



2023 MORTGAGE & HOUSING SUMMIT

THE OUTLOOK FOR ISSUERS AND INVESTORS

MBA[®]

MORTGAGE BANKERS ASSOCIATION

MAYER | BROWN



Market Overview

Michael Fratantoni

Chief Economist and Senior Vice
President of Research & Industry
Technology, Mortgage Bankers
Association

Mortgage Market Overview

Prepared for Mayer Brown Mortgage Day

September 2023

Presented by:

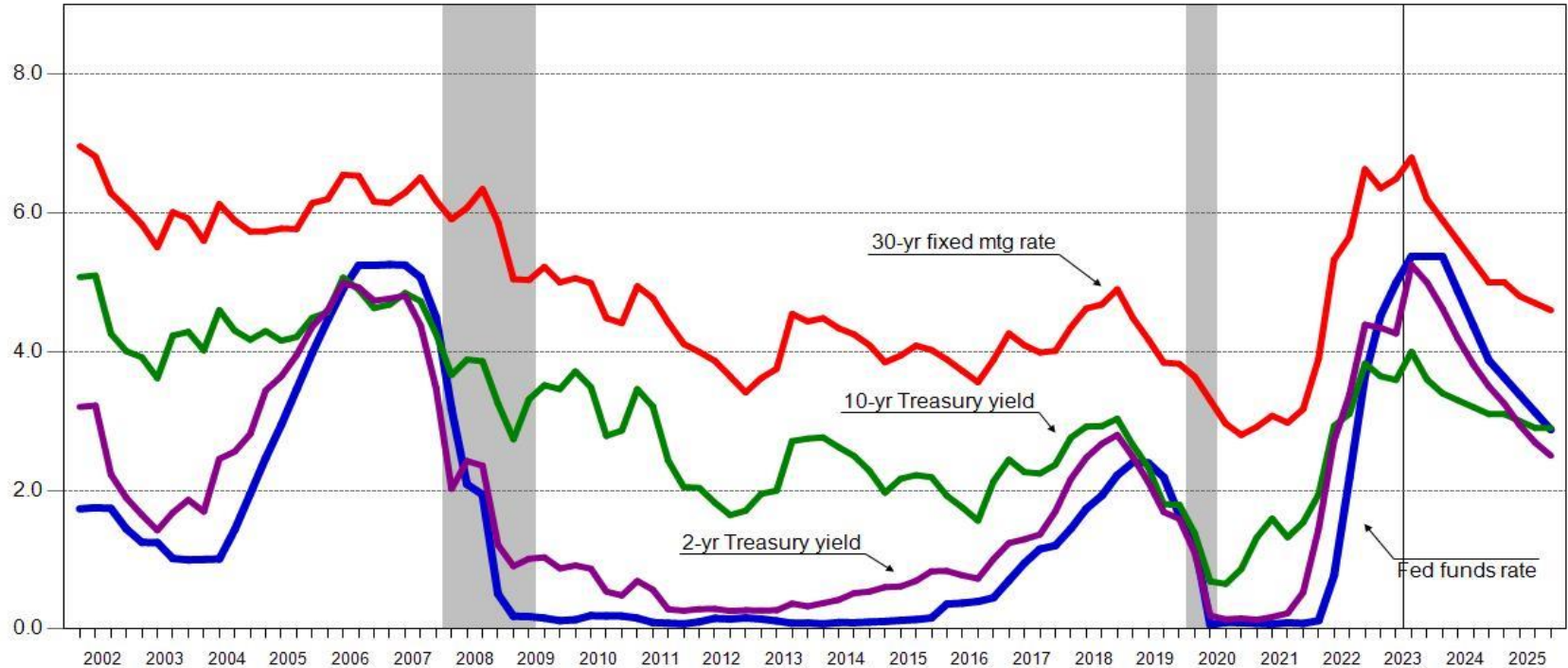
Mike Fratantoni

Mortgage Bankers Association

