MORTGAGE BANKERS ASSOCIATION®
Investing in communities

December 3, 2012

Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street, NW
Washington, DC 20024
Email: SecuritizationInfrastructure@fhfa.gov

On October 4, 2012, the Federal Housing Finance Agency released *Building a New Infrastructure for the Secondary Mortgage Market* (Proposal), a white paper that proposes a new mortgage securitization platform. The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to comment on the Proposal. MBA applauds Acting-Director DeMarco and the FHFA as a whole for boldly acting in the face of uncertain market conditions and Congressional inaction. Nevertheless, the Proposal raises issues that could drastically impact the mortgage finance market, and MBA submits the comments below to address these concerns.

Background

FHFA issued the Proposal to describe a proposed framework for both a new securitization platform (Platform), one that could utilize a standard Pooling and Servicing Agreement (PSA). This PSA would be developed to incorporate by reference standardized documents developed jointly by Fannie Mae and Freddie Mac.

The white paper has two stated goals: 1) to replace the outmoded proprietary infrastructures of the GSEs with a common and more efficient model and 2) to establish a framework that is consistent with multiple states of housing finance reform, including greater participation of private capital in assuming credit risk.

---

[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, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and 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 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

In discussing the white paper further with the FHFA,[2] FHFA officials stated their belief that Fannie Mae and Freddie Mac's legacy software must be upgraded in order to continue to effectively and efficiently service existing and future GSE MBS. While approval for the project has been granted, FHFA has sought efficiencies by pursuing a single platform that can be used by both GSEs. Additionally, FHFA is looking to maximize the utility of the project by building it in a flexible manner to start migrating more of the credit risk to private enterprises with the eventuality that the software and infrastructure could serve as a utility for private label securities.

Finally, the Proposal announces that FHFA and the GSEs plan to develop a model PSA that could be used by the private label MBS market as part of the Platform. The PSA would use preferred features from GSE, Ginnie Mae and private sector experience. The Proposal suggests that the model PSA should be shorter, more flexible, and would utilize selling and servicing standards similar to those used by the GSEs. To this end, it is conceived that the PSA would incorporate by reference the GSEs' Selling Guide, Servicing Guide (collectively, seller/servicer guides) and Master Custodial Agreement.[3]

General Comments

MBA views the Proposal as introducing two related yet materially different projects. The first (Phase 1) is the technological upgrade to the current GSE business systems and software to create a single securitization platform for use by the GSEs for existing and future MBS including future GSE MBS where risk is shared with the private sector. MBA endorses this phase of the Proposal.

The second phase (Phase 2) is the expanded functionality and standardization, evidenced by the model PSA and standardized Master Servicing and Bond Administration functions. MBA has several concerns about this second phase, and requests the FHFA to proceed cautiously and with significant industry input in areas that alter the industry's historic business model.

One concern for MBA and its members is that the Proposal rests on certain assumptions concerning the future role of the GSEs in the housing market. In particular, the incorporation of seller/servicer guides into the model PSAs requires on-going involvement for the life of the security containing such terms, necessitating therefore some GSE involvement in managing these agreements. A second role indicated by the Proposal was to design the Platform to be a utility for a future market whereby there is no government guarantee, express or implied, in the products traditionally securitized by Fannie Mae and Freddie Mac.[4]

---

[2] In addition to meeting at MBA offices, FHFA personnel attended a Secondary and Capital Markets Committee meeting and held one-on-one meetings for members to discuss the Proposal

[3] FHFA, *Building a New Infrastructure for the Secondary Mortgage Market*, October 4, 2012, page 27.

[4] This reading was further supported by the stated goal of "encouraging" the transfer of risk off the GSE balance sheets.

Further discussions with the FHFA revealed these interpretations to be misplaced, with FHFA and MBA agreeing that some of the strategies suggested in the white paper would require Congressional change to Fannie Mae's and Freddie Mac's charters.

However, MBA is concerned that the Proposal leaves unstated significant governance and regulatory issues. For example:

- Who would own the Platform?
- Who would be responsible for its development, governance and day-to-day operations?
- Who would regulate the Platform and securities issued through it? Similarly, who would make and approve changes to seller servicer guides that would be incorporated by reference in the PSA.

