



MORTGAGE BANKERS ASSOCIATION

April 30, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

Industry Views on Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers

Dear Director Calabria:

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to offer comments on the updated net worth, capital, and liquidity requirements for independent mortgage banks (IMBs) that are Fannie Mae or Freddie Mac (the Enterprises) single-family Seller/Servicers, as proposed by the Federal Housing Finance Agency (FHFA).²

MBA supports robust financial eligibility requirements for IMBs that operate as Enterprise single-family Seller/Servicers, regardless of size or business model. Robust requirements help ensure that Seller/Servicers will be able to withstand periods of broader economic or financial stress and serve as strong counterparties to the Enterprises throughout the credit cycle. An appropriately-tailored framework will bolster safety and soundness and promote responsible lending, while not unduly raising the cost of credit for consumers.

MBA also appreciates the extended response period provided by FHFA given the time, energy, and resources currently being devoted to the collective industry response to the COVID-19 pandemic. As will be discussed in greater detail below,

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

² FHFA, "Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers," January 31, 2020. Available at: <https://www.fhfa.gov/Media/PublicAffairs/Documents/Servicer-Eligibility-FAQs-1302020.pdf>.

the wide-ranging impacts of COVID-19, including the broad availability of extended borrower payment forbearance for Enterprise-backed loans, represents a unique stress on the housing finance system. Enterprise eligibility requirements should be calibrated to ensure Seller/Servicers can withstand significant market stress. It is neither appropriate nor feasible, however, to attempt to calibrate eligibility requirements to the stress associated with a global pandemic and associated shutdown in economic activity, combined with policy-induced stress that is less foreseeable and is difficult to model.

Below, please find a summary of MBA's observations regarding the newly-proposed eligibility requirements, as well as our recommendations to enhance this framework.

Observations Regarding Financial Eligibility Requirements for IMBs

- IMBs play a vital role as providers of affordable mortgage credit to single-family borrowers throughout the country, particularly with respect to low- to moderate-income and other historically underserved populations. Any financial eligibility framework for IMBs should recognize their role in the market and should not hinder their ability to serve a broad consumer base.
- Similarly, net worth, capital, and liquidity requirements should not be structured in a way that forces IMBs to institute unnecessary overlays that raise the cost and reduce the availability of credit for consumers.
- A well-designed framework should provide incentives for strong risk management by crediting activities that enhance financial resiliency.
- Sound liquidity risk management requires institutions to build liquid reserves during periods of economic expansion and favorable market conditions and allows institutions to draw on these reserves during periods of economic contraction or unfavorable market conditions.
- Coordinated policies, including common data definitions and calculations, across federal and state regulators will allow for improved oversight while also streamlining compliance for IMBs.
- Structural reforms to improve system-wide resiliency should be adopted, including reforms to the servicing of Federal Housing Administration (FHA)-insured loans, the market for Ginnie Mae mortgage servicing rights (MSRs), and the eligibility requirements for Federal Home Loan Bank (FHLB) membership.

Recommendations for the Framework

- Remove the non-performing loan (NPL) threshold and incremental NPL charge to eliminate the procyclical elements of the framework, while also

clarifying that Seller/Servicers will not exceed the NPL threshold due to loans in forbearance as a result of a COVID-19 hardship.

- Provide recognition of unused portions of committed servicing advance lines of credit for purposes of measuring liquid assets rather than eliminating consideration of these lines altogether.
- Differentiate between scheduled and actual remittances in an operationally feasible manner.
- Align financial eligibility requirements across FHFA and the Enterprises, Ginnie Mae, and state regulators to promote consistency and facilitate compliance.
- Align data definitions and calculations across requirements maintained by FHFA and the Enterprises, Ginnie Mae, and state regulators to promote consistency and facilitate compliance.
- Provide for an implementation period of 18-24 months to allow Seller/Servicers more reasonable opportunities to manage their businesses to the new requirements.
- Coordinate with other regulators and federal housing agencies to implement structural reforms to improve the resiliency of the mortgage servicing market.

The Critical Role of IMBs

IMBs represent a vital source of residential mortgage financing throughout the country, particularly in the Enterprise- and Ginnie Mae-backed portions of the market. Over the past decade, IMB market share for single-family financing has increased from 24 percent to 55 percent of total units. Given their focus in the Enterprise- and Ginnie Mae-backed market segments, IMBs now originate the majority of loans to low- and moderate-income households, as well as several other historically underserved populations.