Fed to Hold Funds Rate Until 2024, Mortgage Rates Expected to Drift Down

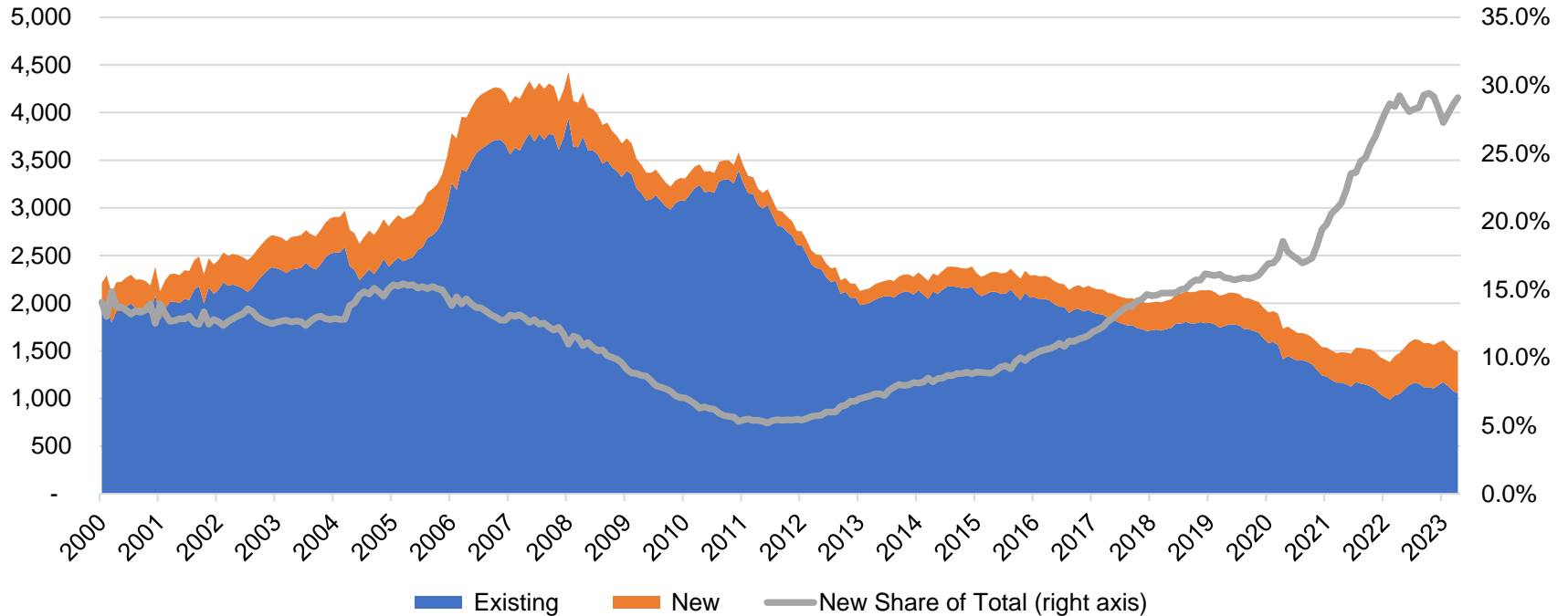
Rate History and Forecast

Percent



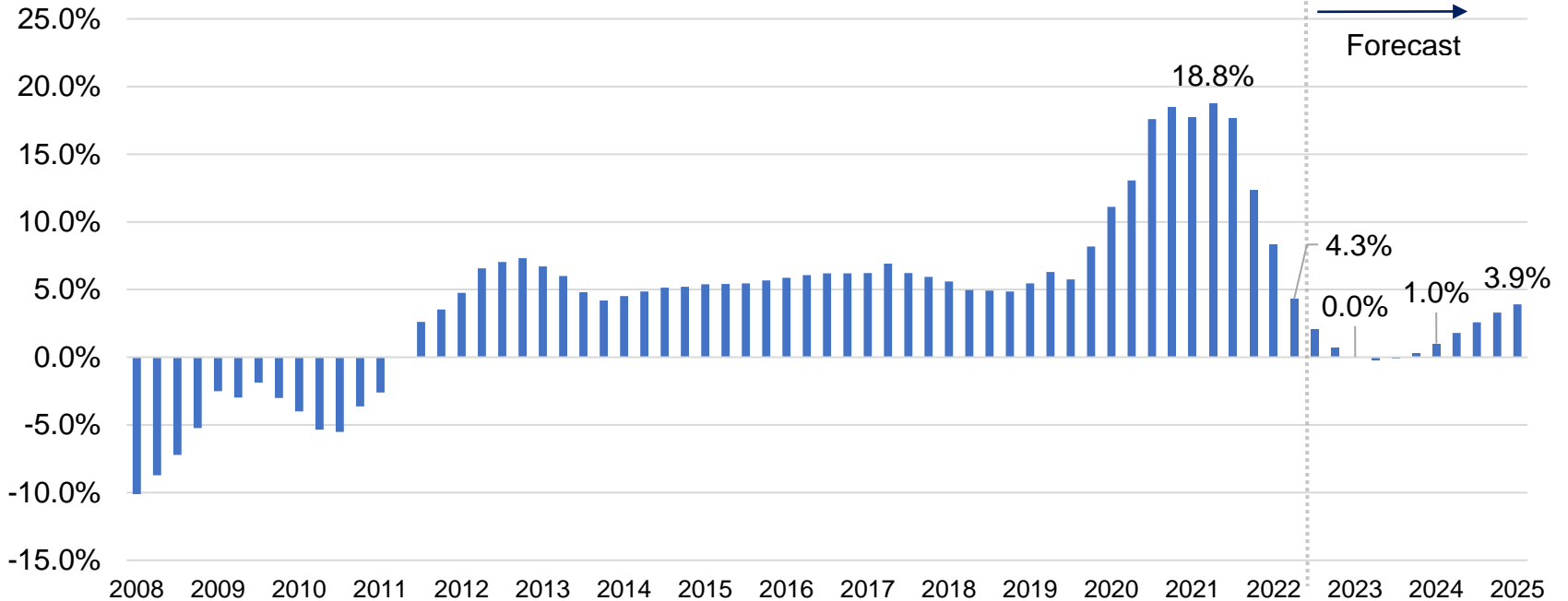
Newly Built Homes a Larger Share of For-Sale Inventory

Housing Units Available for Sale
Seasonally adjusted, thousands



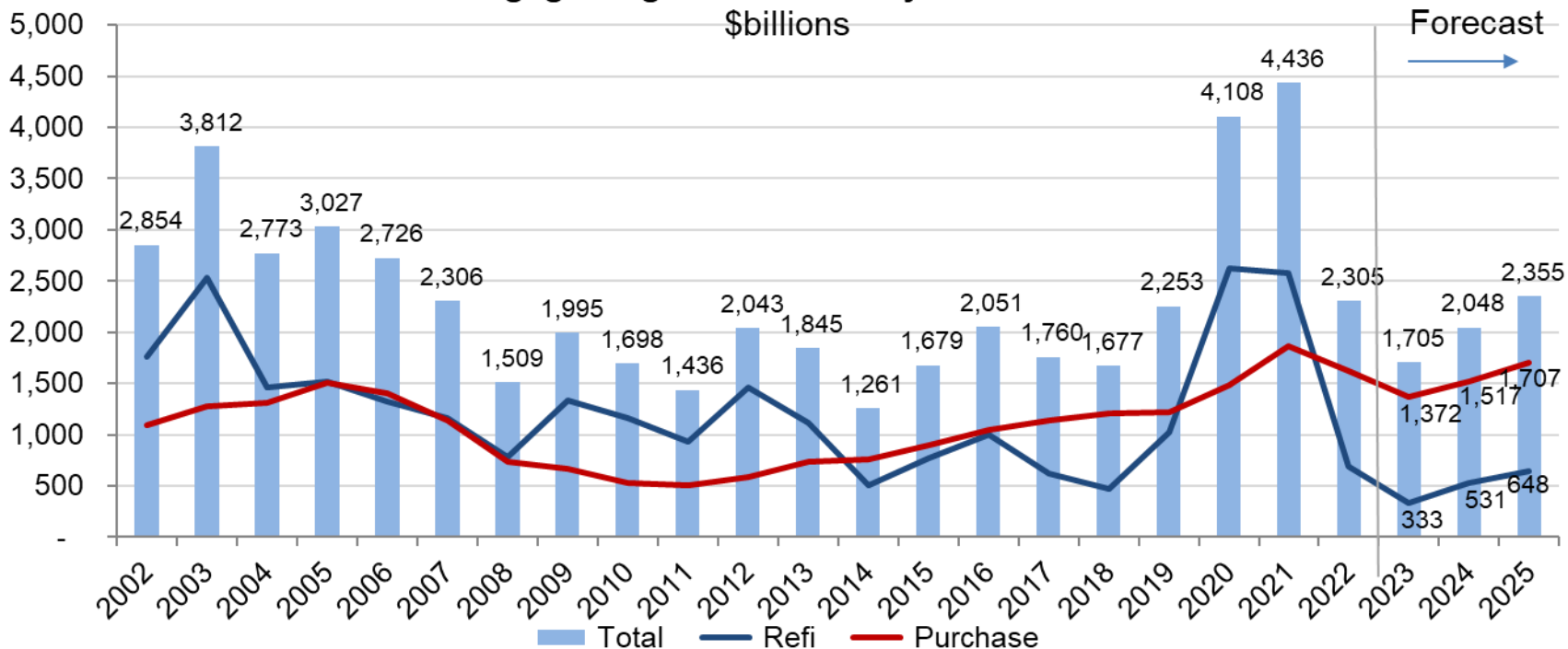
Home Price Growth Supported by Lack of For-Sale Inventory

FHFA Purchase Only House Price Index, MBA Forecast
Non-seasonally adjusted, year over year change

