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MBA MORTGAGE BANKERS ASSOCIATION

August 6, 2014

Mr. Theodore W. Tozer
President
Government National Mortgage Association
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, D.C. 20410

Dear Mr. Tozer,

The Securities Industry and Financial Markets Association ("SIFMA")[1] and the Mortgage Bankers Association ("MBA")[2] are pleased to respond to your June 9th letter requesting feedback regarding the proposed combination of the Ginnie Mae I and II programs and other ways to enhance the liquidity of the Ginnie Mae mortgage-backed securities (MBS) programs and improve market execution. Our organizations have convened working groups of relevant members to discuss this topic and offer a number of comments in the discussion below.

At the outset, we note the critical role Ginnie Mae plays in our housing finance markets and commend Ginnie Mae for its rapid, responsible growth to meet the housing finance needs of millions of Americans in the years following the onset of the financial crisis. We also agree with the premise of your letter that the Ginnie Mae II program represents the future for Ginnie Mae – it is clear when reviewing statistics on issuance that the broader market agrees as well. Ginnie Mae II issuance now accounts for more than 90% of all newly issued Ginnie Mae securities, and the multi-lender pooling feature allows lenders of all sizes the opportunity to access the capital markets on competitive terms. In short, the Ginnie Mae II program is a resounding success. Thus, we support the effort to combine the Ginnie Mae I program into the Ginnie Mae II program.[3]

There are, however, specific issues that are worth considering in the context of combining the two Ginnie Mae programs and improving market execution. These issues can be grouped under three main topics – (1) considerations related to the wind-down of the Ginnie Mae I program and whether or not a conversion process is needed to allow Ginnie Mae I MBS to be converted to the Ginnie Mae II program, (2) SIFMA's concerns and MBA's views related to so-called reperforming loans, and (3) Other Issues. Our members agree on many of the issues that the market faces today, but in some cases they diverge as regards solutions. In those instances, we will discuss each association's view. It is clear that further discussion is warranted, and direct engagement with key stakeholders would be beneficial.

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] 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, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and 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 2,200 companies includes all elements ofreal estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org.

[3] We suggest that Ginnie Mae should continue its outreach to non-US situated holders of Ginnie Mae MBS on these issues.

I. Winding Down the Ginnie Mae I Program and Conversion

SIFMA and MBA members agree that the market has expressed a clear preference for the flexibility and liquidity provided by the Ginnie Mae II MBS program. Your letter requested views on an exchange program to allow holders of Ginnie Mae I securities to exchange them for Ginnie Mae II MBS. We understand from conversations with your staff that Ginnie Mae envisions an exchange program whereby holders of Ginnie Mae I MBS would utilize the Ginnie Mae II Platinum program to effectively exchange their Ginnie Mae I bonds for Ginnie Mae II securities, without any compensation from Ginnie Mae for the change in payment date from the 15th to the 20th, and where the Platinum trustee would hold the cash flows from the 15th and disburse them on the 20th.

We have discussed this issue among our members at length. There are concerns that an exchange program might negatively impact the market and our members do not at this time have a unanimous view on whether a conversion should be offered. We understand that in a perfect world, a frictionless exchange program would combine the outstanding float of Ginnie Mae I and Ginnie Mae II TBA-eligible securities and enhance overall liquidity. However, it could also be the case that the combination of the markets would not be complete, and the impact of "cheapest-to-deliver" could be worsened as holders of legacy Ginnie Mae I securities convert only the securities consisting of the least desirable loan collateral. Indeed, it is unlikely that an exchange would actually be frictionless, and Ginnie Mae should consider these risks to liquidity.