This shift in market share has occurred against a backdrop of significant regulatory and market changes, many of which have deterred depository institutions from playing a larger role. Depository institutions have confronted punitive capital standards related to mortgage servicing activities and uncertainty caused by the excessive use of the False Claims Act to penalize FHA lending, while also recognizing higher returns in other business lines. While some of the regulatory deterrents have been at least partially addressed in recent months, more work is needed to remove these barriers.

IMB market share has ebbed and flowed for more than a century, often influenced by broader market forces. There is no single “correct” balance between IMBs and

depository institutions in the mortgage market; market shares will continue to ebb and flow. As such, regulators should not target a particular market share dynamic, nor should they set regulatory or supervisory requirements based on market share considerations. It is instead more appropriate that such requirements be tailored to safety and soundness considerations to promote stability and resiliency in the market.

In the context of enhanced IMB net worth, capital, and liquidity requirements, it is unclear whether the amendments proposed by FHFA will have a meaningful impact on IMB market share. It would not be appropriate, however, for FHFA to undertake further amendments at a later date simply because IMB market share continued to rise or remained higher than that of depository institutions. Any and all revisions to these requirements should be based solely on safety and soundness considerations.

- **Recommendation:** MBA recommends that FHFA calibrate IMB net worth, capital, and liquidity requirements to the safety and soundness considerations necessary for IMBs to remain strong Enterprise counterparties. Revisions to these requirements should not be undertaken as a means to regulate or influence market share.

Consideration of Pandemic- and Policy-Induced Stress

The onset of COVID-19 and the global slowdown in economic activity has led to significant challenges in a variety of financial markets. In recent weeks, Congress, the Federal Reserve, FHFA, and other policymakers have taken extraordinary steps to stabilize markets for assets or products ranging from agency mortgage-backed securities to money market mutual funds to corporate and municipal bonds.

During this time, the housing finance system has come under pressure due to a unique combination of challenges associated with: 1) impediments to new originations in an environment of limited person-to-person interaction; 2) severely reduced liquidity in fixed-income markets that is dampening investor demand; and 3) servicer advancing obligations in a period of heightened borrower forbearance.

The third of these pressures is of particular importance when considering and assessing IMB liquidity in the coming months. Congress mandated the availability of up to 12 months of payment forbearance – with no documentation requirements – for all borrowers suffering a pandemic-related hardship who have Enterprise-backed loans. This measure, while extraordinary, is appropriate to assist borrowers struggling with unemployment, reduced income, or increased medical expenses. Because servicers are usually contractually required to advance monthly payments to investors, regardless of whether borrowers actually make these payments, servicers

are particularly susceptible to policy actions that facilitate an increased volume of missed borrower payments.

The broad availability of forbearance will exacerbate the volume of missed payments, thereby making Seller/Servicers more likely to exceed the existing NPL threshold if these missed payments are included in the NPL calculation. Over 5 percent of Enterprise-backed loans are estimated to be in forbearance – a figure that is expected to grow in the coming weeks.³ If the NPL threshold and incremental charge are not suspended or removed immediately, or if these loans are not excluded from the relevant calculations, many Seller/Servicers will exceed the threshold shortly, thereby further straining their liquidity positions.

IMB risk management policies, as well as regulator and counterparty requirements, are designed to ensure that IMBs can withstand severe market downturns characterized by rising unemployment, declining home prices, and other economic shocks associated with prior recessions. These policies and requirements therefore consider the credit quality of the loans originated by IMBs, the extent to which there is a robust secondary market for these loans, and the liquid resources available to support ongoing operations, among other factors.

These policies and requirements do not and cannot, however, anticipate wide-ranging shutdowns of economic activity, nor can they anticipate public policy decisions that threaten the health of IMBs by increasing their advance obligations beyond what market conditions would otherwise necessitate. In the case of COVID-19, these policy decisions not only include broad availability of borrower forbearance, but also shelter-in-place orders and other restrictions on commercial activity that have left millions of homeowners with reduced incomes and diminished capacity to make their mortgage payments. Again, these policy decisions are largely justified and appropriate given the dangers associated with COVID-19, but one of their many unfortunate consequences is that they are increasing the number of borrowers who are unable to make their mortgage payments.

Any attempt to calibrate a capital or liquidity framework to this scenario would be highly problematic. Neither financial institutions nor regulators or counterparties can model or predict future policy actions that fundamentally alter the nature of the housing finance system or the flow of payments through this system. To require IMBs – or any financial institution – at all times to hold liquid assets in anticipation of a forced shutdown in economic activity and broad availability of forbearance for borrowers with Enterprise-backed loans, for example, will lead to a severe and unnecessary contraction in available credit for borrowers throughout the country.

