Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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# Here We Go Again — Subprime Lending and Innovative Mortgages*

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Although there were many reasons for the financial crisis that began in 2008, no one disputes that poorly underwritten mortgage loans, often with "innovative" terms such as no down payment or very low initial payments, was a major causative factor. Some point to aggressive Government policies to increase home ownership as another causative factor. One goal of the Dodd-Frank Act was to prevent a return to loose underwriting standards. It was understood that the result was that fewer people would qualify for mortgage loans.

Six years later and the Government is again aggressively pushing for "innovative" mortgages for consumers least able to afford the burdens of home ownership. This time the push is coming from the Federal Housing Finance Agency (FHFA), the agency that has the conflicting responsibilities of acting in the best interest of Fannie Mae and Freddie Mac shareholders as their conservator, while at the same time serving as the safety and soundness regulator for these two companies.

In December of last year, FHFA issued a notice of proposed rulemaking (NPR) that would require Fannie and Freddie to "lead the nation" in providing mortgage loans to very low-income and low-income individuals and families through the use of "innovative" mortgage products. The regulation implements a statutory provision that had previously been deemed not required while these two companies were in conservatorship.

Under the NPR, both Fannie and Freddie would be required to establish a plan for serving underserved markets. The plan, once approved, would be mandatory. It must contain measureable goals. Compliance with the plan would be examined, and form the basis for a public compliance evaluation.

As part of the compliance exam, these enterprises would be evaluated based on one or more factors that include the development of innovative loan products, more flexible underwriting guidelines, and other innovative approaches to increase the availability of loans to very low-, low-, and moderate-income families.

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FHFA will also look to "the volume of loans purchased in each underserved market relative to the market opportunities."

This NPR is a far cry from the goals of the Dodd-Frank Act to restore prudential underwriting standards to the mortgage industry, and the realization implicit in that legislation that home ownership without adequate income may not be in the best interest of the consumer or the country. Yet, barely six years after passage of that landmark legislation, the mistakes of the pre-2008 era seem to have been forgotten, at least by the FHFA.

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