The answers to these questions will significantly impact the future of the mortgage secondary market, and it is because of these ambiguities that MBA and others request FHFA and the GSEs to withhold action on Phase 2 components. MBA believes that FHFA needs to be more specific and address these issues up front and facilitate a discussion among industry and Congress on how best to resolve them.

MBA agrees with the premise that a single platform for securitizing mortgage products makes sense in many respects, and we thank the FHFA for taking a leadership role. For example, some in the industry are encouraged by the potential value such a GSE-backed security could have as a benchmark for the broader MBS market. However, this value is predicated on the Platform being an optional, as opposed to mandatory, securitization vehicle.

However, the Proposal leaves many details unaddressed, particularly in Phase 2. Below, we highlight examples of where ambiguities are causing concern among those in the industry.

PHASE 1 - TECHNOLOGICAL UPGRADES

MBA Agrees With the Need for Technological Updates

As stated above, MBA agrees with the need to update Fannie Mae's and Freddie Mac's legacy systems and software, and applauds the decision to implement the change via a single framework.[5] MBA also agrees with the proposed platform design principles:

- **Open architecture** that could leverage existing standard data sets
- **Functional modularity** whereby internal components communicate via standard interfaces to ensure new modules can be plugged in with minimal impact
- **Scalability** to accommodate growth demands and increased throughput
- **Data transparency and Standardization** using MISMO industry standards

[5] As opposed to developing separate systems for each GSE.

FHFA should prioritize the technological upgrades necessary for making today's processes more efficient and effective for sellers, servicers, and investors. The functionality upgrades and standardized features that comprise Phase 2 should be secondary priorities, and undertaken with close industry cooperation.

PHASE 2 – INCREASED FUNCTIONALITY

Fannie Mae and Freddie Mac Can Transfer Risks Without A New Platform

One of the stated goals of the platform is to attract private capital to assume a portion of the credit risk. MBA believes that the GSEs can already do this now through reinsurance, recourse and other forms of credit enhancement. Relying on the Platform for this capability appears superfluous, and MBA recommends that the GSEs utilize their existing options right away.[6]

A Utility May Not Be What Is Needed to Bring Private Money Back to the Market

Among the benefits the Proposal cites in support of the Platform is that a utility and the resulting standardization will aid the return of private capital to the marketplace. However, this view may underestimate the regulatory uncertainty faced by the mortgage industry. A plethora of new and proposed laws and rules have been issued and implemented, and their combined impact has made securitization too onerous for most on the 1-4 family residential mortgage side. Following is a partial list of laws and rules that are discouraging new market participants:

- Significant proposed changes to Reg AB[7]
- Uncertainty surrounding QM
- Uncertainty surrounding risk retention and QRM
- FAS 166 and 167, which will require most securitizations to fail sale treatment or require MBS' assets and liabilities to remain on the balance sheet of the issuer, credit enhancer or servicer.
- Risk-based capital rules associated with FAS 167 that require banks to maintain capital for assets that are not owned by the bank.
- Onerous proposed Basel III rules that would impose harsh regulatory capital treatment for mortgage servicing rights (MSRs) and securitization interests held by banks.
- Proposed accounting rules that may require structured securities, including RMBS and CMBS, to be accounted for at fair value with changes in fair value going through the balance sheet.

---

[6] It may be the case that the GSEs seek to avoid assuming these risks in the first place. MBA notes that this latter model is substantially similar to its own proposal for the future of the secondary market. *See* MBA, *MBA's Recommendations for the Future Government Role in the Core Secondary Mortgage Market,* c. August 2009. A copy of the Recommendation is attached as Appendix B.

[7] Notably, the current GSE framework is not compliant with this proposed rule.

MBA notes that the GSEs are victims of FAS 167 themselves, requiring trillions of dollars of assets and liabilities to come back on their respective balance sheets in recent years.

PHASE 2 – INCREASED STANDARDIZATION

The Platform Should Respect the Role of Private Enterprise in Master Servicing and Bond Administration

Existing private sector companies currently have the infrastructure, staffing, processes and systems to perform master servicing and bond administration functions. Reliance on the private sector for these functions will likely be significantly more efficient than direct involvement by the GSEs. MBA believes that the master servicing and bond administration software modules should be made available on a fee basis to the private sector.

