A Primer and Perspective on Ginnie Mae

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INTRODUCTION

Several housing finance reform models, including the September 2019 US Department of the Treasury's (Treasury) Housing Finance Reform Plan Pursuant to the Presidential Memorandum Issued March 27, 2019 (the Treasury Plan) and Senate Banking Committee Chairman Mike Crapo's March 2019 housing finance reform outline (Senator Crapo's outline), support an expanded role for the Government National Mortgage Administration (Ginnie Mae) in the future housing finance system.[1] Understanding Ginnie Mae's functions and the structural challenges it faces in the current housing finance system is an essential first step in analyzing these models.

Ginnie Mae performs two core functions in the current housing finance system. First and foremost is Ginnie Mae's guarantee of Mortgage-Backed Securities (MBS) issued by private companies and collateralized by mortgage loans guaranteed by the Federal Housing Administration (FHA), US Department of Veterans Affairs (VA), or US Department of Agriculture Office of Rural Development (RD). Second, Ginnie Mae operates a common securitization platform through which all Ginnie Mae-guaranteed MBS are issued and bond administration functions performed. This platform also offers Ginnie Mae issuers the ability to issue MBS backed by loans pooled by virtually all issuers in a given month, sharing a common Committee on Uniform Securities Identification Procedures (CUSIP) number, pool number, and interest rate.

[1] The author also notes that the previous Milken Institute Housing Finance Program team of Michael Bright and Ed DeMarco also proposed a Ginnie Mae-centric housing finance reform model. See https://assets1b.milkeninstitute.org/assets/Publication/Viewpoint/PDF/Toward-a-New-Secondary-Mortgage-Market.pdf.

Both the Treasury Plan and Senator Crapo's outline would expand Ginnie Mae's role in housing finance by extending these two functions to conventional MBS. For example, noting Ginnie Mae's experience in marketing and administering its MBS guarantee programs, the Treasury Plan recommends that Congress authorize Ginnie Mae to extend its guarantee to "qualifying MBS that are collateralized by eligible conventional mortgage loans."[2] Senator Crapo's outline contains similar language. Second, the Treasury Plan and Senator Crapo's outline each contemplate leveraging Ginnie Mae's capabilities in managing and administering the securitization platform through which Ginnie Mae would provide this guarantee.[3]

However, Ginnie Mae faces funding and hiring issues that challenge its ability to perform its core functions, much less the expanded role envisioned by the Treasury Plan and Senator Crapo's outline. To remedy this situation, the Federal government should treat Ginnie Mae as the government corporation that it legally is and enhance its discretion and flexibility in funding and hiring.

Effecting these changes would require both the Department of Housing and Urban Development (HUD) and Congress to act. However, HUD's Housing Finance Reform Plan Pursuant to the Presidential Memorandum Issued March 27, 2019 does not adequately contemplate these changes. Consideration by HUD and Congress of the steps this paper recommends to address Ginnie Mae's funding and hiring challenges would enhance Ginnie Mae's ability to carry out its core functions more effectively.

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[2] See https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf (Appendix, page A-1).

[3] The Treasury Plan prescribes, as an administrative matter, that Ginnie Mae and the Federal Housing Finance Agency "identify and assess the operational and other issues" posed by extending the Ginnie Mae guarantee, "including any necessary enhancements to existing securitization and bond administration infrastructure." Id. Senator Crapo's outline directs that Ginnie Mae provide its guarantee "…through a securitization platform operated by Ginnie Mae," and that "[t]echnology and infrastructure being developed as part of the [Fannie Mae and Freddie Mac common securitization platform] may be sold or transferred to Ginnie Mae." See https://www.banking.senate.gov/imo/media/doc/Housing%20Reform%20Outline.pdf.

GINNIE MAE'S GUARANTEE ADMINISTRATION

The guarantee Ginnie Mae administers is an entity-level guarantee and not a loan-level guarantee. Ginnie Mae guarantees an issuer's ability to make required payments on a timely basis to MBS owners. The FHA, VA, or RD provides primary credit loss coverage on loans in its respective channels. Ginnie Mae issuers are secondarily responsible for paying from their capital credit losses on their loans that the applicable insuring agency does not cover. The Ginnie Mae guarantee is similar to the guarantee that the Federal Deposit Insurance Corporation provides to bank depositors. Ginnie Mae's guarantee is not called upon unless the issuer is financially unable to make required payments to MBS owners. When an issuer misses a payment due to MBS owners, Ginnie Mae (i) makes the required payment, (ii) seizes all the loans collateralizing the failed issuer's MBS, and (iii) transfers ownership of the loans and the related MBS obligations to a financially strong issuer. The new issuer has all the rights and obligations of the failed issuer. Ginnie Mae has been required in some instances to become the new issuer. Insolvency of Ginnie Mae issuers is an uncommon event. According to Ginnie Mae, since 2008, it has had to intercede to keep MBS owners whole for only 21 failed issuers out of more than 430 Ginnie Mae issuers overall.[4] The 21 failed issuers tended to be smaller issuers to which Ginnie Mae had limited exposure.