The risk for only partial conversion of legacy Ginnie Mae I MBS is the primary concern that has been expressed by our members, since an exchange program would allow Ginnie Mae I holders to adversely select their bonds with the least desirable collateral for exchange into the Ginnie Mae II market. If an investor held a well-performing Ginnie Mae I bond in portfolio with the intention of holding it to maturity, there may be no reason to convert it given the operational costs and the lack of compensation for change in payment date. A number of SIFMA members have expressed concerns with a conversion program that does not include compensation for holders of legacy Ginnie Mae I MBS. The enhancement to liquidity of the legacy security gained from conversion may not be enough inducement and may not matter at all if the holder intends to hold to maturity. However, to the extent a bond is not performing well, the operational costs and detrimental timing of cash flows may be overcome by the ability to exchange for a security that can be delivered into the Ginnie Mae II market and replaced with a better performing security. Such a partial conversion could be detrimental to liquidity in the Ginnie Mae II TBA market. Many of our members believe this argues in favor of there not being an exchange mechanism for Ginnie Mae I MBS.

To the extent a conversion is implemented, SIFMA and MBA have a number of specific suggestions:

First, based on our members' experience with previous securities exchange programs and related to the concerns above, our members believe that the window during which bonds may be exchanged should be short. Indeed, it may be appropriate for an exchange to occur in a single month. In any case, this should be further discussed.

Second, servicers would be concerned with any exchange program that requires servicers to manage remittances on the same bond in a different way – for example, if holders of half of a CUSIP exchange their Ginnie Mae I MBS, and servicers of that exchanged portion of the CUSIP were required to remit cash flows on the 20th, instead of on the 15th for the rest of the CUSIP, servicers would face significant operational challenges. To the extent Ginnie Mae uses the Platinum program as described to us and outlined above, this would not seem to be a problem. We believe it is critically important that the servicing of legacy Ginnie Mae I MBS not be disrupted, and this approach would satisfy that goal. Ginnie Mae should keep in mind the operational burden that an exchange could place on servicers if the plan is changed.

Third, an issue that requires further attention if an exchange program is put in place is whether or not the exchange would create accounting or tax implications for holders of Ginnie Mae I MBS. This would impact the willingness or ability of holders to participate in an exchange and could be an important issue. SIFMA and MBA recommend that Ginnie Mae engage tax counsel to consider the tax implications, if any, of any proposed conversion program.

Fourth, SIFMA and MBA members also recognize that Ginnie Mae securities are held around the world, and that Ginnie Mae must take care to account for the needs of all of its holders. SIFMA members have reached out to their non-US clients to solicit input and they suggest that Ginnie Mae likewise discuss these issues with its clients.

Fifth, if Ginnie Mae does implement a conversion program similar to that described above, Ginnie Mae should waive or significantly lower fees to create Platinum securities to reduce frictions in the exchange program.[4] To the extent there is no compensation for the change in payment date, there should be no charge to create the Ginnie Mae II Platinum.

We believe the mechanics of a conversion will require further industry discussion.

II. Inclusion of Reperforming and Modified Loans in TBA-Eligible MBS

Background

The inclusion of reperforming loans (or "reperformers"; defined for the purposes of this letter to include both loans that self-cure and modified loans) in TBA-eligible MBS has been a topic of much discussion among industry participants. As Ginnie Mae knows, the share of new issuance represented by these loans has grown over the past several years. MBA and SIFMA members note that the guidelines for performing the loss mitigation activities are set and regulated by FHA, VA, and USDA (collectively, the guarantors), and both the guarantors and Ginnie Mae have enforcement mechanisms in place to ensure that the proper protocols are followed throughout the loss mitigation process. Additionally, the guarantors have limits in place which govern the frequency and terms by which a loan can be modified. Investors in Ginnie Mae MBS remain concerned, however, that some servicers may be repeatedly modifying and buying out loans causing repeated losses to holders of Ginnie Mae MBS. To the extent that the failure to comply with regulatory guidance and the resulting poor performance of MBS can be attributed to a limited number of bad actors, Ginnie Mae and the guarantors should ensure that program guidelines are being followed rigorously and enforce these guidelines where they are not. We believe this should be an immediate focus of attention by Ginnie Mae and FHA.

Perspectives of SIFMA and MBA

Market participants have considered their options under the status-quo scenario where servicers remain obligated to fund loss mitigation activities on their balance sheets. The concerns, which we believe are generally well-known, are summarized below.

