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PRINCIPLES OF HOUSING FINANCE REFORM

HEARING

BEFORE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE PRINCIPLES OF HOUSING FINANCE REFORM

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C O N T E N T S

THURSDAY, JUNE 29, 2017

PRINCIPLES OF HOUSING FINANCE REFORM

THURSDAY, JUNE 29, 2017

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. The Committee will come to order.

Today the Committee will discuss and receive testimony on important principles of housing finance reform. Reforming the housing finance system is one of my key priorities this Congress. I have repeatedly stated that the status quo is not a viable option.

In September of 2008, Fannie Mae and Freddie Mac were placed into conservatorship. Nearly 9 years later, the two enterprises remain in limbo. Today Fannie and Freddie, along with the FHA, dominate the mortgage market. Approximately 70 percent of mortgages are backed by the Federal Government, and the largest buyer of mortgage-backed securities is the Federal Reserve.

Fannie and Freddie are currently earning profits, but if the housing market experiences a downturn—and at some point it will—taxpayers could again be on the hook for many billions of dollars. Reform is urgently needed, and the Committee is actively exploring a variety of options.

There are a number of principles that I believe share bipartisan support that we will explore further today. We must preserve the to-be-announced market and an affordable, accessible 30-year fixed-rate mortgage.

We need multiple levels of taxpayer protection standing in front of any Government guarantee, including downpayments, loan-level private insurance, and substantial, robust, loss-absorbing private capital at guarantors comparable to the amount of capital maintained by global systemically important banks.

Strong capital is essential to ensure that guarantors and other market participants can withstand the next downturn. We must ensure that small lenders have a level playing field when accessing the secondary market.

The existing multifamily programs at Fannie and Freddie, which performed well through the crisis and already involve meaningful risk sharing with the private sector, should be preserved in some form as options in a future system. And, importantly, the transition to a new system should be orderly and deliberate and should utilize existing market infrastructure where possible.

Additionally, we will explore some other concepts that could play a role in reform efforts. One interesting idea is to securitize conventional mortgages with a Ginnie Mae wrap. One of our witnesses, Mr. DeMarco, coauthored a paper suggesting one way to do that.

Another important issue to address is how to foster competition among guarantors, to avoid the pre-crisis duopoly of two too-big-to-fail financial institutions.

We also need to consider the role of FHA in the housing finance system and what reforms to FHA may be necessary as we work to establish a new system. A housing finance system dependent on two Government-sponsored enterprises in perpetual conservatorship is not the solution. Recapitalizing the enterprises and releasing them back into the market without significant reforms is also not a solution.

The current system is not in the best interest of consumers, taxpayers, investors, lenders, or the broad economy. Three years ago, a bipartisan group of Senators passed a housing finance reform bill in this Committee. e have an opportunity now to build on that effort and create a broader coalition of Republicans and Democrats to pass a bill into law.

I look forward to working with the other Members of this Committee and with our witnesses today throughout this process.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Chairman Crapo, for holding today's hearing, and thank you for your work for years on this issue with Senator Corker and Senator Warner and so many others.

Thank you, Mr. Stevens, Mr. DeMarco, Mr. Calhoun. Thank you for joining us.

All three of our witnesses have substantial experience in housing. I look forward to hearing their testimony.

I hope in a subsequent hearing we will be able to hear more from smaller lenders as well. For all of its faults, the current system does provide access to small lenders. Protecting small lender access to the secondary market is an important area of bipartisan agreement. I particularly appreciate Senator Menendez's interest in this. We should hear directly from small lenders about the best way to go about this.

Changes to the housing finance system impact everyone from renters and homeowners to lenders and investors to retirees through their 401(k) plans and pension funds. As we learned during the economic crisis, not all changes are equal.

The expansion of exotic subprime mortgage products led to a crisis in which 12.5 million homes were in the foreclosure process in the 5-year period beginning in 2007. The Federal Reserve estimated that families saw a 30-percent decline in wealth in the first 3 years of that crisis.

In writing about the failures that led to the housing crisis in a book called "The Subprime Virus", Kathleen Engel and Pat McCoy concluded, "The avarice of lenders and Wall Street reversed the efforts of cities like Cleveland to revitalize their communities . . .

The Federal Government must make sure that what is good for Wall Street is also good for Main Street."

I would go a step further and say that the Federal Government should focus entirely on what is good for Main Street. The way we do that is by finding solutions for homeowners and renters. I am confident Wall Street will be able to fend for itself.

Some proposals to reform housing finance focus more on how to allow private capital or financial institutions to take over for or stand in front of the GSEs than on the cost of the additional private capital to borrowers. Underrepresenting those costs will have consequences for access to credit and could reduce home values if new borrowers cannot access mortgages at affordable rates. States like Ohio and Nevada are still struggling with underwater homeowners in large numbers and how to address the ongoing problem of negative equity.

Proposals do not focus enough on how to break down the barriers that still exist in the mortgage market for communities of color or providing continued access to credit in rural areas.

As we try to achieve broad bipartisan consensus on a housing finance reform proposal, there are a number of open questions we need to address. How does each proposal avoid the kind of shareholder demand for returns that drove the worst decisions at the GSEs? How do the proposals prevent predatory mortgage products that targeted and stripped wealth from communities like Cleveland and Toledo and Dayton and Youngstown? How do we do a better job of prohibiting discrimination in the mortgage market?

The Committee needs to have clear estimates that break down costs for borrowers across the entire eligible credit and downpayment spectrums. We need to learn more about whether and how adding multiple entities with differentiated products or services could change the national market or TBA market. We need to explore how each of these proposals would provide continuous access to mortgage credit when private capital flees during an inevitable downturn.

There are three opinions represented here today; they are not the only opinions about this issue. I would like to submit for the record a number of plans and principles, including from the Independent Community Bankers of America and the Main Street GSE Reform Coalition, among others.

As the Committee continues, Mr. Chairman, to work on a broad bipartisan plan, I hope we hear from a wide range of opinions and stakeholders about how the housing finance system could work better for Main Street and not just for Wall Street.

Thank you.

Chairman CRAPO. Thank you, Senator Brown. And now we will turn to our witnesses.

First, we will receive testimony from the Honorable David Stevens, president and chief executive officer of the Mortgage Bankers Association.

Next we will hear from Mr. Edward DeMarco, president of the Housing Policy Council.

And, finally, we will hear from Mr. Michael Calhoun, president of the Center for Responsible Lending.

Before we begin, I should announce that I am going to have to slip out at some point for a markup in the Judiciary Committee, and so when I do so, the Committee will simply proceed apace.

We have asked each witness to remember to keep their testimony to 5 minutes. I am going to remind the Senators once again that your question time is 5 minutes.

With that, Mr. Stevens, you may proceed.

STATEMENT OF DAVID H. STEVENS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MORTGAGE BANKERS ASSOCIATION

Mr. STEVENS. Thank you, Chairman Crapo, Ranking Member Brown, and Members of the Committee. Thank you for the opportunity to testify today.

It has been nearly 9 years since the GSEs entered conservatorship, and yet their long-term status remains unresolved. The financial crisis exposed the structural conflicts and misaligned incentives in the GSE business model as well as weaknesses in the regulatory framework that was in place at the time. Extended conservatorship is economically and politically unsustainable and an unacceptable long-term outcome. Without comprehensive reform, borrowers, taxpayers, and lenders will all face increased risk and uncertainty about the future.

Because MBA represents over 2,300 member firms of all sizes, both single-family and commercial/multifamily, including 650 small community-based mortgage lenders, we firmly believe that housing finance reform must foster a competitive primary market that is served by a diverse cross-section of lending institutions.

A year ago, we convened a task force for the future of the secondary market. The task force reflected the composition of MBA's membership, residential and multifamily, from integrated financial institutions to the smallest community lenders. Our task force truly represented the full depth and breadth of the entire real estate finance industry rather than some narrow interest of any one specific market segment.

Our proposal seeks to ensure equitable access for smaller lenders to the secondary market, prohibiting special pricing and underwriting based on loan volume, as occurred prior to conservatorship, preserving the cash window and small pool execution options, and preventing vertical integration by the largest market participants. I have submitted our proposal as part of my written testimony.

Our proposal recognizes the need for any comprehensive GSE reform plan to balance three major priorities: taxpayer protection, investor returns, and consumer cost and access to credit. To achieve these policy priorities, MBA's plan recommends recasting the GSEs' current charters and allowing a multi-guarantor model that features at least two entities and preferably more. Guarantors would be monoline, regulated utilities owned by private shareholders operating in the single-family and multifamily markets.

The core justification for utility regulation rests with the premise that privately owned utilities attract patient capital and derive much of their existence and powers from the State. The guarantors would be subject to rigorous capital requirements that would provide financial stability without unduly raising the cost of credit for borrowers. These requirements would be satisfied through a combination of their own capital and proven means of risk transfer in addition to that.

The implied Government guarantee of Fannie Mae and Freddie Mac would be replaced with an explicit guarantee at the mortgage-backed security level only. This guarantee would be supported by a Federal insurance fund with appropriately priced premiums paid by the guarantors, much like banks pay for FDIC insurance today.

Our plan explicitly calls for deeper first-loss risk sharing that is transparent, scalable to all lenders, and capable of limiting taxpayer exposure to nothing more than catastrophic risk.

The task force also developed recommendations in two areas that have vexed past reform efforts: the appropriate transition to a new system and the role of the secondary market in advancing a national affordable housing strategy. Our proposal specifically notes the importance of leveraging the assets, infrastructure, and regulatory framework of the current system where possible. We also believe that any workable transition must utilize a clear road map and be multiyear in nature.

We sought to develop an affordable housing framework that appropriately focuses the scope of the federally supported secondary market covering both renters and homeowners of various income levels. Our plan suggests other improvements to better serve the full continuum of households, including updating credit scoring and, most importantly, only Congress is the group that can provide the legitimacy and public confidence necessary for long-term stability in the primary and secondary mortgage markets.

We cannot go back to a housing finance system that provides private gains when markets are strong, yet relies on support from taxpayers when losses occur. Calls to simply recapitalize the GSEs and allow them to operate without further structural changes are misguided. Under such plans, the post-crisis reforms already achieved could be reversed at the discretion of future FHFA Directors. The American people rely on a housing finance system that enables them to rent a quality, affordable apartment, buy their first home, or build a nest egg to pass down to their children. We owe it to them to proceed with the hard work of reform without delay.

Thank you for the opportunity to testify, and I want to reiterate the MBA's longstanding commitment to work with this Committee on all elements of GSE reform, and I look forward to your questions. Thank you.

Senator BROWN [presiding]. Thank you, Mr. Stevens.

Mr. DeMarco, thank you for joining us.

STATEMENT OF EDWARD J. DEMARCO, PRESIDENT, HOUSING POLICY COUNCIL OF THE FINANCIAL SERVICES ROUNDTABLE

Mr. DEMARCO. Good morning. I am grateful to Chairman Crapo, to you, Ranking Member Brown, and all the Members of the Committee for the invitation to be here and for this opportunity. It is an honor for me to be back before this Committee, this time in my new capacity as the president of the Housing Policy Council, a role that I have had for a little less than a month now.

Housing finance reform is a top priority for the Housing Policy Council. The status quo is untenable for many reasons, and Dave just went through some of them. And only Congress has the authority to make the permanent changes needed to put the system on a sound footing for the long term.

The good news for all of you is that there is a lot of common ground, and much progress has been made over the last several years. Legislation can and should build on that progress.

For my opening statement, I would like to start with two simple but important points.

First, the passage of time has not diminished the need for Congress to enact legislation that brings the Fannie Mae and Freddie Mac conservatorships to an end while charting a path forward.

Second, we know even more and we have greater consensus on many reform ideas today than we had in 2014 when the Committee last took up this issue.

Consequently, the members of the Housing Policy Council are grateful for this Committee's leadership in restarting this legislative effort, and we are ready to assist in working with the challenges ahead to find a bipartisan path forward. In my limited remaining time, I would like to simply summarize the five principles of housing finance reform that are detailed in my prepared statement.

First, reform legislation should fix what is broken and preserve what works in support of consumers and the market.

Second, the transition from the old system to the new one should avoid disrupting consumers and markets.

Third, private capital should bear all but catastrophic mortgage credit risk so that market discipline contains risk.

Fourth, Government should provide a regulatory framework that is clear and equitable across all participating companies and ensures that participants in the housing finance system operate in a safe and sound manner.

Finally, the Government-protected GSE duopoly should be replaced with a structure that serves consumers by promoting competition, affordability, transparency, innovation, market efficiency, and broad consumer access to a range of mortgage products.

Two of these principles warrant a bit more explanation. In any reform system, HPC, like many other reform advocates, believes that substantial private capital should be ushered in to replace the taxpayer capital directly at risk today. Behind that private capital, we believe that an explicit full faith and credit guarantee on mortgage-backed securities would help private markets work better and would allow us to preserve certain features of the current system that provide benefit to consumers.

Importantly, though, we also believe that this catastrophic Government backstop should include a system to pre-fund potential future catastrophic losses and also include a preset mechanism to ensure that any catastrophic losses that call upon taxpayer support will be repaid fully.

The current system does some things well, but what it does not do is provide much opportunity for competition, innovation, and transparency. Fixing that should create greater opportunity to serve customers and expand credit access.

As the Committee restarts its legislative efforts, as I have detailed in my written testimony, there is a lot of common ground across legislative and other stakeholder proposals on which to build. While important issues remain unresolved, these are not insurmountable challenges, and in many cases, the range of differences has shrunk over time.

While not specifically the focus of today's hearing, the Housing Policy Council respectfully urges you to also consider the FHA program, its role in our housing finance system, and the potential to address pressing FHA issues as part of reform.

So thank you again for inviting me, and I look forward to the questions and answers.

Senator BROWN. Thank you, Mr. DeMarco.

Mr. Calhoun, welcome.

STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. Thank you, Ranking Member Brown, Members of the Committee. The housing finance system profoundly affects American families. It is also critical to the overall housing industry, which is nearly 20 percent of the U.S. economy.

The Center for Responsible Lending is a nonprofit, nonpartisan research group that works to expand economic opportunities. We are affiliated and I have previously worked with Self-Help, a national community development lender, that has provided home loans and other financing to families, small businesses, and others for over 130,000 loans across the country.

There are three key areas I will address in my testimony: first is the importance of our housing finance system to rural and underserved markets; second, how best to ensure our housing finance system works for community banks and credit unions; and, finally, the big question, how do we move forward with housing finance reform?

Turning first to rural and underserved markets, one of the important achievements of our housing finance system is it created a national market where previously we had a fragmented one, with affordable 30-year mortgages available across the country, not just in the most lucrative, often urban markets. Today the GSEs are the largest provider of mortgage funding in rural areas. Other underserved markets include new households where the majority are and increasingly will be borrowers of color, who often bring less generational wealth than other borrowers. This reduces their ability to make large downpayments, and we need to recognize that.

This challenge of first-time homebuyers, though, really drives the mortgage market, and today it is lagging in holding back the mortgage market, and we need further efforts there.

The current GSE provisions—and there are an array of them—to address providing broad access were worked out over a decade of deliberations in Congress and passed in 2008 in HERA, the Housing and Economic Recovery Act, by a margin in the Senate of 80–13, something that we do not see quite as often. Those need to be left in place and not reopened and disturbed. Rather, all who use the Federal housing system and benefit from its Government support should be required to make their loans available to all creditworthy borrowers wherever they live in the country.

Similarly, the housing finance system only works if it serves all qualified lenders, especially community banks and credit unions. These lenders are essential to the areas they serve and often they are the primary financial institution in those areas. Housing market dynamics, though, often tilt the benefits toward larger lenders, and I would urge the Committee to review all proposed changes through that lens and whether the changes exacerbate that condition. As others have said, it is critical that people be able to sell their loans on an individual basis to the GSEs or their successors and not just pool them into securities, which are very difficult for a small lender to do, but the pricing has to work also. You have to be able to get the same price, or you cannot compete.

Thankfully, today as we look forward, we have a far different housing market and regulatory structure than we did pre-crisis. As Mr. Stevens noted, and others, the Great Recession revealed critical flaws with the GSEs, and Congress responded in 2008 with HERA, establishing a robust regulator, a new one, at FHFA. It has the duties and authority to ensure adequate capital, approve new products, and regulate the entire operations of the GSEs. And today the GSEs reinsure or transfer the risk on the majority of loans that they purchase. They also have greatly shrunk their portfolios, which reduces taxpayer risk. These types of reforms should be expanded and continued.

For example, the current ban by FHFA on the GSEs participating in political contributions or lobbying we think should be made permanent, and we, too, support utility-type regulation and returns for the GSEs which would reduce excessive risk taking.

Finally, it is important to recognize the central role that our housing system plays. As others have noted, this system is dependent upon the trust of investors from around the world. If that is disrupted, it will profoundly harm not just the housing system and the availability of mortgages, but home values across the country. Therefore, surgery on this system must be done with extreme care.

Thank you again for your work on this important topic. We look forward to your questions and working with you on it. Thank you.

Senator BROWN. Thank you, Mr. Calhoun.

Questioning will begin with Senator Corker.

Senator CORKER. Well, thank you, Senator Brown. I want to start by saying what a pleasure it was to work with Senator Crapo and yourself and your staffs recently on the Russia sanctions bill. I think it was an incredible effort by two committees working together, and people on both sides of the aisle, and I think it actually set the stage for the kind of thing we need to do with GSE reform when we actually get there. But I do want to thank you, and I appreciate you participating yesterday in the North Korea hearing that we had, and I thank you for turning to me now.

I want to thank also Senator Crapo for his desire but also his great leadership on this issue, and I think all of you know that—because you were each involved, we passed something out of this Committee in 2014 and, you know, there was not much time left on the calendar, and we did not get it where it needed to go, but I want to thank him and his staff for his leadership on this issue. And I certainly look forward to working with them and Senator Brown's staff as we attempt to do it again this year.

Each of you has played a very significant role in this issue, and I apologize, I am—we have a few other things going on, and I apologize. That is Heller calling. Thanks.

[Laughter.]

Senator CORKER. But I want to say to each of you—and I know we had dinner the other night, Mike, with DeMarco, and we have had numbers of off-the-record discussions. We have done the same, Dave and I. What I see happening right now is a real consolidation of ideas. We have had think tanks that lean right, think tanks that lean left. We have had the Mortgage Bankers Association come together, and it just seems to me that the thinking around what needs to happen with GSE reform is coming to a place where I truly believe we are going to be able to pass a piece of legislation this year.

It seems to me that the consolidation is coming around the fact that we do need to have an explicit guarantee that is catastrophic. We need to acknowledge that it is going to be there. There will be people on my side of the aisle that that will be a tough one to get to, but I think that is true. It needs to be paid for. I think there is a recognition that having an implicit guarantee out there that is not paid for is not the right place for our taxpayers.

I think there is an agreement being generated that private capital needs to be in advance of that, that having a half-percent capital like the GSEs had during the crisis is just not where our Nation needs to be, with $5 trillion in assets. Having a pre-funded fund to deal with failures of mortgages, not of companies, is a place we need to go.

Mr. Calhoun, I enjoyed so much talking to you the other night, and I could not agree more that access to secondary markets by entities of all sizes need to be there, and I think there has been a misunderstanding that people think somehow there is something that is being designed that tilts toward the larger institutions. I mean, nothing could be further from the truth, and I think we learned a lot going through this last cycle.

That credit needs to be available through all cycles, through all economic cycles. It seems to me that people understand that, and I think the last go-round we did not focus enough on that component.

And then, last, that simplicity needs to occur. I think our last effort was way, way too complex, had way too many moving parts, and I think we have all learned a great deal from that.

As a matter of fact, I think we have learned that the existing infrastructure that we have in place is something we need to build off of.

So I just want to say to you all I thank you for all the things you have done to help us get to a place of better understanding. It is my hope that this Committee is going to work together and produce something this year, and I would love to hear if any of you disagree with the assumptions I just made about where commonality exists.

Mr. STEVENS. I completely agree with everything you have said.

Mr. DEMARCO. Same here, Senator. Thank you.

Mr. CALHOUN. We agree with all those and have put that in our testimony. I would just flag an issue that you need to make sure that capital is available in those countercyclical times for the entities to operate, and that may be more than just the securities—for example, modifications of loans and maintaining the TBA market in a crisis. There needs to be some mechanism to fund that as well.

Senator CORKER. Well, thank you for your contributions to date and the ones that will come, and I hope this Committee will act on this most important issue that needs to be resolved.

Chairman CRAPO [presiding]. Senator Brown.

Senator BROWN. Thanks. I just wanted an introduction. Thank you.

[Laughter.]

Senator BROWN. Could have been a little more generous than that, but what are you going to do?

Chairman CRAPO. My good friend Senator Brown.

[Laughter.]

Senator BROWN. Or formerly good friend. Thank you. And, Senator Crapo, when you were gone, Senator Corker thanked you and me and Senator Cardin on the work on the Russia sanctions. In a Senate that looks dysfunctional to many on the outside and to many on the inside, it really was a terrific effort, 97–2, and I appreciate the work of the two of you, and Greg and the staff and your Committee and Colin and Mark and my staff and what we are doing in the House to keep this moving. So thank you for that on the sanctions bill.

I have a handful of questions. Mr. Calhoun, I will start with you. The GSEs are again accepting 3 percent downpayment loans. What can we learn from this product? And in the work that the Center for Responsible Lending has done with low-wealth borrowers, I thought your comments about particularly people of color that have not had the historic opportunity, if you will, to accumulate wealth like people that look more like you and me do, what—paint that picture about expanding access to stable credit for borrowers ready for home ownership.

Mr. CALHOUN. The lesson of our lending and the lesson through the crisis, if you look at the GSEs, is what really matters is careful, fully documented underwriting. So while the subprime mortgages get a lot of the attention in the crisis, if you look at the GSEs, 50 percent of their losses came from not subprime but so-called Alt-A loans. Those are loans to higher credit borrowers but with no documentation. They made up only 10 percent of the GSE loans but produced, again, half of their losses and really drove them into insolvency.

In contrast, we have made loans for more than 35 years to families of modest means, including a lot of low-downpayment loans, including through the crisis. We had loans to those borrowers, 50,000 of them, during the crisis, including in 2008, and they performed extremely well. And it is not some magic secret. They were carefully underwritten 30-year fixed-rate mortgages with full escrows and affordable payments. Those borrowers need a place to live, and they will fight to stay in that home. It is not like rent is going to be for free. And, in fact, today many people pay more in rent than what they would pay if they could purchase a home. And we have to serve that market going forward, or the whole housing market also does not work beyond the importance of reaching those households.

Senator BROWN. Thank you. As we write GSE reform legislation, and for many of us on both sides of the aisle, the affordable housing goals are particularly important—talk to me, if you would, talk to us about how GSEs' affordable housing goals have helped expand stable access to credit and in rural and urban underserved areas.

Mr. CALHOUN. So there are really four elements that the GSEs have to reach the whole market. First of all, they have a legal mandate to do it, but the four things they do—and one that is perhaps the most critical and often overlooked is that they are directed to pool risk like insurance usually does. And they have specifically said you need to make sure loans carry their own weight with the payments. But they do not all have to have the same rate of return, just like everybody does not pay a different Medicare premium. And if you do not do that, you price people totally out of the market. Access is one thing, but it has to be reasonably affordable, sustainable access. So that is the most important that needs to be looked at. And some of these proposals will tilt pricing heavily, our concern is, against families of modest means and, again, this is not evil intent or a goal, but they do have the effect of tilting things against community banks. Larger entities in the housing market have benefits of scale, and if the changes are not careful, they tilt things against the community banks, and it is harder for them to maintain the critical role that they do. So that would be the main point I would emphasize.

The other three are the affordable housing goals, but equally important the duty to serve, which includes special measures by statute to serve rural areas, and also the affordable housing fund to sponsor programs carefully reviewed that expand housing efforts.

Senator BROWN. Thank you.

Chairman CRAPO. Thank you very much. I will take my turn now, and, again, I apologize for having to step out.

First, to Mr. DeMarco and Mr. Stevens, each of you in your statements has made a comment. Mr. DeMarco, you said the status quo was untenable for many reasons, and, Mr. Stevens, you said the status quo was an unacceptable long-term outcome. Could you each briefly explain what are the consequences for consumers, taxpayers, and the economy if we do not take action?

Mr. DEMARCO. Sure. Starting with taxpayers, right now with the status quo, we have Fannie Mae and Freddie Mac securitizing trillions of dollars worth of mortgage-backed securities and all of the credit risk and all of the risks that they take on in that process is actually being supported directly by taxpayer capital. So taxpayers are at risk.

We have a problem, a challenge for consumers in that this system continues unabated with a lack of transparency in underwriting and competition that can allow for the kind of innovation and developments that can inure to the benefit of consumers. And it is challenging for the business community to know what is it we are planning for strategically for the long term, as long as these companies are in a Government conservatorship and there is this continued uncertainty about what the long-term path is going to be, including what the long-term or ultimate role of the Government is going to be. So these all pose challenges in the current environment.

Chairman CRAPO. Thank you.

Mr. Stevens.

Mr. STEVENS. I would echo what Ed said. Another additional perspective is there is a false sense of security, I think, amongst too many that the status quo is better than the alternative of reform. I remind everybody in the industry and every consumer group I can talk to that the strength and the role of the GSEs in the current environment today for extending credit to communities depends greatly on who the Director of the FHFA is. The qualified mortgage rule that the CFPB has put in place gives an exemption for the underwriting standards of the GSEs, and should a new Director come in and want to expand or contract that, that will have significant ramifications across the spectrum of home ownership and could whipsaw housing in either productive or unproductive ways. Extraordinary uncertainty.

The other aspect I would just suggest is the GSEs today, their sole backstop is this $260 billion line of credit that is taxpayer-funded. And it is a deep, ample line of credit, but the capital markets around the globe still view that with extraordinary uncertainty. If you look at the price of a Freddie Mac or Fannie Mae mortgage-backed security against a Ginnie Mae security with an explicit guarantee, it is a difference of about three-eighths of a percent or so in rate, depending on the given day. And if the GSEs were to move out of conservatorship back to a previous state, that spread would widen significantly, affecting interest rates detrimentally for Americans everywhere who are looking at housing.

So the view from our side is there is only one pathway here, and I think time is of the essence because we are going to go through a regime change at FHFA, and that should create some motivation to try to eliminate as much of that uncertainty as possible as we go forward.

Chairman CRAPO. Well, thank you, Mr. Stevens. And you actually led into my next question, although it is to Mr. DeMarco. Ginnie Mae mortgage-backed securities currently trade at a premium to Fannie Mae and Freddie Mac mortgage-backed securities in the market, and there are more than 400 Ginnie Mae-approved issuers. I know you, as I indicated earlier, suggested we look at the Ginnie Mae model, Mr. DeMarco. Could you explain some of the potential benefits of using the Ginnie Mae model or Ginnie Mae to guarantee MBS in the private credit enhancement?

Mr. DEMARCO. Right. Well, to start with just Ginnie Mae, if there is consensus, if the legislation is going to have a Government guarantee, catastrophic backstop guarantee on mortgage-backed securities, the Government already has a Government corporation that does that. Its name is known, its function is known globally. So rather than creating a new Government entity, at least it is available as an option as the source of that guarantee. So that is Ginnie Mae as the guarantor.

But let us take the advantages of just the structure here, whether we use Ginnie Mae or we use some parallel system. There are several things about the Ginnie Mae model that accomplish things that all three of us have spoken about, including Mike's comments just a few minutes ago about smaller institutions.

The way the Ginnie Mae security works is that Ginnie Mae does not actually issue the security. There are over 400 different entities that are licensed by Ginnie Mae to issue a Ginnie Mae security. But what that means is these 400-plus issuers are all contributing mortgages into a single security that Ginnie Mae is putting its guarantee around. And what that does is it gives lenders of all sizes and types 400-some outlets in which to place their mortgages into the security, and it allows smaller lenders the opportunity to get the same price that the big lenders get because they are all going into a common security that has a great deal of liquidity. And so that right there in the structure helps to level the playing field between smaller institutions and larger institutions, and it gives them many avenues, including directly themselves, to be able to place mortgages into Government-backed MBS.

Chairman CRAPO. Thank you.

Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman. Let me thank the witnesses not only for their testimony, but for their thoughtful engagement on these issues over many years. Yes, we are looking at each other over many years.

I also want to thank the Chairman and the Ranking Member for making this a priority, but most particularly Senator Corker and Senator Warner for all of the work they have done to keep this issue close to the front burner.

Mr. Calhoun, you reminded us of some of the things that HERA accomplished and that have to be maintained, but there was something else, too, and I would like to get your comment. OFHEO was able to get reimbursement for their activities, but it was subject to the Appropriations Committee, and that I think inhibited some of the robust oversight. HERA changed that, and going forward, I would presume that we have to maintain sort of an independent source of funding, not through the appropriations process, for whatever regulator that we produce. Is that fair?

Mr. CALHOUN. Yes, and I think Ed knows this well, that the GSEs used the appropriation process to restrict what funding was available and how it could be used and essentially handcuffed OFHEO. And so they had a weak regulator. Equally important—and this is a very, I think, effective change made by HERA—was before 2008, the affordable housing, the mission part, was controlled by HUD, which had none of the other regulatory authorities or duties. And I think an important change that was made in 2008 was that you consolidated that within FHFA where you have the same regulator doing both, how do you provide broad access but how do you balance that with making sure that it is safe and sound.

If I can add one quick point just to clarify, on the backing for the GSEs today, just to be clear, they hold tens of billions of dollars of reserves that I think all observers believe are sufficient to cover any expected losses on their mortgage portfolio. They do not have reserves to cover a catastrophic event such as we had in 2008. But I did not want to leave the impression that they had no reserves for their operations today.

Senator REED. Let me just follow up before I get Mr. DeMarco's and Mr. Stevens' comments on the same question. Again, what we discovered post-2008, 2009, was many of the problems were in the servicers, and anything we do now, we are talking at a level of, you know, how do we securitize these products, et cetera. But many of the practical problems came about through poor regulation of services. Would that be something we would have to concentrate on going forward with this approach?

Mr. CALHOUN. Yes, and it is careful about not fragmenting that too much. Today FHFA has implemented a lot of important reforms supported with the help of the MBA that have greatly improved servicing for both the lenders, the investors, and the borrowers. It is just a better system.

Senator REED. Mr. DeMarco, you have some practical experience about the need for independence for the regulators. Can you comment?

Mr. DEMARCO. Yes. I think that there is no reason housing finance regulators should be different than other financial institution regulators. I think we have got plenty of history to indicate that independent funding, fees paid for by the regulated entities is the appropriate way to finance this. Obviously, the Banking Committees should have appropriate oversight over all of our regulators.

With regard to your comment about servicing, yes, I mean, this is an important and challenged area. It is one of the things that I go through a bit in my testimony, and the idea of—we have made a lot of progress in servicing and servicing standards, but we are not all the way there yet, and I think as this Committee does deliberate servicing going forward, continuing to move toward not just a national servicing standard but something that is also paying attention to sort of the efficiency and clarity of what those rules are would help everyone.

Senator REED. Thank you.

Mr. Stevens, a comment?

Mr. STEVENS. Yeah, I will not be redundant to the comments made, but in our proposal, we fully support keeping the FHFA and its independent role as the regulator. I would add, Senator, that HERA is an excellent piece of legislation. It depends significantly on the Director in charge of the FHFA, which is why we continue to say there are many elements here that need to be protected going forward, but we do need legislation to fully reform the GSEs because we cannot depend on the regulator, whoever that may be in 5-year increments, to protect the taxpayer and protect the housing system going forward.

Senator REED. Thank you. My time is expiring, but just one thought or comment. There was some discussion about Ginnie Mae, and there have been some thoughts about spinning that off or letting that agency be independent. Right now, as I think we all know, its revenues go to supplement many critical programs like the Community Development Block Grant, et cetera. And we have to think, if that is the path we take, how are we going to supplement those funds if they are no longer available, particularly in the context of budgets that are proposing the elimination of CDBG. When we were talking about Ginnie Mae going forward, it was simply supplementing what was substantial HUD commitments. Now we are in a situation where the proposal is zero for CDBG, for example, and if you take away the Ginnie Mae contribution, we are out of business. So just let me put that on the record.

Thank you.

Chairman CRAPO. Thank you.

Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman, and I think this is an excellent subject for this Committee to pursue. Personally, I have not made up my mind as to what the right way is to do it. I am open. I like the suggestions that I have heard and that you have laid out.

During the time in which we had this catastrophe to begin with that brings us all together, I was serving as Governor in South Dakota. And I remember at the time thinking that what it appeared to me from the outside looking in was that we had a number of things happen at one time. You had a relaxation of underwriting for an honest attempt to try to allow more people home ownership. So you had political pressure asking for that.

Second of all, you had a time in which the price of gas went up substantially. And individuals who were close, who had stepped in and who were barely making ends meet had a decision to make that either they could put money into the gas pump, and that means gas in their cars so they could actually get to work, or they could make a payment on their mortgage. And while they fully intended to do both, at the end of the month they had been able to get to work, but by that time they did not have enough money to pay the mortgage, and they got behind in many cases.

Then in addition to that, it appeared as though there was also a question as to whether or not the underwriting had been properly done, as you suggested earlier, that the careful documented underwriting was not necessarily followed. A combination of all of them seemed to lend itself to this problem that we have got today.

As we move forward, the regulations that we put in place can either help us rebuild this housing market or it can be detrimental, and, in particular, I am thinking in rural areas qualified mortgages require an appropriate appraisal. And yet the guidelines that have been laid out for those rural appraisals is rather difficult to meet in a large part of our country, and it has restricted the ability of banks in that area to get access to the secondary market.

Regardless of what type of total reform we do with regard to creating this secondary market to provide liquidity, it has still got to be accessible to rural areas as well. And I think, Mr. Calhoun, you have laid that out, that it is critical that we do that.

Could you just give me your thoughts in terms of the relationship between the expectation for a solid marketable security, a packaged security, and the need to be flexible or at least the need to be able to modify or fix problems that come up with the regulatory environment for rural areas or perhaps for inner cities or along the way the different things that come up that really do perhaps in some areas unfairly restrict those local lenders to having access to that secondary market?

Mr. DEMARCO. So, Senator, thank you. Points very well taken. So just to give a basic example, if one has a series of regulatory requirements in mortgage lending that affects the cost of originating a mortgage—let us just take that as an example, and suppose it adds $5,000 to the cost of originating a mortgage. Well, if it is a $500,000 mortgage, that has one sort of share of the cost of the mortgage. If it is an $80,000 mortgage and that same requirement is still $5,000 to accomplish, that is going to make a much bigger impact on that loan in terms of whether it gets made or not or whether that potential homeowner is going to be able to buy a house.

So it is a legitimate concern, and I think as we continually refine our regulatory framework, we need to be mindful of these costs and how it actually affects people particularly in inner cities and rural areas where otherwise the house value would be low but the regulatory costs are high as a percentage.

If I could just briefly, you started this by talking about appraisals, and I think that this is also an area in which the housing finance reform discussion could assist the finance market generally by rethinking our appraisal regulatory regime, what actual information we are collecting, and what the rules are by which that gets done, because there are also some important cost considerations here.

Mr. CALHOUN. And if I may add, a topic that came up earlier, we have some concerns with the Ginnie model for small lenders because it is still—there are over 5,000 community banks, as you know well. It requires them generally, most of them, to sell their loans to someone else, and often those loans have to give up the servicing, too, and that is the customer relationship.

Senator ROUNDS. Yes.

Mr. CALHOUN. And that is not the same as what we have now with the cash window where you get an equal cash price and you get to hold onto that servicing relationship. And I would just lift that up as something really, really important for small institutions to preserve in the system going forward.

Senator ROUNDS. Thank you.

Mr. STEVENS. And if I could just add—and, by the way, I think a discussion needs to be had in the context of Ginnie Mae to separate what you call the wrap itself. What is the guarantee? I think that is the label, and for simplicity purposes you could do that. How the operational platform functions—and Ed I think tried to say that—needs to address, Mike, what you just talked about. So we agree with that.

To your concern, I think this is really important, and we talk about it in our affordable section of our paper, is how do you reach rural communities. Oftentimes the largest financial institutions do not distribute personnel or products to communities; either they do not collect deposits in those areas or just the cost of originating an $80,000 loan, as Ed talked about, is too prohibitive to be profitable. And that is where small community lenders really play a role. That is why you need equal access for every lender to the platform, no special pricing for any institution, large or small, because small community banks have to be able to compete equally as well as a large institution. That was not the case pre-conservatorship of the GSEs.

And the last point I would just make is to your question, is there a way to make credit variances in the future to accommodate the unique needs of rural communities? We expose that as an FHFA authority. The regulator needs to control excesses in credit risk, but they also need to make sure—and our paper explicitly calls for this—that we are meeting the needs of sustainable home ownership demands in underserved communities, and that would clearly call for rural markets.

And so we really look forward to having that discussion because these are very important points that you have raised.

Senator ROUNDS. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. Before I begin, I want to reflect on the pain and suffering endured by tens of thousands of New Jerseyans in the aftermath of the financial crisis. From 2007 to 2016, 85,000 families in New Jersey lost their homes to foreclosure, and the suffering inflicted by financial institutions that played fast and loose then continues to plague our communities.

In 2016, nearly two-thirds of the foreclosures in New Jersey were related to the financial crisis. The sad thing is we knew how to help many of these families. We knew principal reduction would provide a pathway to affordable and sustainable payments for underwater borrowers. We knew if Fannie Mae and Freddie Mac had been permitted to participate in the HAMP principal reduction alternative, half a million homeowners could have been helped and taxpayers could have saved $1 billion.

But despite clear authority and direction from Congress in the Emergency Economic Stabilization Act of 2008, pleas from State Attorney Generals and even the Treasury Department, Mr. DeMarco, you refused to lift a finger. In 2012, you incomprehensibly claimed that allowing Fannie and Freddie to adopt principal reduction would cost Fannie, Freddie, and mortgage servicers too much money; and, two it would create moral hazard by enticing deceitful homeowners looking to abuse a program they did not actually need. Worse, the analysis you used to justify this ideological position was widely regarded as flawed.

So as then-Chairman of the Housing Subcommittee, I held a hearing on the issue. I urged you in a letter to provide the Committee with an accurate analysis of the effects of principal forgiveness versus other mortgage modification options. Yet even after FHFA's own analysis showed the benefit to taxpayers, you remained intransigent.

Now, as I think about where we are going in the future, that is something I cannot forget, and that is something that leads me to believe that what we need is clearer thinking, not ideology.

So let me turn to one of the critical components that I think our current system is not producing enough, and that is access for small lenders to the cash windows that the GSEs, which provides them an opportunity to participate in the secondary market they would not otherwise have. Many of these lenders are community-oriented institutions working to increase affordable options for homeowners and borrowers in locations all across the country. And it is a shame we do not have a small lender here today since these lenders often provide access to credit in underserved communities. And their presence fosters competition so that borrowers can get more competitive rates. And they prevent concentration of the market in exclusively large institutions.

So, Mr. Stevens, can you talk about why small lender access is important from the mortgage banker's perspective? And, Mr. Calhoun, can you speak to what the impact would be on borrowers, particularly those lower- and moderate-income borrowers in traditionally underserved areas where small lenders do not have access to the system?

Mr. STEVENS. Thank you, Senator, and it is an important question. I would just say that of our approximately 650 small lenders who are in our membership, some of whom have been the chairman of the association just in the last couple of years. We spent a great deal of time talking about access and equality, and it was actually under Acting Director DeMarco that we finally got guarantee fees level amongst the—between large and small that did not exist pre-conservatorship. In fact, from 1998 until 2010, concentration of lending in the top ten lenders of this country went from 40 percent to 80 percent because what the GSEs did is they gave far favorable pricing and credit terms to the largest financial institutions, which left the small community banks and smaller lenders in a less competitive position. It is one of the things we want to make sure never happens again.

The cash window actually for Freddie Mac and Fannie Mae today is very active. They have a couple of thousand customers each compared to Ginnie Mae, for example, which only has about 400 and does not have a cash window. And it is oftentimes a complaint from some larger institutions that cash window pricing is better than securitization pricing. It is a longer subject which we could talk about. It is daily spot pricing versus securities execution, which is a forward bid, so that does create some inter-day, inter-week dynamics in terms of ultimate execution.

But to your point, and our paper calls for it, we think the way to resolve this long term is to never let the concentration return based on credit deals or pricing deals from guarantors, the GSEs, like they did before, which creates a concentration risk and an advantage to certain institutions over the thousands of others that are smaller and cannot bring a lot of individual market share. That unto itself made the competitive disadvantage of small lenders to be able to serve New Jersey and other States significant. And that is why we ultimately ended up with large concentrated risk in servicing on the balance sheets of certain institutions and a lot of the things you talked about.

But this is a subject we address in our paper, and we would love to talk about that more as you go through considering reform.

Mr. CALHOUN. If I can add quickly, just to highlight that point, for the cash window to work well, it has to provide equivalent pricing to the security execution. It does not work for a community bank if you have got a cash window. But you are going to get paid a lot less than the big lender who is executing a security transaction. And that requires some pooling of cost because it is more efficient to transfer pools of thousands of loans than to do it on a loan-by-loan basis. But it is critical to protect the role of small lenders.

Senator MENENDEZ. Mr. Chairman, just one point for the record. It is Congress that prohibited volume discounts that created pricing differences for small lenders, and so, therefore, we have an opportunity to revisit that.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Cotton.

Senator COTTON. Thank you, gentlemen, for your testimony today.

Mr. DeMarco, you served as the Director of FHFA and the conservator of Fannie and Freddie from 2009 to 2014. I am sure we can all agree that was an exciting and challenging task for you.

Mr. DEMARCO. We can agree to that.

Senator COTTON. So we are in the ninth year of conservatorship for those two institutions, and it is our responsibility to chart a path forward. I think few people are as well equipped as you are to offer insight to us. Given practical and political considerations and almost a century of established precedent in the American housing finance market, what do you envision as the plausible best case, most practicable scenario for a model that insulates taxpayers from market fluctuations while also maintaining liquidity in the housing finance market in the aftermath of conservatorship?

Mr. DEMARCO. I think essentially, Senator, it means a mortgage market in which we, rather than having two different mortgage-backed securities that had been until 2008 operating with an implied guarantee from the Government and subsequently since 2008 have been operating with explicit support from the taxpayer through the Treasury Department, and that that is the bulk of the capital supporting it, that we move to a market in which private capital bears all but the very end tail risk on mortgage credit risk, that the Government enhances the market by combining these two different securities into one and allow a broader array of participants to be able to issue into that security.

What that does is it preserves the benefit of what works today, including the ability of a homeowner to lock in a rate weeks before settlement, the ability of a lender to engage with that potential homebuyer to buy the mortgage, knowing that even though this mortgage is not going to be settled for a while that there will be a delivery into the secondary market that will be available.

Those are the things that we are trying to build on, and what we are fundamentally trying to do is move away from an incredible systemically risky orientation of having all this mortgage credit risk on the balance sheet of two GSEs with the taxpayer exposed to something which private capital competes to be in this market and holds that risk and the Government is there to provide stabilizers and help enhance liquidity.

Senator COTTON. Ought Congress try to end the conservatorship in prompt fashion?

Mr. DEMARCO. Yes, sir.

Senator COTTON. What are the consequences of not doing so?

Mr. DEMARCO. Continuing to put the taxpayer at risk and continuing to keep the market from evolving and being able to seek better ways of serving customers.

Senator COTTON. GSEs are somewhat unique to America. Are there other countries that you suggest we look to for alternative housing finance models as we study the best path forward?

Mr. DEMARCO. Well, I think we start from a rather unique base with what we have, and since what we are trying to do is evolve from where we are, I am not sure that there are other countries that would make sound examples to look to because of where we start.

Senator COTTON. As a practical matter. There are multiple pending lawsuits about the third net worth sweep from 2012. What is the potential impact of those lawsuits on our efforts to end the conservatorship and move toward a future model?

Mr. DEMARCO. In some sense that is more a question for you all to answer. I think that the Congress of the United States created these two charters. The Congress of the United States has retained for itself the sole authority to alter those charters, end them, add to them. And so I think that the Congress should go ahead and do what is right for the long-term benefit of the country's economy and its housing finance system, and the litigation matters should follow normal course.

Senator COTTON. But if a court finds those parties are entitled to compensation from the Government for the impaired property rights, we would have to take that into account for funding any kind of future model, right?

Mr. DEMARCO. Well, I assume then that there are things—right, I mean, we would have to know what the court ruling is. I cannot go any further. I am directly involved in this, Senator, so—but as I say, I think the Congress needs to get this done because this model is what broke——

Senator COTTON. Sure.

Mr. DEMARCO. This GSE model.

Senator COTTON. Mr. Stevens, in the time I have remaining, I want to ask a somewhat but not entirely off-topic question about PACE loans, a favorite topic of mine. Could you explain the threats to liquidity in the housing market that PACE loans can provide, and why right now Director Watt at FHFA is not underwriting mortgages with PACE loans on them?

Mr. STEVENS. Thank you, Senator, and thank you for your leadership on the subject. The PACE financing is a program that literally violates all the consumer protections we have put in place through Dodd–Frank. It provides no disclosure to consumers, and it creates the opportunity for a cottage industry of chattel providers of varying supposed energy improvements the opportunity to prey on unknowing consumers and sell them overpriced products without any regulation or control.

The other aspect of it, Senator, which you know all too well, is it comes in the form of a tax lien, and in the event of default, tax liens get paid ahead of all other liens. These tax liens can be secured after the fact, after a loan has been put in first-lien position by an originator and by the investor. We applaud the work taken by FHFA to exclude those. HUD right now, the program, does allow them, and it is something that we think is nothing more than taxpayer risk and a consumer protection issue that needs to be resolved. And it is a rare case, Senator, where we are joined by the National Consumer Law Center on this issue in agreeing to the principles that the PACE program needs to be eliminated as an option in terms of the current structure the way it is provided without more clear consumer disclosure and lien protection rights.

Senator COTTON. Thank you, gentlemen.

Chairman CRAPO. Thank you.

Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you, Mr. Chair. Thank you. I likewise am new to the Committee. This has been a great conversation. I appreciate it.

Mr. Calhoun, I would like to start with you and really talk a little bit about changing demographics and access to credit. As you know, we have seen the pendulum swing back and forth when it comes to access to credit in certain communities. On the one hand, communities of color often were locked out of the mortgage market, and they were redlined or only offered products like contracts for deed mortgages, a kind of installment contract open to abuses. On the other hand, during the crisis—and I am from the State of Nevada—communities of color were flooded with subprime predatory mortgage credit.

As we think about GSE reform, how do we ensure that all players serving the secondary mortgage market offer sustainable fair access to all creditworthy borrowers? And if we do not properly calibrate such a duty to serve the market, how could that end up either abandoning communities or inundating those communities with toxic forms of credit?

Mr. CALHOUN. So, first of all, Senator, thank you for the tremendous work you did as Attorney General in fighting to help families hurt by the financial crisis.

