FSB FINANCIAL STABILITY BOARD

# Press release

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## FSB invites feedback on residential mortgage underwriting practices

The Financial Stability Board (FSB) has launched a review of residential mortgage underwriting and origination practices. Problems arising from poorly underwritten residential mortgages contributed significantly to the global financial crisis that began in 2007. The review will survey existing practices across the FSB membership, including recent actions taken by national authorities to promote sound practices, and draw internationally applicable lessons.

The review will be based on the recommendations made by the Joint Forum in its January 2010 *Review of the Differentiated Nature and Scope of Financial Regulation*. The Joint Forum focused on two fundamental areas of concern in the residential mortgage market: poor underwriting practices and the lack of consistent supervisory and regulatory regimes for similar activities and products. A questionnaire (attached) to collect information from national authorities has been distributed to FSB members, and the responses will be analysed and discussed by the FSB later this year. The review will be completed and published in early 2011.

As part of this review, we welcome feedback from financial institutions, industry associations, consumer groups and other stakeholders on their experiences regarding residential mortgage underwriting practices, either in a particular country or across several countries. This could include comments on:

- gaps in regulatory and supervisory oversight;
- areas where regulations or guidance from different agencies might overlap;
- current or best practices for measuring a borrower's ability and willingness to repay;
- how market practices have evolved in recent years; and
- challenges faced by underwriters or originators that operate in several countries.

**Feedback should be submitted by 25 October 2010** to fsb@bis.org under the subject heading "FSB Thematic Peer Review on Mortgage Underwriting Practices." Individual submissions will not be made public.

This is the third FSB thematic peer review in 2010. The first was the review of compensation, completed in March 2010, and the second is the review on risk disclosures, which is currently underway.

**Notes to editors**

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB is chaired by Mario Draghi, Governor of the Bank of Italy. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.

17 September 2010

# Thematic review of mortgage underwriting and origination practices

## Questionnaire

Problems arising from poorly underwritten residential mortgages contributed significantly to the financial crisis that began in 2007. The Joint Forum, in its January 2010 *Review of the Differentiated Nature and Scope of Financial Regulation* (http://www.bis.org/publ/joint24.pdf), recommended actions that supervisors and policymakers should take to promote consistent and effective underwriting practices in residential mortgage origination. The Joint Forum recognised that each country's mortgage industry is shaped by distinct real estate markets, cultural influences and socioeconomic policies, but set out a goal that similar products and activities be subject to consistent regulation, standards and examination, regardless of where conducted.

The objectives of the thematic review are to provide a comprehensive picture of existing practices in the areas covered by the relevant recommendations of the Joint Forum's report and to draw internationally applicable lessons where possible. The questionnaire focuses on current practices in the areas covered by the following Joint Forum recommendations:

- *Recommendation 7*: Supervisors should ensure that mortgage originators adopt minimum underwriting standards that focus on an accurate assessment of each borrower's capacity to repay the obligation in a reasonable period of time. The minimum standards adopted should be published and maintained in a manner accessible to all interested parties.
- *Recommendation 8:* Policymakers should ensure that different types of mortgage providers, whether or not currently regulated, are subject to consistent mortgage underwriting standards, and consistent regulatory oversight and enforcement to implement such standards.
- *Recommendation 9:* National policymakers should establish appropriate public disclosure of market-wide mortgage underwriting practices. In addition, the Financial Stability Board should consider establishing a process to review sound underwriting practices and the results should be disclosed.

Member jurisdictions are requested to provide a consolidated national response to the questionnaire, covering all supervisors and regulators responsible for the oversight of residential mortgage originators (including mortgage brokers) and underwriting activities. The consolidated response should include descriptions of differences, where these exist, in supervisory and regulatory requirements and guidance, and in industry practices within the national market (e.g. between different types of institutions that perform similar origination and underwriting functions). Please ensure answers are brief and respond directly to the relevant questions. Where there is a degree of overlap, and the answer is adequately covered in another response, a cross reference is encouraged. The tables in the Annex are intended to facilitate comparisons across member jurisdictions. Authorities should use their best effort to complete the tables and if the data is not readily available, please report that the data is "not known".

Member jurisdictions are kindly requested to return the completed questionnaire to the FSB Secretariat (grace.sone@bis.org) by Monday, 25 October 2010.