SIFMA Perspective: SIFMA members would strongly prefer that reperforming loans not be pooled in TBA-eligible MBS, or otherwise be significantly limited in their inclusion.

SIFMA's concern (which is held particularly strongly among its Ginnie Mae investor members) relates to the poor performance of pools with a high concentration of reperformers, and that this poor performance has been detrimental to overall liquidity in the Ginnie Mae II market. Investors have borne losses from individual loans that are serially bought out of their premium-priced MBS at par. E.g., a loan is pooled at a price of 105, repurchased at par, repooled at a price of 104, repurchased at par, repooled at 103, and so on. In this example, that is nine points of loss for MBS investors. It is clear that the modification is not working; this causes investors to question why repeated failed modifications are being done to the same loan. This situation reduces investors' desire to be active in sectors of the market where reperformers are prevalent or lowers their valuation on the pools, each of which harms liquidity.

[4] Our members believe that the Platinum fee structure should be generally reviewed as a way to improve liquidity in Ginnie Mae MBS markets.

As reperformers become a greater part of issuance, SIFMA members expect this problem to grow. Reperformers have comprised greater than 8% of issuance in 2014 3.5% coupon MBS, and almost 9% of 2014 4% coupon MBS issuance.[5] This share has generally been increasing over the last few years. Given that new loan origination volumes are low, and are expected to remain low,[6] the relative share of reperformers should be expected to remain the same or increase (assuming that modification volumes remain in their current range, or decrease in line with overall origination volumes, which some of our members expect to be the case). In a cheapest-to-deliver market, the current volume of reperformers is significant. A higher share would be even more problematic.

SIFMA's members believe the poor performance of these reperformer pools has negatively impacted all borrowers served by the Ginnie Mae MBS program. While most Ginnie Mae MBS trade above par due in large part to the full-faith and credit guarantee, they would trade at higher price levels and with greater liquidity if investors did not have to endure the risk, and losses, that stem from the inclusion of reperformers in Ginnie Mae pools.

The market will continue to price the risk of reperforming loans no matter what course is followed. When reperforming loans are included in TBA-eligible MBS, all borrowers whose loans flow through GNMA MBS are impacted negatively by this pricing of risk. If an alternative approach were implemented, such as those suggested below, the pricing of reperformer risk would be more targeted and provide benefits to the vast majority of borrowers served by Ginnie Mae. These borrowers – first-time homebuyers, homeowners refinancing to a lower rate, etc -- would benefit from such a change because today they likely have higher mortgage costs than they otherwise would.

MBA Perspective: MBA understands SIFMA's concerns but believes that these issues may be largely mitigated by the combination of the Ginnie Mae I and II programs, which will afford TBA-investors a great degree of issuer diversification and predictable pool concentrations of reperforming loans, and by recent FHA guidance establishing payment relief standard and limiting re-modifications attempts. Over the last 5 years since re-delivery of modified loans became more prevalent, the Ginnie Mae II TBA market has enjoyed very strong pricing with no appreciable deterioration due to inclusion of modified loans. MBA members believe that it is critical to maintain a liquid TBA execution option for reperforming loans. Servicers operating within the program's published guidelines today incur many business risks (market, financial, and reputational) in performing loss mitigation activities. MBA believes that existing guarantor guidelines concerning loan modification coupled with strong enforcement should substantially reduce the risks identified by SIFMA's members. Adding strict limits as described above to the process will increase these risks and require higher rates on loans insured by the guarantors.

It is MBA's position that the Ginnie Mae re-delivery program for modified loans has been successful in helping consumers. Since Ginnie Mae issued specific guidance as to redelivery of modified loans in 2009, the program has enabled servicers to comply with FHA and VA modification mandates assisting tens of thousands of FHA borrowers and US veterans.

