Developing a Securitization Market for Housing Mortgage Loans (2)—Protecting Consumers and Fostering a Healthy Market

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Introduction—Update Since the Last Report

The previous report, released in May 2003 and entitled "Development of a Securitization Market for Mortgage Housing Loans—Fostering Mortgage Bankers and Brokers," argued that like the securitization of commercial real estate, the development of the housing loan market will require business segmentation and specialization.[1]

Specifically, with mega-banks monopolizing the housing loan market, the paper pointed out that the new mortgage housing loans[2] backed by the Government Housing Loan Corporation (HLC), will play an important role in enabling regional banks, small and mid-sized financial institutions, and a new type of mortgage bankers to enter the market and compete on an equal footing, and fostering American-style mortgage brokers.

In this paper, we examine the progress on these issues since last year. Specifically, we analyze the new housing mortgage loans backed by HLC and the response of financial institutions, and the initiative by the Ministry of Land, Infrastructure and Transportation (MLIT) to build a framework to foster mortgage brokers. Finally, we point out future issues in fostering and developing the housing loan securitization market.

1. Status and Prospects of the New Mortgage Housing Loan

The new HLC mortgage housing loan (purchase type) was introduced last year on October 1. As Figure 1 shows, a cumulative total of 2,294 loans have been issued as of June 30 this year.

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[1] F. Shinohara, "Development of a Securitization Market for Housing Mortgage Loans—The Need to Foster Mortgage Bankers and Brokers," (in Japanese) in *Nissay Kisoken Report*, May 2003 (http://www.nli-research.co.jp/doc/eco0305b.pdf). The report discusses the implementation status of housing loans from HLC (the decreasing market share), status of bond issuance by HLC, description of the HLC Housing Mortgage Loan Facilitating Programs (debt purchase and debt guarantee types), status of U.S. mortgage bankers and brokers, and emergence of Japanese mortgage bankers.

[2] Refers to the new housing loan system conducted by the Housing Mortgage Loan Facilitating Program (debt-purchase type). See the HLC web site for details.

Figure 1 Number of New Housing Mortgage Loans (Debt-Purchase Type)

Period	Loans purchased
October 1, 2003 ～ March 31, 2004	805
April 1, 2004 ～ June 30, 2004	1,489
Cumulative total	2,294

Source: Government Housing Loan Corporation website.

However, compared to the planned debt purchase goal of ¥200 billion (10,000 loans) in the fiscal 2003 budget, initial results have been somewhat disappointing. The poor start can be attributed to the following factors, which would suggest that the forecast was overly optimistic.

① Demand for long-term fixed-rate loans was low because expectations of higher interest rates have yet to materialize.

② Financial institutions did not adequately understand or prepare for the new housing mortgage loans backed by HLC mortgage-backed securities.

③ Since financial institutions have their own competitive housing loan products, they did not aggressively explain or promote sales of the new housing mortgage loan to consumers.

④ Not only was the new housing mortgage loan inadequately advertised to consumers, but it was often issued together with conventional HLC loans which consumers and financial institutions are very familiar with. From April 1 to June 30 of this year, 28,366 conventional HLC loans were issued for new-home purchases alone.

⑤ Interest rate terms offered by financial institutions based on the new housing mortgage loan system were quite diverse, confusing Japanese consumers unaccustomed to market competition and self-selection (Figure 2).

⑥ Newly built homes are eligible for the new loan, while existing homes are not. Moreover, borrowers must satisfy a monthly income standard (at least five times the monthly loan payment), and housing lots must be at least 100 square meters in size.

⑦ As a result, the number of financial institutions participating in the new housing mortgage loan facilitating program was insufficient.

Although lagging a step behind, HLC and MLIT have responded with the following measures to encourage financial institutions and consumers to use the new housing mortgage loan.

① Through efforts to explain the system and call on financial institutions to participate, they have doubled the number of participating institutions since last December, centered around regional and shinkin banks. Due in part to rising long-term interest rates, rates at participating institutions are more stable than at initially. In general, regional and shinkin banks offer better loan products than city banks.

② HLC enhanced the information on its web site with a FAQ section for consumers, and set up a consulting window at the head office. MLIT also enhanced its web site with a FAQ section on housing finance for consumers, where the new housing mortgage loan has been introduced.