This is really one of the key issues, and I think there are a couple aspects. First is preserving requirements that loans be sustainable. Again, it was a lack of documentation. As you know, the liar loans—you were at ground zero for a lot of that lending, and the State paid a heavy price for it.

And then the second is preserve the important tools that we have now at HERA with FHA to advance affordable housing.

And then, finally, in all of these discussions, we all agree that there should be more private capital in front of any Government guarantee of a catastrophic risk. But how that risk is structured and priced and delivers profoundly affects access for families of modest means and also the ability of small lenders to participate in the system, because, again, the mortgage market—the huge economies of scale push things toward the bigger lenders and the more lucrative markets. I mean, that is just people following their duty to their shareholders and, you know, that is appropriate. We have to recognize that and not exacerbate it.

So, for example, the types of risk sharing that FHFA is doing now, they are doing risk sharing on the majority of their transactions, but they are doing it by selling pool insurance on the loans that they acquire, and that enables them to make sure that a broad range of borrowers, including families of modest means, are included in there but are not disproportionately getting hit with fees that can add 200 or 300 basis points to the cost of the loans. And the same thing for small lenders. I mean, if you are selling insurance, it is easier to sell it to somebody who wants it for 50,000 loans than for somebody who wants it for 50 loans. And we have to recognize that but, again, not make a system that pushes things further in that direction, and that is, again, what I would urge the Committee to look at these proposals through that lens, because that will be one of the biggest impacts of what the Committee does.

Senator CORTEZ MASTO. Thank you. That is very helpful.

Let me jump to another topic because my time is running out and follow up on Senator Menendez's conversation about servicing standards. I am more interested in the compensation aspect of this, and, Mr. DeMarco, I was one of those Attorney Generals that you received a letter from concerned about the lack of principal reduction. And so now I have an opportunity to ask you a question specifically, so I am going to put you on the spot here.

What I have found, and particularly in the State of Nevada, with respect to servicing standards, it really was a matter of the compensation. The standards were just as important, but what we were paying servicers and that compensation and how it paid I think contributed to some of the poor conduct. There was more of an incentive to extract fees from homeowners and investors, and neither homeowners nor investors can fire their servicers, as we know, if they are not satisfied.

So my understanding also was that FHFA released a white paper in, I think, 2011 looking to overhaul the way the GSEs pay servicers, and after accepting comments from industry and other stakeholders, it was abandoned, and the work was not complete. I am not sure why, but I would like to know: Do you think there is a way that FHFA should continue this discussion? And how should we pursue GSE reform and bring in the context of compensation and how we pay compensation?

Mr. DEMARCO. Senator, yes, thank you. We did, in fact, issue a couple of papers in which we invited public comment on revamping the mortgage servicing compensation scheme. To me it was not so much that we abandoned it as it ended up being a not ripe issue. But I believe, in fact, it remains an important issue.

The reason it was not ripe at the time that we did those white papers is that servicing standards themselves and the requirements were still very much evolving. The CFPB was just coming online, and what their servicing rules were going to be was really an unknown at that point.

And so what we heard in the comment period was, well, maybe changing the compensation arrangement would work, but until we know what these rules are going to look like, it was very—you would be putting the cart before the horse.

Senator CORTEZ MASTO. So you think there is a role now to address the compensation——

Mr. DEMARCO. I do. I believe that servicing compensation very much should be part of what is being looked at.

Senator CORTEZ MASTO. And you are willing to work with us to address that?

Mr. DEMARCO. Absolutely, Senator.

Senator CORTEZ MASTO. I appreciate that. Thank you.

Chairman CRAPO. Senator Perdue.

Senator PERDUE. Thank you, Chair. And thank you, gentlemen for your years of labor in this.

I want to go to something at the very base of this. Having personal experience in this over the last 30 years, I have been concerned all along that the efficacy of the instrument that we are talking about here—and let us talk about the home mortgage. Mr. Calhoun, you mentioned something earlier that I agree 100 percent with that was lost in the debate. This was not just a subprime issue. But what we did is when trying to encourage more home ownership in this country starting in the late 1990s, we created low-income verification loans, no-doc loans, and so forth. And what this did, it did not just entice subprime lenders—or borrowers to get into a market over their head, but there were prime borrowers that overreached because, if you do not have to decide how you are going to pay for it, it is awful easy to get qualified.

And so I would like to talk about what FinTech and the technology community is doing today regarding the underwriting of both these, and I think it—there is a company called TransUnion. It is a big credit bureau, and they have done a lot of studies on this, and I think the MBA has worked with them, and I applaud the MBA for all the work you are doing in giving us ideas about how to restructure this to learn from what we have seen, but also to adapt to the technology changes we are seeing today, particularly in this underwriting area.

Today traditional, trended, and alternative data—those are three different types of data—are being used, and according to this study, some 26 million borrowers today could possibly be underwritten today using that that could not be under traditional means. And that would basically mean that 95 percent of the borrowing public of America could somehow be evaluated. It does not mean they would all be qualified, but at least we would have a good predictor.

Isn't the way forward what companies like SoFi and Kabbage, some of these FinTech communities are doing right now, with regard to alternative and trended data in addition to the normal traditional data? And I am not talking about a mortgage packet that is a foot deep like we see in some institutions. But what I would like you to do, Mr. Calhoun, is address that, because access to small markets, to the millennials, minorities, and all that, that might not have a—what do they call it? A thick file application? Is that what they call it? That might have a thin file—all of us had thin-file applications at one point. So how do we address the capabilities that technology has given us to create more opportunities for access, not just in small markets but in demographic markets that need our help as well? Would you address that?

Mr. CALHOUN. Certainly, and, again, before my present role, I headed lending programs for more than a decade at our credit unions, including our home loan, both retail and secondary market.

We support use of both the alternative data and the trended data. The alternative is, for example, traditional credit scores do not pick up rent payments. We often find, again, a good measure of someone's ability and willingness to make a mortgage payment is if they paid their rent consistently and what level of rent they were carrying for an extended period. And I know that FHFA—Ed started the process there, and they are looking at alternative scores there.

And trended, as you know, is just looking at how someone's credit score is moving. Are they improving their credit score or going down, either way, rather than just a static snapshot? And I think there is a lot of potential there, too, that that more accurately captures——

Senator PERDUE. Could we do that without having the foot-thick application file for underwriting? Is that still possible?

Mr. CALHOUN. I think FinTech is adding a lot of advances in that area. There are massive amounts of data, as everybody knows.

Senator PERDUE. But we want a predictor. That is what you want. You want an accurate forecast of somebody's ability to repay the loan and not get underwater.

Dr. DeMarco, would you just address real quick—and I am going to run out of time on this question. I would love for you and Mr. Stevens to have a shot at this one. Access to capital is a huge issue in this market. That is what we are all trying to do. With the Fed right now having a $4.5 trillion balance sheet, with current statements saying that the Fed is going to rework that balance sheet down to the tune of somewhere around $2 trillion over the next 2½ to 3 years, what impact is that going to have on the capital markets while we are talking about restructuring the GSEs? Dr. DeMarco.

Mr. DEMARCO. I think the Fed is certainly anticipating doing this in a measured way in which it should have little, if any, effect on capital markets as it affects the mortgages, and I certainly would expect and anticipate that is how they plan to handle it.

Mr. STEVENS. The one thing we do look at—and I think it is an important question. There is a bit of an unknown. If you look over the last 20 years prior to conservatorship, the biggest buyers of agency mortgage-backed securities were the GSEs themselves. In post-conservatorship, it was the Federal Reserve buying most of the mortgage-backed securities. So we do need to make sure that the international, the global markets view the MBS produced out of this country as a credible, good-faith instrument, and that is actually one of the reasons why we think converting to an explicit guarantee on the mortgage-backed security will eliminate this question: Is it really AAA backed in good faith by the U.S. Government, or is it implicit? And if we can through reform get to an explicit guarantee on the MBS only, that will bring in a lot more institutional buyers from around the globe who today many will not buy—they will not buy Freddie and Fannie MBS. They will buy Ginnie's because that does have that explicit guarantee. And that is one way to help smooth out this transition process.

Senator PERDUE. Thank you, gentlemen.

Chairman CRAPO. Thank you.

Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman.

I want to start with Hawaii. It is unique. Ninety percent of the loans are originated in the State of Hawaii. We have got a couple of the best banks in the country as measured by independent analysis. And yet one of the idiosyncrasies of Hawaii is that we have sort of Manhattan real estate prices and not the corresponding salaries. And so the debt-to-income ratio has to be tweaked, and the local banks that originate the loans are more comfortable because they know that everybody stretches in order to afford a mortgage. And so they are more willing to extend credit to individual homeowners than perhaps a bank from the Mainland.

So I will start with Mr. Calhoun and if we could work down the line. How does reform account for the geographic and demographic and economic idiosyncrasies? And how do we make sure that the system does not start to amalgamate into one bit sort of FinTech, three or four originators, and we are back to the point where we are, either through an app or whatever it may be, trying to persuade someone that we really can swing the mortgage, when we actually do not have a problem with our local banks? And, of course, they move it off their balance sheet just like everyone else does, but the problem that I see is that, to the extent that we start to establish debt-to-income ratios that are too firm, you are not accounting for the fact that Hawaii is different. We did not really have the same real estate market crash that the rest of the country had, despite our high prices. So there is something that they are doing right that I want them to be able to continue to do. And I will start with Mr. Calhoun.

Mr. CALHOUN. We agree with the need for standards, but flexibility so it works. We would commend and note that the GSEs recently increased their debt-to-income ratios to provide more space there, with compensating factors which show up in the files in Hawaii because of the experiences of many of—I am sure the staffers here know that you have to stretch to buy a house, for example, in the D.C. market. So we experience some of that here as well.

But I think that the FHFA and the GSEs have moved in that direction, need to continue to make that aware, but then the big key is also this support for all financial institutions, all the mortgage lenders, not just the large ones, so that it is a viable program for them.

Senator SCHATZ. Quickly, Mr. DeMarco and Mr. Stevens.

Mr. DEMARCO. Yes, in some sense, Senator, your question gets to the point that Mike Calhoun has raised repeatedly during this hearing about community lenders. As you pointed out in your question, community lenders have a particular insight into their community, the stability or risks that are involved, and they know their borrowers in a more personal or direct way. But the way the current system works is they do not get to, the technical term is, “monetize” that benefit under the current system, so that is why in housing finance reform the idea of creating multiple channels for lenders to be able to access markets, to deliver mortgages to the secondary market, but also multiple channels for which to put that private capital in front—and this is an example of where the lender themselves might say, you know, the best thing for me to do for my bank and my customers is to be the credit enhancer on this. Leveling that playing field will help a lot with what you have outlined.

Senator SCHATZ. Mr. Stevens, I am going to let you answer, but I am also going to ask another question in the interest of time just to you. So a family has to make $75,000 a year to afford a twobedroom rental in the State of Hawaii. And so I want to understand the distinction that we are trying to make in policy between single-family and multifamily lending and how we work on reform, sort of thinking about not just affordable housing as defined under statute, but just affordable housing in the sort of common sense of the word, housing that people are able to afford, which is not always—you know, not everybody in the country is supposed to own a home. Everybody in the country is supposed to live in a home, and that is where we are trying to get in the State of Hawaii.

Mr. STEVENS. Thank you, Senator. My nephew, who is an Army doctor at that pink hospital in Honolulu, went through struggles with his own home, trying to get affordability to buy his first place. I know it all too well, and I tried to help him out.

In our paper we talk about affordability in the same context that you are discussing it now, as a spectrum. The GSEs do a great role in both multifamily and single-family in today's environment. We think affordability in communities across the country, expensive States like Hawaii, needs to be considered, and rural areas. We need to be able to look at them with a unique lens, and look at both affordable, available rental housing as well as affordable home ownership and make sure both are sustainable and that every American has the opportunity to live in a safe home. That is the most important thing. And as has been said here earlier, you never want to get past the tipping points where people create no-doc, negative amortizing products just to put people into home ownership when it may ultimately explode on them downstream. So you need to consider both.

I will say for Hawaii—and you know this all too well—the GSEs have tried to address that over time through things like high-cost limits, which affected your State particularly, along with a few other metropolitan areas in this country. Those are tethers, those are triggers you can execute, and under our plan and most other plans, that is where the regulator plays a role to make sure that there is an obligation to serve communities of all shapes and sizes in this country. And, clearly, the uniqueness of Hawaii would fall into that.

Senator SCHATZ. Thank you.

Chairman CRAPO. Thank you.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman, and I want to follow up on Senator Perdue's question to Mr. Calhoun, but I want to ask Mr. Stevens to answer that question about the credit invisible, the folks who have a thin credit file. In South Carolina—he talked about the 26 million people around the country. In South Carolina, about three-quarters of our folks are scored or can be scored. There is about 16 percent that are credit invisible, and as has been suggested, they are making their rent payment on time, they are paying their utilities on time, they are paying their cell phones on time, but the FHFA does not use the latest model.

Can you just speak for a few seconds on the benefits of the FHFA updating, using the latest model?

Mr. STEVENS. Yes, Senator, thank you. And I appreciate the question. The issue of credit scoring today is a challenge, and there are new models. If you look at the 2017 FHFA scorecard, they have a test to actually look at new credit models in the marketplace and determine whether there are alternatives. But without question, the models being used today are antiquated.

Now, there are a lot of problems with looking at new models and adverse selection and things that credit experts will talk about. But without question, new models like VantageScore as an example, they can find ways to score a new population. The reason why this is important for all of us is, unlike the history of home ownership in this country, two-thirds of every new household formed over the next decade, according to the Joint Center for Housing Studies at Harvard, is going to be minority. And they come with less inherited wealth, more variable income patterns, and different sort of histories around credit. Many come from countries that were unbanked traditionally, did not trust the banking systems, and they just do not have the traditional credit patterns, but yet as Mike referred to earlier, there are other alternative forms where you can score them.

We need to look at that. We need to understand the risks, if there are any increased risks with this new scorable population. But FHFA, until they take this on seriously and look at it, I think we are going to face this delta of those who can and those who cannot based on underwriting and credit standards of a long time ago. And that is what needs to be modernized.

Senator SCOTT. Thank you, sir. Another question about the future economy or what really has become the current economy, the gig economy. When you think about the fact over the last 20 years somewhere around 27 percent of the payroll employees have increased through the gig economy. This is a shared economy with a number of jobs, and when I was owning a business in the insurance industry, I was paid on commission. There is a lot of fluctuation in the paychecks. Our housing financing system has not caught up. The same mortgage payments are due month in and month out.

The real question is: Is there a way—Mr. DeMarco, you have said creating shock absorbers by looking at savings accounts and other ways. What is the new opportunity for those folks in the gig economy to be a homeowner in this new economy?

Mr. DEMARCO. Thank you, Senator. This raises issues on both sides, right? I mean, the regulations, are so much about basic underwriting, qualified mortgage, really have an embedded presumption of a stable flow of income, and yet that is not where so many households are at. And so there is the challenge qualifying.

On the other side, on the risk side, this also lends to greater income volatility, and so as we think about mortgage lending and mortgage risk, this income volatility, which is really growing throughout our economy, more and more households face it, is a risk factor we need to consider in how we are managing to that. So these things all need to be addressed.

In terms of shock absorbers, this is where thinking a little bit more innovatively about products and about how we underwrite can help, and so I will give just two simple examples, not at all meant to be exhaustive.

One is—and the work that Mike Calhoun's group has done really focuses on this. It is not just about full documentation. It is about where are the reserves and helping families build and establish reserves so that they can weather bumps in their income to pay their mortgage.

The other is the mortgage product itself, and not to endorse an idea, but to use it to illustrate that ideas are being developed, there are some economists at the Federal Reserve that are looking at essentially the equivalent of a 30-year fixed-rate mortgage but with a savings component to it that actually builds in those kinds of buffers.

So these are ideas that I think really warrant more consideration because I think it can expand credit access, but not just access. It can help make mortgage lending more sustainable.

Senator SCOTT. Thank you.

In terms of furthering what I call my "opportunity agenda," I am very interested in promoting sustainable home ownership versus home buyership, so this is an important discussion. Thank you for your participation.

Chairman CRAPO. Thank you.

Senator Heitkamp.

Senator HEITKAMP. Thank you so much, Mr. Chairman.

Reviewing your testimony, and if I can just get you to agree, we all know that a foundational principle in all of this is preserving the 30-year fixed-rate mortgage.

Mr. CALHOUN. Yes.

Mr. STEVENS. Absolutely.

Senator HEITKAMP. Mr. DeMarco.

Mr. DEMARCO. Yes.

Senator HEITKAMP. Thank you. So I do not have to ask that question then. I am concerned about the rental market, which, Mr. DeMarco, in your testimony you made a critical point that one of our greatest challenges is actually in the rental market. You correctly point out that QM rules generally require household debt be no more than 43 percent of a family's monthly income, where we have 11 million renter families spending more than 50 percent of their monthly income just on rent, not getting any equity. You know, that idea that your equity in your home was going to be the third leg of your retirement stool, you know, when you think about Social Security, equity in your home, and some kind of pension/401(k). We no longer have that third leg because of this problem.

Are there improvements to the way we handle the multifamily portfolio at Fannie and Freddie that could help address high rental costs? And I will ask you, Mr. DeMarco, to go first.

Mr. DEMARCO. I am not sure that the financing side, and particularly the role that Fannie and Freddie are playing in securitizing multifamily mortgages is the constraint or the barrier here. They are really on the renter side. It is income growth, right?

Senator HEITKAMP. Yes.

Mr. DEMARCO. It is stable jobs. It is growing income. And on the supply side, we have some real challenges in a lot of communities with regard to having developers be able to either rehabilitate or bring new multifamily units online quickly. And there are several reasons for that. The Obama administration actually last year had a report outlining some of this, but it goes to building requirements, zoning restrictions, and——

Senator HEITKAMP. I only have so much—we can maybe get some other opinions on this. I only have so much time.

Mr. STEVENS. The challenge is—and if you look at both Freddie Mac and Fannie Mae's multifamily programs over the last couple of years, as you know, there is a cap. They set a limit to how much they can lend. And they have come near those caps, and not enough of that has been affordable.

So what Director Watt has done under his leadership, he has modified the cap so that you are unlimited if you provide—if it is affordable. So that is a step in the right direction. But I think for Ed, he highlighted some of it, but I will tell you that a real challenge is the demographic mix of who is renting and who is owning, and the pressure of the millennial generation delaying their decision to buy and putting upward pressure on rent rates, and that is affecting long-term renters and pricing them out of their ability to afford the rental. Yes, wages are really the core part of this, but on top of it, we are seeing unique upward pressure on rents because people are not going to buy homes at the same ages that they used to before.

Senator HEITKAMP. There was another report out today talking about the lack of savings for that downpayment. Millennials, I think in this report, 1K, that is the extent of their savings. They are paying off their student debt. They are living in higher-cost cities, which I think has an effect as well.

One of the things I would suggest that we could do is encourage diversification, not put all of the Google employees in the high-price areas and look at lower-cost locations. But, you know, we need to have this discussion, and so I just wanted to lay down a marker.

I want to talk about access to secondary market for small lenders. You know, we tried to address this when we were doing the Corker–Warner analysis and work a couple years ago, and one option we explored as part of Corker–Warner was expanding the role of the Federal Home Loan Bank to serve as an aggregator of small loans.

What is your view on allowing the Federal Home Loan Banks to actually be an aggregator so that we can have greater access to the secondary market? And we will start with you, Mr. Stevens.

Mr. STEVENS. It is a complicated question, so this is a follow-up one. But I actually thought that was a work-around because the way the legislation was written, there was a concern that small lenders would not have access to the main system.

Senator HEITKAMP. Right.

Mr. STEVENS. I worry about the ability to have effective, what we call "execution," pricing for small lenders, if you use only the Federal Home Loan Banks as the aggregator platform. As you know, the Federal Home Loan Banks work with community banks today. They all get access to a home loan——

Senator HEITKAMP. They all have a relationship.

Mr. STEVENS. That is correct. But nonbank originators do not have access to that system, and we believe strongly that the Federal Home Loan Bank is a tool here that can be used as you think about GSE reform to affect the overall market.

But I would say the way we have resolved it in our plan is we think addressing the small lender issue is actually critical and based on the debates we have seen over the last few days, just over this hearing, that is the case, making a cash window that is at the same price with the same credit terms in the new guarantor model gives an outlet for all small lenders, regardless of size and regardless of business model, and it does not force them into some other system that because of liquidity and size may not get them the same pricing ultimately. So we need to consider all the levers.

Senator HEITKAMP. Mr. Chairman, I will follow up with written questions.

Mr. CALHOUN. Can I add just two quick statements?

Senator HEITKAMP. You have to ask the Chairman if you can do that.

Chairman CRAPO. If you are very brief.

Mr. CALHOUN. The Federal Home Loan Bank, as Mr. Stevens said, it is helpful. It is not sufficient. They have got to have a workable cash window. It cannot be a substitute for that.

On the rental housing, one thing, we have got to preserve the things that are really helping. Those include the important role the GSEs play in multifamily financing, and also things like the low-income housing tax credit. If you do not preserve that, you are certainly making the problem even much worse.

Chairman CRAPO. And I thank Senator Heitkamp for helping me keep an eye on the clock.

Senator Tillis.

Senator TILLIS. Thank you, gentlemen, for being here, and I want to go back, Mr. DeMarco, to a question that you were asking. On rental, I think the low-income housing tax credit is very important. We have a housing crisis in North Carolina, affordable housing crisis. It is not limited just to urban areas. We have similar challenges in rural areas. But you were going on to a point that I think is very important to make, and it is really the cost of entry for someone to build a multifamily unit, and it relates directly to a number of the zoning and regulatory hurdles within the very areas that say we need more affordable housing, we need a product that in order to be able to have affordable rent can come at a right price. But it is the additive cost of the regulatory hurdles.

Can you expand on—any of you can, but because you went down that direction with Senator Heitkamp, I wanted you to touch on it.

Mr. DEMARCO. Right. So we clearly have seen in quite a number of communities the land-use restrictions, the zoning restrictions, and then the building requirements—even if you have a piece of property and can develop a multifamily development on it, the requirements that are whether it has to do with amenities or environmental or health and safety, many of which—all of which probably are good and valuable, but when these get so substantial——

Senator TILLIS. The projects do not work.

Mr. DEMARCO. ——that the fixed cost of the project, it either is not going to get done or it is going to end up being a high-rent development.

Senator TILLIS. They will by definition not be affordable, although the original intent was to produce an affordable product.

Mr. DEMARCO. Exactly.

Mr. STEVENS. It is interesting, and not wanting to sound like anti-regulation because good regulations are good, and we need to protect our consumer rights, et cetera, the time to get to occupancy in the multifamily market is extremely long comparatively to where it was a decade ago. And a lot of these are to the points that Ed made, and so it makes the marginal return of building small unit—large-unit buildings but low-cost-per-unit properties. You cannot get the margin out of it ultimately when you factor in all the capital costs associated, and the delay-to-market cost. So that is why you see all this high-end rental stuff being built, but not enough focus on the low end, and that has to do a lot with the regulatory barriers that Ed referred to.

Senator TILLIS. Yeah, I feel like we have to hold jurisdiction—to your point, Mr. DeMarco and Mr. Stevens, there are clearly regulations that should be in place for good reasons, but I believe that there are some that—at least in my State, some of the communities that are asking for more and more affordable housing are the worst offenders of putting in road blocks that create an additive cost that make it impossible. That is why I have really advocated as it relates to any kind of tax credits or grants from the Federal Government that we should come up with some sort of indexing scheme for these local areas to say once you reach a certain threshold where we think you are making it almost impossible to produce a product, then you are no longer eligible for the help to create—they can do whatever they want to, but they have to own the consequences of doing that, because I think it is a very big hurdle, or at least I can speak for North Carolina.

In my remaining time, I wanted to ask really about the need for moving forward with reform, and I want to start with, you know, something pretty basic. Director Watt was here. He expressed his concerns about companies being required to operate without any capital. We also had Senator Cotton and Senator Crapo talk about the risk of another downturn, and you all made it very clear that the taxpayers are at risk.

Can you give me some sense, if we reached a crisis of 2008 proportions, just what that risk is on a dollar basis or some scope, some order of magnitude?

Mr. CALHOUN. Yes, so Treasury did do a detailed analysis, and the costs would be something in the range of $200 billion. They concluded that there was sufficient cushion within the existing line of credit, but that is the kind of dollar amount.

I would point out that——

Senator TILLIS. So the taxpayers—without reform, the taxpayers would be at risk somewhere to the tune of about $200 billion?

Mr. STEVENS. That is correct.

Mr. CALHOUN. I would say in looking at that—and I think there is unanimity here, and I think broadly, about needing capital there to protect it. There are things that have democracy made this a safer housing system that——

Senator TILLIS. So that I finish my question before my time is out, a follow-up question, I am kind of curious if you all believe that financial institutions operating or maintaining no capital is sound policy.

Mr. STEVENS. All I would say is the easy answer is no. The good news is there is an ample line of credit to cover all losses, and focusing on anything other than legislative reform I think is a diversion and we should not go down that path.

Mr. DEMARCO. Completely agree.

Mr. CALHOUN. They obviously need capital, and they need to accumulate it.

Senator TILLIS. I will be submitting a number of questions for the record.

Thank you all for being here.

Thank you, Mr. Chair.

Chairman CRAPO. Thank you.

Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. Thank you all for being here today.

There is an affordable housing crisis in this country. Many people cannot afford to buy homes, and it has pushed the home ownership rate below 64 percent, which is well below the rate it was before the pre-bubble years of the early 2000s.

Now, that in turn has put enormous strain on the rental market. A recent report from the National Low Income Housing Coalition found there is a shortage of about 7.4 million affordable rental units across this country. Millions of families are forced to spend more than half of their income on rent. This affordable housing crisis squeezes working families across the country and holds back economic growth.

So any effort to reform our housing finance system must address this crisis. If it does not address this crisis, then it does not solve the problem in front of us and, in my view, is not worth doing at that point.

So I just want to get all of you on record on a core point. Do you think that a primary goal of housing finance reform should be to meaningfully increase access to affordable housing, including the rental market? Mr. Calhoun, can I start with you?

Mr. CALHOUN. Yes, absolutely.

Senator WARREN. Thank you.

Mr. DeMarco.

Mr. DEMARCO. Yes.

Senator WARREN. And, Mr. Stevens.

Mr. STEVENS. Absolutely.

Senator WARREN. All right. Good. So we have got that much going.

Of course, the question is: How do we accomplish that? How do we get to that goal? When this Committee last considered housing finance reform, the two major proposals, Corker–Warner and Johnson–Crapo, including a 10-basis-point strip to provide funding for affordable housing. But both of those proposals also eliminated the affordable housing goals.

So let me start there. Mr. Calhoun, do you think that creating a 10-basis-point strip for affordable housing while eliminating housing goals will address our affordable housing crisis or make the affordable housing crisis worse?

Mr. CALHOUN. No, and, again, when we say affordable housing goals, that is often shorthand for the range of tools that the GSEs and any successor should have and which have under HERA, and the biggest one is that pooling of risk. The pooling of risk far dwarfs the impact even of that increased housing affordability fund fee.

Senator WARREN. So let me ask then, what are some of the ways that we could make progress on this front? I assume that it starts by maintain the goals in the affordable housing strip, but what else could we be doing? How could we be building from there?

Mr. CALHOUN. So one example is, as we have talked some about today, the GSEs today as a model are off—are transferring risk, credit risk transfers, and they are doing it largely on a pool basis where they acquire the loans and then they sell that risk to a diversity of guarantors in the market. So it creates the kind of competition that Mr. DeMarco is talking about, but it allows for that pooling of risk that helps both families of modest means and the smaller lenders, particularly the rural lenders. And so that program should be maintained and continued, and if it is replaced with one—and this is the point of respectful disagreement. If it is replaced with one where that credit risk is all divided up on so-called the front end, before the bank makes the loan or before the issuer acquires the loan, that is going to push pricing that will favor the opposite way, to the larger lenders, to the wealthier borrowers.

Mr. DEMARCO. May I?

Senator WARREN. Thank you. Yes, Mr. DeMarco, please. Very quickly.

Mr. DEMARCO. So you asked a great question. What more can we do? What can we do better?

Senator WARREN. Right.

Mr. DEMARCO. I will answer at the programmatic level and the borrower level.

At the program level, approaches that are under consideration in housing finance reform include a dedicated funding stream that you mentioned. It also includes a duty to serve requirement for the secondary market. What that really is about is about creating better partnerships between secondary markets and primary lenders. If a lender is in Boston and says, "I have got this particular issue in Boston," there ought to be not just sort of a national rule but a way of working with a secondary market aggregator to tailor something to those unique needs. We had an earlier discussion about the unique circumstances in Hawaii. There is also the importance of thinking about FHA and how we make that work better.

At the borrower level, to create better opportunities and access, we also need to think about how we are preparing borrowers to become homeowners. That includes downpayment building and assistance getting there. It includes financial education, homebuyer counseling. And it includes not measuring that we made a loan, but was the loan successful or not?

Senator WARREN. So thank you. This is very helpful, and we will talk more about this as we talk about some of the details.

You know, I think it is worth looking at the original legislation. A big reason that the Government created Fannie and Freddie to begin with was to promote access to affordable home ownership. That is the reason for their existence, and that should be our main goal as we try to rewrite in this area.

I am all for ending Government conservatorship, and I am certainly all for ending the old system where the private investors pocket all the profits while the taxpayers take all the risks. But I cannot be for reform if it does not address the affordable housing crisis in this country. So I would like to see us stay focused there.

Thank you.

Mr. CALHOUN. If I may add, this is the point where we agree with the MBA and commend them. It only works if these actors all have a duty to serve the national market. Otherwise, you are going to have plenty of people who want to serve New York and San Francisco, and I love them both. But, you know, who will go to the rural counties in northeast North Carolina where it is much harder? Who will go to the other markets that are not as lucrative? You should not be able to just cherrypick and cream the market with the aid of a Government guarantee.

Senator WARREN. Good. Thank you. That is very helpful.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you very much, and that concludes are questioning. I want to thank our witnesses for being here today and providing your testimony. I am looking forward to working with you and other stakeholders as we address this critical issue.

I also look forward to working with our Committee Members, Senator Brown and the other Members of the Committee, on this issue and building a strong, bipartisan solution.

For Senators who wish to submit questions for the record, those questions are due on Thursday, July 6, and I encourage the witnesses, if you receive questions, to please respond promptly.

With that, the hearing is adjourned.

[Whereupon, at 11:47 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF DAVID H. STEVENS

PRESIDENT AND CHIEF EXECUTIVE OFFICER, MORTGAGE BANKERS ASSOCIATION

JUNE 29, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA). My name is David H. Stevens, and I am President and CEO of MBA. From 2009 to 2011, I served as Assistant Secretary for Housing and Federal Housing Administration (FHA) Commissioner at the U.S. Department of Housing and Urban Development (HUD). I am a Certified Mortgage Banker (CMB), and I have over 35 years of experience in real estate finance, including nearly a decade as Senior Vice President for Single-Family Business at Freddie Mac, where I witnessed the strengths of the business model as well as the weaknesses that contributed to the financial crisis and led to the current state of our housing finance system.

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. The association works to ensure the continued strength of the Nation's residential and commercial real estate markets, to expand home ownership, 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. MBA's membership of over 2,300 companies represents all elements of real estate finance, including firms serving both the single-family and commercial/multifamily markets. Our membership includes commercial banks, investors, brokers, conduits, and industry vendors, as well as nearly 650 independent mortgage bankers, community banks, and credit unions, which comprise almost 80 percent of our single-family membership.

We are now nearing 9 years since Fannie Mae and Freddie Mac (the GSEs) first entered conservatorship, and yet their long-term status remains unresolved. The financial crisis exposed the structural conflicts and misaligned incentives in the GSE business model, as well as weaknesses in the regulatory framework that was in place at the time. The result—a breakdown of the secondary mortgage market, $187 billion in taxpayer assistance, and continuing Federal support of almost $260 billion—underscores the importance of comprehensive reform.

Conservatorship of the GSEs has already persisted far longer than was ever intended. And while the Federal Housing Finance Agency (FHFA) has taken important administrative steps during this period, an extended conservatorship is economically and politically unsustainable. In the absence of comprehensive reform, borrowers forego the benefits made possible by a more vibrant secondary market, taxpayers remain exposed to elevated levels of credit risk, development of the private-label securities market remains stagnated, and lenders face increased uncertainty about the future. In short, the status quo is an unacceptable long-term outcome.

To address the need for change, MBA convened its Task Force for a Future Secondary Mortgage Market (Task Force) in early 2016. The Task Force was comprised of members covering a broad cross-section of the real estate finance industry, including bank and nonbank lenders serving the single-family and multifamily markets and spanning a wide range of sizes and business models, mortgage insurers, REITs, and title companies. The members of the Task Force spent over a year considering and debating many potential models before issuing final recommendations for a reformed and improved secondary mortgage market system. The result of this extensive work was a detailed proposal released in April 2017, titled *GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market*. I have submitted this proposal as an addendum to my written testimony.

It is important to note that our Task Force focused on balancing key public policy objectives with the realities of the marketplace. As industry practitioners, our members placed a premium on pragmatism. We are fully aware that there is no single perfect solution to GSE reform—all proposals involve various trade-offs. We believe that our plan addresses these trade-offs in a way that will benefit consumers, industry, and taxpayers, while also providing the long-term stability so essential to a healthy housing finance system.

The Task Force took particular interest in two areas that have tested past reform efforts—the appropriate transition to a new system and the role of the secondary market in advancing a national affordable-housing strategy. Distinct working groups within the Task Force studied these issues and developed carefully crafted recommendations that we believe can bridge the divides that currently exist.

With respect to the transition from the status quo to a new end state, the MBA proposal makes use of concepts that are well-established in finance and banking, as well as historical examples that have provided insights into the key elements of successful models. The Task Force specifically noted the importance of leveraging the assets, infrastructure, and regulatory framework of the current system wherever possible, while also emphasizing that any workable transition must utilize a clear road map and be multiyear in nature.

The Task Force also sought to develop an affordable-housing framework that appropriately targets the scope of the federally supported secondary market within the full continuum of households, covering both renters and homeowners of varying income levels. To advance this objective, the MBA proposal features a framework that involves quantitative and qualitative metrics that focus on outcomes and that are transparent, well-defined, measurable, and enforceable. The GSEs' multifamily executions and their support for rental housing would be preserved. The proposal also recommends other potential improvements to better serve the full continuum of households, including updating credit-scoring models, better capturing nontraditional income, and providing enhanced liquidity for small-balance loans.

Another critical objective of the Task Force—and one that has been the subject of intense debate during past reform efforts—was to ensure that secondary market reform fosters a competitive primary market that is served by lenders of all sizes and business models. In particular, the Task Force recognized the important role that smaller lenders play in strengthening the system for consumers by focusing on niche markets and leveraging unique knowledge of local needs (see Exhibit A—"Small Lender Access: Why It Matters"). The MBA proposal reflects this objective by ensuring equitable access to secondary market programs, prohibiting special pricing based on loan volume, preserving cash window and small pool execution options, and preventing vertical integration by the largest market participants.

After contemplating many different types of business structures and regulatory frameworks for the Guarantors that will issue eligible mortgage-backed securities (MBS), the Task Force determined that a model based on regulated utilities would be most effective. The core justification for utility-style regulation rests with the premise that privately owned utilities derive much of their existence and powers from the state. Because the Guarantors will be granted the ability to distribute securities carrying a full faith and credit guarantee from the Federal Government, they must also accept the responsibility—and the regulatory oversight—to serve customers in an efficient and fair manner. The regulator would ensure that the premiums charged by the Guarantors are neither excessive nor inadequate, and that they remain nondiscriminatory in nature. Pricing would be transparent, with rates posted for public input. And in addition to the legal and economic rationale for utility-style regulation, this framework is also intended to address the problematic growth-company models and mindsets that existed at the GSEs prior to the financial crisis. Investor-owned utilities will aim to provide shareholders with a steady dividend over time rather than taking on excessive risks in a reach for market share. Companies with a dividend-focused culture will compete through more efficient operations, product and process improvements, and customer service.

GSE Reform: Core Principles

The MBA proposal recognizes the need for any comprehensive GSE reform plan to balance three major priorities: (1) taxpayer protection; (2) investor returns; and (3) consumer cost and access to credit. Pushing too far in any one direction may lead to a mortgage market that does not adequately meet the needs of all participants. To achieve the appropriate equilibrium among these priorities, the Task Force developed the following core principles to guide its work:

Core Principles:

- Preserve the 30-year, fixed-rate, prepayable single-family mortgage, as well as long-term financing for multifamily mortgages;
- Maintain a deep, liquid to-be-announced (TBA) market for securities backed by conventional single-family loans;
- Attract global capital and preserve liquidity during times of economic stress through an explicit Government guarantee for eligible MBS backed by single-family or multifamily mortgages;
- Limit the explicit Government guarantee to the eligible MBS, while prohibiting the extension of the guarantee to the equity or debt of the Guarantors;

- Require the Guarantors to support an effective national affordable-housing strategy that helps meet the needs of low-income and underserved households and communities;
- Support a competitive and diverse primary market for lenders of all sizes and business models;
- Enable a robust, innovative, and purely private mortgage market to coexist alongside the Government-backed market;
- Preserve existing multifamily financing executions and permit new options;
- Establish a strong, transparent regulatory framework that promotes liquidity while protecting the taxpayers;
- Ensure that private capital assumes most of the credit risk;
- Ensure liquidity in the event of a full-blown systemic crisis; and
- Minimize risks to the liquidity and stability of the mortgage markets during the transition to the end state.

GSE Reform: Guardrails

The MBA proposal also addresses the risks that are inherent in any plan to reform the secondary mortgage market. To mitigate these risks, the Task Force developed a set of "guardrails"—a statutory and regulatory framework designed to protect taxpayers, ensure liquidity, preserve what works in the current system, and align incentives across both the primary and secondary markets. These guardrails are comprised of structural requirements, prudential standards, and market conduct regulation:

Structural Requirements:

- The end state should allow for more than two approved Guarantors to issue Government-guaranteed MBS;
- The regulator should be authorized to grant additional Guarantor charters;
- The Government guarantee should be explicit, funded by appropriately priced insurance premiums, and limited only to the MBS issued by the Guarantors;
- Guarantors should disperse credit risk to private capital investors through a variety of credit risk transfer (CRT) mechanisms, including deeper first-loss CRTs that are transparent, scalable to all lenders, and capable of limiting taxpayer exposure to nothing more than catastrophic risk;
- Guarantors should be stand-alone companies and lenders should not be allowed to own controlling interests in Guarantors;
- Guarantors' rate of return should be regulated using a utility regulation framework;
- Guarantors should issue a single uniform type of security for single-family mortgages;
- The Common Securitization Platform (CSP) should be established as a self-funding, Government-owned corporation and must be accessible to new Guarantors;
- The CSP should own all GSE historical single-family data, and new Guarantors and other market participants should be able to access and analyze this information for an administrative fee; and
- The regulator should have established mechanisms in place to respond to liquidity disruptions during severe market downturns or catastrophic events.

Prudential Standards:

- The regulator should have sufficient powers and discretion with respect to capital regulation and other aspects of prudential oversight;
- Single-family loans eligible for inclusion in the Government-backed MBS should meet a Qualified Mortgage (QM) type standard;
- Multifamily mortgages of a type and quality similar to those financed by the GSEs today should be eligible for inclusion in the Government-backed MBS;
- Guarantors may hold only limited mortgage portfolios to support cash window operations, delinquent loan repurchases, loss mitigation activities, and certain multifamily assets; and
- Guarantors that reach a given size may be designated and regulated in a manner similar to systemically important financial institutions (SIFIs).

Market Conduct Regulation:

- Guarantor charters should expressly maintain a bright line between the primary and secondary mortgage markets, with the Guarantors' allowable activities limited to the secondary market;
- The regulator should ensure that Guarantors provide equitable, transparent, and direct access for lenders of all sizes and types, and pricing and program participation should not be based on the loan volume or asset size of lenders;
- Guarantors should be required to maintain both cash window and MBS execution options; and
- Guarantors should be required to support an effective national affordable-housing strategy that helps meet the needs of low-income and underserved households and communities.

Why Congress Needs To Act

In its role as conservator of the GSEs, FHFA has put in place a number of policies and procedures to improve access to the secondary mortgage market and reduce the risks to taxpayers. These changes include more appropriate guarantee fee (g-fee) pricing that is based on the riskiness, not the volume, of the loans delivered; the development of the CSP and the Single Security initiative; extensive use of credit risk transfers by the GSEs; substantial reductions in the GSE retained mortgage portfolios; and enhanced oversight of, and risk management at, the GSEs.

Despite these important steps, there is a critical need for legislative reform—both to bring about the remaining structural changes that are necessary to achieve the core principles listed above, as well as to "lock in" the recent improvements made by FHFA. It is only Congress that can:

- Alter the existing GSE charters to reconstitute the firms as Guarantors;
- Establish an explicit Federal Government guarantee on eligible MBS, as well as a Mortgage Insurance Fund (MIF) to stand ahead of taxpayers;
- Empower FHFA with a utility-style regulatory mandate to maintain a level playing field, as well as the authority to grant charters to new Guarantors in order to better enable competition in the secondary market; and
- Preserve the administrative reforms made by FHFA as conservator of the GSEs.

And perhaps most importantly, legislative reform is the only outcome the provides the legitimacy and public confidence necessary for long-term stability in both the primary and secondary mortgage markets.

It is therefore clear that calls to simply recapitalize the GSEs and allow them to operate without further structural changes are misguided. Under such plans, the post-crisis reforms already achieved could be reversed at the discretion of future FHFA directors. And recapitalization absent comprehensive legislation would likely embolden those who seek private profit at the expense of sound public policy, while mortgage market participants may lose confidence in the prospects of serious reform, creating further uncertainty around business planning.

Finally, any movement towards recapitalization without corresponding reforms would be unnecessary from a safety and soundness perspective given the large levels of Federal support currently available to the GSEs. Even worse, this type of recapitalization plan would likely be counterproductive to efforts to develop and implement much-needed reforms.

We cannot go back to a housing finance system that provides private gains when markets are strong yet relies on support from taxpayers when losses occur. Only by enacting comprehensive legislative reform can borrowers, lenders, and investors realize the full benefits of a diverse, competitive primary market and a vibrant, liquid secondary market. The hard work of reform should proceed without delay.

Once again, I appreciate the opportunity to present this testimony, and I will reiterate MBA's long-standing commitment to working with the Committee on all elements of GSE reform.

Exhibit A

Small Lender Access: Why It Matters

Small Lender Access: Why It Matters

It is important to recognize and address in reform legislation the role that limited access to the GSEs played in driving the sharp consolidation that began in the late-1990s. Between 1998 and 2010, the market share of the 10 largest single-family originators rose from less than 40% to almost 80%.

The GSEs played a significant role in driving this concentration. Beginning in the late 1990s, the GSEs competed for business by negotiating market share agreements with the largest volume lenders, providing lower guarantee fees and underwriting exceptions that drove even more business to these institutions. Unable to compete against lower guarantee fees and aggressive underwriting variances, smaller lenders were forced to deliver their loans to the largest lenders. This "aggregation" model played a contributing role in the GSEs' financial troubles by driving underpriced guarantee fees, spreading weak underwriting standards, and concentrating counterparty risk into a handful of aggregators.

In the wake of the crisis, the market share of home mortgage originations from the larger institutions declined sharply. By 2015, large depository institutions' market share had fallen to 21 percent for purchases, and 27 percent for refinances.[A] Several factors — legacy issues with pre-crisis mortgage and servicing portfolios, Basel III rules, regulatory burden and reputational risk in the mortgage business — all played a role in the decision of larger banks to shift their capital into more promising lines of business.

Fortunately for consumers, the gap in funding was filled by independent mortgage bankers (IMBs), whose market share in both purchases and refinances increased from the low-20s in 2008 to nearly 48 percent in 2015. Most of these institutions are smaller companies, but several IMBs grew to become top 20 originators. Community banks and credit unions also picked up market share, despite a decline of more than 1,100 reporting institutions.

Importantly, FHFA helped facilitate the transition through key policy changes intended to strengthen access to the GSEs for smaller lenders, including requiring guarantee fees to be based on the underlying loan risk (not loan volume), and eliminating preferential underwriting standards for selected institutions. Direct access to the GSEs' cash and MBS windows played a critical role in the recovery by ensuring these smaller lenders could provide the liquidity the market needed.

MBA believes that the mortgage market and consumers benefit from a large and diverse base of lenders. Smaller lenders, in particular, play a key role in strengthening the system for consumers by focusing on niche markets and leveraging unique knowledge of local consumer needs. Recent post-crisis research shows that highly concentrated mortgage markets through the 2000s reduced the sensitivity of mortgage rates to movements in the MBS market, and that more competitive local markets tended to narrow primary-secondary market rate spreads and deliver lower rates to consumers.[B]

- To that end, the Task Force's recommendations embody several key small-lender principles:
- Ensure equitable, transparent and direct access to secondary market programs;
- Prohibit G-fee pricing based on loan volume or asset size of single-family lenders;
- Preserve cash window and small pool execution options for smaller lenders;
- Maintain the "bright line" to ensure that Guarantors do not compete with lenders;
- Prevent vertical integration by prohibiting lenders from owning or controlling a Guarantor.

A. *MBA Executive DataBook, 2015 Origination Trends,* © 2016.

B. *Concentration in Mortgage Lending, Refinancing Activity and Mortgage Rates,* NBER Working Paper Series; David S. Scharfstein, Adi Sunderam, Working Paper 19156; http://www.nber.org/papers/w19156.

Exhibit B

GSE Reform: Creating a Sustainable,
More Vibrant Secondary Mortgage Market


ONE VOICE. ONE VISION. ONE RESOURCE.
GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market
This paper explains MBA's recommended approach to GSE reform, the last piece of unfinished business from the 2008 financial crisis. It outlines the key principles and guardrails that should guide the reform effort and provides a detailed picture of a new secondary-market end state. It also attempts to shed light on two critical areas that have tested past reform efforts — the appropriate transition to the post-GSE system and the role of the secondary market in advancing an affordable-housing strategy. GSE reform holds the potential to help stabilize the housing market for decades to come. The time to take action is now.
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Executive Summary

The Mortgage Bankers Association (MBA) is the national association representing the full depth and breadth of the real estate finance industry. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, commercial banks, community banks, credit unions, thrifts, REITs, securitization conduits, life insurance companies and others in the mortgage lending field.

This paper is the product of more than a year's worth of work by MBA's Task Force for a Future Secondary Mortgage Market. The task force was created in March 2016 and directed to develop a proposal that will address the future of the secondary mortgage market as it relates to Fannie Mae and Freddie Mac (the Government Sponsored Enterprises, or "GSEs"), and in particular, an end state model that can also fulfill an affordable-housing/duty-to-serve mission. The members of this task force are made up of individuals from MBA member companies those in the market every day, representing a broad cross-section of the residential and multifamily real estate finance sectors, including entities of varying sizes and business models.

