Frequently Asked Questions

What makes your proposal different from others?
Our proposal is unique because it does more to leverage what currently works while at the same time reforming the fundamental flaws in the prior system, including:

- Reforming and re-chartering the GSEs with a strong regulator to ensure equal and transparent access to lenders of all sizes.
- Eliminating the implied guarantee that allowed private gains and socialized losses.
- Establishing an explicit government guarantee at the MBS level.
- Putting more private, first loss capital ahead of an explicit guarantee.
- Increasing competition by allowing new entrants beyond two guarantors.

In addition, our final paper includes substantive options to support affordable housing and a framework for transitioning from the current state to the end state while minimizing market disruption.

If MBA's desired end state of reformed, privately-owned guarantors is adopted, what MUST be done by Congress?
Only Congress can establish or attach a full faith and credit guarantee to the MBS, establish an insurance fund and require the collection of an insurance premium. Additionally, any amendments to the GSEs' charters allowable scope of activities would require Congressional action, including establishing statutory limits to the portfolios and a statutory mandate to ensure a level playing field. Also, only Congress can authorize the granting of additional charters, establish the CSP as a government corporation and empower the regulator to establish the operational guardrails.

Is GSE Reform still a viable option if Fannie Mae and Freddie Mac are privatized?
"Privatize" can mean many things: MBA supports structural reform of GSEs and has long supported private guarantors in the reformed end state. Reform and re-chartering of Fannie and Freddie as private, utility-like guarantors, while establishing an explicit federal guarantee for certain MBS, is not inconsistent with "privatization."

Who was on this MBA Task Force?
The Task Force was comprised of senior industry leaders from a cross-section of residential and multifamily members, including small, medium, and large independent mortgage bankers and bank lenders. It was led by Rodrigo Lopez, MBA's 2017 Chairman, and it included 9 multifamily members and 14 residential members, including 7 small and mid-sized independent mortgage bankers. The group included CEOs, capital markets experts, mortgage insurance executives, and other seasoned industry practitioners. The goal was to ensure a wide breadth of industry perspectives that could build a bridge connecting key public policy goals with the realities of the marketplace. We intend to help design a secondary market system that works for all market

participants and through all economic cycles, while ensuring affordable mortgage credit to help the broadest range of homeowners and renters.

Who owns the newly chartered guarantors?
Private shareholders would own the guarantors. However, lenders (including banks and bank holding companies) would be limited to owning no more than 10% of a guarantor, limiting the ability of a lender and guarantor to vertically integrate.

How are the chartered guarantors organized?
Guarantors could be shareholder owned or mutually owned.

How are the guarantors regulated?
They would be regulated as utilities, with posted pricing, and rates of return monitored by the regulator to balance need for consistent investor returns and public mission to serve consumers, borrowers and the market. FHFA (or a successor) would be the primary supervisory regulator, and the Fed could regulate them, depending on their size, in a manner conistent with other nonbank institutions currently regulated as Systemically Important Financial Institutions (SIFIs).

How many chartered guarantors would there be?
Our model calls for competition between multiple guarantors, ideally more than two.

How can new entrants become chartered guarantors?
A Guarantor would apply to FHFA (or successor) for a charter. The process should be similar to the national bank chartering process, rather than statutorily fixed charters, as is the case today for Fannie Mae and Freddie Mac.

Can the chartered guarantors fail?
Yes, but the MBS would have the government guarantee to protect investors and maintain market liquidity. Shareholders and debtholders of the guarantor entities would not be covered by the guarantee.

To what does the government guarantee attach?
The guarantee covers only the MBS issued by the chartered guarantors.

How are the taxpayers protected from credit risk?
Taxpayers are protected by multiple layers of private capital at risk, including:

- Primary market credit enhancement (private mortgage insurance, recourse)
- Capital markets risk transfer (reinsurance and other back-end credit risk transfer),
- Guarantor capital (at levels significantly higher than under the GSEs' prior capital model), and
- A federal insurance fund supported by appropriate risk-based insurance premiums.
- For multifamily finance, existing GSE risk sharing and transfer mechanisms with lenders and the capital markets and other to-be-determined approaches.

How much capital should the new guarantors hold?
The regulator should have the authority to set specific capital levels, both risk-based and overall leverage limits/ratios. The modeling indicates required capital of three to five percent should be sufficient. The capital requirements should be consistent with the capital requirement for single-family or multifamily mortgages set for banks and other competing investors in mortgages, such as insurance complanies to ensure that similar risks require similar capital. As a point of comparison, the GSEs had a minimum capital requirement of only 45 bps on guaranteed mortgage-backed securities pre-crisis.