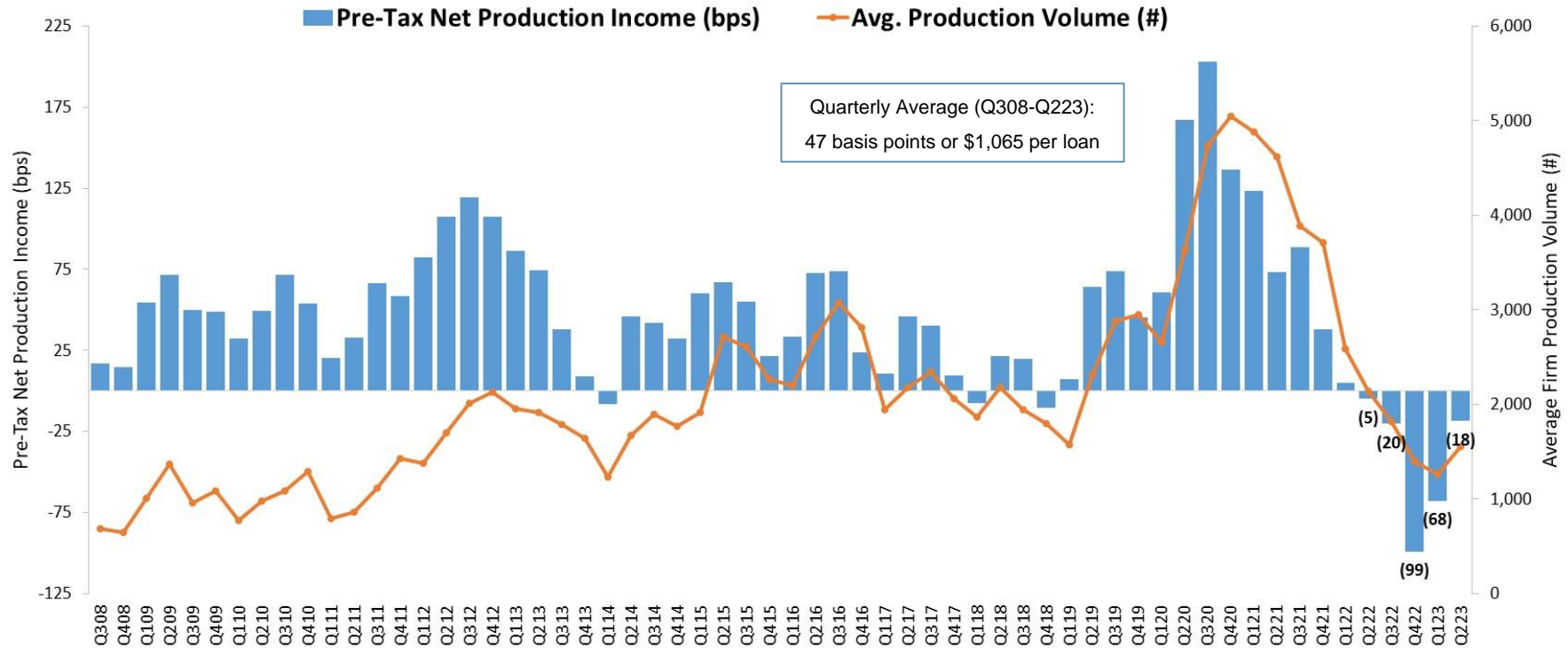


Mortgage Origination Dollar Volume to Decline 26% in 2023

Mortgage Originations History and Forecast



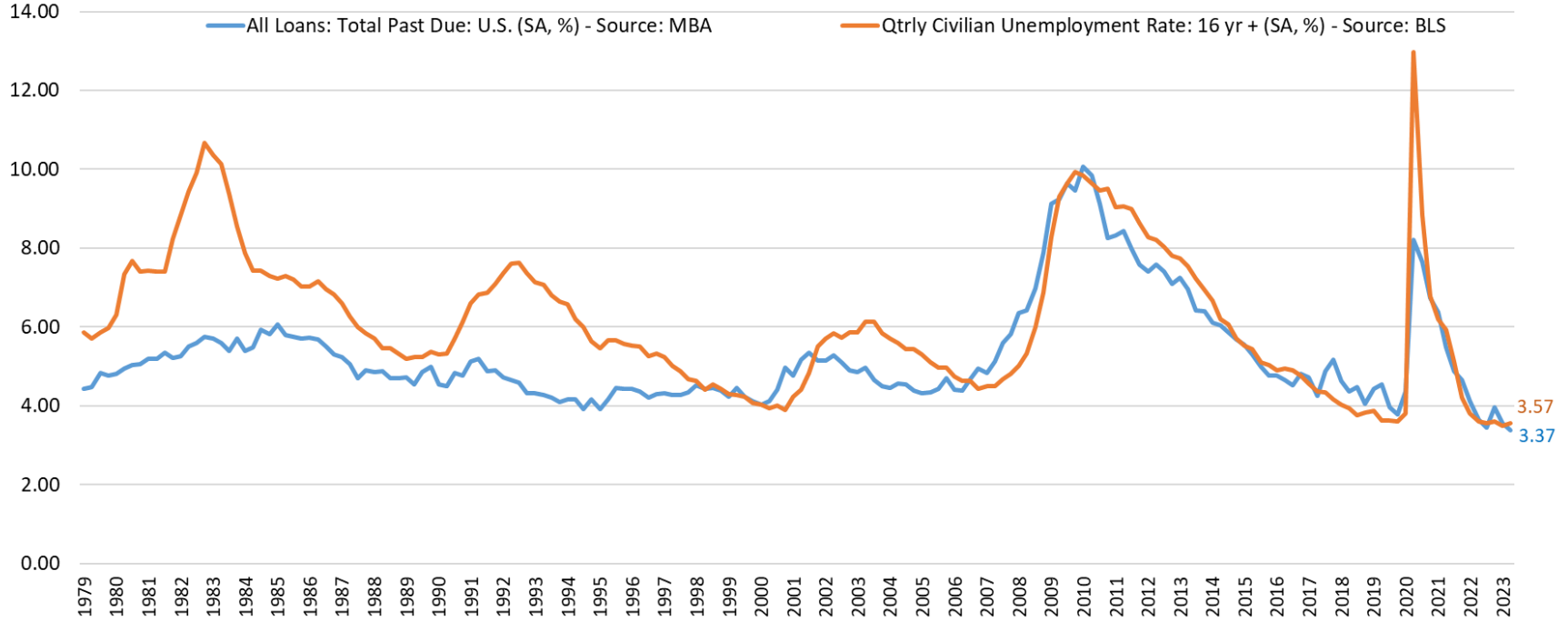
Pre-Tax Net Production Income for IMBs: Some Improvement in Q2 2023



Delinquencies Helped by Low Unemployment (though Q2 2023)

Mortgage Delinquency Rate and Unemployment Rate

Seasonally adjusted, percent



Contact Information and MBA Resources

Mike Fratantoni, Ph.D

Chief Economist & Senior Vice President | Research and Industry Technology

(202) 557-2935

mfratantoni@mba.org

MBA Research:

www.mba.org/research

RIHA:

www.housingamerica.org



Capital Markets and M&A Trends Affecting Mortgage REITs and SEC Reporting Updates