Figure 2 Financial Institutions Participating in the New Mortgage Housing Loan

	Loan disbursement in December 2003		Loan disbursement in August 2004	
	Initially registered financial institutions	Interest rate range over life of loan (%)	Newly registered financial institutions	Interest rate range over life of loan (%)
City bank	Mizuho, UFJ (2 total)	3.30～3.95%	Tokyo-Mitsubishi, Sumitomo Mitsui, Resona, Saitama Resona (6 total)	3.35～3.39%
Regional bank	Aomori, Michinoku, Shonai, Iwate, Tohoku, 77, Gunma, Yokohama, Daishi, Yamanashi Chuo, Shizuoka, Suruga, Ogaki Kyoritsu, Juroku, Hyakugo, Shiga, Senshu, Ikeda, Tottori, Hiroshima (20 total)	2.98～3.80%	Hokkaido, Hokuto, Joyo, Kanto Tsukuba, Musashino, Chiba, Hokuetsu, Hachijuni, Hokuriku, Toyama, Hokkoku, Shimizu, Mie, Kyoto, Kinki Osaka, Nanto, Kiyo, Tajima, San-in Godo, Chugoku, Awa, Hyakujushi, Iyo, Fukuoka, Chikuho, Shinwa (46 total)	3.27～4.00%
Tier 2 regional bank	Hokuyo, Sapporo, Yamagata Shiawase, Kita-Nippon, Fukushima, Daito, Aichi, Tochigi, Nagoya, Biwako, Shimane, Tomato, Hiroshima-Sogo (Momiji), Saikyo, Kumamoto Family, Yachiyo (16 total)	2.95～3.49%	Shokusan, Ibaraki, Keiyo, Higashi-Nippon, Taiko, Gifu, Chukyo, Daisan, Wakayama, Tokushima, Kagawa, Ehime (28 total)	3.27～3.77%
Shinkin bank	Sapporo, Muroran, Sorachi, Tomakomai, Hidaka, Hakodate, Asahikawa, Shibetsu, Kushiro, Daichi Mirai (see note 3), Morioka, Nagano, Kanazawa, Enshu, Ogaki, Takayama, Tono, Seki, Toyota, Toshun, Kuwana, Kyoto, Hanna, Nara Chuo, Kinokuni, Banshu, Awaji, Tottori, Okayama, Mizushima, Tamashima, Shimonoseki, Fukuoka Hibiki, Amakusa, Oita, Nobeoka, Nango (37 total)	2.89～3.87%	Hokumon, Date, Oshima, Rumoi, Kitami, Abashiri, Shiba, Takinogawa, Tsurugi, Fukui, Tsuruga, Hamamatsu, Mishima, Gifu, Seino, Toyohashi, Okazaki, Chita, Hekikai, Kyoto Chuo, Osaka, Osaka Kosei, Osaka-shi, Kobe, Himeji, Hyogo, Tanyo, Hiroshima, Kure, Hofu, Higashi Yamaguchi, Hata, Kumamoto Dai-ichi, Kagoshima Sogo (71 total)	3.17～3.97%
Credit cooperative	Nagano Prefecture (1 total)	3.45%	Dai-ichi Kangyo, Oita Prefecture (3 total)	3.25～3.40%
Insurance co., mortgage banker	Mitsui Sumitomo Insurance, Co-op Housing Loan, Mortgage Corporation of Japan (3 total)	2.90～3.35%	Tokyo Godo Finance (4 total)	3.29～3.81%
Total	78 institutions Interest rate spread 0.97% 2.90% (Mortgage Corporation of Japan)～3.95% (UFJ)		158 institutions Interest rate spread: 0.83% 3.17% (Oita Shinkin)～4.00% (Daishi Bank, Nanto Bank)	

Notes: 1. Financial institutions in the August 2004 column are new participants since December 2003, bringing the current total number of participants to 158. The interest rate range covers all 158 institutions.
2. For August 2004, UFJ Bank's 4.50% interest rate is omitted from the interest rate range due to a campaign that reduced the rate by up to 1% (to 3.5%) until September 24.
3. Daichi Mirai Shinkin Bank's loan is omitted from the August 2004 interest rate range because the rate is not fixed for the life of the loan, but rises from 3.97% to 4.77% from the 11th year.
4. Other financial institutions also offered preferential terms: Ikeda Bank (2.95% rises to 3.55% from 11th year),, Kumamoto Family Bank (up to 0.1% preferential rate cut when coupled with another loan), Yachiyo Bank (3.55% rate reduced to 3.10% during August), Sorachi Shinkin Bank (2.95% rises to 3.75% from 11th year), Kyoto Chuo Shinkin Bank (3.10% rise to 3.70% from 11th year), Mizushima Shinkin Bank (2.99% rises to 3.55% from 11th year), Kagoshima Sogo Shinkin Bank (0.1% preferential rate cut with salary deposit), Co-op Housing Loan (0.1% preferential rate cut from affiliated bank).

