

## Frequently Asked Questions about Ginnie Mae's Amended Eligibility Requirements

### Why are you using Basel-type bank capital tools to address non-banks whose major vulnerability is liquidity?

- We are attempting to ensure that balance sheets containing large concentrations of Mortgage Servicing Rights (“MSRs”) are adequately capitalized, and that the widely varying risk characteristics of different balance sheet items are incorporated into capital standards that until now have not considered them.
- MSRs are difficult to value because of the opaqueness of the MSR market. MSR values are also highly volatile. MSRs are often financed with terms that could result in margin calls. In a rapidly declining market, precisely when funding needs are at their highest, these terms could lead to margin spirals and significant MSR write downs. Because of the inherent importance of leverage in non-bank balance sheets, this constitutes a direct threat to liquidity and stability.
- The Risk Based Capital Ratio (RBCR) that Ginnie Mae adopted, while similar to Basel treatment of MSRs in some respects, is significantly more lenient, reflecting the realities of today’s mortgage finance business. Basel deducts MSRs exceeding 25% of Common Equity Tier 1 (CET1), while RBCR does not deduct MSRs from Adjusted Net Worth (“ANW,” essentially Equity minus certain unacceptable assets) unless MSRs exceed 100% of ANW.

### Why do you deduct “Excess MSRs” from ANW in the Risk Based Capital Ratio (RBCR)?

- Ginnie Mae believes that a risk-based approach without a deduction of “Excess MSRs” is inadequate. With only a 6% capital requirement and a 250% risk weight, Independent Mortgage Banks (IMBs) could theoretically borrow 85 cents on the dollar  $[(100\% - (250\% \times 6\%)) = 85\%]$  against MSRs without limit. Through the addition of a risk-based capital requirement, Ginnie Mae seeks to limit that exposure to ensure long-term viability for all of our Issuers.
- Consider an IMB with MSRs that are valued at 3 x their net worth. In the event the MSRs are marked down by 25% in a single quarter, all other things being equal, the mortgage bank’s total equity capital would decline by 75% (ignoring the impact of taxes). In this example, the Issuer would likely experience a margin spiral or other demands on their liquidity, resulting in further write downs of assets that could render them insolvent in a very short period.
- Deducting “Excess MSRs” from the numerator of the RBCR is designed to address the risk of extreme concentrations in MSRs.

### Is the RBCR more punitive than Basel III capital requirements?

- RBCR is more liberal than Basel III, primarily because RBCR deducts significantly less of total MSRs from Adjusted Net Worth (ANW), which is Equity less certain unacceptable assets. The Basel III regime requires that any MSRs exceeding 25% of Common Equity must be deducted

from Common Equity Tier 1 (which is equivalent to ANW for our purposes). RBCR deducts MSRs from ANW only when MSRs exceed 100% of ANW.

- In the example in Appendix A, an IMB with a RBCR of 15.7% would have a RBCR of less than zero under a Basel III type regime.
- Risk weightings are similar in both regimes, although Basel III requirements are far more complex.

#### Why doesn't the RBCR give relief for the sale of Excess Servicing Spread?

- There are many types of Excess Servicing Spread (ESS) agreements. Some are very effective at transferring most or all the risk of holding MSRs to the buyers, and some leave significant residual risk with the seller. The nature of the agreement is typically opaque to third parties
- As a result of the RFI process in 2021, Ginnie Mae received comments suggesting that the sale of ESS should result in capital relief. Considering these legitimate comments, Ginnie Mae reduced the RBCR requirement to 6% from 10% and have committed to further investigation of potential future capital relief.
- The most significant challenge Ginnie Mae faces is creating a uniform standard of capital relief for the sale of ESS in a market where each ESS contract is unique and may have dramatically varying risk transfer characteristics.
- A standardized ESS purchase and sale agreement developed and implemented by market participants would be helpful to Ginnie Mae in implementing capital relief in those instances when a meaningful transfer of risk has occurred.