Brian Hirshberg

Partner, Mayer Brown

Anna Pinedo

Partner, Mayer Brown

Capital Markets and M&A Trends

- The sector continues to trade at a discount to stated book value
 - As a result, there have been very few “follow on” offerings (Two Harbors is an exception)
 - ATM issuance is “eating up” follow on activity
 - M&A is indirectly providing non-dilutive growth
 - No IPOs since Angel Oak in June 2021
- That said, interest in “going public” – largely by private vehicles merging (reverse mergers) with existing public REITs (or even SPACs)

Mortgage REIT M&A Legal Considerations

- Significant increase in mortgage REIT M&A transactions over the past several months driven in part by difficult market conditions, the target REIT's need to raise capital and/or a desire to monetize the value of the REIT's external manager
- Mortgage REIT M&A transactions raise legal considerations
 - Structuring transaction to acquire the manager entity or terminate management contract
 - Consideration and notice to the REIT's manager and/or servicer
 - Special committee may be formed to address external manager's conflicts
 - Change of control consents
 - Mortgage servicer licensing requirements
 - Target REIT's outstanding convertible and unsecured debt, preferred stock and warrants
 - Diligence of target REIT's mortgage loan portfolio

AG Mortgage and Western Asset Mortgage

- MITT will acquire WMC in a fixed exchange ratio stock/cash transaction
 - WMC terminated its previously announced acquisition agreement with Terra Property Trust, a private vehicle
 - Transaction value of \$11.23 per WMC common share, consisting of stock consideration of \$10.11 per share and cash consideration of \$1.12 per share, representing a 34% premium to WMC's closing stock price
 - Cash consideration equal to the lesser of \$7.0 million and approximately 9.99% of the aggregate per share merger consideration
 - Angelo Gordon will waive \$2.4 million of management fees for the first year following the merger's closing
 - MITT's Board of Directors will be increased from six to eight directors to include two WMC-designated directors
 - MITT stockholders are expected to own approximately 69% of the combined company's stock, while WMC stockholders are expected to own approximately 31% of the combined company's stock

Ellington and Arlington

- Ellington will acquire Arlington in a combined stock/cash transaction
 - Arlington common stock will be converted into 0.3619 shares of Ellington's common stock, or approximately 11.7 million shares of Ellington Financial common stock in the aggregate
 - Arlington common stockholders will also receive \$3 million in cash in the aggregate (or \$0.09 per share) to be contributed by Ellington's external manager
 - Arlington is internally managed
 - Implies an offer price of \$4.77 per Arlington share, representing a 73% premium to Arlington's share price and a 15% discount to diluted tangible book value per share
 - Ellington Financial will assume Arlington's outstanding preferred equity, senior unsecured notes and trust preferred securities
 - Ellington stockholders are expected to own approximately 85% of the combined company's stock, while Arlington stockholders are expected to own approximately 15% of the combined company's stock after the merger's closing

Ellington and Great Ajax

- Ellington will acquire Great Ajax in a fixed exchange ratio 100% stock transaction
 - Great Ajax common stock will be converted into 0.5308 shares of Ellington common stock, or 12.5 million shares of Ellington common stock in the aggregate
 - Implies an offer price of \$7.33 per share of Great Ajax common stock, representing an approximate 19% premium to the Great Ajax common stock closing price
 - Ellington will assume Great Ajax's outstanding senior unsecured notes and convertible senior notes
 - Equity investment in Gregory Funding LLC, affiliated servicer, is expected to unlock multiple synergies and operating efficiencies across Ellington's investment portfolio
 - Ellington stockholders are expected to own approximately 84% of the combined company's stock, while Great Ajax stockholders are expected to own approximately 16% of the combined company's stock after the closing



New Share Repurchase Disclosure Rules

Background

- SEC proposed share repurchase disclosure modernization in December 2021
- Comment period initially closed April 2022; comment period reopened twice
- Final amendments adopted May 3, 2023 in a 3-to-2 vote
- Share repurchase disclosure modernization distinct but related to SEC's Rule 10b5-1 and related insider trading disclosures rulemaking

Share Repurchase Disclosures

- Daily tabular buyback disclosure will be required on quarterly or semiannually basis
- No materiality threshold, extensive narrative disclosure
- Disclosures required in structured, machine-readable data language in Inline XBRL
- Adopting release asserts the amendments “will provide investors with enhanced information to assess the purposes and effects of repurchases, including whether those repurchases may have been taken for reasons that may not increase an issuer’s value.”
- Dissenting Commissioner Peirce argues that the rule is “flawed in its granularity” and that daily repurchase information will “bury [investors] in an avalanche of trivial information[,] a result that is hardly conducive to informed decisionmaking”

Corporate Policies

- Final amendments require narrative discussion regarding the objectives or rationale for each repurchase plan or program
- From the perspective of the adopting release and the issues highlighted in both the proposing and the adopting release, the SEC appears to be focused, among other things, on the following:
 - An explanation of why the issuer undertook a repurchase, rather than, say, a dividend
 - The particular objectives of, or the perceived benefits of, the repurchase: for example, is the repurchase intended to offset or mitigate the dilutive effect of the issuance of a convert, or of a stock acquisition, or of stock-based compensation issuances? Or does the issuer believe the stock to be undervalued?

Disclosure Controls and Procedures

- Process in place to gather and maintain buyback information to be presented in the required tabular daily buyback disclosure
 - Useful to prepare this buyback information throughout the particular quarter to allow time for the report to be accurately gathered from brokers and then compiled and checked
- Process to assess the narrative buyback disclosure, keeping in mind that objectives and rationales may change from filing to filing based on circumstances impacting the period
- Process in place to track director and officer trades within 4 business days before or after the announcement of a share repurchase program or increase

Potential Changes to Consider

- Continued reliance on Rule 10b5-1(c) and Rule 10b-18
 - Assess decisions with respect to reliance on the affirmative defense and/or the safe harbor
 - Potential for greater scrutiny of buyback decisions
- Documentation of buyback decisions and processes
 - Consider language in resolutions and minutes
 - Any formal advice from financial intermediaries
- Adding restrictions to insider trading policies
- Begin planning for disclosures regarding objectives, rationales and processes for share repurchases
- Assess consistency of buybacks with disclosed objective/rationale
- Useful for companies to draft sample language well in advance



New Clawback Policy Requirements

Background

- On October 26, 2022, the SEC adopted new Rule 10D-1, directing national securities exchanges to establish listing standards that prohibit the listing of any security of a company that does not adopt and implement a written policy requiring the recovery, or “clawback,” of certain incentive-based executive compensation
- On June 9, 2023, the SEC approved the clawback listing standards proposed by the NYSE and Nasdaq, each as required by SEC Rule 10D-1
- The NYSE and Nasdaq proposals included an October 2, 2023 effective date
- Listed companies have 60 days after the effective date of the clawback listing standards (*i.e.*, until Friday, December 1, 2023) to adopt and implement a compliant clawback policy

Persons Subject to Clawback Policy

- Rule 10D-1 as adopted applies to any individual who served as an “executive officer” of the listed company at any time during the performance period for that incentive-based compensation, whether or not such individual is an executive officer at the time the company is seeking recovery
- An individual will be an “executive officer” if he or she is the listed company’s president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the listed company or a subsidiary in charge of a principal business unit, division, or function (such as sales, administration, or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the listed company or a subsidiary