MBA notes that the GSEs have been in conservatorship for longer than predicted, and will continue to be for the foreseeable future. As such, development and maintenance of the standardized documentation will occur under the overt or implied direction of the FHFA, a government agency. The Platform, as described, will contain numerous "touch-points" between it and a participant, resulting in many ways in which the FHFA can impose housing policy. Because of the unique structure of the conservatorship, it is likely that these touch-points may fall outside the purview of the Administrative Procedures Act, eliminating a key check that ensures stakeholders have the opportunity to provide meaningful input on the rules by which they will be governed.

Incorporating the Seller/Servicer Guides by Reference into the Model PSA Would Harm Investors

One example of the potential harm the Platform can cause through its touch-points is the impact on investors caused by the Platform's incorporation by reference of a unified seller/servicer guide. Since the PSA is the contract that dictates the future servicing expectations, investors need the certainty that the servicer will continue to act in the best interest of the investors of the MBS. A static PSA certainly accomplishes that, and issuers of private label MBS use static PSAs to govern existing private label securities.

In contrast, the current seller/servicer guides of Fannie Mae and Freddie Mac are frequently changed, and some of those changes relate to social programs desired by Treasury, FHFA, and the Administration.[8] Even if the FHFA were to restrict the applicability of these guides to prospective MBS, the terms of the seller/servicer guides impact the value of securities that incorporate them; thus, subsequent changes to the seller/servicer guide has the potential to impact the value of these securities on the secondary market. Investors will be hesitant to commit capital in such an environment.

Impact of the Model PSA on Seller/Servicers

[8] In addition, some changes operate retroactively, impacting loans already issued into a MBS.

Similarly, sellers and servicers need the protection afforded by a static PSA. The industry's reaction to recent changes to the seller/servicer guides evidences the harm that uncertain contract terms can have on the efficient operation of the marketplace. Such changes include the imposition compensatory fees and increases in G Fees, as well as unilaterally allowing Fannie Mae's and Freddie Mac the increased ability to move servicing with or without cause and provide for additional servicing requirements without additional compensation, among others. Servicers do not want the private label market to be reborn in an environment that one party, like the government, has all the power.

The unilateral power exerted by the GSEs in conservatorship has driven the value and the liquidity of MSRs down and significantly reduced the incentives for new entrants into the market. As stated above, without knowing the future governance and ownership of the utility and who would be responsible for making changes to the seller/servicer guides, MBA requests the FHFA and GSEs withhold action on Phase 2 matters until the industry and Congress can have a meaningful dialogue on the best way to move forward.

MBA Opposes Resurrecting the Joint Servicing Compensation Initiative

The Proposal also indicates that the Platform may resurrect the joint servicing compensation initiative. Announced last year, this initiative would have converted servicing fees to a low monthly fee for service for current loans and existing incentives for delinquent loans, and MBA reminds FHFA that most servicers and other constituents strongly opposed it. The FHFA should not incorporate yet another iteration of this initiative, and private sector parties should be allowed to negotiate the economics of fees for private label securitizations.

MBA again thanks FHFA for taking a leadership role in this, and we look forward to working with FHFA on this project. Any questions should be directed to Jim Gross, Vice President of Financial Accounting and Public Policy at (202) 557-2860 or jgross@mortgagebankers.org, or Dan McPheeters, Policy Advisor (202) 557-2780 or dmcpheeters@mortgagebankers.org.

Sincerely,

David H. Stevens
President and Chief Executive Officer

Appendix A

RESPONSES TO FHFA'S SPECIFIC QUESTIONS

1. The proposed securitization platform has four core functions (issuance, disclosure, bond administration and master servicing). Will these core functions provide an efficient and effective foundation for the housing finance system going forward?

MBA's Response: MBA believes that the development of software to serve as a utility for the private label MBS market makes sense, but functions that are already being performed effectively and efficiently by the private sector should remain in the private sector. For example, the utility's software for master servicing and bond administration could be made available to private sector vendors for a fee. MBA also notes that the uncertainty or constraints related to the layering of various laws, rules and regulations is what is keeping private capital on the sidelines not the absence of a utility. See general comment above, ***A Utility May Not Be What Is Needed to Bring Private Money Back Into the Market**,* for further details.

2. Are there additional functionalities that should be considered as core functions of the platform? For example, should the platform independently verify or determine the following or rely on an issuer or guarantor:
   a. underwriting and loan eligibility rules?
   b. pooling rules?

