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Playing Monopoly?

As one of the only financial institutions to remain wholly committed to mortgage lending, how is Wells Fargo's origination domination impacting the industry?

By Chuck Green

While they might not go so far as to cast Wells Fargo Home Mortgage as an alpha dog among mortgage originators, some experts say someone has to be top dog in that category, so why not Wells.

Charles Thornberg said Wells Fargo's been one of the "more prudent banks" in that it didn't sustain the same losses as some of its primary competitors, like Bank of America and SunTrust, during the downturn. Consequently, Wells was better positioned to step in during the apex of the housing crisis, which was fortuitous, said Thornberg, founding partner of Beacon Economics, a research and consulting firm specializing in analyses of real estate markets. After all, given that a lack of credit could have stopped a slowly recovering market in its tracks, "you might argue the economy we're seeing now would be nowhere near as robust" had Wells not stepped up, he said.

If one institution's going to assume control of private market share, it's Wells Fargo, added Clifford Rossi, an executive in residence and Tyser Teaching Fellow at the Robert H. Smith School of Business at the University of Maryland. "They know the mortgage lending business, which they've demonstrated, year after year." For example, he pointed out that Wells has managed its mortgage business "fairly well over time—better than most." Additionally, while it didn't entirely escape the mortgage crisis, among the major players then and now, Wells showed relatively good discipline in managing its risks, he explained.

Weighing the Numbers

According to the Mortgage Bankers Association (MBA), in 2010, Wells Fargo originated 1,047,363 loans, valued at more than $238,505,448,000. Second was Bank of America with 581,248 loans for more than $136,836,583,000; JPMorgan, 326,281, generated more than $73,861,312,000; USCB, 201,614 for $39,537,776,000; and Citigroup, at 132,604, totaled more than $31,878,368,000. Among all originators, there were 7,366,299,000 originations, totaling $1,568,516,061,000.

In May, the MBA announced it was increasing its mortgage origination forecast for 2012 by almost $200 billion, due entirely to an increase in refinances. MBA now expects that mortgage originations will reach $1.28 trillion in 2012, up from $1.26 trillion in 2011.

The most recent refinance estimates for 2012 reflect an upward revision of $188 billion from MBA's April forecast, driven by an increase in the pace of refinance applications and originations, while purchase origination estimates were revised downward by $6 billion to reflect lower than previously expected home prices and weaker than previously expected home sales.

With the 10-year Treasury yield still near record lows, mortgage rates continue to decline, as evidenced by rates in the MBA's Weekly Applications Survey, continuing to reach new lows for the series. Rates posted under 4 percent for several months and have been on a decreasing trend since March. Lower rates continue to provide incentive for borrowers to refinance. The MBA anticipates that rates will remain at their current level through the end of 2012 and that refinance volume will be $932 billion for 2012 compared with $858 billion in 2011. This is an upward adjustment of almost $40 billion from the previous forecast as data on mortgage applications continue to show elevated levels of refinance activity.

Purchase mortgage application activity remains stagnant, although with improving starts data, there is some upside potential to this picture, states the MBA. Purchase originations are expected to decrease slightly in 2012 compared with 2011, to around $390 billion from $400 billion. The MBA continues to expect a strong rebound in purchase originations in 2013, with volume reaching just under $640 billion, but there is significant downside risk to this forecast if the economy remains stuck in low gear. As rates increase and fewer eligible borrowers remain, refinance originations should drop sharply in 2013 to $400 billion.

Additionally, Wells Fargo has funded 6.4 million mortgages since the housing crisis started about three-and-a-half years ago, observed Mike Heid, EVP of the company.

Banking on Agility

Tony Garritano's take on Wells is more temperate. "The market will determine whether [Wells is] good at what it does. That's the nature of a free market. Someone's going to rise to the top and someone will fall by the wayside. If Wells can be agile enough, they'll succeed, as will those that work with them," said Garritano, founder of the Progress in Lending Association, designed to promote thought leadership in the mortgage space. "The opposite also could be true; it's the nature of the game."