Requirements for Clawback Policy Under Rule 10D-1 and the NYSE Listing Standards

- **Triggering Events:** Clawback is triggered by both “Big R” and “little r” accounting restatements and without regard to fault of covered executives
- **Look-Back Period:** Rule 10D-1 requires listed companies to recover incentive-based compensation received by covered executives during the three completed fiscal years immediately preceding the date that the company is required to prepare an accounting restatement
- **Amount Subject to Clawback:** Gross amount that would not have been paid if financial statements had been done correctly
- **Taxes:** No reduction for taxes paid. Gross amount must be repaid
- **Discretion**
 - Board discretion as to whether to recover erroneously awarded compensation is not allowed, but discretion as to how recovery is achieved is permitted
 - Attempt to clawback is required unless financially it does not make sense (*i.e.*, the expense of enforcing the clawback would exceed the amount to be recovered)
- **Indemnification:** Prohibited

External Managers

- Does the new clawback policy requirement apply to external managers of REITs?
 - The executive officer group for the REIT must include its president, principal financial officer and principal accounting officer
 - In addition, there are other individuals who may be deemed executive officers based on function, such as any vice-president in charge of a principal business function and any other officer or individual **who performs a policy-making function** and, in some cases executive officers of parent or subsidiary companies, which may require a company-specific facts and circumstances analysis
 - Typically, the REIT's board of directors (together with any board appointed executive officers) perform the policy-making function for the REIT
 - Absent further clarification from the SEC or the exchanges, any compensation paid under the management agreement or paid by the manager to its employees will be outside the scope covered by the new clawback policy requirement
 - Certain management agreements include their own form of clawback trigger for incentive-based compensation



Cybersecurity Incident Disclosure

What's required?

- On July 26, 2023, the SEC issued a release adopting final rules aimed at standardizing and enhancing disclosure relating to cybersecurity incidents and risk management processes
- The Final Rules are effective September 5, 2023
- With respect to Item 106 of Regulation S-K and Item 16K of Form 20-F, all registrants must provide such disclosures beginning with annual reports for fiscal years ending on or after December 15, 2023
- With respect to compliance with the incident disclosure requirements in Item 1.05 of Form 8-K and in Form 6-K, all registrants other than smaller reporting companies must begin complying on December 18, 2023
- With the Final Rules, public companies will be required to report (1) material cybersecurity **incidents** and (2) cybersecurity risk management **processes** in a more standardized manner, subject to specific timelines, in order to provide greater comparability of disclosures
 - Information required to be disclosed under the Final Rules, as well as timing and means of disclosure, are summarized in the following tables

Summary: Incident Disclosure on Form 8-K

Final Rule	What to disclose	When to disclose
<p>Incident Disclosures: Item 1.05 of Form 8-K</p>	<p>Disclose any cybersecurity incidents determined to be material and describe the material aspects of:</p> <ul style="list-style-type: none"> • the nature, scope and timing of the incident; and • the impact or reasonably likely impact of the incident on the registrant, including on the registrant’s financial condition and results of operations. <p>The registrant need <i>not</i> disclose specific or technical information about its planned response to the incident or its cybersecurity systems, or potential system vulnerabilities, in such detail as would impede the registrant’s response or remediation of the incident.</p>	<ul style="list-style-type: none"> • Disclose within four business days after the registrant determines it has experienced a <i>material</i> cybersecurity incident. • A registrant must determine whether a cybersecurity incident is material “without unreasonable delay.” • A registrant may delay filing an Item 1.05 on Form 8-K if the United States Attorney General determines that immediate disclosure would pose substantial risk to national security or public safety.
<p>Incident Disclosures: Amendment to Item 1.05 of Form 8-K</p>	<p>Include a statement in its Item 1.05 on Form 8-K to identify information that was either:</p> <ul style="list-style-type: none"> • not determined when the initial Form 8-K was filed; or • unavailable when the initial Form 8-K was filed. 	<p>The amendment to Item 1.05 on Form 8-K must be filed within four business days after either:</p> <ul style="list-style-type: none"> • the registrant, without unreasonable delay, determines such information exists; or • the information to be disclosed in the amendment becomes available.

Summary: Process Disclosure under Reg. S-K

Final Rule	What to disclose	When to disclose
Process Disclosures: Item 106(b) of Regulation S-K	Describe: <ul style="list-style-type: none"> • processes, if any, to identify, assess and manage cybersecurity risks; and • whether any risks from cybersecurity threats have materially affected or are reasonably likely to materially affect business strategy, results of operations, or financial condition. 	Disclose in registrant’s annual report (<i>i.e.</i> , Form 10-K).
Process Disclosures: Item 106(c)(1) of Regulation S-K	Describe the Board of Directors’ oversight of cybersecurity risk. Registrants need <i>not</i> disclose information about the frequency of board discussions of cybersecurity or information about any director expertise in the field.	Disclose in registrant’s annual report (<i>i.e.</i> , Form 10-K).
Process Disclosures: Item 106(c)(2) of Regulation S-K	Describe management’s role in assessing and managing material risks from cybersecurity threats.	Disclose in registrant’s annual report (<i>i.e.</i> , Form 10-K).



The Basel Endgame and its Effect on the Mortgage Market, Mortgage REITs and Access to Capital

Matthew Bisanz

Partner, Mayer Brown



The Basel Endgame and its Effect on the Mortgage Market, Mortgage REITs and Access to Capital

- Credit Risk Weights
- Cross-Default Treatment
- MSA Deduction
- Loan Servicing Revenue
- Market Risk

Scope of Proposal

- US banking organizations with total consolidated assets of \$100 billion or more
 - Category I, II, III, and IV banking organizations
 - 8 US G-SIBs, approximately 17 larger and mid-sized US BHCs (ranging from traditional regional banking organizations to credit card and other niche organizations), 8 US IHCs of FBOs and 3-4 other US banking organizations
- US banking organizations with significant trading activity (only for market risk rule)
 - Banking organizations with aggregate trading assets and liabilities exceeding (i) 10% of total assets or (ii) \$5 billion
 - Increase in absolute threshold from \$1 billion to \$5 billion
 - Approx. 5 US BHCs, 2-4 US IHCs, and 4-5 other US banking organizations
- Does not apply to FBOs or US branches or agencies of FBOs
- Does not apply to banking organizations subject to community bank leverage ratio

Affected Banking Organizations

- Ally
- American Express
- Ameriprise
- Bank of America
- Bank of New York Mellon
- Barclays US
- BMO Financial
- BNP Paribas USA
- BOK Financial
- Capital One
- Cedar Rapids Bank and Trust
- Charles Schwab
- CIBC Bancorp USA
- Citigroup
- Citizens
- Comerica
- DB/DWS USA
- Discover
- Fifth Third
- First Citizens
- First Horizon
- Goldman Sachs
- Hilltop Holdings
- HSBC North America
- Huntington
- JP Morgan Chase
- KeyCorp
- M&T Bank
- Mizuho Americas
- Morgan Stanley
- MUFG Americas
- New York Community Bancorp
- Northern Trust
- PNC
- Raymond James
- RBC US
- Regions
- Santander Holdings USA
- SMBC Americas
- SouthState
- State Street
- Stifel Financial
- Synchrony
- TD Group US
- Truist
- US Bancorp
- UBS Americas
- USAA
- Wells Fargo & Company



Credit Risk Weights

Residential Real Estate

Current US Requirements

Mortgage Type	Risk Weight
FHA/VA guaranteed	20%
Qualifying first lien residential	50%
Statutory multifamily mortgages	50%
Pre-sold construction	50%/100%
All other	100%
Past due	100%/150%

When calculating LTV, the loan amount will be reduced as the loan amortizes. The value of the property generally will be maintained at the value measured at origination.

