HOUSING POLICY COUNCIL

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Request for Input on Eligibility Requirements for Single-Family MBS Issuers
Submitted August 9, 2021

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Michael R. Drayne
Acting Executive Vice President
Ginnie Mae
425 3rd Street, SW, Suite 500
Washington, DC 20024

Re: Request for Input on Eligibility Requirements for Single-Family MBS Issuers ("RFI")

Dear Acting Executive Vice President Drayne:

The Housing Policy Council ("HPC")[1] advocates for a safe, sound, resilient, and equitable mortgage finance system, and shares in Ginnie Mae's goal to promote the success of the MBS Program while protecting its government guarantee. From this perspective, HPC supports revisions to the financial eligibility requirements for single-family MBS issuers that would contribute to systemic market stability and regulatory alignment, including the adoption of risk-based frameworks that are well calibrated to the diversity of Ginnie Mae MBS Program participants. We welcome the dialogue initiated by this RFI and emphasize the need for additional collaboration between Ginnie Mae and MBS Program stakeholders on this consequential topic.

HPC Encourages Implementation of Prudential Financial Requirements for MBS Issuers that are Risk-Calibrated, Consistent Across Regulators, and Developed in Collaboration with Stakeholders.

HPC has continually called for prudential standards that are clear, aligned, tailored to specified risks, and consistent across regulatory frameworks.[2] The net worth, liquidity, and capital requirements imposed by Ginnie Mae, FHFA, and state regulators can be a source of market stability provided that these requirements are established, defined, and applied in uniform fashion. The opposite is also true. A regulatory landscape with divergent and fast-evolving prudential requirements can be unsettling to the market.

HPC believes the proposed revisions to Ginnie Mae's net worth and liquidity requirements promote regulatory alignment and reflect a rational risk-based approach to counterparty oversight that should enhance safety and soundness in the government-backed mortgage segment. Accordingly, HPC extends its general support for implementation of the proposed revisions to issuer net worth and liquidity requirements.

In contrast, <u>we urge Ginnie Mae to withhold implementation of the proposed Risk-Based Capital (RBC) Ratio in the manner and timeline outlined in the RFI.</u> As an essential component of our housing finance system, Ginnie Mae is faced with the difficult task of balancing the

[1] HPC is a trade association comprised of the nation's leading mortgage lenders, servicers, mortgage insurers, and title and data companies. HPC advocates for the mortgage and housing finance interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable home ownership opportunities that lead to long-term wealth-building and community-building for families.

[2] For example, HPC has emphasized the need for state-based prudential standards to demonstrate "consistency with federal practices, uniformity in application, and alignment with the risks of mortgage servicing and the business models of nonbank mortgage servicers." See [HPC Response Letter to CSBS Relating to the Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers](#).

implementation of program standards that enhance safety and soundness against the potential for market disruptions. We encourage Ginnie Mae to not shoulder this task alone. HPC and its full membership are willing to dedicate the time and resources necessary to coordinate industry outreach and collaboration efforts to inform the thorough development of prudential standards. In this spirit, we offer the following observations.

Implementation of the RBC Ratio, as expressed in the RFI, May Cause Undue Disruption that Reduces Systemic Safety and Soundness, and Therefore, the RBC Ratio Proposal Is Not a Reasonable or Adequate Counterparty Risk Oversight Tool for Ginnie Mae.

While HPC supports exploration of a risk-based framework, we caution that making the proposed RBC Ratio effective for the current fiscal year will likely cause more disruption than necessary. We cannot overstate our concern that stakeholders have not had sufficient time or information to conduct a comprehensive assessment of the downstream impacts associated with implementation of the RBC Ratio proposal or to explore an alternative flexible framework that may better address Ginnie Mae's concerns. Without the benefit of a more thorough analysis, industry cannot provide Ginnie Mae with the depth and breadth of information necessary to weigh the systemic benefits of the RBC Ratio proposal, or some alternative risk-based framework, against potential systemic risks nor to advise as to the probability or degree of the same.