## 1. Mortgage industry characteristics

1.1. What types of institutions within your jurisdiction arrange, originate or underwrite residential mortgage loans? Please use Tables 1a and 1b in the Annex to provide the types of institutions and their approximate share of the mortgage origination and underwriting market, if readily available.

1.2. What are the most common types of residential mortgage loans in your jurisdiction? Please use Table 2 in the Annex to provide the approximate market share of the most common types of mortgage loans, if readily available. Separately, please comment on whether these characteristics evolved in the years prior to or since the crisis.

1.3. Do the firms that originate or underwrite mortgages typically hold the loans on their balance sheet, or sell the loans to other financial institutions? What is the main instrument used in your jurisdiction for securitising mortgages: covered bonds, mortgage-backed securities, or both? Please use Table 2 in the Annex to provide, if readily available, the approximate proportion of mortgage loans sold, issued as mortgage-backed securities or as covered bonds.

1.4. Is mortgage insurance widely available or used in your jurisdiction? If so, what is the relative importance of private versus public mortgage insurers?

1.5. For what types of borrowers or residential mortgage loans, if any, is mortgage insurance mandatory (e.g. borrowers with impaired credit histories, high loan-to-value[1] mortgages)?

1.6. Does the government play a major role in the overall residential mortgage origination or underwriting market? If so, please briefly describe the main forms of government support (e.g. mortgage insurance, tax benefits, state-owned residential mortgage originator for public sector workers). In addition, please describe whether the forms of government support have evolved in your jurisdiction in the years prior to and since the financial crisis.

## 2. Regulatory and supervisory framework

2.1. Which regulatory and supervisory agencies within your jurisdiction have responsibility for oversight of residential mortgage originators? And of residential mortgage underwriters? Please briefly describe the responsibilities of each agency and their involvement in overseeing residential mortgage originators.

2.2. Is there any overlap concerning the legal responsibilities of each regulatory or supervisory agency in your jurisdiction (e.g. is the responsibility of each agency well-defined)? Is there any joint effort regarding action, communication, decision-making or exchange of information between the agencies?

2.3. Are all residential mortgage originators or underwriters subject to regulation or supervisory oversight? Is the market share of non-regulated residential mortgage originators or underwriters significant? Please describe whether the market share of the

[1] Loan-to-value (LTV) is the principal value of the loan as a percent of the purchase value of the home.

non-regulated residential mortgage origination market evolved in your jurisdiction in the years prior to and since the financial crisis.

2.4. In the case where prudential regulatory and supervisory requirements or guidance on residential mortgage underwriting standards do not exist, are market practices influenced by other guidelines or codes (e.g. securitisation, mortgage insurers)? If so, please briefly describe the guidelines or codes.

2.5. What actions can supervisors take to ensure compliance with their guidance on residential mortgage origination or underwriting activities (e.g. higher loan loss provisioning or required capital)?

2.6. Do supervisors require residential mortgage originators and underwriters to have internal credit scoring methods to assess borrowers' creditworthiness? Are internal credit scoring methods reviewed by supervisors? Even if not required, what is the general market practice?

2.7. How often are regulatory or supervisory requirements or guidance updated to reflect cyclical changes in the housing market (e.g. do supervisors modify their requirements or guidance on underwriting standards when house prices rise or decline rapidly on a national, regional or local basis)?

2.8. During the latest financial crisis, were there weaknesses in residential mortgage origination or underwriting practices that became apparent?

2.9. Are initiatives underway in your jurisdiction to revise the regulatory or supervisory framework for residential mortgage origination or underwriting, especially given the experience during the financial crisis?

## 3. Measuring a borrower's ability and willingness to repay

If practices for assessing borrower creditworthiness differ for different types of residential mortgage originators (e.g. commercial banks, specialized mortgage lenders), please answer separately for the main types. Similarly, if practices differ for different segments of the residential mortgage market (e.g. owner-occupied residences versus buy-to-let properties, standard homes versus luxury homes), please answer separately for each segment. In addition, please explain how market practices evolved prior to and since the financial crisis, and what were the main drivers that gave rise to those changes.

***Effective verification of income and financial information***

3.1. Are residential mortgage originators required to verify the income, employment, outstanding debt and other financial circumstances of residential mortgage applicants? If verification is not actually required, is it a general market practice to do so?