US Basel Endgame Proposal

Mortgage Type	Risk Weight
FHA/VA guaranteed mortgages	20%
Statutory multifamily mortgages	50%
Pre-sold construction	50%/100%
Non-HVCRE ADC	100%
Not CF Dependent, LTV ≤ 50%	40%
Not CF Dependent, 50% < LTV ≤ 60%	45%
Not CF Dependent, 60% < LTV ≤ 80%	50%
Not CF Dependent, 80% < LTV ≤ 90%	60%
Not CF Dependent, 90% < LTV ≤ 100%	70%
Not CF Dependent, LTV > 100%	90%
CF Dependent, LTV ≤ 50%	50%
CF Dependent, 50% < LTV ≤ 60%	55%
CF Dependent, 60% < LTV ≤ 80%	65%
CF Dependent, 80% < LTV ≤ 90%	80%
CF Dependent, 90% < LTV ≤ 100%	95%
CF Dependent, LTV > 100%	125%
Other residential	100%/150%
Past due	100%/150%

Commercial Real Estate

Current US Requirements

Mortgage Type	Risk Weight
Statutory multifamily mortgages	50%
All other	100%
HVCRE	150%
Past due	100%/150%

When calculating LTV, the loan amount will be reduced as the loan amortizes. The value of the property generally will be maintained at the value measured at origination.

US Basel Endgame Proposal

Mortgage Type	Risk Weight
Statutory multifamily mortgages	50%
Non-HVCRE ADC	100%
Not CF Dependent, LTV ≤ 60%	60%/Borrower RW
Not CF Dependent, LTV > 60%	Borrower RW
CF Dependent, LTV ≤ 60%	70%
CF Dependent, 60% < LTV ≤ 80%	90%
CF Dependent, LTV > 80%	110%
Other commercial	150%
HVCRE	150%
Past due	100%/150%

Off-Balance Sheet Commitments

Current US Requirements

Loan Type	CCF
Unconditionally cancelable	0%
Not unconditionally cancelable, \leq 1 year maturity	20%
Not unconditionally cancelable, $>$ 1 year maturity	50%

US Basel Endgame Proposal

Loan Type	CCF
Unconditionally cancelable	10%
Not unconditionally cancelable	40%

Also, would impose capital requirements on undrawn commitments that have no express contractual maximum amount or pre-set limit based on prior activity.

Securitizations

- Proposal would address securitizations by adopting a form of the securitization framework that is used in the Advanced Approaches, with modifications
 - Additional operational requirements for synthetic securitizations
 - A new securitization standardized approach (SEC-SA), as a replacement to the supervisory formula approach and standardized supervisory formula approach
 - New maximum capital requirements and eligibility criteria for certain senior securitization exposures (*i.e.*, the long-sought “look-through approach”)
 - A new framework for non-performing loan securitizations
- SEC-SA would be a modified version of the current standardized supervisory formula approach
 - Modified definitions of attachment and detachment points, W parameter, and KG
 - Higher p-factor
 - Lower risk-weight floor for securitization exposures that are not resecuritization exposures
 - Higher risk-weight floor for resecuritization exposures



Cross-Default Issue

Defaulted/Past Due Exposures

- Current Requirement: “if **an** exposure is 90 days or more past due or on nonaccrual ... assign a 150% risk weight to the portion of **the** exposure that is not guaranteed or that is unsecured”
- BCBS Standard (limited cross-default): “A defaulted borrower is a borrower [who has] **any** material credit obligation that is past due for more than 90 days”
- US Proposal (universal cross-default): “The obligor has any credit obligation that is 90 days or more past due or in nonaccrual status with **any creditor**”
 - Only for non-retail exposures (*e.g.*, CRE)



MSA Deduction

MSA Deduction

- Under the current rules, Category III and IV banking organization must deduct from CET1 the amount of MSAs that exceed 25% of CET1
- US G-SIBs and Category II banking organizations subject to (i) 10% deduction threshold and (ii) separate, aggregate 15% deduction threshold
- MSAs not subject to deduction are risk weighted at 250%
- Proposal would impose 10% and 15% deduction thresholds on all banking organizations with \$100 billion or more in total assets
 - Non-deducted MSAs would remain subject to 250% risk weight



Loan Servicing Revenue

Expanded Operational Risk Capital Requirement

- Currently, only banking organizations that use the Advanced Approaches for credit risk are required to calculate an amount of assets against which they must hold capital for the operational risk of their activities
 - Operational risk means the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events
 - Capital charge is calculated using internal estimates of a banking organization's operational risks
- Proposal would replace the internal estimate of operational risk with a standardized measure
 - “Are all revenues equally bad, really? ... what person in what ivory tower thinks that that is a rational thing to do” *Jamie Dimon*
 - Measure's internal loss modifier would be based on a banking organization's historical losses (*i.e.*, through capturing of operational risk loss data over a 10-year horizon)
 - Retains antiquated international definition of “operational risk”
 - Operational risk capital charge may be included in determining stress capital buffer requirement (potential duplication of risk)

Operational Risk Capital Requirement *(cont'd)*

- Component for services-related income/expenses would not be capped, exacerbating effect on fee-dependent banking organizations
 - Includes items such as income from mortgage servicing assets, custody/safekeeping services, issuing letters of credit, investment banking and securities brokerage, insurance activities, and annual and interchange-related fees for credit cards
 - May see significant operational risk capital charges, exceeding 20% of current risk-weighted assets for some organizations
 - **Impact for real estate will most likely be an increase in cost for banks to perform loan servicing, issue letters of credit, manage or agent syndications, advise or manage funds, and rent OREO**
- By generally setting the internal loss multiplier based on a banking organization's unique operational loss experience (and with a floor of 1), the Proposal would introduce the potential for greater variability in operational risk capital charges
 - Stricter than required by Basel Committee



Market Risk

Increased Market Risk Capital Requirement

- Currently, certain banking organizations calculate an amount of assets against which they must hold capital for the market risk of their trading activities
 - A banking organization is subject to the market risk capital requirement if its aggregate trading assets and trading liabilities equal to (i) 10% or more of total assets or (ii) \$1 billion or more
 - Market risk consists of general and specific market risk, and currently is calculated as the sum of the value-at-risk (“VaR”)–based capital requirement, stressed VaR–based capital requirement, specific risk add-ons, incremental risk capital requirement, comprehensive risk capital requirement, and capital requirement for de minimis exposures