③ Loan application criteria have been eased, and the new loan has also been slightly differentiated from conventional loans as follows.

From April 1, 2004:

- Housing on lots smaller than 100 square meters are eligible. Minimum lot size rules have been relegated to the building code and local public organizations.
- For collective housing, dwellings with floor space of at least 30 square meters are eligible (down from 50 sq. meters; maximum floor space is 280 sq. meters).
- In addition to freestanding and collective housing, terrace houses and multi-story houses are also eligible.
- When building new housing, it is possible to leave the existing housing, storage shed, or garage standing on the same lot (restrictions apply for conventional loans).

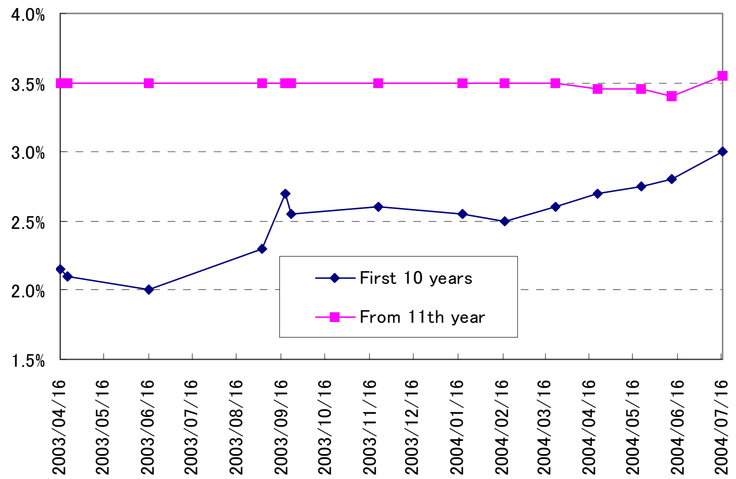
From October 1, 2004:

・The required monthly income has been reduced from five times loan payment to four times.

・The new loan can be used to purchase an existing home that is less than ten years old and certified to meet the loan's technical standards.

④ Finally, an unintended but contributing factor is rising long-term market rates and the need to raise the conventional HLC loan standard rate, which is linked to the Fiscal Investment and Loan Program. These have enhanced the relative merit of the new loan's fixed rate and attracted more consumers.

Figure 3　Standard Interest Rate of Conventional HLC Loan



Source: Compiled using data from the HLC website.

With the doubling of participating institutions, stabilization of offered loan rates, easing of application criteria, and increasingly advantageous fixed interest rates, we expect the new housing mortgage loan to grow steadily.

However, the MLIT's challenging goals for the loan facilitating programs—80,000 loans worth ¥1.6 trillion in the fiscal 2004 budget (70,000 debt-purchase loans[3] worth ¥1.4 trillion and 10,000 debt-guarantee loans worth ¥200 billion), and 100,000 total loans worth ¥2 trillion in the fiscal 2005 budget request—these ambitious goals appear difficult to obtain due to competition with private sector housing loans, even if conventional HLC loans continue to shrink.

The MLIT is further trying to promote the new housing mortgage loans by: (1) raising the maximum loan amount from ¥50 million to ¥80 million, and (2) providing housing loan insurance (on 10% of the total loan) for co-loans that combine the new securitized housing loan with a private loan.

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[3] Refers to the new housing loan system conducted by the Housing Mortgage Loan Facilitating Program (debt-guarantee type). See the HLC web site for details.

Figure 4 HLC Operating Budget

	FY 2005 budget request	FY 2004 budget
Securitization facilitating program		
Debt purchase	90,000 loans (¥1.8 trillion)	70,000 loans (¥1.4 trillion)
Debt guarantee	10,000 loans (¥0.2 trillion)	10,000 loans (¥0.2 trillion)
Sub-total	100,000 loans (¥2 trillion)	80,000 loans (¥1.6 trillion)
Housing mortgage brokerage	200,000 loans (¥3.2 trillion)	220,000 loans (¥3.5 trillion)
Total	300,000 loans (¥5.2 trillion)	300,000 loans (¥5. trillion)

Source: Compiled using data from the HLC website.