#### Why doesn't the RBCR give relief for MSR hedging?

- The most fundamental challenge in giving capital relief for MSR hedging is that the underlying asset being hedged has significant valuation risk. The MSR market is extremely opaque. Ginnie Mae observes substantial and difficult-to-explain variations in MSR multiples among our single-family Issuers. Measuring hedging efficacy is essentially impossible when the value of the underlying asset being hedged is uncertain.
- Very few Ginnie Mae Issuers report that their MSRs are hedged. In the most recent quarter, only 14 of the 200 Ginnie Mae Single Family Issuers reported hedging in their MBFRF disclosure.
- Among the 14 Ginnie Mae Issuers who have reported hedging their MSRs, only 2 have offset at least 50% of MSR losses/gains in at least 5 of the last 8 quarters.
- The development of market practices that would make the MSR market less opaque, such as those examples listed below, would assist Ginnie Mae in developing forms of capital relief for MSR hedging:
  - On a voluntary basis, publicly disclosing market clearing transactional information (including price) within a reasonably brief period after the transaction closes; and
  - Standardizing the contractual terms of MSR purchase and sale agreements.

#### Why doesn't Ginnie Mae include Unsecured Debt maturing in more than 1 – 2 years as part of capital?

- The purpose of our capital requirements is to ensure the ongoing solvency of our Ginnie Mae Issuers

- While debt with longer maturities may be helpful in managing liquidity risk, debt is not “loss absorbing” in the sense of guarding against insolvency. In a scenario of rapidly declining MSR values, unsecured debt provides no protection against insolvency since debt is a liability.
- Other reasons for not including unsecured debt in our definition of capital include the ongoing cashflow required to service interest payments and the risk that upon maturity, the debt may not be able to be refinanced.

Does Ginnie Mae care about potential dislocation in the MSR market, and what are you doing about it?

- One of Ginnie Mae’s statutory purposes is to “provide stability in the secondary market for residential mortgages.”<sup>1</sup> For this reason, we have thought hard about potential sources of instability, and this policy is largely an attempt to address that by ensuring that the distribution of MSRs is balanced, in terms of distribution among institutions and diversification of sources of capital.
- Ginnie Mae monitors the MSR market mainly through ongoing engagement with our Issuers, as we are unable to observe the market directly.
- As part of our new eligibility requirements, we allowed for an extended implementation period of over a year for compliance with the RBCR to avoid market dislocation.
- If some Issuers decide to transfer MSRs because of RBCR, we believe the system has the capacity to absorb those transfers. If RBCR were imposed today, 95% of our Issuers (by count) would be compliant. Of those Issuers already compliant with RBCR, many have ample equity capital to support the acquisition of MSRs that may come on the market.
- While in the aggregate we believe that MSR transfers can be accommodated, we believe that in this highly opaque market a small number of significant transfers occurring in quick succession could affect pricing or the liquidity of MSRs. We put in place a yearlong implementation period in part to address this concern.
- As we engage with our Issuer base regarding our standards, we are being mindful of how their plans to comply with our standard may impact other Issuers and the broader market. If our review suggests that Issuer compliance efforts will have a material adverse impact on the MSR market, we are able to mitigate that impact, including but not limited to further extending timeframes for compliance.

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<sup>1</sup> 12 U.S.C. 1716.

## Appendix A: Ginnie Mae RBCR versus a Basel type RBCR

Asset Type	Asset Amount	Risk Weight	RWA per RBCR	RWA per Basel - type Rules
Cash & Equivalents	100	0 %	0	0
Government Loans HFS	1000	20 %	200	200
Conforming Loans HFS	1500	20 %	300	300
Other Loans HFS	100	50 %	50	50
Gross MSRs	800	250 %	1500 (1)	375 (2)
Other Assets	500	100 %	500	500
Total	4000		2550	1425
Equity (ANW)	600			

(1) RWA applied to lesser of ANW or Gross MSRs:  $250\% \times 600 = 1500$

(2) RWA applied to lesser of 25% of ANW or Gross MSRs:  $250\% \times 150 = 375$

### **RBCR Calculation for Ginnie Mae**

Excess MSRs = Greater of 0 or (gross MSRs – ANW).

Excess MSRs =  $800 - 600 = 200$

RBCR =  $(\text{ANW} - \text{Excess MSRs}) / \text{RWAs}$

=  $(600 - 200) / 2,550$

= **15.7%**

### **RBCR Calculation per Bank Rules**

Excess MSRs = Greater of 0 or (gross MSRs – (25% x ANW)).

Excess MSRs =  $800 - (25\% \times 600) = 650$

RBCR =  $(\text{ANW} - \text{Excess MSRs}) / \text{RWAs}$

=  $(600 - 650) / 1425$

= **- 3.5%**



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