Increased Market Risk Capital Requirement *(cont'd)*

- Proposal would increase the market risk capital requirement
 - Raise \$1 billion threshold to \$5 billion, but apply requirement to all banking organizations with total assets of \$100 billion or more
 - New, more prescriptive framework for segregating banking book from trading book
 - Restrict use of internal models for risks that are “too hard” to model and impose a standardized approach to be used when internal modeling is not feasible
 - Requiring modeling of risk at the level of individual trading desks for particular asset classes, instead of at the organization level
 - Does not address the duplicative interaction between the market risk capital requirements and the global market shock component of the Federal Reserve’s stress capital buffer requirement

Banking Book/Trading Book Boundary

- New mandatory assignment rules for market risk include:
 - A trading asset or trading liability that is a position held for the purpose of regular dealing or making a market in securities or in other instruments and is free of any restrictive covenants on its tradability or where the banking organization is able to hedge the material risk elements of the position in a two-way market
 - A publicly traded equity position or an equity position in an investment fund that is not expressly excluded from being a market risk covered position
 - A net short risk position of \$20 million or more
 - An embedded derivative on instruments that the banking organization issued that relates to credit or equity risk that it bifurcates for accounting purposes
 - The trading desk segment of an eligible internal risk transfer of credit risk, interest rate risk, or CVA risk
 - A position arising from a transaction between a trading desk and an external party conducted as part of an internal risk transfer
 - The CVA segment of an internal risk transfer or CVA hedge with an external party that is not an eligible CVA hedge

Banking Book/Trading Book Boundary *(cont'd)*

- Switching between books would be strictly limited, potentially penalized, and irrevocable
 - A capital benefit as a result of switching will not be allowed in any case or circumstance
- **Net financial impact on real estate will most likely be modest, but may affect pricing of derivatives and liquidity of certain real estate-related instruments (e.g., certain public REITs)**

Webinar: An Overview of Regulatory Capital Requirements Proposed Revisions



SAVE THE DATE

▶ An Overview of Regulatory Capital Requirements Proposed Revisions

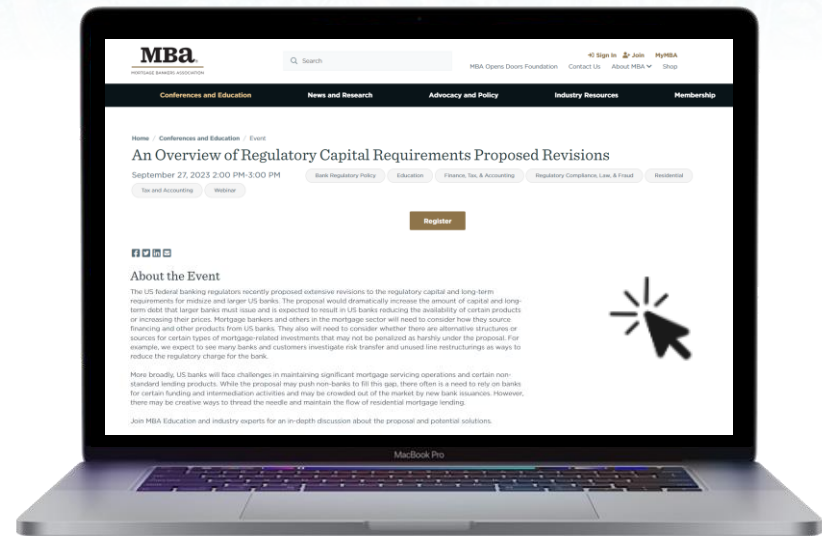
WHO: Michael Fratantoni, MBA and Matt Bisanz, Mayer Brown

WHEN: September 27, 2023, 2:00pm – 3:00pm ET

WHERE: Zoom Webinar



▶ Register and add this event to your calendar



Also visit Mayer Brown's Dedicated Basel Resources Center at:
freewritings.law/basel-endgame-resources/





Insurance Sector Interest in Mortgage Sector Assets and Regulatory and Structuring Considerations

Haukur Gudmundsson

Partner, Mayer Brown



Insurance Sector Interest in Mortgage Sector Assets and Regulatory and Structuring Considerations

- Overview of Insurance Company Investments in Mortgage Loans
- Upcoming Webinar

Insurance Company Investments in Mortgage Loans

- What was old is new again (again)
- Licensing and regulatory considerations
- Insurance regulations and Risk-Based Capital
- Structures and practical considerations
- FHLB financing
- Role of asset managers


▶ Join Mayer Brown's upcoming webinar for more

Insurance Company Investments in Mortgage Loans

Thursday, October 12
1:00 p.m. – 2:30 p.m. EDT

[Register](#) here ▶





Investments in Mortgage Servicing Assets

Haukur Gudmundsson

Partner, Mayer Brown



Investments in Mortgage Servicing Assets

- Ways to Invest in MSR
- Ginnie Mae RBC requirements
- Ginnie Mae Advances
- Excess Yield Transactions

How to Invest in MSR's (or how to fund MSR's)

- What's an MSR?
 - MSR's tend to perform well in rising interest rate environments
- Buy servicer stock
- Buy a servicer
- Build a servicer
- Buy excess spread
- MSR securitizations
- Alternative arrangements (*e.g.*, TSPA/RSPA)
- Stripped Coupon Certificates
- MSR Funds
- MSR Loan Facilities

Ginnie Mae RBC Requirements

- Ginnie Mae announced Risk-Based Capital Requirements on August 17, 2022
- Originally effective December 31, 2023, postponed to end of 2024
- Requires Risk-Based Capital Ratio of at least 6%
- $$\text{RBCR} = \frac{\text{Adjusted Net Worth} - \text{Excess Mortgage Servicing Rights}}{\text{Total Risk-Based Assets}}$$
- Excess MSR are MSRs in excess of Servicer's Adjusted Net Worth

Ginnie Mae Advances

- Ginnie Mae advances differ from GSE advances in many respects
- Traditionally difficult to finance
- Can Ginnie provide financing?

Excess Yield Transactions

- What was old is new again
- Excess Yield sold to Fannie or Freddie
- Servicer receives SMBS/Stripped Interest Certificates
- Certificate sold simultaneously
- Advancing obligation
- Finance and sale of remaining MSR

Implementing Basel III: What's the Fed's Endgame?



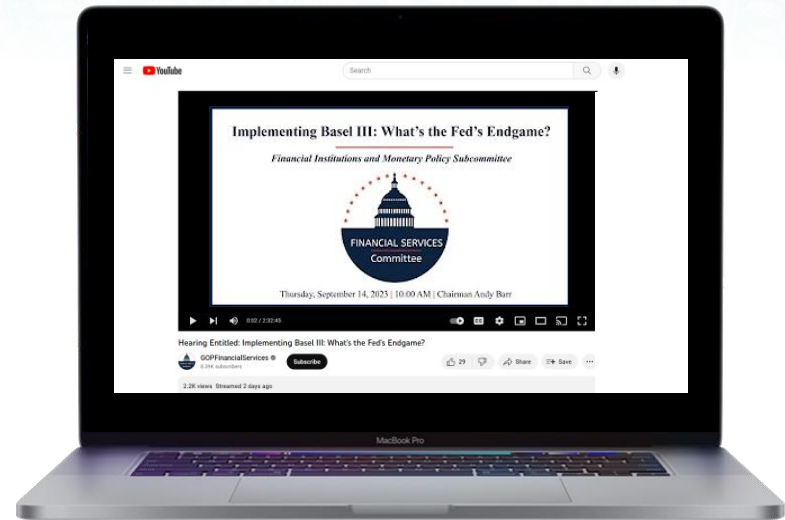
Mayer Brown partner Andrew Olmem [testified](#), on September 14, before the House Financial Services Committee at a hearing titled: *Implementing Basel III: What's the Fed's Endgame?*



US federal banking regulators recently proposed extensive revisions to the regulatory capital requirements, referred to as the Basel Endgame, which are of critical importance.



