



Topic Brief

Monitoring of Nonbank Issuers Presents Challenges for Ginnie Mae

This briefing paper highlights challenges the Government National Mortgage Association (Ginnie Mae) faces in monitoring nonbanks and outlines our past, current, and future efforts to help it address those challenges.

Summary

By the end of fiscal year (FY) 2016, Ginnie Mae had made guaranties on loans with a remaining principal balance (RPB) of approximately \$1.73 trillion.¹ Through these guaranties, Ginnie Mae facilitates capital inflows to the U.S. housing market. Since 2010, Ginnie Mae's RPB has grown by approximately 62 percent. During this time, Ginnie Mae's business has increasingly relied on nonbanks, which now represent a majority of issuances annually.² As the Office of Inspector General (OIG) and Ginnie Mae have previously noted, the increase in the number of nonbank issuers and their complexity present a challenge for monitoring efforts. We are highlighting monitoring challenges so HUD leadership is aware of and can be better prepared to address them. It is imperative that Ginnie Mae has the appropriate staffing with the skills, knowledge, and abilities to monitor nonbanks. OIG is focusing on Ginnie Mae's capacity to monitor nonbanks with an ongoing audit.

Ginnie Mae's Mission

Ginnie Mae's mission is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential mortgages. It accomplishes this mission through its Mortgage Backed Securities (MBS) program. Under this program, Ginnie Mae issues guaranties on securities issued by private institutions, or "issuers." The securities are backed by single-family, multifamily, manufactured housing, and home equity conversion mortgages, and these mortgages must be insured or guaranteed by a federal agency. Single-family loans insured by the Federal Housing Administration (FHA) and the Department of Veterans Affairs were the vast majority of Ginnie Mae's RPB at the end of FY 2016, accounting for 57.6 percent and 27.8 percent respectively. Single-family loans insured or guaranteed by the Department of

¹ A guaranty is a formal pledge to pay another person's debt or to perform another person's obligation in the case of default.

² The U.S. Government Accountability Office has defined banks as "bank holding companies, financial holding companies, savings and loan holding companies, insured depository institutions, and credit unions, including any subsidiaries or affiliates of these types of institutions." Nonbanks are any other entities.



Agriculture and HUD's Office of Public and Indian Housing (PIH) accounted for 5.9 percent of Ginnie Mae's RPB. Non-single-family loans accounted for the remaining 8.7 percent of Ginnie Mae's RPB.

Unlike the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac), the underlying mortgages are not Ginnie Mae assets. Instead, issuers securitize these mortgages and sell them to investors with Ginnie Mae's guaranty of timely principal and interest payments. This guaranty is backed by the full faith and credit of the U.S. government. In exchange for the guaranty, issuers pay Ginnie Mae a monthly fee based on the unpaid principal balance of the collateral loans. In the past 10 years, Ginnie Mae has increased its issuance volume to become a primary facilitator of capital inflows into the U.S. housing market.

Three external payment sources – homeowners' equity, a Federal insuring agency, and the issuer – must fail or be exhausted before Ginnie Mae faces financial risk. This risk insulation has helped Ginnie Mae to never post an annual loss. However, this lack of an annualized loss does not mean the performance of the underlying mortgages is not of concern to HUD. FHA, a separate entity within HUD, insures most of the mortgages in the Ginnie Mae portfolio. As of September 2016, Ginnie Mae owned just over \$1 billion of FHA insured loans that were over 90 days delinquent.³

Monitoring Nonbank Issuers Challenges Ginnie Mae

As HUD Inspector General Montoya noted in March 2016 Senate testimony, a “key challenge facing Ginnie Mae is the risk posed by the growing number of Ginnie Mae issuers that are institutions other than banks.” Ginnie Mae acknowledged this risk itself in 2014, saying that the shift away from “enormous banking institutions with substantial resources, diverse lines of business and deep access to low-cost funding...represents a meaningful increase in the possibility of loss to Ginnie Mae.” In response, Ginnie Mae created a five-point strategic plan to address its changing operating environment.⁴ Ginnie Mae has continued to raise the challenge of nonbank monitoring. In January 2017, Ginnie Mae's outgoing President said it needed to continue to evolve to understand its nonbank risks and proactively address them.

³ Although Ginnie Mae does not generally hold loans, it may do so when an issuer defaults.

⁴ Ginnie Mae planned to (1) advocate to ensure mortgage servicing was economically viable, (2) modify its operations to support new issuers, (3) upgrade its ability to assess issuers' capabilities, (4) focus on improving liquidity for MSR, and (5) ensure issuer compliance with program requirements.