The following are the major areas within the Guarantee Administration function.

Setting Financial Standards for Issuers

Ginnie Mae sets financial standards for its issuers, including minimum capital standards, minimum liquidity requirements, minimum servicing fee levels, maximum loan delinquency standards, and minimum credit quality standards of the loans in the lender/issuer's portfolio. Ginnie Mae has an interest in the credit quality of an issuer's portfolio not because Ginnie Mae is exposed to any loan-level credit risk but because a good mix of credit quality in the portfolio is critical to the issuer's financial health, if not survival. A portfolio of high-risk loans could jeopardize the issuer's financial well-being because of the issuer's obligation to cover excess losses and to advance delinquent mortgage payments to MBS owners. Ginnie Mae also has approval power over an issuer's ability to pledge or sell its Ginnie Mae Mortgage Servicing Rights.

Ginnie Mae is developing a stress test to evaluate an issuer's ability to handle two discrete events through a full economic cycle. First, the issuer must cover losses when claim proceeds from FHA or VA are inadequate to cover the full costs of failed/foreclosed loans. Meeting all FHA's servicing requirements to receive a claim that covers the losses on a loan is expensive. Most issuers have resigned themselves to losing on average about $10,000 on loans that go to claim. VA's loan guarantee is

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[4] Based on information provided by Ginnie Mae as of June 2019.

equal to 25 percent of the loan amount. The VA loan guarantee amount has proven adequate if home prices are appreciating. If home prices stagnate or go down, the VA guarantee has proven inadequate to cover losses.

Second, and most importantly, an issuer must make payments to the MBS holder on all loans, including delinquent loans. Advancing delinquent payments can be cash-intensive. In some states, an issuer may have to make payments on delinquent loans to the MBS owner for several years while the status of a foreclosure is resolved. Ginnie Mae allows an issuer to buy a loan out of a pool after the borrower is 90 days delinquent so that the issuer no longer has to make these payments. However, loan buy-outs are also cash-intensive since the issuer must pay the MBS owner the loan's unpaid principal balance. A loan buy-out also creates interest rate risk for the issuer. If the nonperforming borrower becomes current on the mortgage now owned by the issuer, the issuer would have to resell the loan in a new MBS at current market pricing.

Ginnie Mae has developed an issuer risk evaluation model based on the financial characteristics of issuers that have previously failed to determine the probability of an issuer failing in the future. The model assigns a score to each issuer. Ginnie Mae uses these scores to assign staffing resources to monitor issuers that are at the highest risk of failure.

Document Custodian Requirements

Ginnie Mae determines the loan documentation that issuers can deliver to a document custodian and how the document custodian secures these collateral documents. Document custodian management is a critical component of the guarantee because if an issuer fails, it will likely declare bankruptcy. In this situation, Ginnie Mae will promptly seize and transfer the loans collateralizing the guaranteed MBS to another issuer without having to compensate the general creditors of the failed issuer. Ginnie Mae's portfolio management area sets policies for loan documentation and document custody. Ginnie Mae is currently researching the application of "e-notes" and "e-mortgages" in its program.

Oversight of Issuers

Ginnie Mae currently has over 430 approved issuers.[5] Relationship managers in Ginnie Mae's issuer management department maintain ongoing communications with their assigned issuers on many different topics. Typical concerns include challenges the issuers face in the current economic environment, actual and potential management changes, and other matters that might affect the issuer's financial viability. The issuer management department also develops remediation plans for

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[5] Ibid.

issuers that Ginnie Mae's risk grading models deem "high risk." These functions are vital since an issuer's failure has financial implications for Ginnie Mae.