◀ [Read](#) Andrew's written testimony



[Watch](#) the hearing ▶





FHLB Reform and Related Developments

Andrew Olmem

Partner, Mayer Brown

FHFA Home Loan Bank System Review

- FHFA Director Sandra Thompson has initiated a review of the Federal Home Loan Bank System
- FHFA has solicited comments on:
 - The FHLBanks' general mission and purpose in a changing marketplace;
 - FHLBank organization, operational efficiency, and effectiveness;
 - FHLBanks' role in promoting affordable, sustainable, equitable, and resilient housing and community investment;
 - Addressing the unique needs of rural and financially vulnerable communities;
 - Member products, services, and collateral requirements; and
 - Membership eligibility and requirements

Financial Stability Oversight Council (FSOC)

- FSOC has authority to designate nonbank companies for enhanced prudential regulation by the Federal Reserve
- FSOC is revising its procedures to facilitate designations (Friday's meeting)
- Treasury Secretary Yellen has signaled that FSOC needs to designate more nonbanks
- FSOC has focused on hedge funds, nonbank mortgage, and asset management companies



HELOC and Related Regulatory Developments

Steven Kaplan

Partner, Mayer Brown

What is HELOC?

- A real estate secured revolving line of credit with a draw period and repayment term
- HELOC typically documented with a loan agreement, instead of a promissory note, and a security instrument



HELOCs Raise Unique Regulatory Considerations

How Does Federal Law Define HELOC?

- CFPB Regulation Z, which implements the Federal Truth in Lending Act defines “open-end credit” as consumer credit extended by a creditor under a plan in which:
 - the creditor reasonably contemplates repeated transactions;
 - the creditor may impose a finance charge from time to time on an outstanding unpaid balance; and
 - the amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

Satisfying TILA/Regulation Z Requirement

- **Existence of a Plan.** There must be a contractual arrangement between the creditor and the borrower that prescribes terms that govern all draws under a single credit plan. It is acceptable for some terms to be determined at a future date, as long as the contract describes how those terms will be determined. Advances generally should not be separately negotiated or underwritten
- **Repeated Transactions.** The creditor must “*reasonably contemplate*” that the borrower will use the credit plan for repeated transactions. The credit plan accordingly must be “usable from time to time” and the creditor must “legitimately expect that there will be repeat business rather than a one-time credit extension.” The inquiry focuses both on how the creditor has designed the plan and on whether borrowers actually engage in repeated transactions over time

Why Do We Care Whether Satisfies TILA/Regulation Z Requirements?

- Closed-end home equity installment loans (“HEILs”) are subject to different regulatory requirements, including ability-to-repay (“ATR”) requirements

ATR Requirements

- The Regulation Z requirement that a mortgage creditor consider and verify the consumer's ability to repay the loan (the "ATR Requirement")
- ATR Requirement does not apply to a home equity line of credit subject to 12 C.F.R. § 1026.40 (a "HELOC")
- Regulation Z provides, however, that in connection with credit secured by a consumer's dwelling that does not meet the definition of open-end credit, a creditor is prohibited from structuring the loan as an open-end plan to evade the ATR Requirement. The standards for determining whether a creditor has intentionally structured a loan as an open-end plan to evade the ATR Requirement are unclear

State Licensing


- Lender licenses generally are required if make or extend credit
- Must consider licensing implications when sell receivable or account

Other Regulatory Considerations


- Negotiable Instruments/Holder-in-Due-Course
- Requirement to disclose fees
- Application of payments
- Changes in terms – limited authority to eliminate access devices, suspend or freeze line of credit

Supplemental Resources

PANEL 1 ▪ Capital Markets and M&A Trends Affecting Mortgage REITs

- Legal Update - [SEC Adopts Final Rules on Public Company Cybersecurity Disclosures of Incidents and Processes](#)
- Legal Update – [SEC Approves Dodd-Frank Clawback Listing Standards with October 2, 2023 Effective Date](#)
- Legal Update - [SEC Adopts New Share Repurchase Disclosure Rules](#)
-  Global Financial Markets Podcast - [How Capital Markets May Be Affected by the US Basel Endgame Proposal](#)



PANEL 2 ▪ The Basel Endgame and its Effect on the Mortgage Market, Mortgage REITs, and Access to Capital

- Free Writings & Perspectives [Blog – Basel Endgame Dedicated Resources](#)
- Legal Update - [Overhaul of Regulatory Capital Requirements Proposed by US Banking Regulators](#)
- Legal Update - [A Road Not Taken: Where the US Capital Proposal Differs from Basel](#)
- White Paper - [The Final Stretch: Securitization in the US Under the Proposed Basel III Endgame Rules](#)
- Legal Update - [Residential Mortgage Loans: Capital Relief Through Synthetic Securitization](#)
-  Global Financial Markets Podcast - [Mortgage Market Update Part 1: Bank Capital Requirements and Related Developments](#)



Supplemental Resources *(cont'd)*

PANEL 3 • Insurance Sector Interest in Mortgage Sector Assets and Regulatory and Structuring Considerations

-  Global Financial Markets Podcast - [Mortgage Market Update Part 2: Mortgage Securitization and MSR Updates](#)
-  **Upcoming Webinar** (*October 12, 2023*) – Learn more and register: [Insurance Company Investments in Mortgage Loans](#)


PANEL 5 • FHLB Reform and Related Developments

- Legal Update - [Fannie Mae and Freddie Mac Are Poised to Issue Single-Family Social Bonds](#)
- Legal Update - [US FHFA to Examine Role of Fintechs in Housing Finance](#)

PANEL 4 • Investments in Mortgage Servicing Assets

- Legal Update - [MSR Fund Investments: 7 Aspects to Consider](#)
- Legal Update - [Treatment of Mortgage Loans and Mortgage Servicing Rights Under the Hart-Scott-Rodino Act](#)

PANEL 6 • HELOC and Related Regulatory Developments

-  Global Financial Markets Podcast - [Mortgage Market Update Part 3: Alternatives to Conventional Mortgage Loans](#)
- Newsletter – [Licensing Link](#)
 - [Licensing Link: July 27, 2023](#)
 - [Licensing Link: June 29, 2023](#)
 - [Licensing Link: May 25, 2023](#)
 - [Licensing Link: April 27, 2023](#)
 - [Licensing Link: March 23, 2023, First Edition](#)



Additional Resources

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