. | **This function involves:**   * Origination: generating loan applications * Processing: verifying information and documents * Underwriting: analyzing whether the lending risk is acceptable * Closing: delivering the deed, signing the note, and disbursing the funds |
| --- | --- | --- |
| **Function**  **Funding, Warehousing, and Shipping** | **Description**  Warehousing is the process by which most mortgage lenders fund loans at closing. Warehousing is the short-term borrowing of funds by mortgage lenders from banks called "warehouse lenders". Using the note as collateral, warehouse lenders provide interim financing until the mortgage is sold to a permanent investor on the secondary market.  Before the loan is shipped to the investor, it usually goes through a quality control check. The warehousing period ends when the loan is shipped and delivered to the investor and the funds are wired from the investor to the lender, and from the lender back to the warehouse lender. | **This function involves:**   * Funding the loan * Managing the warehouse line * Performing quality control check * Shipping and delivering the loans to an investor |
| **Function**  **Secondary Marketing** | **Description**  Secondary marketing generates the investment funds that enable the cycle of mortgage lending to begin and continue. Some view secondary marketing as the starting point of the mortgage banking process because the funds for the lending cycle originate here.  In this stage, lenders sell mortgages or mortgage-backed securities to investors and others. This provides funds for more lending by mortgage bankers and saving institutions. Since secondary marketing is concerned with selling the loan at a price that will obtain a good return, it is also tasked with setting the price at which loans are made to the borrower. | **This function involves:**   * Managing the loans in the lender's "pipeline" (loans in process but not yet created) * Negotiating investor commitments * Setting prices for loans * Managing market risks |
| **Function**  **Loan Administration** | **Description**  Loan administration, also known as loan servicing, involves "tending" to the mortgage loan from the time it is produced until it is paid off, usually at the end of the loan term. Typically, the mortgage lender retains the right to perform the administrative functions (such as collecting payments and providing customer service) on the loans after they are sold on the secondary market.  The investor pays the servicer a servicing fee for managing the loan. The servicing fee is generally one of the mortgage bankers primary sources of income. | **This function involves:**   * Receiving payments from borrowers * Remitting funds for principal and interest (less a "servicing fee" for the lender) * Paying taxes and insurance from escrow accounts * Handling loan payoffs, assumptions, loss mitigation, and foreclosures * Responding to customer inquiries |

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# Introduction to Mortgage Banking

# Types of Mortgage Specialists

As the process has become more complicated, the industry definitions for the various types of mortgage companies have become less clearly defined. Below you will find definitions and common usage notes for some types of specialists.

| **Type**  **Mortgage Banker** | **Definition**  An individual, firm, or corporation that originates, sells, and/or services mortgage loans. Mortgage bankers can be independent mortgage bankers or depository institutions. | **Notes**  Most people use the term "mortgage banker" to refer to companies that fund the loans at closing and service the loans after closing.  Bankers may either sell the loans on the secondary market or keep them in portfolio (less common). |
| --- | --- | --- |
| **Type**  **Correspondent** | **Definition**  A specialized type of mortgage banker whose function is limited to the production of mortgage loans that are then sold to other mortgage bankers under a specific commitment. | **Notes**  The term "correspondent" is generally used for companies that do everything mortgage bankers do except service loans. |
| **Type**  **Broker** | **Definition**  A firm or individual who, for a commission, matches borrowers and lenders. | **Notes**  The term "broker" is generally used for individuals and companies that originate and sometimes process loans but generally do not underwrite or fund loans at closing. |
| **Type**  **Wholesaler** | **Definition**  A lender who specializes in the purchase and servicing of mortgages obtained from other mortgage origination entities, such as brokers, correspondents, thrifts, credit unions, or commercial banks. | **Notes**  The term "wholesaler" is generally used to describe entities that purchase loans and the rights to service those loans from another entity, such as a broker or correspondent. Wholesalers may underwrite and fund the loans, or they may purchase loans that have already been closed. They generally sell the loans on the secondary market. |
| **Type**  **Conduit** | **Definition**  An entity that issues mortgage-backed securities backed by mortgages that were originated by other lenders. | **Notes**  The term "conduit" is used to describe companies that purchase closed loans and pool the closed loans for sale to investors as securities. |

# Discovery Activity

Which of these categories describes your company? If you don't know, ask your manager.

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# Introduction to Mortgage Banking

# Regulation of Mortgage Banking Overview

|  | The goal of mortgage banking regulation is to protect consumers, investors, and ultimately taxpayers. It is in everyone's interest to make good quality, sustainable loans, and to provide credit opportunities to all creditworthy borrowers. Regulation at federal, state, and local levels tries to support these goals. |
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# Federal, State, and Local Laws

Here are highlights on the types of laws and regulations that are generally found at the federal, state, and local/municipal level.

### **Federal**

**Federal laws:**

* Require mortgage lenders to disclose honest, timely, and concise information about loan costs
* Assure the fair and equal treatment of all consumers, protect the confidential information of the borrowers
* Provide certain expanded protections to service members and their families
* Regulate debt collection practices

Here are highlights on the types of laws and regulations that are generally found at the federal, state, and local/municipal level.

