



MORTGAGE BANKERS ASSOCIATION

March 29, 2020

Robert W. Cook
President and Chief Executive Officer
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Mortgage Industry Concerns Regarding Broker-Dealer Margin Calls on TBA Hedge Positions

Dear Mr. Cook and Chairman Clayton:

The Mortgage Bankers Association (MBA),¹ the national association representing all elements of the real estate finance industry, writes today to bring to your attention an urgent concern in the market that is threatening mortgage lenders of all sizes throughout the country. In short, the dramatic price volatility in the market for agency mortgage-backed securities (MBS) over the past week is leading to broker-dealer margin calls on mortgage lenders' hedge positions that are unsustainable for many such lenders.

We urge, therefore, the Financial Industry Regulatory Authority (FINRA) and the U.S. Securities and Exchange Commission (SEC) to call on their regulated broker-dealers to work constructively with their mortgage lender counterparties in response to the COVID-19 outbreak. Greater flexibility during this period would enhance financial

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.

stability and mitigate severe threats to the functioning of the housing finance system that already is operating under significant duress.

In mid-March, as the impact of the COVID-19 outbreak became more acute, the agency MBS market – typically one of the most liquid fixed-income markets in the world – was besieged by a lack of buyers, a sharp decline in liquidity, and rapidly falling valuations. These dynamics caused significant strains on a variety of agency MBS investors, many of whom are critical participants in the housing finance system. MBA was pleased that the Federal Open Market Committee took decisive action, increasing the Federal Reserve's purchases of agency MBS to restore liquidity to this market. Conditions have since improved and agency MBS valuations have risen rapidly.

A full week of such large-scale agency MBS purchases, and the subsequent rally in agency MBS valuations, however, has produced a new set of market dynamics that is harming a wide range of mortgage lenders. Many mortgage lenders hedge their pipelines of new originations by taking short positions in the To-Be-Announced (TBA) agency MBS market. Because loans in lenders' pipelines could fall in value prior to their sale in the secondary market, for example due to a rise in interest rates, lenders often seek to hedge this risk to avoid adverse impacts due to loan price fluctuations.

One common, prudent hedge entails a lender taking a short position in TBA securities. The lender has a natural long position in the mortgages in its pipeline, and a short TBA position allows for an offset in the effects of interest rate movements. When interest rates rise, the lender will suffer losses in the valuation of its pipeline, but it will gain on its hedge – and vice versa when interest rates fall. Lenders most frequently engage in these transactions with broker-dealers that are regulated and supervised by FINRA and the SEC.

Over the past week, agency MBS valuations have risen dramatically. While lenders can expect to recognize gains on their pipelines, they will also recognize losses on short TBA positions used for hedging purposes. These pipeline gains will be recognized over a period of weeks, but the sharp movement in lenders' hedge positions typically entails daily adjustments and margin calls from their broker-dealer counterparties.

Because of these dramatic price changes, broker-dealers' margin calls on mortgage lenders reached staggering and unprecedented levels by the end of the past week. For a significant number of lenders, many of which are well-capitalized, these margin calls are eroding their working capital and threatening their ability to continue to operate. MBA has been made aware of many cases in which lenders in strong financial positions only a few days ago will not be able to meet these margin calls after only another day or two of market movements at the pace observed last week.

The inability of a large set of responsibly-managed lenders to meet these margin calls would jeopardize the very objective of the Federal Reserve's agency MBS purchases – the smooth functioning of both the primary and secondary mortgage markets.

Further, in recent days many financial regulators have emphasized the importance of regulated institutions working with customers and counterparties in a flexible manner in response to the COVID-19 outbreak. MBA believes this flexibility should extend to broker-dealers' treatment of mortgage lender hedging practices. These practices represent sound business decisions by companies that are critical to the continued flow of mortgage credit to consumers. Their inability to operate and lend would exacerbate the already significant negative impact that the COVID-19 outbreak has had on the national economy.

As such, MBA urgently requests that FINRA and the SEC issue guidance to the nation's broker-dealers, making clear that margin calls on mortgage lenders' TBA hedge positions should not be escalated to destabilizing levels. Absent such guidance and an immediate shift in broker-dealer practices, the U.S. housing market is in danger of large-scale disruption.

Thank you in advance for your consideration of these comments

Sincerely,



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

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