Resolution of Failed Issuers

When an issuer fails, the portfolio management department seizes the loans collateralizing the guaranteed MBS. This department then negotiates with a new issuer to assume the servicing of these loans and the related issuer obligations. If Ginnie Mae is unable to secure a new issuer, Ginnie Mae will assume the issuer's responsibilities and hire a sub-servicer to service the seized loans. This department may have to manage terms of the portfolio transfer agreement—for example, administering a limited indemnification agreement with the new issuer.

GINNIE MAE'S COMMON SECURITIZATION PLATFORM[6]

Ginnie Mae has been operating a common securitization platform for over 35 years.

The platform and common securities it produces have been critical in facilitating issuers' entries and exits from the government mortgage servicing space without negatively impacting homebuyers. The years following the Great Recession have demonstrated the scalability of the Ginnie Mae program. Before the financial crisis, Ginnie Mae guaranteed approximately $500 billion in MBS; today, these guarantees total over $2 trillion in MBS. Prior to the crisis, five financial institutions controlled over 60 percent of Ginnie Mae's business. Today, those five issuers control less than 10 percent of Ginnie Mae's new business, and over 300 issuers use the platform monthly. This shift has increased competition and the affordability of financing home purchases. The replacement in Ginnie Mae's issuer base of large financial institutions by non-banks and smaller lenders has increased Ginnie Mae's issuer counterparty risk; however, homebuyers have not felt a negative impact from this shift.

The Ginnie Mae common securitization platform has been evolving since its inception. During the last 10 years, Ginnie Mae has modernized its platform, including moving from a mainframe-based platform to an Oracle client-server-based

[6] Designed over 35 years ago, the Ginnie Mae common securitization platform ensures consistency in the issuance of Ginnie Mae guaranteed MBS, including bond administration and reporting. The Federal Housing Finance Agency mandated the development of a common securitization platform for Fannie Mae and Freddie Mac (government-sponsored enterprises, or GSEs) MBS for similar reasons. Ginnie Mae's common securitization platform also employs standardized MBS issuance and monthly servicing data sets, which allow for the entry of new Ginnie Mae issuers without major financial or operational investments. This low barrier to entry contrasts with the GSE common securitization platform, which purposefully accommodates only Fannie Mae and Freddie Mac. In a future housing finance system that allows for competitors to the current GSEs, the GSE common securitization platform would require significant financial and operational investments from new entrants.

system for key distributed processing. In 2018, Ginnie Mae commenced moving parts of the platform to the cloud and completed the cloud migration for investor reporting and data disclosure that year. Ginnie Mae upgrades its hardware, software, and security patches on a regular schedule, ensuring it leverages the most up-to-date releases and upgrades. Ginnie Mae is also embracing emerging technology, including robotics process automation, or "Bots," to enable operational efficiencies. Ginnie Mae is investigating machine learning and artificial intelligence to facilitate its use of unstructured data in support of issuer risk management.

Ginnie Mae has worked with various vendors that offer loan pipeline management and pooling products to mortgage bankers. This collaboration helps to ensure that creating Ginnie Mae pool issuance files will not constitute a barrier to entry to new issuers. The Ginnie Mae pooling file is now a standard function in pipeline management and pooling software.

Ginnie Mae has also worked with major servicing software vendors that have created products that allow issuers to send raw monthly servicing data to Ginnie Mae. Ginnie Mae uses these raw data to calculate pool factors and other information disclosed to the capital markets on active Ginnie Mae guaranteed pools. Ginnie Mae does not require issuers to calculate any information at the pool level. Ginnie Mae also uses the servicing data to calculate the funds the issuer must remit to MBS owners, and will automatically charge the issuer's custodial funds account for required MBS remittances.

Additionally, Ginnie Mae uses the raw servicing data to calculate data required by the Federal Reserve Bank to distribute principal and interest to MBS owners. In the early 1990s, Ginnie Mae hired the Federal Reserve Bank of New York to be the paying agent on Ginnie Mae MBS. This arrangement enabled more efficient trading of Ginnie Mae MBS through the Federal Reserve's book-entry system.

Ginnie Mae only requires that the issuer submit a loan-level servicing file monthly. Monthly reporting is another example of how data collection under Ginnie Mae's platform does not pose a barrier to entry for new issuers.

These and other features help to support a critical component of Ginnie Mae's program: the issuance of Ginnie Mae's common security.