MBA's Response: MBA notes that Wall Street underwriters and credit enhancers of private label MBS have competent private sector vendors to choose from to perform the MBS underwriter's or credit enhancer's due diligence. MBA is concerned that use of the utility for these purposes will add yet another layer of regulation and may not satisfy the needs for the issuer, credit enhancer and underwriter to perform their own due diligence processes. Would the utility be willing to pay settlements on lawsuits if they missed something in their review?

3. Will the framework for a model PSA described in this paper provide the foundation for a standardized contractual framework for the housing finance system going forward?

MBA's Response: MBA believes that the white paper has insufficient information to conclude whether the suggested model PSA that incorporates by reference GSE seller/servicer guides will provide the certainty needed by investors and servicers. MBA also needs more information on the ownership, governance and regulation of the proposed utility. Finally, MBA notes few other areas of commerce where private sector parties rely on the government to dictate the form and content of private commerce contracts.

4. Are there additional elements/attributes that should be included in a model PSA? For example,
   a. should the model PSA define when a non-performing loan is required to be purchased out of the trust?
   b. should the model PSA define when a non-performing loan is required to be transferred to a specialty servicer?

MBA's Response: See general comments above entitled ***Function, Ownership and Governance of Proposed Utility****;* ***Incorporating the Seller/Servicer Guides by Reference into the Model PSA Would Harm Investors***; and ***Impact of the Model PSA on Seller/Servicers****.*

MBA further believes that defining when a non-performing loan is required to be purchased out of the trust and when a non-performing loan is required to be transferred to a specialty servicer should be determined by the MBS underwriter, issuer and credit enhancer and not by the federal government.

5. If the framework for a model PSA is a good contractual foundation, how should compliance with the PSA be monitored in the future?

MBA's Response: As noted above, MBA believes the Proposal contains insufficient information to evaluate the utility of the proposed model PSA that would incorporate by reference the GSEs' seller/servicer guides as a foundational document. MBA notes that the SEC is responsible for regulating the securities industry including the form and content of the prospectus and periodic reports. The CFPB is responsible for protecting the consumer. Thus, there is a regulator looking after the investors' interest and a regulator looking after the consumers' interest. Those regulators should deal with monitoring. MBA also notes that the ambiguous treatment of this issue in the Proposal highlights the governance and regulatory concerns expressed above.

6. What enhancements to the role of trustee should be considered in order to better attract private capital to the housing finance system?

MBA's Response: MBA believes that the role of the trustee in existing private label securities is well-defined in existing PSA agreements. The trustee should continue to serve in a fiduciary capacity and should not also be given a regulatory function.

7. How should document custodial and assignment responsibilities be handled in the housing finance system going forward?

MBA's Response: The document custodial and assignment responsibilities should continue to be handled in the private sector.

Appendix B

MBA's RECOMMENDATIONS FOR THE FUTURE GOVERNMENT ROLE

IN THE CORE SECONDARY MORTGAGE MARKET

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

9397

INTRODUCTION

Since the creation of Fannie Mae in the 1930s, the federal government has played a key role in providing stability to the secondary mortgage market. The current housing crisis has tested the government's role and led to calls for a fundamental rethinking of how the government plays its part.

To provide information and insights to this rethinking, in October, 2008 the Mortgage Bankers Association (MBA) established the Council on Ensuring Mortgage Liquidity. The Council's mission has been to look beyond the current crisis, to what a functioning secondary mortgage market should look like for the long term.

On November 19, 2008, the Council hosted a summit on the future of the secondary mortgage market and the GSEs that brought together leading thinkers from industry, academia and regulators to discuss what fundamental elements would be required for a functioning secondary market. The discussion led to the Council-issued report *Key Considerations for the Future of the Secondary Mortgage Market and the Government Sponsored Enterprises (GSEs),* which was released in January, 2009.

The Council's second task was to develop a set of guiding principles embodying the key considerations mentioned in the primer. The report *Principles for Ensuring Mortgage Liquidity* was released by the Council on March 19, 2009. The principles serve as a tool for evaluating proposals that arise for restructuring the secondary market.