Furthermore, the liquidity in the TBA market enables servicers to efficiently hedge interest rate locks for trial modification plans which last between 4 and 5 months. Without such option, servicers would be exposed to significant price risk for the duration of the trial payment period. Any restrictions on redelivery would impose significant balance sheet costs to servicers and impair their ability to service delinquent loans, which will harm the borrowers, the guarantors and ultimately expose GNMA to higher servicer risk.

Higher rates will provide less assistance to borrowers in need, will increase the costs to the guarantors via denials or increased reliance on principal forbearance modification, and force servicers to incur increased operational

[5] Source: Bank of America Merrill Lynch.

[6] See, e.g., http://www.mortgagebankers.org/files/Bulletin/InternalResource/88695_.pdf

costs and reputational risks as denials increase or the quality of modifications are reduced and borrowers re-default.

For these reasons MBA believes that it is critical to maintain a liquid execution option for servicers who are working to help borrowers remain in their homes. By changing the long established rules via delivery limitations as suggested, will increase risks and costs to borrowers, the guarantors and servicers.

Solutions Discussed by SIFMA and MBA

The issue of reperformers confronts participants differently depending on their place in market. However, both MBA's and SIFMA's members agree that reperformers are a unique aspect of the Ginnie Mae MBS program, and to the extent reperformer concentrations in TBA-eligible pools are hard to predict, investors are exposed to higher degree of uncertainty and loss. Accordingly, members of SIFMA and MBA agree that this is an important issue facing the program. SIFMA and MBA encourage Ginnie Mae, as the owner of the securitization platform, to champion discussions with the guarantors, investors, liquidity providers and servicers that can lead to beneficial impacts for all parties involved in the program.

A well designed plan will benefit all parties involved:

- *Existing Borrowers* - greater flexibility to retain their homes;
- *New Borrowers* – better mortgage rates due to better liquidity that is not weighed down by investor uncertainty;
- *FHA/VA/USDA* - reduced credit exposure to their insurance funds and certainty that servicer incentives are properly aligned with those of the guarantors and the borrowers;
- *Ginnie Mae* - Ability to offer competitive products for which investors have confidence to invest;
- *TBA Investors* - Confidence in the loans underlying the security, better returns, and continued desire to invest at higher prices;
- *Servicers* - Ability to assist delinquent borrowers and meet the modification mandate imposed by FHA, VA and USDA without undue balance sheet costs.
- *Market Makers* – Improved liquidity.

Below is a summary of some of the proposals discussed by the joint SIFMA and MBA working group and their respective pros and cons. If anything, this discussion demonstrates that this is a complicated issue with no easy solution.

Development of an Approach that Does Not Rely on TBA Execution for Loss Mitigation: As you know, in the conventional market loss mitigation does not rely on the balance sheet of the servicer nor a TBA-market execution because Fannie Mae and Freddie Mac are able to hold loans on their own balance sheets. Instead, loans are removed from MBS pools, and if these loans are subsequently reinstated, they are pooled outside of the TBA market. This means that TBA investors in Fannie Mae and Freddie Mac MBS are not faced with the prospect of loans being repeatedly repurchased at par from pools which likely had been purchased at a premium in the TBA market and repooled in new TBA-eligible MBS, resulting in losses for investors due to the unexpected prepayments. Likewise, servicers are not presented with the business risks of managing loss mitigation through their balance sheets. We also note that the re-default rate for modifications in the conventional market is far lower than that in the Ginnie Mae market.[7] Since Fannie Mae and Freddie Mac "own" the loans removed from MBS pools, they don't need to worry about redelivery, and they are free to calculate a positive NPV at the loan level and control the rate, term, and UPB inputs without market constraints.

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[7] See, e.g., Center For Responsible Lending, "A Framework for Housing Finance Reform", at 39. Available here: http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/2013-crl-working-paper-on-gse-reform-a-framework-for-housing-finance-reform-oct-15pdf.pdf.