When implementing the comparable prudential standards, the traditional practice across bank regulators has been to allow ample time for careful, analytical consideration of capital and liquidity requirements and significant lead-time for implementation. Typically, Ginnie Mae too has recognized the importance of providing ample time prior to increasing net worth, liquidity, or capital requirements.[3] This gradual approach helps to avoid unintended consequences by ensuring new requirements are vetted across the array of business models and risk management and funding practices in the marketplace. The immediate enactment of substantial revisions to the issuer financial eligibility requirements would amount to a shift in policy posture[4] and could be a source of market disruption.

We understand Ginnie Mae "anticipates that only a small number of issuers"[5] would be unable to meet the RBC Ratio requirement by the end of fiscal year 2021. Models and projections about the likely degree of non-compliance with the new requirements do not fully illustrate the downstream impacts associated with the proposed RBC Ratio formula. Issuers and their counterparties rely on the issuer financial requirements in the Ginnie Mae Mortgage-Backed Securities Guide ("MBS Guide) to structure agreements and transactions. Due to the potential repercussions associated with breaching established minimum financial ratios, Issuers are likely to set a compliance floor that would be higher than the minimum ratio announced, which in turn, would cause Issuers to rebalance their asset allocations within a short time frame. While we acknowledge that the rebalancing of capital structures for certain Issuers may well be the intended outcome for Ginnie Mae, we also warn that forcing this market activity within such

[3] For changes to net worth, liquidity, and capital requirements, Ginnie Mae typically provides lead times that go into at least the fiscal year following the date of publication. See, e.g., APM 14-16: New issuer Net Worth and Liquidity Requirements (providing Issuers over 14 months to comply with increased net worth and liquidity requirements; see also APM 19-06: Counterparty Risk Management Policy Series – Volume 3: New Rating Requirements, New Risk Factors, Revised Financial Requirements, and Other Revised Participation Requirements.
[4] While Ginnie Mae does implement some program changes immediately upon announcement, it is typical for the agency to provide longer implementation dates for changes to financial eligibility requirements. Please see footnote 3, *supra.*
[5] Ginnie Mae RFI, Eligibility Requirements of Single-Family MBS Issuers.

short time periods is likely to prove unduly disruptive to the government-backed mortgage servicing segment.

Moreover, disruption is neither warranted nor necessary to advance Ginnie Mae's objective. The net worth, liquidity, and capital structure of MBS Issuers would more than likely begin to shift in the direction sought by Ginnie Mae immediately upon the publication of an announcement formally adopting revised standards—even if those standards were not mandatory until fiscal year 2022 or later. <u>To be clear, HPC advocates for an adequate adoption timeline for all changes proposed in the RFI, but more importantly, we emphasize the need for Ginnie Mae to have further engagement with program stakeholders before finalizing any potential RBC Ratio or alternative requirement.</u>

HPC Invites Ginnie Mae to Collaborate on the Development of a Risk Based Approach to Capital Requirements or Other Risk-Based Alternatives That are Better Calibrated to Specified Risks and Reflective of the Diversity of MBS Program Participants

The government-backed mortgage segment is, at its core, a public-private partnership, in which the ultimate success of the MBS Program, the FHA, the VA Loan Benefit Guaranty Program, and the USDA Rural Development Loan Guaranty Program is inextricably intertwined with the long-term success of MBS Issuers and the value of their service offering to the targeted borrower segments. We believe that Ginnie Mae's dual objective of supporting successful MBS Issuers while protecting its government guarantee would be well served by providing the data, assumptions, risk descriptions, and testing scenarios underlying the proposed RBC Ratio. The determination of whether the RBC Ratio is reasonable and appropriate must be made by reference to a better understanding of the specific risk(s) that Ginnie Mae intends to minimize by its adoption. The disclosure of the data, factors, and assumptions informing Ginnie Mae's RBC Ratio proposal would afford program stakeholders the opportunity to advise on optimization and drive toward greater regulatory alignment.

We presume that the notion of an RBC Ratio is an attempt to prevent the risks stemming from an event of issuer default —that is the risk that an issuer will not be able to remain a going business concern and meet its investor and servicing obligations required by the Guaranty Agreement due to financial impairment. What remains unclear is whether Ginnie views the RBC Ratio as a tool to mitigate issuer-specific risks that it has identified, such as potential government losses incurred upon the taking of a defaulted portfolio, or as a tool to protect against catastrophic risk of systemic failure, such as the risk Ginnie Mae will not be able to direct transfer of issuer responsibility to another issuer or absorb servicing and investor reporting responsibilities through its own master subservicers timely in the event of multiple issuer failures.