Having said that, Garritano believes the fact that Wells carries 40 percent of the market helps to consolidate it. "While it gives [Wells] more power and authority over how lending is done, if I'm a small- to medium-sized lender, I now have greater flexibility," he said. In other words, he explained, previously, when, say, the top 20 lenders were more evenly matched in terms of market share, originators had to compete against 20 different processes. "With the consolidation in the market, sure, the big lenders are becoming bigger, but I think it also gives small- to medium-sized lenders, like community banks and credit unions, an opportunity to innovate and do something really different to stand out," he said.

For instance, they could offer a more automated mortgage process, leverage technology to enhance customer service, or extend a shorter close time or greater availability at the point of sales, Garritano pointed out.

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> — Tony Garritano, Progress in Lending Association

However Wells' market position is construed, even Thornberg, despite his bullish take on the bank, acknowledged that industry supremacy—by Wells or anyone—isn't necessarily for the best. "We need to get away from this sort of market that's dominated by a few big players," he said. "I think, in general, if we want to wean ourselves off Fannie Mae and Freddie Mac, we need to diversify. Obviously, we're not."

Domination Downsides

For his part, Rossi believes that any institution carrying 40 percent of the market "would seriously raise the antennae of the Financial Stability Oversight Council," which, according to the U.S. Department of the Treasury, was established under the Dodd-Frank Act to provide comprehensive monitoring to ensure stability of the nation's financial system. "The [FSOC] would ask themselves whether [such dominance] is something they should allow," Rossi said. Has that happened? "Among regulators, I've talked to privately about this issue, I think there are concerns that prompt their attention," he said. For instance, he cited anti-competitive issues that could stem from Wells' success, creating an environment that would position it to assert greater market power than others on pricing and products. "I think that will have repercussions and create more tension in the marketplace," Rossi said.

Perhaps, but Heid said market share growth is an outcome of providing good service to customers and clients who choose to bring Wells first-time and repeat home lending business. "We do our best to deliver well, and in a fair and responsible way," he said.

In any event, Wells' prominence, of course, might prompt some to wonder whether the bank's treading into so-called too big to fail territory. Thornberg doesn't think it is. "They're not keeping mortgages in house; they're mostly acting as a conduit," he said.

Rossi begs to differ. "Yes, that's exactly it," he said of Wells' lurching into the too big to fail zone. "Any time a single institution in a particular sector—such as mortgage origination—dominates like Wells does, you should start to ask why."

Wells Fargo is a too big to fail bank, Mark Williams flatly stated. Williams, executive in residence at Boston University's School of Management, where he also teaches finance, said that as Wells aggressively grows its mortgage business, "it's become increasingly dangerous—particularly because Wells Fargo is an FDIC-insured banking behemoth that continues to grow larger post 2008 banking crisis." The acquisition of Wachovia, "the risk-taking" bank from the South, has expanded Wells Fargo's national deposit base, reach, and risk profile, said Williams.

"The bank is intertwined, coast to coast, in residential and business lending and deposit taking, increasing its risk taking at taxpayer expense," continued Williams, a former Fed bank examiner. "JPMorgan's done it by expanding risky trading, while Wells Fargo expanded mortgage lending in a weak economy."

However, post-crisis, Wells Fargo was designated by the FSOC as financially significant to the stability of the financial system, explained Williams. "The bank's strength or weakness impacts the economy," he said. "An aggressive foray into mortgages might show profit if the economy turns around, but what if Europe or China push the global economy into a new recession? Should the nation's biggest bank by stock market value be allowed to take such risks?"

Value-Added Vision

Too big to fail or not, Rossi's encouraged in part by the fact the bank is maintaining a strong value, enhancing its attractive in the marketplace. He believes Wells' foreseeable future is promising and that it could be a stabilizing influence on the industry.

Heid said as market conditions change, market share might go up or down, but regardless, Wells simply is intent on serving its customers well.

Along those lines, Thornberg doesn't believe Wells is any imminent of being overtaken, largely because other mortgage originators still are repairing their balance sheets. However, that might not stop them from trying, he added. "There's a lot of big boys out there, and if they want to step into this market, they have the ability and will if they see a reason to," he said.