The task force considered many potential models in developing its recommendations for a new secondary market system, ranging from the formation of a government-owned corporation to restoration of the GSEs to their pre-crisis form. In assessing the trade-offs among various approaches, several core principles emerged as critical to ensuring the long-term health of the secondary mortgage market.

Principles

We believe that all GSE reform options should be evaluated and measured against these core principles. Working from these principles, MBA's proposal is for a new government-guaranteed secondary market "end state" that would advance the following critical policy objectives:

- Maintain the liquidity and stability of the primary and secondary mortgage markets through the establishment of a resilient and vibrant housing finance system, throughout the transition process to the end state.
- Replace the implied government guarantee of Fannie Mae and Freddie Mac with an explicit guarantee at the mortgage-backed security (MBS) level only, supported by a federal insurance fund with appropriately priced premiums.
- Protect taxpayers by putting more private capital at risk through expanded front- and back-end credit enhancements.
- Establish strong capital standards and enhanced regulatory powers to ensure a sound and stable secondary market system.
- Promote a strong, diverse primary market through a level playing field for lenders of all sizes and business models.
- Ensure that there is a bright line separating the primary and secondary mortgage markets.
- Heighten competition by allowing the regulator of the new system (either the Federal Housing Finance Agency [FHFA] or a successor agency) to charter new entities ("Guarantors") to provide for securitization of eligible single-family and multifamily MBS.
- Preserve where possible the existing infrastructure — for example, a rechartered Fannie Mae and Freddie Mac could be the first two Guarantors.
- Strengthen affordable-housing policy consistent with sound lending principles and a holistic national housing strategy.
- Ensure that a robust private mortgage market can exist parallel to the government-backed market, with each complementing and balancing the other through different economic cycles.

Recommendations

To achieve these policy objectives, the Task Force makes the following recommendations for a new end state for the government-guaranteed secondary mortgage market:

- The system would be a multiple Guarantor model, with at least two entities and preferably more.
  - Rechartered successors to Fannie Mae and Freddie Mac would likely be the first two Guarantors.
  - The regulator would be permitted to charter additional Guarantors, encouraging competition (or at least the threat of it). New firms would be able to apply for a Guarantor charter that authorizes them to serve either the single-family or multifamily market or both markets.
- Guarantors would compete primarily on operations/systems development, customer service, product parameters and innovation (within guidelines set by the regulator and the CSP for single-family mortgages), and pricing/execution.
- Additional private capital would come from rigorous capital requirements for Guarantors that could be satisfied through a combination of their own capital and proven means of credit risk transfer (CRT). Guarantors would be encouraged to disperse risk through credit risk transfers:
  - Lenders would maintain their current role of obtaining primary market credit enhancement (e.g., deeper private mortgage insurance, recourse, and existing multifamily risk-share mechanisms).

MBA believes that the transition to a new secondary-market end state remains among the most critical and challenging components of comprehensive reform.

- Guarantors would be monoline, regulated utilities owned by private shareholders. Guarantor activities would include:
  - Acquisition of single-family loans through both cash-window and MBS executions.
  - Acquisition of multifamily loans through existing multifamily financing and other executions.
  - Issuance of a single MBS for single-family mortgages through the Common Securitization Platform (CSP), which would be established and operate as a self-funded government corporation.
  - Holding a limited mortgage portfolio intended only for aggregation prior to MBS issuance from cash-window operations, for delinquent loan buyouts and loss mitigation, and for limited multifamily purposes.
  - Guarantors would also engage in secondary market risk sharing through reinsurance, structured notes and other instruments for institutional credit investors and existing multifamily risk-transfer executions.
  - The regulator could reduce risk-sharing levels during periods of market duress.
- MBS issued by the Guarantors would be backed by the federal government's full faith and credit guarantee supported by a federal mortgage insurance fund (MIF).
  - The MIF would be built up over time through appropriately priced insurance premiums paid by the Guarantors.
  - The MIF would cover catastrophic risk, kicking in only in the event of a Guarantor failure after all layers of private capital had been exhausted.

+ The taxpayers would be at risk only after all layers of private capital and the MIF are exhausted.

+ In the event of a taxpayer bailout, future Guarantors would be tapped with higher insurance premiums going forward to reimburse taxpayers and rebuild the MIF reserves to their required reserve ratio.

- The entire system would be regulated by the FHFA (or a successor agency) with expanded authorities. This regulator would:

  + Provide prudential supervision over the Guarantors, including requiring higher capital levels than in the pre-crisis system.

  + Monitor and regulate target rates of return for the Guarantors, designed to attract investors seeking low-volatility, safe and consistent equity investments.

  + Ensure fair and equitable access to the secondary market for lenders of all sizes (e.g., no preferential single-family pricing based on volume).

  + Ensure that Guarantor activities comply with rules establishing a bright line separating the primary and secondary markets.

Transition

MBA believes that the transition to a new secondary market end state remains among the most critical and challenging components of comprehensive reform. The path toward reform outlined in this paper seeks to minimize disruptions to the housing finance system during this transition, while bringing the new system up to speed in a reasonable time period and ensuring that genuine, sustainable reform occurs to increase the stability of the system. As a result, the Task Force's transition recommendations in this regard include elements that would mitigate the disruptive impact of the change:

- Preserving the existing human capital and operational processes at both GSEs and reasonably supporting their emergence as viable Guarantors.

- Transitioning to the new system over a multiyear period, with implementation occurring gradually to avoid market disruption and to build required capital.

- Reducing barriers to entry and allowing new entrants to become Guarantors as soon as possible in order to encourage competition.

- Utilizing FHFA and its existing legal authorities as the starting point, modified as necessary to accomplish the objectives of secondary market reform.

The Essential Role of Congress: Why Congress Needs to Act

To create this new secondary mortgage market system, only Congress can:

- **Change the existing charters for Fannie Mae and Freddie Mac;**
- **Create the Mortgage Insurance Fund (MIF) to guarantee eligible mortgage-backed securities;**
- **Establish a new, explicit government guarantee that stands behind the MIF;**
- **Empower FHFA or a successor regulator to grant charters to the new Guarantors;**
- **Provide the legitimacy and public confidence necessary for a long-term solution to housing finance reform.**

- Encouraging the improvement of technology platforms supporting secondary mortgage market activities as part of the transition process.
- Providing the regulator sufficient flexibility to adjust the timing and execution of the transition based on market conditions or other critical factors to mitigate potential disruption.

Affordable Housing

Finally, MBA believes that America's housing finance system should meet the housing needs of the full continuum of households, from families residing in the most directly subsidized, affordable rental homes to those served by the prime jumbo single-family lending market. As part of this effort, the Guarantors operating in the government-guaranteed secondary market must serve three critical affordable-housing missions:

- Provide responsible, sustainable access to credit for prospective homeowners.
- Provide liquidity for the development and preservation of affordable rental housing.
- Improve liquidity for segments of the market that are currently underserved.

To achieve these missions, MBA recommends that the regulator periodically develop a comprehensive affordable-housing plan against which it would hold the Guarantors accountable. The key parts of the plan would be:

- The establishment of both quantitative and qualitative affordable-housing goals.
- The annual assessment of an affordable-housing fee (set within a permissible cost range defined by statute) on new business purchases of the Guarantors.

Because affordable-housing policy should be responsive to feedback from existing programs and seek new paths forward when necessary, the regulator would have flexibility to adjust the appropriate mix of goals and the fee to maximize the policy's effectiveness.

GSE Reform: Quick View

	GSEs PRE-Conservatorship	GSEs IN Conservatorship	Guarantors (MBA Model)
Investor purpose	Growth stock returns/risks	Conserve assets	Utility-level returns/risks
Government backing of MBS	Implicit government guarantee	Explicit government guarantee	Mortgage Insurance Fund (MIF) funded by premiums paid, backed by explicit government guarantee
Government backing of corporate debt	Implicit guarantee	Explicit guarantee	No guarantee
Regulatory limitations on pricing	No	Yes	Yes
Retained investment portfolio	Large	Reduced	Minimal
Capital standards	Low capital levels on both retained/ guaranteed risk	Reduce capital cushion to zero by 2018	Enhanced Guarantor capital standards
SF risk transfers to private market	Front-end only (MI and lender recourse)	Testing back-end structures in addition to front-end	Deeper front-end and back-end
MF risk transfers to private market	Lender Risk Share	Lender and Capital Markets Risk Share/Transfer	Lender and Capital Markets Risk Share/Transfer
Number of entities	Two	Two	Two or more
New Guarantor entrants permitted	No	No	Yes
SF lender access	Preferential pricing and underwriting by loan volume	Guarantee fee and underwriting variances restricted	Prohibit guarantee fee and underwriting variances based on volume
Support for single-family TBA market	Yes	Yes	Yes
Support for multifamily finance	Yes	Yes	Yes
Preserve operational infrastructure and processes	Yes	Yes	Yes
Affordable housing mission	Yes	Yes	Yes

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Introduction

Resolving the status of Fannie Mae and Freddie Mac (the GSEs), now nearing their ninth year of government conservatorship, remains the final piece of unfinished business from the 2008 financial crisis. The financial crisis plainly exposed the structural conflicts, misaligned incentives, and other weaknesses in the GSE business model and its regulatory framework. The result was a catastrophic failure of the secondary mortgage market that required more than $187 billion in direct taxpayer support and a continuing federal commitment of more than $250 billion.

Administrative reforms undertaken by the Federal Housing Finance Agency (FHFA), as both regulator and conservator of the GSEs, have resulted in significant progress in stabilizing the companies while paving the way for future reform. Indeed, the GSEs today, operating in conservatorship and subject to strict regulation, are in a state that is already closer to our recommended utility-model end state, relative to the pre-crisis GSE system that required dramatic federal intervention in 2008.

Meanwhile, legislative reform proposals introduced in both the U.S. House of Representatives and the U.S. Senate have yielded productive discussions but no concrete outcomes. Both chambers passed comprehensive GSE reform legislation in committee during the 113th Congress, but these efforts stalled for various reasons, including concerns about complexity, cost to consumers, fears of exacerbating the impact of credit and economic cycles, and the legislation's perceived lack of a sufficient affordable-housing strategy.

As the GSEs move closer to having no retained capital, the possibility of another draw from the U.S. Treasury — even if the GSEs incur just a modest loss — is very real. While the GSEs have an ample financial backstop remaining at Treasury, the current government-dominated system, in which the GSEs are in a state of conservatorship, is unsustainable over the long term. Looking ahead, establishing a strong, vibrant secondary mortgage market will be essential to help power economic growth and secure a more prosperous future. The stakes are high: GSE reform must be a top and immediate policy priority for the new administration and Congress.

To address the need for change, MBA formed a member task force last year to jump-start the reform conversation and develop a plan for a revitalized secondary market that could be implemented by Congress working with the next administration. The Task Force, representing a cross-section of both single- and multifamily lenders of varying sizes and business models, was charged with two overarching goals:

- Re-evaluate MBA's prior policy proposals for GSE reform and develop a durable end-state model that could facilitate access to mortgage credit through all economic cycles while protecting taxpayers;
- Evaluate a broad range of reform options, considering the trade-offs between different approaches as measured against a guiding set of principles; and
- Develop a vision for an affordable-housing strategy that could serve citizens along a continuum of economic circumstances.

To make the results of those efforts actionable, the Task Force was further charged with developing a road map that would ensure an orderly transition to the new secondary market system that will minimize disruptive impacts.

Our recommendations are outlined in detail below, along with a description of principles and guardrails critical to ensuring a healthy, stable and vibrant market for single-family and multifamily mortgages. We explain the recommended end-state model and provide a transition road map designed to minimize disruption to the system and the broader economy. Finally, we outline our vision for supporting America's affordable-housing needs through the role of the Guarantors.

Balancing Competing Priorities

In evaluating any proposal for GSE reform, three major objectives must be balanced: protecting taxpayers, attracting capital to Guarantors, and ensuring consumers and borrowers have access to affordable financing. Pushing too far in any direction may result in some of the objectives being missed.

1. **Taxpayer Protection:** The system should greatly reduce the likelihood that it would require taxpayer support in all but truly catastrophic, systemic events. In order to accomplish this objective, the system should have significant private capital in place to absorb potential losses, a clearly defined government backstop, strict regulation and supervision, a well-defined credit box and carefully targeted efforts to make housing more affordable.

2. **Investor Returns:** To generate the large amount of private capital required to fund such a system, the Guarantor business model and expected returns through the cycle need to be attractive. That is, private investors in the Guarantors would have a reasonable expectation of a market rate of return on a risk-adjusted basis. To achieve this objective, investors would want to ensure that capital requirements are not too high, regulation and supervision is not too expensive, credit standards are sound and efforts to make housing more affordable do not impinge significantly on returns. Being able to issue MBS with a government backstop, even if the backstop is paid for through insurance premiums, is a business benefit because the backstop ensures the market will stay open during financial market disruptions.

3. **Consumer Cost and Access to Credit:** Homebuyers and borrowers are concerned with the all-in cost of obtaining financing. Higher capital requirements, more costly regulation and affordable-housing fees all add to consumer costs. Higher consumer costs, however, would likely be offset by a move to an explicit government guarantee of eligible MBS, as evidenced by the spread between prices on Ginnie Mae and GSE securities. Of course, not being able to get a loan — either because of tight credit criteria, increased costs or market disruption — has a negative impact as well. Roughly one-third of existing-home sales today go to first-time homebuyers, down from a historical average closer to 40 percent. One of the primary causes for this drop-off is the higher costs and tighter credit environment in today's mortgage market. For first-time buyers and others on the margin, a tighter credit box can mean being shut out of the market altogether. Efforts to extend affordability and access to underserved borrowers are one of the items that FHFA or its successor would closely monitor in the system we envision.

Principles and Guardrails

Principles

The Task Force developed the following core principles. Applying these principles is critical to ensuring that the end state provides the broadest possible liquidity through all economic cycles while protecting taxpayers.

- Preserve the 30-year, fixed-rate, prepayable single-family mortgage and long-term financing for multifamily mortgages.
- Maintain a deep, liquid to-be-announced (TBA) market for securities backed by conventional single-family loans.
- Attract global capital and preserve liquidity during times of economic stress through an explicit government guarantee for eligible MBS.
- Limit the explicit government guarantee to the eligible MBS, while prohibiting the extension of the guarantee to the equity or debt of the Guarantors.
- Require the Guarantors, as a condition of their charter, to support an effective national affordable-housing strategy that helps meet the needs of low-income and underserved households and communities.
- Support a competitive and diverse primary market for lenders of all sizes and business models.
- Enable a robust, innovative and purely private mortgage market to coexist alongside the government-backed market.
- Preserve existing multifamily financing executions and permit new options.
- Establish a strong, transparent regulatory framework that promotes liquidity while protecting the taxpayers.
- Ensure that private capital (including single-family loan-level credit enhancement such as mortgage insurance, lender recourse and other available forms of credit risk transfer) assumes most of the credit risk. For the multifamily finance market, the Guarantors would utilize current risk sharing and risk transfer structures used as part of Fannie Mae's Delegated Underwriter Servicing (DUS) program and Freddie Mac's K Deals, and other securitization structures to be developed.
- Ensure liquidity in the event of a full-blown systemic crisis.
- Minimize risks to the liquidity and stability of the mortgage markets during the transition to the end state, giving special attention to potential operational disruptions.

Guardrails

MBA recognizes that reforming the secondary market presents certain risks — to taxpayers, consumers, and the stability of the housing finance system itself. To mitigate these risks, we have also developed the following guardrails — a statutory and regulatory framework designed to protect taxpayers, ensure liquidity, preserve what works today, and align incentives across both the primary and secondary markets.

Structural Requirements

- The end state should allow for more than two approved Guarantors to issue government-guaranteed MBS. The new regulator, FHFA or its successor, should be authorized to grant charters subject to statutory requirements and regulatory guidelines, and the charters should not be limited in number.
- New entrants should be able to apply for a Guarantor charter to serve the single-family or multifamily market or both markets.
- The government guarantee should be explicit, funded by appropriately priced insurance premiums and limited only to the MBS issued by the Guarantors, and should not extend to the Guarantors or their corporate debt and equity.
- Guarantors should disperse credit risk to private-capital investors through a variety of CRT mechanisms in addition to the loan-level credit enhancement provided by the primary market.
- Guarantors should be stand-alone companies and should not be subject to undue influence by any individual shareholder. For example, individual lenders or bank holding companies should be limited to a maximum 10 percent ownership interest in any Guarantor.
- Guarantors' rate of return should be regulated using a utility regulation framework, with posted and transparent guarantee fee pricing designed to produce a reasonable rate of return for investors. The expectation is that the Guarantors will be low-volatility companies that would pay steady dividends over time, not growth companies that aggressively seek to expand market share or generate above-market returns.
- Guarantors should issue a single uniform type of security for securitizing single-family mortgages.
- The CSP should be established as a self-funding, government-owned corporation and must be accessible to new Guarantors once chartered.

- To reduce barriers to entry for future Guarantors, the CSP should own all GSE historical single-family data. New Guarantors and other market participants should be able to access and analyze this information for an administrative fee.

- The end state should have established mechanisms in place to respond to liquidity disruptions during severe market downturns or catastrophic events. These mechanisms should aim to stabilize the overall housing finance system and not necessarily the Guarantors.

Prudential Regulation

- The end state regulator should have sufficient powers and discretion with respect to capital regulation and other aspects of prudential oversight.

- Single-family loans eligible for inclusion in the government-backed MBS should meet a Qualified Mortgage (QM) type standard and be subject to conforming loan limits established by Congress and adjusted over time based upon home-price appreciation in a manner determined by the regulator. Guarantor credit parameters within the QM-eligibility framework, pricing engines and customer interfaces would be subject to prudential oversight, but should remain proprietary to each Guarantor. Multifamily mortgages of a type and quality similar to those financed by the GSEs today would also be eligible for inclusion in the government-backed MBS.

- Guarantors may not hold mortgage portfolios for investment purposes. However, they may hold a short-term liquidity book to aggregate loans from cash-window operations, a contingency portfolio for loss-mitigation purposes and a limited multifamily portfolio.

- Guarantors that reach a given size should be designated and regulated in a manner similar to systemically important financial institutions (SIFIs).

Market Conduct Regulation

- Charters should expressly maintain a bright line between the primary and secondary mortgage markets, with the Guarantors' allowable activities being limited to the secondary market, to guard against systemic risk concentration and to facilitate competition.

- The regulator should ensure that Guarantors provide equitable, transparent and direct access for lenders of all sizes and types — pricing and program participation should not be based on the loan volume or asset size of participating lenders.

- Guarantors should be required to maintain both cash-window and MBS execution options in order to support large and small lenders alike.

- Guarantors, as a condition of their charter, should be required to support an effective national affordable-housing strategy that helps meet the needs of low-income and underserved households and communities. This strategy should incorporate both single- and multifamily approaches to support homeowners and renters.

In the recommended end state, the Guarantors would be focused exclusively on providing sustainable credit availability to the single-family and multifamily markets in all geographies and through all economic cycles.

Small Lender Access: Why It Matters

It is important to recognize and address in reform legislation the role that limited access to the GSEs played in driving the sharp consolidation that began in the late-1990s. Between 1998 and 2010, the market share of the 10 largest single-family originators rose from less than 40% to almost 80%.

The GSEs played a significant role in driving this concentration. Beginning in the late 1990s, the GSEs competed for business by negotiating market share agreements with the largest volume lenders, providing lower guarantee fees and underwriting exceptions that drove even more business to these institutions. Unable to compete against lower guarantee fees and aggressive underwriting variances, smaller lenders were forced to deliver their loans to the largest lenders. This "aggregation" model played a contributing role in the GSEs' financial troubles by driving underpriced guarantee fees, spreading weak underwriting standards, and concentrating counterparty risk into a handful of aggregators.

In the wake of the crisis, the market share of home mortgage originations from the larger institutions declined sharply. By 2015, large depository institutions' market share had fallen to 21 percent for purchases, and 27 percent for refinances.[A] Several factors — legacy issues with pre-crisis mortgage and servicing portfolios, Basel III rules, regulatory burden and reputational risk in the mortgage business — all played a role in the decision of larger banks to shift their capital into more promising lines of business.

Fortunately for consumers, the gap in funding was filled by independent mortgage bankers (IMBs), whose market share in both purchases and refinances increased from the low-20s in 2008 to nearly 48 percent in 2015. Most of these institutions are smaller companies, but several IMBs grew to become top 20 originators. Community banks and credit unions also picked up market share, despite a decline of more than 1,100 reporting institutions.

Importantly, FHFA helped facilitate the transition through key policy changes intended to strengthen access to the GSEs for smaller lenders, including requiring guarantee fees to be based on the underlying loan risk (not loan volume), and eliminating preferential underwriting standards for selected institutions. Direct access to the GSEs' cash and MBS windows played a critical role in the recovery by ensuring these smaller lenders could provide the liquidity the market needed.

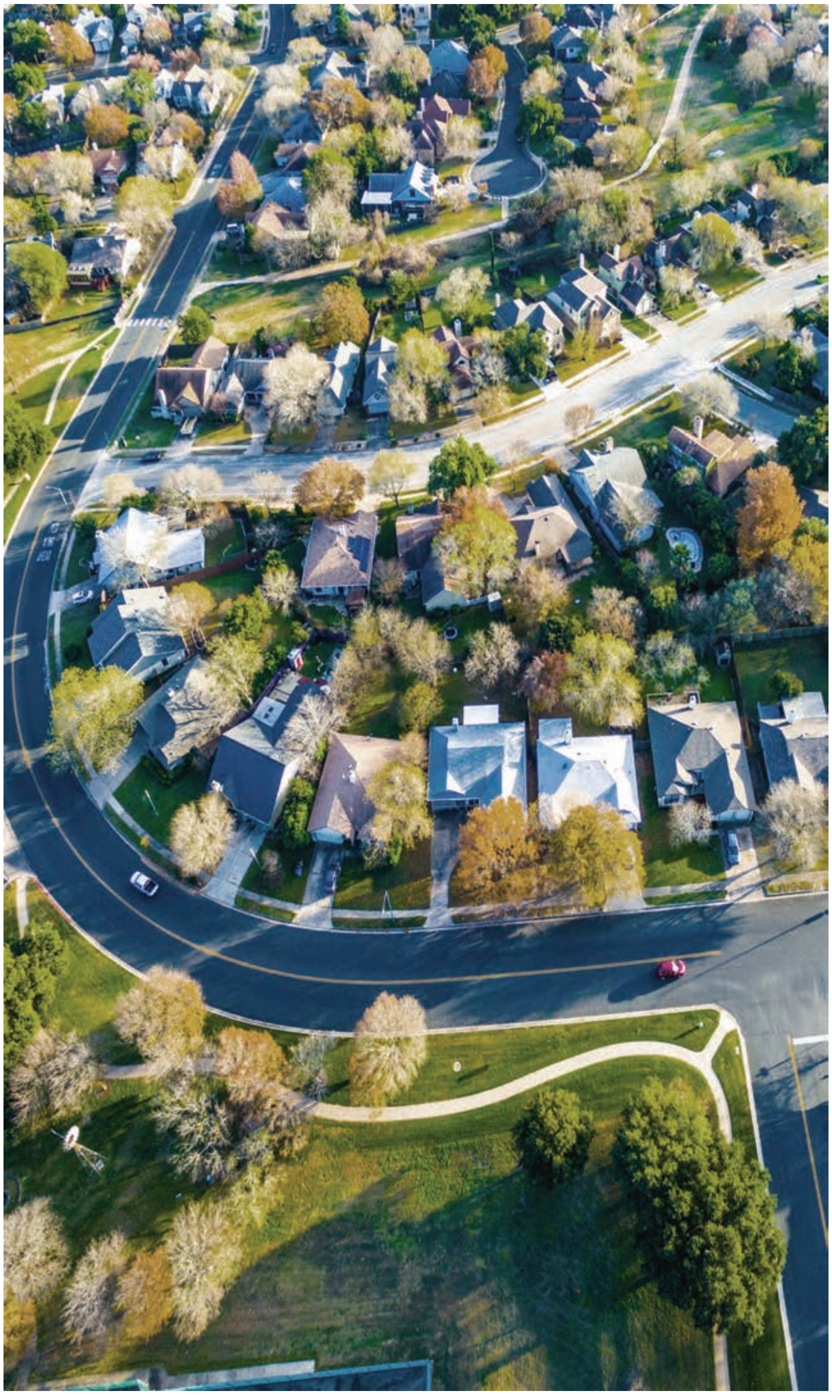
MBA believes that the mortgage market and consumers benefit from a large and diverse base of lenders. Smaller lenders, in particular, play a key role in strengthening the system for consumers by focusing on niche markets and leveraging unique knowledge of local consumer needs. Recent post-crisis research shows that highly concentrated mortgage markets through the 2000s reduced the sensitivity of mortgage rates to movements in the MBS market, and that more competitive local markets tended to narrow primary-secondary market rate spreads and deliver lower rates to consumers.[B]

- To that end, the Task Force's recommendations embody several key small-lender principles:
- Ensure equitable, transparent and direct access to secondary market programs;
- Prohibit G-fee pricing based on loan volume or asset size of single-family lenders;
- Preserve cash window and small pool execution options for smaller lenders;
- Maintain the "bright line" to ensure that Guarantors do not compete with lenders;
- Prevent vertical integration by prohibiting lenders from owning or controlling a Guarantor.

A. *MBA Executive DataBook, 2015 Origination Trends*, © 2016.

B. *Concentration in Mortgage Lending, Refinancing Activity and Mortgage Rates*, NBER Working Paper Series; David S. Scharfstein, Adi Sunderam, Working Paper 19156; http://www.nber.org/papers/w19156.

In the recommended end state, the Guarantors would be focused exclusively on providing sustainable credit availability to the single-family and multifamily markets in all geographies and through all economic cycles.



The End State

In many respects, MBA's proposal is intended to preserve what works in the current system — it supports a highly competitive primary mortgage market composed of lenders of a variety of sizes and business models. Primary market lenders place loan-level credit enhancements; including private mortgage insurance, lender recourse and multifamily risk-share structures. All of these primary market activities take place on one side of the bright line, the dividing line between primary and secondary market activities.

Lenders would sell conventional conforming loans into the secondary market by working with Guarantors. Lenders would also continue to originate and securitize loans utilizing other forms of guaranteed and non-guaranteed options, including Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), U.S. Department of Agriculture (USDA), Ginnie Mae and conventional loans held on bank balance sheets or securitized through private-label securities (PLS).

From a lender's perspective, the process of selling conventional conforming loans should be similar to the current process. Lenders could sell through a cash window or pool loans into securities. The Guarantors, including rechartered Fannie Mae and Freddie Mac and any new entrants, would manage the credit risk on these pools, and would be the issuers of the MBS. Single-family securitizations would utilize the CSP, at which time the explicit guarantee is placed on the MBS for the benefit of investors, ensuring timely payment of principal and interest. A portion of the guarantee fee would be used by the Guarantors to cover the MIF premium.

Each of the Guarantors would issue into a single security. Most likely, the single security would be structured the same as the forthcoming Uniform MBS (UMBS), but will also have an explicit guarantee. Investors will trade single-family MBS through a TBA market similar to today.

Multifamily loans sold to the Guarantors would be securitized in the same manner as today, utilizing current executions such as Fannie Mae's DUS program, Freddie Mac's K Deals, and perhaps other securitization and risk-sharing/transfer structures to be developed by Guarantors and approved by the regulator.

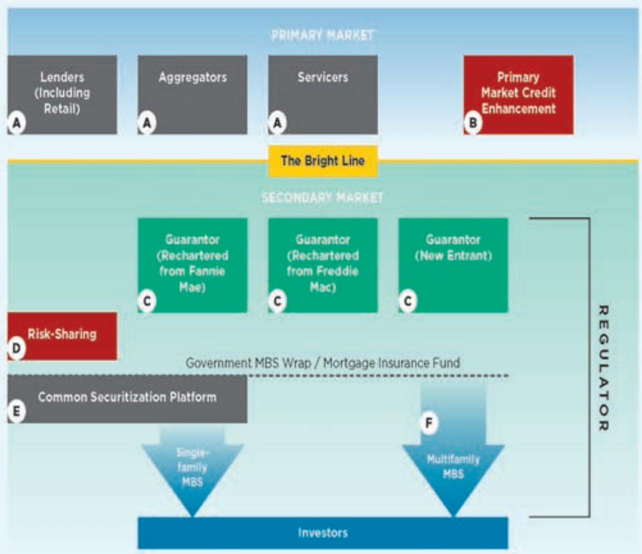
The Guarantors would manage the credit risk on these mortgages through underwriting, retained capital and through front-end and other risk sharing. In addition, Guarantor pricing would be tightly regulated by the regulator just as GSE pricing is tightly regulated by FHFA as conservator.

Number of Guarantors

MBA believes there should be multiple (i.e., more than two) Guarantors that are authorized to acquire eligible loans from lenders and issue government-guaranteed single-family and/or multifamily MBS. Legislation should authorize a process to allow other entities to apply for and receive a charter, similar to the current process for applying for a national bank charter. A new charter could be specific to the single-family market, multifamily market or both markets.

As a utility-style regulator, one of the key factors the FHFA would be required to consider would be the impact of new competitors on both existing Guarantors, on the relevant market and on consumers. Maintaining the balance in the regulatory compact would be an important factor in evaluating new charters. FHFA would determine whether the applicants meet the standards for a Guarantor charter.

End State Model



Primary Market

A. **Single-family lenders (including correspondent aggregators) and servicers.** Would be explicitly afforded "level playing field" in delivery/credit enhancement and pricing terms, regardless of volume. **MF Lenders** would operate in the same fashion as today.

B. **Primary market credit enhancement.** To ensure that private capital assumes most of the credit risk, and that the risk is dispersed rather than overly concentrated, the regulator may require certain levels of single-family loan-level credit enhancement (such as mortgage insurance, lender recourse, loss sharing) and other forms of secondary market risk-sharing (see box "D"). Current MF executions and risk sharing would remain and retain existing platforms, and not be part of the single security.

Secondary Market

C. **Chartered Guarantors.** Monoline, regulated rate of return utilities owned by private shareholders; rechartered Fannie and Freddie could be the first two. Corporate debt NOT backed by government. Acquires loans in order to issue MBS (including SF single security) and credit risk transfer (CRT) instruments; performs master servicer functions. Subject to prudential supervision by FHFA or its successor, including strong regulatory oversight of operations, and supplemental regulation similar to SIFIs. Mortgage portfolios allowed ONLY for liquidity/contingency purposes (esp. for delinquent loan (DQ) buyouts/loss mitigation) and short-term cash window and limited multifamily investment. Would compete on operations/systems development, customer service, certain product innovation (w/in CSP and regulator guidelines) and pricing/execution. Primary regulator would enforce duty to serve requirements. Would remit commitment fee to government for federal wrap on MBS; could also include an affordable-housing contribution fee.

D. **Secondary market risk-sharing.** Reinsurance, structured note and other forms of distributing Guarantor portfolio risk to institutional credit investors. Secondary market risk-sharing, as well as various forms of loan-level credit enhancement (see box "B"), would be used to protect taxpayers and would be actively monitored by the regulator to ensure safety and soundness. Per regulatory determination, risk-sharing requirements could be reduced during a stress environment as part of a countercyclical role.

E. **CSP.** Issuance platform for government-backed single-family MBS. Validates collateral, processes disclosures/issuances. Owns existing GSE historical data/compensating factors analysis and QM compliance engine. Owned independent of Guarantors as a government corporation, and able to facilitate PLS as separate business.

F. **Multifamily.** Existing DUS and K-deal programs are preserved. Could be subject to separate charter to facilitate multifamily-only guarantor.

A credible threat of additional entrants would encourage dynamism and spur the Guarantors to provide better service to their seller/servicers and ultimately to consumers. In addition, the prospect of new Guarantors would ensure that the existing Guarantors have an incentive to compete against each other in areas such as:

- Offering technology solutions and systems for interfacing with seller/servicers;
- Structuring and executing risk-sharing transactions;
- Product innovation;
- Pricing and execution; and
- Customer service.

Operating Structure

From the perspective of a lender or investor, Guarantors would operate in a way similar to how the GSEs operate today to perform critical secondary mortgage market functions. As an example, we strongly urge the continuation of both GSEs' multifamily operations in their current form. The Guarantors' single-family operations would also be similar to today's market, with their activities focused on purchasing eligible mortgages and issuing mortgage-backed securities wrapped by the full faith and credit of the federal government, and dispersing credit risk to private investors.

The Uniform MBS, scheduled to launch in 2019, should be the basis for the single-family MBS issued by the Guarantors in order to maximize liquidity. Guarantors would be provided incentives to distribute credit risk to private market investors rather than retaining all of the risk. Single-family risk transfer would consist of both (1) front-end, lender-arranged primary market credit enhancement like mortgage insurance and lender recourse,

What Is the Bright Line?

CONCEPT IN DEPTH

MBA has historically held that the proper role of Fannie Mae and Freddie Mac is confined to the secondary mortgage market, consistent with their respective charters. We believe that the separation of the primary and the secondary markets has been an important element of what has made the secondary market effective in providing liquidity and making mortgage credit available nationwide. The division between the primary and secondary markets has become known as the "bright line."

The separation of primary and secondary mortgage market activities is embedded in the GSEs' statutory charters. Both GSEs' charters expressly prohibit the use of their lending authority "to originate mortgage loans" — the defining primary market activity.

More broadly, the public purposes set forth in their respective charters, which are substantively similar in this regard, specify a secondary mortgage market role that is responsive to private capital: "To provide stability in the secondary market for residential mortgages; to respond appropriately to the private capital market; to provide ongoing assistance to the secondary market for residential mortgages... by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."

Given the critical role that this separation has played in the nation's mortgage markets, MBA underscores the importance of maintaining the bright line, both as it governs current GSE activities and in our recommended end state.

How Will the Guarantors Compete and Why Will This Competition Benefit Consumers?

The secondary mortgage market benefits from alignment and standardization in many areas. Outside of these areas, however, Guarantors (new entrants and rechartered GSEs) should compete with each other on price, product, and service.

Price

Some question the feasibility of price competition because Guarantors would be restricted by the same capital standards and qualified mortgage (QM) limitations. But think of a close parallel: thousands of banking institutions are subject to similar capital standards and regulation, and yet a variety of business models flourish. Even though all face similar capital standards, they engage in price competition along a number of dimensions.

Others have argued that price competition would be impossible because any competitor with the lowest price for the safest business would skim the cream off of the market, leaving others unable to earn a market return. Adverse selection is always a concern but pricing for risk is rarely one-dimensional and market participants are always dealing with uncertainty regarding potential outcomes, not just risk.

Product

Within the umbrella of Qualified Mortgage status for eligible single-family mortgages, there would be no ability for Guarantors to offer high-risk products such as NINJA (no-income, no-job, no-asset) loans or other non-QM products. But there would be room for product development and product differentiation within the QM rubric.

For instance, new adjustable-rate mortgage (ARM) products that are viable under QM have been developed recently as portfolio products. We are currently in a predominantly fixed-rate market, but if rates do rise as expected, it is likely that the ARM share of the market will increase. Future Guarantors would also compete on product development to meet a range of housing needs (e.g., condos) just as the GSEs do now.

Service

Beyond pricing and product strategy, as any lender knows, service matters, too. The GSEs both have experienced, knowledgeable sales forces with deep understanding of lenders operating in the primary market. With this knowledge, they have been able to provide differentiated offerings of services, along with product and service bundles, which fit large and small, bank and nonbank, publicly held and privately owned customers.

Superior service can win customer loyalty even if the product and pricing strategy is not always the "best." Just like any other business, there are aspects that are difficult to quantify but are nonetheless extremely important.

Of course, poor service can also have an impact. In the post-crisis environment, many lenders were unhappy with the GSEs' approach to repurchase demands and "rep and warrant" enforcement. In a more competitive market, this behavior could have led lenders to move away from the GSEs. In the absence of such competition, lenders had little negotiating leverage.

Even the potential for additional competition can have an impact. Economist William Baumol coined the term "contestable markets" to recognize the fact that if new competitors could potentially enter a market, even that threat of entry can help to ensure that incumbents will provide good service and will keep their pencils sharpened with respect to pricing and product strategy.

What is a "Qualified Mortgage" (QM)?

CONCEPT IN DEPTH

The Dodd-Frank Act's ability-to-repay/Qualified Mortgage (QM) rule requires single-family lenders to determine that a borrower has a reasonable ability to repay a mortgage before the loan is consummated. The rule provides a compliance safe harbor for mortgage loans that are originated as QMs. In order for a loan to qualify as a QM, it may not contain certain "risky" features, such as interest-only or negative-amortization terms, and it must meet specified underwriting standards.

These standards also include a debt-to-income ratio cap of no more than 43 percent, or in the alternative, eligibility for the programs of Fannie Mae and Freddie Mac ("the patch"), the Federal Housing Administration (FHA) or other government agencies. The safe harbor is also limited to loans that are of "prime" quality based on a pricing benchmark. Considering the significant potential liability and litigation expenses for a violation of the rule, many lenders have limited themselves to making only QM "safe harbor" loans.

As a result, some categories of borrowers who should qualify for a QM are having trouble gaining access to safe, sustainable and affordable mortgage credit. MBA is continuing to work with policymakers, including the CFPB, to improve the rule in order to responsibly widen the credit box.

As the QM patch will expire in 2021, legislation and/or regulatory action is necessary to formulate this QM standard going forward.

and (2) back-end structures such as reinsurance and capital markets transactions developed by the Guarantors for the credit-investor market.

MBS eligible for the government guarantee would consist of single-family mortgages that meet current or future QM standards. However, Guarantors would be able to define their own credit criteria within the government's eligibility parameters. Making Guarantor credit decisions open to competition is one of the most important reasons for having multiple competing Guarantors. We believe this approach is superior to a structure in which a single, monopolistic entity provides the government guarantee.

Common Securitization Platform

The Common Securitization Platform is expected to play a significant role in the future single-family market, though repurposed in critical ways. The CSP would be required to facilitate issuance of MBS backed by eligible loans/pools presented by any Guarantor, reducing barriers to entry for future entrants. In connection with its core functions, the CSP would also collect the insurance premiums from the Guarantors and remit them to the Mortgage Insurance Fund (MIF), as described below.

The CSP would also house all GSE historical single-family data. In exchange for an administrative fee, prospective Guarantors and other market participants would be able to access this data. Transferring historical data to the CSP and making it available will provide more opportunities for standardization and transparency, while removing a critical barrier to entry for future Guarantors.

Because the CSP's functions are those of a natural monopoly — the sole entity that can review and certify conventional single-family MBS as eligible for issuance with a government guarantee — the CSP should be established as a government corporation under the direction of the FHFA. As a government corporation, it would not rely on federal appropriations and would fund its operations exclusively through the fees it collects as part of the issuance and guarantee process.

The Common Securitization Platform (CSP): What is it? How is it Funded and Regulated?

What is the CSP? As described by Freddie Mac, the "CSP is a technology and operational platform that is being developed by Common Securitization Solutions, LLC, a joint venture of Fannie Mae and Freddie Mac. CSP will perform many of the core back-office operations for the Single Security, as well as most of the Enterprises' current securitization functions for single-family mortgages, on behalf of the Enterprises. The CSP is necessary for the implementation of the Single Security."

Why is the CSP important? The CSP provides many potential benefits. First, it has significantly upgraded the core infrastructure at the heart of the agency MBS market. Second, by updating it jointly for Fannie Mae and Freddie Mac, it has fostered the alignment necessary to support the Single Security.

Beyond the benefits to the market while the GSEs are in conservatorship, the CSP also paves the way for new entrant Guarantors under the recommended end state. To make a transportation analogy, without a CSP, a new entrant would need to lay the tracks for a new railroad along with buying the locomotive and train cars. With the CSP, it will still be a major effort to launch a new Guarantor, but the infrastructure will be in place and available, dramatically lowering the barriers to entry, particularly as the new Guarantor would also be able to issue into the Single Security.

How will it work in the MBA model? Currently the CSP is a joint venture of Fannie Mae and Freddie Mac. The CSP should be carried forward in the new end state, with new entrants given the opportunity to directly connect once they have received their Guarantor charter from the regulator. However, MBA believes that a better long-term structure for the CSP would be as a government corporation overseen by FHFA. Fannie Mae and Freddie Mac would be compensated for their shares of the CSP as part of the transfer to a government corporation.

The CSP would be run by its own executive with the authority to hire staff and budget to keep the platform operating efficiently. FHFA would manage the MIF, but the operational task of issuing MBS with the explicit guarantee would fall to the CSP. The CSP would be funded through administrative fees on the issuance of MBS and not through federal appropriations. Given its status as a government corporation, it would target a modest rate of return to ensure adequate staffing and necessary technology upgrades over time.

Why government ownership? As the foundation of the secondary market's critical infrastructure, the CSP in economic terms is a "natural monopoly," with economies of scale such that it makes sense to only have a single operator. Moreover, in this role, the CSP truly cannot fail, for if it did, the market would shut down. The two choices available in this type of situation are for the government to form a corporation to operate the entity or for the government to bless and then tightly regulate a financial market utility that may be cooperatively owned. MBA believes that a government corporation makes more sense, as it eliminates the concerns with respect to a private entity being too big to fail. However, as the debate develops, the choice between the relative merits of a government corporation versus a financial market utility should continue to be considered.

What are some examples of Government Corporations? Several representative government corporation models illustrate the wide variety of structures of federal government corporations, including Ginnie Mae, the Federal Deposit Insurance Corporation ("FDIC") and the Pension Benefit Guaranty Corporation ("PBGC"). These examples warrant further study as possible models for the CSP.

Privately Owned Utility Model

MBA believes that the Guarantors should be owned by private shareholders and regulated as utilities. Private ownership would better encourage ongoing investment in the Guarantors, allowing them to keep pace with market demands and technological developments.

Prior to the crisis, Fannie Mae and Freddie Mac operated as "growth" companies, aggressively pursuing market share, leveraging their capital and implied guarantees, and promising investors growth-stock returns on equity. MBA believes that, given their unique ability to distribute the government guarantee, chartered Guarantors should be required to focus on long-term, steady returns that support a stable housing finance delivery system similar to the way public utilities must support power, water or other critical infrastructure.

Management of the Guarantors should be focused on providing a steady, although not risk-free, stream of dividends over time. The lower-risk, lower-volatility equity investment in the Guarantors should be attractive to investors seeking a competitive, risk-adjusted rate of return while receiving higher dividend yields than are available from fixed-income instruments.

What Is the Single MBS?

CONCEPT IN DEPTH

One of the strategic goals of the Federal Housing Finance Agency is to develop a single mortgage-backed security in the single-family market that could be issued and guaranteed by Fannie Mae or Freddie Mac. Currently, the securities issued by the each of the GSEs are not interchangeable with one another. A single MBS would enhance access to the TBA market, improve overall liquidity, reduce costs to taxpayers, lower barriers for prospective new entrants, and lay the groundwork for a more competitive and efficient secondary market. MBA strongly supports this effort.

As regulated rate-of-return utilities, the Guarantors would have the following characteristics:

- Operated as monoline businesses;
- Directed by charter and regulation to serve the defined public purposes of ensuring mortgage liquidity and broad access to credit;
- Subject to tight regulation of their activities and strong corporate governance;
- Owned by patient-capital investors;
- Held to explicit capital requirements by their regulator; and
- Incentivized by profit motive to innovate and compete.

Although our proposal would not require the Guarantors to be mutually or cooperatively owned and managed by lenders, we believe the new regulatory system should permit the chartering of lender-owned mutuals, provided ownership was broadly distributed. For example, no single lender or bank holding company should be permitted to hold more than a 10 percent ownership interest,[1]

1 A 10 percent ownership limitation to prevent undue influence would be comparable to a provision in Federal Reserve regulations that establishes a rebuttable presumption of control when a person, or persons acting in concert, acquire a 10 percent interest in a state member bank or bank holding company. See 12 CFR 225.419(c).

to prevent it from having undue influence over the Guarantor. A mutual or cooperative structure could prove to be an attractive option for either of the successors to the GSEs or a new Guarantor entrant.

In addition, reform should establish mechanisms to address liquidity disruptions during severe market downturns that would aim to stabilize the overall housing finance system and not necessarily the Guarantors.

Capital

To ensure that additional private capital is placed at risk ahead of the MIF, the federal government and taxpayers, MBA's proposal would give the regulator authority to set specific capital levels, both risk-based and overall leverage limits/ratios. In making that recommendation, we recognize that setting capital requirements is a complex exercise and that setting them correctly is vital, particularly since the GSEs were insufficiently capitalized to survive the financial crisis.

Establishing the appropriate level (and types) of capital depends upon the credit quality of the underlying loans, on an understanding of stressful environments, their likelihoods and their impacts on credit losses. Moreover, capital requirements cannot be set in isolation. Capital standards should require similar capital for similar risks, regardless of the charter or business model of the entity holding the risk. When that is not the case, there will be regulatory capital arbitrage, with loans flowing to whichever entity has the lower capital requirement for each type of loan, rather than the entity that is best equipped to hold and manage the risk. Fannie Mae and Freddie Mac were insufficiently capitalized to survive the crisis. MBA's proposal requires that Guarantors have sufficient capital to cover all but catastrophic risk.

Congress should have the regulator develop a stress loss capital standard rigorous enough that Guarantors meeting that standard could have withstood the Great Recession. These capital requirements for the Guarantors, including the types of instruments that count as capital, should be consistent with the capital requirements for single-family and multifamily mortgages set for banks and other competing investors in mortgages such as insurance companies, in order to ensure that similar risks require similar capital, regardless of where those risks are held. The capital base for the requirement should primarily be composed of Tier 1 capital, i.e., common and preferred equity, but should also provide capital relief to the Guarantors for distributing rather than retaining credit risk, so long as this is done on an economically sensible, equity equivalent basis.

Background on the regimes governing banks, insurance companies, SIFIs and the impact of credit risk transfer mechanisms should be looked to as guides for the development of Guarantor capital requirements.

Bank Capital Requirements and Supervision

The objective of bank capital regulation is to reduce the probability of a bank failure, which could put the taxpayer at risk as the government insures deposits. Bank capital regulation has evolved considerably over the past 30 years. In 1988, Basel I, developed by the Basel Committee on Banking Supervision, introduced the notion of risk-based capital requirements, with different risk weights applied to different types of assets. For example, Treasury securities carried a zero percent weight, agency MBS a 20 percent risk weight and residential mortgages a 50 percent risk weight. Banks were required to have total capital, composed of both common and preferred equity, subordinated debt and other components, of at least 8 percent of risk-weighted assets. Thus, for mortgages, banks were effectively holding 50 percent risk-weighted capital (half of 8 percent = 4 percent), almost 10

Regulated Utility Model: How Does it Work?

MBA has proposed that the Guarantors be regulated similar to investor-owned utilities. The core justification for utility style regulation rests with the premise that the privately-owned utility derives much of its existence and its powers from the state.