Also, we understand that Ginnie Mae regards the capital structure of an issuer and the relative volatility of the assets on their balance sheet as indicators of Ginnie Mae's exposure to these risks. Due consideration should be given to the impact of volatility and HPC encourages further analysis, but we note that the proposed changes in net worth and liquidity requirements aim to mitigate these same risks. The simultaneous addition of the RBC Ratio, as proposed, may lead to a more punitive financial impact on the retention of MSRs held on balance sheet than Ginnie Mae intends, while adding little to the measurement and calibration of the risks in other asset classes.

Ginnie Mae should give due consideration to the fact that the additional capital charges that will result from implementation of the RBC Ratio could reduce IMB participation in government servicing. Considering a risk-based prudential framework for IMBs is a reasonable pursuit. But the proposed RBC rule falls short in how it assesses risk, and it may simply not be appropriate for independent monoline mortgage bankers given their much more simplistic balance sheets and limited number of asset exposures. Our initial assessment of the current formulation identifies potential substantive design flaws. First, the ratio as expressed in the RFI may greatly increase volatility in required capital, which would make it difficult for IMBs to manage capital levels over time. Second, the formulation could discourage the hedging of interest rate risk intrinsic in MSRs given the mismatch between the capital treatment of MSRs and related hedges, and the resulting potential adverse impact on capital ratios. Put differently, the RBC Ratio formula, as proposed, assigns a risk weight to the very assets that are needed to hedge against extreme swings in MSR values without providing any offsetting benefits—an irrational if unintended result.

Among larger, sophisticated, and more diverse IMB operations, the simplistic approach to assessing risk in the formula will not treat all firms equally, will create perverse incentives, and will favor some firms over others without meaningfully reducing risk to Ginnie Mae or to the financial system. If implementation of the proposed RBC rule results in exits from government servicing, the rule could precipitate the realization of the very risks it was designed to mitigate. We believe that measures that expand participation in the government servicing segment are the most effective means to reduce systemic risk and consequently, taxpayer exposure. Hence, we support increasing the clarity and flexibility in Ginnie Mae's proposal in order to maintain and even increase all lender participation in affordable lending.

Given the variety of IMB business models, a risk-based approach should have more dimensions than are reflected in the proposed formula. We recommend that Ginnie Mae evaluate whether its RBC equation is reflective of and responsive to default risks associated with the variety of IMB operating and financial management models.

For example, the formula could assign different treatment to assets with positive convexity used for hedging, reduce the risk weight of MSRs when hedging assets are present, or distinguish between Ginnie, GSE, and PLS MSRs given the different risk profile of each. The model may also require consideration and adjustments based on funding sources, the stability of those sources, the presence of corporate parent guaranties, cross-default agreements with affiliates, as well as the corporate structure of the IMB.

Previously, Ginnie Mae has expressed a desire "to avoid a one size fits all approach which can create unintended limitations on program participation and can cause unnecessary restrictions on all issuers."[6] Without including additional factors, the RBC formula amounts to the type of one size fits all blunt tool that Ginnie Mae has sought to avoid in its counterparty risk oversight. In collaboration with its issuers, Ginnie Mae could and should explore risk-based alternatives that may be more flexible to various circumstances yet more robust to the risks Ginnie Mae wishes to mitigate. In short, the particular RBC Ratio requirement proposed in the RFI may be a less optimal tool to address counterparty and/or systemic risks than other alternatives.

We Encourage Exploration of Other Risk-Based Alternatives More Closely Tailored to the Risks Underpinning the RBC Ratio Proposal.

[6] See Ginnie Mae's issuer Risk Analytics and Risk Management Processes presentation.

HPC believes that safeguarding the availability of sufficient servicing capability in the government segment is paramount. The RBC Ratio, as proposed, not only does not address this risk but also could exacerbate it. For this reason, HPC believes that Ginnie Mae should pursue a resolution planning framework to facilitate an orderly transition of MSRs in the event of issuer failures. HPC recognizes a resolution planning policy as one of the most worthwhile counterparty risk measures that Ginnie Mae could implement.

