

Press release

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Ref no: 09/2011

18 March 2011

FSB publishes peer review on residential mortgage underwriting and origination practices

The Financial Stability Board (FSB) published today a peer review report on residential mortgage underwriting and origination practices in FSB member jurisdictions.

Problems arising from poorly underwritten residential mortgages contributed significantly to the financial crisis that began in 2007. As the global crisis showed, the consequences of weak underwriting practices in one country can be transferred globally through securitisation markets. Such spillovers highlight the importance for financial stability of sound residential mortgage underwriting practices across the FSB membership.

The Joint Forum, in its *Review of the Differentiated Nature and Scope of Financial Regulation*, recommended actions – endorsed by the FSB – that supervisors and policymakers should take to promote consistent and effective underwriting practices for residential mortgage origination. These included:

- Supervisors ensuring 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.
- Policymakers ensuring 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.
- National policymakers establishing appropriate public disclosure of market-wide mortgage underwriting practices.

The peer review report released today provides a comprehensive picture of existing practices and oversight – including recent crisis-induced reforms – in the areas covered by the Joint Forum's recommendations and draws internationally applicable lessons.

Overall, national authorities are making good progress in following the Joint Forum's recommendations. Nearly all mortgage lenders across the FSB membership are regulated, either by prudential supervisors or consumer protection authorities, and in some cases by both. As a result, industry practices are moving in the right direction. However, most FSB member jurisdictions do not yet have adequate public disclosure or monitoring of information concerning the overall health of their mortgage market, including evolving mortgage underwriting practices and market trends.

The FSB report contains six recommendations to promote sound residential mortgage underwriting practices globally, and hence financial stability:

- National supervisors should develop a framework for sound residential mortgage underwriting standards and practices that is as explicit and specific as possible.
- The FSB will develop an international principles-based framework for sound underwriting practices.
- Financial authorities should regularly review their standards on residential mortgage underwriting and adjust them as appropriate to address the build-up of risks in the housing market or to help counteract a lending boom that pose significant risks to financial stability.
- Policymakers should broaden the regulatory perimeter to ensure all residential mortgage lending activity is supervised and/or regulated to safeguard both borrowers and investors and to promote financial stability.
- Regulators and supervisors should ensure that mortgage insurers, where active, are appropriately regulated and robustly capitalised in order to avoid regulatory arbitrage.
- Authorities should collect and disclose enough detailed data to allow a comprehensive view of residential mortgage lending activities.

Mario Draghi, Chairman of the FSB, said “National authorities are taking actions to promote sound residential mortgage underwriting practices in the wake of the crisis.” He added that “These actions should be complemented with regular public reporting on developments in the mortgage market as well as regular monitoring that mortgage lenders of all types comply with minimum standards for underwriting.”

Supervisors and regulators will need to maintain momentum in improving lending practices. Internationally agreed principles that draw on the Joint Forum’s recommendations could help to strengthen residential mortgage underwriting practices. Tiff Macklem, Chairman of the FSB’s Standing Committee on Standards Implementation, said that “the peer review extracts useful lessons from current experience, highlights best practices being followed in member jurisdictions, and illustrates some potential high-level principles that could guide future standard-setting.”

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 in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB began a regular programme of peer reviews in 2010, consisting of thematic reviews and country reviews. Two thematic peer review reports are being published today - the other report (covered by a separate press release) is a peer review of risk disclosure practices relating to structured credit products and certain other exposures. The review reports published before today comprise a thematic peer review on compensation practices and country peer reviews of Mexico, Spain and Italy. Thematic peer reviews focus on

implementation of international financial standards, policies agreed within the FSB or, where such standards or agreed policies do not exist, a stock-taking of existing practices in the policy area. The objectives of the reviews are to encourage consistent cross-country and cross-sector implementation, to evaluate the extent to which standards and policies have had their intended results and, where relevant, to make recommendations for potential follow up by regulators, supervisors and standard setters. They provide an opportunity for FSB members to engage in dialogue with their peers and to share lessons and experiences.

This report describes the findings of the thematic review on mortgage underwriting and origination practices, including the key elements of the discussion in the FSB Standing Committee on Standards Implementation (SCSI). The draft report for discussion was prepared by a team of experts drawn from FSB member institutions and led by Guillermo Babatz, President, Mexican National Banking and Securities Commission. In addition to information provided by FSB members, the review benefited from input from industry associations, financial institutions and other stakeholders on practical experiences regarding residential mortgage underwriting practices and interactions with regulatory and supervisory authorities, and from discussion in the FSB SCSI and in the FSB Plenary.

The next thematic peer review will follow up on the March 2010 review of compensation and will assess the further progress made by national authorities and significant financial institutions in implementing the FSB *Principles for Sound Compensation Practices* and their *Implementation Standards*. The report will be published later this year, following approval by the FSB Plenary.

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.