2. Fostering Mortgage Brokers

1. Expectations for Housing Suppliers

With economic and institutional conditions increasingly favoring the new HLC housing mortgage loan, the way to encourage competition in the loan market so as to obtain better loan terms, consumers themselves need to gain more information and knowledge, and be able to choose the most favorable loan terms through competition.

However, since many consumers cannot be expected to act in this way, what is needed in Japan are mortgage brokers like those in the U.S. and U.K., who stand in the consumer’s shoes and give appropriate advice, and help find the best loan products suited to the consumer’s requests.

Thus far in Japan’s housing loan market, intermediaries serving a broker-like function have consisted only of financial planners. Much of the lending is actually arranged by “housing suppliers” (including developers, house builders, and real estate agents), who have ties to specific banks. This situation is not expected to change in the near future.

To promote the housing loan securitization market and the interests of consumers, the MLIT, through the Housing Finance Progress Association, organized the Committee for the Safe and Smooth Origination of Housing Loans Through Developers, House Builders and Real Estate Agents.[4] The committee released a final report that calls for housing developers to act as “housing loan advisers” (tentative name) and voluntarily play a minimal role for consumers. It is

[4] The committee consists of Prof. Shinya Imura of Chuo University (chairman), Prof. Higashi Ohgaki of Ritsumeikan University (and president of Mortgage Corporation of Japan), and Hajime Inou (director of Real Estate Economic Institute Co.). Participating government offices are the MLIT General Policy Bureau (Real Estate Industry Section) and Housing Bureau (Housing Policy Section, Housing Production Section, and Housing Funds Management Office), and HLC. Observers include the Real Estate Companies Association of Japan, FRK(The Association of Real Estate Agents of Japan), National Federation of Real Estate Transaction Associations (NFRETA), Japan Federation of Housing Organizations (JHO), General Federation of Construction Workers’ Unions. The Housing Finance Promotion Association served as organizer. NLI Research Institute cooperated in managing the study group and writing the report. The author would like

the first time the government has taken such an initiative in this field. The report's findings are detailed below.[5]

2. Findings of the Committee's Final Report

① *Housing loan intermediary business*

Housing suppliers often act as loan intermediaries between financial institutions and consumers. Even among the new mortgage bankers, there have been cases where housing suppliers use their sales representatives to introduce customers to banks and act as intermediaries in processing loans.

In the U.S., mortgage brokers account for 65% ($1.69 trillion) of all housing loans. The number of brokers is estimated at 44,000 companies (449,000 employees). While brokers generally must register with state banking regulators, registration qualifications such as work experience are relatively lenient. However, under Department of Housing and Urban Development guidelines, brokers who do not charge reasonable commissions are in violation of the law.

In the U.K., the same role is played by mortgage intermediaries, who account for a 60% market share (14,000 persons). In the past, the Council of Mortgage Lenders (CML), a trade association, has relied on voluntary registration and compliance with ethical and business guidelines, but registration with the Financial Services Authority (FSA) has become mandatory beginning in October of this year.

In Japan, it is assumed that housing loan intermediaries will perform the following activities:

> *Sales activity*—gather housing loan information from multiple financial institutions; disclose customer inquiries and intermediation activities, commissions, handling of personal data, etc.
>
> *Consulting*—explain lending conditions such as financial institution, type of interest rate, interest rate fluctuation risk, payment method, expenses, etc.; ask customers about desired conditions such as maximum repayment amount, etc.; perform loan simulations with various loan amounts, repayments, loan periods, etc.; gather and select housing loans that meet customer's conditions, etc.; present several alternative repayment plans.
>
> *Intermediation for preliminary credit approval*—report preliminary credit approval result to customer, and negotiate with financial institutions if approval is denied.
>
> *Intermediation for loan application*—Present and recommend repayment plans to customer for their selection; assist in preparing loan applications and submitting to financial institution; report loan approval result, or explain reasons for denial.
>
> *After loan disbursement*—Confirm loan disbursement; provide advice and intermediation

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to thank the MLIT for permission to use the report's findings in this paper.

[5] The final report is available at (http://www.mlit.go.jp/jutakukentiku/house/jyuutaku-loan/saisyuuhoukoku16.06.pdf).

regarding accelerated repayment and refinancing.

