MORTGAGE BANKERS ASSOCIATION

March 22, 2020

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mortgage Industry Views on the Urgent Need for Market Stabilization and Liquidity

Dear Secretary Mnuchin and Chair Powell:

The Mortgage Bankers Association (MBA),[1] the national association representing all elements of the real estate finance industry, writes today in response to the extreme volatility in financial markets arising from the spread of COVID-19. As businesses and societal institutions are forced to close their doors, millions of households throughout the country will likely find themselves with reduced incomes, which will impede their ability to meet their debt obligations in the coming weeks and months. While it is our sincere hope that the effects of the COVID-19 outbreak are short-lived, it is apparent that there will be at least several weeks of severe disruptions to all facets of our economy. Some of the most significant impacts are occurring with respect to the nation's system of housing finance.

We appreciate the actions taken thus far by both the Department of the Treasury (Treasury) and the Federal Reserve System (Federal Reserve) to help stabilize the

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[1] 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, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to 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 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

economy and financial markets. The establishment of emergency facilities to support liquidity for commercial paper and money market mutual funds, for example, represented necessary interventions to address the impacts of COVID-19. Statements emphasizing flexibility for financial institutions regarding capital, liquidity, and loan modifications were also welcome. MBA firmly believes that further action by Treasury and the Federal Reserve is needed to ensure the orderly functioning of the housing finance market. Specifically, Treasury and the Federal Reserve should:

1) ***Increase the scale and scope of agency mortgage-backed security (MBS) asset purchase operations; and***

2) ***Develop a liquidity facility to support the mortgage servicing sector in anticipation of widespread borrower payment forbearance.***

We believe these actions should be taken as urgently and swiftly as possible to counter volatility in the market, protect consumers, and ensure all market participants that the liquidity strains being caused by COVID-19 do not escalate into solvency problems throughout financial markets.

The Need for Increased Agency MBS Asset Purchases

Over a sustained time horizon, the market for agency MBS has exhibited high levels of liquidity, trailing only the market for U.S. Treasury securities in terms of trading volume and many other common measures of liquidity. This liquidity is a key driver of investor demand, which raises asset prices and lowers the interest rates that American homeowners pay on their mortgages. As such, ensuring the presence of a highly-liquid market is, and should continue to be, a public policy priority.

In recent days, however, as COVID-19-related fears have shaken confidence among fixed-income investors, the market for agency MBS has become severely dislocated due to uncharacteristic and abnormal levels of illiquidity. Price volatility has led to significant and sudden mark-downs in valuations of agency MBS, which prompted margin calls, thereby leading to asset sales by institutions seeking to raise cash. Transactions at much-reduced prices then led to further sector-wide mark-downs, triggering yet more margin calls. This negative spiral in valuations is producing a market in which sellers far outnumber buyers, liquidity continues to suffer, and valuations continue to fall.

This secondary market dislocation is flowing into the primary market, with interest rates on both single-family and multifamily mortgages spiking and spreads to Treasury securities widening, despite the Federal Open Market Committee (FOMC) taking swift action to reduce its target range for the federal funds rate and increase

purchases of agency MBS. As mortgage interest rates have risen, the ability of homeowners to refinance their loans – a potentially powerful form of stimulus in a recession – has been stalled.

The volatility in the agency MBS market also presents an immediate threat to market participants that are heavily exposed to these securities. In a market characterized by rapidly declining prices and an overabundance of sellers, an unprecedentedly volatile agency MBS market could drive important market participants into insolvency if not rectified. Unlike past instances of seizures in fixed-income markets, the current situation is unique given the remarkable credit quality associated with agency MBS. These securities, guaranteed by a government agency or government-sponsored enterprises (GSEs) that operate with capital support from Treasury, feature essentially no credit risk for investors. There is no inherent or fundamental reason, even against the backdrop of COVID-19 fears, that these securities should face such downward price pressure, other than forced selling resulting from illiquidity in other adjacent markets.

MBA therefore recommends that the Federal Reserve significantly expand its agency MBS asset purchase operations to a level well beyond the $200 billion minimum specified by the FOMC on March 15. Rather than provide a target for total agency MBS purchases, the FOMC should commit to increasing its purchases to the level necessary to stabilize the agency MBS market and, as a result, mortgage interest rates in the primary market.

