Economic Policy Program

Housing Commission

Ginnie Mae: How Does it Work and What Does it Do?

The Government National Mortgage Association (or Ginnie Mae) is a government corporation within the U.S. Department of Housing and Urban Development (HUD). It was established in 1968 when Fannie Mae was privatized. Its mission is to expand funding for mortgages that are insured or guaranteed by other federal agencies. When these mortgages are bundled into securities, Ginnie Mae provides a full-faith-and-credit guarantee on these securities, thus lessening the risk for investors and broadening the market for the securities.

What Does Ginnie Mae Do?

Ginnie Mae only guarantees securities created by approved issuers and backed by mortgages covered by other federal programs.

The Ginnie Mae guarantee ensures that investors in these mortgage-backed securities (MBS) do not experience any disruption of the timely payment of principal and interest, thus shielding them from losses resulting from borrower defaults. As a result, these MBS appeal to a wide range of investors and trade at a price similar to that of U.S. government bonds of comparable maturity. However, the guarantee also places Ginnie Mae, and ultimately American taxpayers, at risk of losses not covered by the other federal programs (see **When Does a Ginnie Mae Guarantee Apply?**).

When Does a Ginnie Mae Guarantee Apply?

Ginnie Mae guarantees MBS backed by loans covered by the following programs:

- The Federal Housing Administration's single-family and multifamily mortgage insurance programs, which provide 100 percent insurance on the mortgages.
- The Department of Veterans Affairs guarantee program, which generally guarantees 25 percent of the mortgage, but can guarantee up to 50 percent for smaller loans.
- HUD's Office of Public and Indian Housing loan guarantee program, which guarantees 100 percent of the mortgage.[1]
- U.S. Department of Agriculture's Rural Housing Service loan guarantee programs, which guarantee up to 90 percent of the mortgage.

Steps to Minimize Claims and Protect the American Taxpayer

Ginnie Mae's key challenge is to minimize claims against the guarantee and in particular to minimize the likelihood that it will have to call upon taxpayers for a bailout. It does this in a number of ways.

1. Ginnie Mae places the issuers of the MBS on the front line to make the timely payments to investors.

As homeowners make their mortgage payments each month, investors in the MBS receive regular payments of principal and interest. While Ginnie Mae provides the ultimate guarantee that investors will receive these payments without disruption, the issuers of the securities bear primary responsibility for covering any losses resulting from borrower defaults. Besides creating a buffer to absorb losses, this approach encourages issuers to ensure proper underwriting, originating, servicing, and securitization, thus maintaining an alignment of interests between the issuers and Ginnie Mae.

To guard against the possibility that issuers will not be able to meet their obligations (referred to as counterparty risk), Ginnie Mae screens financial institutions that apply to participate in its program, examining their net worth and their track record as an issuer, originator, and servicer. Furthermore, Ginnie Mae regularly reviews the qualifications of issuers when, as required, they apply each quarter for commitment authority to issue new securities. This ability to limit issuances allows Ginnie Mae to manage its overall potential liability.

Why Does Ginnie Mae Use the Term "Issuer/Servicer?"

Ginnie Mae MBS can include mortgages purchased from multiple originators and serviced by third parties. However, Ginnie Mae looks only to the issuer of the MBS to ensure that the servicing meets its standards. Therefore, to be approved, an issuer must also demonstrate its ability to satisfactorily originate and service the mortgages.

Ginnie Mae maintains a "watch list" for those issuers that fail to meet risk thresholds related to

- default risk (which includes thresholds for borrower delinquency),
- financial risk (which includes requirements for adjusted net worth, adjusted net income, and other financial ratios),
- insurance risk (which includes verification that mortgages backing the securities have insurance from specified federal programs), and
- compliance score (which includes the results of issuer reviews).

If it is determined that an issuer is unable to make the payments or cannot meet net worth or performance standards, then Ginnie Mae will take over its portfolio and transfer servicing to an approved entity.

1. Ginnie Mae provides a wrap on the Indian and Native Hawaiian Guarantee Home Loan programs. While important to these specialized markets, they are very small in volume.

2. Ginnie Mae charges a fee for its guarantee.

The proceeds of this fee—now at the maximum allowed by Congress of 6 basis points (0.06 percent)—are used to cover eligible operating costs and claims paid during the year. Fee proceeds are also added to a capital reserve that is set aside to cover future losses, with any remaining surplus sent to the Treasury Department to go back into the federal budget. Ginnie Mae has never had to tap the reserve that it has built over time, nor has it required appropriations from the federal budget to cover any losses.

3. Ginnie Mae relies on other federal agencies.

Because Ginnie Mae only guarantees securities backed by mortgages that are insured or guaranteed by other federal agencies, it can rely to some extent on their oversight of the underwriting, originating, and servicing of these loans and on their insurance/guarantees to limit the impacts on the issuers from borrower defaults. (As noted above, this interdependence makes it essential that Ginnie Mae verify the proper enrollment of the mortgages in these other government programs.)

Managing Risk—Ginnie Mae Takes the Following Steps to Minimize its Losses from Borrowers Who Fail to Make Their Mortgage Payments:

1. Contracts with issuers to hold them responsible for making timely payments of principal and interest even when borrowers stop paying.
2. Sets net worth and performance standards for issuers.
3. Requires all mortgages to be enrolled in a federal insurance or guarantee program.
4. Replaces servicers who fail to make timely payments.
5. Maintains a capital reserve to absorb losses before calling on the U.S. government or taxpayers.
6. Funds a capital reserve through fees on Ginnie Mae–backed MBS.

Ginnie Mae Differs From Fannie Mae and Freddie Mac

Ginnie Mae differs from Fannie Mae and Freddie Mac in several important ways.

- **It has the explicit backing of the U.S. government,** unlike Fannie Mae and Freddie Mac. Although privately owned, Fannie Mae and Freddie Mac were perceived to have the implicit financial backing of the government prior to being placed in conservatorship.
- **Ginnie Mae does not hold an investment portfolio** of mortgages and MBS. Losses from these portfolios contributed to the decision to place Fannie Mae and Freddie Mac into government conservatorship in 2008.
- **The Ginnie Mae model allows banks to gain the benefits from securitization while still being held primarily at risk** for the timely payment of principal and interest. In the Fannie Mae and Freddie Mac models, banks sell mortgages to Fannie Mae and Freddie Mac and are thereby relieved from having to hold capital against the mortgages—the only potential liability of the lenders is if they sell improperly originated mortgages (referred to as a violation of representations and warranties). Without being able to realize these reductions in capital, bank originators/issuers would find securitization much less attractive.

  With Ginnie Mae, the bank-based issuers are held responsible for the timely payments of principal and interest, although they are able to achieve the same capital reduction. Such a responsibility would generally cause bank regulators to treat the loans as if they were still on a bank's books. However, because the mortgages are backed by other federal programs, no capital is required to be held.

This is one in a series of primers on key concepts in housing finance prepared by the Bipartisan Policy Center. Visit www.bipartisanpolicy.org/projects/housing to view the full series.