The key tenet of regulating privately-owned utilities is the "regulatory compact:" private firms that are granted an exclusive or limited number of franchises accept the responsibility (and the regulatory oversight) to serve customers in an efficient and nondiscriminatory manner. This compact requires a balancing of interests by the regulator:

"Investors will only provide capital for provision of utility services if they anticipate obtaining a return that is consistent with returns they might expect from employing their capital in an alternative use with similar risk; customers will only accept utility rates if they perceive that the rates fairly compensate the utility for its costs, but are not excessive as a result of the utility taking advantage of its privileged position."[A]

In addition to the legal and economic rationale for utility-style regulation of the Guarantors, this framework is also intended to directly address the problematic growth-company models and mindsets that existed at the GSEs prior to the financial crisis. The compulsion to grow led to excessive risk taking in a reach for market share, an unhealthy focus on the portfolio businesses and encroachment on the bright line, as the GSEs leveraged their duopoly power to grab an ever-larger share of industry profitability.

By contrast, investor-owned utilities — and their regulators — aim to provide shareholders with a steady dividend over time. Utilities are encouraged to deploy large capital outlays in relatively low risk, regulated business models to achieve stable outcomes for investors and consumers. Companies with this mindset and culture in competitive markets compete through more efficient operations, product and process improvements, and customer service.

Investor-owned utility regulation is based on "cost of service regulation." The regulatory compact requires a two-fold focus:

"(1) establish prices based on the actual prudent costs (i.e., avoid monopoly pricing); and

(2) provide incentives to maintain a reasonable level of efficiency in serving the customers. Rates are set with reference to the Total Revenue Requirement (TRR)..."[B]

Regulators can directly monitor and control rate of return or pricing. For monopolies, regulators may set rates based upon observed costs and an agreed-upon level of return. In markets with multiple utilities operating, those with significant market power may be held to regulated, cost-based rates, while new entrants may be allowed greater flexibility to charge market-based rates.

Typically price regulation in these markets requires nondiscriminatory pricing across the customer base, i.e., there is a level playing field. Pricing also tends to be transparent, with rates and the rate calculation posted for public input.

Clearly many aspects of this style of regulation and business model are good fits for the role of Guarantors in a future market. Moreover, FHFA in its role as conservator has moved regulation of pricing in this direction already, with more level and more transparent pricing than was the case pre-crisis.

A. *Cost of Service Regulation in the Investor-Owned Electric Utility Industry: A History of Adaptation;* Dr. Karl McDermott, Edison Electric Institute. 2012.

B. Ibid.

times the GSE requirement. Additionally, banks were held to a leverage limit, which required that capital made up at least 4 percent of their total assets.

By the mid-2000s, bank regulators were concerned that the simple risk-based capital weights were causing distortions in the financial markets because these weights did not align with the underlying risk — and in fact in many cases led to regulatory capital arbitrage — where banks were holding riskier assets that had relatively low risk weights while selling safer assets that had higher risk weights. Within the mortgage market, an example was the ability of a bank to sell a low-risk mortgage with a 4 percent capital requirement in exchange for an MBS with a 1.6 percent capital requirement, but that might hold a higher-risk mortgage that could be a profitable investment at the 4 percent capital level. This led to a large incentive for banks to securitize conforming mortgages with the GSEs and hold the MBS. Given that the GSEs were only required to hold 0.45 percent against the off-balance-sheet MBS, the financial system as a whole held less capital against the mortgages than would have been the case if the loans had remained on bank books.

Basel II was an attempt to provide a more flexible risk-based approach, but the effort in fact may have led to too little capital in the banking system.

Following the crisis, Basel III was an effort to enhance the quantity and quality of capital backing the banking system. Regulators and accounting treatment brought more assets onto the balance sheet. There was also a move to both higher minimum capital ratios and a greater reliance upon common equity as the primary form of loss-absorbing capital. The risk weights for holdings of residential mortgages were left unchanged. However, the risk-based capital treatment of mortgage servicing rights (MSRs) was much more severe, with an effective cap of 10 percent of equity capital and a higher risk weight.

Another change post-crisis has been much greater regulatory action around stress testing. The Comprehensive Capital Analysis and Review (CCAR) program is a horizontal review of large banking organizations. The Federal Reserve provides a set of adverse economic scenarios the large banks use to simulate how their organizations would fare with respect to having sufficient capital. The Fed then uses the results of these stress tests as an input into its approval of bank dividend and stock buyback programs. Regulators are viewing stress tests as a more dynamic approach to measuring a financial institution's strength. (FHFA requires that Fannie Mae and Freddie Mac conduct a similar exercise using the stress scenarios posited by the Fed.)

Insurance Capital Requirements

In the United States, insurance is regulated at the state level, with some consultation among the different state regulators. Insurers are also regulated against capital standards, but these are often expressed relative to risk-in-force rather than total or risk-weighted assets. Insurance regulation is also more likely to see a stream of future premiums as a source of loss-absorbing capacity, and hence looks to be sure that pricing is sufficient to cover losses under all but the most catastrophic scenarios.

In MBA's proposal, with the Guarantors having only a minimal investment portfolio holding assets of short duration, insurance regulatory concepts may become more applicable than bank regulatory concepts.

SIFI Requirements

Dodd-Frank gave the Financial Stability Oversight Council (FSOC) the authority to designate financial firms systemically important financial institutions (SIFIs) if they "could pose a threat to the financial stability of the United States." SIFIs are subject to oversight from the Federal Reserve and stricter capital requirements. At present, bank holding companies with more than $50 billion in assets are subject to SIFI regulation. Four non-bank SIFIs have been designated. SIFIs are subject to tougher regulatory oversight than their smaller and less complex competitors.

Should they meet that threshold, Guarantors should be held to SIFI-consistent capital requirements and regulatory supervision to eliminate the potential for regulatory capital arbitrage. Capital requirements should be set in consultation with the Federal Reserve, FSOC and Treasury. Guarantors should also be subject to regular stress tests comparable to, if not part of, the CCAR process.

Institutions that exceed the SIFI threshold are not "too big to fail." However, they may be too big to resolve quickly. As a result, they are required to adhere to stricter regulation to ensure that they have sufficient resources to be sustained through a crisis and longer resolution period.

GSE Capital Requirements Pre-Crisis and through HERA

In the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Congress precisely defined the contours of an economic scenario that would form the basis for Fannie and Freddie's risk-based capital requirements, and also defined minimum capital levels, which would limit the GSEs' leverage.

For loans or securities kept on balance sheet, the minimum capital requirement was 2.5 percent, while for MBS that were guaranteed but sold to other investors, the minimum requirement was 0.45 percent. These capital levels were found to be inadequate through the crisis as default rates exceeded 12 percent for certain mortgage vintages, with loss rates above 4 percent.

In the wake of the crisis, accounting rules and bank regulatory standards changed in a manner to bring assets and liabilities that were previously considered "off balance sheet" onto the balance sheet through consolidation.

The Housing and Economic Recovery Act, passed in the summer of 2008, provided the FHFA director broader authority and more discretion with respect to both risk-based and minimum capital requirements for the GSEs. These authorities were not really utilized as the GSEs were subsequently placed into conservatorship. Note that guarantee fees charged by Fannie Mae and Freddie Mac have roughly tripled through the conservatorship period, a symptom of the implied capital standards for the GSEs being increased substantially. As shown in the chart below, another indication of this implicit increase in capital is that rates on 30-year fixed jumbo mortgages, which previously had been 25-50 basis points higher than those for conforming loans, crossed over in 2013 and since have regularly been lower than conforming rates. This suggests that current implied capital levels for the GSEs are similar to those embedded in bank pricing models for jumbo mortgages.

Capital Relief for Distributing Rather than Retaining Credit Risk

GSE reform legislation should have the regulator set a "system level" of capital that ensures that all but catastrophic risk is borne by private capital. However, the regulator should also be required to develop a framework for the Guarantors to distribute rather than hold risk when it is economically sensible to do so. Thus, the capital requirements should count Guarantor capital, but also provide relief to the extent that Guarantors lay off the risk in a bona fide manner through front-end and back-end risk sharing, i.e., distribute the risk to be borne by mortgage insurance (MI) capital, lender capital and fully funded capital market structures.

The regulator should grant such CRT capital relief for approved structures and counter parties that have proven capability to absorb losses over the market cycle. Capital relief from CRT, either front-end or back-end, should be evaluated on an equity equivalent basis, i.e., the economic benefit of the transfer should be measured relative to another dollar of equity capital. Credit should be given only when risk-share capital is truly committed and targeted to cover losses ahead of the Guarantors.

What Is the Capital Requirement Measured Against?

The capital requirements set forth in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 differed for balance-sheet assets versus off-balance-sheet obligations. Given the accounting and regulatory changes to bring more assets and liabilities explicitly on balance sheet, that distinction likely should not be maintained.

However, the nature of the risks is different. Assets on the cash balance sheet need to be financed, and given the nature of the assets, the interest-rate risk is quite large and demands its own capital. Guarantees on MBS held by others result in credit risk exposure. Note that on Fannie Mae's and Freddie Mac's balance sheets, assets financed by Fannie Mae with debt are tracked separately from loans held in trusts for MBS investors.

MBA believes that Guarantor investment portfolios should not only be limited in terms of size, but also have strict parameters with respect to allowable investments. For example, loans held for purposes of aggregation should only be held for a limited period of time as determined by the regulator. Delinquent loans purchased out of pools should be sold as nonperforming loans (NPLs) or reperforming loans (RPLs) within a defined time period, barring a systemic risk event, at which point the regulator may grant a reasonable extension.

In sum, the risk-based capital standard for Guarantors should be set with respect to the entire credit book and potential losses in a stress environment. The regulator should establish Guarantor capital standards that are aligned with the Guarantors' risks, including the impacts of credit risk transfer, and they should be consistent with other capital regimes (such as the banking and insurance industries) for comparable risk exposures. These requirements would be more stringent for entities subject to SIFI-like regulation. The regulator's judgment as to capital adequacy should also be informed by the results of stress testing, such as the CCAR process or a similar adverse-scenario exercise.

Multifamily Considerations

Multifamily rental housing is a critical part of the U.S. housing market and our communities. More than 18 million households live in multifamily rental housing — a development with five or more units — and this includes workforce rental housing, seniors housing, student housing, rental properties that primarily serve low- and moderate-income families, and market-rate rental housing. While the GSEs' multifamily businesses are not as large as their single-family counterparts, their role is vitally important in supporting a necessary element of the housing continuum.

MBA's end state recommendations encompass both the single-family and multifamily roles of the GSEs. At the same time, we recognize that certain recommendations apply to specific market segments. For example, the single security concept, the continuation of the TBA market, the CSP and others are relevant to the single-family mortgage market. Likewise, the unique elements of the multifamily finance business should inform the application and implementation of policy changes to the multifamily lending sector and the GSEs' role therein.

In particular, the strengths of the existing multifamily finance system and infrastructure should be carried over into the newly chartered Guarantors. As noted below, both GSEs' multifamily businesses have experienced very low default rates, even during the financial crisis, and their predominant multifamily business executions have incorporated significant private capital through risk-sharing and risk-transfer mechanisms. In addition, given that the GSEs do not play the same dominant role in multifamily finance as in single-family finance, there is strong competition among a range of capital sources in apartment lending — with banks, life insurance companies, commercial mortgage-backed securities and other market participants competing actively in this sector.

Because of the nature of multifamily lending, the underlying real estate asset and the competitive environment in multifamily housing finance, the application of our recommendations and any action by policymakers should take into account the unique attributes of the GSEs' core activities in this market. Whether in crafting the specifics of regulations to implement the end state framework, the treatment of multifamily loans under regulatory capital standards or the details of the transition process such as the possibility of stand-alone multifamily Guarantors — we recommend that the characteristics of the underlying business line define the application of policy changes governing the GSEs.

Taxpayer Protection

In our recommended end state, taxpayers would be protected by a clear set of market conduct rules, prudential requirements and the MIF.

First, eligibility standards, established by FHFA, would restrict the mortgages the Guarantors can acquire to safe, stable Qualified Mortgages and well-underwritten multifamily mortgages, mitigating the potential credit risk. In addition, competition based on underwriting concessions or pricing benefits — especially when such benefits are based on delivery volume — would be prohibited.

Second, Guarantors would be engaged in both front-end risk sharing (such as private mortgage insurance and recourse) as well as laying off risk through back-end structures such as reinsurance or structured risk transfers for credit investors. Existing multifamily risk share (with lenders) and risk transfer (with investors) would be utilized in the multifamily sector. The regulator would assess the depth of such risk transfers to ensure they would be sufficient to absorb losses in all but the most catastrophic scenarios.

Third, Guarantor capital requirements would be significantly higher than under the old system for Fannie Mae and Freddie Mac.[2] Capital standards similar to those established for mortgage assets held by banks would likely have allowed the GSEs to survive the 2008 crisis.[3] FHFA would set such standards and apply corrective-action supervisory measures to ensure Guarantor capital is maintained.

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2 The GSEs' capital ratios were well below 2 percent in the years immediately preceding the financial crisis. Congressional Budget Office, *The Effects of Increasing Fannie Mae's and Freddie Mac's Capital* (October 2016), https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/52089-gse-report.pdf.

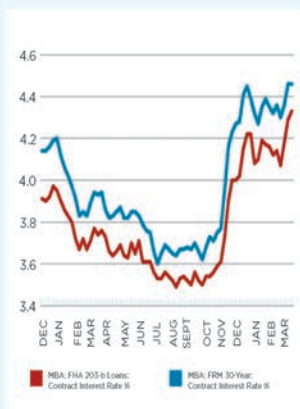
3 12 U.S.C. § 1821(n).

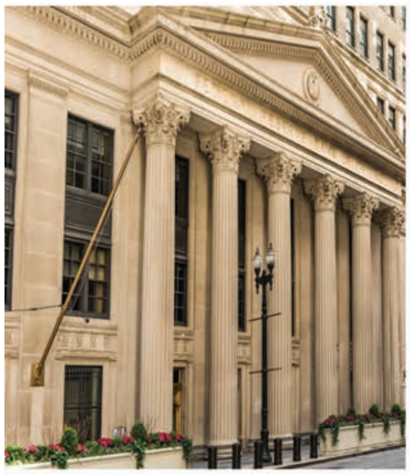
Proposal's Impact on the Cost of Mortgage Credit

Under our proposed model, higher capital standards for the Guarantors and increased levels of private capital at risk would produce somewhat higher consumer and borrower costs. Guarantee fees are likely to be modestly higher than today given the increase in private capital required at the Guarantor level.

However, moving to an explicit federal guarantee should increase the value of MBS, offsetting some of the higher costs to consumers. The chart shows a comparison between FHA and conforming conventional mortgage rates over the past few years. A primary reason for the higher price on the Ginnie Mae securities is the full faith and credit guarantee behind those MBS. Fannie Mae and Freddie Mac MBS are backed by the Treasury through the PSPAs, but even the relatively small distinction in the current environment leads to a marked difference in price. At a consumer level, note the spread (chart below) between mortgage rates on conventional vs. FHA loans.

Ultimately the system will be more stable over time and hence the mortgage market will be available to consumers, even during severe downturns — a benefit that is worth the trade-off of modestly higher costs.





Finally, the MIF would add an additional layer of taxpayer protection in the case of a catastrophic or systemic market disruption. In exchange for the explicit guarantee, Guarantors would pay an insurance premium on each MBS issued. This fee would be deposited into the MIF managed by the FHFA. After a transition period, the MIF would be required to maintain a minimum level of reserves as insurance on outstanding MBS.

The MIF would be called upon to make timely payment of principal and interest to MBS investors in the event of a failure of a Guarantor. Only if the MIF were fully exhausted would there be a cost to taxpayers. Under these circumstances, the remaining Guarantors would be charged higher insurance premiums going forward to pay back taxpayers and rebuild the MIF reserves to their required reserve ratio, similar to the FDIC's practices with the Deposit Insurance Fund (DIF).

Transition: From Status Quo to End State

Although the GSEs' transition out of conservatorship remains among the most critically important components of comprehensive GSE reform, this subject has not received the significant analytical treatment it deserves. This section seeks to describe the objectives of the transition process and to provide some concrete detail as to what would be involved in its successful implementation.

The overall goal of transition is to execute the steps necessary to move to a more sustainable, vibrant secondary mortgage market, while preventing and mitigating any potential adverse impacts to liquidity and the availability of mortgage credit. Upon enactment of GSE reform legislation, the transition from the GSEs to two newly chartered Guarantors operating under a suitable regulatory framework would occur over a multiyear period. The transition would encompass both operational and ownership elements. It would involve the transformation of the government-controlled GSEs into privately owned Guarantors with new charters, subject to new regulatory requirements. The transition should also open the door for new entrants seeking a Guarantor charter and attract greater levels of risk-bearing private capital to the housing finance system.

To convert the GSEs to Guarantors, and to allow for the chartering of new Guarantors, GSE reform must provide a mechanism to relieve the GSEs of their existing statutory charters, recharter them under the new regulator-conferred charter and create a process for new entrants to obtain such a charter. The transition examples discussed below are possible options that demonstrate that this can be done while keeping operations functioning. Other options may also be viable, subject to the guiding principles below that focus on market liquidity and operational stability throughout the transition process.

Notably, certain key decisions will affect the transition, including decisions as to the corporate structures used for the transition, the extent to which FHFA transfers GSE assets and liabilities to new entities, the treatment of untransferred assets and liabilities, and statutorily directed modifications to the Preferred Stock Purchase Agreements (PSPAs). GSE reform legislation may specify the outcomes of such decisions or delegate decision-making authority to FHFA.

Transition Principles

The overarching objective for any transition process must be to minimize risks to liquidity and stability of the mortgage markets. As a result, the following principles should guide the transition process:

- **Clear Road Map and End State.** To promote market understanding of the transition, GSE reform legislation should outline the transition road map in sufficient detail, including steps that must be completed prior to chartering the Guarantors. The legislation should also clearly identify the target end state.

- **Continuity of Business Operations and Government Backstop.** To foster continued liquidity and market stability in the single-family and multifamily markets, and to support the preservation of the TBA market, the business operations performed by the GSE should continue throughout transition. In addition, it is critical that the government backstop now provided through the PSPAs remain in place at least until the new end state is fully functioning, capitalized and replaced by an explicit government guarantee at the MBS level.

- **Preserve and Leverage Existing Assets and Infrastructure.** To reduce operational risks, the transition should leverage existing human capital and operational processes at both GSEs and build on reforms that FHFA and the GSEs have already put into place during conservatorship. Where legacy technology can be upgraded during this process, those opportunities could be explored.

- **Utilize Existing Regulatory Framework Where Appropriate.** To reduce implementation risks, GSE reform legislation should leverage FHFA and its existing legal authorities and the existing regulatory framework as the starting point, modified as necessary to accomplish the objectives of GSE reform, as well as actions it has taken as conservator for the GSEs.

- **Regulatory Flexibility.** To allow FHFA to react promptly to changing conditions in the mortgage market and for the Treasury Department to divest its ownership stake in the GSEs in prudent fashion, the transition should provide the regulator with adequate flexibility.

- **Guarantors as Viable Businesses.** To enable the Guarantors to emerge from transition as privately owned entities that can sustainably support a secondary mortgage market, the transition process and regulatory requirements should enable the rechartered GSEs and any newly chartered Guarantors to be viable businesses with sufficient (but not guaranteed) prospects of long-term value to attract private capital.

- **Multiyear Transition Period.** To give FHFA sufficient time to put the necessary infrastructure into place, enable the Guarantors to meet regulatory capital standards and reduce the risk of market disruption, the transition should occur over a multiyear period.

The Three-Phase Transition

Upon the enactment of GSE reform legislation, the transition would consist of three phases, as illustrated below:

1. Preparation,

2. Implementation; and

3. Divestiture by the federal government.

While the steps within each phase may occur concurrently or in an order different from how they are listed, the transition should complete each phase before moving on to the next one.

Phase 1: Preparation

The Preparation phase establishes the regulatory foundation and creates the infrastructure necessary to carry out the Implementation phase.

Comprehensive Transition Plan

Congress should direct FHFA to develop a Comprehensive Transition Plan. This plan should describe in detail the activities that will occur during the Preparation phase, including steps to mitigate the risk of disruption. It should also outline the key decisions that must be made as well as the mechanics for carrying out those decisions. The plan should also address the need for FHFA resources, personnel and infrastructure to establish, administer and set premiums for the MIF; supplement the existing regulatory framework with new regulatory authorities; and otherwise administer the transition. The plan must also include a communications component aimed at enhancing transparency and providing critical information to market participants.

Regulatory Framework

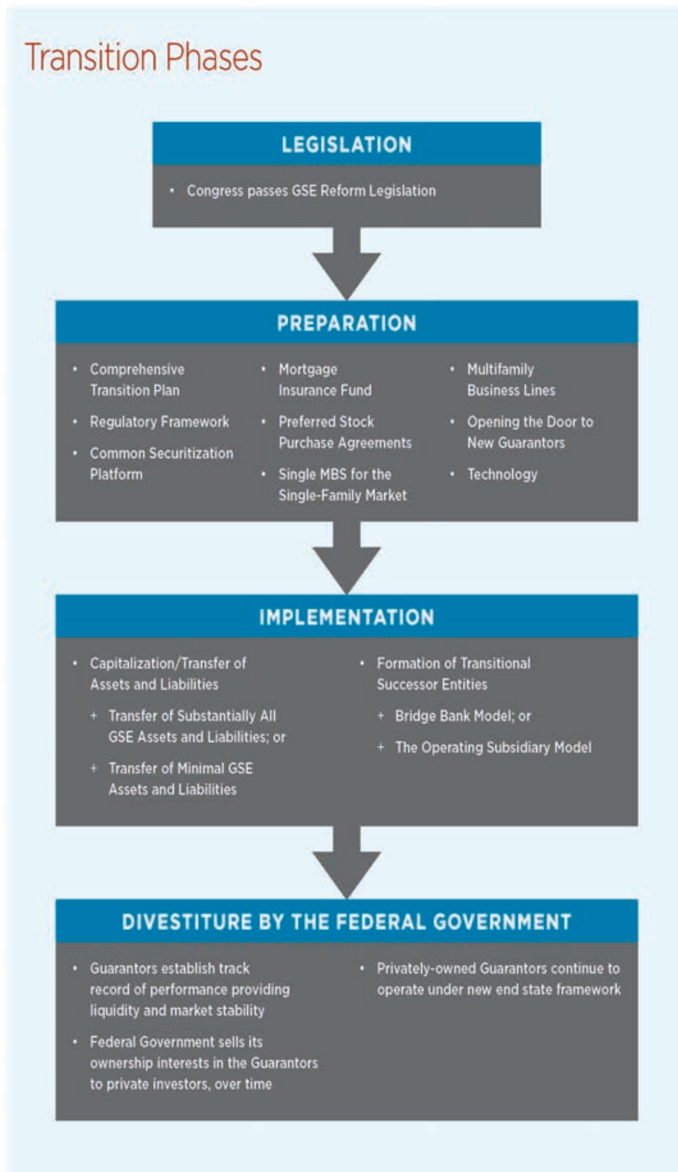
To regulate the Guarantors from the time they are granted their charters, FHFA would need to have a new regulatory framework substantially in place prior to the start of the Implementation phase. Because the charters and functions of the Guarantors will be different from those of the GSEs, FHFA will need to review its regulations and implement any necessary amendments or issue new regulations. FHFA would similarly need to review and revise other regulatory issuances, such as policy and examination guidance or examination procedures. While existing FHFA regulations should be leveraged, the development of the regulatory framework could require some time to complete.

Common Securitization Platform

Today the two GSEs jointly own the Common Securitization Platform (CSP). Our proposed end state includes a transfer of ownership of the CSP and its conversion to a government corporation. Congress or FHFA might also consider other ownership/governance models that would advance the principles and guardrails we have identified.

Mortgage Insurance Fund

Legislation would direct FHFA to establish the MIF and implement regulations and processes for setting premiums, processing claims and otherwise operating the MIF.


Transition Phases
LEGISLATION
• Congress passes GSE Reform Legislation
PREPARATION
• Comprehensive Transition Plan
• Regulatory Framework
• Common Securitization Platform
• Mortgage Insurance Fund
• Preferred Stock Purchase Agreements
• Single MBS for the Single-Family Market
• Multifamily Business Lines
• Opening the Door to New Guarantors
• Technology
IMPLEMENTATION
• Capitalization/Transfer of Assets and Liabilities
+ Transfer of Substantially All GSE Assets and Liabilities; or
+ Transfer of Minimal GSE Assets and Liabilities
• Formation of Transitional Successor Entities
+ Bridge Bank Model; or
+ The Operating Subsidiary Model
DIVESTITURE BY THE FEDERAL GOVERNMENT
• Guarantors establish track record of performance providing liquidity and market stability
• Federal Government sells its ownership interests in the Guarantors to private investors, over time
• Privately-owned Guarantors continue to operate under new end state framework

Preferred Stock Purchase Agreements

While the GSEs together have drawn approximately $187.5 billion from the PSPAs, approximately $258 billion remains collectively available to the GSEs under the PSPAs' current terms. To foster liquidity and market stability, Congress should direct Treasury and FHFA to amend the PSPAs to ensure that they provide an appropriate MBS-level backstop for the GSEs' existing MBS. As discussed below, GSE reform legislation could direct that the PSPAs be amended to permit the Guarantors to build capital by retaining earnings after they begin operations and before Treasury sells its equity interest in them.

If preserving the PSPA backstop is not an option, Congress could grant an explicit guarantee to the existing MBS and other legacy GSE obligations; or the GSEs, rechartered as Guarantors, could establish a voluntary exchange mechanism for investors to obtain an explicit guarantee on existing MBS. Accounting and tax considerations may lead investors to desire to retain their existing securities. The actual risk borne by taxpayers as to GSE obligations would diminish as the existing book ages.

Single MBS for the Single-Family Market

One of the most important steps of the transition will be to determine how best to move from an implicit to an explicit guarantee on the MBS without harming the liquidity of the outstanding $5 trillion MBS market. The GSEs have developed a liquid forward market for mortgage-backed securities for the single-family market, which is generally referred to as the TBA market. The TBA market enables lenders to hedge risk, attracts private capital to mortgage markets and reduces the cost of mortgage lending.

On this issue, the drive to develop a single and fungible GSE security for the single-family market is particularly instructive. In 2019, both Fannie Mae and Freddie Mac are expected to issue the UMBS with the same payment-delay and investor-disclosure features. Freddie Mac will also offer an exchange for investors, providing UMBS in exchange for its outstanding Participation Certificates or a cash payment. The UMBS is an important step toward a true single security.

In the new system, the Guarantors, including new entrants, should issue only a single security for the single-family market. The key features of a single security — including an exchange mechanism between the old and new securities — are essential in order to reap the consumer benefits of the TBA market.

Although making securities from different Guarantors fungible and able to be commingled in a second-level securitization will be beneficial in terms of leveling the playing field between Fannie Mae and Freddie Mac, the move to a true single security will enable new entrants to successfully compete in the secondary market. As an analogy, consider the recent changes in the Ginnie Mae market. Previously most issuance was in the Ginnie I security, where each of the hundreds of issuers pooled loans into their own issuances. Investors could track the performance of individual issuers, and may have expressed preferences for particular lenders given their propensity to have faster or slower prepaying collateral. Recently, for many reasons but also to benefit smaller issuers, Ginnie Mae has encouraged more volume into the Ginnie II security, which is a large pool composed of loans from many different issuers. This approach of pooling loans from different Guarantors into a single issue, a true single security, may be beneficial for market liquidity and may also help new Guarantors gain a foothold in the market.

Multifamily Business Lines

The multifamily businesses of the GSEs differ substantially from their single-family credit guarantee businesses. The recommended end state would largely preserve the operations, infrastructure and market executions of the current multifamily businesses, and would allow them to remain with their respective single-family credit guarantee businesses. Alternatively, it might be appropriate for one or both GSE multifamily lines of business to carry forward into separate new Guarantors. We believe that the transition process should allow for this option. Regardless, the Preparation phase, and the overall transition process as it impacts the multifamily business lines, should allow for appropriate differential treatment of multifamily in light of differences in the underlying business models.

Opening the Door to New Guarantors

Legislation should open the door for new entrants as early in the transition process as possible. New entrants then can apply for a Guarantor charter under the standards and procedures established in the legislation and implementing regulations. A new charter could be specific to the single-family market, multifamily market or both markets. As a utility-style regulator, one of the key factors the FHFA would be required to consider would be the impact of new competitors on both existing Guarantors, on the relevant market, and on consumers and borrowers. Maintaining the balance in the regulatory compact would be an important factor in evaluating new charters.

FHFA would determine whether the applicants meet the standards for a Guarantor charter. Because of the time that may be required to complete the process of applying for and receiving a charter, it may be appropriate for FHFA to begin accepting and processing applications during the Preparation phase, providing a way for new entrants to begin competing with GSEs now rechartered as Guarantors. The OCC process for chartering new national banks or federal savings associations may provide a useful model.

Technology

The transition to Guarantors issuing MBS under a new regulatory and guarantee framework may provide a unique opportunity to upgrade the technology that Guarantors could use to support their secondary market activities. As a result, the Comprehensive Transition Plan should include consideration of leveraging the opportunity to explore and implement new technology solutions.

Phase 2: Implementation

The Implementation phase would include (1) completing the steps necessary to transform the GSEs into Guarantors in the new system and (2) granting Guarantor charters to new entrants under the procedures and standards established during the Preparation phase.

Capitalization/Transfer of Assets and Liabilities

GSE reform legislation should direct FHFA and Treasury to explore a wide range of efficient and cost-effective ways to raise capital for the GSEs as they are rechartered as Guarantors. The most appropriate capitalization approach and process will depend on a combination of factors, including:

- The regulatory capital requirements that the legislation and FHFA apply to the Guarantors;
- The extent to which FHFA reorganizes the GSEs and winds down noncore businesses and the GSEs' retained portfolios;
- The extent to which the GSEs are permitted to retain earnings;
- The capital levels of the GSEs at the time of transfer;
- The extent to which FHFA transfers legacy GSE assets and liabilities to the new entities;
- The nature of PSPA or other support for legacy GSE obligations, and the use of the PSPA backstop going forward;
- The extent to which Guarantors receive a management fee for the administration of legacy GSE MBS under a management contract, if applicable;

- When and how the government would seek to divest its equity interests in the Guarantors; and
- Market views of risk and expected returns on new capital for equity investors in the Guarantors.

While there are many variations on possible recapitalization approaches, they fall into two general categories: (1) transfer of all or substantially all GSE assets and liabilities to the new Guarantors, and (2) transfer of only a minimal level of assets and liabilities to the new Guarantors.

Under both approaches, the Guarantors could become capitalized through combinations of selective transfer of GSE assets and liabilities, potential management contract income, accumulation of retained earnings or Treasury capital draws under the PSPAs. Treasury also may ultimately exercise its warrant for common equity and sell its common and senior preferred equity interests in the GSEs to private investors, choosing the time and manner to the benefit of taxpayers and the future stability of the housing finance system. The following are the major differences between the two approaches that Congress will need to consider:

Transfer of Substantially All GSE Assets and Liabilities

This approach may be the most straightforward one to recapitalization, as it would effectively keep the core operations and books of business of the GSEs largely intact and would reduce the risk of market distress or confusion. It would also be consistent with the FDIC's bridge bank model, the limited life regulated entity (LLRE) approach under the Housing and Economic Recovery Act of 2008 (HERA) and the federal government's general approach with the restructuring of AIG — all familiar to the market. The transfer could also be for certain types of assets such as single-family mortgage assets, multifamily mortgage assets or a certain combination thereof.

On the other hand, the fact that the new Guarantors would bring forward their existing GSE books of business would require that they raise substantially more capital. In addition, the resulting size of the Guarantors under this approach could act as a barrier to entry or make it more difficult for new entrant Guarantors to compete. The transfer of substantially all of the legacy GSEs' books of business might also confuse investors as to the change in the nature of the government backstop resulting from the reform. Specifically, investors may find it challenging to understand that, post-reform, the government no longer backs the Guarantors themselves, but only the MBS. The PSPA backstop placed on legacy GSE obligations during conservatorship could also result in confusion regarding which assets are backed by the PSPA, which are backed by the MIF and which assets are not federally backed at all.

Transfer of Minimal GSE Assets and Liabilities

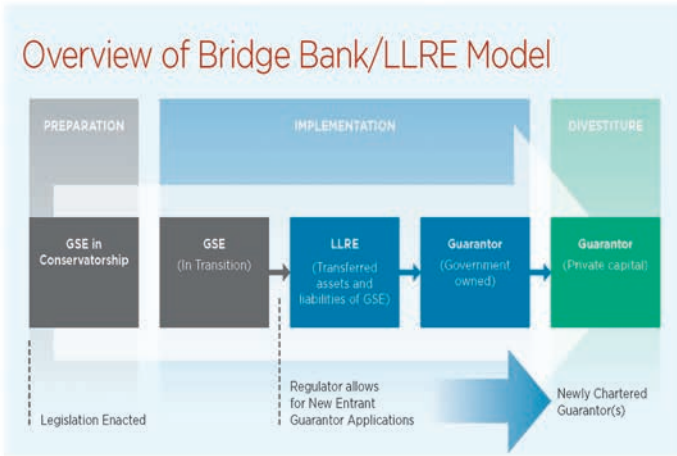
This approach might include the transfer of staffing, buildings, systems and operations to the new Guarantors and holding back the prior books of business. It would likely require the continued existence of two entities for each GSE — one to become the new Guarantor and the other to hold the legacy assets and liabilities. For continuity, the entities holding the old books of business would likely contract with their respective Guarantor to administer legacy GSE assets and liabilities in exchange for a management fee.

Key benefits of this approach are that the new Guarantors would be smaller and require less capital, which might enable them to raise adequate capital as well as provide new entrants a better opportunity to compete against them. On the other hand, this approach would include more moving parts and so might be more complicated to execute. The fact that the government would retain the legacy GSE securities could also extend the time necessary for the government to fully divest. In addition, a pure stand-alone Guarantor — without its prior credit guarantee or retained portfolio book — is an untested business model and so may be less attractive to new private capital.

Formation of Transitional Successor Entities

There are several models that could be utilized to complete the transition of the GSEs to Guarantors. Two possible paths are the **bridge bank model** and the **operating subsidiary model** — each of which has its own set of trade-offs. The former would be more amenable to transferring substantially all assets and liabilities to the Guarantors; the latter would be more amenable to transferring only minimal assets and liabilities. Both would result in newly chartered Guarantor entities emerging from the GSEs, and allowing for new Guarantor entrants as well.

Congress could legislatively authorize either or both alternatives, or another path that meets our transition principles. Alternatively, it could authorize and provide discretion to the regulator to pursue a path that meets several statutorily defined objectives, including minimizing disruption in the investment and mortgage markets, so long as it moves the GSEs toward the recommended end state.



Bridge Bank Model

One transition approach that would allow the GSEs to effectively be rechartered as Guarantors is the bridge bank model. As discussed below, Congress modeled the approach already in the HERA statute after the bridge bank model the FDIC has long applied to resolve banks that have become insolvent.

Bank resolution models like bridge banks are designed to protect depositors and the federal DIF. By law, the FDIC must choose the bank resolution method that is the least costly to the DIF.

The "bridge depository" provisions of section 11(n) of the Federal Deposit Insurance Act[4] allow the FDIC to restructure insured depository institutions during conservatorship after passing the insolvent institution through a receivership to reduce certain liabilities. The remaining assets and liabilities of the institution are then salable to private parties through stock offerings.

One resolution method employed by the FDIC is a purchase and assumption transaction (P&A) utilizing a bridge bank in which a third-party institution buys some or all of the assets and some of the liabilities of the institution. A bridge bank P&A may be a useful model for transitioning to Guarantors and addressing the legacy MBS assets and liabilities of the GSEs. In a bridge bank P&A, the FDIC temporarily acts as the acquiring institution and a new bank is chartered by the Office of the Comptroller of the Currency and controlled by the FDIC. The new bank bridges the gap in time, enabling the FDIC to evaluate and market the bank to third parties, and enabling prospective purchasers to evaluate the bank in order to submit an offer.

An advantage of a bridge bank is that it provides time to arrange a permanent resolution, giving purchasers and investors the opportunity to evaluate the bank and submit bids. During the time the FDIC is operating the bridge bank, the FDIC prepares to sell the bank by soliciting interest and arranging for due diligence by potential acquirers, and by receiving and evaluating bids.

Significantly, a bridge bank preserves franchise value, ensures continuity of services, and gives the FDIC and purchasers time to consider pricing. These features of a bridge bank could be advantageous in resolving and reforming the GSEs.

FHFA authority under current law provides for something very much like an FDIC bridge bank in a receivership situation. Under HERA, FHFA can establish a bridge bank — known as an LLRE — that can operate for two years, with three one-year extensions before it must be sold or resolved.

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4 12 U.S.C. § 1821(n).

Upon its creation, an LLRE may purchase such assets and assume such liabilities of the pre-receivership GSE, as FHFA, in its discretion, determines to be appropriate except that the amount of liabilities assumed by the LLRE cannot exceed the amount of assets purchased or transferred from the pre-receivership estate. The purpose of this requirement is to ensure that an LLRE has a sound balance sheet. The receiver can also selectively transfer assets and liabilities to the LLRE to create an institution that satisfies regulatory capital requirements.

Application to Transition

This approach would have the advantage of leveraging existing legal authorities as opposed to creating a new framework. However, Congress would need to modify the current receivership approach under HERA to make it an appropriate vehicle for the transition. Under HERA, the LLRE must succeed to the charter of the original GSE. By contrast, GSE reform legislation would need to authorize the regulator to grant each LLRE the new Guarantor charter, consistent with our end state recommendations. Because of the need for an extended and flexible transition period, it also may be necessary to extend the statutory time limits for LLRE operations. Alternatively, legislation could specify a new, analogous process, modeled on elements of the FDIC bridge bank and HERA receivership process, tailored to the needs of this unique situation and our recommended end state.

To reduce the risk of market disruption from the use of a wind down and transition process, GSE reform legislation and FHFA must explicitly delineate the key features of the end state. In addition, because the term "receivership" could invoke market uncertainty or confusion, notwithstanding the fact that the process would be a path to the recommended end state, the legislation should describe the process with alternative language, such as the Regulatory Transformation Process, Transition Conservatorship Process, or functionally similar language.

Regardless of nomenclature, the market must understand the end state and the transition process. Precise legislative language and the use of established bridge bank procedures could help ensure that this message comes through. Clear communication that the PSPAs and the MIF remain in place throughout the Implementation phase can also reduce the risk of the market misunderstanding the impact of the transition process.

The Operating Subsidiary Model

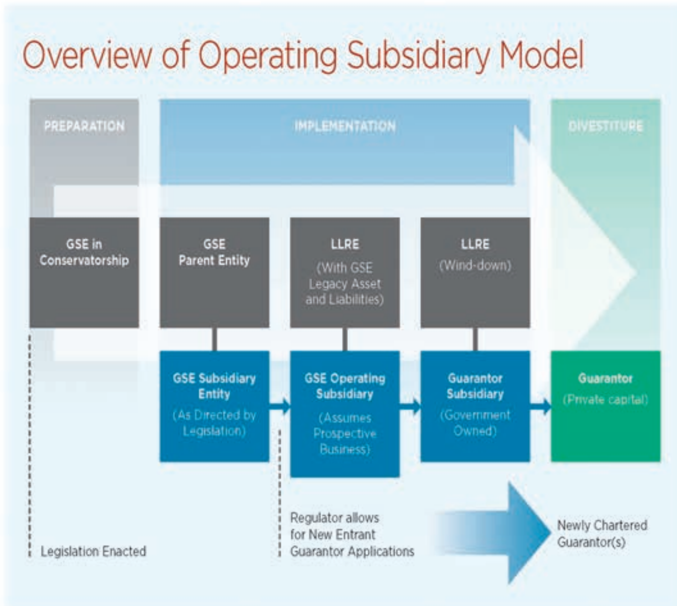
An alternative transition approach would be to direct each GSE to form wholly owned subsidiaries (or affiliates) to operate in a parallel manner with the parent entities during the transition. The subsidiaries could be paid a fee for managing the legacy assets of their parent companies and would be prohibited from paying dividends to them. This management fee could begin to capitalize the entities that would become the two initial Guarantors. Such an approach could leverage FHFA's and the GSEs' experience establishing the CSP as a jointly owned subsidiary of the Enterprises. This approach would be more attractive if the legacy (pre-GSE reform legislative enactment) books of business were to be separated from the operating entities going forward.

Establishing the subsidiaries could require a modification of the PSPAs to facilitate this structure. Also, because the GSEs have typically operated under a single legal structure and are currently limited from setting up subsidiaries, GSE reform legislation could direct the GSEs to establish them, and the GSEs would need to absorb the cost of setting up new systems to be able to track operations across additional legal entities.

At the appropriate point, the GSEs could spin off their subsidiaries by selling all of their equity interest in them. The subsidiaries would emerge as the newly chartered Guarantors, authorized to issue new MBS backed by the Mortgage Insurance Fund and subject to the principles and guardrails specified in our end-state recommendations.

Application to Transition

The value of this approach is that the entities that would become the newly chartered Guarantors would also develop a track record, and markets would gain familiarity with them prior to the date on which they become stand-alone entities. It also may create a structure that is adaptable to a decision to transfer minimal assets and liabilities to the Guarantors, and for the subsidiaries to enter into management contracts with the parent companies to administer the GSEs' untransferred books of business.



Phase 3: Divestiture by the Federal Government

The final phase of the transition, divestiture, replaces government ownership and control with private capital. That occurs when Treasury sells its equity interests in the GSEs to private-sector investors. This approach is similar to the one taken with respect to AIG.

As part of the Comprehensive Transition Plan, FHFA and Treasury should develop a high-level plan that sets out the objectives and strategies for divestiture. Importantly, the regulators must possess sufficient flexibility to account for market conditions during the divestiture process. The outcome will be favorable only if the transition process and regulatory requirements result in Guarantors with sufficient potential for long-term value to attract private capital. Moreover, many investors will be interested in purchasing equity in the Guarantors only after they have established a track record of performance (for example, a period of three or more years).

During such time, the Guarantors should be permitted to build their capital bases by retaining earnings. We envision legislation directing such amendments to the PSPAs in the context of comprehensive reform. We underscore that the legislation should provide substantial flexibility to regulators to calibrate and sequence the divestiture process in a smooth manner that both strengthens the transition process and protects taxpayer interests.

AIG Recapitalization as Example

The process the government employed to recapitalize and sell its common and preferred stock interests in AIG provides a possible model for restructuring the GSEs. The substantial amount the federal government invested in AIG ($182.3 billion) was one of the government's largest investments in a private sector company.

Both Treasury and the Federal Reserve assisted AIG with numerous restructuring and reform efforts, and those efforts ultimately enabled both agencies to recover substantially greater repayment amounts than they invested to stabilize AIG. Other aspects of the restructuring may be instructive as models for restructuring the Enterprises in ways that protect taxpayer interests.

A salient aspect of the AIG restructuring is that AIG's operations were streamlined. AIG retained its core insurance operations while selling non-core assets and reducing its MBS and derivatives exposure, thereby decreasing the size of the company. Over a period of 19 months, the Treasury conducted six different public offerings of AIG common stock.

Treasury's steps resulted in a positive return on taxpayers' investment and Treasury continues to hold warrants to purchase shares of AIG common stock, which could increase the return when exercised. Treasury also allowed AIG's board of directors to declare a dividend to AIG's common stockholders in the form of warrants to purchase shares of AIG's common stock, with a condition that each party to the recapitalization plan would agree to close the deal on a certain date.

GSE reform legislation, therefore, should grant FHFA and Treasury substantial discretion to divest the government's equity interests over time.

Affordable Housing: A Seamless Continuum of Housing

America's housing finance system should meet the needs of the full continuum of households, from families requiring the most directly subsidized, affordable rental homes to those served by the completely private prime jumbo single-family lending market.

Looking ahead, these housing needs must continue to be met through a broad variety of approaches that include single-family and multifamily housing capitalized by private, nonprofit, government or a combination of sources. But, with affordable-housing needs so great, the secondary market must also play a supporting role.

MBA research shows that in the United States there will be demand from 1.4 million to 1.6 million additional household units each year for the next 10 years.[5] Demand for housing will come from households that are increasingly diverse across dimensions of age, race, ethnicity and geography. In addition to these differences, Americans are increasingly divided by income and wealth. While some families are prospering, others feel they are falling further behind as they struggle to pay bills, secure an affordable home or send their children to college.

The growing economic divide has real-life consequences for the housing market: In 2015, the typical college-educated worker earned nearly twice as much as someone with a high school degree.[6] This divergence means that better-educated households often outbid others for limited housing resources, placing upward pressure on rents and prices — especially in desirable neighborhoods with decent housing, low crime and good schools. Falling homeownership rates among those without a college degree also contribute to growing wealth inequality. Affordable-housing policy is an essential part of the solution to these serious socioeconomic challenges.

The government-backed secondary mortgage market must provide liquidity to facilitate the development, preservation and purchase of all types of housing. Where it cannot achieve this goal alone, it should act in tandem with other resources to facilitate access to safe and reasonable-quality housing. Moreover, government policy in general should reflect a unified, holistic approach that responds to the full scope of housing needs. An effective affordable-housing policy must also be flexible and innovative, responding to feedback from existing programs and seeking new paths forward.

The continuum framework provides a single context for integrating the roles of single-family, multifamily and other programs in serving the housing market. The framework identifies five broad housing market segments that policymakers should consider in crafting a holistic housing strategy.

The continuum roughly categorizes households as:

- Low- and very-low-income renters occupying affordable rental units,
- Renters occupying market-rate housing,
- Credit-ready prospective homeowners,
- Homeowners currently served by the GSE single-family and condominium business, and
- Homeowners served by the prime jumbo market (who should not benefit from a government guarantee).

5 *Housing Demand: Demographics and the Numbers Behind the Coming Multi-Million Increase in Households*. Fisher and Woodwell (July 2015).

6 MBA Economic and Mortgage Finance Outlook, MBA Annual Convention, October 2016.

The framework also identifies some of the federal programs that directly or indirectly impact consumers within the various segments along the continuum. A core objective of affordable-housing policy should be to promote opportunities for economic mobility along this continuum. This objective undergirds our recommendations in this section.

A Viable Plan for Addressing Affordable-Housing Needs Is a Political Requirement for Bipartisan GSE Reform

Consideration of GSE reform offers a once-in-a-generation opportunity to reimagine federal housing policy. It provides the chance to assess how best to meet housing needs along the full continuum of households. Only by identifying who will — and will not — be served by the government-guaranteed secondary market in the new system can we be clear about the role of the Guarantors and the need for other initiatives to help those not adequately served.

The Continuum

Affordable Rental (with and without subsidies): Households that are significantly below the area median income and may be eligible for policy-directed subsidies.

Moderate Income and Market-Rate Rental: Households that earn in the range of area average income. Depending on market circumstances, rents may be moderately burdensome.

