Wells Fargo faces mortgage risk by Apil Gupta

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One out of every three home loans in the USA is currently being funded by Wells Fargo and Co., which scaled back its subprime lending in 2004, around 4 years before the housing boom. Besides this move, the bankâ€™s reduced exposure to investment banking and Europe is the reason why Wells Fargo was able to escape depreciation in ratings by Moodyâ€™s recently. However, banking experts and ex regulators are concerned over the fact that Wells Fargo, which is the fourth largest bank in the USA, may begin to get over-exposed to the housing market. The firm is adding mortgages to its books as the economy is slowing down and interest rates are near record lows.

However, if there in an improvement in the economy and the rates increase, mortgages will suffer more than other kind of loans, and the income of the firm will reduce. There may be the case that another recession has an impact on the bank, since there defaults would rise. According to Wells Fargo, it has the capacity to manage the risk and does not see a reason to stop expanding. Hundreds, probably thousands of underwriters, loan processors and call center employees are being hired, and the bank is also investing billions in new loans and tens of millions in the infrastructure to manage the same.

For a very long time, investors have praised Wells Fargo for their allegiance to traditional commercial and consumer banking, ignoring risky initiatives like credit derivatives trading. However, this also does not take away the fact that even traditional banking can be pretty risky, and by expanding its operations to such an extent in the mortgage industry, Wells Fargo is inherently dependent for its revenues on just one kind of loan. It is no secret that diversification is of vital significance in the banking industry, and Wells Fargo does not seem to be following this time-tested principle. However, the bank is confident of pulling this off, owing to its decades of experience in risk management, and its officials also mentioned that it is expanding operations even as underwriting standards are conspicuously strict and property values are also quite low. The combination of its delinquency and foreclosure rate was 6.89 percent at the end of the first quarter, which was nearly half of the Bank of America Corp, one of its chief rivals.

Besides the obvious risk to Wells Fargo, the mortgage growth is also raising eyebrows owing to the fact that just one company is having such unparalleled dominance in one of the industries that is so critical to the economy of the USA. According to a senior official at the Federal Housing Finance Agency, itâ€™s important that the mortgage market should become more competitive. However, Wells Fargo sell them on is also a key source of funding for many smaller banks that issue mortgages and to lenders and the company, in the form of correspondent lending. Hence, in a way, the firm is also helping the economy recover.

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