Since Ginnie Mae first acknowledged the risk from nonbanks, nonbanks' share of its Single Family MBS issuance volume has continued to increase. In FY 2016, nonbank issuers accounted for 73 percent of Ginnie Mae's Single Family MBS issuance volume for the year, up from 51 percent in June 2014, and from 18 percent in FY 2010. Figure 1 shows large gains by nonbanks over banks in terms of their own RPB and their share of Ginnie Mae's RPB in 2016.

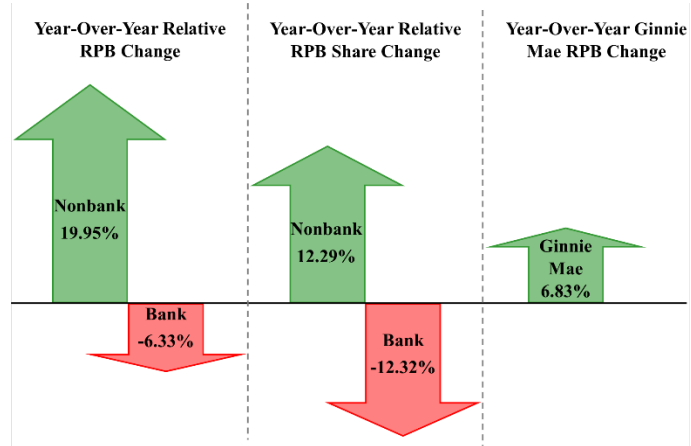


Figure 1: Year-Over-Year RPB Change during Calendar Year 2016

As nonbanks increased their share of MBS issuance volume, this issuance volume has become more distributed across issuers. Between 2010 and 2016, the cumulative new issuance market share of the top five issuers decreased from 76 percent to 35 percent. Ginnie Mae notes this trend has reduced its risk for the failure of a single issuer. However, Ginnie Mae also notes this trend will require it to oversee significantly more issuers than in the past.

As Ginnie Mae reported in its FY 2016 Report to Congress, “monitoring [nonbanks] has affected [its] staff workload exponentially.” During his Senate testimony, Inspector General Montoya explained an additional repercussion of the shift, noting that “Ginnie Mae’s potential for losses occurs when an issuer fails to fulfill its responsibilities. With the significant shift of its business going to nonbanks, Ginnie Mae can no longer rely on the Office of the Comptroller of the Currency and other bank regulators to ensure that its servicers can meet their financial obligations.” In March 2016, the U.S. Government Accountability Office reported that Ginnie Mae officials were concerned that constrained resources prevent it from increasing monitoring of nonbanks.⁵

Not only is the Ginnie Mae portfolio made up of more issuers, many new issuers tend to have more complex financial and operational structures. Whereas bank issuers tended to operate all business functions internally, nonbanks are likely to rely on external credit lines and more frequent trading of servicing rights, including the use of subservicers. Although subservicers must be approved as issuers, as of September 2016 only 19 of 380 issuers were acting as subservicers. These 19 entities serviced more than \$550 billion of Ginnie Mae’s \$1.7 trillion portfolio. Although a larger distribution among the issuer pool may have had the effect of reducing Ginnie Mae’s risk for any single issuer failure, concentration at the subservicer level may affect multiple issuers in the event a single subservicer fails. As HUD’s Office of Policy Development and Research noted, “mortgage servicers can significantly affect whether borrowers can repay their mortgages” because “effective servicing can potentially help borrowers avoid foreclosure.”

⁵ U.S. Government Accountability Office, Nonbank Mortgage Servicers Existing Regulatory Oversight Could be Strengthened, GAO-16-278, page 41



OIG Efforts Relating to Ginnie Mae

OIG’s most substantial investigation of a Ginnie Mae nonbank issuer was Taylor, Bean & Whitaker (TBW). In 2009, OIG participated in a joint investigation into officials who had worked for TBW. TBW had been an FHA direct endorsement lender and a Ginnie Mae issuer. As a result of the investigation, the company’s former owner and chairman, chief executive officer, president, treasurer, and accounting supervisor, as well as two employees from a second company, pled guilty to, or were convicted of, conspiracy to commit bank, wire, and securities fraud or making false statements to Federal agents.