Affordable Homeownership: Qualified prospective borrowers who may lack savings or family wealth necessary for traditional down-payment.

TBA Conforming: Core of conforming GSE single-family market. Benefit from government guarantee is primarily lower mortgage rates created by the additional liquidity.

Prime Jumbo: Loans above the conforming loan limit. Not intended beneficiary of government guarantee.

The housing system is made stronger by helping aspiring homeowners purchase their first home in a sustainable manner so that they can begin building wealth through equity appreciation. Further, a stable, vibrant housing system is one in which the secondary market provides ample liquidity for affordable multifamily rental housing.

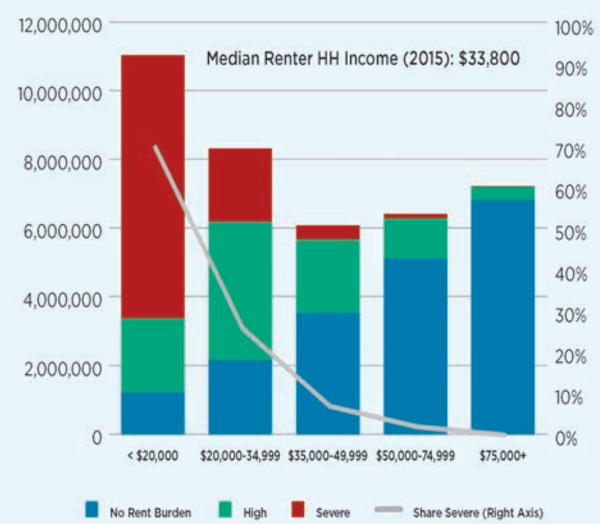
The following sections outline an affordable-housing plan for GSE reform. This plan sets out three critical affordable-housing missions and then charges the future regulator with assessing market conditions and developing a plan to meet these missions. The plan would be implemented with measurable goals that are enforceable against the Guarantors. An affordable-housing fee, charged against the new business purchases of the Guarantors, would play an important supplemental role.

Three Critical Affordable-Housing Missions

A government-guaranteed secondary mortgage market must serve three critical missions:

1. **Guarantors should actively seek to provide responsible, sustainable access to credit for prospective homeowners.** The government-backed secondary market should promote opportunities for sustainable homeownership by facilitating access to affordable mortgage credit for first-time homebuyers. This objective is especially important for low- and moderate-income borrowers, as homeownership remains the primary means by which these groups build wealth. Progress on this front will require a range of responsible underwriting, documentation, product and outreach strategies, including ways to deal with the economic challenges of originating and servicing small balance mortgage loans and reaching nontraditional households. Innovation and responsible risk taking must be part of a comprehensive strategy to reach more creditworthy borrowers.

Renter Households: Rent Burdens



The Three Affordable-Housing Missions

2. **Guarantors must work to provide liquidity for the development and preservation of affordable rental housing.** Widespread access to affordable rental housing of decent quality is essential to enhancing social mobility and promoting economic growth. Unfortunately, the gap between household incomes and the cost of building and maintaining rental housing (including moderate-income working households and those with special housing needs continues to grow. The figure above shows that the share of households with moderate rent burdens (paying more than 30 percent of income toward housing) and with severe rent burdens (paying more than 50 percent) is high. The housing system must place a renewed focus on facilitating the renovation and preservation of the existing housing stock serving low- and very-low-income households, as well as the development of new affordable rental homes.

3. **Guarantors must improve liquidity for segments of the market that are currently underserved.** Access to both mortgage credit and affordable rental housing remains a challenge for many segments of the market. These market segments include minority households as well as traditionally underserved parts of urban, suburban and rural communities. Credit also remains constrained in the market for lower-cost manufactured housing. Without an adequate policy response, these challenges will likely grow even more acute in light of powerful demographic trends now underway, including the increasing diversity of the U.S. population. The secondary market must therefore seek new ways to evaluate and underwrite borrowers and develop innovative products, partnerships and programs to respond to changing demographics and reach underserved groups and communities.

While these missions are critical, the government-guaranteed secondary mortgage market cannot, and should not, serve the entire continuum of households by itself. The government-guaranteed market can help facilitate financing for the development and preservation of good-quality, affordable rental housing, but the role of equity investment will be critical as well. In some cases, the secondary market will require partnership with other programs, such as Low Income Housing Tax Credits (LIHTCs), Section 8 Housing Choice Vouchers and the National Housing Trust Fund, to serve those with the most acute affordable-housing needs. Programs such as these should be appropriately funded to meet the needs of households on the low-income end of the continuum.

On the other end of the continuum, in the prime jumbo segment and luxury multifamily, the highest income and credit-quality borrowers should be served by the private mortgage market and do not require the support of a government guarantee.

The housing needs of historically underserved racial and ethnic groups and communities warrant special attention. Some of these needs can be met through existing regulatory frameworks like the Community Reinvestment Act (CRA). Others may require collaboration and information sharing between primary and secondary market participants, including mission-oriented and nonprofit organizations. Still others are best addressed through broader policies to reduce income inequality, create jobs and spur economic growth.

Preserve What Works, Enhance Other Parts of Existing System

Many aspects of the existing secondary mortgage market benefit households in a manner that should be preserved in any new system. At the same time, other elements require improvement. In this section, we highlight what currently works in the multifamily and single-family segments of the market and then provide some guidance on areas where improvements are necessary.

The current GSE multifamily businesses are major success stories. Both GSEs' multifamily businesses have experienced very low default rates, even during the financial crisis, and their predominant business executions have incorporated significant private capital.[7] In addition, because the GSEs do not play the same dominant role in multifamily finance as in single-family finance, there is strong competition among private capital sources in apartment finance — with banks, life insurance companies, commercial mortgage-backed securities and other market participants competing actively in this sector. A particular affordable-housing success for the GSE multifamily businesses is the provision of liquidity for mortgage debt that is paired with equity raised by the LIHTC program, one of the most effective public/private financing programs for the production and preservation of affordable rental housing.

The future system of housing finance should ensure there is sufficient liquidity in the multifamily housing market broadly, with a particular focus on moderate-income and affordable rental housing. The vast majority of the two GSEs' multifamily businesses currently serve households with incomes at or below the area median. The Guarantors should assume this same role in the new system, supporting moderate-income and affordable rental housing while providing liquidity during periods of market disruption.[8]

Any affordability goals imposed in the context of GSE reform should align with and promote this focus.

The single-family Guarantors should serve a market segment similar to that of the GSEs today. In the single-family market, the GSEs are, and have historically been, the dominant liquidity providers, particularly for longer-term, fixed-rate mortgages for middle-income homeowners. Borrowers benefit as a result of two key features of the current system: First, the GSEs are perceived as being backstopped by the federal government; and second, the majority of GSE single-family mortgage-backed securities are traded through the TBA market.

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7 Mortgage Bankers Association, *Affordable Rental Housing and Public Policy: Toward Greater Housing Security and Stability.* (December (2015).

8 For the calendar year 2015, 64 percent of the rental units in multifamily buildings with mortgages purchased by Fannie Mae had rents that were affordable to households at or below 80 percent of area median income, and 82 percent of the units were affordable to those at or below median income. At Freddie Mac, the shares were 75 percent and 89 percent, respectively. (See Fannie Mae *2015 Annual Housing Activities Report and Annual Mortgage Report;* and *2015 Annual Housing Activities Report Federal Home Loan Mortgage Corporation.*)

Together, these features allow a broad segment of borrowers who obtain financing through conforming loans to receive lower interest rates, while ensuring that financing for the nation's home purchase needs are met even through economic downturns. An explicit government guarantee of eligible MBS, paid for by the privately owned Guarantors, would continue to provide these benefits and, if properly managed, further reduce the risk of market disruption during a regional or national downturn. While there is much to recommend and preserve in the existing GSE multifamily business, there is greater room for improvement within the single-family business.

The current conforming loan limits should be preserved, with similar adjustments for high-cost areas, because they provide a well-understood threshold and relative ease of execution as compared with other metrics that rely on local area house prices or household incomes.

The Guarantors should have the flexibility to underwrite and price credit risk to ensure a reasonable cross-subsidy that can result in some savings for qualified borrowers while maximizing access to credit. Pricing and underwriting across various programs and markets should be as transparent as possible to ensure that eligibility, qualification and pricing information is clearly communicated to the market and balanced by sound risk-management practices.

Other elements of the existing housing finance system can be improved in ways that expand access to affordable mortgage credit.

Potential improvements include:

- **Updating credit-scoring models to leverage changes in technology, data and analytics that assess the creditworthiness of a larger segment of the population.** Credit-scoring models should continue to adapt to changing demographics and labor markets. Augmenting the type of data used to assess the creditworthiness of prospective buyers, including those with "thin" credit files, holds the potential to responsibly expand the pool of potential first-time homebuyers. A considerable amount of work has already been undertaken on this subject.

- **Updating documentation and derivation of income requirements to better capture self-employed or nontraditional household income that may help to identify creditworthy borrowers.** Nearly 15 million Americans are self-employed. Many face significant obstacles in meeting mortgage underwriting requirements, including income documentation.

- **Increasing the transparency of well-calibrated guarantee/credit enhancement pricing and underwriting eligibility.** The impact of loan-level price adjustments and other credit enhancements must be evaluated as part of any affordable-housing strategy. Lenders in the primary market are better able to serve borrowers to the full extent of the credit box when the parameters of eligibility requirements are well understood and consistent.

- **Providing enhanced liquidity for small-balance single-family and multifamily loans.** Small-balance loans in the residential market present unique economic challenges for lenders to originate and service. Reliable secondary market funding for these loans is important for serving lower-income borrowers and communities. In the multifamily market, incentives should be targeted toward improving liquidity for small-balance loans on projects providing affordable rental housing.

- **Partnering with lenders and other third parties to facilitate outreach and/or counseling programs for emerging demographics.** As the United States becomes increasingly diverse over the coming decades, serving these emerging borrowers will require different tools and approaches.

- **Improving access to credit for manufactured housing purchases.** Manufactured homes remain an important part of the affordable-housing stock in the United States, especially in rural areas, but there is a lack of uniformity in underwriting standards for assessing the collateral and credit risk associated with financing this product.

Harmonize Federal Housing Policy

The at times overlapping missions of FHA, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, the Rural Housing Service, Ginnie Mae and the GSEs should be made complementary. One approach would be to empower a single body or special advisor to harmonize and manage the various roles and targeted missions of these entities. A Special Advisor for Housing Policy Coordination could be created as part of the president's National Economic Council to help manage and rationalize housing policy and regulation. Integrating our fragmented housing policy into a single, unified strategy would allow for greater coordination and more dynamic program development, as well as clearer communication with market participants, stakeholders and regulators. Moreover, it would help reduce the risk of discrete segments of consumers falling through the cracks as specific policies are developed and executed. Housing policy should also facilitate the movement of households along the continuum, enhancing — and not discouraging — geographic and economic mobility for those who seek it.

Setting the Stage: The Affordable-Housing Plan

To achieve the three overarching affordable-housing missions, the end state regulator would be charged with developing a comprehensive plan. The Guarantors would then be held accountable for executing against this plan. A key part of the plan would be the achievement of affordable-housing goals established annually by the regulator. The regulator would determine whether each guarantor is meeting these goals, hold the Guarantors accountable for any failure to meet them, and recalibrate the goals as needed. In addition, the regulator would assess an affordable-housing fee on new business purchases of the Guarantors to help finance affordable-housing activities. The regulator would have flexibility in identifying and adjusting the appropriate mix of goals and fees.

Getting the mechanics right for both the Guarantors and the regulator is critical. We believe a successful approach will include the following key components:

- The end state regulator must create an affordable-housing plan that furthers the three affordable-housing missions. The regulator must periodically develop an affordable-housing plan that furthers each of our missions — namely expanding access to credit, preserving and developing affordable rental housing and improving liquidity for underserved markets.

  The plan must be supported by research conducted by the regulator and with input from industry stakeholders, public interest groups and others, and aspire to achieve meaningful change within the broader framework of regulatory requirements, market trends, and safety and soundness.

- The regulator should implement the plan through a combination of affordable-housing goals for the Guarantors and a fee assessed against their new business purchases. The regulator should try to identify the best mix of goals and the fee (assessed within a permissible cost range defined by statute) to achieve the overarching plan.

This flexibility is important for several reasons. First, we do not yet know exactly how investors, Guarantors and other mortgage market actors will respond to a new end state system. For example, the exact shape of future credit risk transfers to private investors is unknown. This uncertainty will surely affect the ability of the secondary market to bear and price risk, a function that will likely mature over time. In addition, the needs of households themselves may change over time.

A More Dynamic, Market-Based Approach to the Affordable-Housing Goals that Focuses on Outcomes

The GSEs have historically fulfilled their public mission through Affordable-Housing Goal regulations that mandated a particular ratio of loans purchased by the GSEs to be made to very-low-, low- and moderate-income borrowers and borrowers in low-income areas, or to multifamily property owners serving these communities.

In addition, "duty to serve" legislation required that the GSEs serve underserved markets in rural areas, affordable rental housing and manufactured housing. While recent duty-to-serve rules are relatively untested, the goals approach only evaluated performance based on whether or not the GSEs purchased qualifying loans. This blunt instrument sometimes led to suboptimal outcomes, particularly when the regulatory goal-setting process became disconnected from market signals.

The regulator should assess the performance of the Guarantors in each of the relevant mission areas, including consideration of actual mortgage purchases, outreach activities, and related research and development efforts.

Because of this uncertainty, the regulator should be empowered to choose a combination of goals and a fee, within limits set to ensure the continuity of business strategies, to best achieve its affordable-housing missions. Flexibility will be especially important in the early stages of GSE reform, but the concept of dynamic housing goals, with appropriate governors, should be a core part of the new system.

- The plan and its implementation should be updated according to a periodic timeline that is defined in statute. The timeline should include adequate opportunity for the regulator to evaluate market conditions, establish a set of proposed goals and recalibrate them after receiving public input. It should also allow the Guarantors a reasonable implementation period. The regulator would then report to Congress on an annual basis on its progress in meeting the objectives of the affordable-housing plan.

The following discussion outlines a new approach to affordable-housing goals that addresses these and related concerns. Under this approach, some of the goals would include specific, quantifiable outcomes based on loans made to distinct borrower/market segments. Others would focus on qualitative efforts, such as outreach, research and targeted initiatives. Both are intended to work in tandem with and complement each other, and not be substituted for the other.

The regulator should assess the performance of the Guarantors in each of the relevant mission areas, including consideration of actual mortgage purchases, outreach activities, and related research and development efforts. A combination of quantitative, market-based targets and qualitative, activity-based targets should be used. The regulator must define goals in a manner that is appropriate for single-family and multifamily Guarantors, provided that goals for similar business lines are the same.

Affordable-Housing Goals, whether quantitative or qualitative, should be:

1. **Transparent and well defined.** Quantitative targets should be specified as a number, percentage or range within a demographic, geographic or income-based cohort. Qualitative targets should be assessed or graded according to established criteria that consider activities in combination with desired outcomes.

2. **Assessed in terms of market impact.** Success is ultimately based on concrete evidence about performance in certain markets, not merely on the level of resources committed or activities conducted. FHFA should focus on results that actually make a difference. At the same time, any goals should be based on market needs and circumstances, with realistic benchmarks.

3. **Measurable.** Clear metrics should allow for FHFA to evaluate performance against the affordable-housing objectives. These assessments should be made available in public, annual reports to Congress.

4. **Enforceable.** Failure to meet established goals should carry appropriate consequences, with financial penalties for more egregious failures. All significant failures should require remediation plans submitted by the guarantor to the FHFA for review and approval.

5. **Recalibrated periodically.** The FHFA should provide for formal, periodic opportunities for public input on potential refinements and adjustments to the goals. The timing of such input should be consistent with a schedule that allows the regulator to consider it fully before taking action. Any refinements and adjustments to the goals should be supported by independent research and data analysis by the regulator.

6. **Reviewed to avoid market distortions.** FHFA, in seeking to set or adjust the goals, should attempt to ensure that all goals are realistic, aligned with market circumstances, and do not inadvertently distort behavior or incentives for entities serving the affordable portion of the housing continuum. Consistent with sound risk-management practices, the Guarantors should have the flexibility to price credit risk in a way that provides a reasonable cross-subsidy to support segments of the mortgage market that are currently underserved.

7. **Balanced by safety and soundness.** FHFA should ensure that the affordable-housing obligations of the Guarantors are balanced by prudent risk-management practices.

Completing the Missions with An Affordable-Housing Fee

To complement the affordable-housing goals of the Guarantors, we believe that an affordable-housing fee should be assessed on new business purchases of the Guarantors. The fee should be used to help support efforts along the continuum, including for market segments not traditionally served by the GSEs. By allocating resources in this way, particularly to assist lower-income renters, the Guarantors will be promoting stability and mobility along the continuum — keys to a healthy housing market.

The Affordable-Housing Fee Should Supplement Secondary Market Activity

Fulfilling the three affordable-housing missions cannot be achieved exclusively through the government-guaranteed secondary mortgage market. As a supplement to secondary market activity, an affordable-housing fee should be dedicated to support certain affordable-housing funds, such as the National Housing Trust Fund and the Capital Magnet Fund. This fee should supplement the use of goals to support the three critical affordable-housing missions: providing access to credit for prospective homeowners, developing and preserving affordable rental housing, and improving liquidity for underserved markets.

Certain core principles should guide the size and use of an affordable-housing fee. The fee should:

- Work in a manner similar to the current (4.2 bps) fee assessed on new business that the GSEs pay to the National Housing Trust Fund and the Capital Magnet Fund under HERA. The current fee is charged on each dollar of the outstanding principal balance of total "new" single-family and multifamily business purchases each year. Thus, it is a one-time annual assessment on each year's acquisitions.

- Be established by FHFA through a public notice and comment rulemaking, subject to a range or band established by Congress in statute.

- Be set at a level that generates meaningful contributions to a range of important affordable-housing efforts without unduly raising the cost of mortgage credit for consumers. The impact on pricing to borrowers should be transparent.

- Be consistently applied for reasonable time periods to ensure continuity and maximize compliance. The schedule for setting and changing the fee should be transparent.

- Support mission-related activities undertaken by funds such as:

  + **National Housing Trust Fund:** A fund currently administered by The U.S. Department of Housing and Urban Development (HUD) with monies allocated to states via a formula. The National Housing Trust Fund focuses primarily on housing support for "extremely" low-income (up to 30 percent of area median income [AMI]) and "very" low-income (up to 50 percent of AMI) renters.

  + **Capital Magnet Fund:** A fund currently administered by Treasury with competitive grants provided to qualified affordable-housing organizations, such as Community Development Financial Institutions. The fund is used to leverage private capital and support investment in housing primarily for low-, very-low- and extremely-low-income households, as well as for certain community development activities.

  + **Market Access Fund:** A new fund that would be administered by the regulator to support research, development and innovations in consumer education, product design, new market segments (such as single-family rentals), underwriting and servicing, as well as credit support for certain mortgage loans or pools and the development of affordable housing for rent and for sale. (A similar fund was proposed in the Johnson-Crapo GSE reform legislation in 2014.)

Once the fee is established, the regulator should report annually to Congress regarding the use of the funds generated by the fee, providing appropriate metrics to gauge performance and outcomes. In making these reports, the regulator should coordinate with the federal agencies charged with administering the funds described above.

Moving Forward

Today far too many households suffer from housing cost burdens that are consuming excessive amounts of their income. The supply of rental homes affordable to the lowest-income families on the housing continuum is inadequate to meet demand. At the same time, the national homeownership rate has declined significantly since the financial crisis, with many minority and low-wealth communities falling even further behind. For many Americans, access to credit and the ability to obtain a mortgage to become a first-time homebuyer have been denied. Left unaddressed, these problems will likely intensify in the coming decade as our country undergoes a profound demographic transformation.

GSE reform offers the opportunity to develop an inclusive approach to affordable housing — one that serves the full spectrum of households, addresses shortcomings in today's system, provides greater protection for taxpayers, and attempts to anticipate future issues and obstacles. It is imperative that we seize this opportunity.

When Congress last considered GSE reform legislation in 2014, affordable housing was at the center of the debate. And it remains there today. This framework is designed to help outline a viable path forward.

Conclusion: A Call to Action

As we approach the ninth anniversary of the decision to place Fannie Mae and Freddie Mac under government conservatorship, it is nearly universally acknowledged that maintaining the status quo of the housing finance system is not a viable solution.

The GSEs continue to move closer to a point where they will have no retained capital. The threat of a draw on their line of credit with the U.S. Treasury looms as a very real possibility. At the same time, the housing needs of millions of lower- and moderate-income families today remain unmet. Access to mortgage credit is unnecessarily tight, while rental cost burdens continue to weigh heavily on family budgets.

This paper is designed to provide the spark for a renewed focus on GSE reform. It outlines the key principles and guardrails that should guide this effort and provides a snapshot of what the new secondary-market end state should look like. It also attempts to shed light on two critical areas that have tested past reform efforts — the appropriate transition to the post-GSE system and the role of the secondary market in advancing an affordable-housing strategy.

While achieving GSE reform will not be easy, the potential upside is great. Our recommended approach to reform will:

- Inject much higher levels of risk-bearing private capital into the mortgage system, while dramatically reducing the system's reliance on government support.
- Protect taxpayers and consumers with a clear set of market conduct rules, prudential requirements, and a new Mortgage Insurance Fund financed with appropriately priced insurance premiums.
- Enhance the stability of the mortgage system with multiple Guarantors replacing the GSEs and operating as privately-owned utilities that are not too big to fail.
- Improve service and performance in the secondary market with multiple Guarantors competing on operations and systems development, customer service, product parameters and innovation, and pricing and execution.
- Ensure that mortgage lenders of all sizes and business models have equal access to the secondary market.
- Minimize disruption during the transition to the new system by preserving what works in the current system and utilizing the existing regulatory framework where appropriate.

Ultimately, GSE reform holds promise to create a more vibrant and sustainable housing finance system that can enhance the lives of millions of Americans and help stabilize the housing market for decades to come. The hard work of reform should proceed without delay.

MORTGAGE BANKERS ASSOCIATION

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PREPARED STATEMENT OF EDWARD J. DEMARCO

PRESIDENT, HOUSING POLICY COUNCIL OF THE FINANCIAL SERVICES ROUNDTABLE

JUNE 29, 2017

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the invitation to be here today. It is an honor to be back before this Committee, this time in my new capacity as the President of the Housing Policy Council (HPC, or the Council), a division of the Financial Services Roundtable. The Council's 32 member firms are among the Nation's leading mortgage originators, servicers, insurers and mortgage data service and settlement providers. They operate in the mortgage market every day and they want it to be strong and stable for the future to serve their customers—current and future homeowners.

The topic of this hearing—housing finance reform—is a top priority for the Housing Policy Council. While the housing finance system continues to function with Fannie Mae and Freddie Mac in conservatorships, the status quo is untenable for many reasons and only Congress has the authority to make the permanent changes needed to put the system on a sound footing for the long term. The good news is that much progress has been made since I last appeared before this Committee in 2013 as the Acting Director of the Federal Housing Finance Agency and since this Committee approved reform legislation in 2014.

In these prepared remarks, I will review that progress and its importance to this effort. I will also describe the strides made since 2013 in developing a broad consensus not just on the need for legislation but, in many ways, on such legislation's content. While significant differences of opinion remain on some key aspects of housing finance reform, they are relatively few and in some instances, multiple approaches may be workable and acceptable. The critical point is that reform cannot be completed without Congress. Your leadership in this effort is much appreciated and HPC's members stand ready to help you forge the bipartisan consensus needed to get this legislation to the finish line.

Enacting comprehensive housing finance reform will put the country on a better course to ensure future homebuyers have broad access to credit and that our financial system can deliver this credit with much less systemic risk than in the past. Comprehensive housing finance reform can also ensure that taxpayers are protected and that Congress will not need to consider another bailout, even if we face a deep recession and a nationwide collapse in house prices as we did last decade. While ending the GSE conservatorships dominates housing finance reform discussions, any comprehensive review of housing finance should include the Federal Housing Administration (FHA) program as a critical component of the housing finance system.

Principles for Housing Finance Reform

An appropriate starting point for discussing major legislation that will affect so many citizens and a large segment of the economy is to agree upon a set of principles that can guide reform. The Housing Policy Council centers its reform views on the following principles:

1. Fix what is broken and preserve what works in support of consumers and the market.
2. The transition from the old system to the new one should avoid disrupting consumers and markets.
3. Private capital should bear all but catastrophic mortgage credit risk so that market discipline contains risk. The Government should provide an explicit, full faith and credit guarantee on MBS but with a pre-set mechanism to ensure any catastrophic losses that call upon taxpayer support will be repaid fully.
4. Government should provide a regulatory framework that is clear and equitable across all participating companies and ensures that participants in the housing finance system operate in a safe and sound manner.
5. The Government-protected GSE duopoly should be replaced with a structure that serves consumers by promoting competition, affordability, transparency, innovation, market efficiency, and broad consumer access to a range of mortgage products.

Fixing What Is Broken

Among the many things broken in the current system are: the burden the system places on taxpayers for the bulk of the capital needed to backstop mortgage credit risk; the lack of meaningful market forces in evaluating mortgage credit risk; persistent concerns about access to and affordability of credit for consumers despite the enormous subsidies inherent in the current system; the barriers to entry inherent in a system structured around two Government-sponsored enterprises (GSEs); and the systemic risk that results from concentrating most mortgage credit risk on two balance sheets. As we have seen, this systemic risk leaves taxpayers exposed to emergency bailouts when the system fails. All these flaws need to be fixed.

At the same time, we need to preserve the features of the system that are working well, some of which have been greatly strengthened since the crisis. We should preserve: the efficient forward market that allows borrowers to lock in rates before settlement (known as the To-Be-Announced, or TBA market); the standardization of data and reporting; transparent and consistent reps and warrants; attracting private capital from mortgage insurers and a range of other capital providers; and the ongoing, nationwide access to the secondary mortgage market by lenders of all sizes and types, which benefits consumers and all participants in the mortgage market.

Ensuring a Smooth Transition

The pathway to the new system should be constructed with care. Hasty or ill-conceived transitions can disrupt markets, add risk, and limit credit availability. By the same token, an excessively drawn out transition can also be disruptive, especially if it leads to more interim measures that add costs and risks. Legislative reform can and should continue the gradual transition process that has been underway for several years. Such an approach allows new infrastructures and business arrangements to form around the new system before the old system is ended. A thoughtful transition also protects the value of $5 trillion in mortgage securities already trading today and the new securities that will be issued during the transition period.

Private Capital Should Bear Mortgage Credit Risk

As the crisis demonstrated, the GSE-duopoly system created immense systemic risk and the imminent collapse of the housing finance market forced Congress to pass emergency legislation bailing out investors in the GSEs' mortgage-backed securities (MBS). Since then, progress has been made in drawing private capital back into a meaningful first-loss position, but more progress is needed. Housing finance reform should continue that gradual transition away from taxpayer capital support to a system based upon private capital that protects taxpayers and restores market discipline on risk-taking. The heads-shareholders-win, tails-taxpayers-lose construct must be banished. Instead, as described below, a new system should encourage multiple channels for bringing private capital to this market, including bank balance sheets, mortgage insurance, various capital market structures, equity markets, and reinsurance.

Regulation Should Be Consistent and Transparent

Today's mortgage market has thousands of firms engaged in the origination and servicing of mortgages. Some are large and operate nationwide, some are small and operate in a single community. Some are regulated as insured depository institutions, often with multiple Federal and State financial institution regulators overseeing their operations. Others are not subject to oversight by banking regulators, but have multiple Federal and State agencies monitoring their activities. This leads to duplication of regulatory effort and inevitable inconsistencies in the interpretation and application of rules, which drives up costs and ultimately limits credit access. We can do better. An improved regulatory framework should promote consistency and efficiency, which would lower costs to consumers while delivering more consistent and equitable outcomes for firms and consumers alike. Supervisory and other enforcement mechanisms should be consistent and transparent. Penalties should be commensurate with the harm and the intent of the violation. As in other areas of financial regulation, we need to return to an environment in which regulators seek first to encourage correction of errors rather than to immediately punish and penalize. But if egregious or persistent patterns of neglectful or willfully wrong activity exists, appropriate enforcement should follow. In sum, greater regulatory transparency and consistency are needed, across all types and sizes of firms and regulators.

Competition Promotes Superior Outcomes

We should not lose sight of the numerous benefits that competitive markets deliver to consumers. Reform should establish a market structure that removes barriers to entry while fostering competition and innovation. Competition benefits consumers by driving down costs. Innovation benefits consumers by adding new products and making the delivery of existing products more efficient and consumer-friendly. Appropriate standard-setting promotes healthy market competition by establishing rules of the road for all competitors. Standard setting may include data and disclosure standards, servicing rules, basic borrower eligibility rules, and standards around acceptable credit enhancement. Clear and enforceable standards, in turn, give market participants a more equitable basis to resolve disputes than what we have experienced since the financial crisis.

Desired Outcomes

Given these principles, HPC supports comprehensive housing finance reform that leads to the following outcomes:

1. A deep and liquid mortgage-backed securities market for multiple mortgage products, including 30-year, fixed-rate mortgages, that gives eligible borrowers access to credit throughout the business cycle and removes barriers to entry in the secondary market.
2. A TBA market with a means to normalize around loan delivery and performance standards that allows borrowers to lock interest rates when they apply for a mortgage.
3. A level playing field for secondary market access across charter type, size of lender, and source of credit enhancement giving homebuyers choices among mortgage originators.
4. Competition and market efficiency in lending, credit risk syndication, and mortgage servicing to keep mortgage rates low and give consumers choice among lenders and mortgage products.
5. Replacing the separate Fannie Mae and Freddie Mac MBS with a single deep, liquid MBS security with multiple issuers, backed by private capital and wrapped with a Government guarantee to broaden the investor pool for U.S. mortgage assets, thereby keeping mortgage rates low.
6. A common securitization infrastructure that operates with a uniform set of standards for mortgage servicing, investor disclosure, and dispute resolution.
7. A better approach to meeting affordable housing needs that may include elements such as a duty to serve, a dedicated funding stream, a modernized FHA, and/or other means to create sustainable mortgage loans for low- and moderate-income borrowers and communities.
8. Consistency in regulation and enforcement to reduce unnecessary compliance costs and provide certainty to lenders, servicers and their customers.

Restarting the Legislative Process To Achieve Housing Finance Reform

Since this Committee approved the Johnson–Crapo bill in 2014, administrative and marketplace actions, and additional policy analysis have improved the foundation for reform legislation. Those developments should make your legislative effort easier because reform concepts have been getting a real-life market test, and continued policy analysis is helping build a consensus among stakeholders.

In this section, I will review this progress and its implications for legislation. I also will highlight the numerous common elements across most, if not all, reform proposals before assessing the critical things left to be decided.

The Threshold Question—Should There Be a Government Guarantee of MBS?

The approach to reform that HPC supports, and that is reflected across most reform proposals, provides for a single MBS that has an explicit catastrophic backstop Federal guarantee to replace the separate MBS issued by Fannie Mae and Freddie Mac that carried an "implied" guarantee. A common platform would be used to issue these securities and place the Federal guarantee. Multiple private entities would be able to add loans to the common pool. This is how the Ginnie Mae securitization process works today.

But why any Federal guarantee at all? The simple answer is that an explicit, Federal guarantee to cover catastrophic credit risk is needed to ensure a steady flow of mortgage credit in all economic cycles. Housing finance, however, is far from simple, so I will provide a little more context for this important issue.

Consider how the Fannie, Freddie, and Ginnie MBS work today. In each case, securitizing a pool of mortgages in a MBS separates the two essential risks in mortgage lending—credit risk and interest rate risk. Credit risk is the risk that the borrower is unable to make their payments and defaults on the loan. Interest rate risk is the risk that interest rates move up or down over time, while the investors are holding long-term, fixed-rate mortgages. Interest rate movements also influence borrower's likelihood of refinancing, which alters the expected time to maturity and creates reinvestment risk for investors.

In a Ginnie Mae MBS, the credit risk remains with the Government insurance program (chiefly FHA and VA) with some residual risk to servicers. Interest rate risk goes to the private investors in the Ginnie Mae MBS. In the GSE world preconservatorships, beyond traditional mortgage insurance coverage, all mortgage credit risk on mortgages placed in Fannie Mae and Freddie Mac MBS resided on the balance sheets of those two companies. This was a recipe for systemic risk—$5 trillion in mortgage credit risk on two balance sheets (and those balance sheets had capital requirements for that risk that were a fraction of the capital required for other regulated entities). The interest rate risk on those MBS went to the private MBS investors. So, in the process of securitization, Ginnie, Fannie, and Freddie effectively separate credit risk from interest rate risk. Private capital retains the interest rate risk and Government capital retains the credit risk (in the case of Ginnie) and GSE shareholders retained the credit risk (in the case of Fannie and Freddie).

Of course, market participants believed that the GSE shareholders were not alone in this process. They looked at the GSEs' Federal charters, subsidies, protected duopoly status, and weak capital standards together as indicating the Government would not let Fannie and Freddie default. This was the frequently discussed and officially denied implicit guarantee of the GSEs. Investors believed, rightly as it turned out, that the U.S. Government would not permit a global financial market disruption resulting from a default on Fannie and Freddie MBS.

It is also important to understand how other significant elements of our current housing finance system grew out of this structure. The development of a TBA market rested on the proposition that MBS investors faced no credit risk and the MBS issuers' exemptions from certain securities laws. Thus, investors in MBS could buy and trade contracts for delivery of mortgages not yet originated. The TBA market does two important things—it adds substantial liquidity to the mortgage market, assuring lenders in the process of originating mortgages that investors are ready to buy and it assures borrowers that they can lock in today's interest rates even though it could be weeks before settlement.

It is conceivable that, in the absence of a Government guarantee of MBS, the market would develop methods of separating credit risk from interest rate risk and create a hedging mechanism to replace the TBA market. Yet the experience of the private label MBS market should give us pause. That market, operating without the clarity of a Government guarantee, imperfectly separated credit risk from interest rate risk via complex security structures that parsed mortgage payment streams across multiple security tranches. There was no equivalent of TBA and the private label market was heterogeneous, which limited investor participation.

In the context of housing finance reform, we envision a new secondary mortgage market in which multiple sources of stable private capital bears all but catastrophic mortgage credit risk on mortgages placed into this new MBS. We believe it is the responsibility of private market participants to bear this risk. But ensuring the liquidity of some $5 trillion in mortgages—the size of the Fannie and Freddie market today—requires more than that. To ensure that families get the benefit of deep and continued investor interest in MBS to finance long-term, fixed-rate mortgages, the consistency of the loan pools and the absence of credit risk in those pools needs to be protected. A meaningful segment of MBS investors today would not continue to invest in this market if they had to also manage credit risk. Fewer investors means higher rates for consumers.

In all reform proposals that include a Government guarantee, that guarantee is limited to catastrophic or so-called tail risk; that is, private capital would directly bear all credit losses except losses caused by catastrophic economic circumstances (that is, the tail of the distribution of possible economic outcomes). Private market participants face several huge obstacles in managing mortgage tail risk. The frequency of a catastrophic event is rare. At most we have seen such events only twice in the past 100 years. The severity of the outcome is also extreme—losses far greater than in normal circumstances.

Under corporate tax and accounting rules, it is difficult and expensive for private firms to price and hold reserves for such large and rare contingencies. So, in the absence of a catastrophic backstop, the cost of mortgages would go up and the supply would become more limited (for instance, downpayment requirements would be greater).

Looked at this way, a Government guarantee is a way to enhance market performance by ensuring that credit risk is kept separate from interest rate risk in all economic environments. But we also believe that the system should have a pre-established system to fully repay taxpayers for any support provided as a result of the Government guarantee.

HPC supports proposals for the Government establishing a Mortgage Insurance Fund and charging a fee for the Government's catastrophic guarantee on all Government-backed MBS replacing the Fannie and Freddie market. The Government would manage the Mortgage Insurance Fund and use it to pay MBS holders if we ever encountered a catastrophic market outcome that wiped out the private capital support.

Importantly, though, this would not be the end of the story. Just as with Federal deposit insurance, any taxpayer advances to the Fund would be fully repaid over time through premiums assessed on future mortgages. The role of the Government's guarantee would be to more efficiently distribute catastrophic losses over time. As a pre-established system, the Fund would also serve as an automatic economic stabilizer; Congress and market participants alike could count on this mechanism to keep liquidity and confidence in housing finance through a catastrophic storm and any funds taxpayers lent into this system would have a built-in repayment mechanism.

To make the likelihood of activating the Government backstop remote, there needs to be robust and reliable private capital standing ahead of the Mortgage Insurance Fund. Rather than the 45 basis points of capital required of Fannie Mae and Freddie Mac, first loss capital should be at least as great as what banks would be required to hold if the mortgages were on their books rather than placed into MBS.

In sum, the future system must be properly structured and capitalized both to absorb even catastrophic losses and to provide countercyclical support. We view a Government guarantee as enabling markets to work more efficiently, making more mortgage credit available consistently and at lower cost to consumers. Since private capital would bear a substantial first-loss position, private capital would be incented to keep mortgage credit risk at prudent levels. And since the Government backstop for catastrophic losses would be pre-funded and have an ex post repayment mechanism already in place, taxpayers would not be bailing out the system but rather stabilizing it and enhancing the distribution of rare but substantial credit losses across time in a way private markets cannot.

Building on Progress Made

As the Committee restarts its legislative efforts, we believe there is a lot of common ground across legislative, industry, think tank, and other stakeholder proposals on which to build. Most, if not all, of the leading reform plans have the following elements:

- A common securitization platform operating either as an industry utility or a Government corporation.
- A single, Government-backed MBS to give rate investors (the private capital backstopping interest rate risk and the source of the long-term funding for long-term mortgages) freedom from credit risk concerns and deepening the universe of MBS investors. Some proposals call for creating a new Government entity to provide this insurance (for example, the Johnson–Crapo bill created the Federal Mortgage Insurance Corporation (FMIC)) while others recommend using an existing Government MBS guarantor (Ginnie Mae), and yet others are silent on this point.
- Substantial private capital would back each mortgage pool, supplemented by the capital of the pool aggregator (the entity bundling mortgages for securitization) and by an industry-funded, Government-backed reserve fund (as described just above).
- The credit risk transfer market that FHFA directed Fannie and Freddie to initiate is the basis for continuing to attract private capital using multiple structures and appealing to multiple types of investors in credit risk assets.
- A Government regulator would oversee this credit risk syndication and the sufficiency of the capital provided.
- Fannie Mae and Freddie Mac would be wound down and then ended as GSEs and their GSE charters would be extinguished. Whether and how they are merged or broken up or otherwise repositioned in the marketplace under a new charter and ownership regime is unresolved.
- The GSEs' current affordable housing goals regime would be eliminated (or at least altered), typically replaced by a funding stream generated from a small fee placed on all of the new Government-backed MBS created by reform. The use and control of these funds to support affordable housing varies by proposal. Most proposals also include some expression of a duty of secondary market entities to serve the broad market, including low- and moderate-income borrowers and communities.

This extensive amount of common ground provides a strong foundation on which to legislate. Importantly, relative to 2013–2014, the uncertainty associated with change is much less. For example, work on a common securitization platform, which was first announced in 2012, now has 5 years of thought and development and is partially operational today. Another example: the idea that private capital can be raised to back mortgage credit risk via risk syndication has moved from theory to practice. The first transaction was completed in 2013. Today, FHFA reports that the GSEs have transferred risk on more than $1.4 trillion of MBS, with nearly $50 billion in capital support raised through this process. Moreover, this capital support has been raised through multiple channels and structures, ranging from lender recourse and deeper private mortgage insurance to reinsurance and structured capital market transactions. This is a very encouraging development as it shows both the interest of private capital in this emerging asset class and the multiple ways in which the capital can be raised and the multiple sources of that capital. By establishing post-conservatorship secondary market entities, Congress would be completing the development of this market. Secondary market entities engaged in this credit risk syndication should give lenders and investors alike confidence in this credit intermediation process.

Key Issues Still To Resolve

While important issues remain unresolved, these are not insurmountable challenges and in many cases, the range of differences has shrunk over time. Among the key issues left to be resolved are the following:

- Who owns and who may access the common securitization infrastructure? May it be used to issue private label MBS? What is the source of the Government guarantee—a new Federal entity, Ginnie Mae, or some other approach?
- How will legislation ensure consistent national servicing standards and other forms of standardization such as mortgage data standards, disclosure standards, and so on?
- Assuming multiple forms and channels for bringing private capital to back all but catastrophic credit loss on mortgages, how would FHFA (or some other regulator) ensure equivalency of these various credit enhancement structures in front of any Government guarantee? Should legislation direct bank regulators to update bank capital and liquidity rules for this new system? Whatever the approach, clearly the movement from a GSE-dominated secondary market to a post-conservatorship market will require a holistic review of capital, liquidity, and disclosure rules.
- How does this new regime ensure equitable access to the secondary market for loan originators of all size and charter?
- What requirements should be placed on secondary market entities to ensure they strive to reach traditionally underserved markets and borrowers?
- May lenders credit enhance their own mortgage production if they meet the same standards as guarantors must meet?
- What other legal changes are needed to make the new system work (for example, amendments to securities and tax laws would enable mortgage real estate investment trusts to more readily be a source of private capital in this new market)?
- What is the role of the Federal Home Loan Bank System in this new regime? Should their mission or membership change?

Other Issues and Opportunities

Beyond all the plumbing and market structure issues just reviewed, comprehensive housing finance legislation needs to concern itself with how our housing finance system serves the needs of all Americans.

The Rental Market

My testimony to this point has focused largely on the ownership market. Yet, today the country's greatest housing challenges are in the rental market. While the CFPB's Qualified Mortgage rule generally requires household total debt (including mortgage payment) to be no more than 43 percent of a family's monthly income, we have more than 11 million renter families spending more than 50 percent of their monthly income just on rent. The waiting list for rental vouchers in many communities is years long. Moreover, local zoning, land use ordinances, and building requirements drive up the cost of new construction and rehabilitation, thereby limiting supply. While better education, jobs, and wages are the best solution, these supply constraints remain critical obstacles in many communities.

FHA

Few reform proposals deal with FHA, which is ironic since this agency offers the Government's flagship program for encouraging home ownership and because it is in such need of repair and modernization. While some of FHA's many challenges may be handled administratively, and HPC appreciates HUD Secretary Carson's openness to stakeholder input for improving the program, there can be a role for Congress here as well. At a fundamental level, Congress could give FHA a clear mission for serving 21st century borrowers and markets and ensure FHA has the resources to fulfill that mission.

In my short time at HPC, I have been struck by the deep concern our membership has for the FHA program and its future. HPC members see great value in the program as a means for the Federal Government to target subsidies that promote home ownership opportunities. In that way, FHA should complement private sector efforts rather than using those subsidies, and FHA's thin capital base, to compete away business that the private market already is serving. There is enough need for access to credit for low- and moderate-income homebuyers that both FHA and private lenders should be actively and fully engaged.

Yet, trends in the FHA program are troubling. Its market share in 2016 grew to 17 percent yet participation by depository institutions has been declining. Former Ginnie Mae President Ted Tozer frequently remarked on the risks this combination was creating for taxpayers. Neither FHA nor Ginnie Mae has the staff nor the resources to manage the evolving risk profile in the FHA program, which risks its long-term ability to serve its customers.

Earlier this month, HPC submitted a public comment letter to HUD outlining our concerns about the program as currently administered. From operational issues like property conveyance rules and weak quality control practices to legal requirements such as certifications to the use of enforcement tools such as the False Claims Act, these features of the FHA program as administered today are counter-productive to serving borrowers. As the Committee weighs housing finance reform, HPC respectively urges you to also consider the FHA program, its role in our housing finance system, and the potential to address pressing FHA issues as part of reform.

Preparing Borrowers To Become Sustainable Homeowners

A common element across many housing finance proposals is a goal of making mortgage lending more sustainable; that is, reducing the likelihood of default by borrowers, especially borrowers with less than perfect credit profiles. This requires more work and thought than simply subsidizing the cost of credit to low downpayment, low credit score, low-income borrowers. It requires greater attention to saving both for downpayments and for cash reserves once in the home, greater financial literacy, homebuyer education and home ownership counseling, and more effort to repair credit histories. Many HPC members sponsor and support programs that do these things.

A challenge facing many lower income renter and owner households, indeed even moderate and some higher income households, is increased income volatility. Many people lack the resources to buffer themselves from life's disruptions, and income disruptions are more common today than in the past. Housing policy and our housing finance system needs to become more attuned to this challenge so better solutions may be found.

Loan qualification standards also need to evolve and improve. For instance, greater competition has already led to more innovative approaches to credit scoring. With greater market transparency around mortgage performance and a competitive market for private capital risk-bearing, these developments will be more likely to get adopted, resulting in more consumers qualifying for mortgages.

Conclusion

In the 9 years since Fannie Mae and Freddie Mac were placed into Government conservatorships, the market has evolved substantially away from the failed system of the past. That process cannot be completed absent bipartisan legislation that deals with the status and charters of the GSEs and addresses related issues such as the role and health of FHA. The good news is that there are numerous common elements across the leading reform proposals. HPC is supportive of this consensus, which forms a solid foundation for legislation. While differences remain to be worked out, we are encouraged that compromise solutions are within reach. We stand ready to support this Committee as it crafts legislation that will set the country's housing finance system on a more market-based and competitive path because we believe this is the way to best serve the housing finance needs of our Nation's families. Thank you for inviting me here today.

PREPARED STATEMENT OF MICHAEL D. CALHOUN

PRESIDENT, CENTER FOR RESPONSIBLE LENDING

JUNE 29, 2017

Introduction

Good morning Chairman Crapo, Ranking Member Brown, and Members of the Senate Banking Committee. Thank you for the opportunity to testify regarding our nation's housing finance system, an issue that profoundly affects American families and is also critical to the overall housing industry, which is nearly 20% of the United States economy. I am the President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a community development lender headquartered in Durham, NC. Since 1980, Self-Help has provided over $7 billion in financing to 131,000 families, individuals and businesses under-served by traditional financial institutions. It helps drive economic development and strengthen communities by financing hundreds of homebuyers each year, as well as nonprofits, child care centers, community health facilities, public charter schools and residential and commercial real estate projects. Through its credit union network, Self-Help's two credit unions serve over 130,000 people in North Carolina, California, Chicago, Florida and Wisconsin and offers a full range of financial products and services. Learn more at www.self-help.org and www.self-helpfcu.org.