3.2. What are the main elements of the verification process (e.g. are residential mortgage originators expected or required to verify the borrower's financial history, income level, total debt level)? If verification is not actually required, is it general market practice to do so?

3.3. What sources are residential mortgage originators expected or required to use to verify a borrower's financial information? What type of information is provided by these sources?

3.4. What penalties are imposed on borrowers for misrepresenting financial information?

3.5. If financial information is misrepresented, are residential mortgage originators subject to a penalty for not adequately verifying the information?

3.6. What, if any, are the fiduciary responsibilities (e.g. to advise or act in the borrower's interest) that affect residential mortgage underwriting? Can residential mortgage underwriters be held legally liable for violating their fiduciary responsibility by extending loans that are against the interest of a borrower?

3.7. Are residential mortgage originators subjected to any legal restrictions with respect to access to borrowers' financial information?

3.8. How do residential mortgage originators assess the creditworthiness of borrowers whose income is undocumented? Are there any regulatory guidelines to ensure the reliability of income estimates? If not, what is the general market practice?

3.9. Are credit scores by external providers commonly used by residential mortgage originators?

***Reasonable debt service coverage***

3.10. What are the main metrics used in your jurisdiction to assess the debt servicing capacity or affordability of a borrower (e.g. debt-to-income, loan-to-income)?[2] Please use Table 3 in the Annex to provide summary information, where readily available, on the main affordability metrics used in your jurisdiction and a brief description of the metric.

3.11. Do regulators or supervisors provide any requirements, guidance or limits regarding appropriate levels of affordability (e.g. provide guidance or limits on DTI or LTI ratios)? Do such requirements, guidance or limits differ for owner-occupied residences and buy-to-let properties?

3.12. For buy-to-let properties, is the landlord's own income assumed to be the primary source of repayments in calculating debt-service coverage? To what extent are reasonable income and costs associated with the buy-to-let property considered in assessing debt servicing capacity for the buy-to-let segment of the housing market?

3.13. What, if any, expenditures are lenders required to consider or verify when assessing the debt servicing capacity of residential mortgage applicants for owner-occupied homes (e.g. living expenses, total debt payments)? Even if not required, are there general market practices in this respect and did they evolve prior to or since the financial crisis?

***Realistic qualifying mortgage payments***

3.14. Are residential mortgage originators expected or required to consider borrowers' repayment capacity based on an assumption of full amortisation of the loan over its life

[2] Debt-to-income (DTI) and loan-to-income (LTI) are examples of affordability metrics. There is no internationally agreed definition of these measures. According to the Joint Forum Report's definition, DTI measures annual debt service requirements (for the borrower's total debts) as a percentage of gross annual income, while LTI, or payment-to-income, shows the monthly payment amount for the loan as a percentage of monthly gross or net income. Some mortgage markets, however, may typically define DTI and LTI in other ways.

at the fully indexed rate[3]? Are there safeguards to prevent a borrower's repayment capacity from only being assessed based on an initial period of a loan when the interest rate or amortisation of the mortgage may be set at low levels?

3.15. What analyses are residential mortgage originators required to consider when estimating prospective mortgage payments (e.g. sensitivity to interest rate changes, compatibility of the loan term with the life of the property being financed, working life of the borrower). Even if not required, are there general market practices in this respect?

***Appropriate loan-to-value (LTV) ratios***

3.16. What, if any, requirements or guidance do supervisors or regulators provide regarding appropriate LTV ratios? Are there different LTV requirements for different types of mortgage loans (e.g. fixed rate versus variable rate mortgages)?

3.17. What is the average LTV ratio for all residential mortgage loans at the time of origination? Please provide summary information, where readily available, on the typical range of LTV levels around that average. Please use Table 3 in the Annex to answer this question.

3.18. Do supervisory guidance or requirements restrict residential mortgage originators or underwriters from considering future home price appreciation in evaluating a borrower's ability to repay the mortgage?

3.19. Are there additional supervisory requirements or guidance for residential mortgage applicants with high LTV ratios (e.g. mandatory mortgage insurance)? Even if not required, are there general market practices in this respect?