The report recommends that housing loan intermediation by housing suppliers should be implemented in an appropriate manner. While financial institutions also benefit from brokers, very few financial institutions currently use this type of business model. However, with housing suppliers playing a key role in newly formed non-banks (mortgage banks), and with the potential growth of skilled housing loan brokers, a new and viable fee business may emerge vis a vis financial institutions.

2. Providing housing loan information to consumers

Financial institutions are the principal provider of information on loan product characteristics, risk, etc. to consumers. Under the Banking Law, banks have a duty to provide material information to counterparties. In addition, the Act Against Unjustifiable Premiums and Misleading Representations stipulates fair competition rules for representation in the banking industry as follows: "In representing their financial products and services, banks must in the plainest and most straightforward language possible, strive to present accurate information with clarity" regarding "loan duration and amount, risk, conditions of borrowing, interest rate, conditions of repayment, fees, and other matters stipulated in the rules of implementation."

However, while banks and other financial institutions have the primary duty to explain housing loans, housing suppliers who act as intermediaries have no particular duty to inform consumers about anything.

By comparison, in the U.S., the Real Estate Settlement Procedures Act (RESPA) requires lenders to provide applicants a good faith estimate (GFE) of title insurance, registration and other specific settlement service charges not later than three business days after an application is received. Disclosure of charges in connection with the settlement is also required in the uniform settlement statement. Although somewhat complicated, under the Truth in Lending Act, the loan amount, interest and other expenses, annual repayment amount and other information must be disclosed in the truth-in-lending statement.

Similarly, in the U.K., starting at the end of October 2004, the Financial Services Authority requires the disclosure of initial disclosure documents (IDD) at the start of transactions, and key facts illustration (KFI) statements.

Since disclosure of loan product characteristics, risk, etc. helps to enhance consumer protection, it is critical that financial institutions as well as housing suppliers enhance their disclosure practices. Recently, while a variety of loans are offered, consumers do not always shop around to find the best available loan.

Given the significant size of loans and interest rate effects, real estate sellers and agents must be kept from making misleading explanations that will invite future trouble. A key challenge is to establish the proper environment so that consumers can responsibly select a housing loan.

3. Training and development of housing loan advisers

For housing suppliers, expanding training opportunities for housing loan intermediaries helps boost consumer confidence. In addition, they also benefit from continual in-house training and knowledge acquisition and information gathering from outside.

With private financial institutions offering new housing loans including long-term fixed-rate loans, and the HLC offering both conventional loans and the new housing mortgage loan, consumers are increasingly seeking more reliable advice on loan selection.

Loan specialists are needed who have the confidence of consumers. To fulfill this need, voluntary efforts by housing suppliers and industry groups should be augmented by a framework to train and develop housing loan advisers (tentative name), thereby building consumer confidence as well as opening up new business opportunities between financial institutions.

Regarding real estate sales and brokering, since housing suppliers deal directly with consumers, it would be useful for them to provide more information on housing loans. With the main objective of enhancing the loan expertise of sales representatives, housing suppliers should voluntarily train housing loan advisers as part of employee training programs, and then designate them as loan intermediaries to interact with consumers. The training program should impart the minimum essential functions for handling housing loans: customer data management, compliance issues, and basic characteristics and risk related to housing loans.

A new designation of senior housing loan advisers (tentative name) would be capable of proposing comprehensive life planning for consumers, while offering advice on methods of borrowing and loan repayment, refinancing, prepayment, and loan delinquency. The committee also proposes an advanced training program on matters of financing, taxation, housing and real estate.

To nurture public confidence in housing loan advisers and raise their public profile, one possibility is for housing suppliers and industry groups to collaborate with a neutral organization to train housing loan advisers.

To achieve a certain degree of neutrality and objectivity in managing housing loan advisers, an ethical code of conduct should be considered for loan intermediation operations, including protection of personal data, legal and ethical compliance, and disclosure practices toward users.

Since the training of housing loan advisers is essentially a private sector scheme, a wide range of entities may become engaged in creating diverse training curriculums. To establish a quality standard for housing loan advisers and ensure the reliability of trainees, we should also consider ways to issue certifications through a neutral institution, or to establish a collaborative framework among various training institutions. In addition, we also must study how to coordinate or arrange the new certification with similar certifications already in existence.

4. Report's conclusion

Since housing loan users have direct contact with housing suppliers rather than with financial institutions, housing suppliers need to enhance the loan product information they provide. Based on the coordinated efforts of housing suppliers and related parties, the committee expects that the environment will improve for the public to choose appropriate housing loan products. If the need arises, the committee must pursue further research on how to flexibly deal with issues and policies for the Japanese-style mortgage broker business.