This important hearing provides an opportunity to offer ways that we can build on existing reforms within the secondary mortgage market, and repair parts that are broken without major disruption to the overall market. The goal must be to ensure that the full universe of credit worthy borrowers--regardless of where they live, including in rural areas, or who they are--have access to the credit they need to be able to secure a mortgage so that they can build their American dreams. The system must also continue to offer equal access for lenders of every size, taking special care to serve community banks and credit unions. Additional changes to the system, must factor in existing progress made by the Housing and Economic Recovery Act of 2008 along with the new mortgage protections created by Dodd-Frank and the Consumer Financial Protection Bureau. Further, it is important to remember that radical changes to housing finance could provoke unanticipated harms— some suggested changes could create heightened systemic risks, adversely impact community lenders and make housing credit unnecessarily expensive and restricted. Our testimony today draws heavily from our October 2013, working paper, *A Framework for Housing Finance Reform.*[1]

I. The Important Role Played by the GSEs Pre-and- Post Great Recession

A. The GSEs Created a National Housing Market

In evaluating proposed changes to the housing finance system, it is important to start by reviewing the role that the GSEs and FHA have played in the nation's housing market. Together they have made stable and affordable mortgage credit available across the country and throughout economic downturns. Today, they hold mortgages worth $6.17 trillion with Fannie Mae at 44.2 percent, Freddie Mac at 27.5 percent,

[1] Eric Stein and Carrie Johnson, A Framework for Housing Finance Reform: Fixing What Went Wrong and Building on What Works, Center for Responsible Lending, October 2013, available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/2013-crl-working-paper-on-gse-reform-a-framework-for-housing-finance-reform-oct-15pdf.pdf.

and Ginnie Mae at 28.3 percent.[2] The GSEs were created by Congress in the 1930s to provide stability to the capital markets and to increase the availability of mortgage credit throughout the United States following periods of severe economic volatility. The GSEs have a mandate to serve all credit markets at all times, which ensures broad credit availability in all regions of the nation. The GSE's charter states that they must "promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."[3] By bundling and securitizing mortgages with an implied federal government guarantee, the GSEs have increased the flow of credit to all parts of the nation. We now have a national mortgage market; investor confidence; increased loan volume; and widespread use of the 30-year fixed rate mortgage. This in turn has resulted in more affordable loans for consumers.

B. Fannie Mae and Freddie Mac Follow The Market in a Race to the Bottom

The housing boom and the subsequent financial crash, though, revealed defects in the structure and operation of the GSEs. In the years leading up to the 2008 crisis, financial incentives at Fannie Mae and Freddie Mac drove them to chase market share by loosening underwriting guidelines, particularly for Alt-A no doc loans. This increased risk-taking led to larger credit losses that ultimately pushed the GSEs into conservatorship.

Prior to entering conservatorship in 2008, both Fannie Mae and Freddie Mac were perceived to have implicit government backing, and subsequent events showed this to be the case. This guarantee was combined with private shareholders seeking market share to drive high quarterly gains and returns on equity. In the early 2000's, both GSE market share and profits were put at risk in the face of growing private-label securitizations competition. As the subprime and Alt-A markets grew in size from 2001 through 2006, the percentage of loans eligible for purchase by Fannie Mae and Freddie Mac under their traditional underwriting standards – also called conforming loans – decreased significantly. From 2003 to 2006, the GSE and government share of the MBS market (Fannie Mae, Freddie Mac and Ginnie Mae) fell from 78 percent to 44 percent while the private label securities share rose from 22 percent to 56 percent.[4] It is no coincidence that this 34 percent swing in favor of private label securities occurred during the worst period of lending in American history since the Great Depression, as Wall Street pushed riskier loans and riskier securities backed by these loans.[5]

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[2] Laurie Goodman et.al., Housing Finance at a Glance: A Monthly Chartbook, at 6-7 (May 2017), available at http://edit.urban.org/sites/default/files/publication/90451/may_chartbook.pdf.

[3] Fannie Mae's charter is in Title III of the National Housing Act, 12 U.S. Code § 1716 et. seq. Freddie Mac's charter is in 12 U.S.C. §1451 et. seq.

[4] Over this time, mortgage-backed securities accounted for roughly 69 percent of the entire mortgage market. See CRL calculations based on data provided in 2011 Mortgage Market Statistical Annual, Inside Mortgage Finance (Volume II: Secondary Market) (2011).

[5] See e.g., The Financial Crisis Inquiry Commission, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, at 105 (January 2011) (stating that "[s]imultaneously, underwriting standards for nonprime and prime mortgages weakened. Combined loan-to-value ratios—reflecting first, second, and even third mortgages—rose. Debt-to-income ratios climbed, as did loans made for non-owner-occupied properties. Fannie Mae and Freddie Mac's market share shrank from 57% of all mortgages purchased in 2003 to 42% in 2004, and down to 37% by 2006. Taking their place were private-label securitizations—meaning

In response to this declining market share and harm to quarterly earnings targets, both Fannie Mae and Freddie Mac eased their underwriting standards and begin guaranteeing Alt-A mortgages – generally loans that did not fully verify income and assets – that were previously outside of the GSE credit box. While these Alt-A loans constituted roughly 10 percent of Fannie Mae's outstanding loans in 2008, they were responsible for 50 percent of its credit losses.[6]

Additionally, the GSEs purchased securities bundled with subprime loans that had risky product features for their own portfolio in order to obtain higher financial rates of return.[7] This race to the bottom in order to shore-up returns for shareholders proved disastrous. These loans soon resulted in high default rates and generated substantial losses that the entities lacked the capital to cover. Although the GSEs were not the instigators of this abusive lending, their follow-the-leader approach hurt borrowers and led Fannie and Freddie into conservatorship. The Fiscal Crisis Inquiry Commission determined that the housing crisis that led to the Great Recession was totally avoidable and primarily the result of lax regulation and excessive risk taking by Wall Street Firms.[8] While misaligned incentives and insufficient oversight led to risk and volatility at the GSEs themselves, the activity of the GSEs contributed to the resulting harm, but did not cause the crash.[9] Nonetheless, this experience exposed weaknesses in the GSEs' structure, capital, operations and oversight.

C. Following the Financial Crash, GSE and FHA Lending Saved the Market from Complete Shutdown

Private capital retreated during the housing crash. The countercyclical nature of the GSEs and FHA insured mortgage programs sustained the market. Private label lending peaked in 2006 with approximately 40% of all mortgage originations.[10] It began to decline in 2007 and virtually ceased by 2008.[11] With record levels of defaults and foreclosures occurring amid sharp declining prices nationwide, overall mortgage lending dropped precipitously.

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those not issued and guaranteed by the GSEs.") (available at http://fcic-static.law.stanford.edu/cdn_media/fcicreports/fcic_final_report_full.pdf).

[6] See Federal National Mortgage Association, United States Securities and Exchange Commission Form 10- Q, for the quarterly period ended June 30, 2008, at 6 (available at http://www.fanniemae.com/ir/pdf/earnings/2008/q22008.pdf).

[7] See e.g., Written Testimony of Martin Eakes, CEO, Center for Responsible Lending and Center for Community Self-Help, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, Hearing: Preserving the American Dream: Predatory Lending Practices and Home Foreclosures (February 7, 2007) (stating that "[c]urrently Fannie Mae and Freddie Mac are purchasing the senior tranches of mortgage backed securities backed by abusive subprime loans. By doing so, they are essentially supporting and condoning lenders who market abusive, high-risk loans that are not affordable. This is clearly counter to the mission of those agencies. The agencies should cease purchasing the securities, the Office of Federal Housing Enterprise Oversight (OFHEO) should prohibit their purchase, and the U.S. Department of Housing and Urban Development (HUD) should stop providing credit for these securities under HUD's affordable housing goals.") available at http://www.responsiblelending.org/mortgage-lending/policylegislation/congress/martin-testimony.pdf

[8] The Financial Crisis Inquiry Commission, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, at 27 (January 2011), available at https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

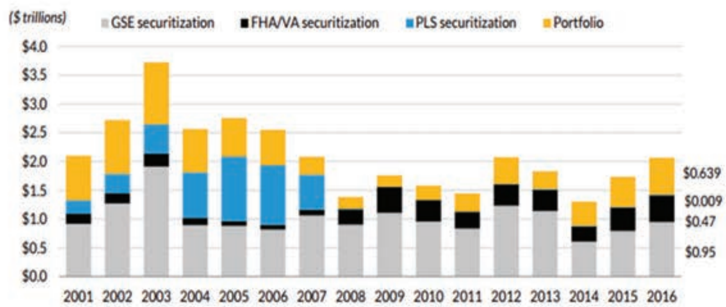
[9] Id.

[10] Laurie Goodman et.al., Housing Finance at a Glance: A Monthly Chartbook, at 8 (May 2017), available at http://edit.urban.org/sites/default/files/publication/90451/may_chartbook.pdf.

[11] Id.

Credit would not have been available for most mortgagees if not for government support during the financial crisis. Backed by government guarantees, the GSEs under Federal Housing Finance Administration conservatorship beginning in September 2008 and FHA continued to ensure that credit would be available. GSE lending jumped to over 65 percent of all mortgage originations in 2008.[12] FHA lending also stepped in and played a key role, increasing rapidly.[13] Since then, FHA purchase loans have dropped steadily and returned to more normal levels of the early 2000s, falling to less than 600,000 purchase loans in 2014.[14] Moody's estimated that FHA's contribution prevented a second collapse in the housing market, which could have sent the U.S. economy into a double-dip recession and caused the economy to shed another 3 million jobs and the unemployment rate to rise an additional 1.6 percent.[15]

Figure 1. First lien origination volume



Source: Inside Mortgage Finance and Urban Institute, last updated February 2017

Congress also acted quickly with a bi-partisan response to the market crash with the Housing and Economic Recovery Act of 2008 (HERA).[16] HERA created the power for the GSEs to be taken into conservatorship in an effort to rein them in from their misaligned incentives. Simultaneously, HERA created important reforms for the GSEs that allow for much needed regulatory oversight by providing a strong regulator, the Federal Housing Finance Agency (FHFA). These changes have greatly reduced the risk of future problems at the GSEs, and better aligned their incentives to their chartered missions. HERA's

[12] Id.

[13] John Griffith, "The Federal Housing Administration Saved the Housing Market" (Washington: Center for American Progress, 2012), available at https://www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federalhousing-administration-saved-the-housing-market/. This report cites data estimates from Moody's Analytics in October 2010.

[14] US Department of Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2010, at 2 (November 2010), available at https://portal.hud.gov/hudportal/documents/huddoc?id=report_to_congress.pdf.

[15] John Griffith, "The Federal Housing Administration Saved the Housing Market" (Washington: Center for American Progress, 2012), available at https://www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federalhousing-administration-saved-the-housing-market/. This report cites data estimates from Moody's Analytics in October 2010.

[16] 12 U.S.C. § 4501 et. seq.

conservatorship was not intended to be indefinite, nor was it intended to be the catalyst for receivership of the GSEs. The GSEs have now paid far more into the Treasury Department than they received in assistance and they are operating in a much more safe and sound manner.[17]

II. Goals of Housing Finance Reform

As further housing finance reforms are considered, they must be evaluated by how well they serve the goals of the housing finance system; providing stable mortgage credit to all credit worthy borrowers; supporting the participation of all lenders, including community lenders; and, protecting taxpayers.

A. Access to Mortgage Credit for all Credit Worthy Families Must be Supported Going Forward

Homeownership is the primary way that most middle class families build wealth and achieve economic stability. Wide access to credit is critical for building family wealth, closing the racial wealth gap, and for the housing market overall.

Home equity accounts for much of American family wealth. For many low-to-moderate income families and people of color in particular, a home represents the only asset that a family may ever own and the equity in their homes constitutes a larger share of personal wealth. Home equity accounts for only 30 percent of the net worth for wealthier households, but constitutes sixty-seven percent for middle-to- low income households.[18] Home equity accounts for fifty-three percent of African-American wealth as compared to 39 percent for whites.[19]

The great recession exacerbated inequality in wealth distributions. According to the Pew Research Center, in 2012 whites had 13 times the wealth of African-Americans and 10 times the wealth of non-white Hispanics.[20] Specifically, whites had a median wealth of $141,900 compared to $13,700 and $11,000 for non-Hispanic whites and African-Americans respectively.[21] Also, the St. Louis Federal Reserve reports that one in nine whites have less than $1,000 in wealth compared to one in four for Latinos and one in three

[17] Congress of the United States Congressional Budget Office, The Effects of Increasing Fannie Mae's and Freddie Mac's Capital, at 5 (October 2016), available at https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/52089-gse-report.pdf.
[18] Brendan Greely, U.S. Homeowners Are Repeating Their Mistakes, Bloomberg, February 14, 2013, available at https://www.bloomberg.com/news/articles/2013-02-14/u-dot-s-dot-homeowners-are-repeating-their-mistakes.
[19] Thomas Shapiro, Tatjana Meschede, and Sam Osoro, The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide, Institute on Assets and Social Policy, (February 2013), p.3., available at http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf.
[20] Rakesh Kochhar and Richard Fry, Wealth inequality has widened along racial, ethnic lines since end of Great Recession, Pew Research Center, December 12, 2014, available at http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/.
[21] Id.

for African-Americans.[22] Home equity plays a great role in determining a families' wealth and is the furthermost contributor to the racial wealth gap between whites and people of color.[23]

The different levels of wealth accumulation for whites and people of color are mostly correlated to each group's historic ability to become homeowners. In fact, Federal Housing Administration FHA housing policies after World War II until the mid-1960s explicitly discriminated against people of color and limited their access to FHA mortgages, while promoting expanding homeownership's access for whites.[24] According to a report by Demos, if homeownership rates were the same for whites and people of color we would see a decrease in the racial wealth gap by 31 percent for African-Americans and 28 percent for Latinos.[25]

Despite historical inequities in access to mortgage credit, the future of the market depends on these often-excluded borrowers. Existing homeowners, especially Older Americans, will need buyers when they want to sell and new families need access to affordable mortgage credit to buy their homes. The homebuyers of the future will be more racially and ethnically diverse than those of the past. Harvard's Joint Center for Housing Studies found that non-whites accounted for 60% of household growth from 1995-2015 and predicts that half of Millennial households by 2035 will be non-white.[26] As stated above, these borrowers have less wealth, which has translated into lower credit profiles and an inability to make large down payments on mortgage loans.[27]

A study of Self-Help's Community Advantage Program (CAP), however, shows that when provided an opportunity and safe mortgage loans these borrowers succeed.[28] In fact, the borrowers in the study

[22] Ray Boshara and William Emmons, Stark Disparities in Wealth Are Key in Discussions on Race in the United States, Washington Post, December 30, 2014.

[23] See Shapiro et al., The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide, Institute on Assets and Social Policy, (February 2013).

[24] For a more in depth review of how federal housing policies have discriminated against people of color, See Ta-Nehisi Coates, The Case for Reparations, The Atlantic, June 2014, available at http://www.theatlantic.com/features/archive/2014/05/the-case-for-reparations/361631/; See also, Bob Herbert, Against All Odds: The Fight for the Black Middle Class, Bob Herbert and Public Square Media, Inc (2016), available at http://www.pbs.org/wnet/chasing-the-dream/films/against-all-odds/.

[25] Tanvi Misra, Why America's Racial Wealth Gap is Really A Homeownership Gap, Demos, March 12, 2015, available at http://www.demos.org/news/why-americas-racial-wealth-gap-really-homeownership-gap.

[26] Joint Center for Housing Studies of Harvard University, State of the Nation's Housing 2017, June 2017, available at: http://www.jchs.harvard.edu/research/state_nations_housing.

[27] See The State of the Nation's Housing, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make downpayments. For example, among renters aged 25–34 in 2010, the median net wealth was only $1,400 for blacks and $4,400 for Hispanics, compared with $6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-downpayment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.")

[28] See Setting the Record Straight on Homeownership, UNC Center for Community Capital, Research Brief (2012).

amassed a net worth of $38,000, compared with renters' $266, even as housing values plunged.[29] The Community Advantage Program securitized mortgages for more than 50,000 families in 48 states.[30] Still, access to mortgage credit continues to be a challenge for far too many people. The Urban Institute found that from 2009 to 2014, there were 5.2 million mortgage loans missing from the market due to unnecessarily tight credit standards, including restrictions and measures put in place by the GSEs.[31]

GSEs and Ginnie Mae Provide Access to Mortgage Credit in Underserved Communities
Both the GSEs and Ginnie Mae continue to provide critical mortgage capital to underserved communities. The GSEs purchased over 2 million home purchase and refinance mortgage loans in 2015, including nearly a half a million loans to low- and moderate-income borrowers, nearly 400,000 loans to borrowers of color and over 300,000 loans to borrowers living in rural areas. At the same time, smaller financial institutions (those with assets less than $2 billion) relied on loans sold to the GSEs to meet the credit needs of nearly 200,000 borrowers seeking mortgage credit in rural communities. Loans backed by Ginnie Mae also continue to play a significant role in serving borrowers whose credit may warrant additional enhancement or who have limited resources for a down payment. Government-backed lending cannot and should not be sole source of mortgage lending in these communities.

To better understand the GSE market share among low- and moderate-income borrowers, borrowers of color, rural borrowers and among community banks and credit unions, CRL analyzed over six million home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes (including manufactured homes) reported under the Home Mortgage Disclosure Act in 2015 (referred to as purchase lending and refinance lending going forward). Of these loans, 34.2% were sold to Fannie Mae, Freddie Mac or Farmer Mac (collectively, the GSEs) and 16.2% were loans guaranteed through Ginnie Mae (see Figure 2).

Figure 2. 2015 purchase and refinance loans by purchaser

	All loans		Loans to LMI borrowers		Loans to borrowers of color	
	#	%	#	%	#	%
GSEs	2,065,978	34.2%	457,450	31.3%	374,133	30.0%
Ginnie Mae	976,119	16.2%	235,514	16.1%	262,773	21.1%
Not sold in 2015	1,245,698	20.6%	275,054	18.8%	225,453	18.1%
Other	1,752,868	29.0%	493,318	33.8%	382,781	30.7%
Total	6,040,663		1,461,336		1,245,140	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data, home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes, including manufactured homes. GSEs refers to all loans sold to Fannie Mae, Freddie Mac or Farmer Mac in 2015 calendar year. Other category includes loans acquired by an affiliate institution, commercial bank, savings bank, savings association, life insurance company, credit union, mortgage bank, finance company or private securitization.

[29] Allison Freeman and Roberto G. Quercia, Low- and Moderate-income Homeownership and Wealth Creation, UNC Center for Community Capital, at 2 (June 2014), available at http://ccc.sites.unc.edu/files/2014/08/6-20-14-Wealth-Creation-Policy-Brief.pdf.
[30] Id.
[31] Bing Bai, Lauri Goodman, and Jun Zhu, Tight credit standards prevented 5.2 million mortgages between 2009 and 2014, available at http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014.

The GSEs and Ginnie Mae Provide Important Credit Access for Low- and Moderate-Income Borrowers and Borrowers of Color

In 2015, GSEs purchased 457,450 purchase and refinance loans made to low- and moderate-income borrowers making up 31.3% of purchase and refinance mortgage lending to LMI borrowers, or borrowers with incomes less than 80 percent of the area median income. Likewise, Ginnie Mae guaranteed 235,514 purchase and refinance loans to LMI borrowers making up 16.1% of all purchase and refinance lending to low- and moderate-income borrowers (Figure 2).

During the same year, GSEs purchased 374,133 loans to borrowers of color, or 30.0 percent of all loans to these borrowers and Ginnie Mae guaranteed 262,773 FHA loans to borrowers of color—a 21.1 percent market share.

GSE Market Share Exceeds Ginnie Mae Market Share in Rural Communities

The GSEs also provide an important source of mortgage capital in rural communities, where they purchased nearly one out of every three new mortgages in 2015. In 2015, lenders made over one million purchase and refinance loans in rural areas.[32] The GSEs also purchased 76,661 purchase and refinance loans to LMI borrowers in rural areas and 20,504 loans to rural borrowers of color, a 26.2 percent and 21.9 percent market share, respectively (Figure 3).

In comparison, Ginnie Mae guaranteed 196,963 FHA loans in rural areas, including 52,876 loans (18.1 percent) to LMI borrowers and 24,234 loans (25.9 percent) to rural borrowers of color.

Figure 3. 2015 purchase and refinance loans by purchaser in rural areas

	All rural loans		Loans to rural LMI borrowers		Loans to rural borrowers of color	
	#	%	#	%	#	%
GSEs	320,525	30.0%	76,661	26.2%	20,504	21.9%
Ginnie Mae	196,963	18.4%	52,876	18.1%	24,234	25.9%
Not sold in 2015	271,145	25.3%	77,405	26.4%	22,872	24.4%
Other	281,233	26.3%	85,999	29.4%	25,982	27.8%
Total	1,069,866		292,941		93,592	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

The GSEs also provide a critical source of mortgage capital for smaller lenders, those with assets of less than $2 billion in 2015. The GSEs purchased 177,028 purchase and refinance loans from smaller lenders lending in rural areas, or 25.1 percent of the market. Ginnie Mae guaranteed 139,792 purchase and refinance loans made by small lenders in rural areas that same year—a 19.8 percent market share (Figure 4).

[32] Census tracts, which were classified as either urban or rural areas based on the 2017 definition of *rural area* at 12 CFR 1282.1 and available at https://www.fhfa.gov/DataTools/Downloads/Pages/Duty-to-Serve-Data.aspx

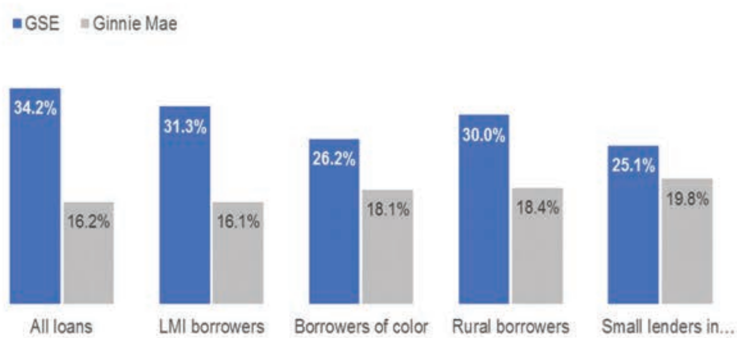
Figure 4. 2015 purchase and refinance loans originated by small lenders by purchaser in rural areas

	Purchase loans		Refinance loans		Total	
	#	%	#	%	#	%
GSEs	73,564	18.5%	103,464	33.4%	177,028	25.1%
Ginnie Mae	70,417	17.8%	69,375	22.4%	139,792	19.8%
Not sold in 2015	86,709	21.9%	71,089	22.9%	157,798	22.3%
Other	165,920	41.8%	66,122	21.3%	232,042	32.8%
Total	396,610		310,050		706,660	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

In all, the GSE market share exceeds the market share of Ginnie Mae among low- and moderate-income borrowers, borrowers of color and rural borrowers. The GSEs also purchase one out of every four loans issued by smaller lenders in rural areas, exceeding the market share of loans guaranteed by Ginnie Mae and even exceeding the market share of loans that are originated but not sold to other institutions or the secondary market (Figure 5).[33]

Figure 5. Market share of GSEs and Ginnie Mae



Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

In addition to support for home ownership, the GSEs also play a vital role in supporting affordable rental housing, which is essential for many working families. These programs have performed well, even through the financial crisis, and should be continued going forward.

[33] FHA operations have been hampered in recent years due to a variety of challenges including excessive uncertainty regarding lending liability, structural defects in its servicing process and outdated and under resourced technology and operations infrastructure. See, The Federal Housing Administration Can Do More With More, April 2017 available at https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/

B. *Pricing Practices Should Expand Mortgage Access*

The GSEs and FHA today have an affirmative duty to serve all markets which incentivizes them to set prices in a way that balances risk and access.[34] These participants in today's housing finance system are incented to pool risk and price credit risk on a pooled basis. Unfortunately, recent proposals for legislative housing finance reform share a common feature that undermines this pricing approach. Deep upfront credit risk transferred to private capital would incent actors to segment, rather than pool, credit risk and prices. Segmented pricing puts mortgage credit out of reach for too many credit worthy borrowers.

The total amount borrowers pay to cover credit risk is a function of modeled losses, capital standards and the required rate of return on capital.[35] Modeled losses are largely independent of system structures.[36] Capital requirements and required rates of return on capital are dependent on the structure of a future system, and function to increase or decrease the overall total amount to be held to guard against losses.

It is the policies of participants in the housing finance system that translate predicted credit losses into borrower prices and distribute prices for borrowers with different characteristics. Importantly, the degree to which costs are pooled or distributed is determined by the structure of the housing finance system. For example, FHA (a fully government-backed mortgage insurance program) charges the same insurance premium to borrowers regardless of credit score, [37] whereas private mortgage insurers charge widely different fees to borrowers with different credit scores and/or levels of downpayment (Figure 6).

[34] CRL continues to work with FHFA to encourage changes which could further open up access to credit. For example, eliminating the loan level price adjustments (LLPAs) that were put in place after the crisis.
[35] For a more detailed discussion of the levers that affect pricing and the distribution of pricing for credit risk see Calhoun, M. and Wolff, S. Who Will Receive Home Loans, and How Much Will They Pay?, 2016 available at http://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-finance-reform-incubator/mike-calhoun-and-sarah-wolff-who-will-receive-home-loans-and-how-much-will-they-pay
[36] System structure could introduce new risks. For example, if a future system made it very difficult or costly for first-time homebuyers to purchase a home, then existing homeowners would have a difficult time selling their homes. This could depress housing prices or limit liquidity in the housing system overall, which could result in a downturn and create losses in the system above what would be predicted by current models.
[37] FHA premium rates available at: https://portal.hud.gov/hudportal/documents/huddoc?id=17-07ml.pdf.

Figure 6. Private mortgage insurance pricing, 2017

	97-95.01% LTV 35% Coverage	95-90.01% LTV 30% Coverage	90-85.01% LTV 25% Coverage	85% LTV and under 12% Coverage
>=760	55	41	30	19
740-759	75	59	41	20
720-739	95	73	50	23
700-719	115	87	60	27
680-699	140	108	73	32
660-679	190	142	100	41
640-659	205	150	105	43
620-639	225	161	110	45

From online published rate sheets for Borrower Paid Mortgage Insurance from private mortgage insurers Genworth (https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf) and Radian (http://www.radian.biz/sfc/servlet.shepherd/version/download/068C0000002osy9IAA)

Underwriting structures determine if borrowers are credit worthy, but pricing structures determine if a credit worthy borrower can afford a mortgage. Differential pricing creates an additional barrier to mortgage credit by increasing the price, sometimes significantly, for some borrowers relative to others. There is evidence of price acting as a barrier even in today's mortgage market. For example, although Fannie Mae's guidelines allow the GSE to purchase loans with credit scores down to 620 and loan-to-value (LTV) ratios of up to 97%, very few loans purchased by the GSE have these characteristics.[38] One reason is that risk-based pricing by both the GSEs and private mortgage insurers add significantly to the cost of loans for borrowers with lower scores and less wealth for a downpayment. For example, the combination of LLPAs and MI premiums adds over 300 basis points to the cost of a mortgage for a borrower with a credit score of 620 and an LTV of 97%.[39]

The GSEs, though, currently set prices based on a more consolidated set of borrower characteristics than private actors like private mortgage insurers. They lay off credit risk largely through back-end credit risk transfer mechanisms which allows for pooling of loans and risk. Ultimately, these policies limit the degree to which loan pricing is highly segmented.[40]

Comparing the GSE guarantee fee structure to the MI pricing structure reveals the private market's tendency to create finely defined bands. GSE guarantee fee pricing[41] breaks up credit scores into three

[38] See pg 6 of *2017 First Quarter Credit Supplement*, Fannie Mae, May 5, 2017 available at: http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2017/q12017_credit_summary.pdf

[39] 350/4+225=312.5 basis points. Fannie's Mae's LLPA for this combination of credit score and LTV is a one-time fee of 350 basis points (see page 2: https://www.fanniemae.com/content/pricing/llpa-matrix.pdf), we assumed a LLPA multiple of 4 to convert this upfront fee to an ongoing cost comparable to the MI premium. Borrower paid MI from Genworth for this combination of credit score and LTV is a continuing fee of 225 basis points (see: https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf).

[40] Through the LLPAs the GSEs also have differential pricing, which limits their reach to underserved borrowers.

[41] As described in *Fannie Mae and Freddie Mac Guarantee Fees: Request for Input*, FHFA, 2015, available at: https://www.fhfa.gov/policyprogramsresearch/policy/documents/gfeerfi060514f.pdf

bands: >=740, 700-739, and 620-699. From December 2013 to April 2016, MI companies broke up this same range into four bands: >=760, 720-759, 680-719, and 620-679. The most recent set of MI pricing, released in April 2016,[42] breaks this same range of credit scores into eight different bands: >=760, 740-759, 720-739, 700-719, 680-699, 660-679, 640-659, and 620-639.

Finely defined pricing frameworks produce more extreme pricing. Figure 7 below shows the change in basis points borrowers with a given credit score saw as a result of PMI pricing changes implemented in April 2016. Some borrowers, those with credit scores above 740, enjoyed a reduction in fees whereas others, almost all borrowers with scores below 680, experienced increases. The cells highlighted in dark green saw a decrease of more than 30 basis points. The cells highlighted in dark orange saw an increase of more than 30 basis points.

Figure 7. Change in MI pricing by credit score and LTV December 2013 to April 2016

	97-95.01% LTV 35% Coverage	95-90.01% LTV 30% Coverage	90-85.01% LTV 25% Coverage	85% LTV and under 12% Coverage
>=760	-50	-13	-9	-4
740-759	-35	-3	-3	-7
720-739	-15	11	6	-4
700-719	-16	-2	3	-6
680-699	9	19	16	-1
660-679	42	27	29	2
640-659	57	35	34	4
620-639	77	46	39	6

From online published rate sheets for Borrower Paid Mortgage Insurance from private mortgage insurers Genworth and Radian for December 2013 and April 2016.

Proposed housing finance systems that rely on deep, upfront private capital to cover credit risk do not provide a countervailing pressure to market incentives to finely and differentially price credit risk. Even in the current system, in which the GSEs have incentives for risk and price pooling, troubling pricing differences prevent credit worthy borrowers from getting mortgages. Unfortunately, the legislative proposals further erode incentives for pooling and are likely to result in even greater differential pricing. This will make it even harder and more costly for credit worthy borrowers of modest means to afford a mortgage.

C. Community Banks And Other Small Lenders Must Be Supported In Housing Finance Reform

Community banks, credit unions and other small lenders play a critical role in providing mortgages and other financial services on a local basis to American families, and they must be supported by the housing finance system. The current system has many provisions to do this, and these should be continued and

[42] Shown in Figure 6.

expanded. Some proposals for changes in housing finance, though, would strongly tilt the system against these institutions.

Community banks, credit unions, and other small financial institutions deliver mortgages to their customers, along with other essential financial services, in the communities where they are located. As has been noted by many, these institutions have a different business model than larger institutions, often serving local markets and having close relationships with their customers. In rural areas, these institutions play a particularly important role. In many rural communities, community banks and credit unions are the only financial institutions providing retail branches and services in the community. These institutions also focus on traditional banking services and do not engage in many of the complex lines of business that larger institutions do, such as securities issuance, credit default swaps, or proprietary trading.[43] Disruptions to the traditional banking services, such as mortgages, cannot be offset with other products and lines of service. As a result, stress on community banks and their mortgage lending would be felt elsewhere. For example, community banks provide almost half of small business lending, and that is dependent on the overall sustainability of the institutions.

The GSEs provide a number of features that are essential for community banks. First is the GSEs' cash window, which provides lenders the option of selling individual loans. This means that smaller institutions do not have to trade their loans for securities or sell their loans to other large banks. Although many larger lenders trade their loans for GSE securities, this is difficult for small lenders. The securities carry the interest rate risk of the underlying loans and, as a result, can change substantially in value if market interest rates change. An increase in market interest rates would significantly reduce the value of the securities and create a loss for the bank holding the security. Larger institutions can purchase interest rate swaps to hedge this risk, but this is much harder for small lenders to do.

Another advantage of the current cash window is that the GSEs purchase these loans without requiring the transfer of the servicing of the loans to a third party. This enables the community banks and credit unions to continue the relationship with the customer during the life of the loan rather than having the loan serviced by a third party or even a competitor. Private loan purchasers and aggregators often require the seller to transfer the loan servicing to the purchaser. Keeping loan servicing in the hands of the community based financial institutions usually results in better consumer outcomes in terms of customer service and loan performance

The current cash window also provides comparable pricing to trading for securities. This is critical, as options such as the cash window are viable only if the pricing is at a level that permits community banks to be competitive in the mortgage market. Overall, the mortgage market favors larger lenders and larger transactions, particularly for securities. Sales of large pools of loans are more attractive to buyers of the loans and buyers of the securities backed by the loans. Absent safeguards, large lenders can leverage the government support to use these structural advantages to squeeze community banks and other small lenders out of the market. These important features of the cash window option, which are not available for FHA loans, are a reason that the FHA program, while vitally important, is not a substitute for community banks having access to conventional lending for their full spectrum of customers.

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[43] These distinctions have been recognized by the CFPB, which created a number of special provisions for these lenders in the mortgage regulations, exempting smaller lenders from many requirements and providing additional flexibility for underwriting and servicing of loans.

Given the importance of these provisions in the current housing finance system, they should be continued and expanded. However, some of the proposals for housing reform have provisions that would tilt the government supported mortgage market heavily against community banks. While most options preserve some form of a cash window, they do not have the supporting protections that make it workable. Most important is pricing parity with the securities option. If securities trade at a better price, it greatly diminishes the value of the cash window. This is true even if there is a provision that prohibits volume pricing or discounts. If all cash transactions are disfavored to securities, the lack of discounts in either market are of little consolation to community banks who are disproportionately dependent on the cash window transactions. To provide this pricing parity, the guarantor/issuer must have the ability to pool costs across the market. This makes it essential that guarantor/issuers serve a national market and have a duty to equitably serve all lenders. Otherwise, if some guarantors/issuers can choose to cream the market, serving only the large lenders and the most lucrative markets, the remaining guarantors will not have sufficient loans from the full market to be able to provide pricing parity to small lenders and still compete in the overall market. In order to provide this parity, the guarantor/issuers also must be able to pool the credit risk that they hold and reinsure. If all but the catastrophic credit risk is transferred before the loans are purchased by the guarantor/issuers, there is insufficient revenue remaining for the guarantors/issuers to pool the costs and provide viable pricing to small lenders. If substantially all of the credit risk is sold and priced before the loans are acquired by the guarantor/issuer, then these other parties control the access and pricing and they will favor the larger lender transactions, which will be more profitable.

Provisions for a small lender security or issuer are offered in some plans to address this problem, but they are inadequate. Securities resulting from small groups of loans from many lenders will be measurably more expensive to assemble. They would also still lack the size to create enough loans to provide the large volume of securities for the economies of scale and liquidity that investors in securities desire, and would also reduce the price community banks received for the mortgages.

Other aspects of the mortgage market already have headwinds for community lenders. Many components of the production of mortgages favor large lenders due to their market size. These larger lenders can demand lower prices for many of the third party services provided to lenders, and overall they have the advantage of economies of scale over smaller lenders. These conditions make it all the more important that the government elements of the mortgage provide a level playing field and not contribute to the squeezing out of community bank mortgage lending.

III. Further Changes in the Housing Finance System Must Build On The Substantial Reform Already Implemented

A. *Enactment of HERA*

One of the major reforms in response to the financial crash was Congressional action to strengthen and improve the regulatory structure of the housing market. The Housing and Economic Recovery Act (HERA) substantially changed the regulatory landscape of the housing finance system.[44] As we pursue further reform we need to build upon the current market and regulatory structure, which was substantially

[44] 12 U.S.C. § 4501 et. seq.

strengthened by HERA. In fact, after the passage of HERA substantial GSE reform has already been implemented, and these reforms should be continued, expanded, and made permanent.

Congress' creation of the Federal Housing Finance Agency (FHFA) was a central reform of the housing finance system. HERA abolished the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board, and established FHFA – a strong independent regulator with the legal authority and tools required to supervise the full activities of the GSEs. Prior to HERA, oversight of the GSEs was split between OFEO and the Secretary of HUD. The absence of a primary and comprehensive regulator resulted in the lack of robust and efficient enforcement. OFHEO, an independent agency within HUD, was the safety and soundness regulator, and the Secretary of HUD was the mission regulator. The affordable housing goals were under the Secretary of HUD's purview. This regime was problematic for many reasons, but the most significant issue was that OFHEO did not possess the legal authority necessary to adequately supervise the GSEs or enforce the law. As FHFA's General Counsel stated in congressional testimony in 2013, "At OFHEO much had to be done with implied authorities; HERA corrected that, providing explicit authorities and language regarding 'incidental authority.'"[45]

OFHEO's authority over the GSEs was weak and not comparable to other financial regulators. The agency did not have sufficient authority to establish prudential standards, including internal controls, audits, risk management, and management of the portfolio. In contrast, HERA empowered FHFA with the legal authority to comprehensively and robustly regulate the GSEs. FHFA has the tools to ensure adequate capital,[46] establish prudential standards,[47] review and approve new product offerings,[48] place a regulated entity into receivership,[49] and closely supervise the full activities of the GSEs.

Furthermore, OFHEO did not hold adequate enforcement authority. OFHEO had to rely on the Attorney General to sue on the agency's behalf. HERA provided FHFA with a broad range of administrative enforcement tools, including cease and desist orders, civil money penalties, debarment of officials, and the ability to act against entity-affiliated parties.[50] FHFA may also access the courts through its independent litigation authority.[51] Additionally, while OFHEO funded operations through assessments on the GSEs, it could only collect the assessments when approved through appropriations. Consequently, OFHEO was perpetually underfunded. HERA corrected this so FHFA would not be subject to the appropriations process and the politics accompanying it.[52]

In addition, HERA corrected the bifurcated authority issue that OFHEO experienced. On the mission side, HERA provided FHFA with authority over the affordable housing goals and established a duty to serve underserved markets requirement. The purpose of this requirement is to increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing

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[45] Housing Finance Reform: Powers and Structure of a Strong Regulator, Statement of Alfred M. Pollard before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Nov. 21, 2013), *available at* https://www.fhfa.gov/mobile/Pages/public-affairs-detail.aspx?PageName=Housing-Finance-Reform-Powers-and-Structure-of-a-Strong-Regulator.aspx.
[46] 12 U.S.C. §§ 4611-4613.
[47] 12 U.S.C. § 4513b.
[48] 12 U.S.C. § 4541.
[49] 12 U.S.C. § 4617.
[50] 12 U.S.C. §§ 4581, 4631.
[51] 12 U.S.C. § 4635.
[52] 12 U.S.C. § 4516.

for very low-, low-, and moderate-income families in manufactured housing, affordable housing preservation, and rural markets.[53] FHFA's authority to administer the duty to serve requirement plus the affordable housing goals should be applied robustly to expand affordable homeownership opportunity.

These important HERA reforms should be continued and expanded. For instance, FHFA has required reinsuring of credit risk and it has greatly shrunk portfolios to reduce taxpayer exposure. The ban on lobbying and campaign activity should be made permanent, portfolios should be further reduced and limited to necessary business purposes (such as modifying loans and supporting the TBA market), and capital standards should be set and achieved. Utility regulation and returns for the GSEs would further prevent excessive risk taking. Much authority already exists to continue advancing this reform while Congress considers GSE legislation.

B. Credit Risk Transfers

One of the major reforms of HERA was to provide the FHFA Director with the authority to ensure that the GSEs did have excessive risk. A main objective of FHFA has been that the GSEs share credit risk with private investors. Utilizing credit risk transfer products, the GSEs are able to carry out their Congressional mandate to serve all markets and drive affordable access to housing finance, while simultaneously reducing their underlying risk, thereby protecting taxpayers from market downturns. By creating a wide variety of credit transfer products, the GSEs ensure that a sufficient number of investors will remain in the market through all phases of a housing price cycle, creating reliable liquidity and funding.[54] This objective was meant to work alongside, and strengthen, the underlying mission of the GSEs to serve all markets and foster affordability and access to the housing finance system. By reducing the underlying risk of the GSEs, and preserving their role in the housing market as drivers of access and affordability for all markets and borrowers, credit risk transfer is a large part of how the GSEs can function in a financially sound manner, while at the same time providing access to affordable home loans, especially for communities of color and credit worthy LMI borrowers.

In fact, the GSEs have been very effective in this mission. In total, from 2013 to December 2016, the GSEs have transferred almost $49 billion of credit risk on $1.4 trillion of UPB.[55] In 2016 alone, the GSEs transferred $18 billion of credit risk on mortgages with an UPB of $548 billion, utilizing various credit transfer products and the capital markets.[56] Furthermore, from 2013 through 2016, the GSEs transferred an additional $186 billion of credit risk and $731 billion of UPB to primary mortgage insurers.[57] This transfer results in a reduced risk to taxpayers, greater market stability, and does not disrupt the TBA market, while also empowering the GSEs to provide broad national secondary market liquidity for residential mortgage financing and carry out their affordability and duty to serve goals.

The GSEs have developed a portfolio of diverse credit transfer products including: Credit risk debt issuances (STACR/CAS) Transactions; Insurance/reinsurance transactions; Senior-subordinate securities;

[53] 12 U.S.C. § 4565; 12 C.F.R. 1282, Subpart C.

[54] See, FHFA Report Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions, August 2015, available at https://www.fhfa.gov/ABOUTUS/REPORTS/REPORTDOCUMENTS/CRT-OVERVIEW-8-21-2015.PDF

[55] Id.

[56] Id.

[57] Id.

and Collateralized lender recourse transactions.[58] Credit risk transfer has become a regular part of the GSE business structure, and they are currently transferring a substantial amount of the credit risk on almost 90% of the loans that comprise the majority of the GSEs' underlying credit risk.[59] Of this amount, the debt issuances (STACR/CAS) make up 72% of the total amount transferred, 25% of the transfers were made via insurers and reinsurers, and the remaining 4% transferred through front-end transactions.[60] FHFA has also recognized that the success of the GSEs credit risk transfer products depends on broad investor participation. Since 2013, the GSEs have transferred credit risk to numerous private market participants such as asset managers, hedge funds, insurance and reinsurance companies, banks, sovereign funds, REITs, and lenders.[61] Up until December 2016 more than 100 unique investors have participated in both the CAS and STACR programs.[62] The success of the GSEs to reduce their underlying risk and fulfill their Congressional charter is in large part due to their ability to offer credit risk transfer products. The enactment of any restrictions that altered the GSEs' ability to transfer and pool risk in this manner would severally limit the progress that has been made since 2013 under the direction of FHFA.

IV. Principles for Housing Finance Reform

As shown by the data and discussion above, leading up to the financial crisis the GSEs certainly made critical mistakes and took excessive risks, though substantially less so than actors in the private label security market. At the same time, both pre-crisis and post crisis, they provided essential mortgage credit that supported not only the housing market, but the overall economic recovery. In addition, their operations have been critical for community banks, credit unions and other small lenders, who must compete with much larger institutions in the mortgage market. Similarly, the GSEs have extended additional credit to rural borrowers, LMI borrowers and communities of color, who all struggle to get access to affordable home loans. The challenge of housing finance reform is to build on those features that have served the market well and reform those that need to be fixed, at the same time ensuring that the overall system is viable and protects taxpayers. Fortunately, as set out above, HERA and subsequent actions by FHFA have implemented many of the needed reforms to achieve these goals.

A. *Features of the current housing finance system that must be preserved going forward include the following:*

- **Ensure equal treatment for small lenders**. This includes maintaining the cash window, with critical pricing parity to securities, and requiring all issuer-guarantors to serve all qualified lenders. It also requires structuring risk transfer transactions in a way that does not disadvantage small lenders.
- **Serve all markets across the country throughout the business cycle.** Prior to the GSEs there were significant differences in mortgage pricing and availability among different areas of the country. Issuer-guarantors must have an explicit duty to serve a national

[58] Id.
[59] See, FHFA Report Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions. August 2015, available at https://www.fhfa.gov/ABOUTUS/REPORTS/REPORTDOCUMENTS/CRT-OVERVIEW-8-21-2015.PDF
[60] See Credit Risk Transfer Progress Report, December 2016 available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRTProgressReport_Dec2016.pdf
[61] Id.
[62] Id.

market rather than creaming the market by serving only lucrative markets and leaving other less lucrative markets, such as rural markets, unserved.

- **Serve all credit worthy borrowers.** Rural borrowers, new emerging households, LMI borrowers and borrowers of color all face obstacles to receiving competitive and affordable mortgage loans. Current provisions include important measures to further service of these markets: the mandate to serve the broad market, even at a lower rate of return; affordable housing goals; the duty to serve under-reached markets; and the affordable housing funds. These were all included in or reaffirmed by HERA, which passed with strong bipartisan support. These bipartisan compromises, worked out over nearly a decade, must be preserved and expanded in order to meet the current and future mortgage market, which will include large proportions of these borrowers. Equally important, credit risk transfers must continue to be done by the issuer-guarantors through mechanisms that do not price these borrowers or small lenders out of the market. This means credit risk transfers must be executed through reinsurance structures that permit pooling of loans and risk, and not through deeper upfront risk transfers.
- **Promote cost-effective loan modifications.** Notwithstanding the recent long stretch of economic growth, the business cycle will return and there will periods of decline in the economy and the housing market. During these times, the issuer-guarantors must be able to serve the market and service distressed mortgages, as the most mobile funding will be unavailable, as has occurred in the recent and other past downturns. In order to do this, the issuer-guarantors must have the liquidity to modify distressed loans. This will require limited, but critical, government back stop, when necessary, to be able to finance the acquisition and holding of distressed loans while they are modified. A very limited backstop is also required to ensure during periods of deep crisis that the issuer-guarantors have sufficient liquidity to be able to purchase and aggregate loans to securitize. There should be appropriate limitations to ensure these loans do not morph into the arbitrage strategies of the past.
- **Preserve the 30-year fixed rate mortgages and the TBA market.** Thirty-year fixed rate mortgages provide families the ability to set their mortgage payments and plan on them into the future. They also permit borrowers to build in a future cushion of financial protection, including for retirement. Without the government credit guarantee, it is very difficult for other parities to hold the interest and credit risk of thirty year mortgages. In addition, the TBA market is critical for both borrowers and lenders alike. First, borrowers are very dependent on being to determine and lock in their monthly payment obligation. Without a TBA market, this become very difficult, as increases in interest rates before loan closing can dramatically increase their required payments. Lenders, and especially smaller lenders, are likewise dependent on being able to lock in an interest rate and price at which they can sell their mortgages to an issuer-guarantor.

B. Areas that need continuing reform include the following:

- **Maintain a strong regulator.** Here, the FHFA is dramatic change from the handcuffed authority of OFHEO. OFEHEO had limited authority, with appropriations control of its funding (often thwarted by the GSEs) and limited enforcement authority. FHFA, in contrast has extensive authority both in regular circumstances and conservatorship, as described above. This authority should be maintained and expanded consistent with other recommendations set out below.