Additionally, because the current liquidity strains are particularly acute in the markets for specified pools and agency multifamily securities, the FOMC should commit to expanding the scope of its purchases to include these assets, as well. Finally, a new version of the Term-Asset Backed Securities Loan Facility (TALF) should be launched to help support liquidity for other less-liquid portions of the securitization markets.

MBA urges the Federal Reserve to take aggressive action immediately. Even an announcement of its intention to accelerate its agency MBS purchases will provide stabilizing signals to the market. By doing so, the Federal Reserve can arrest the abnormally high volatility in the agency MBS market. It is becoming clearer by the day that such action is necessary to prevent more sweeping dislocations across fixed-income markets and the housing finance system.

The Need for a Liquidity Facility to Support Mortgage Servicing

As millions of households throughout the country face the prospect of temporary unemployment or lost wages due to the shuttering of businesses and short-term

economic malaise, it is natural and appropriate for regulators and financial institutions to find ways to help them remain in their homes. Actions such as mortgage payment forbearance will ensure that borrowers not only remain in their homes during this public health scare, but also that they have the best chance possible to resume their lives without detrimental impacts to their credit or ability to sustain homeownership.

One consequence of widespread borrower forbearance on a national scale, however, is the severe liquidity shortage that will befall the housing finance system. This liquidity shortage will most acutely affect mortgage servicers, who are contractually bound to continue to advance monthly payments to investors, insurers, and taxing authorities, regardless of whether the borrower actually made those payments. This advancing requirement can stretch from a few months for loans backing MBS guaranteed by the GSEs to many months – or potentially over a year – for loans backing MBS guaranteed by Ginnie Mae.

Mortgage servicers maintain liquid reserves to cover these advances when borrowers miss their payments, but virtually no servicer, regardless of its business model or size, will be able to make sustained advances during a large-scale pandemic when a significant portion of borrowers could cease making their payments for an extended period of time. While a mortgage servicer might have some additional flexibility for loans held on its balance sheet, advancing is required for loans that back Fannie Mae, Freddie Mac, or Ginnie Mae MBS – which constitute over 60 percent of the mortgage market. In these instances, investors are guaranteed monthly payments, and while servicers are eventually reimbursed by the guarantor for advancing these payments, there is a timing mismatch. The servicer needs enough liquidity to remain in operation and continue to fulfill its critical functions, including remitting property tax and hazard insurance premiums, until the reimbursement occurs.

In normal and even stressed environments, such as a localized natural disaster, servicers can withstand this liquidity pressure. Widespread, national borrower forbearance at the levels being proposed in response to the COVID-19 outbreak, however, extends well beyond any servicer advance obligations previously envisioned, and is beyond the capacity of the private sector alone to support. MBA has estimated, for example, 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.[2]

Due to the scale of this liquidity shortfall, and the importance of the housing finance system in providing both economic stimulus (through interest rate reduction refinancing) and temporary borrower hardship assistance, public sector resources will be needed. It is critically important for policymakers to emphasize that such

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[2] Actual advancing demands are highly sensitive to assumptions regarding borrower take-up of forbearance and the projected duration of forbearance.

resources are provided through liquidity facilities – that is, they will provide liquidity to otherwise solvent companies in order to support borrowers through this challenging time.

MBA therefore recommends that the Federal Reserve immediately establish a program through its authority under Section 13(3) of the Federal Reserve Act to provide liquidity for the residential mortgage servicing sector. Such a program should be supported by credit protection from Treasury's Exchange Stabilization Fund. A program of this nature would satisfy the requirements of the Federal Reserve Act; it would be developed in response to "unusual and exigent circumstances," entail lending on a temporary basis to solvent institutions, and provide for "broad-based" eligibility. Further, the high quality of mortgage underwriting over the past decade, combined with the government or GSE guarantees on the collateral, would minimize any credit risk associated with the program.

It is critical that such a program be announced and developed *in advance* of any obligations that mortgage servicers must meet due to borrower forbearance. By ensuring that the necessary liquidity is available before it is truly needed, the Federal Reserve and Treasury can provide stability to this vitally important segment of the market and remove barriers to the successful implementation of forbearance options on a national scale.

Again, we urge the Federal Reserve and Treasury to coordinate in developing a liquidity facility to support mortgage servicing. Failure to do so could jeopardize the infrastructure of housing finance, causing irreparable harm to consumers and market participants of all types.

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Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 and pmills@mba.org.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association