3.20. Is the minimum amount of equity borrowers are required to provide upon obtaining a residential mortgage loan based on borrower-provided cash, and not on loans?

3.21. Are there any specific restrictions or guidance on homeowners borrowing against the value of equity in their home (e.g. taking a second mortgage against the home which increases the overall LTV of the borrower), particularly during periods of rapid house price appreciation?

3.22. Are second mortgages written to a tighter standard than if the lender had made the first loan for the entire amount and same LTV?

***Effective appraisal management***

3.23. Are appraisers regulated or supervised?

3.24. What, if any, guidance or requirements do supervisors or regulators provide regarding sound appraisal and valuation practices for residential mortgage collateral? Do such guidance or requirements mandate the independence of the appraiser or valuer from the residential mortgage originator?

3.25. Are there any regulatory or supervisory requirements or guidance to confirm the legal validity of collateral? If so, please describe the main elements.

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[3] A fully indexed rate is the index rate prevailing at mortgage origination plus the interest rate margin that applies after the expiration of any introductory interest rate.

*Other factors important to an effective underwriting programme*

3.26. Please explain the foreclosure process and typical factors that may hinder the foreclosure process, including estimated time from default to foreclosure and whether a court's approval is necessary to foreclose on a residential property (e.g. judicial foreclosure).

3.27. Do lenders have full recourse to the borrower in the case of residential mortgage delinquency/foreclosure? What are the potential challenges?

3.28. Are residential mortgage borrowers able to prepay their mortgage loan (e.g. pay down principal faster than its amortisation schedule or pay off the entire loan) without penalty?

3.29. Are there any circumstances under which residential mortgage borrowers are required to obtain life insurance that pays the lender the balance of the loan in the case of death or permanent disability of the borrower?

3.30. Do supervisors or regulators provide any guidance or limits regarding the sale of the residential mortgage (e.g. the borrower's approval)?

## 4. Consistency of practices and oversight

The questions in sections 1, 2 and 3 asked for differences between the functioning, practices and oversight of different types of mortgage originators to be set out, where relevant.

4.1 What mechanisms are in place to ensure coordination and consistency of residential mortgage underwriting practices and oversight?

4.2 If there are inconsistencies, are there changes to legal, supervisory or regulatory regimes that would be needed to address them?

4.3 Do cross-border differences in residential mortgage regulation, particularly with regards to underwriting standards, pose particular challenges in your jurisdiction? Please explain.

## 5. Disclosures

5.1. What information, if any, are residential mortgage originators required to disclose about their underwriting practices to the public?

5.2. As part of continuous supervisory oversight, what information do supervisors require residential mortgage originators to provide?

5.3. What information, if any, do national authorities or other bodies (e.g. mortgage agencies or trade associations) collect about market-wide residential mortgage origination practices? Does this cover all residential mortgage market participants (e.g. regulated and unregulated entities) or only particular segments of the residential market (e.g. owner-occupied, buy-to-let, low-income)?

5.4. Do the authorities or other bodies publish data on market-wide residential mortgage origination practices? Does the information cover all segments of the residential mortgage market (e.g. regulated and unregulated)? Are there any practical obstacles to the collection of comprehensive data on a comparable basis?

5.5. Do the authorities publish a comprehensive review of trends, including potential vulnerabilities, in the mortgage market? If so, please provide a copy of the latest review.

5.6. Is there a private or public entity that calculates and publishes comprehensive housing price and home sales data that are widely available and used by the industry?

## Annex

Please use the tables below to answer questions 1.1, 1.2, 1.3, 3.10 and 3.17, using your best effort to complete the tables. If the data is not readily available, please report that the data is "not known". Please specify whether market share statistics are based on the amount outstanding at a given time or the flow of new origination for a certain period.