GINNIE MAE'S COMMON SECURITY

The Ginnie Mae common security is truly a common security. The Ginnie Mae II multi-issuer pools compose between 85 and 90 percent of single-family Ginnie Mae guaranteed MBS issuance each month.[7]

[7] Ginnie Mae II multiple issuer MBS was the first major evolution of the Ginnie Mae MBS program. The Ginnie Mae I—or single issuer—program, established in 1970, was the first MBS program offered with either an explicit or implied government guarantee. This program is similar to the recently launched GSE Uniform Mortgage-Backed Security program, in that only one issuer can include loans in an MBS pool. Also, Ginnie

The Ginnie Mae II multi-issuer pool program allows an issuer to contribute one or more loans into a pool for a given month. Each issuer receives a pro-rated piece of the MBS backed by the pool based on the unpaid principal balance of the loans the issuer contributed. Ginnie Mae II MBS thus allow investment in a multi-billion dollar pool reflecting a range of issuers and a national loan pool, rather than just one issuer and its applicable footprint. A smaller issuer receives approximately the same execution on its MBS as a larger issuer, as does one that contributes a small number of loans to a pool relative to one who contributes many loans. The Ginnie Mae II multi-issuer program has been a vital tool for new entrants. Without the program, a new issuer could take months or even years to develop sufficient scale in the capital markets for its MBS to compete with the MBS of established issuers. The Ginnie Mae common securitization platform can track each loan separately in a multi-issuer pool, determine each issuer's required payments to MBS owners, and reconcile current servicing data with each issuer. These capabilities also allow issuers to transfer their servicing to other issuers without affecting the reporting and payments to MBS owners of a multi-issuer pool. For purposes of reporting to the capital markets, Ginnie Mae rolls loan-level data from each issuer into one pool and then reports the individual loan characteristics in each multi-issuer pool. Notably, the Securities Industry and Financial Markets Association has determined multi-issuer pools are the only MBS that can be delivered against a Ginnie Mae II To-Be-Announced (TBA) trade.[8]

REMAINING CHALLENGES FOR GINNIE MAE

Ginnie Mae's primary challenge currently is the funding and hiring of staff. This situation might be surprising to those who assume the biggest challenge is developing

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Mae I MBS only permit loans that have the same interest rate to be pooled in any given MBS. The single interest rate was the norm when the Ginnie Mae I MBS program was established; in fact, until the mid-1980s, FHA and VA set the interest rate lenders could offer in 50 basis point increments. However, Ginnie Mae recognized that by maintaining tight controls on the characteristics of the loans included in MBS pools, MBS buyers were indifferent to which issuer issued a pool. Ginnie Mae thus rolled out its Ginnie Mae II program in the early 1980s, allowing for pools backed by mortgage loans from different issuers and having different interest rates. This new pooling structure allowed lenders to offer interest rates to consumers in 12.5 basis point increments and allowed for FHA and VA to deregulate the interest rates offered on mortgages they guaranteed. Also, allowing more than one issuer to contribute loans to and receive a proportionate slice of a larger national pool shifted the dominance of Ginnie Mae's issuer base from a handful of issuers to a substantially larger group.

[8] See https://www.sifma.org/resources/general/tba-market-governance/. The TBA market is an essential part of MBS trading. Generally, the Ginnie Mae TBA market allows issuers and investors to engage in the sale and purchase of Ginnie Mae MBS knowing at the time of trade only (i) the pass-through interest rate, (ii) the trade settlement date, and (iii) whether the MBS has a 30- or 15-year term, and a fixed or variable interest rate. Forty-eight hours prior to settlement, the parties to the trade learn the pool numbers and CUSIP number of the pools being delivered. The TBA market enables mortgage lenders to obtain commitments to buy Ginnie Mae MBS at a specific price even before they have committed to an interest rate to a borrower. Locking in the price allows a lender to offer a consumer a 60-day interest rate lock without knowing if the borrower will close on his or her mortgage loan. Because the lender has a generic sale commitment on the Ginnie Mae MBS, the lender can build pools just prior to settlement, which is normally 60 days after the trade date using closed loans.

Ginnie Mae's common securitization platform, but the platform is already state-of-the-art. Widespread reporting on the inferior state of FHA's technology, and the fact that both FHA and Ginnie Mae are part of HUD, have fueled this misperception.

From a funding perspective, Ginnie Mae fees, which totaled over $2.8 billion in 2018, more than cover its expenses. This does not mean, however, that Ginnie Mae retains all this revenue.

Ginnie Mae's spending capacity comes from two channels: congressional appropriations and the Office of Management and Budget (OMB). Unlike other HUD entities, the only part of Ginnie Mae's spending that requires the congressional appropriations process is personnel costs. Personnel costs include salaries, benefits, training, conferences, and travel. These costs totaled $28 million in 2018.