- **Provide an explicit-and fully paid for- government guarantee.** The housing market is such a critical part of the US economy- approximately 20% of the overall economy, that it will be difficult for the US government, or any government, to permit it to collapse. Instead, the government should make its guarantee explicit and charge an appropriate fee for this guarantee. In addition, as is done with federal deposit insurance, premiums for this backstop should be put into a guaranty fund so they will be available in the event they are needed.
- **Put more private capital in front of the government guarantee.** There is widespread agreement that the GSEs were substantially undercapitalized prior to the enactment of HERA. HERA gives the Director of FHFA the responsibility and authority to require the GSEs to maintain adequate capital. This authority must be maintained and implemented. While sufficient capital is essential, excessive capital requirements place a heavy fee on all homebuyers. In determining the appropriate level of capital, several factors should be kept in mind. First, when comparing the capital of the GSEs to banks that hold mortgages, it is important that banks hold substantial interest rate risk on the mortgages, while that risk is sold off to investors for the loans the GSEs guarantee. Second, when the level of risk is compared to the financial crash, a number of fundamental changes have dramatically reduced the risk of a crash of that severity. First, and most important, requirements that loans have full documentation and determination of the borrowers' ability repay greatly reduce the level of default of for mortgages. The types of loans that caused the mortgage crisis are largely prohibited today. Second, the overall financial system is safer due to these mortgage protections and systemic protections for other financial actors.
- **Prevent portfolio arbitrage.** There is also widespread agreement that the GSEs exploited their implicit government backstop to borrow at advantaged interest rates and used this funding to arbitrage the purchase and holding of an outsized mortgage portfolio. Doing so produced much higher rates of return than just guaranteeing loans that they securitized. However, this placed additional risk on the books of the GSEs. Such arbitrage should be prohibited, and the GSEs have dramatically reduced the size of their portfolios in recent years under pressure from FHFA and Congress. However, some portfolio is necessary for the aggregation of TBA loans, the modification of distressed loans and the holding of specialized loans. Borrowing for these limited purposes should continue to be permitted and should be protected in times of stress. Otherwise, when the need for these services is greatest for the benefit of the overall economy, funding will be unavailable or unaffordable.
- **Require mutual ownership and/or utility regulation.** The structure of the GSEs created a conflict that has been noted by many. While they had public purposes and goals, their structures made them accountable to shareholders who expected maximum returns. This created an incentive for them to take on more risks to increase returns. It also encouraged the GSEs to focus on the most lucrative segments of the market, underserving small lenders and rural and LMI borrowers. To counteract this conflict, issuer-guarantors should be restructured as either mutual owned organizations or regulated utilities. Mutual ownership has a long and successful history in the Federal Home Loan Banks, which have

this structure and provide mortgage financing, yet required no bail out in the financial crisis. However, both large and small lenders worry that they will be disadvantaged by the other in a mutual structure. Utility structure, under which investors are provided a lower, but less volatile, rate of return, has many advantages. It also includes closer oversight of the entities, including regulation of fees, as has been done in conservatorship of the GSEs. Either or both of these changes in structure would prevent the present conflict of interest created by the GSEs' structures. Other reforms that would also better align the issuer-guarantors with their public goals include; making permanent the ban on their political and lobby activities and continuing the prohibition on any vertical integration of their activities into the retail mortgage market.

Conclusion

Our housing finance system plays a key role in the lives of American families and it affects our overall economy. As changes are considered, we do so with the benefit of substantial recovery from the financial crash and with many reforms already implemented- the pre-crisis housing finance system and market has already been profoundly changed for the better, and fortunately no longer exists. Further changes must be undertaken with great care to preserve the many benefits of stable, affordable widely available mortgages for American families and lenders.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM DAVID H. STEVENS

Q.1. Housing counseling is critical both at the pre-purchase stage to help potential borrowers evaluate their options and understand the risks, and it is an essential tool to borrowers that have run into trouble with their mortgages. We have strong evidence that housing counseling works—a 2013 study of nearly 75,000 borrowers found that borrowers who received pre-purchase housing counseling were one-third less likely to become 90-days delinquent on their mortgage loans.

Mr. Stevens, given your role in the previous administration as FHA Commissioner when housing counseling initiatives were expanded, what is your view of the value of pre-purchase housing counseling?

A.1. We agree that housing counseling is a valuable tool for consumers—both prior to the purchase of a home and over the life of a loan. A mortgage is a complex financial transaction that can be intimidating for many borrowers. This complexity can be particularly daunting for first-time homebuyers, who are often unfamiliar with the requirements of a mortgage application or the general process for choosing a mortgage provider or product. While resources do exist to aid potential borrowers, these materials can be difficult to locate and compare.

Some of the potential benefits of pre-purchase housing counseling for borrowers include:

- Improved financial literacy, which allows them to better understand mortgage-related terminology and concepts;
- Improved financial management skills, such as budgeting, long-term financial planning, and approaches to strengthen their credit profiles;
- More comprehensive knowledge of the process for searching for available homes, mortgage providers, and mortgage products;
- More comprehensive knowledge of the resources available to assist them, including educational materials and financial assistance programs; and
- Greater capacity to decide on a mortgage product that suits their particular needs or whether home ownership is the correct decision for them at that particular time.

These benefits to the consumer could carry important implications through the life of the loan, such as reducing the likelihood of serious delinquency, which in turn could lead to more sustainable home ownership and fewer foreclosures. Our experience during the financial crisis and its aftermath showed that unsustainable home ownership can lead to costs for communities that extend beyond the individual households in default. Concentrated foreclosures have been tied to lower home values, blight, crime, population declines, and Government fiscal strains. On a national level, widespread foreclosures were shown to contribute substantially to financial and economic instability. Services that can reduce the likelihood of these negative feedback loops taking hold, such as counseling, should be encouraged and made more widely available.

In order to help raise awareness of the benefits of counseling, MBA joined a coalition of groups representing lenders, investors, real estate agents, and counseling agencies to create the "Home ownership Collaborative" in 2016. Over the past year, the Home ownership Collaborative brought together industry stakeholders to host partnerships in a variety of local housing markets. These partnerships connected potential borrowers with HUD-approved housing counseling agencies and explored new and innovative ways to augment the benefits and expand the reach of counseling opportunities. MBA and the other sponsors of the Home ownership Collaborative will continue to host counseling events in the coming months with the goal of further raising awareness among consumers and developing new strategies to increase usage of counseling services.

Q.2. In the past, I have expressed concerns about conforming loan limits for the GSEs, which is why I led efforts in the Senate to ensure that borrowers in states like New Jersey, which has some of the highest home prices in the Nation, are able to secure GSE mortgages. Last time the Committee considered reform, there was interest in lowering the conforming loan limits. Studies and reports have shown that larger loans actually perform better and default at significantly lower rates than smaller loans.

Do you agree that conforming loan limits should be retained as we consider changes to the housing finance system?

A.2. Currently, both Fannie Mae and Freddie Mac are restricted to purchasing single-family mortgages that fall below the conforming loan limits calculated annually through a formula set by the Housing and Economic Recovery Act of 2008. We agree that this is an appropriate mechanism for targeting the benefits provided by the GSEs—primarily lower interest rates on mortgages and continued access to credit through all parts of the business cycle—to low- and moderate-income borrowers.

We do not support lowering the conforming loan limits as a strategy by which to attract more private capital into the housing finance system. While it is important to diversify exposure to mortgage credit risk and shift this exposure away from taxpayers, there are more effective options for doing so. For example, increasing the amount and types of credit risk transfers used by the GSEs will move mortgage credit risk into private-sector hands with less potential for disrupting financing for low- and moderate-income borrowers.

We do support the current system of providing for higher conforming loan limits in high-cost areas, such as many counties in New Jersey. The housing finance system should recognize that access to modest, sustainable housing requires more resources in certain portions of the country, and therefore it is appropriate for the GSE conforming loan limits to reflect this reality. Similarly, we believe it is appropriate for the conforming loan limits to be adjusted over time as home prices increase. This process will help ensure that the GSEs serve a similar segment of the market, regardless of movements in home prices.

These views are consistent with the policies described in MBA's recently released proposal for an improved secondary mortgage market. As our proposal notes, "The current conforming loan limits should be preserved, with similar adjustments for high-cost areas, because they provide a well-understood threshold and relative ease of execution." Our proposal also calls for these conforming loan limits to be "adjusted over time based upon home-price appreciation." These policies were designed to keep the scope of borrowers served by the GSEs fairly consistent and targeted to those borrowers for whom the benefits of GSE-provided liquidity are greatest.

We therefore agree that the conforming loan limits should be retained in a substantially similar structure in any future housing finance system.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM MICHAEL D. CALHOUN

Q.1. Do you think discrimination based on business judgment should be allowed as part of housing finance reform?

A.1. The Fair Housing Act of 1968 [1] and the Equal Credit Opportunity Act of 1974 [2] prohibit discrimination in lending and lending transactions, and along with other provisions [3] articulate the policy of the United States that the housing market, including the system for financing housing, operates in a manner that is free of discrimination. Fair treatment is required regardless of race, gender, national origin, or other protected status. Additionally, where Federal funding is involved, whether in the form of loans, insurance or guarantees, Federal agencies administering such funds have an obligation to take affirmative steps to further fair housing. Further, the GSEs have a mandate to serve all credit markets at all times, which ensures broad credit availability in all regions of the Nation. The charters of the GSEs state that they must "promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing." [4]

Under the Fair Housing Act's disparate impact liability, which was recently upheld by the United States Supreme Court in Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc., actions that have a discriminatory effect on a protected class are prohibited unless the defendant has a valid business justification. [5] Under the burden shifting test of disparate impact theory, the initial burden is on the plaintiff to establish a prima facie case that a housing decision or policy caused a dis-

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[1] 42 U.S.C. §3601.
[2] 15 U.S.C. §1691.
[3] Executive Order 11063, adopted in 1962, prohibits discrimination in the sale, leasing, rental, or other disposition of properties and facilities owned or operated by the Federal Government or provided with Federal funds. Available at *http://portal.hud.gov/hudportal/HUD?src=/program_offices/fair_housing_equal_opp/FHLaws/EXO11063*; Executive Order 12892, as amended, (adopted in 1994), requires Federal agencies to affirmatively further fair housing in their programs and activities, and provides that the Secretary of HUD will be responsible for coordinating the effort. Available at *http://portal.hud.gov/hudportal/HUD?src=/program_offices/fair_housing_equal_opp/FHLaws/EXO12892.*
[4] Fannie Mae's charter is in Title III of the National Housing Act, 12 U.S.C. §1716 et seq. Freddie Mac's charter is in 12 U.S.C. §1451 et. seq.
[5] (83 U.S.L.W. 1993, 6/30/15).

parate impact on a protected class.[6] Once the plaintiff establishes disparate impact, the defendant can then counter with the defense that the policy or decision is "necessary to achieve a valid interest."[7] The defendant's "valid interest" will stand unless the "plaintiff has shown that there is an available alternative practice that has a less disparate impact and serves the entity's legitimate needs."[8]

For more than 40 years, disparate impact liability has been used to further the goals of the Fair Housing Act. It has helped to curb overt discrimination and redlining in lending decisions opening up the housing finance system to all Americans, particularly those in rural areas and urban communities. Moreover, it has not provided an undue burden on lending nor flooded the courts with litigious claims. Instead, it has helped make lending decisions smarter and more efficient in an effort to be fairer.[9]

Q.2. Housing counseling is critical both at the pre-purchase stage to help potential borrowers evaluate their options and understand the risks, and it is an essential tool to borrowers that have run into trouble with their mortgages. We have strong evidence that housing counseling works—a 2013 study of nearly 75,000 borrowers found that borrowers who received pre-purchase housing counseling were one-third less likely to become 90-days delinquent on their mortgage loans.

As we look to the future of the housing finance system, are there ways that we can better utilize pre-purchase housing counseling to expand affordable and sustainable home ownership? For instance, does it make sense to combine pre-purchase housing counseling with pricing incentives or as a compensating factor for credit scores or downpayment?

A.2. There is strong evidence that housing counseling is effective in reducing foreclosures.[10] Incorporating pre- and post-purchase counseling has significantly reduced delinquencies and has increased the frequency of positive outcomes for troubled borrowers.[11] A recent study was conducted by the Federal Reserve Bank of Philadelphia. A pre-purchase home ownership counseling study released in 2014 confirmed the continued efficacy of housing counseling.[12] The study was drawn from a random sample control group that received varying counseling delivery models. The delivery models were standardized across the entire sample. Participants who received the counseling education and one-on-one counseling saw an average increase of 16.2 points of their credit score over the course of the study, and reduced the number of delinquent accounts that were 30, 60, or 90 days past due.[13] This study reaf-

[6] Id.
[7] Id.
[8] Id.
[9] For a more detailed analysis of the benefits of disparate impact liability on the Nation's housing finance system, See the brief of the National Fair Housing Alliance et al., available at *https://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/BriefsV4/13-1371_amicus_resp_NFHA.authcheckdam.pdf.*
[10] See "Has Foreclosure Counseling Helped Troubled Homeowners?" Urban Institute. Available at *http://www.urban.org/research/publication/has-foreclosure-counseling-helped-troubled-homeowners/view/full_report.*
[11] Id., at 2–3
[12] *https://www.philadelphiafed.org/community-development/homeownership-counseling-study/*
[13] Id.

firms significant research that finds housing counseling as an effective means to keep borrowers from becoming delinquent, and improving outcomes for troubled borrowers.[14] Based on these research findings we would encourage combining pre-purchase housing counseling with pricing incentives or as a compensating factor for credit scores or downpayment.

[14] *https://portal.hud.gov/hudportal/documents/huddoc?id=ohc_counselingworks1214.pdf*

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER SUBMITTED BY THE NATIONAL MULTIFAMILY HOUSING COUNCIL AND THE NATIONAL APARTMENT ASSOCIATION

NMHC NATIONAL MULTIFAMILY HOUSING COUNCIL NAA NATIONAL APARTMENT ASSOCIATION

June 29, 2017

The Honorable Mike Crapo
Chairman
Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Building
Washington, DC, 20510

Dear Chairman Crapo and Ranking Member Brown:

We are writing on behalf of the members of the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) who represent the $1.3 trillion apartment industry and its nearly 39 million residents. Thank you for your leadership regarding housing finance reform and your examination of this critical issue through the hearing before the Committee titled "Principles of Housing Finance Reform".

As we near the beginning of our tenth year of conservatorship of Fannie Mae and Freddie Mac (the Enterprises), the need to address the current status of the Enterprises is vitally important. To reform a system as complicated as housing finance, policy makers should begin with a strong cornerstone. We believe the multifamily system of the Enterprises can and should serve as that cornerstone, having operated with distinction during the recession.

Delayed marriages, an aging population and immigration are just some of the factors leading to an increasing and pressing need for new apartments, according to a new study conducted by Hoyt Advisory Services and commissioned by the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA). This increased apartment demand means a critical need for 4.6 million new apartments at all price points by 2030. Currently, nearly 39 million people live in apartments, and the apartment industry is quickly exceeding capacity. In the past five years, an average of one million new renter households were formed every year, which is a record amount. Meeting this current and growing demand for multifamily housing will prove challenging and any disruption in access to capital will further exacerbate a housing affordability crisis already impacting millions of Americans.

NMHC/NAA urge the Committee to recognize the unique needs of the multifamily industry. We believe the goals of a reformed housing finance system should be to:

1. Maintain an explicit federal guarantee for multifamily-backed mortgage securities available in all markets at all times;
2. Ensure that the multifamily sector is treated in a way that recognizes the inherent differences of the multifamily business; and

3. Retain the successful components of the existing multifamily programs in whatever succeeds them.

We look forward to working with the Committee as you undertake this important work.

Sincerely,

Douglas M. Bibby
President
National Multifamily Housing Council

Robert Pinnegar, CAE
President & CEO
National Apartment Association

STATEMENT SUBMITTED BY THE NATIONAL ASSOCIATION OF REALTORS

NATIONAL ASSOCIATION of REALTORS®
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Joe Ventrone, Vice President & Deputy Chief for Regulatory Affairs
Scott Reiter, Vice President
Jamie Gregory, Deputy Chief Lobbyist

STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

THE UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING, & URBAN AFFAIRS

HEARING TITLED

"PRINCIPLES OF HOUSING FINANCE REFORM"

JUNE 29, 2017

Introduction

The nearly 1.3 million members of the National Association of REALTORS® (NAR) thank the U.S. Senate Committee on Banking, Housing and Urban Affairs for holding a hearing on "The Principles of Housing Finance Reform."

NAR is America's largest trade association, including our eight affiliated Institutes, Societies and Councils, five of which focus on commercial transactions. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®.

REALTORS® Perspective

While the housing industry has generally improved since the financial crisis, REALTORS® recognize that the current conservatorship of Fannie Mae and Freddie Mac (Enterprises) is unsustainable. REALTORS® also strongly believe that policymakers need to address the mounting risks and challenges facing the secondary mortgage market and overall housing market, which could have a severe impact on taxpayers and American households' ability to access affordable mortgage credit.

The main risks to the housing industry include, but are not limited to, inadequate housing inventory, low levels of single-family construction, rising interest rates, declining affordability, tight mortgage credit conditions, stagnate job and wage growth, increased student loan debt levels, and low levels of home purchases by the Millennial generation.

These risks are elevated alongside the substantial challenges facing the secondary mortgage market. These include declining capital reserves at the Enterprises, volatile profits at the Enterprises, limited private label securities (PLS) participation, the need for a steady flow of capital, standardization of mortgage-backed securities (MBS), liquidity over the economic cycle, limited participation in credit risk transfers (CRTs) or equity capital, and the impact of the Federal Reserve's wind down of its reinvestment position and long-term decline in demand for Agency MBS.

In order to minimize the effects of these threats, NAR urges Congress to enact comprehensive housing finance reform legislation. As part of comprehensive reform to the secondary mortgage market, NAR urges policymakers to prioritize the establishment of capital reserves to prevent disruptions from losses during market fluctuations and economic downturns.

NAR's Comprehensive Housing Finance Reform Recommendation

As NAR began exploring the question of "how to improve the U.S. housing finance sector," there were two primary issues for which REALTORS® sought a solution. First, REALTORS® want to ensure that in all markets mortgage capital will always remain available for creditworthy Americans. Second, REALTORS® believe that taxpayer dollars should be protected. These are the driving forces behind our organization's housing finance reform principles (see Appendix A) that NAR modified in May 2017, and they are the drivers behind the recommendations that the Association puts forward today.

In order to ensure a steady flow of capital into the mortgage market in both good times and bad, NAR believes **the Enterprises should be converted into government-chartered, non-shareholder owned authorities that are subject to tighter regulations on products, profitability, and minimal retained portfolio practices in a way that ensures the protection of taxpayer monies.**

REALTORS® expect that the new government-chartered non-shareholder owned authorities will ensure that there is liquidity in the marketplace for those standard mortgage products (e.g. long-term fixed-rate mortgages along with traditional adjustable rate mortgages with reasonable annual and lifetime caps) that are the foundation of our housing finance market. Additionally, the establishment of two authorities will create necessary competition needed to continue to foster innovative mortgage products that can expand consumer choice for safe and reliable mortgages. With the new authorities offering standard and innovative products, private capital will be free to compete, and pursue opportunities to offer products in addition to those offered by the new authorities. With the full recovery of the market, the conversion of the Enterprises into these new authorities, and a return of private capital; the nation will see the appropriate balance of government, government-hybrid, and private capital activity in the secondary mortgage market.

Key Elements of NAR's Recommendation

REALTORS® believe that any entity with a private profits that are implicitly backed by public losses, as the Enterprises were structured before conservatorship, is flawed and problematic. NAR proposes a structure that is not driven by shareholders' desire to maximize profits. Instead, the authorities' mission is clarified and their federal backing is made explicit.

NAR believes a "government-chartered" structure, with clearly defined roles and enhanced safeguards, is the best model for the new authorities because this structure establishes a separate legal identity from the federal government, while serving a public purpose (e.g. the Export-Import Bank of the United States). Unlike a federal agency, government-chartered organizations are established to be politically independent and often are self-sustaining—not requiring appropriations from Congress. The ability of the authorities to focus on their mission (providing affordable liquidity to the housing market), without the need to chase risky, profit-driven opportunities, meets an important criteria for REALTORS®.

Moreover, a government-chartered authority should remove any ambiguity regarding the government's backing of these secondary market authorities. REALTORS® believe that explicit government backing of new authorities is required in order to instill confidence in potential investors of the authorities' mortgage-backed securities (MBS). Without the confidence of these investors, the ability of the authorities to raise capital for the purpose of providing liquidity to the secondary mortgage market will be limited.

However, REALTORS® also believe that the authorities should not be operated as if the government/taxpayers are in the first loss position. The authorities should be self-sufficient (need no appropriations) and price risk effectively to cover potential losses. Most importantly, the new authorities must utilize any profits to establish capital reserves to alleviate losses that occur during market fluctuations and economic downturns.

Lastly, REALTORS® believe that the conversion of the existing government-sponsored enterprises (Fannie Mae and Freddie Mac) into government-chartered authorities will pose the least amount of market disruption, and ensure a continuous flow of capital to the secondary mortgage market during the transition period. Because of their existing capabilities and infrastructure, the current Enterprises are best positioned to become government-chartered authorities. With this in mind, REALTORS® also suggest that the new authorities import the best components from the current Enterprises such as their ability to create MBS and their automated underwriting systems.

Why not Full Privatization or Nationalization?

Privatization

NAR considered a number of different models for the future structure of the Enterprises. Our members first considered a fully private or fully federal system. REALTORS® believe that neither would effectively solve the two issues deemed necessary to address the challenge of restructuring the secondary mortgage market.

REALTORS® believe that full privatization, even a private utility, is not the most effective option for the secondary market because a private firms' business strategy will inevitably focus on optimizing its revenue/profit generation or dividend distribution. This model would foster mortgage products that are more in line with the businesses' goals (e.g. higher profits and limited risk-taking) than in the best interest of the nation's housing policy, the economy, or consumers. The situation would likely lead to a decline in access to long-term, fixed-rate mortgage products like the 30-year fixed-rate mortgage, an increase in the costs of these products to consumers, or both.

Additionally, there is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without a strong federal backstop. Some other developed countries have encouraged the use of fully amortized long-term fixed-rate loans. However, in all instances save for Denmark, loans typically have adjustable rates and reset frequently. The United States is unique in supporting a residential mortgage that is long-term, amortizing, fixed-rate and pre-payable. Americans have come to view this product as critical to sustainable ownership and a hedge against unforeseen life events. Lastly, it is important to note that in early 2000, when former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he quickly abandoned that position.

Second, the issue of the size of the U.S. residential mortgage market must be considered. Currently, the U.S. residential mortgage market stands at $9.8 trillion, with the Enterprises owning or guaranteeing $4.8 trillion of mortgage debt outstanding and providing capital that supports roughly 47 percent of new first-lien mortgage originations. REALTORS® believe that it is extremely unlikely that enough purely private capital could be attracted to replace existing mortgage funding and continue to make mortgage lending available in all types of markets.

Finally, REALTORS® fear that in times of economic upheaval, a fully private secondary mortgage market will severely contract. This contraction occurred during the financial crisis in the markets for private label securities (PLS), commercial mortgages, and manufactured housing mortgages. When the economy turns down, private capital rightfully flees the marketplace. Should that happen in the residential mortgage market, the results for the entire economy would be catastrophic.

Nationalization

In contrast to privatization, full nationalization places the government/taxpayer in the first loss position should the housing market turn down and these institutions run into financial trouble. A priority of NAR is to reduce the taxpayer exposure to losses of these authorities. Converting the Enterprises to federal agencies, or merging them with the FHA, conflicts with this goal of REALTORS®.

Moreover, nationalization would yield a number of undesirable consequences. First, establishing one public secondary mortgage market entity may remove competition and incentives for innovation in the secondary mortgage market. Though REALTORS® favor more vigorous regulation of the products the new authorities will purchase, they also recognize that innovation is required along the mortgage origination supply chain in order to foster a more efficient and less costly product for consumers.

In addition, a single entity that dominates the secondary mortgage market could lose focus on specific housing missions. For example, an entity that combines the FHA with the Enterprises could lose focus on either low- and moderate-income housing mission or ensuring that the middle market has access to affordable mortgage capital.

<u>Protecting Excess Revenue</u>

REALTORS® believe that it is prudent to have the new authorities invest excess revenue earned in strong markets into a capital reserve fund so that they can pursue countercyclical activities in weaker markets, as well as store capital to prevent the need for taxpayer funds during economic downturns. Again, a primary goal of NAR is to ensure that the government and taxpayers are not immediately on the hook even if a serious downturn occurs.

Also, in the current economic environment, as banks and other financial institutions are being encouraged to hold more capital against well performing assets, the new authorities should set the industry standard for safe and sound operations.

Utilization of Retained Portfolio

NAR believes that the authorities should maintain a portfolio for the purpose of funding their daily operations, to use in a countercyclical fashion when the market turns down and private capital inevitably leaves the market place. It could also be used to test innovative products and house mortgages on products that are not easily securitized (e.g. multi-family housing loans and rural mortgages). The use of the portfolio will ensure that there is a continual flow of capital into the secondary mortgage market during downturns thus preventing a crisis within the housing market, as well as provide much needed capital to those portions of the housing market that don't traditionally have access to large amounts of private capital.

REALTORS® do not recommend a specific size of the portfolio. They do believe that the portfolio should be large enough to support the authorities' business needs, the products that lack private capital, and when necessary ensure a stable supply of capital consistent with market conditions. REALTORS® insist that the portfolio size should not be driven by profit motives.

Increased Sustainable Homeownership & Assumability

As first-time homebuyers continue to sit on the sideline and the housing market experiences inconsistent growth, NAR believes that the authorities should focus their mission on encouraging increased sustainable homeownership by providing continued mortgage financing and refinancing, especially if the authorities – lenders and other mortgage product providers – benefit from an explicit government guarantee.

Moreover, NAR believes that any new secondary mortgage market must allow for mortgages that are syndicated through explicitly government-guaranteed MBS to be assumable. REALTORS® believe that when interest rates rise, especially in high cost areas, the ability to assume a lower-rate mortgage on a property may become the most affordable source of financing for a qualified buyer.

Addressing the Enterprises' Declining Capital Reserves

Under the terms of their agreements with the U.S. Treasury, the Enterprises' capital reserves will decline to zero by January 1, 2018. NAR believes that, as Congress contemplates reforming the secondary mortgage market, the amount of capital reserves needed in the system will be an important question that will not only have immediate implications for taxpayers but ultimately Americans' access to credit and homeownership.

While there is less concern that a draw on the Enterprises' line of credit at the U.S. Treasury due to accounting rules would disrupt mortgage markets, it is important to have a buffer between any losses and the taxpayer. This is especially the case if comprehensive housing finance reform legislation has not yet been adopted. It makes sense to build that buffer now while the Enterprises have positive cash flows.

To address this concern, a prudent intermediate step would be to establish a Mortgage Market Liquidity Fund (MMLF) through legislation or under existing regulatory authority. A portion of the Enterprises' profits could be deposited into the fund, controlled by the Federal Housing Finance Agency (FHFA) Director, which would cover future losses due to market fluctuation as described above. The FHFA Director could release funds from this account to buffer against further U.S. Treasury involvement. As a result, some capital will be in place to avoid significant market disruptions and to continue to ensure that Americans have access to affordable mortgages.

The MMLF would protect taxpayers by reducing the need for the Enterprises to draw additional funding from the U.S. Treasury. Finally, the fund would provide Congress the necessary time to enact comprehensive housing finance reform.

Conclusion

The stakes have never been higher for the housing market and the broader economy. Yet, there are sizeable challenges and risks associated with the ongoing conservatorships of the Enterprises. Comprehensive housing finance reform enacted by Congress will help address many of these issues. However, any misstep in the implementation of a new housing finance system could cause serious harm to our housing market and economy. In the balance hang many potential homebuyers with the desire and ability to purchase a home. Any disruption to the housing finance system could injure these aspiring new homeowners, as well as existing homeowners.

REALTORS® support a secondary mortgage market model that includes an explicit government guarantee. That guarantee protects the taxpayer while ensuring that all creditworthy consumers have reasonable access to affordable mortgage capital so that they too can attain the American Dream – homeownership. REALTORS® recognize that this is an extensive and important conversation regarding how we mend, and improve, a housing finance system that has served us well for many years.

Furthermore, if Congress is unable to enact reasonable and comprehensive housing finance reform in the near term, NAR strongly urges policymakers to consider addressing the declining capital reserves at the Enterprises through the creation of a MMLF. This will ensure hardworking Americans have continued access to affordable mortgage credit while protecting taxpayers from unnecessary threats.

NAR's recommendations will help Congress and our industry partners design a secondary mortgage model that will be in all of our nation's best interest today, and in the future.

Appendix A

Updated: May 20, 2017

NAR Principles for Housing Finance Reform

NAR supports restructuring the secondary mortgage market to ensure a reliable and affordable source of mortgage capital for consumers, in all types of markets, to avoid a major disruption to the nation's economy that would result from the total collapse of the housing finance sector. Restructuring is required in response to the failure of Fannie Mae and Freddie Mac, which has been under government control since entering conservatorship in September 2008.

• **An efficient and adequately regulated secondary market is essential to providing affordable mortgages to consumers.** The secondary market, where mortgages are securitized, is an important and reliable source of capital for lenders and therefore for consumers. Without a secondary market, mortgage interest rates would be unnecessarily higher and unaffordable for many Americans. In addition, a poorly functioning secondary market will impede both recovery in housing sector and the overall economy.

• **The old GSE system with private profits and taxpayer loss must be replaced.** The current GSEs (Fannie Mae and Freddie Mac) should be replaced with government-chartered, non-shareholder owned authorities that are subject to sufficient regulations on product, revenue generation and usage, and retained portfolio practices in a way that ensures they can accomplish their mission to support long-term mortgage financing and protect the taxpayer.

• **Reforms should ensure a strong, efficient financing environment for homeownership and rental housing.** The mission of the new authorities must include increasing sustainable homeownership, providing access to mortgage financing and refinancing for consumers who have demonstrated the ability to sustain homeownership. Creditworthy consumers require a steady flow of mortgage funding that, even during economic downturns, will continue to be available as insured by an explicit government guarantee.

• **The government must clearly, and explicitly, offer a guarantee of mortgage instruments facilitated by the authorities that meet the Qualified Mortgage (QM) standards.** This is essential to ensure qualified, creditworthy borrowers have access to affordable mortgage credit. Without government backing, consumers will pay much higher mortgage interest rates and mortgages may at times not be readily available at all-as happened in jumbo and commercial real estate loans. Taxpayer risk would be mitigated through the use of mortgage insurance on loan products with a loan-to-value ratio higher than 80 percent, or through other fees paid to the government.

• **The new authorities should guarantee or insure a wide range of safe, reliable mortgage products.** These mortgage products include 15-year and 30-year fixed rate loans, traditional adjustable-rate mortgages (ARMs), and other products that have stood the test of time and for which American homeowners have demonstrated a strong "ability to repay."

• **Provide a self-sufficient mechanism whereby safe, sound, transparent, and insured Mortgage Backed Securities (MBS) may be packaged and sold.** There must be an option for an explicit government guarantee or insurance for all offered MBS within the secondary mortgage market. The creation of a not-for-profit "utility" facility is needed to receive, package, sell and guarantee MBS. The authorities should operate with similar insurance and enforcement components as the FDIC. This option must minimize taxpayer exposure.

• **Sound and sensible underwriting standards must be established.** Establish standardized, sound underwriting principles and products that provide the foundation for responsible, credit worthy borrowers to be able to achieve homeownership goals. For additional safety, these standards must also be applied to securities (MBSs), purchased for portfolio (to a limited extent).

• **The authorities should price loan products or guarantees based on risk.** In addition, the new authorities must set standards for the MBS they guarantee that establish transparency and verifiability for loans within the MBSs.

• **Ensure solid, verifiable, current loan level data is available to investors that empowers and enables them to conduct their own risk analysis.** There is a strong consensus among multiple market participants that solid loan level data is the essential foundation from which to rebuild the private mortgage security industry. Investors want to be empowered and enabled to conduct their own analysis. With properly structured loan level data the mortgage collateral supporting a regulated, securitized instrument will lead to a verifiable, current predictable instrument of cash flow and thus will attracting private capital.

• **The reformed authorities must have a separate legal identity from the federal government but serve a public purpose.** Unlike a federal agency, the authorities will have considerable political independence and be self-sustaining given the appropriate structure.

• **The GSEs should remain politically independent.** Political independence of the authorities is mandatory for successful operation. CEOs should have fixed terms so they cannot be fired without cause, and they should not be allowed to lobby. Additionally, the authorities should be self-funded instead of receiving ongoing appropriations.

• **There must be strong oversight of the authorities**. The new authorities should be overseen by the Federal Housing Finance Agency (FHFA) or a successor agency that would make timely reports to allow for continual evaluation of the authorities' performance.

• **Restore investor confidence and trust in the Representations and Warranties via the standardization of pooling and servicing contracts.** Standardization of Representations and Warranties is imperative. Pooling and Servicing Agreements (PSAs) must be simple with clear terms and definitions so they are easily understood by investors. They must have clear disclosures of any deviations from "Federal Best Practice Standards", clearly define "buy back" rules, and servicer operational policies must be consistent with their fiduciary duties to the investor.

• **The new system must allow for mortgages that are syndicated through explicitly government guaranteed mortgage-backed securities (MBS) to be assumable.** When interest rates rise, especially in high cost areas, the availability of an assumable low rate mortgage on a property may become the most affordable source of financing for a qualified assuming buyer.

LETTER SUBMITTED BY THE NATIONAL ASSOCIATION OF REALTORS

NATIONAL ASSOCIATION *of* REALTORS®

William E. Brown
2017 President

Dale A. Stinton
Chief Executive Officer

GOVERNMENT AFFAIRS DIVISION
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June 27, 2017

The Honorable Michael Crapo
Chairman
Senate Committee on Banking, Housing & Urban Affairs
239 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking, Housing & Urban Affairs
713 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the 1.3 million members of the National Association of REALTORS® (NAR), I want to express NAR's concerns regarding the scheduled elimination of capital reserves held by Fannie Mae and Freddie Mac (Enterprises).

Under the terms of their agreements with the U.S. Treasury, the Enterprises' capital reserves will decline to zero by January 1, 2018. NAR believes that, as Congress contemplates reforming the secondary mortgage market, the amount of capital reserves needed in the system will be an important question that will not only have immediate implications for taxpayers but ultimately Americans' access to credit and homeownership.

While there is less concern that a draw on the Enterprises' line of credit at the U.S. Treasury due to accounting rules would disrupt mortgage markets, it is important to have a buffer between any losses and the taxpayer. This is especially the case if comprehensive housing finance reform legislation has not yet been adopted. It makes sense to build that buffer now while the Enterprises have positive cash flows.

To address this concern, a prudent intermediate step would be to establish a Mortgage Market Liquidity Fund (MMLF) through legislation or under existing regulatory authority. A portion of the Enterprises' profits could be deposited into the fund, controlled by the Federal Housing Finance Agency (FHFA) Director, which would cover future losses due to market fluctuation as described above. The FHFA Director could release funds from this account to buffer against further U.S. Treasury involvement. As a result, some capital will be in place to avoid significant market disruptions and to continue to ensure that Americans have access to affordable mortgages.

The MMLF would protect taxpayers by reducing the need for the Enterprises to draw additional funding from the U.S. Treasury. Finally, the fund would provide Congress the necessary time to enact comprehensive housing finance reform.

The stakes have never been higher for the housing market and the broader economy. Yet, there are sizeable challenges and risks associated with the ongoing conservatorships of the Enterprises. A MMLF would ensure Americans have continued access to affordable mortgage credit while shielding taxpayers from unnecessary hazards.

Sincerely,

William E. Brown
2017 President, National Association of REALTORS®

Cc: Secretary of the U.S. Treasury
Director of the Federal Housing Finance Agency
Senate Committee on Banking, Housing & Urban Affairs
House Committee on Financial Services

EQUAL HOUSING OPPORTUNITY

STATEMENT OF MAIN STREET GSE REFORM COALITION

MAIN STREET GSE REFORM COALITION

COMMON GSE REFORM PRINCIPLES

Introduction

For a variety of reasons, the time has come to end the conservatorships of Fannie Mae and Freddie Mac. The nation's homeownership rate is hovering near a 50-year low, and the gap between the demand for and availability of affordable rental housing continues to widen. As Congress once again faces tight annual spending caps and sequestration cuts enacted by the Budget Control Act of 2011 and with sweeping tax reforms on the table, federal support for homeownership and affordable housing efforts will be in the cross hairs. Substantial profits at the government-sponsored enterprises (GSEs) generated from a 250 percent increase in their guarantee fees and improvements in the performance of the single-family and multifamily books of business should be used to support affordable housing finance and build appropriate capital reserves at the Enterprises. Instead critical investments in affordable housing are being swept into the general fund of the U.S. Treasury to pay for a multitude of non-housing related purposes and the Enterprises are at risk of having to guarantee much of the nation's mortgage credit risk with a zero-capital buffer starting in January 2018.

Because of the Housing and Economic Recovery Act (HERA) of 2008 and administrative reforms undertaken by the Federal Housing Finance Agency (FHFA) acting as Conservator, critical "GSE Reforms" have already been achieved. The primary objective of any GSE reform legislation should be to promote broad access to affordable, sustainable mortgage credit in all communities while minimizing risk to taxpayers. Affordable housing advocates and small and mid-sized lenders alike share the following principles - which are designed to increase competition, prevent financial concentration, and prevent artificial barriers to entry in the GSE loan origination market.

Create a Capital Buffer:

- Fannie Mae and Freddie Mac should begin rebuilding a capital buffer now, which could be done through a suspension of the dividend being paid on the preferred stock held by the U.S. Treasury. The guarantee fees being charged by Fannie Mae and Freddie Mac include the cost for holding capital reserves in case of future losses.
- The Enterprises should retain earnings for the purposes of building the capital buffer they are charging the market to hold, consistent with prudential management of financial institutions, and to avoid any market uncertainty.

Continue and Expand Reform:

- Maintain a strong independent regulator, FHFA.
- Full FHFA oversight and approval of operations, capital requirements, fees, charges and prudential standards.
- Full and equal access for all lenders regardless of size, including a prohibition on volume discounts with respect to both guarantee fees and risk-sharing pricing.
- Serve all markets, including underserved, rural and urban areas, equally.
- Expand access to all creditworthy borrowers and affordable housing through risk pooling, strengthening and ensuring compliance with the GSEs' affordable housing goals, enforcement of statutorily defined duty to serve obligations, and continued funding of the Housing Trust Fund and Capital Magnet Fund.
- Prohibit any form of vertical integration in which primary market participants are granted the right to charter new GSEs, or use their aggregator status to gain a competitive advantage in mortgage loan origination.
- Expand risk reinsurance by the GSEs to reduce their overall risk consistent with an economic benefit, with prohibitions on market structures/actions that create an un-level playing field for loan origination.

Ending the GSEs' Conservatorship Responsibly:

- The FHFA, utilizing its authority under the Housing and Economic Recovery Act (HERA), should establish capital standards for Fannie and Freddie and direct the GSEs to draw up plans on how to meet those standards.
- Payment of an ongoing fee by the GSEs for maintenance of the existing Treasury line of credit or any explicit federal guarantee.
- FHFA should draw up and issue publicly a plan to release the GSEs from conservatorship upon instituting a capital restoration plan with specified capital standards.
- While we believe the critical GSE reforms have already been accomplished through the enactment of HERA and administratively by FHFA, any Congressional legislation should achieve and conform to the above principles.

Community Home Lenders Association
Community Mortgage Lenders of America
Leadership Conference on Civil and Human Rights
Leading Builders of America
National Association for the Advancement of Colored People
National Community Reinvestment Coalition

STATEMENT SUBMITTED BY THE NATIONAL COUNCIL OF LA RAZA

STATEMENT OF THE NATIONAL COUNCIL OF LA RAZA

Presented at

Hearing on "Principles of Housing Finance Reform"

Submitted to

U.S. Senate Committee on Banking, Housing and Urban Affairs

Submitted by:

Eric Rodriguez
Vice President, Office of Research, Advocacy and Legislation

July 6, 2017

Introduction

The National Council of La Raza (NCLR) is the largest national Hispanic civil rights and advocacy organization in the United States, an American institution recognized in the book *Forces for Good* as one of the highest-impact nonprofits in the nation. We represent nearly 300 Affiliates—local, community-based organizations in 41 states, the District of Columbia, and Puerto Rico—that provide education, healthcare, housing, workforce development, and other services to millions of Americans and immigrants, annually.

To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates' work at the state and local level to advance opportunities for individuals and families.

NCLR has a long history of fighting for fair, equitable and affordable housing, as evidenced through our work in the Hispanic community, in states, and in Washington, D.C. For more than two decades, NCLR has actively engaged in public policy issues such as preserving and strengthening the Community Reinvestment Act and the Home Ownership Equity Protection Act, supporting strong fair housing and fair lending laws, increasing access to financial services for low-income families, and promoting homeownership in the Latino community.

Historically, Hispanic families have struggled to achieve homeownership rates similar to their White peers. Nearly 10 years after the financial crisis, the Latino homeownership rate is on the rise but not fully recovered, and stands at 46.3% at the end of the fourth quarter in 2016, lower than the national homeownership rate of 63.7%.[1] One of the factors affecting Latino homeownership is that access to credit remains unnecessarily tight and has locked out many qualified Latino homebuyers. As we move to consider reforms to the housing finance system, we urge you to consider the unique needs of communities of color and positive innovations that emerged after the financial crisis. These considerations should factor into any new system aiming to promote sustainable homeownership for communities of color.

The National Council of La Raza appreciates the opportunity to submit this statement for the record. This testimony provides relevant background information on our organization's expertise about these issues, outlines principles we believe any housing finance reform should adhere to, and concludes with short-term recommendations.

Background

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[1] U.S. Census Bureau, "Quarterly Residential Vacancies and Homeownership, Fourth Quarter 2016," news release, January 31, 2017, http://www. census.gov/housing/hvs/files/currenthvspress.pdf (accessed July 4, 2017).

As evidence of our commitment to housing-related policy and programmatic research, NCLR has published a number of reports on Latinos' interaction with the market, including:

- *Banking in Color: New Findings on Financial Access for Low- and Moderate-Income Communities*, published by NCLR, National Urban League, and National Coalition for Asian Pacific American Community Development (May 28, 2014)
- *Puertas Cerradas: Housing Barriers for Hispanics*, published by NCLR and the Equal Rights Center (July 19, 2013)
- *Making the Mortgage Market Work for America's Families*, published by NCLR and the Center for American Progress (June 5, 2013)

In addition to policy research, NCLR has, for more than 15 years, supported local housing counseling agencies as one of 34 Department of Housing and Urban Development (HUD)-approved housing counseling intermediaries. The NCLR Homeownership Network (NHN), comprised of 52 community-based housing counseling providers, works with over 50,000 families annually and has nurtured more than 30,000 first-time homebuyers since its inception. In the early stages of the financial crisis, the NHN responded by shifting resources to loss mitigation counseling, helping thousands of families stay in their homes. NCLR's combination of housing-related policy research and local community experience through the NHN gives us a unique perspective on how Latino families interact with the mortgage market, their credit and capital needs, and the impact of government regulation on financial services markets.

Based on these facts and NCLR's policy and fieldwork over the past two decades, we believe that best practices and innovations in four areas have served the unique needs of Latino borrowers:

- **Housing counseling.** Housing counseling supports safety and soundness for several reasons and should be more fully integrated into the credit process by encouraging borrowers to utilize this service through pricing discounts or as a compensating factor for higher-risk borrowers. Evidence that housing counseling helps borrowers continues to mount. Whether the consumer is a first-time homebuyer navigating the pitfalls of predatory lending or a distressed homeowner trying to stay in their home, housing counseling produces noticeably better outcomes. For example, a 2013 study measuring the impact of pre-purchase counseling and education, provided by the NeighborWorks housing counseling network, on 75,000 loans originated between October 2007 and September 2009 found that borrowers with pre-purchase counseling and education were one-third less likely to be over 90 days delinquent with payment than those who did not receive counseling.[2] Through counseling efforts, the report estimated that local governments, lenders, and homeowners saved roughly $920 million in 2008 and 2009.[3]

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[2]Neil Mayer and Kenneth Temkin, Pre-Purchase Counseling Impacts on Mortgage Performance: Empirical Analysis of NeighborWorks® America's Experience.

[3]Neil Mayer, Peter A. Tatian, Kenneth Temkin, and Charles A. Calhoun, National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects (Washington, DC: Urban Institute, 2010).

This study confirms earlier research that documented significant reductions in delinquency and foreclosure resulted from pre-purchase housing counseling.[4]

- **Flexible underwriting.** One of the most important advances in mortgage finance was the creation of FHA- and VA-insured mortgages that allowed borrowers who lacked cash but had sufficient income to purchase a home with an affordable loan. Over time, the industry has learned more about how to accommodate different borrower profiles in a manner that does not jeopardize the financial safety and soundness of the family or the bank. For example, Latino borrowers are more likely than others to have a cash income, multiple co-borrowers on the same loan, or multiple sources of income, and they are less likely to have a traditional credit history. For many years, integrating these alternative features into underwriting formulas was difficult because they had to be incorporated manually. However, recently Fannie Mae and Freddie Mac have announced changes to their automated underwriting processes that allow borrowers that do not have credit scores to use non-traditional credit to qualify for mortgage loans. Borrowers can use documents and records that demonstrate timely rental housing, utility and other credit payments. For example, Fannie Mae has announced that it will purchase loans from lenders who underwrite and originate mortgage loans to borrowers with nontraditional credit, per the guidelines of Fannie Mae's low-down payment product, HomeReady.[5]

- **Nontraditional credit.** Latino communities continue to face challenges accessing credit, in part because they are inadequately captured by traditional credit reporting systems. A CFPB report indicates that Latinos are more likely to be "credit invisible" than their White counterparts.[6] The historically limited access Latinos have to mainstream banking services and conventional tools used to predict a borrower's creditworthiness works against them in a credit system that favors consumers who already have an established credit score.[7] Even so, the evidence shows that nontraditional borrowers can succeed as homeowners when provided access to fair, affordable credit, and lenders can originate sustainable mortgages while maintaining responsible, profitable lending standards.

- **Improving language access in mortgage origination and servicing.** A little more than 9% of the U.S. population has limited English proficiency (LEP), and more than 60% of the LEP population speaks Spanish as a native language. While LEP borrowers remain underserved by today's mortgage market, LEP borrowers are also among the most vulnerable to be targeted by fraud and predatory practices. Just this year, Fannie Mae and

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[4] Abdighani Hirad and Peter M. Zorn, "A Little Knowledge Is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling," Joint Center for Housing Studies of Harvard University, Low Income Homeownership Working Paper Series, No. LIHO-01.4. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/liho01-4.pdf(accessed on July 3, 2017).

[5] Fannie Mae, see https://www.fanniemae.com/content/faq/homeready-faqs.pdf.

[6] Brevoort, Kenneth. Phillip Grimm, and Michelle Kambara. "Data Point: Credit Invisibles," Consumer Financial Protection Bureau, last modified May 2015, http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

[7] "FDIC National Survey of Unbanked and Underbanked Households," Federal Deposit Insurance Corporation, October 20, 2016, https://www.fdic.gov/householdsurvey/2015/2015report.pdf.