### **Federal**

**Federal laws:**

* Require mortgage lenders to disclose honest, timely, and concise information about loan costs
* Assure the fair and equal treatment of all consumers, protect the confidential information of the borrowers
* Provide certain expanded protections to service members and their families
* Regulate debt collection practices

### **State**

**State laws** control statutory matters such as:

* The recordation of mortgage lien interests
* Licensing of mortgage bankers
* Enforcement of prepayment penalties
* The mailing of required default notices
* The foreclosure process
* The eviction process
* The payment of interest on borrower escrow accounts
* The timeliness of providing loan satisfaction

### **Local/Municipal**

At the **local/municipal**level, ordinances are passed that require lenders to:

* Register vacant properties
* Report vacancies
* Protect and maintain abandoned houses
* Clear code violations

# Intent of Mortgage Banking Regulations

Regulatory compliance is one important way of ensuring that mortgage lending is fair, sound, and conducive to a healthy economy. The information below describes the general purpose or intent of these regulations in various areas of mortgage lending.

### **Loan Production**

**Loan Production**

Regulations are intended to...

* Protect and inform applicants during the financing process
* Prohibit discrimination
* Inform borrowers of the terms and conditions of the credit arrangement
* Notify borrowers in a timely manner on the nature and costs of the settlement process
* Prohibit unnecessarily high settlement charges
* Protect the privacy of borrower information
* Enable borrowers to review the appraisal (or other estimate of the home's value) prior to closing
* Provide borrowers the opportunity to review settlement costs prior to closing
* Publish information showing whether lenders are serving the housing credit needs of their neighborhoods and communities

### **Loan Administration**

**Loan Administration**

Regulations are intended to...

* Prohibit any abusive actions in the collection of mortgage payments
* Provide statutory requirements for completing foreclosures or evictions
* Properly administer escrow accounts held on behalf of the borrower
* Protect neighborhoods by maintaining abandoned properties while in the foreclosure process
* Provide loan mandated notices to borrowers in a timely and concise manner
* Notify borrowers when their loans have been sold to another loan servicer
* Prohibit the charging of fees not expressly permitted by law and the loan agreement
* Protect confidential information concerning the borrower
* Provide additional protection to members of the military service and their families

### **Secondary Marketing**

**Secondary Marketing**

Regulations are intended to...

* Make mortgage credit available for low-income and moderate-income families
* Ensure that federally-sponsored or regulated financial and housing institutions are adequately capitalized and operating in a financially safe and sound manner
* Apply financial accounting standards regulation to the real estate finance industry
* Prohibit discriminatory practices in the extension of credit
* Protect confidential information concerning the borrower

# Discovery Activity

What are the key regulations that impact your department? If you don't know, ask your manager.

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Regulatory Agencies

Often, when Congress passes a law regulating mortgage finance, a regulatory agency is identified to administer and enforce those laws. These agencies promulgate rules and regulations that guide specific implementation of the law and have the force of law. Federal agencies that play critical regulatory role include but are not limited to:

* U.S. Department of the Treasury and its bureaus, such the Office of the Comptroller of Currency (OCC)
* The Federal Reserve Board (FRB)
* The Securities and Exchange Commission (SEC)
* The Department of Housing and Urban Development (HUD)
* The Federal Trade Commission (FTC)
* The National Credit Union Association (NCUA)

Consumer Financial Protection Bureau

The Dodd-Frank Act, passed in 2010 with the intent of addressing some of the issues in that caused the credit crisis, created an important new regulatory agency, the **Consumer Financial Protection Bureau(CFPB)**. The central mission of the CFPB is to make markets for consumer financial products and services work for Americans — whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products.

### **RESPA**

The **Real Estate Settlement and Procedures Act (RESPA)**was passed in 1978 and was originally administered and enforced by HUD. One of the many goals of the act was to provide clarity to consumers regarding settlement costs. To help achieve this goal, HUD developed the Good Faith Estimate (GFE), which was provided to consumers early in the loan process to help them understand what their settlement costs at closing will be. It had to reconcile within certain tolerances to the HUD-1 disclosure of settlement costs (also developed by HUD to achieve RESPA goals), which was also provided at closing.

### **TILA**

The **Truth-in-Lending Act (TILA)**was originally enforced by the Federal Reserve Board. It is also concerned with providing transparency for consumers and to help achieve this goal, the Truth-in-Lending disclosure, or TIL, as it is commonly known, was developed. An "early" or "initial" TIL disclosure was provided to consumers soon after they completed a loan application, and it had to reconcile with the revised TIL disclosure at closing.

### **Dodd-Frank**

In 2010, the **Dodd-Frank Act** established a new agency called the Consumer Financial Protection Bureau (CFPB) which took over responsibility for the administration and enforcement for many existing laws, including RESPA and TILA. One of the first tasks of CFPB was to combine the GFE and initial TIL into a single form, called a Loan Estimate. CFPB also combined the HUD-1 Settlement Statement with the final TIL into a single form, called a Closing Disclosure; reconciling some of the requirements of existing RESPA and TILA rules. Requiring these new, integrated forms required mortgage lenders to update their processes, loan origination systems, and forms.

# For More Information

More information about the laws that affect mortgage lending and recent related issues can be found on [MBA's Issues page](https://www.mba.org/issues).

Introduction to Mortgage Banking Summary

This course covered the foundational concepts of mortgage lending, introducing the "common sense" concepts of mortgage banking finance that are the background of all daily work that goes on in the business of mortgage lending.   
  
The course began with a description of the basic business model of mortgage lending. Next, it reviewed the evolution of mortgage banking in the United States. It then identified the primary functions of mortgage banking. Toward the end of the course, it described the major specialists in mortgage lending. The course ended by examining the role of regulation in the industry.

Objectives

Upon completion of this course, the learner should be able to:

* Describe the basic business model of mortgage lending.
* Outline the history of mortgage lending in the United States.
* Explain the function and goals of the major segments of the mortgage banking business.
* Discuss the major specialists in the mortgage lending industry.
* Provide an overview of the role of regulation in mortgage lending.