SIFMA and the majority of MBA members believe that Ginnie Mae, HUD, and the guarantors should consider developing a modification waterfall that does not depend on the securitization of the completed modifications into Ginnie Mae II TBA securities. This approach would remove the risk to investors from high redefault rates on previous modifications, should improve pricing on Ginnie Mae MBS, and should benefit all borrowers served by Ginnie Mae. The goal should be to develop a program where the guarantors take assignment of the defaulted loans. Additionally, SIFMA believes Ginnie Mae should encourage and assist the guarantors as needed to revise and develop modification waterfalls that can still utilize another securitization outlet (via Ginnie Mae but not in TBA-eligible pools) for completed modifications, or one that allows the guarantors retain the loans themselves. While the disposition approach is critical to establishing a basis for comparative valuation of a modification versus liquidation, the goal should be to develop a program that balances the need to better help troubled borrowers and maintain the strength of the particular insurance funds.

Other MBA members have serious concerns with such proposal as it would drastically re-make the FHA, VA and GNMA programs and may have significant unintended consequences. The proposal does not address the issue of servicer credit risk, which is a unique feature of the GNMA program. Furthermore, there may be a number of political concerns with openly endorsing the creation of a new government balance sheet at a time when Congress is looking for ways to reduce the government footprint and attract more private capital to the mortgage market or possibly increasing government expenditures at a time where the government is trying to better control its expenditures.

Multi-Issuer Custom Pools for Reperformers: As noted above, SIFMA investor and dealer members would prefer that, as soon as possible, reperforming loans were not pooled in TBA-eligible securities and instead were pooled in non-TBA custom pools. They recognize, however, the economics of loss mitigation for servicers under the Ginnie Mae regime and have discussed ways to optimize the non-deliverable execution for reperforming loans. They suggest that Ginnie Mae create a new, multi-issuer custom pool where reperforming loans would be delivered and where one CUSIP would be issued into the market per month. Given the expected continued increase in the amount of these loans, SIFMA members believe that issuance and liquidity of this new multi-issuer pool would be robust and support loss-mitigation activities by servicers. SIFMA's members believe this approach could be implemented in the near-term, would serve to protect the interests of TBA investors, and therefore enhance liquidity and improve mortgage rates for the borrowers the TBA market serves. At the same time, it could provide a liquid outlet for reperforming loans that should allow for effective loss mitigation activities to serve struggling borrowers.

Limitations on Number of Buyouts Per Loan: As a less-preferred alternative, SIFMA dealer and investor members have discussed whether or not Ginnie Mae should apply limitations on how many times a loan may be repurchased and pooled into TBA-eligible securities. They believe that if reperforming loans are allowed in TBA-eligible pools at all, there should be a limit of one instance of re-pooling per loan. In other words, a loan could be bought out and re-pooled only once. If another buyout became necessary, the loan would need to be re-pooled in a non-TBA custom pool. SIFMA members have also discussed limitations on the concentration of reperforming loans in deliverable pools, similar to the 10% threshold for relocation loans, buydown loans, co-op loans, and jumbo-conforming loans. While these members do not view this as an optimal approach, it would represent an improvement over the status quo for the Ginnie Mae investor.

MBA Concerns With Custom Pools and Buyout Limits: MBA has significant concerns with using multi-issuer custom pools for reperformers or placing a limit on the number of buyouts per loan. Servicers assume substantial credit and interest rate risk when engaging in loss mitigation activities. Applying strict limitations on these loans' eligibility for delivery into Ginnie Mae TBA-eligible pools without a guaranteed funding option would subject servicers to additional market risk and force them to potentially sell the loan at a discount to par – making the economics of the loss mitigation process unattractive and limiting the ability to offer assistance to borrowers. It is likely that the economics would also result in credit overlays for government lending programs to minimize the risks associated with loss mitigation activities, impairing access to credit for the very borrowers the government seeks to help. MBA believes these pricing dynamics make it unlikely for a robust, liquid market to develop for a "reperformer" class of MBS.

Further, if a strict limit of any kind is placed on the redelivery of reperforming loans or if a new security is created, it is quite likely that the actual rate that servicers would need to charge would violate existing rules governing what rate a servicer can offer a borrower seeking a modification under the rules of the guarantors' loss mitigation program, adding yet another hurdle for servicers to engage in loss mitigation efforts. While these are secondary issues to investors, it is MBA's position that the current market price for Ginnie Mae MBS already reflects the pricing by investors of the risk of these reperforming loans.