As the policy spotlight has turned to the futures of Fannie Mae and Freddie Mac, the Council has taken on the questions of what an appropriate future government role in the core secondary mortgage market might look like. After thoughtful discussions and deliberations, we now present the Council's *Recommendations for the Future Government Role in the Core Secondary Mortgage Market.*

This report presents the Council's suggested framework for government involvement in the single-family and multifamily secondary mortgage markets, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac. While clearly not the only potential framework for the future, the Council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market. The proposed framework carefully balances the government's ability to ensure liquidity with the need to protect taxpayers from credit and interest rate risks associated with mortgage finance. This and the other Council reports can be found at: www.mortgagebankers.org/CEML.

In the coming months, MBA and the Council will continue to study the critical issues related to the future of the secondary mortgage market, and will continue to provide information and insights to regulators, legislators and others involved in the policymaking process. We want to thank the members of the Council for their valuable service, and for helping define a workable model for the future government role in the secondary mortgage market.

John Courson
President and Chief Executive Officer
Mortgage Bankers Association

Michael Berman, CMB
President and Chief Executive Officer, CWCapital
Vice Chairman, Mortgage Bankers Association
Chair, Council on Ensuring Mortgage Liquidity

1. OVERVIEW

The importance of housing in the economic and social fabric of the United States warrants a federal government role in promoting liquidity and stability in the market for mortgage debt. The size and scope of the U.S. housing market mean that, except in times of extreme duress, the federal government's role should be to promote liquidity for investor purchases of mortgage-backed securities, not to attempt to provide the capital for or absorb the risks itself.[1]

As a necessary component of this provision of liquidity and stability, a security-level credit guarantee backstop will be needed for the core mortgage market,[2] which should rely on security-level risk-based premiums paid into a federal insurance fund and loan-level guarantees provided by a small number of privately-owned, government-chartered and regulated mortgage credit-guarantor entities (MCGE). The government backstop should be explicit and should be focused on the credit risk and market liquidity of mortgage-related products, not any interest rate risk. The loan-level MCGE guarantee should be such that it absorbs all mortgage-related credit losses and that the federal insurance fund is called upon only in situations of extreme distress.

The centerpiece of federal support for the secondary mortgage market should be a new line of mortgage-backed securities. Each security would have two components: a) a security-level, federal government-guaranteed "wrap" (GG) like that on a GNMA security; which would in turn be backed by b) private, loan-level guarantees from privately owned, government-chartered and regulated mortgage credit-guarantor entities (MCGEs). The GG would be conceptually similar to the Ginnie Mae model and would guarantee timely interest and principal payments to bondholders, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. The MCGEs would in turn rely on their own capital base as well as risk-retention from originators, issuers and other secondary market entities such as mortgage insurers. Through these programs, the credit risk of the underlying mortgages would be removed from the securities issued, while the interest rate risk would remain with the security investor.

2. MORTGAGE CREDIT-GUARANTOR ENTITIES (MCGE)

The MCGEs should be privately owned, mono-line institutions focused solely on the mortgage credit guarantee and securitization business. This business encompasses both single-family and multifamily residential mortgages. The loan-level MCGE guarantee would be backed by private capital held by the MCGEs which would be overseen by a strong regulator. The MCGEs would be required to manage their credit risk by using risk-based pricing, originator retention of risk (such as reps and warrants backed by sufficient capital to support them), private mortgage insurance (PMI) and risk transfer mechanisms including other risk-sharing arrangements, to ensure that there is a strong capital buffer before the GG and insurance fund would come into play. Loans would not be included in a GG security unless they were guaranteed by a MCGE.

In most cases the MCGEs would own the loans underlying the GG securities they issue, and in the event of foreclosure could own the real estate collateral.

The MCGEs would have standard corporate powers to raise debt and equity. Other than access to the related GG security they could issue, none of the corporate debt or equity the MCGEs issue would be guaranteed, either explicitly or implicitly, by the federal government. The corporate capital levels of the MCGEs must be actuarially sound and the entities should report regularly to the satisfaction of the GG, Treasury and the MCGEs' regulator.

The number of MCGEs should be based on the goals of a) competition, b) strong and effective regulatory oversight, c) efficiency and scale, d) standardization, e) security volume and liquidity, f) ensuring no one MCGE becomes "too big to fail" and g) the transition from the current government sponsored entity (GSE) framework. Initially, the number of MCGEs should be either two or three. The regulator would have the ability to increase that number over time, through the granting of charters, as the market develops. The ownership of at least one of the MCGEs could be in a co-op form with mortgage lenders as shareholders. The governance structure of the MCGEs should adequately represent both the multifamily and single-family mortgage markets.