³ MBA Forbearance and Call Volume Survey, April 27, 2020. Available at: <https://www.mba.org/2020-press-releases/april/share-of-mortgage-loans-in-forbearance-increases-to-699>.

- ***Recommendation:*** MBA recommends that FHFA give appropriate consideration to the unique circumstances of the global COVID-19 pandemic, combined with the extraordinary policy measures that followed. While these circumstances can and will provide insight into potential strains on IMBs' liquidity under severely adverse scenarios, FHFA should consider historical, market-based stress events – such as the 2007-2009 recession – as guides for setting forward-looking net worth, capital, and liquidity requirements.

The Procyclicality of the NPL Threshold and Incremental NPL Charge

The most problematic feature of the existing liquidity requirements for Enterprise Seller/Servicers, as well as the newly-proposed requirements, is the use of an NPL threshold and incremental NPL charge. These features require IMBs to strengthen their liquidity positions during periods of heightened delinquencies – and presumably broader market stress. Said differently, IMBs must grow their liquid assets, potentially by a significant amount, exactly when it is most difficult to do so and when they need to use these assets to meet increasing advancing obligations. This scenario is not hypothetical; it is unfolding as the impacts of the COVID-19 pandemic deepen and the number of loans in forbearance continues to rise.

A far more sensible approach would require IMBs to build their liquidity positions during periods of low delinquencies. Well-managed IMBs would grow their liquid assets to feature a buffer above the Enterprises' minimum requirements, which would then allow them to use some portion of their liquid assets during periods of high delinquencies while remaining in compliance with the minimum requirements.

The problematic nature of a procyclical liquidity framework extends beyond safety and soundness considerations for IMBs. The presence of an NPL threshold and an incremental NPL charge disproportionately harms IMBs that primarily service FHA loans or loans in states with judicial foreclosure processes, as well as IMBs that specialize in the servicing of distressed loans. The differential treatment of certain types of business models or geographic concentrations is a significant weakness of this framework.

Perhaps more concerning is that IMBs are pressured to institute credit overlays on loans with higher historical default rates – namely, FHA loans – to reduce their likelihood of breaching the NPL threshold. These credit overlays cause direct harm to the low- to moderate-income households and first-time homebuyers that are disproportionately served by FHA lending.

The NPL threshold and incremental NPL charge also lead to diminished liquidity in the market for Ginnie Mae MSR. Potential MSR buyers reduce their demand for

pools with higher delinquencies for fear of triggering the NPL threshold, which in turn makes it more difficult to transfer servicing if needed.

Together, these concerns represent a serious deficiency in the proposed framework that we believe must be rectified prior to any implementation.

- ***Recommendation:*** MBA recommends that FHFA remove the NPL threshold and the incremental NPL charge to eliminate the procyclicality of the framework. At a minimum, FHFA should reduce the incremental NPL charge to reduce procyclicality. FHFA also should either suspend or remove the NPL threshold and incremental charge immediately, or clarify that loans in forbearance due to a COVID-19 hardship are not included in the relevant calculations.

Committed Servicing Advance Lines of Credit

A well-crafted framework for setting IMB minimum eligibility requirements not only will promote safety and soundness, but also will provide incentives for IMBs to engage in strong risk management practices. One example of such strong risk management practices is the use of committed servicing advance lines of credit.

While committed lines vary in structure, their common element is the committed nature of the funding from the counterparty, which typically can be withdrawn only in response to one or more specific covenant violations by the IMB. These lines are more dependable than uncommitted lines that can be withdrawn at any point.

The current Enterprise eligibility requirements incent IMBs to obtain committed lines, as the available portion of these lines is recognized as a liquid asset for purposes of the minimum liquidity requirements. Under the newly-proposed requirements, however, this recognition would be eliminated. As such, IMBs would lose an important incentive to obtain and pay for these committed lines. Some IMBs may determine that, absent recognition from FHFA and the Enterprises, the costs of obtaining a committed line exceed the benefits of doing so. As a result, aggregate IMB liquidity would be weakened.

If the Enterprise requirements do not include credit for committed lines, moreover, IMBs will have an incentive to draw down the available portion of their committed lines at the end of each reporting period to strengthen their liquidity positions. This practice is not necessary under the current framework, as the available portions of committed lines are also credited by the Enterprises. This unintended consequence of the proposed framework does nothing to increase the actual resiliency of IMBs, but rather forces a substitution of available liquidity sources for reporting purposes.

