U.S. Mortgage Market Pipeline Risks
Global Crossroads 2015: Financial Market Adaptation to Regulation and Monetary Policy
Nancy Wallace
Haas School of Business
March 20, 2015
Federalized Mortgage Securities Issuance ($ Millions)

Source: Inside Mortgage Finance, 2015
Pipeline is not Funded with Deposits ($ Billions)

Source: Flow of Funds
Mortgage Pipeline Funding Challenges

**TBA Market**
1. Central Clearing
   ~ 60% of trades
2. Increase in delivery failures
3. New Margin requirements
   - TMPG (11/2012)
   - SIFMA Rule 4210 (1/2014)

**Warehouse Lending**
1. Decreased capacity and increased concentration
2. Runs on funding structures (4/2007)
   - Extendable ABCP
   - Repurchase funding – MRAs.
3. Issues with regulatory capital transparency

**FHLB Advances**
1. Significant source of funding and liquidity
2. Quality of collateral on advances.
3. Distortions due to GSE status.
   - Implicit debt guarantees
   - Super-lien status
New Challenges in the To-Be-Announced (TBA) Agency Pass-Through Forward Market

- Most purchases of agency MBS are forward transactions that settle about one month after trade
  - Counterparty risk
  - Margin
    - Common in trading on Mortgage-Backed Securities Division (MBSD) of the Fixed Income Clearing Corporation
    - Uncommon in bilateral trading (dealers and customers).
- Mandatory margining
  - Treasury Market Practices Group (TMPG) – 11/2012
Margin Requirements and TBA Average Daily TradingVolumes ($ Billions)

Source: SIFMA TRACE
Fragility of Pipeline Funding

- **Master Repurchase Agreements** – collateralized lines of credit, repo status, safe harbor under BAPCPA, funded via FHLB advances or repo, 45 day maturities, regulatory treatment is opaque.
- **Extendable ABCP** – off-balance sheet lines of credit, commercial paper issued, credit and/or liquidity supports, 45 day maturities, collapsed Spring 2007, off-balance sheet regulatory treatment.
- **Other loan forward contracts and commitments** – Regulatory treatment is opaque.
Mortgage Origination Networks for Bank/Thrift Holding Companies: Importance of Wholesale and Warehouse Channels

Collapse in Wholesale Channels ($ Billions)

Source: Inside Mortgage Finance, 2015
Collapse of the Extendable ABCP Market ($ Billions)

Source: Moody’s Investment Services
Bank Holding Company Shares of Mortgage Related Assets: Short-Term Funding Still Important

Source: FR Y-9C
Importance of Federal Home Loan Bank Advances (Liability) and Asset Receivables (Loan repurchases)

Source: FR Y-9C
Opaque Regulatory Capital Reporting: Collateralized Lending or Loans Held-for-Sale?

Regulatory Reporting Mortgage Banking Activity

Loan sale with agreement to repurchase

Forward Commitments
1. **Off Balance Sheet:** notional amount of forward contract
2. **On Balance Sheet:**
   a. Derivatives with a positive (negative) fair value held for purposes other than trading.
   b. Offset with non-interest income.

Sale:
1. Remove from balance sheet.
2. Record loan proceeds from sale.
3. Add a forward purchase.

Secured Borrowing

**Purchaser cannot sell or repledge the asset:**
1. Keep loan as trading assets or assets held for sale.
2. Offset with "other borrowed money" or FHLB Advances.

**Purchaser has the right to sell or repledge the asset:**
1. Assets receivables (included in "other assets")
2. Offset with "other borrowed money"
Advances are the largest category of assets on the FHLB balance sheet (62% as 6/30/2014). FHLB protects against credit risk on advances by collateralizing all advances.

- Collateral is loans and securities from member/borrower HFS books.
- Residential mortgages are the principal form of collateral (including loans that are no more than 90 days delinquent) – 72.1%
Recent FHLB Advances to JPMorgan Chase, Wells Fargo, Citibank, Bank of America ($ Billions)

Source: FHLB
FHLB Coverage Ratios on Advances Have Fallen

Source: FHFA
Sobering Challenges Ahead

- Effect of new margin requirements on TBA liquidity and pricing?
- Non-existent private label securitization due to collapse in pipeline funding facilities and risks to agency securitization without GSE liquidity supports of 45 day loan-to-MBS pipeline?
- FHLB advances are potential source of systemic risk and illiquidity.