Allowable Mortgage Products of the MCGEs

The federally related securitization guarantee should support only "core" mortgage products with well-understood, well-documented risk characteristics. The federally related securitization guarantee should generally support: a) "conventional" single-family mortgage products traditionally supported by the GSEs, including those currently eligible for TBA funding; and b) multifamily mortgage products that fit the GSEs' published underwriting guidelines, including affordable multifamily rental housing mortgage products. If CRA-related loans are included in the definition of core products, the MCGEs and GG should provide a transparent and liquid market into which lenders can deliver them on a pricing and risk-adjusted basis.

In defining the products covered by the new guarantees, industry participants, the MCGEs, the GG and federal regulators should carefully review current product definitions and classifications to ensure maximum market transparency, efficiency and liquidity. New products would be proposed by the MCGEs, recommended by the GG and would require approval from the regulator. Thus new product development would be measured, prudently regulated and conservatively responsive to market demands.

Portfolio Authority

The key mission of the MCGEs should be to guarantee and securitize mortgages through the program described. The MCGEs should therefore hold only a *de minimus* portfolio of mortgage assets.[3] The portfolios' purposes would be to support securitization by allowing the MCGEs to a) aggregate allowable mortgages for securitization, b) manage loss mitigation through foreclosure, modifications and other activities, c) incubate mortgages that may need seasoning prior to securitization, d) develop new mortgage products through a strictly limited level of research and development prior to the development of a full-fledged securitization market and e) fund highly structured multifamily mortgages that are not conducive to securitization.

Regulator

The MCGEs' regulator should be strong, empowered and adequately funded through the GG insurance premiums.[4] The regulation regime contemplated would be similar to that of a public utility, with the MCGEs earning a conservative return on equity. The regulator should have the power to adequately oversee the MCGEs, specifically with regard to products, pricing and capital adequacy.

3. FEDERAL GOVERNMENT GUARANTEED "WRAP" (GG) SECURITIES

GG securities would carry a guarantee of timely interest and principal payment, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. Ginnie Mae could potentially take on the responsibilities of the GG.

The GG would be responsible for standardization of mortgage products, indentures and mortgage documentation for the core mortgage market. Minimum regulated fees would be established for ongoing servicing, surveillance and reporting. This would ensure standardization and liquidity throughout the core market. Each MCGE would individually issue GG securities under this standardized regime. These new GG securities could also be issued by private institutions approved by the MCGEs. These securities would also carry the GG security-level guarantee backed by the MCGE loan-level guarantee; accordingly, the MCGEs will have approved and insured the underlying collateral.

The GG is not intended to support the entire mortgage market, but rather only those products needed to keep the secondary market for core mortgage products liquid and functioning through all environments. There would continue to be key roles for FHA, VA, RHS and Ginnie Mae as well as for the fully private market, particularly as such roles evolve in support of public or social housing policy goals and objectives. FHA, VA, RHS and Ginnie Mae would continue to play critical roles in providing government credit support for affordable housing, while the fully private market would provide finance vehicles for mortgages that fall outside of core product profiles. Mortgages made outside of a federally guaranteed framework would rely entirely on private capital and management of risks, in as much as such mortgages may exhibit risk characteristics that would not be well documented or well understood (and therefore would not be allowable products eligible for inclusion in GG securities).

The mission of any federally related mortgage securitization and guarantee program should be explicitly limited to ensuring liquidity in the core mortgage market through the issuance and guarantee of mortgage-backed securities.[5] This important mission should not be distorted by additional public or social housing policy goals. To the degree additional objectives are desired, they should be pursued through FHA, VA, RHS, Ginnie Mae and direct federal tax and spending programs, which should be adequately funded and supported to meet these important objectives. The self-supporting GG federal insurance fund, which is likely to run surpluses in all but the most extreme circumstances, could be a potential source of funds for Congress when considering affordable housing expenditures.