We therefore believe it is inappropriate to remove recognition of committed lines in the new framework. Doing so would remove an important incentive for strong risk management while leading to unintended consequences as IMBs attempt to manage their liquidity positions.

- ***Recommendation:*** MBA recommends that FHFA revise its proposal to allow recognition of an IMB's available, committed servicing advance lines of credit to be included in the definition of "Allowable Assets for Liquidity." Further, FHFA and the Enterprises should consider the merits of recognizing other sources of committed liquidity, such as lines of credit from affiliates or banks, as well as MSR financing facilities, when determining exceptions to the minimum requirements for particular institutions.

Differing Remittance Structures

Another risk management tool employed by IMBs relates to their use of scheduled and actual servicing remittances. Because actual remittances, whether for principal or both principal and interest, require the servicer to advance only the payments received from borrowers, they entail less risk that the servicer will be obligated to fund significant payments to investors if the event of rising delinquencies.

As is the case in the existing framework, however, FHFA's newly-proposed liquidity requirements do not provide credit for servicers that opt for actual servicing remittances. The failure to recognize the important difference between these remittance types is another missed opportunity to incent IMBs to adopt risk management practices that will strengthen their liquidity positions – an observation made by MBA in our comments on the prior revisions to the financial eligibility requirements, as well.

In the proposal, FHFA acknowledges that it does not differentiate between these remittance types and notes that the Enterprises "will continue to evaluate the requirement on an ongoing basis to determine whether a differentiation should be made." Rather than wait until after the revisions to the framework are implemented, FHFA and the Enterprises should develop a mechanism for crediting IMBs that use actual servicing remittances that can be offered on the same timeline as the other revisions to the framework.

- ***Recommendation:*** MBA recommends that FHFA and the Enterprises recognize actual servicing remittances in the framework by instituting lower liquidity requirements for the portion of the servicing portfolio featuring this remittance type. If FHFA and the Enterprises determine that it would be too operationally difficult to implement this policy, they should work with

Seller/Serviceers to implement any necessary changes to systems or procedures.

Consistency across Regulators and Counterparties

The net worth, capital, and liquidity requirements for Enterprise Seller/Serviceers are not implemented or enforced in an isolated manner, as IMBs are subject to regulation, supervision, and oversight by a wide array of entities. All IMBs are licensed and supervised by state-level financial regulators that, in addition to setting safety and soundness requirements, also conduct on-site examinations and collect and analyze company financial reports. IMBs that are Ginnie Mae issuers are likewise subject to net worth, capital, and liquidity requirements imposed by Ginnie Mae. Finally, warehouse lenders and other counterparties typically impose financial covenants that trigger adverse actions or reductions in available credit if breached.

It is undoubtedly in the best interest of both the regulators and the regulated institutions that these various requirements be aligned to the greatest extent possible. Harmonized requirements ensure a common set of benchmarks that increase comparability across IMBs and better enable information sharing and collaboration among regulators. Common benchmarks may also reduce the frequency with which on-site examinations are needed, particularly if state regulators consistently share information and data, freeing resources for other purposes.

For IMBs, the operational challenges and complexities associated with managing regulator and counterparty requirements grow significantly as these requirements diverge. In particular, divergences across state-level requirements create excessive compliance burdens for IMBs that operate nationwide or across a large set of states. These challenges and complexities make it more difficult for IMBs to exercise prudent risk management and develop long-term business plans – a consequence that is only magnified as individual state regulators or other counterparties update or revise their requirements.

Similarly, FHFA, the Enterprises, state regulators, Ginnie Mae, and other counterparties should collaborate to develop consistent data definitions and calculations that underpin net worth, capital, and liquidity requirements. Components such as the types of assets that are deemed to be “liquid” or the calculations to determine an IMB’s “tangible net worth” should be harmonized to promote a broadly-accepted understanding of an IMB’s financial health by all relevant parties.

More simply, there is no inherent reason why these requirements, or the data definitions and calculations that support them, should differ across various regulators and counterparties.

- ***Recommendation:*** MBA recommends that FHFA and the Enterprises work closely with state regulators (including through the Conference of State Bank Supervisors) and Ginnie Mae to align net worth, capital, and liquidity requirements for IMBs. Similarly, these parties should align on common data definitions and calculations. Such collaboration should include engagement and consultation with warehouse lenders and other IMB counterparties, as appropriate.