How will your plan impact costs to consumers?
Higher capital standards and more private, first loss capital to fix the flaws of the prior system will tend to raise costs through higher guarantee fees passed on to consumers through slightly higher rates. However, moving to an explicit guarantee will increase the value of MBS and offset some of these higher costs. It is hard to predict precisely how the tradeoff of increased MBS value and capital costs will play out, but the net increase in costs to consumers is likely to modest. The ultimate benefit to consumers and taxpayers is that 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 we believe is worth the tradeoff of modestly higher costs.

How will small lenders be protected under a new system?
One of the critical objectives is to ensure that recent market reforms that have leveled the playing field between large and small lenders are preserved and protected. Lenders of all sizes and business models should have equal access on similar terms to government-backed capital markets conduits.

Who owns the Common Securitization Platform (CSP)?
The CSP would ultimately be converted to a government-owned corporation and would own all GSE single-family historical data. The CSP would also validate loan and pool eligibility for government-guaranteed MBS.

Can the guarantors hold a retained investment portfolio?
Portfolio holdings would strictly limited to liquidity/contingency operations, loss mitigation and maintaining a cash window, and a limited multifamily portfolio.

If Fannie and Freddie are reformed and then released from conservatorship, how would they be regulated?
FHFA or its designated successor would remain the primary, prudential regulator for the GSEs. They would be regulated similar to privately owned utilities, where the regulator would balance the need for steady investor returns with the public mission of serving consumers and lenders in a fair and equitable manner through all business cycles. Additionally, due to their size, it is likely that both GSEs could be subject to a SIFI-type designation and placed under heightened safety and soundness standards.

Would the Single Family and Multifamily businesses of each GSE stay together?
The charter application process would allow for a “joint charter” for Single Family and Multifamily businesses, but also accommodate separate charters.

How will the GSEs' Multifamily Businesses be treated?
While the GSEs' multifamily businesses are not as large as their single-family counterparts, their role is vitally important in supporting an essential part of housing. 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, and the unique elements of the multifamily finance businesss must be taken into account within housing finance reform. The strengths of the existing multifamily business lines should be carried over into the newly-chartered Guarantors, as 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 transfer mechanisms. Also, 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 should take into account the unique attributes of the GSEs' activities in this market — whether in crafting the specifics of the end state framework, the treatment of multifamily loans under regulatory capital standards, or the details of the transition process such as allowing standalone multifamily Guarantors.

What about affordable housing goals?
Enabling access to credit for qualified borrowers and ensuring the development and preservation of affordable rental housing are critical policy objectives that should be part of any secondary mortgage market reform. MBA addressed its vision for a holistic affordable housing system in a paper submitted to the Urban Institute in June, 2016, and incorporates this framework into our full proposal.

Was this plan created by most of the same firms that left the GSEs holding the bag for their poorly originated loans?
MBA’s membership and the task force encompass the entire industry, large and small, bank and non-bank, residential and multifamily, and include many lenders that were not even in existence during or before the crisis. The plan is desigend to serve the entire market by promoting a competitive primary market that serves all lenders regardless of size or business model, and protecting taxpayers with significantly more private capital at risk.

Doesn’t HERA give Congress and FHA all the authority needed for reform?
Congressional action is necessary, both to provide an explicit guarantee on MBS, and to fundamentally restructure and re-charter the GSEs to address the flaws that led to their failure. As we note in the paper, FHFA should utilize their current powers under HERA to the fullest extent, and we envision that they will use the various powers as part of a methodical transition directed by Congress.

Does Recap and Release Protect Small Lenders?

Definitely not. For small lenders, relying only on HERA to protect their interests would be risky. While HERA gave FHFA broad powers in its role as conservator, how a future FHFA might exercise those powers could change. There are no guarantees that reforms the FHFA put in place in its role as conservator -- like requiring the GSEs to eliminate preferential g-fee pricing for high volume single-family lenders – would hold once the GSEs were released from conservatorship. A new FHFA Director could easily backslide on these reforms. Under our proposed utility-style regulations, requirements to serve all lenders fairly would be part of the "regulatory compact." Legislation is needed to establish a reformed statutory framework, strengthen FHFA's authorities and clarify FHFA's oversight mission, especially around issues like g-fee parity and maintaining a bright line between primary and secondary market activities that are so important to lenders.

Isn't competition counterproductive in utility businesses, driving uneconomic pricing of risk, creating higher operating costs and requiring scale?

MBA has been very careful to say that we don't expect significant price competition among the guarantors. All will be subject to the same capital standards, and pricing will be posted/filed with the regulator, so there will not be an ability to compete on average price. The competing guarantors may price differently across different types of business or products, and this may lead to losses and gains for the competitors.

A core aspect of the "utility" model in our proposal is that the guarantors are akin to dividend paying stocks, not growth stocks. They will compete on service and process to maximize returns for their investors, but there is not the same benefit from increasing market share as there was in the pre-crisis system.