While the full faith and credit of the U.S. government should mean there will not be a need for a liquidity backstop, in times of extreme market distress, liquidity could be provided to the GG securities market through Treasury and/or Federal Reserve purchases of GG mortgage securities.[6] As a result, there would not be a need for the MCGEs portfolios to be sized and structured to take on the role of "liquidity providers of last resort."

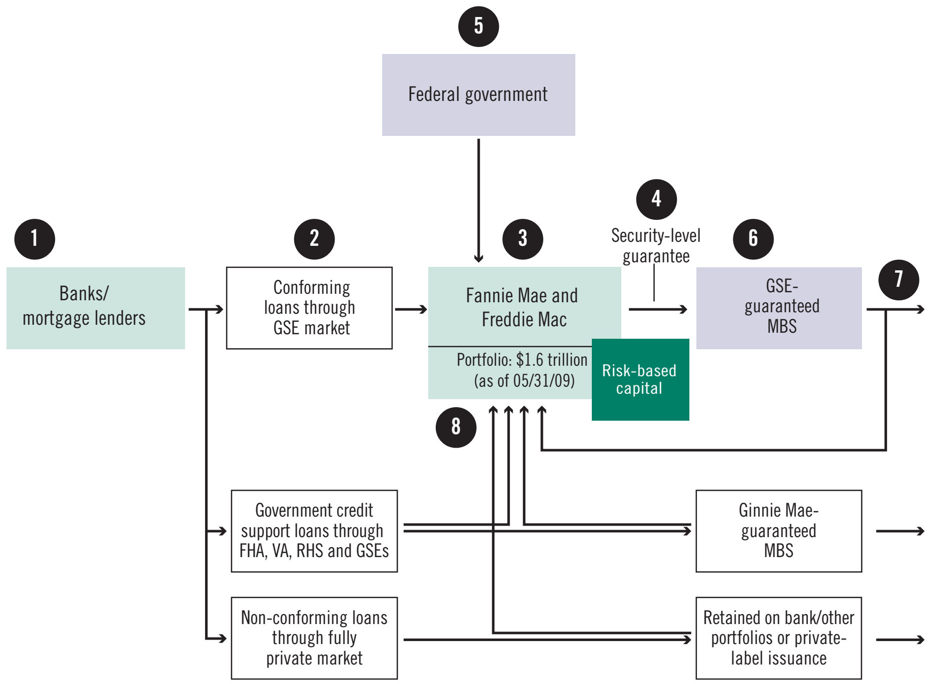
4. TRANSITION

The infrastructure of the existing GSEs should be used as a foundation for new MCGEs, with the technology, human capital, standard documents and existing relationships that the GSEs have developed available to one or more MCGEs. Every effort should be made to transfer existing origination, servicing and other industry relationships from the GSEs to the new MCGEs so as not to strand originators and servicers with ties to the existing GSEs. Historical performance data and other information should be made available to originators, the MCGEs, regulators, rating agencies, investors and providers of credit support to enhance the efficiency of the market.

Decisions regarding the futures of the GSEs should be made expeditiously so as to reduce continued losses of talent at Fannie Mae and Freddie Mac. This will be important both to maintain the ongoing management of the GSEs' existing books of business as well as to fully leverage their infrastructures for use by the new MCGEs.