> Freddie Mac have been engaging more intentionally with the primary market to understand how to expand access to safe and affordable loan products for these underserved borrowers. In addition, primary market players have been considering the role of housing counseling agencies with multilingual staff capacity to support LEP borrowers' understanding of the mortgage market and improve the chances that LEP homeowners will establish appropriate contact with a servicer at the time of default.

However, many of these innovations have disappeared or slowed since the financial crisis, and the Latino homeownership rate is now stalled at an abysmally low level—approaching from nearly 50% pre-recession compared to 46% now. After a decade of study, it is clear that the roots of the financial crisis were three-fold: excessive subprime and often predatory financial products, mainly originated by non-regulated financial institutions; securitization of these loans through exotic securities that later became toxic; and inadequate regulation by those entities charged with ensuring safety and soundness of the banking system. However, there remains a prevalent in the Community Reinvestment Act. Yet this narrative has been soundly refuted by numerous studies, including the Financial Crisis Inquiry Commission's report which found that the cause of the crisis flowed from a regulatory failure.[8] Similarly, a 2012 independent study published through the Research Division of the Federal Reserve Bank of St. Louis found no evidence that affordable housing mandates of the Government Sponsored Enterprises (GSEs) played a role in the crisis.[9] Indeed, the simple fact that conventional loan portfolios, including those with substantial "affordable" mortgages, continued to perform within historical norms until unemployment rates exceeded typical norms, belies the unproven assertion that legitimate efforts to serve minorities contributed to, much less were the cause of, the financial crisis.

Moreover, the historic role that the federal government has played in enforcing, then reinforcing housing segregation and mortgage discrimination and thereby limiting the housing choices of generations of minorities must be accounted for in any future mortgage finance system.

These realities are critical because without an obligation to serve all markets, history has proven that communities of color will find it extremely difficult to access mortgage credit. Without an explicit duty to serve, private capital inevitably will gravitate to the "cream of the crop": more affluent buyers with traditional borrowing profiles. This will result in an unsustainable housing finance market where creditworthy but lower-wealth and lower-income buyers, especially minorities, will be underserved. This is already evident today; since the crisis, the private market overwhelmingly caters to traditional borrowers in more affluent locations.[10] Lenders have been making fewer mortgages to borrowers with FICO credit scores below 750 and a less- than-

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[8] Financial Crisis Inquiry Commission. 2011. "Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States." https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf (accessed on July 3, 2017).

[9] Ruben Hernandez-Murillo, Andra C. Ghent, and Michael T. Owyang. 2012. "Did Affordable Housing Legislation Contribute to the Subprime Securities Boom?" Federal Reserve Bank of St. Louis Working Paper Series, No. 2012-005B. http://research.stlouisfed.org/wp/2012/2012-005.pdf (accessed on July 3, 2017).

[10] Bhutta, Neil, and Glenn B. Canner. 2013. "Mortgage Market Conditions and Borrower Outcomes: Evidence from the 2012 HMDA Data and Matched HMDA–Credit Record Data," Federal Reserve Bulletin. http://www.federalreserve.gov/pubs/bulletin/2013/pdf/2012_HMDA.pdf (accessed on July 3, 2017).

perfect credit history.[11] In response to a clear overcorrection in the credit market since the height of the crisis, lenders have demonstrated a preference to serve the "easiest" to close and least risky borrowers, at the expense of those who are equally able to sustain homeownership but require more customization and consideration due to nontraditional family structures, employment, or credit histories. In fact, estimates from the Urban Institute indicate that 6 million additional mortgages would have been made between 2009 and 2015 if 2001 credit standards had been employed.[12]

Access to credit could be further limited by proposals to replace the current federal mandate to ensure broad access and affordability in our housing finance system. Recent legislative proposals have suggested alternative mechanisms for ensuring access and affordability through incentive or fee structures. NCLR has deep concerns about some of the proposed incentive structures, including "affordability" fees, that would allow primary market participants the opportunity to "opt-out" of lending to underserved borrowers.

These trends do not just harm borrowers in minority communities, but rather the whole housing sector. Although Asians, Hispanics and Blacks are already significant segments of the housing market, they are projected to be an even larger portion of the market over the next 10–20 years. According to the Joint Center for Housing Studies at Harvard, minorities will account for 80% of net new households during this period and 33% of all households by 2020. These households will be younger than traditional borrowers and will likely have lower incomes and less credit histories than their predecessors. And as family structures and the labor market continue to evolve, these new "nontraditional" borrowers will therefore need more flexible underwriting systems and access to affordable housing mortgage products to have a chance to become homeowners.

Principles in Housing Finance Reform

Nearly 10 years have passed since the collapse of the credit markets, the beginning of the great recession and foreclosure crisis. Critical reforms to the financial markets have been ushered in by the Dodd-Frank Wall Street and Consumer Protection Act (Dodd-Frank), and the rulemaking of the Consumer Financial Protection Bureau (CFPB) has brought clarity to mortgage lending standards for both borrowers and lenders. Despite this clarity in the market, the economic and housing recoveries have been uneven. Hispanic and low-income families of color, who lost a significant amount of household wealth during the foreclosure crisis, continue to struggle in gaining access to affordable credit in a tight market. As a result, many creditworthy households,

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[11] Laurie Goodman, Jun Zhu, and Taz George, "Where have all the loans gone? The impact of credit availability on mortgage volume," *Housing Finance Policy Center Commentary*, March 13, 2014, http://www.urban.org/sites/default/files/publication/22386/413052-Where-Have-All-the-Loans-Gone-The-Impact-of-Credit-Availability-on-Mortgage-Volume.PDF and Laurie Goodman, "Squeaky-clean loans lead to near-zero borrower defaults—and that is not a good thing," *Urban Wire* (blog), August 31, 2016, http://www.urban.org/urban-wire/squeaky-clean-loans-lead-near-zero-borrower-defaults-and-not-good-thing.

[12] Laurie Goodman, Jun Zhu, and Bing Bai, "Overly tight credit killed 1.1 million mortgages in 2015," Urban Wire (blog), November 21, 2016, http://www.urban.org/urban-wire/overly-tight-credit-killed-11-million-mortgages-2015.

including Latino millennials and families seeking homeownership a second time around, are being locked out of the American Dream of homeownership.

Issues described above such as "market creaming" and proposals to eliminate or replace federal mandates regarding access and affordability are concerning for the prospects of Latino borrowers and their families, and as a result, the stability of the entire housing market. Therefore, NCLR has three primary goals for a reformed housing finance system and a revived homeownership market:

1. To ensure that the secondary market promotes the principles of access and affordability through an explicit "duty to serve" and enforceable affordability goals.
2. To ensure that qualified Hispanic families and other families of color of modest means have the opportunity to access a home loan at fair, equal, and affordable rates.
3. To ensure that Latinos' home purchase will develop into an asset for their children, and will have a positive impact on the neighborhoods and communities where they live and their children thrive.

With these goals in mind, we have developed the following set of principles to guide the shaping of the nation's future housing finance system:

- **Increase access to affordable homeownership.** The federal government has a responsibility to bolster the private market, and should set the standard for affordable and sustainable loan products. The housing finance system must follow suit and be based on creating affordable and sustainable credit to the broadest possible range of creditworthy borrowers. The system must include an explicit "duty to serve" and affordability goals to ensure communities of color, low- and moderate-income households, and other underserved borrowers gain needed access to quality loan products, including 30-year fixed-rate mortgages that do not mandate excessive down payment requirements in underwriting standards. Any duty to serve provision must include effective enforcement tools to be meaningful in the primary and secondary markets.
- **Uphold fair and nondiscriminatory lending practices.** The federal government should ensure that the secondary market serves all borrowers in a fair and equitable manner, and affirmatively monitor the market for discrimination. The housing finance system should have a clear obligation to serve all qualified borrowers, and an entity that will approve originators. Consistent with existing civil rights statutes including the Fair Housing Act (FHA) and Equal Credit Opportunity Act (ECOA), no homebuyer should be subject to discrimination based on race, sex, religion, age, or any other designated protected class.
- **Formally recognize the role of housing counseling in the sustainability of the housing finance system**. Research shows that housing counseling is good for all parties—lenders, borrowers, and taxpayers. Loan performance is greater when a family has housing counseling support. Housing counseling supports safety and soundness and should be more fully integrated into the credit process. The lender and investor benefit from pre-purchase counseling by having a more informed consumer. Post-purchase counseling can help families manage their obligations and remain in their homes. In addition, rental counseling can help renters prepare and plan for a future transition into

homeownership. The redesigned housing finance system should, at a minimum, recognize this role by including housing counseling data fields in the Uniform Mortgage Database and include housing counseling as a risk reduction tool in evaluations by the Office of Underwriting.

- **Expand the role of lenders that deliver innovative and responsible lending models.** For a housing finance system to be viable, in addition to traditional objectives such as liquidity and safety and soundness, it must support product flexibility and sustainable innovation, which includes providing access to institutions of all sizes and in all geographic areas. Credit unions, community development financial institutions and community lenders have provided safe and affordable mortgages to underserved communities for generations. The need for capital and liquidity is even more important for underleveraged lenders in certain geographic regions, such as urban cores and rural areas, and those who serve underserved populations and first-time home buyers. A redesigned housing finance system should support the types of innovations by such lenders that have proved so successful in the past and, when appropriate, should support these lenders in bringing their products and services to scale without unnecessary barriers, such as volume-based pricing.
- **Find balance among the multiple market players.** The Federal Housing Administration plays a critical role by making credit available to people with modest incomes and first-time home buyers, who can repay a mortgage but have limited resources to cover a down payment or closing costs. In 2015, more than 60% of FHA mortgages were made to Latinos. In 2016, more than one-third of millennial first-time homebuyers relied on an FHA loan to finance their home purchase. However, the Federal Housing Administration will work best in a competitive market where it is one of many options. A secondary market structure that is too narrow raises the risk of perpetuating a two-tiered lending system where white borrowers and communities of color are treated differently and are funneled into separate channels with different fees.

Conclusion

There is strong public demand for a robust housing finance market that delivers a steady flow of affordable credit on fair terms in all corners of the country, and to all creditworthy borrowers equally. History has shown that this is not likely to happen without strong regulation, carefully-designed incentives, and targeted investments from the federal government. The private market cannot adequately serve borrowers from low-income, immigrant, senior, and rural communities and communities of color on its own. Therefore, we respectfully urge that future housing finance reforms are consistent with the principles outlined above.

In the interim, as it considers long-overdue first steps toward redesigning and revitalizing the mortgage system, Congress can take the following short-term initiatives to ensure a sustainable housing market for all:

- **Support robust loss mitigation measures that help homeowners at risk of default recover and return to timely payments or exit gracefully, and to support homeowner protections in mortgage servicing.** To achieve this, servicers should be required to work with and support HUD-approved housing counseling agencies; homeowners should be provided with access to all loss mitigation options; and, appropriate federal regulatory agencies should monitor the market for improper servicing practices such as dual tracking.

- **Support federally-funded programs that support the creation or preservation of affordable housing, including the Community Development Block Grant, Home Investment Partnership and the Housing Trust Fund.** Taken together, these HUD-administered programs provide critical assistance to low-income households and communities of color seeking access to affordable and sustainable homeownership opportunities. These programs increase access to housing counseling services in hard to reach low-income and underserved communities, reduce poverty by investing in neighborhood stabilization and job creation initiatives, and make down payment assistance more accessible for underserved borrowers, including many Latino and low-income households, who have limited resources for a down payment or closing costs.
- **Restore appropriations for the HUD Housing Counseling program back to its pre-recession $65 million levels.** The program has proven effective in reducing delinquency and foreclosure, and should remain a cornerstone of any strategy to increase and sustain homeownership opportunities for low- and moderate-income Americans.

Throughout our testimony, NCLR has placed emphasis on the critical role of the federal government to ensure broad access and affordability in the housing finance system. Based on NCLR's history of policy and fieldwork, we have observed notable innovations in mortgage underwriting and the critical programs of federal agencies playing a role in the market that have effectively increased access to homeownership for underserved borrowers. In addition, NCLR continues to lift up the role of housing counseling to effectively prepare low- and moderate-income communities for sustainable homeownership, and assist hard to reach homeowners in underserved areas to stay in their homes.

Thank you for the opportunity to share our insight on the future of the housing finance system. If you would like to discuss our recommendations in greater detail, please contact Eric Rodriguez, Vice President, Office of Research, Advocacy and Legislation at erodriguez@nclr.org.

LETTER SUBMITTED BY THE NATIONAL ASSOCIATION OF FEDERALLY INSURED CREDIT UNIONS

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June 28, 2017

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, DC 20510

RE: Tomorrow's Hearing: "Principles of Housing Finance Reform"

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only trade association exclusively representing the federal interests of our nation's federally-insured credit unions, I write today in conjunction with tomorrow's scheduled hearing examining the principles of housing finance reform. We appreciate the committee's focus on the importance of reforming our nation's mortgage finance market.

As Congress and the Committee examine the future of the Government Sponsored Enterprises (GSEs) and ideas to reshape the housing finance market, we want to share with you NAFCU's recently released whitepaper entitled "Housing Finance Reform Principles." We urge you to consider these principles that are important to credit unions as you examine the future of housing finance.

Thank you for holding this important hearing. We look forward to working with the committee as it determines the best way forward to creating a healthy and stable housing finance marketplace and stand ready provide input and assistance throughout the process. Should you have any questions or require any additional information please contact me or Allyson Browning, NAFCU's Associate Director of Legislative Affairs, at 703-842-2836 or abrowning@nafcu.org.

Sincerely,

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Senate Banking Committee

Attachment: NAFCU's "Housing Finance Reform Principles"

HOUSING FINANCE REFORM PRINCIPLES

NAFCU

National Association of Federally-Insured Credit Unions

The National Association of Federally-Insured Credit Unions (NAFCU) is a direct membership association that serves the needs of federally-insured credit unions through unparalleled federal advocacy, education, and compliance assistance. NAFCU and its member credit unions have long supported a vibrant secondary mortgage market that provides equal access to lenders of all sizes. NAFCU's members play a significant role in the mortgage lending industry and strive to provide high-quality loans all while increasing member access to credit.

Since 2008, when the federal government took control of Fannie Mae and Freddie Mac (the government-sponsored enterprises or GSEs) from their stockholders and placed them into conservatorship, the future of the GSEs and the secondary mortgage market has become an important topic of debate among lawmakers and three administrations. NAFCU and its members have been intimately involved in housing finance reform efforts in Congress since that time. Representatives from several of NAFCU's member credit unions have provided testimony on various legislative proposals, including the *Protecting American Taxpayers and Homeowners* (PATH) *Act* and *the Housing Finance Reform and Taxpayer Protection Act* introduced by Senators Bob Corker (R-TN) and Mark Warner (D-VA). These testimonies provided Congress with vital insight into the credit union perspective on the secondary mortgage market. NAFCU also participated in the discussion surrounding the Housing Finance Reform and Taxpayer Protection Act of 2014 (Johnson-Crapo) and has consistently commented on proposals coming out of the Federal Housing Finance Agency (FHFA) to provide the agency with information on the potential affects their proposals may have on credit unions. As the FHFA has become more active in their internal piecemeal efforts at GSE reform, NAFCU has stepped up to the plate as the leader in the credit union industry regarding housing finance reform.

Now, more than ever since the financial crisis, Washington D.C. is abuzz with talk of housing finance reform. This paper outlines NAFCU's principles for the future state of housing finance reform. Although this paper is not an official proposal for GSE reform, NAFCU believes that whatever reform option is ultimately adopted must include these core principles to ensure the safety and soundness of credit unions nationwide. The time has come for Congress to take action on housing finance reform to establish a safe and viable housing market for the foreseeable future.

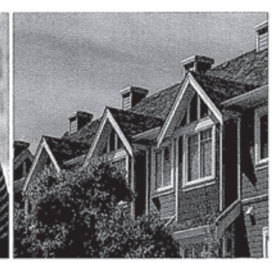
THE CREDIT UNION PERSPECTIVE

The housing market is a critical aspect of our nation's economy and the future of the housing finance system is of great importance to our nation's credit unions and their 108 million members. In the years since the Great Recession, it has become increasingly clear that the status quo for our housing finance system is an unsustainable long-term option. It is essential that we now devote time to establishing workable principles through which to guide potential housing finance reform efforts.

Before, during, and after the financial crisis, credit unions continued to make quality loans through solid underwriting practices. Regulatory restrictions, however, have made it difficult for credit unions to hedge against interest rate risk. The government-sponsored enterprises are of particular importance to credit unions because they serve as an important management tool to access the liquidity necessary to enable credit unions to serve the mortgage needs of their member-owners. Overall, the GSE securitization process remains a key component of the safety and soundness of credit unions nationwide.

In addition to maintaining access to a healthy and viable secondary mortgage market, fair pricing is equally as critical in ensuring community-based financial service providers have a seat at the table. Credit unions serve communities of varying compositions and believe that the GSEs should continue to do the same and not discriminate against a financial institution based on the type of institution, an institution's asset size or any other geopolitical factors. As such, GSE pricing for loans should be based on loan quality and not quantity.

These general positions underlie the following specific GSE reform principles that NAFCU believes must be a central part of any legislative reform effort. The ultimate goal is to create a thriving and sustainable market for mortgage-backed securities (MBS) that will provide equal access to lenders of all sizes and will not require another taxpayer bailout.



PRINCIPLES FOR HOUSING FINANCE REFORM:

› A healthy, sustainable and viable secondary mortgage market must be maintained.

Credit unions must have unfettered, legislatively-guaranteed access to the secondary mortgage market. In order to achieve a healthy, sustainable and viable secondary market, there must be vibrant competition among market participants in every aspect of the secondary market. Market participants should include, at a minimum, at least one GSE, the Federal Home Loan Banks (FHLBs), Ginnie Mae, and private entities.

› The U.S. government should issue an explicit government guarantee on the payment of principal and interest on MBS.

The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in MBS, and facilitate the flow of liquidity through the market.

› The GSEs should be self-funded, without any dedicated government appropriations.

Although the U.S. government should be involved in the secondary mortgage market, the GSEs should not be government-funded mortgage programs. The GSEs' fees should provide the revenue necessary for sustained independent operation. Those fee structures should, in addition to size and volume, place increased emphasis on the quality of loans. Risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of the GSEs' securities.

› Creation of a FHFA board of advisors.

A board of advisors made up of representatives from the mortgage lending industry should be formed to advise the FHFA regarding the GSEs and the state of the secondary mortgage market. Credit unions should be represented in such a body.

› The GSEs should be allowed to rebuild their capital buffers.

Rebuilding capital buffers ensures the safety and soundness of the GSEs, maintains investor confidence, prevents market disruption, and reduces the likelihood of another taxpayer bailout in the event of a future catastrophic market downturn. The GSEs should be permitted to begin rebuilding capital slowly over a period of several years.

› The GSEs should not be fully privatized at this time.

There continue to be serious concerns that in a fully privatized system, in which the GSEs are sold off to the secondary market, small, community-based financial institutions could be shut out of the secondary market. Any privatization efforts should be gradual and ensure that credit unions have continued access to the GSEs and the secondary mortgage market.

› The FHLBs must remain a central part of the mortgage market.

The FHLBs serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Housing finance reform must take into account the consequence of any legislation on the health and reliability of the FHLBs.

› Credit risk transfer transactions should be expanded and the Common Securitization Platform (CSP) and Single Security retained.

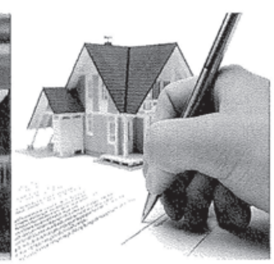
Although there are concerns regarding credit unions' ability to participate in certain credit risk transfer (CRT) transactions, the GSEs should continue to expand CRT as well as initiatives to create deeper mortgage insurance to further disperse risk among private investors. Credit unions should be permitted to participate in transactions such as front-end CRTs through a special purpose vehicle, such as a credit union service organization or the FHLBs. The CSP and Single Security have the potential to simplify the sale of loans to the GSEs and allow greater, more affordable access to the secondary mortgage market.

› The FHFA or its successor should continue to provide strong oversight of the GSEs and the new system, whatever it may look like.

A strong, reliable single federal regulator helps to provide consistency and focus to the GSEs so they can stay on track with their core missions and objectives. The FHFA helps maintain safety and soundness in the secondary mortgage market. A new system should also utilize the current regulatory framework and GSE pricing and fee structures.

› The transition to a new system should be as seamless as possible.

Regardless of whether the GSEs in their current form are part of a new housing finance system, credit unions should have uninterrupted access to the GSEs or their successor(s) and the secondary mortgage market as a whole, in particular through the cash window and small pool options.

NAFCU'S VISION FOR THE FUTURE OF HOUSING FINANCE

NAFCU's vision is two-fold: continued access to the secondary mortgage market and a level playing field for lenders of all sizes. Currently, the GSEs provide credit unions with the liquidity necessary to offer new mortgages to their member-owners. In the future, credit unions must continue to be able to sell directly to the GSEs without having to aggregate their loans through larger lenders. The GSEs must also continue to offer fair prices and fees.

Although NAFCU does not support full privatization at this time, the GSEs should be permitted to begin rebuilding their capital buffers. This is imperative to preserving liquidity and overall market stability. Additionally, in a new housing finance system, the GSEs should provide an explicit guarantee backed by the full faith and credit of the United States government. If the GSEs are to continue to attract private investors, an explicit guarantee is necessary to ensure market continuity in the event of a financial downturn.

As Congress considers housing finance reform, the process will not be easy and it will be undeniably filled with uncertainties. The above principles provide a concrete foundation for reform. Credit unions play a vital part in the mortgage market and their ability to sell loans to the GSEs must remain uninterrupted through any potential transition to a new housing finance system. Unfettered access to the secondary mortgage market for credit unions with fair pricing based on loan quality as opposed to volume must be maintained to ensure the continued safety and soundness of our nation's housing market.

NAFCU

National Association of Federally-Insured Credit Unions

STATEMENT SUBMITTED BY GRAHAMFISHER

GRAHAMFISHER

April 26, 2017

Joshua Rosner
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The MBA's Plan for GSE Reform – Unsolved Problems & a Dangerous Recipe

The MBA's plan, like many other proposals, fails to address the question: 'What is the problem we should be seeking to solve'. Any changes to the system should seek to create a stable, cyclically neutral or countercyclical, system for the provisioning of mortgage credit in economically adverse environments during which banks and market participants are unwilling to make or hold new mortgage loans. Such is the reason for the social contract that led to the creation of the GSEs in the first place. The recognition of the provisioning of societally necessary goods and services is the reason that we charter electric, water, gas and other utilities. Without the ability to ensure the provisioning of these goods and services, regardless of economic environments, lights and water would either fail in economic downturns or become economically inaccessible to all but the few and wealthiest consumers.

While the MBA's acknowledgement of the value of a utility model is a step in the right direction, but what they propose is not a utility model at all. In exchange for governmentally conferred powers, the utilities chartering body regulates their rates of return, ensures adequate scale and requires they are overcapitalized and counter-cyclical entities that compete not on price but efficiencies and service. For reference, see our paper and PowerPoint *"GSE Reform: Something Old, Something New, and Something Borrowed" (available at* https://tinyurl.com/lfoxkye & https://tinyurl.com/kbctr5n)

The real costs of acquiring the necessary scale and infrastructure (efficient costs of capital), combined with regulated rates of return would make it impossible for new entrants to survive without the distortive subsidization of some players to the disadvantage of others – which is precisely what the MBA proposes.

Importantly, even without addressing the issues we should be trying to solve for, other key elements of their proposal are unresolvable and problematic.

- **Taxpayers are exposed to *more* risk and uncertainty.**
  - Foreign holders of U.S. mortgage debt would be more exposed to incalculable risk due to the MBA plan's structure.
  - MBA's mechanism for attempting to protect taxpayers works "through expanded front- and back-end credit enhancements." However, even in a stable economic environment, back-end credit enhancements have proven

to be needlessly costly and uneconomic to Fannie and Freddie for the given risk they are purportedly laying off.

- Unnecessary complexities and inherent inequities are created via an explicit government subsidy where "new entrants may be allowed greater flexibility to charge market-based rates."

- Creates the risks of further skewed government policies via unnatural incentives, which are not market driven, by providing guarantors with *"incentives* to distribute credit risk to private market investors rather than retaining all of the risk."

- **Housing market liquidity will be significantly *reduced*.**

  - Requires "deeper front-end and back-end" single family risk transfers to the private market. There is no evidence of adequate investor appetite for this risk and the market remains very illiquid, even in the best of times. Specific requirements for such sharing also allow issuers to game guarantors on price.

  - Public knowledge that the guarantor can reduce requirements in an economic downturn introduces pro-cyclical incentives for investors to exit the market as a herd, and to benefit from higher yields. This is in stark contrast to a properly capitalized GSE with clear and enforced regulatory controls that would provide countercyclical support to assist the economy and dramatically reduce this incentive.

  - Articulates the idea that the MIF would ensure "liquidity in the event of a full-blown systemic crisis," but this liquidity falls on the shoulders of the government without a clear ability for repayment post-crisis. Costs of failed institutions that have no capital reserves for put-backs on loans that are found to have defects in reps and warranties will cause these exposures to compete with depositors in FDIC resolutions. This, like the existing priority of FHLB loans, would take priority over depositors in bank resolutions. The GSEs sued surviving banks for such put-backs after the banks had received TARP monies and had begun to recapitalize.

- **The MBA's Mortgage Insurance Fund ("MIF") concept is dangerous to the mortgage market's stability and liquidity.**

- The MIF would be primarily is funded by interconnected and highly correlated Too Big to Fail ("TBTF") guarantors instead of via more predictable guarantee fees from entities like Fannie and Freddie. The MBA's MIF would leave taxpayers exposed to dramatic risks when TBTF banks inevitably require another bailout in a crisis situation.

- The MIF would create an underpricing of risk, relative to private markets, and confer a new government subsidy of at least 2% to 5% (and explicit guarantee) to the industry at the expense of taxpayers. This subsidy exists with the FHA's Mortgage Insurance Fund. Big banks win, taxpayers lose.

- The MIF concept creates undue risk if there were another economic downturn before the fund was adequately capitalized. This would leave taxpayers exposed with no workable recourse for recovering losses.

- Government deposit insurance schemes effectively price for individual failures in normal times but are inadequately funded for systemic events effecting the largest and most interconnected institutions. This required significant open-market assistance and government expenditures during crisis without regard to the ability to reclaim those costs.

- **Wholly incomplete plan with respect to implementation costs, time, and property rights.**

  - The plan does not address the economic cost or risk associated with a "transfer [of] legacy GSE assets and liabilities to new entities."

  - Does not address property rights associated with the GSEs. Implementing the MBA's proposal before resolving those issues would only lead to further risk and uncertainty.

  - Does not address the government's warrants for 79.9% of each company.

  - No cross analysis of impacts on mortgage rates or costs associated with implementing such a plan were articulated. The cost burden of the MBA plan will ultimately fall on the government or the GSEs.

- **Relies on the Common Securitization Platform ("CSP") and other unproven structures, which introduces more liquidity risk and taxpayer exposure than ever before.**

- The complexity of the various parts (e.g., guarantors, CSP, risk sharing, single security) will make the Federal Housing Finance Agency the most complex financial safety and soundness regulator with the broadest regulatory mandate – a recipe for failure.

- Proposes the creation and use of new, untested, and complex financial instruments, *instead* of Tier 1 capital (i.e., capital on the entity balance sheet) as a means to move, transfer, and hide risk – not dissimilarly from CDO's during the financial crisis. Guarantor developed "back-end structures such as reinsurance and capital markets transactions" will lead to new and complex structures where the guarantors will be incentivized to innovate around the regulators.

- Like regulatory failures to oversee MBS & CDOs, this type of risky development will disadvantage regulators who will either not be able to keep up with proper oversight, or will be exposed to political pressure and capture.

- Relies heavily on "issuance of MBS for single-family mortgages through the CSP." The CSP has already cost the GSEs over $450 million with no firm guidance on where the capital has gone or how much more is required. This has been an enormously costly, failed experiment that clearly disadvantages Fannie Mae.

- The rationale behind the CSP was to allow guarantors to fail but keep the securitization platform working in crisis. In actuality, the CSP is just back office support (e.g., disclosure and fund administration) and doesn't have the infrastructure to issue securities in good or bad times. The platform will not be able to support the market in crisis without acquiring all of the tools to issue securities.

- The CSP would become a government-owned, systemically important, central clearing party that would expose the taxpayer to massive exposures. Is the government capable of keeping it up to date?

- **Too Big to Fail banks would control yet another segment of the economy.**

  - Allowing primary market players to gain control over any aspect of the secondary market creates the same type of blurring of the lines between primary and secondary market that created GSE pro-cyclicality and led to the 2008 economic crisis.

- Allowing joint ownership of a guarantor by several TBTF banks invites collusion, increased interconnectedness, and systemic risk. This lesson was learned with municipal bond bid rigging, the Forex scandal, and the LIBOR scandal.

- "Charters and functions of the guarantors will be different from those of the GSEs…" leading to a convoluted and subsidized system where certain guarantors have certain rights, whereas others have a variation.

STATEMENT SUBMITTED BY THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA®

June 29, 2017

Community Banks and Housing Finance Reform

On behalf of the more than 5,800 community banks represented by ICBA, we thank Chairman Crapo, Ranking Member Brown, and members of the Senate Banking Committee for convening today's hearing on "Principles of Housing Finance Reform." We appreciate you taking up the critical policy challenge of creating a stable and enduring housing finance system to strengthen the American economy.

Attached is ICBA's recent white paper, "ICBA Principles for GSE Reform and a Way Forward," which we are pleased to offer as a statement for the record for today's hearing. Below is a summary of critical points made in the white paper.

The GSEs Have Facilitated Home Ownership for Decades

For decades, American homeowners have benefited from the critical role Fannie Mae and Freddie Mac (the government sponsored enterprises or "GSEs") have played in helping finance homeownership. The GSEs have provided a steady, reliable source of funding for home mortgage lending through all economic cycles and in all markets. The GSEs have accomplished this by developing a strong liquid global market for conventional mortgage-backed securities (MBS), which enables the GSEs to attract funding worldwide. GSE securities trade with the same ease as U.S. Treasury debt. The GSEs operate as friendly aggregators and a source of capital for mortgage lending institutions of all sizes and charters.

Community banks depend on the GSEs for direct access to the secondary market without having to sell their loans through a larger financial institution that competes with them. The GSEs allow community banks to retain the servicing on the loans they sell, which helps keep delinquencies and foreclosures low. And unlike other private investors or aggregators, the GSEs have a mandate to serve all markets at all times. This they have done, in contrast to some private investors and aggregators that severely curtailed their business in smaller and economically distressed markets, leaving those community bank sellers to find other outlets for their loan sales.

Reform Should Preserve What Works, Draw Private Capital into the System, and Protect Taxpayers

ICBA's approach to GSE reform is simple: use what's in place today and is working and focus reform on aspects of the current system that are not working or that put taxpayers at risk.

As noted above, the current GSE secondary mortgage market structure has worked well for community banks by providing direct and equitable access, not competing at the retail level, and permitting community banks to retain mortgage servicing rights on the loans they sell.

One Mission. Community Banks.®

However, ICBA strongly supports secondary market reform measures that will prevent or significantly reduce the risk of devastating market failures that have hobbled our economy in the past. There is bipartisan consensus that there should be more private capital in the housing finance system. Private capital should come from multiple sources, not just the largest Wall Street firms. ICBA welcomes the return to a more balanced and less concentrated housing finance system with an appropriate role for portfolio lenders, originate-and-sell lenders, and small as well as large lenders. If implemented thoughtfully, such a system would reduce the moral hazard and taxpayer liability of the current system.

Reforms that would break up the GSEs or sell off their assets to large Wall Street firms would further concentrate the mortgage lending and the secondary market in a small number of megafirms. This would significantly increase the risk of another market failure.

ICBA's attached white paper provides a roadmap for reform that will preserve the role of community bank mortgage lenders, restore the safety, soundness, and financial stability to the GSEs, and ensure that Wall Street and the megabanks do not effectively capture the secondary market system to the detriment of borrowers and communities.

Recapitalization of the GSEs Cannot Wait

It will take time to reach consensus on the many critical features of comprehensive reform legislation. Pending completion of that effort, FHFA should protect taxpayers from another bailout. ICBA urges FHFA to follow the Housing and Economic Recovery Act of 2008 (HERA) and require both GSEs to develop and implement a capital restoration plan, start to retain earnings and, over time, build capital to a level that adequately supports their operations and protects U.S. taxpayers.

Closing

Thank you again for convening today's hearing. ICBA looks forward to working with this Committee to create a housing finance system that will support a robust and resilient housing market for many decades to come. We encourage all members of the Committee to read our attached white paper and discuss its principles with community bankers in their states.


ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA®
ICBA Principles for
GSE Reform and
a Way Forward
www.icba.org

In September 2008, the Federal Housing Finance Agency (FHFA) and the Treasury Department placed Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs) into conservatorship. Described at the time to the public as a temporary "time out" to allow both companies to stabilize, the plan of those policymakers who put the GSEs into conservatorship was to release both institutions from this "time out" once they were financially sound again. More than eight years have passed, and a third administration has inherited these conservatorships. Unfortunately, Fannie Mae and Freddie Mac have less capital today than when they were placed under control of their regulator and the Treasury. Yet, both companies have returned to profitability and have worked through the majority of their defaulted loans, all while continuing to provide the liquidity to the housing market that's been critical for its recovery from the worst recession in more than 80 years.

GENERAL POSITION ON GSE REFORM

American homeowners have benefited from the critical role Fannie Mae and Freddie Mac have played in helping finance homeownership for decades. The GSEs have provided a steady, reliable source of funding for home mortgage lending through all economic cycles and in all markets. The GSEs have accomplished this by developing a strong liquid global market for conventional mortgage-backed securities (MBS), which enables the GSEs to attract funding worldwide. GSE securities trade with the same ease as U.S. Treasury debt and securities. The GSEs operate as friendly aggregators and a source of capital for mortgage lending institutions of all sizes and charters.

Community banks depend on the GSEs for direct access to the secondary market without having to sell their loans through a larger financial institution that competes with them. The GSEs help support the community bank business model of good local service by allowing them to retain the servicing on the loans they sell, which helps keep delinquencies and foreclosures low. And unlike other private investors or aggregators, the GSEs have a mandate to serve all markets at all times. This they have done, in contrast to some private investors and aggregators that severely curtailed their business in smaller and economically distressed markets, leaving those community bank sellers to find other outlets for their loan sales.

PRINCIPLES FOR GSE REFORM

- ***The GSEs must be allowed to rebuild their capital buffers***. The first step in GSE reform requires the FHFA, the GSEs' safety and soundness regulator, to follow the mandates prescribed in the 2008 Housing and Economic Recovery Act (HERA), namely, to restore the GSEs to a safe and sound condition. Regardless of which approach or structure reform takes, the existing system must be well capitalized to prevent market disruption or additional taxpayer support in the event of one or both GSEs requiring a draw from the U.S. Treasury during what's likely to be a lengthy debate and transition period to any new structure or system.

- ***Lenders should have competitive, equal, direct access on a single-loan basis***. The GSE secondary market must continue to be impartial and provide competitive, equitable, direct access for all lenders on a single-loan basis that does not require the lender to securitize its own loans. Pricing to all lenders should be equal regardless of size or lending volume.

- ***Capital, liquidity, and reliability are essential***. The GSEs must be adequately capitalized, liquid, and reliable enough to effectively serve the entire mortgage industry in all markets, at all times, including challenging economic circumstances.

- ***Credit risk transfers must meet targeted economic returns***. The FHFA has required the GSEs to engage in ever increasing levels of credit risk transfers (CRTs). While these CRTs may help mitigate the amount of credit risk both the GSEs and taxpayers bear, these transactions also drain revenue away from the GSEs and expose them to operational risks. Additionally, CRT securities are currently illiquid and would likely dry up in times of market stress. CRTs, regardless of their form or structure, must reflect a real transfer of credit risk, minimize counterparty risk, be scalable, meet a targeted economic rate of return set by FHFA, and not encourage further concentration of the mortgage business in the largest banks.

- ***An explicit government guarantee on GSE MBS is needed***. For the market to remain deep and liquid, government catastrophic-loss protection must be explicit and paid for through the GSE guaranty fees, at market rates. This guarantee is needed to provide credit assurances to investors, sustaining robust liquidity even during periods of market stress.

- ***The TBA market for GSE MBS must be preserved.*** Most mortgage lenders are dependent on a liquid to-be-announced (TBA) market that allows them to offer interest rate locks while hedging interest rate risk with GSE MBS that will be created and delivered at a later date. Creating new GSE MBS structures, or using customized capital markets structures that provide front-end CRTs, generally makes the resulting MBS "non-TBA."

- ***Strong oversight from a single regulator will promote sound operation.*** Weak and ineffective regulation of the GSEs enabled them to stray from their primary mission as aggregators, guarantors, and securitizes. As required by HERA, the FHFA must ensure the secondary market operates in a safe and sound manner so taxpayers are not put at risk. It is incumbent upon the FHFA to ensure the GSEs are adequately capitalized commensurate with their risks and compliant with their primary mission.

- ***Originators must have the option to retain servicing, and servicing fees must be reasonable.*** Originators must have the option to retain servicing after the sale of a loan. In today's market, the large aggregators insist that lenders release servicing rights along with their loans. Transfer of servicing entails transfer of customer data, which can be used for cross-selling. While servicing is a low-margin business, it is a crucial aspect of the relationship-lending business model, giving originators the opportunity to meet the other lending or financial services needs of their customers. Additionally, consumers generally receive better service when their loans are serviced locally than when they are serviced by entities that did not originate their loan and are located out of their market area.

- ***Complexity should not force consolidation.*** Under the current GSE model, selling loans is relatively simple. Sellers take out commitments to sell loans on a single-loan basis and are not required to obtain complex credit enhancements, except for private mortgage insurance for loans exceeding 80 percent loan-to-value or other guarantees. Any future secondary market or GSE structure must preserve this relatively simple process for community banks and other small lenders that individually do not have the scale or resources to obtain and manage complex credit enhancements from multiple parties.

- ***GSE assets must not be sold or transferred to the private market.*** Assets such as the GSEs' automated underwriting technology, loan delivery portals, Common Securitization Platform, and multi-family housing businesses should not be sold or transferred to private market aggregators.

- ***The purpose and activities of the GSEs should be appropriately limited.*** The resources of the GSEs must be focused on supporting residential and multifamily housing. They must not be allowed to compete with originators at the retail level, where they would enjoy an unfair advantage.

- ***GSE shareholder rights must be upheld.*** Any reform of the housing finance system must address the claims of GSE shareholders and respect the rule of law that governs the rights of corporate shareholders.

ICBA'S WAY FORWARD

Policymakers, industry stakeholders, think tank gurus, and politicians have weighed in on how to resolve this last remaining part of the Great Recession. There have been multiple papers and numerous legislative proposals, including some that have been attached to appropriations legislation, all seeking to end the conservatorship of the GSEs. Yet, the GSEs remain in conservatorship and subject to the net-worth sweep that is slowly bleeding away what little capital they have. This will eventually bring a day of reckoning for FHFA, the Treasury, and the housing market.

If asked about GSE reform, most mortgage lenders would say: fix what's wrong, let the GSEs recapitalize, regulate them, and release them from conservatorship. These mortgage lenders depend on the GSEs for access to the secondary market and do not want their options to sell or securitize loans controlled or dictated by a few large entities that also compete with them in providing financial services.

ICBA's approach to GSE reform is simple: use what is in place today and is working, and address or change the parts that are not. Our approach has two parts: (1) reforms that can be accomplished administratively by FHFA within HERA, and (2) reforms that will require congressional action.

ADMINISTRATIVE REFORMS

- FHFA should end the net-worth sweep and, per HERA, require both GSEs to develop capital restoration plans. These plans would include continued use of credit risk transfers, provided they meet a targeted economic return threshold that balances GSE revenue and capital-building needs with prudent credit risk management standards.

- FHFA should review and approve those capital plans, establish prudent risk-based capital levels as required by HERA, and set reasonable timeframes and milestones for achieving re-capitalization goals.

- FHFA should monitor the GSEs' performance against their respective plans and release each GSE from conservatorship as they become well capitalized.

- The GSEs should complete construction of the Common Securitization Platform and issue their respective MBS from the platform. Ownership and management of the CSP should remain with the GSEs through the current LLC structure. Expanding access to the CSP to other entities should be up to the Common Securitization Solutions LLC board, with final approval by FHFA.

- Launch of the Uniform Mortgage Backed Security should be deferred until both GSEs are recapitalized and released from conservatorship.

LEGISLATIVE REFORMS

- Congress should create a catastrophic mortgage insurance fund to be administered by the FHFA and funded through GSE guaranty fees. The size of the fund should be determined based on actuarial standards and should be similar to the FDIC's Deposit Insurance Fund. The fund would stand behind the explicit U.S. government guarantee of the GSE MBS.

- Congress should change the GSE corporate charters from the current government-chartered, shareholder-owned, publicly traded companies, to regulated financial utilities that are shareholder owned. All current shareholders should be able to exchange common and junior preferred GSE shares for a like amount of shares in the new structures. The Treasury should exercise its warrants for senior preferred shares of GSE stock and convert those shares to stock in the new structure. No dividends should be paid to any shareholders until the company is deemed well capitalized per its recapitalization plan by the FHFA. The Treasury should be required to divest itself from its shares once a company is well capitalized.

CONCLUSION

GSE reform will be difficult, but it remains critically important to the future of the housing market and the U.S. economy, and HERA provides the road map needed to restore the GSEs to a safe and sound condition. ICBA is confident that a strong plan to improve their capital position, grow earnings, manage expenses and restore high-quality service and increased liquidity to the mortgage market will drive a more robust primary and secondary mortgage market. It will make the housing finance system safer and more sound, providing access to lenders of all sizes and the communities they serve.

JOINT LETTER RE: PRESERVE THE GSE AFFORDABLE HOUSING GOALS

June 6, 2017

Chairman Mike Crapo and Ranking Member Sherrod Brown
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Preserve the GSE Affordable Housing Goals in Housing Finance System to Ensure Fair Access for All Creditworthy Borrowers

Dear Chairman Crapo and Ranking Member Brown:

Last week, calls were made to eliminate the GSE affordable housing goals as a means to move forward legislation to reform the secondary housing finance market. This misguided attempt is not new, and it would harm creditworthy borrowers who cannot access the mortgage credit they deserve, deny them their chance at the American Dream of homeownership, and weaken our nation's economy.

In 2010, the *Civil Rights Principles for Secondary Market Reform* were offered, and chief among them was a call for federal housing finance policy to align with and support our nation's longstanding federal housing goal to protect against discrimination.[1] Additionally, we called for the federal government to meet its responsibility to ensure that the secondary market serves all borrowers in a fair and equitable manner and to foster access to credit, particularly in underserved markets. In order to achieve these goals, GSE reform legislation must include provisions to strengthen affordable housing goals, among other measures.

In 2014, our organizations rejected a similar call to end the affordable housing goals in the Johnson-Crapo GSE reform legislation. Today, we adamantly oppose any attempt to legislatively or administratively eradicate the goals, and we call on all members of Congress to join us.

The affordable housing goals help expand credit access for underserved groups, help ensure liquidity in the financial markets, and further fair lending goals. They are the result of long-

[1] http://www.prrac.org/pdf/GSE-Principles-December2010.pdf.

term advocacy efforts to ensure access and affordability in the secondary mortgage market. Congress created the goals in 1992 with the Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA), and carried them forward in 2008 with the Housing and Economic Recovery Act (HERA). Originally, they advanced lending opportunities to low-income families in underserved areas, which resulted in mortgage originators making more affordable loans. Now, they are a metric for accountability by the GSEs' conservator, the Federal Housing Finance Agency, to address the underservice to important, and often excluded, market segments.

The enterprises' affordable housing goals made a tremendous impact on helping creditworthy borrowers purchase homes. From 2003 through 2012, the National Community Reinvestment Coalition reported that more than 25 million hard-working families nationwide were able to become homeowners due to the goals.[2] In fact, we know that loans to low and moderate income consumers, done right, perform well and serve lenders, borrowers and communities. For example, a report on Self-Help Credit Union's Community Advantage Program from the University of North Carolina's Center for Community Capital, showed that borrowers amassed a net worth of $38,000, compared with renters' $266, even as housing values plunged during the crisis.[3] The Community Advantage Program securitized mortgages for more than 50,000 families in 48 states.

Yet access to quality credit is still a continuing challenge for many people. The Urban Institute found that from 2009 to 2014, there were 5.2 million mortgage loans missing from the market due to overly tight credit standards, including restrictions and measures put in place by the GSEs.[4] Following the true purpose and intent of the affordable housing goals will provide a safe and sound means of creating and strengthening household wealth, as well as shore up economic growth in a responsible way.

Any reform of the secondary mortgage market must ensure access and affordability to mortgage credit for all creditworthy potential homebuyers in all regions of the nation. These obligations start with the Fair Housing and Equal Credit Opportunity Acts; extend through the GSEs' actual charters; and are implemented through FHEFSSA and HERA. Taken together, it is clear that Congress intended for the secondary housing finance market to serve as an active catalyst for the creation of equal and fair credit opportunities. Diminishing the role and importance that the secondary housing finance system plays in achieving this goal will continue to deepen the racial wealth gap that already exists in America today. It is not sufficient to replace this robust structure with a fee, such as the Market Access Fee offered in the proposed Johnson-Crapo legislation, as some have suggested.

We believe that any legislative reform of our housing finance system must amount to true reform — and not retrogression. The goal of reform should be to create a secure housing finance system

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[2] http://www.ncrc.org/images/PDFs/ahg/nationwide%20ahg.pdf.

[3] http://ccc.unc.edu/projects/community-advantage-panel-study-2/.

[4] Bing Bai, Lauri Goodman, and Jun Zhu, *Tight credit standards prevented 5.2 million mortgages between 2009 and 2014*, available at http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014.

that is open and available to all creditworthy borrowers and lenders of all sizes, and that provides affordable mortgages to families with lesser incomes and wealth. Many reforms have already taken place under Dodd-Frank and the CFPB's mortgage rules, which have rid the market of most of its risky practices and established an Ability-to-Repay standard for all mortgage loans.

Any legislation that emerges from the Senate Banking Committee must ensure that all secondary housing finance market entities comply with strong and effective affordable housing goals and statutorily-defined duty to serve obligations; expand access to quality, sustainable, affordable credit—particularly for underserved groups; employ risk-pooling measures; and protect taxpayers from bearing the cost of a housing downturn.

Respectfully,
The Leadership Conference on Civil and Human Rights
NAACP
National Coalition for Asian Pacific American Community Development
Center for Responsible Lending
National Council of La Raza
National Fair Housing Alliance
National Urban League
National Community Reinvestment Coalition