**Table 1a –Residential Mortgage Originators by Sector**
***Response to Question 1.1***

| Primary residential mortgage originators by sector | Approximate Share of Residential Mortgage Origination Market (%) | | |
|---|---|---|---|
| | 2000 | 2007 | 2009 |
| Deposit taking institutions | | | |
| Other regulated credit institutions | | | |
| Other non-banking regulated firms | | | |
| Unregulated firms | | | |
| **Total** | | | |

**Table 1b – Residential Mortgage Originators by Type of Institution**
***Response to Question 1.1***

Please modify the example of types of residential mortgage originators to reflect the primary types of institutions that originate mortgages in your jurisdiction.

| Primary types of residential mortgage originators | Approximate Share of Residential Mortgage Origination Market (%) | | |
|---|---|---|---|
| | 2000 | 2007 | 2009 |
| Commercial banks | | | |
| Specialised mortgage lenders | | | |
| Mortgage brokers | | | |
| Insurance companies | | | |
| Pension funds | | | |
| Public agency | | | |
| Other | | | |
| | | | |
| | | | |
| **Total** | | | |

**Table 2a – Most Common Types of Residential Mortgage Products**
***Response to Questions 1.2 and 1.3***

Please modify the examples listed in the table of the most common types of residential mortgages to reflect those in your jurisdiction. Please provide a brief description of each type of mortgage loan you list below. In addition, please specify whether mortgage loans are securitised as mortgage-backed securities or covered bonds in your jurisdiction. If both types of securitisation are common, please amend the table to separately reflect the market share of each type of securitised product.

| | **Approximate Share of Residential Mortgage Origination Market (%)** | | | **Approximate Proportion of Residential Mortgages Originated That Were Sold (%)** | | | **Approximate Proportion of Residential Mortgages Originated That Were Securitised (%)** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2000** | **2007** | **2009** | **2000** | **2007** | **2009** | **2000** | **2007** | **2009** |
| **Most Common Types of Residential Mortgage Products** | | | | | | | | | |
| Fixed-Rate Loans | | | | | | | | | |
| Variable Rate Loans | | | | | | | | | |
| Hybrid Loans[4] | | | | | | | | | |
| Foreign Currency | | | | | | | | | |
| Negative Amortisation | | | | | | | | | |
| Other | | | | | | | | | |
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| **Total** | | | | | | | | | |

[4] An example of a hybrid loan is a 2/28 30-year residential mortgage that has a low variable interest rate for the initial 2 years, and then resets typically at a higher rate, and remains fixed at that interest rate for the remaining 28 years of the mortgage loan.

**Table 2b – Most Common Segments of the Residential Mortgage Market**
***Response to Questions 1.2 and 1.3***

Please modify the examples listed in the table below of the most common segments of the residential mortgage market to reflect those in your jurisdiction. Please provide a brief description of each segment of the market you list below. In addition, please specify whether mortgage loans are securitised as mortgage-backed securities or covered bonds in your jurisdiction. If both types of securitisation are common, please amend the table to separately reflect the market share of each type of securitised product.

| | Approximate Share of Residential Mortgage Origination Market (%) | | | Approximate Proportion of Residential Mortgages Originated That Were Sold (%) | | | Approximate Proportion of Residential Mortgages Originated That Were Securitised (%) | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2000 | 2007 | 2009 | 2000 | 2007 | 2009 | 2000 | 2007 | 2009 |
| **Most Common Segments of the Residential Mortgage Market** | | | | | | | | | |
| Owner-Occupied Residence | | | | | | | | | |
| Standard Homes | | | | | | | | | |
| Luxury Homes | | | | | | | | | |
| Buy-to-Let Properties | | | | | | | | | |
| Low-Income Households | | | | | | | | | |
| Other | | | | | | | | | |
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| | | | | | | | | | |
| **Total** | | | | | | | | | |

**Table 3 – Types of Credit Features at Mortgage Origination**
***Response to Questions 310 and 3.17***

Please modify the table to include the same residential mortgage products you listed in Table 2. In addition, please modify the table to reflect which affordability metric (e.g. LTI, DTI) is most commonly used in your jurisdiction and provide a brief description of the metric.

| | **Average DTI or LTI Ratios** | | | | **Average LTV Ratios** | | | |
|---|---|---|---|---|---|---|---|---|
| | **2000** | **2007** | **2009** | **Typical Range** | **2000** | **2007** | **2009** | **Typical Range** |
| **Most Common Types of Residential Mortgage Products** | | | | | | | | |
| Fixed-Rate Loans | | | | | | | | |
| Variable Rate Loans | | | | | | | | |
| Hybrid Loans | | | | | | | | |
| Foreign Currency | | | | | | | | |
| Negative Amortisation | | | | | | | | |
| Other | | | | | | | | |
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