Safeguarding the economic value of MSRs across business cycles is another approach to managing counterparty risk. For example, Ginnie Mae could increase its Minimum Portfolio Servicing Spread Requirements and enforce limits on encumbrances of excess servicing strips. In APM 19-02, Ginnie Mae already established minimum portfolio servicing spreads. Ginnie Mae could announce gradual increases to preserve servicing income in Ginnie MSRs. Likewise, Ginnie Mae has previously required disclosure of transactions that encumber excess servicing but has not put in place additional controls or limits. Implementing such limits as well as gradual increases to minimum portfolio servicing spreads are two risk-based changes that would lead to lower leverage levels that could moderate the impact of MSR valuation swings. Moreover, such changes are a natural evolution of prior Ginnie Mae policies that could prove less disruptive than the proposed RBC Ratio while protecting Ginnie Mae against potential portfolio losses in an event of issuer extinguishment.

To address concerns related to capital structures reliant on MSRs more directly, Ginnie Mae could consider whether and how MSR to Equity and/or MSR to ANW thresholds might fit within the context of Ginnie Mae's permissible risk parameters policy in Chapter 3, Section 21(b) of the MBS Guide. Express recognition of permissible thresholds would enable Ginnie Mae to assess the adequacy of an issuer's capital structure based on the totality of the circumstances, including the issuer's financing sources and operating model. Notably, unlike the proposed RBC Ratio, this alternative would not apply a negative value to Ginnie Mae's own asset. Moreover, Ginnie Mae has been explicit that it already relies on such metrics when assessing its counterparties. By formally adopting the relevant thresholds in the MBS Guide, Ginnie Mae could promote the equitable treatment of program participants and increase transparency.

To be clear, HPC is not endorsing in specificity any of these approaches. We assume there may be other alternatives that also should be considered. Indeed, among HPC's membership, there are differing views among these alternatives and a consensus that each would need more careful analysis than could be produced with a 30-day comment period. Rather, in the spirit of constructive dialogue with Ginnie Mae and to be responsive to Ginnie Mae's request for input, we are providing examples that demonstrate that alternative approaches to solving for Ginnie Mae's concerns exist. These alternatives, and other that could be developed with more time, warrant deeper review and discussion that cannot be achieved in the timeline outlined in the RFI.

HPC Believes that the Proposed Revisions to Net Worth Standards are Reasonable and Appropriate Risk-Based Counterparty Risk Controls that Could be Improved but May be Implemented without Causing Undue Disruption.

Ginnie Mae has proposed increasing minimum net worth requirements by an amount equal to 25 basis points of an issuer's outstanding GSE obligations thereby making its net worth standard encompassing of both Ginnie Mae issuer responsibilities and GSE seller/servicer requirements. By imposing a lower net worth requirement on the portion corresponding to an issuer's GSE portfolio, the proposal differentiates the risk associated with each program and advances a framework that is aligned with prior FHFA proposals. HPC believes that it is reasonable and appropriate for issuer total net worth requirements to be based on or inclusive of both Ginnie Mae and GSE lines of business. Hence, HPC supports, without qualification, implementation of the net worth framework outlined in the RFI.

HPC does not identify any risks of undue or counterproductive disruptions other than the risks associated with the implementation date already addressed in this letter, but we note that Ginnie Mae should provide additional clarification with respect to the proposal. For example, the term Ginnie Mae obligations is defined as the sum of three pool-level elements, namely "a) all Single-family Ginnie Mae securities outstanding, b) available commitment authority to issue new Single-family pools, and c) total Single-family pools funded."[7] If Ginnie Mae intends to define GSE obligations by reference to the same three general elements, Ginnie Mae should delineate how it plans to accommodate for the differences between the pool level and loan level structures and between the various loan delivery mechanism across programs.