3. Present Status in Japan—Desired Policies

The report of the Committee for the Safe and Smooth Origination of Housing Loans Through Developers, House Builders and Real Estate Agents proposes that housing suppliers, being directly engaged in housing loan intermediation, take the initiative in training housing loan advisers with a minimal standard of knowledge and ethical and legal compliance. The committee's report should be commended as the first endeavor in Japan to propose guidelines for a training curriculum and ethical code of conduct.

While the proposal envisions a mortgage brokerage system in the future, under the current deregulatory environment, the industry is vigorously resisting additional regulations and related costs. Thus the proposal's initial thrust has been lenient, and limited to urging the industry to take voluntary steps.

However, in the U.S. and U.K., real estate and financial regulations have actually grown more rigorous despite the prevailing deregulatory environment. As explained earlier, the U.S. home mortgage market has strict disclosure rules regarding mortgage broker operations, compensation, and expenses.

In the U.K., the traditional adjustable interest rate loan market has witnessed a growing demand for new fixed-rate loans, while the percentage of financing through securitization has been rising. From the perspective of consumer protection and investor interest, the regulation of mortgage intermediaries has shifted from a voluntary industry-led framework to official regulation by the FSA as of the end of October 2004.

However, in sharp contrast to Japan, the U.K. industry has welcomed new regulations as a step toward enhancing the quality and reliability of intermediaries, thereby leading to further market development.

Let us examine the contrasting receptions. The development of housing loan advisers will admittedly enhance consumer protection. But in the U.S. and U.K., a further important goal is sought—to assure the healthy development of the securitization market and heightened confidence of institutional investors, thereby improving financing conditions in the market.

In 2004, for example, Fannie Mae, a key player in the U.S. mortgage securitization market, announced the goal of "expanding responsible lending" to eliminate predatory lending practices.[6] This goal is supported by an eight-point responsible lending strategy, as quoted below.

① Issuing business guidelines to avoid purchasing loans with abusive features
② Expanding the application of conventional conforming practices to the subprime market
③ Advancing a Mortgage Consumers Bill of Rights agenda
④ Offering a broad range of alternative responsible products
⑤ Leveraging technology to expand markets and reduce costs for consumers
⑥ Working with servicing partners to keep borrowers in their homes
⑦ Providing tools and resources for the home-buyer education industry that allow educators to assist potential borrowers in preparing for homeownership and understanding the total costs associated with homeownership
⑧ Supporting the Fannie Mae Foundation and its consumer outreach and education efforts

Moreover, a May 2004 survey of approximately 40,000 Freddie Mac mortgages empirically confirmed that borrowers participating in re-purchase counseling programs saw a 19% decrease in 90-day delinquency rates of mortgages; the decrease was as large as 34% for borrowers participating in individual counseling programs.[7]

These results, which show that future loan delinquency rates can be improved by housing loan advisers who provide appropriate information and consultation at borrowing time, are being applied to policies.

At the same time, Japan's media has reported on the massive injection of tax money due to delinquent and nonperforming HLC loans, including those of credit guarantee corporations.[8] As the housing mortgage facilitation programs (debt-purchase and debt-guarantee types) expand in the post-HLC era, housing loan advisers will need to play a growing role in Japan's securitization market. Their role will not only be to protect consumers, but to reduce the debt delinquency rate, thereby improving ratings for future residential mortgage-backed securities (RMBS), and

[6] See the Fannie Mae website (http://www.fanniemae.com/initiatives/lending/index.jhtml?p=Initiative&s=Expanding+Responsible+Lending).
[7] H. Abdighani and P. Zorn (2001), "A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling."
[8] See the August 19, 2004 morning edition of *Nikkei Shimbun*. This also appears in HLC disclosures to investors.

attracting more investors into the market.

To prevent economic stimulation policies from triggering excessive borrowing, lenders must heed their duty to always consider the payment ability of borrowers and collateral value of housing. In emulating Fannie Mae, HLC essentially must win the unwavering confidence of investors. A key factor in this is the training of housing loan advisers, which due to strong industry resistance has been left to voluntary compliance. However, if progress is slow, the government may initiate a system similar to those in the U.S. and U.K. with the aim of protecting consumers and developing the RMBS market. If Fannie Mae's strategy provides any clue, these efforts will lead to better products that serve consumers' interests.