In August 2009, shortly after the investigation became public, Ginnie Mae defaulted TBW. Ginnie Mae assumed TBW’s mortgage servicing rights (MSR) and engaged a third party subservicer for the underlying loans. The third party had difficulty servicing the loans, which resulted in a significant deficiency finding against Ginnie Mae in its FY 2011 financial audit. The finding was the result of deficiencies in the collateral documentation for loans supporting the MBS servicing portfolio it assumed from TBW. Ginnie Mae’s decision to default TBW was a result of concerns about fraud relating to TBW’s financial statements rather than its failure to maintain principal and interest payments to investors. Nevertheless, TBW’s nonbank status and Ginnie Mae’s challenges in servicing TBW’s MBS will be relevant if another issuer fails in the future, especially if the issuer is an increasingly prevalent nonbank.

Ginnie Mae struggled to manage the approximately \$26 billion portfolio it assumed from TBW; yet as of December 2016, Ginnie Mae had eight nonbank issuers with portfolios at least as large as \$26 billion, and two of these nonbanks had portfolios in excess of \$100 billion. As shown in table 1, the largest nonbank issuers grew 50 percent faster than nonbanks as a whole and more than four times faster than Ginnie Mae as a whole during calendar year 2016.

Table 1: Recent Growth in Largest Nonbank Issuers’ RPB (billions)

		December 2015	December 2016	Year-over-year*
Ginnie Mae	Total RPB	\$1,645	\$1,758	6.83%
	5 Largest Issuers RPB	\$307	\$398	29.95%

*Percentages are based on non-rounded RPB

When Ginnie Mae assumes MSR, it assumes the cost and risk of servicing the underlying loans. Ginnie Mae said it wants to avoid assuming MSR in the future by finding issuers willing to assume them instead. However, it may be difficult to know in advance whether Ginnie Mae can find an issuer willing to assume another issuer’s MSR. Because Ginnie Mae may lack the capacity to assume a large nonbank issuer and it may not find another issuer to do so, proactively ensuring issuers’ financial soundness is essential.



Since 2008, OIG has completed 14 audits of Ginnie Mae or its issuers; 9 were financial audits and 5 were program audits. OIG performs annual financial statement audits on Ginnie Mae and completed its most recent audit in November 2016. OIG was not able to express an opinion on Ginnie Mae's financial statements due to significant issues that could not be resolved. The audit identified four material weaknesses, which were deficiencies in internal controls that created a reasonable possibility that Ginnie Mae would not prevent, detect, or correct a material misstatement on its financial statements in a timely basis. Most of these issues stemmed from problems Ginnie Mae encountered in servicing the loans it assumed from TBW. One material weakness stemmed from a lack of an appropriate financial management governance structure. The audit also identified one significant deficiency, which although less serious than a material weakness, still merited attention from Ginnie Mae management. Finally, the audit determined that Ginnie Mae did not comply with the Debt Collection Improvement Act of 1996 by failing to ensure it had exhausted all debt collection tools prior to discharging certain debt.

Future OIG Work

OIG is focusing on Ginnie Mae's capacity to monitor nonbanks with an ongoing audit. During preliminary work, OIG found that Ginnie Mae's organizational structure and staff levels have not kept pace with the growth and changes in the mortgage industry. OIG believes this poses a greater risk to Ginnie Mae's ability to properly monitor and mitigate the risks posed by nonbanks than whether its compliance reviews ensure nonbank issuers service loans in accordance with its rules and requirements. If the final audit results confirm this condition, it will correspond with the finding of a fall 2016 study self-initiated by Ginnie Mae.⁶

Beyond this audit, OIG will regularly collect and analyze data to focus on Ginnie Mae's most pressing challenges. OIG analytics are intended to identify trouble spots before they become another event like TBW. OIG looks forward to continuing a respectful and productive relationship that maintains its independence while furthering its role in helping HUD and Ginnie Mae identify risks and overcome challenges to their missions.

⁶ KPMG LLP conducted a Business Process Reengineering study and delivered its results to Ginnie Mae on September 26, 2016. KPMG concluded that understaffing creates "...an impaired ability for Ginnie Mae to monitor its Issuers for sources of risk that could impair investor confidence in the Ginnie Mae Mortgage-Backed Security (MBS), to resolve Issuer failures effectively and with minimal cost and disruption, and to support the government mortgage finance system by allowing a competitive market to flourish." KPMG found that contractors account for 68 percent of the FTEs performing Ginnie Mae core competencies, and 84 percent of all Ginnie Mae FTEs. When KPMG benchmarked Ginnie Mae staffing, KPMG determined the Ginnie Mae work force difference when compared to similarly situated entities was 582, meaning Ginnie Mae staffing would be approximately 1434 rather than 852 if it were staffed at a level comparable to similarly situated entities.