Ginnie Mae's other spending does not require congressional approval but is instead part of the "mandatory" side of the federal budget and subject to OMB's rigorous approval process. OMB-approved expenditures include computer hardware, computer software, and contractors, and amounted to $198 million in 2018. All Ginnie Mae revenue above congressional—and OMB-approved spending—is credited to HUD's budget.

One reason that this split funding poses a challenge is that the common securitization platform is almost entirely funded through OMB-approved funding. Only 40 of the 130 Ginnie Mae staff work on the common securitization platform. Ginnie Mae uses staff to direct contractors, design the hardware and software architecture, and establish the long-term direction of the common securitization platform. The common securitization platform receives appropriate funding to ensure that it can meet the needs of the industry and leverage modern information technology.

Of the remaining 90 employees, approximately 30 handle administrative functions such as accounting, human resources, procurement, and communications. The remaining 60 employees manage the government guarantee side of Ginnie Mae's business. Managing the Ginnie Mae MBS guarantee—which has quadrupled since the financial crisis—has become a bigger challenge as depository institutions (banks) have reduced their participation in the Ginnie Mae program, and non-banks such as independent mortgage firms have become more dominant issuers. Other factors also increase taxpayer risk in the Ginnie Mae channel, including significant growth in the overall issuer base, greater complexity of the largest non-banks' financial structures, and inadequate risk management staffing (which depends upon congressional appropriations).

Ginnie Mae also faces limits in recruiting and retaining staff with the qualifications to run the program effectively. For example, Ginnie Mae can only pay a staff member approximately 67 percent of what the Federal Housing Finance Agency can pay a staff member with similar background and experience.

One way to address Ginnie Mae's funding and hiring challenges would be to allow Ginnie Mae's management to determine the required spending levels and use excess revenue to increase Ginnie Mae's capital to cover losses from issuer failures (similar to how the Federal Deposit Insurance Corporation uses its capital to cover losses from bank failures). Management direction of spending would also enable Ginnie Mae to optimize its hiring and personnel decisions to meet its operational needs more effectively.

LOOKING FORWARD

Over the last 50 years, Ginnie Mae has successfully enabled MBS issuers to leverage the government guarantee and transfer interest rate risk to the capital markets and credit losses to insurers. For Ginnie Mae to assume the expanded role envisioned in various housing finance reform models, including the Treasury Plan and Senator Crapo's outline, the Federal government should treat Ginnie Mae as the government corporation that it legally is. Ginnie Mae's management should determine its spending levels and hiring dynamics and protect taxpayers by minimizing losses under its MBS guarantee program while maximizing its financial well-being. Congress should also hold Ginnie Mae accountable for its fiscal performance in the way that a board of directors holds a private-sector organization accountable. Actions within HUD and Congress to enable these changes would position Ginnie Mae to carry out its core functions more effectively and assume a greater role in the housing finance landscape.

ABOUT THE AUTHOR

Theodore W. Tozer is a senior fellow at the Milken Institute Center for Financial Markets, where he helps lead the Milken Institute's housing finance reform work. Before joining the Institute, Tozer was the president of Ginnie Mae for seven years, bringing more than 30 years of experience in the mortgage, banking, and securities industries. As president of Ginnie Mae, Tozer managed the growth of Ginnie Mae's government guarantees of mortgage-backed securities (MBS) from $900 billion to $1.73 trillion, and more than $460 billion in annual guarantees of MBS issuance for fiscal year 2016. Ted led the modernization of Ginnie Mae's securitization platform. He also transformed Ginnie Mae's program by leading the shift in its issuer base majority from financial institutions to independent mortgage bankers. Before joining Ginnie Mae, Tozer was senior vice president of capital markets at the National City Mortgage Company (NCM) for more than 25 years, overseeing pipeline hedging, pricing, loan sales, loan delivery, and mortgage product credit guidelines. He was instrumental in transforming NCM from an originate-and-hold lender to an originate-and-sell lender. From 2000-2004 Ted served as Chairman of the Mortgage Bankers Association (MBA) Capital Markets Committee, and as a member of the MBA Residential Board of Governors. From 2000 to 2009 Tozer served on both Fannie Mae and Freddie Mac's Lender Advisory Councils. Ted is currently a member of Fannie Mae's Affordable Housing Advisory Council.