"Not in this environment," said Rossi of the possibility of Wells getting muscled out. "I've heard no one come forward and say anything other than they don't like the mortgage business right now."

Wells embraces competition, emphasized Heid. "Customers should have choices," he said. Besides, it sounds like he believes the bank has leverage. "Unlike some competitors, Wells is part of a well-capitalized company that provides the strength and stability to sensibly grow home lending," he said.

Whether or not Wells is prime for the plucking, Garritano believes things could get a bit more interesting among the top five, whom he noted will have more say in the mortgage space and, as a result, must fight harder to differentiate themselves. If all of the top five offer the same process, products, and pricing, over time, further consolidation at the top is inevitable, he continued. "The top five lenders are fierce competitors among themselves, which is good," said Garritano. "You don't want to have any one player dominate the market."

Not Without My Lawyer

In addition to the company's headline-grabbing lending operations, Wells Fargo's legal maneuvers have also generated buzz in the marketplace.

Wells Fargo Home Mortgage, the nation's largest residential home mortgage originator, will pay at least $175 million to settle accusations that it discriminated against black and Hispanic borrowers, violating fair lending laws, the Justice Department (DOJ) recently announced.

The penalty's "a huge lesson learned," said Clifford Rossi, executive in residence and Tyser Teaching Fellow at the Robert H. Smith School of Business at the University of Maryland. Meantime, Tony Garritano, founder of the Progress in Lending Association, said the government didn't have any choice in the matter. "The government has to curtail predatory practices," he said. "I don't think the industry's done a great job of policing itself, and a lot of predatory practices have been revealed, whether they were intentional or not."

Nevertheless, Garritano's less than enamored by what he perceives as the government's relative unwillingness to consider suggestions for improving the system from industry members themselves. "I think there's an overriding effect among Washington [officials] that mortgage lenders and bankers are part of the problem, but not necessarily the solution," he said. "[It appears] Washington plans to crack down and dictate the moves of lenders and bankers and believes everything will be fine."

But that's impractical, he believes. "[Washington] has to take feedback; there has to be a more valid partnership between lenders and the government," Garritano said.

At the same time, Charles Thornberg of Beacon Economics said to keep in mind that external mortgage brokers—rather than Wells Fargo directly—were culpable in this issue. Wells had a model by which independent mortgage brokers were permitted to run mortgages through the bank, continued Thornberg, founding partner of Beacon, a research and consulting firm specializing in analyses of real estate markets.

The U.S Department of Justice claims are based on a statistical survey of Wells Fargo Home Mortgage loans between 2004 and 2009, and the claims primarily relate to mortgages priced and sold to consumers by independent mortgage brokers, Wells said in a statement.

Wells Fargo settled this matter because "we believe it is in the best interest of our team members, customers, communities, and investors to avoid a long and costly legal fight and to instead devote our resources to continuing to contribute to the country's housing recovery," according to a statement.

In light of the settlement, Wells recently discontinued its wholesale business, a decision that bank spokesman James Hines said was driven by the "complexities of the mortgage wholesale—or broker—business in the current environment." That means the legal theories that underlie the settlement with the DOJ would require that Wells take direct responsibility for the interactions independent brokers have with borrowers, he noted.

Mortgage brokers, which operate as independent businesses and are not employed by Wells Fargo, price the loans they sell, he explained. "Wells Fargo can't set loan prices for independent brokers nor control the combined effect of the negotiations that thousands of these independent businesses have with their customers," he said. Through its decision to no longer fund mortgages by independent mortgage brokers, Wells can control how that commitment is met on every loan Wells Fargo makes, he noted.

Mark Williams, executive in residence at Boston University's School of Management, added that Wells Fargo's settlement in the discrimination suit and exit from the less lucrative wholesale lending business frees it up to put more capital at risk in mortgage lending: a strategy Wachovia and Countrywide proved fraught with financial danger, noted Williams, who also teaches finance at the university.

Ultimately, Rossi's not so sure the punishment levied against Wells will help guard against similar issues in the future. "Many of the same sins have been revisited. We have a bad habit of not remembering," added Rossi. "You cant fully regulate human behavior."