Implementation Timeline

Within the proposal, FHFA notes that it “anticipates finalizing these requirements in the second quarter of 2020 and anticipates that the requirements will be effective six months after they are finalized.” MBA is concerned that the timeline for implementation will cause unnecessary strains on IMBs, particularly in a period during which they are likely to be managing the ongoing effects of the COVID-19 pandemic and related borrower forbearance.

The imposition of heightened minimum requirements would cause very few IMBs to fall out of compliance immediately – that is, most IMBs already satisfy these requirements. This fact does not, on its own, support or necessitate a compressed implementation timeline that is far shorter than the timelines associated with comparable changes in bank liquidity requirements in recent years. Many IMBs seek to maintain a particular buffer above the minimum requirements as a matter of prudent risk management. An increase in the minimum requirements would therefore lead many IMBs to increase their liquid assets to maintain their desired buffers.

Such efforts to strengthen liquidity positions should not be undertaken throughout the market in such a concentrated period. If, for example, many IMBs sell MSRs to increase their cash positions in a window of a few months, these actions could further depress already-weakened MSR valuations and liquidity, thereby triggering other financial strains among IMBs and in the broader market.

While MBA had concerns regarding the 6-month implementation timeline prior to the COVID-19 pandemic, those concerns are only magnified as a result of current market conditions. Over the next several months, IMBs will face potentially severe liquidity challenges due to what could be an unprecedented level of required borrower forbearance. Many IMBs may need to access temporary liquidity facilities, such as the Ginnie Mae Pass-Through Assistance Program, to ensure congressionally-mandated borrower forbearance does not jeopardize their ability to advance payments to investors. Simply put, this is not the context or environment in which IMBs should be adjusting their business models to new requirements in a compressed timeframe.

- ***Recommendation:*** MBA recommends that FHFA target a more reasonable implementation timeline of 18-24 months. If FHFA deems more immediate action to be necessary, it could phase in certain requirements – for example, by implementing new net worth requirements after 12 months, base liquidity requirements after 18 months, and any other changes after 24 months. FHFA should act immediately, however, to clarify that loans in forbearance due to a COVID-19 hardship will not cause Seller/Servicers to exceed the NPL threshold.

Other Structural Reforms to Enhance Resiliency

Net worth, capital, and liquidity requirements are important components of prudent risk management and regulatory oversight, but they are not the only mechanisms by which policymakers can strengthen the mortgage servicing market. A number of structural reforms to the housing finance system have the potential to further enhance stability, attract more diverse sources of capital to the mortgage market, and increase the capacity of regulators to respond to market stress.

Misalignment in servicing requirements across various federal agencies and the Enterprises raises costs for servicers while also producing varied outcomes for borrowers. Standardization of these requirements – particularly adapting FHA requirements to better align with those of the Enterprises – would increase the value of Ginnie Mae MSRMs and with it the overall health and strength of servicers with Ginnie Mae portfolios. Specific FHA servicing improvements include adoption of a single foreclosure timeline, use of proportional curtailment of advances, elimination of costly anachronisms like the face-to-face meeting requirement for delinquent borrowers, and a streamlining of heavy documentation requirements.

Increased functionality in the Ginnie Mae program also holds the potential to improve MSR valuations and liquidity. Steps already underway to transition the program to one featuring loan-level capabilities – that is, the ability to transfer servicing on individual loans (also known as “splitting pools”) – will encourage more institutions to invest in Ginnie Mae servicing. Reforms to allow a broader range of institutions to maintain direct ownership of MSRMs should also attract more investment into this market. These program improvements also should facilitate more fluid servicing transfers when servicers are facing periods of severe stress.

Finally, FHFA should consider mechanisms by which well-managed IMBs that meet appropriate financial benchmarks can gain eligibility for FHLB membership. Such eligibility could come directly through legislative actions permitting IMB membership or through expanded use of captive insurance affiliates, as has been permitted previously. Membership for IMBs could entail FHLBs offering advances that are collateralized by MSRMs or servicing advances. This expansion of FHLB membership

eligibility, if exercised responsibly, would diversify and strengthen IMB liquidity sources while further promoting the housing finance mission of the FHLB System.

- *Recommendation:* FHFA should coordinate with other regulators and federal housing agencies to implement structural reforms and standardization of requirements where possible to improve the resiliency of the mortgage servicing market. Specific reforms include harmonization of servicing requirements across the Enterprises and the federal housing programs, development of loan-level program capabilities at Ginnie Mae, and expanded FHLB eligibility to encompass IMBs.

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Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 and pmills@mba.org.

Sincerely,



Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association