Issuers Warned to Keep Prepayment Speeds in Line or Risk Sanctions

By: Jann Swanson | Fri, Feb 9 2018, 11:29 AM

A small group of VA approved issuers have been warned that the speed at which their loans are being prepaid **makes it appear they are participating in "churning."** Ginnie Mae said on Thursday that the issuers who have been notified are expected to deliver a corrective action plan that identifies immediate strategies to **bring prepayment speeds in line** with those of loans issued by their peers.

In January, a Ginnie Mae official testified before hearing of the House Committee on Veterans Affairs about loan churning. He told committee members that, starting in early 2016, the agency, as well as investors in its mortgage backed securities (MBS), began to note that loan prepayment rates and serial refinancings were occurring with unusual frequency among VA mortgages. Some of the prepayments were at speeds that **could not be justified by economic factors.** There was also a weakening of Ginnie's MBS prices when compared to other types.

The official said a Ginnie Mae analysis showed that some lenders appeared to be aggressively pushing a series of loan refinances solely to increase profits. He cited two underlying dynamics; the increasing number of vets, many of whom seem to be susceptible to advertising schemes that "appear to come from reputable sources." Second, the premium at which Ginnie Mae MBS trades, typically $1.05 to the dollar, which may incentivize issuers to pull loans from pools at "par," $1.00, and deliver them into a security at premium, **booking a 5 percent profit each time.**

It also appears that some lenders are originating loans substantially above prevailing interest rates to borrowers; sometimes but not always those needing cash out or with low credit scores. They then sell these loans at a premium and use the high rates as a wedge to move the borrower to quickly refinance.

This churning goes beyond hurting individual borrowers, having implications for the broader mortgage market. The premium paid for Ginnie Mae loans translates into lower rates not only for VA eligible borrowers but for those in other government loan programs. As the VA loans are refinanced, they are removed from the pools, taking away the returns investors expect, and the incentive to buy the securities above par. This will **ultimately increase interest rates**, not just for VA loans but also for ones guaranteed by FHA and USDA.

The action announced by Ginnie Mae this week builds off the work of the Ginnie Mae-VA Loan Churn Tax Force which came into being last September. The agency said that if issuers are unable to prove with the required action plans that they have strategies for bringing their prepayment speeds into line with the market, they risk being restricted from access to Ginnie Mae multi-issuer pools. Thereafter, those issuers may only have access to Ginnie Mae custom pools.

"We have an obligation to take necessary measures to prevent the lending practices of a few from impairing the performance of our multi-issuer securities, and thus raising the cost of homeownership for millions of Americans," Michael Bright, Ginnie Mae Executive Vice President and Chief Operating Officer said. "By addressing the **anomalous performance of a few lenders**, Ginnie Mae is acting to protect veterans, the broader Ginnie Mae program, the American taxpayer and the consumers we serve. We expect issuers receiving these notices to respond quickly, produce a corrective action plan and come into compliance with our program."

Ginnie Mae's notice follows other announcements of program changes. These changes, outlined in APM 17-06 and APM 18-02 provide acceptable risk parameters for mortgages backing Ginnie Mae securities and the agency's ongoing issue evaluation.

"We are focusing on outliers that are harming Ginnie Mae's program, not at issuers that genuinely help support responsible lending," continued Bright. "The vast majority of our issuers fall squarely in the latter category, and we look forward to continuing to work with them to provide refinance opportunities to veterans, rural communities, and low to moderate-income homeowners." This action comes after Ginnie Mae completed a comprehensive review of issuer performance, which included an in-depth evaluation of prepayment speeds on the MBS pools of individual issuers. This analysis identified a small number of issuers with prepayment speeds that **substantially deviate** from the mean for an **extended period of time.**

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