Given the proposal for upward revisions to Ginnie Mae's minimum net worth requirements, HPC believes that Ginnie Mae could improve its risk posture and support issuer stability by establishing a framework that clearly delineates how issuers may allocate capital during periods of temporary financial stress. The current net worth framework based on strict compliance with a minimum metric is inadequate because it does not recognize the variety of circumstances under which permitting an issuer to go below the minimum threshold to address a temporary situation is preferable to declaring the entity in default. As Ginnie Mae knows, an event of default affects arrangements with third-parties and could make it more difficult for an otherwise viable entity to remain operational. Ginnie Mae's deployment of the COVID-19 PTAP Program is an implicit recognition that such circumstances exist.

Similarly, the minimum threshold framework identifies all Issuers above the minimum as equally compliant with Ginnie Mae requirements even though Ginnie Mae's risk exposure could be substantially different based on an issuer's proximity to the minimum threshold. To address these issues, Ginnie Mae could structure different levels of net worth compliance that enable it to better manage risk while providing additional flexibility to Issuers and their own counterparties if needed and justified. Again, HPC encourages exploration of additional alternatives.

HPC Believes that the Proposed Revisions to Liquidity Standards are Reasonable and Appropriate Risk-Based Counterparty Risk Controls that Could be Improved but May be Implemented without Causing Undue Disruption.

HPC believes that imposing additional liquidity requirements based on an issuer's GSE obligations is an appropriate liquidity measure so long as it reflects coordination between Ginnie and FHFA. Conceptually, HPC also supports increasing liquidity levels based on the amount of loans held for sale but believes that Ginnie Mae needs to provide additional data and assumptions for industry to opine whether the incremental 20 basis points are reasonable and appropriate. HPC would urge recalibration if subsequent FHFA standards differ substantially as this is an area where alignment should be reached to minimize compliance and regulatory costs.

As is the case for the net worth requirements, HPC recommends that Ginnie Mae outline with greater specificity the definitional framework that will govern which loans are subject to the additional liquidity charge. For example, it is unclear whether re-performing or modified loan

[7] See https://www.ginniemae.gov/issuers/program_guidelines/MBSGuideLib/Chapter_03.pdf

buyout held temporarily in an issuer's portfolio awaiting redelivery are considered loans held for sale or how Ginnie Mae's own seasoning and re-pooling requirements affects such determinations.

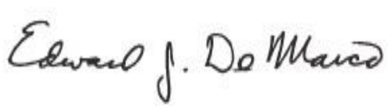
A True Risk-Based Approach to Liquidity Should Provide Different Treatment of Committed but Unused Credit Lines.

The proposed liquidity standard excludes, in their entirety and in all cases, committed but unused credit lines from counting toward satisfaction of issuer's available liquidity requirements. HPC views the total exclusion of committed, but unused lines as an extreme and unwarranted remedy. Committed lines are subject to contractual agreements that recognize the strength of the servicer and include performance monitoring by the creditor banks. Nonbank mortgage servicers pay fees for these commitments in order to have funds available for future use and banks that extend the credit are required to hold capital to support the lines and are required to meet their own liquidity requirements. Therefore, the treatment of committed, but unused credit lines should not be a binary, all-or-nothing, choice; some credit should be given to these credit lines. Moreover, excluding committed, but unused credits lines could create a perverse incentive for IMBs by discouraging the prudent practice of prepositioning liquidity sources before such sources are needed.

Before concluding, we want to return to an important procedural consideration. Ginnie Mae is proposing a significant change in its approach to eligibility standards yet has afforded only a 30-day review and is proposing an effective date this year. As Ginnie Mae considers HPC's response to the RFI, and the responses from other stakeholders, we suggest that Ginnie Mae follow the more traditional practice of providing ample lead-time before effectuating changes to net worth, liquidity, and capital requirements. Likewise, we encourage Ginnie Mae to collaborate with its Issuers to perform quantitative impact studies to assess and calibrate significant changes to capital requirements. A process that would allow IMBs to assess the impact of proposed changes, and Ginnie Mae to evaluate those results, could assist Ginnie Mae in fine-tuning its framework while avoiding the type of disruption associated with the current approach.

Again, we reiterate our commitment to collaborate efficiently and effectively with Ginnie Mae on these and other ideas so that the ultimate outcome best achieves Ginnie Mae's objectives while also enhancing the soundness and stability of the Ginnie Mae market.

Yours truly,



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