[PULSE] Ginnie Mae restricts long-time legitimate business activity of mortgage servicers

July 10, 2020, 1:02 pm By Laurence Platt

Ginnie Mae’s newly imposed restriction on repooling of reperforming forborne loans yet again penalizes servicers acting as essential service providers in the continuing efforts to protect mortgagors facing financial hardship due to COVID-19.

Let me count some of the ways Ginnie Mae servicers are bearing the brunt of mortgagor forbearance under the CARES Act: no servicing fee income during forbearance of up to a year (and potentially longer should Congress decide its necessary); no relief from advance requirements for the period of such forbearance; no revision of the structural impediments to private financing to fund advances; and no reimbursement for the cost of funds for advances.

Laurence Platt

Yet, investors in Ginnie Mae securities generally are insulated against the risk of mortgagor forbearance under the CARES Act because they are timely paid on the securities they hold irrespective of borrower or servicer defaults.

In issuing APM-20-07 on June 29, 2020, Ginnie Mae decided to further protect investors from the potential enhanced prepayment risk resulting from early pool buyouts of forborne loans. This protection, however, comes at the expense of servicers.

By restricting servicers from relying on long-standing, legitimate business activity – early pool buyouts coupled with the repooling of reperforming loans – Ginnie Mae has elected to deem a routine activity as inappropriate because it is unnecessary and, gosh, may produce a profit.

Context

Under the Ginnie Mae program, servicers (labeled as "issuers") are required to advance to Ginnie Mae securities holders the regularly scheduled mortgage payments on the underlying pooled mortgage loans backing the securities if the mortgagors do not pay.

This obligation lasts until the defaulted loan is purchased out of the pool by the servicer or is paid off by either the mortgagor or through mortgage insurance or guaranty proceeds. Backed by the full faith and credit of the federal government, Ginnie Mae guarantees the servicers' advance obligations to securities holders.

A servicer purchases loans out of pools backing Ginnie Mae securities for one of three reasons:

1. It may elect to repurchase a loan that is unpaid for three consecutive months or is delinquent for four consecutive months (such as a loan that continues to be one month delinquent for four consecutive months). For this purpose, Ginnie Mae considers a loan in forbearance to be unpaid. Many servicers make this election if they have the funds to do so in order to cease the obligation to advance regularly scheduled mortgagor payments of principal and interest.
2. Except with respect to trial modifications, Ginnie Mae prohibits the modification of pooled loans, and, thus, a servicer effectively is required to repurchase a delinquent loan to be modified.
3. As a last resort after exhaustion of efforts to cure, Ginnie Mae requires the servicer to repurchase a loan that proves to be ineligible for mortgage insurance or guaranty, since such insurance or guaranty is a statutory requirement for Ginnie Mae to issue guaranteed securities backing a pool of mortgage loans.

Servicers routinely obtain private financing to fund loan repurchases, referred to as "early pool buyouts," and the cost of funds on such financing often is lower than the pass-through rate on the securities or the cost of continuing to make advances on the pooled loan.

A modified or delinquent loan that reinstates as a reperforming loan is eligible to be repooled to back newly issued Ginnie Mae mortgage-backed securities. Proceeds from the sale of these securities is the source of funds to repay the early pool buyout financing; depending on the interest rates of the repooled loans relative to current market yields, the sale also may generate secondary market gains.

One way to reinstate a delinquent **FHA**-insured loan and thereby make it eligible for repooling is through a "stand alone partial claim." The **USDA** has a similar concept called a "mortgage recovery advance." A "partial claim" is a no-interest junior loan secured by the mortgaged property, the proceeds of which are used to bring the loan current.

In the case of COVID-19, no payments by the mortgagor are due on the "stand alone partial claim" until the payoff, maturity or acceleration of the insured mortgage, including for the sale of the mortgaged property, a refinancing or the termination of FHA insurance on the mortgage.

