CSBS Comment Letter: Congress Should Establish a Liquidity Facility to Keep Mortgage Markets Functioning

Statements & Comments

Read the full letter [PDF]

Dear Chairwoman Waters, Chairman Crapo, Ranking Member McHenry and Ranking Member Brown,

On behalf of the Conference of State Bank Supervisors (CSBS)[1], I am writing to highlight the urgent need for Congressional action to ensure the orderly functioning of the U.S. housing market and bring stability and confidence to banks and their business customers. Notably, we ask that subsequent legislation to address the economic and financial turmoil associated with the COVID-19 pandemic include Congressional action to establish a credit facility for nonbank mortgage servicers, and to reestablish the Transaction Account Guarantee (TAG) program for at least two years.

Establish a Liquidity Facility to Keep Mortgage Markets Functioning

The recently enacted the Coronavirus Aid, Relief and Economic Security Act (CARES Act; P.L. 116-136) provides up to one year of mortgage forbearance for all federally-backed mortgages; a 60-day moratorium on foreclosure proceedings, foreclosure-related evictions, and foreclosure sales for federally-backed mortgages; and up to 90 days of forbearance for multifamily borrowers with a federally-backed multifamily mortgage loan. Federal and state agencies with authority over housing finance have responded to allow borrowers to stay in their homes during the crisis by instituting moratoriums on foreclosure and encouraging institutions to extend forbearance to distressed borrowers.[2]

As state officials with consumer protection and financial oversight responsibilities, CSBS's members strongly support these critical protections at a time when individuals and families are being asked to stay at home to help curb the spread of the coronavirus. We strongly believe that corresponding actions must follow to support the mortgage servicing sector through this period of mortgage forbearance. To accomplish this, CSBS urges Congress to establish a credit facility for nonbank mortgage servicers to be administered by the Federal Reserve in anticipation of widespread borrower payment forbearance.

Nonbank mortgage servicers process close to 50% of the GSE and Ginnie Mae market, which comprises $7 trillion of the overall $11 trillion in mortgage debt outstanding. Over the past several years, state regulators – on a multistate basis and with various federal agencies -- have devoted significant attention to the oversight and supervision of nonbank mortgage servicers, monitoring their financial condition and operational capacities. Additionally, our members' lengthy experience as on-the-ground mortgage regulators—including through the 2008 financial crisis – has shown us first-hand the consumer harm and market instability that result from even minor disruptions in the mortgage servicing sector.

This regulatory experience, coupled with the data on hand and the unprecedented nature of our current national challenge, demonstrate the need for a dedicated credit facility for nonbank mortgage servicers:

- In the last three weeks alone, nearly 16.5 million Americans have filed for unemployment insurance benefits. For the week ending April 4, 6.6 million Americans filed for unemployment, nearly matching the week before which was roughly four times greater than the worst reading on record.
- According to the Mortgage Bankers Association (MBA), "the total number of loans in forbearance grew from 0.25 percent to 2.66 percent from March 2 to April 1, 2020, with mortgages backed by Ginnie Mae seeing the largest growth (from 0.19% to 4.25%)."[3] This uptick represents a 10 percent increase in March alone, at a time

largely prior to the passage of the CARES Act which required servicers to provide forbearance. Additionally, based on newer data, mortgage forbearance for the week of March 30 through April 5 rose to 3.74%.[4]

- Additionally, MBA's analysis shows that if "approximately one-quarter of borrowers avail themselves of forbearance for six months or longer, advancing demands on servicers could exceed $75 billion and could climb well above $100 billion."[5]

If a significant number of borrowers cease making payments for the duration of the COVID-19 pandemic, mortgage servicers will face servicing advance obligations that far exceed those ever experienced or anticipated. Although mortgage servicers maintain liquid assets to ensure they can sustain high levels of servicing advance obligations, it is unlikely that these assets will be sufficient to cover servicing advances when, as is estimated, between one-quarter and one-half of borrowers enter forbearance and suspend payments.

