



## Mortgage Industry Bulletin

### **Subprime Crisis Spotlight on CRA and GSE**

August 25, 2011 — Many stories have circulated in the financial and mortgage industry that lay blame for the subprime crisis on the doorstep of the Community Reinvestment Act (CRA) and affordable housing goals of the government sponsored enterprises (GSE). These have characteristically been based on the associated outcomes in the mortgage market, related to delinquency rates and measures of loan quality.

Released recently by the Federal Reserve Board, a whitepaper entitled "The Subprime Crisis: Is Government Housing Policy to Blame?" (1) tackles the issue to determine the culpability of the CRA and GSE. This is the first comprehensive statistical analysis based on factual data from the marketplace. Lender and servicer management teams will be interested in what this report says about loans in their portfolios.

"We find little evidence that either the CRA or the GSE goals played a significant role in the subprime crisis," stated the report abstract. "Our lender tests indicate that areas disproportionately served by lenders covered by the CRA experienced lower delinquency rates and less risky lending. Similarly, the threshold tests show no evidence that either program had a significantly negative effect on outcomes."

Targeting the initiatives aimed at expanding mortgage credit and home-ownership to low and moderate income borrowers, many in the mortgage industry have blamed the CRA and GSE as a primary cause of the crisis. Even dissenting members of the FCIC (Financial Crisis Inquiry Commission) have expressed opinions blaming government housing policy and community reinvestment for reducing underwriting standards.

This FRB commissioned report focused on whether LMI (low and moderate income) tracts experienced worse underwriting outcomes than otherwise similar tracts. As the CRA applies only to commercial banks and thrifts, many subprime mortgage lenders operated outside of the "safe and sound" manner consistent with the regulation. GSE goals were limited to LMI borrowers, underserved areas and affordable housing.

Using an empirical approach, the report relied on two indirect methods: analyzing variations in lending by lender type and a regression discontinuity examination of outcomes by geographic designation through a common set of census tract-level control variables. Results from the Variation by Lender Type approach showed lower 2008 delinquency rates, indicating better, not worse, loan quality for lending by CRA-covered institutions. Additional state group analysis also reflected lower levels of delinquency. Statistical reviews performed on minority populations (although CRA does not target tracts by racial composition) in LMI census tracts demonstrated no evidence of higher delinquency associated with this segment of low and moderate income borrowers.

In addition to the focus on the role of the lender, the regression discontinuity compared the outcome of lending in census tracts favored under the CRA or GSE goals and those that were not. There was no evidence found that CRA-covered lenders experienced worse outcomes, whether measured by delinquency rates, high PTI (payment-to-income) loans, or higher-priced lending. Analysis in the report concluded that neither the CRA nor the GSE goals contributed to any discontinuity in outcome measures.

Both the CRA and GSE accounted for a disproportionate share of growth in lending during the subprime buildup before the crisis, but the analysis failed to prove any direct connection that either regulation caused or contributed to the financial calamity. In concluding, the report stated "We do not see evidence of this (loans being underwritten with different prices or terms than might otherwise have taken place) in our indirect tests. However, direct evidence is potentially available by focusing on the performance of loans originated through these programs." Until that data is publicly available, proof and definitive conclusions cannot be demonstrated. In the interim, this report presents the most authoritative analysis to date of factors related to the mortgage crisis.

(1) A link is provided below to the Federal Reserve Board report.

<http://www.federalreserve.gov/pubs/feds/2011/201136/201136pap.pdf>

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