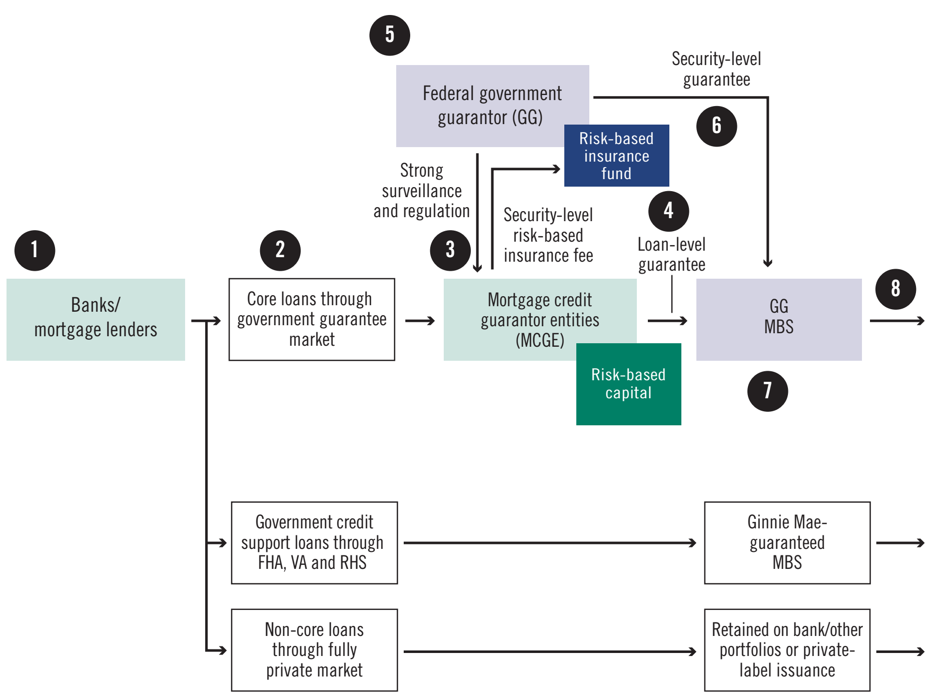
In order to facilitate a more rapid transition, to maximize the usefulness of the existing infrastructure of the GSEs and to allow the federal government to continue to use that infrastructure to address the current housing market challenges, a good bank/bad bank resolution of the GSEs, their assets and liabilities should be considered.

HIGH-LEVEL VIEW
CURRENT STATE: FANNIE MAE, FREDDIE MAC AND THE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are sold to Fannie Mae or Freddie Mac (FM).
3. FM prices and holds capital for the credit risk of the loans. FM either holds the loan in portfolio or includes it in MBS.
4. FM guarantees timely payment of principal and interest on MBS.
5. Federal agency provides oversight and regulation.
6. FM or mortgage lender issues FM-guaranteed security to the market.
7. Based on special status of the GSEs, security trades at a premium to other MBS.
8. FM may also purchase their own or other GSE-issued, Ginnie Mae or private label MBS as well as non-conventional government credit support loans to hold in portfolio, taking both the credit and interest rate risks.

HIGH-LEVEL VIEW
TARGET STATE: POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN THE CORE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are submitted to MCGE for credit underwriting and pooling.
3. MCGE prices and holds capital for the credit risk of the loans.
4. MCGE guarantees timely payment of principal and interest of the loans.
5. Federal agencies provide oversight, regulation and security-level guarantee in exchange for risk-based fee.
6. GG guarantees timely payment of principal and interest of the security.
7. MCGE or mortgage lender issues GG security to the market.
8. Based on the GG guarantee, security trades in equivalence to full faith and credit of the U.S. government; security buyer takes all the interest rate risk.

NOTES

1. The Mortgage Bankers Association's Council on Ensuring Mortgage Liquidity. *Principles for Ensuring Mortgage Liquidity*. March 2009. "1.a. Except for times of extreme market stress, and except for the availability of a credit guarantee program as described in section 7 below, secondary market transactions should be funded by investors seeking market returns and who take on the credit, interest rate and / or other associated market risks for market-derived yields."

2. Ibid. "7. There is a role for a government credit-guarantee program to help attract investment to the residential secondary mortgage market."

3. Ibid. "7.c. Any government sponsored entity or program should preclude the creation of a GSE-like investment portfolio assembled for the purpose of arbitrage profits. A GSE or GSE-like entity may require a portfolio to support its securitization activities (i.e. aggregation, incubation, innovation), to accommodate limited amounts for highly structured products not conducive to securitization and /or to maintain an infrastructure for serving as a liquidity backstop for the market."

4. Ibid. "5.c. The regulator of any government sponsored / owned entity and other secondary mortgage market regulators should be strong, empowered and adequately funded."

5. Ibid. "8.a. The government should balance and coordinate any pursuit of social policy goals through the secondary mortgage market operations of government sponsored / owned entities with their implications for safety and soundness, the efficient operation of the secondary mortgage market and their consistency with primary mortgage market and / or other requirements. Such policy goals should be limited to residential housing in a way that does not contain market distortions."

6. Ibid. "10.a. In times of extreme market stress, the government should provide a mechanism to step into the secondary mortgage market as a liquidity provider of last resort by providing a liquidity backstop." MBA is currently developing a working brief discussing the merits of this approach.

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

1331 L Street, NW
Washington, DC 20005
www.mortgagebankers.org