By using a junior lien, the loan does not need to be modified. Presently, a servicer may accomplish a “stand alone partial claim” or a “mortgage recovery advance” without repurchasing the delinquent loan from the pool, but servicers routinely combine the permissible early buyout of a delinquent loan, a reinstatement through a “stand alone partial claim” or “mortgage recovery advance,” and a repooling of the reperforming loan into newly issued securities.

What did Ginnie Mae do?

Under the new APM, “any Reperforming Loan that entered into forbearance, of any type, regardless of duration, on or after March 1, 2020, and is bought out on or after July 1, 2020, as reflected in the Issuer’s servicing system of record, is ineligible collateral for Ginnie Mae securities backed by any existing pool types.”

Instead, Ginnie Mae is creating a new pool type to securitize this type of reperforming loan based on a seasoning requirement. First, the borrower under a reperforming loan must have made timely payments for the six months immediately preceding the month in which the associated mortgage-backed securities are issued. Second, the issue date of the mortgage-backed securities must be at least 210 days from the last date the loan was delinquent. This restriction does not apply to modified loans, only reperforming loans.

“Reperforming Loans” are not limited to loans that are reinstated through a “stand alone partial claim” or “mortgage recovery advance.” The term is broadly defined to be a loan that is not more than thirty days delinquent, previously was bought out of a Ginnie Mae pool, and has the same rate and terms as the originally pooled loans.

This means that the new policy prohibits repooling of loans that are reinstated solely as a result of the borrower’s repayment of forborne amounts and resumption of regularly scheduled payments.

Why did Ginnie Mae do it?

The APM only hints at the reason behind Ginnie Mae’s change in position, stating that “Ginnie Mae seeks to ensure that transactional activity related to these options does not impair market confidence in Ginnie Mae securities.” It highlights that FHA’s “Stand Alone Partial Claim” and USDA’s “Mortgage Recovery Advance” do not require pool repurchases unless the terms of the loan require modification.

Ginnie Mae states that it is implementing the new pooling eligibility restrictions “to ensure that loan buyout activity is aligned with borrower and MBS program interests … while continuing to provide for buyout transactions that are appropriate and necessary.”

While not expressly stated, the purpose seems to be to prevent any enhanced prepayment risk to Ginnie Mae securities holders resulting from early pool buyouts, which Ginnie Mae correctly notes are not required to effect a “Stand Alone Partial Claim” or “Mortgage Recovery Advance” in order to cause the delinquent loan to be reinstated as a reperforming loan.

What does it mean for issuers?

Simply put, Ginnie Mae is depriving servicers of a long-standing, legitimate, elective business strategy under the Ginnie Mae program apparently because this discretionary activity is not

necessary to enable a servicer to cease servicing advances in respect of
forbearance. Generating a profit from repooling reperforming loans somehow is viewed as a nefarious activity.

But perhaps generating a bit of profit from such repooling is a necessary and appropriate survival tool for servicers to offset the costs they bear and the servicing fee income they lose in implementing the CARES Act's requirements.

In isolation, insulating investors in Ginnie Mae securities from enhanced prepayment risk relating to forbearance certainly is a worthy public policy goal. When compared to the costs, expenses and lost revenue servicers are bearing in respect of forbearance, one has to wonder whether Ginnie Mae is fairly balancing the interests of servicers and investors.

In this regard, the new restriction is a material adverse change on servicers, which is predicated on neither any legislative change requiring the revision nor any real abuse by servicers that the policy is designed to correct.

While Ginnie Mae may have the authority to revise the Mortgage-Backed Securities Guide from time to time, servicers have a right to reasonably rely on the basic construct of the program without material adverse changes not grounded in law or abuse. Servicers create, acquire and finance their Ginnie Mae MSRs based on this reasonable expectation.

As a matter of sound public policy, as well as acting in good faith and dealing fairly with its contract counterparties, Ginnie Mae should not unilaterally and materially alter the rights and obligations of issuers in an adverse way without just cause.