MBA notes that these loss mitigation activities consist of detailed requirements set by the guarantors, and the re-pooling guidelines are part of the Ginnie Mae MBS Guide. MBA strongly believes that the existing good-delivery requirements should remain in place. The guarantors' loss mitigation programs provide a much needed service to at-risk borrowers. With servicers forced to bear the risk of holding the loan on their balance sheet for roughly six or seven months, the need for a liquid execution option for the loan once the mitigation efforts are complete is critical.

III. Other Issues Ginnie Mae Should Consider

Deliverability of custom pools into Ginnie Mae II TBA

As a part of our consideration of your request, SIFMA and MBA members have discussed whether or not certain Ginnie Mae II Custom MBS should be deliverable into TBA. SIFMA's dealer and investor members believe it would be appropriate for a specifically designated Custom prefix to be deliverable into TBA, but only to the extent that issues with reperformers are addressed. SIFMA members expect that enhancements to the liquidity of the TBA market by removing the risk of reperformers would offset any expected detriment from loans being directed away from Ginnie Mae II TBA issuance into a new Custom pool (that has a TBA deliverability backstop).

On the other hand, MBA does not believe that the resolution of the re-performing loan issue is relevant to its views on the appropriate pooling characteristics, and MBA rejects the idea of creating a new Ginnie Mae II custom pool, which is TBA-deliverable but which does not allow for inclusion of reperformers.

MBA supports allowing custom pooling parameters, but further believes that any such pool should be open to all approved issuers. Multi-lender pooling, even for pools with highly customized parameters, would be a significant benefit for the market for two reasons:

First, it would allow smaller lenders to access the better execution options available to specified pool issuers. Whereas lack of volume can make an issue uncompetitive in the market, a multi-lender execution requirement would resolve that and ensure that all lenders could obtain competitive access to the secondary market.

Second, multi-lender execution requirements would increase liquidity and by extension reduce costs to borrowers. By allowing smaller lenders to be more competitive, the program would attract a greater number of loans, increasing the amount and diversity of collateral supporting both the custom and general pooling programs.

28-Year Final Maturity Guideline

Similar to the discussion above, SIFMA dealer and investor members have indicated they would be receptive to removing the 28-year final maturity guideline on Ginnie Mae TBA MBS and aligning it with the 20-year guideline for Conventional MBS if the treatment of reperforming loans were better aligned with the treatment in the conventional market (i.e., excluded from or significantly limited inclusion in TBA eligible pools). Absent a change to the treatment of reperforming loans, SIFMA members are concerned that shorter maturity pools could be concentrated in reperforming loans (which are seasoned and thus have a shorter remaining term), and detrimental to liquidity.

Disclosure

While we recognize that Ginnie Mae must take steps to protect the privacy of borrowers on loans that collateralize Ginnie Mae MBS, SIFMA's members note that many potentially valuable fields are disclosed blank (such as LTV/CLTV). Ginnie Mae should explore to what extent this disclosure could be enhanced. As a general matter, SIFMA's members suggest that Ginnie Mae should strive to make its disclosure as similar as possible to that of Freddie Mac, and indeed Ginnie Mae has the opportunity to create best-in-class disclosure. Investors would be pleased to discuss how disclosure could be improved.

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We appreciate the opportunity to provide these comments to Ginnie Mae, and look forward to working with you to enhance the liquidity, execution, and robustness of the Ginnie Mae MBS programs, which play such an important role in our housing finance system. Please contact Chris Killian (212-313-1126 or ckillian@sifma.org), or Dan McPheeters (202-557-2780 or dmcpheeters@mba.org) with any questions or additional requests related to this issue.

Sincerely,

Kenneth E. Bentsen Jr.
President & Chief Executive Officer
SIFMA

David H. Stevens
President & Chief Executive Officer
Mortgage Bankers Association