We are particularly concerned about mortgages underlying Ginnie Mae MBS, namely mortgages backed by the Federal Housing Administration (FHA) and the U.S. Department of Veterans Affairs (VA). These borrowers are more vulnerable, credit strained and prone to suffer loss of employment. Servicers responsible for this segment of the market may experience greater liquidity stress due to higher rates of delinquency and the near term need for forbearance assistance. Nonbank servicers play a disproportionately large role in this key market segment as they are responsible for 69 percent of FHA/VA loan servicing yet, unlike banks, do not have access to low cost funding in the form of deposits. While Ginnie Mae has announced liquidity support through their Pass-Through Assistance Program, this will only cover principal and interest on roughly one-third of the agency mortgage market and leaves a significant burden on servicers to address forbearance-related shortfalls.

We must not lose sight of the interconnectedness within the industry, especially when 59% of nonbank servicers are also originators. Establishing a baseline expectation of liquidity in the servicing market will not only help servicers and their borrowers, it will begin to provide certainty that loans originated in this low-rate environment can be serviced properly and sold into a healthy and functional MSR market.

It has been suggested that one solution to this COVID-created liquidity crisis is to transfer servicing away from mortgage servicers to larger, “more reputable” entities. Recent history shows us that entity size is not necessarily correlated with mortgage servicing success or with consumer protection. In the aftermath of the 2008 financial crisis, smaller nonbank servicers stepped in when larger entities and depositories fled the sector or went out of business. Unnecessary additional market dislocation caused by a lack of liquidity would unduly harm vulnerable borrowers and drive otherwise stable companies out of the market.

Also, while servicing transfers are much more structured and regulated in the post-financial crisis years, a disorderly forced transfer will needlessly punish both transferor company and their borrowers who are dealing with job loss and economic difficulties created by the COVID-19 national emergency and create additional market dislocation. Culling the market of nonbank mortgage servicers in particular at this critical juncture will have a disproportionate impact on markets they serve in relatively higher percentages: first-time homebuyers, low- and moderate-income borrowers and veterans. This is largely an avoidable outcome if we heed the call for a uniform, consistent and predictable source of liquidity support to assist this industry in meeting the needs of their borrowers during this crisis.

Finally, it is important that any legislation creating a dedicated credit facility for mortgage servicers not interfere with or limit state regulators’ ongoing roles and responsibility as the primary regulator for nonbank mortgage servicers. State regulators are a first line of defense in ensuring consumer protection and market stability through supervisory activities, and are the only regulators monitoring nonbank mortgage entities for safety and soundness.

Reestablish the TAG Program Immediately

While the CARES Act authorized the FDIC to reestablish the Transaction Account Guarantee (TAG) program, one has yet to be established. During the 2008 financial crisis, the FDIC's TAG program was established quickly after the Treasury provided a temporary guaranty to protect shareholders and the Federal Reserve created a similar money market liquidity facility. TAG provided similar protection to banks and their depositors and preserved balance in the deposit markets. The TAG program provided security to many businesses' commercial accounts and kept these critical funds within banks, notably, community banks.

The Federal Reserve has taken extraordinary steps to support the flow of credit to households and businesses, including by establishing – as it did in 2008 -- a Money Market Mutual Fund Liquidity Facility (MMLF). State bank regulators urge Congress to act to reestablish the TAG program. This will help ensure market stability and confidence as our country continues to address the consequences of the pandemic. Acting now will bring stability and ensure liquidity of banks, particularly smaller banks.

Conclusion

State banking regulators stand ready to continue to work with Congress and our federal regulator counterparts to ensure the safety and soundness of the financial services system. We ask for your speedy consideration of these initiatives as the nation continues to address the financial impacts of COVID-19.

Sincerely,

John W. Ryan
President & CEO

Footnotes

[1] CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-by-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.

[2] Government-sponsored enterprises Fannie Mae and Freddie Mac are also offering, among other homeowner assistance, streamlined forbearance plans for up to 12 months.

[3] Mortgage Bankers Association: https://www.mba.org/2020-press-releases/april/mba-survey-shows-spike-in-loans-in-forbearance-servicer-call-volume.

[4] https://www.mba.org/2020-press-releases/april/mba-survey-share-of-mortgage-loans-in-forbearance-continues-to-climb.

[5] Mortgage Bankers Association: https://newslink.mba.org/servicing-newslink/2020/march/mba-servicing-newslink-tuesday-march-24-2020/potential-wave-of-mortgage-delinquencies-could-bankrupt-the-payment-system/.

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