As both the incumbents and new entrants can utilize the CSP and the single security, economies of scale are much less significant than under the pre-crisis business model. There will still be substantial startup costs in developing a sales force, analytic models, etc., but likely akin to that of starting a new MI. And we have seen new MI entrants this cycle.

Could the mortgage insurance fund (MIF) be subjected to legislative interference?

It could be, which is why we call for the framework to be enshrined in statute, as opposed to leaving it to the discretion of each new Administration.

Does your plan consider transition costs?

The challenge with defining a transition path is to get the new system capitalized and operating as quickly as possible while minimizing the chance of any market disruption. One means of minimizing transition costs is to maximize the use of existing infrastructure, business processes, etc. MBA's proposal does exactly this. In fact, this was one of the main takeaways from the Johnson-Crapo debates, i.e., to make greater use of existing infrastructure, and move forward with a less complex proposal that does not reinvent the wheel.

Doesn't your plan exacerbate the private gain/public loss problem?
Our proposal would establish structural, prudential and market conduct rules designed to mitigate the private gain/public loss flaws in the prior system:

- The federal guarantee is limited to the MBS only, not debt holders or shareholders of the Guarantors.
- New system requires more private first loss capital at risk
- New system has significantly higher capital requirements for the Guarantors
- Utility-style regulation is put in place to ensure Guarantors manage for long-term, lower risk stable returns.

Every GSE proposal under consideration carries this same risk; MBA's plan has taken pains to ensure that the private gain/public loss concerns are mitigated. .

How does your plan avoid "brain drain" at the GSEs and disruption to the market?
The brain drain from the GSEs has been an ongoing concern. Remaining in conservatorship with an ongoing uncertainty, including the risk of liquidation, likely encourages many GSE employees to seek better options. Moving to a resolution which provides both market and political certainty regarding future business opportunities for re-chartered GSEs would help with employee retention.

How will the GSEs be compensated for making the CSP a government-owned entity?
If the CSP is converted from GSE ownership to a government corporation, a compensation arrangement could be appropriate. That is one of the costs of transition, but in the long run, would better serve the housing finance system.

Does this proposal lead to a market advantage for large banks?
No. A fundamental principle of MBA's proposal is that the Guarantor segment of the market needs to provide a level playing field, with equal access in terms of pricing, products, and credit variances for lenders of all sizes and business models.

Through the conservatorship period, FHFA has taken administrative actions which have led to level gfee pricing across all approved originators who sell to the GSEs. This leveling of the market has been a profound positive for many smaller and mid-sized originators. MBA would advocate to retain this feature, with pricing driven by loan-level mortgage credit risk, not by the volume of loans produced by an originator.

Additionally, MBA's proposal maintains a bright line between the primary and secondary markets. Originators cannot control Guarantors, although they may own up to a 10% stake in a mutually owned Guarantor. Guarantors cannot originate mortgages. This division has served the market well in the past and will in the future.

FAQ’s on Transition Section/Issues

Why does MBA propose a transition process?
The current system needs to be reformed. At the same time, its function of purchasing mortgage and issuing mortgage-backed securities a critical element of the nation’s mortgage markets. Therefore, MBA has described a transition process designed to minimize disruption to that function all the way to our recommended end state of reform.

Why is the transition broken into different phases?
MBA has divided the transition into three phases: Preparation, Implementation and Divestiture as a way to identify which sets of activities must be completed before one can move on to the next set of activities. For example, the planning and other activities within the Preparation phase will generally need to be complete before the activities in the Implementation phase can occur. Similarly, Implementation should be completed prior to Divestiture.

Why does MBA describe alternative paths for some parts of the transition to the recommended GSE Reform end state?
MBA recognizes that there may be more than one way to achieve the recommended end state for GSE reform. We have described alternative approaches for transitioning to the recommended end state, and there may be others. The measure of any approach is the extent to which it can achieve an end state consistent with our principles and guardrails.

How would the transition mitigate the risk of disruption?
Our recommended transition includes an extensive Preparation period during which FHFA, Treasury and other stakeholders can transparently lay the groundwork for a smooth implementation, before the actual implementation begins. This includes developing a Comprehensive Transition Plan. To further mitigate the risk of disruption, we also recommend that GSE reform legislation provide FHFA or successor regulator with substantial flexibility as to both actions and timing, to be able to take actions necessary to maintain market stability throughout the transition.

When would the Guarantors be owned by private investors?
The transition contemplates that the Guarantors that are initially formed – likely a re-chartered Fannie and Freddie -- would have a chance to operate in the marketplace, develop track records of performance and build up capital levels before the government would sell its interests in them. This would enable potential private investors to evaluate the value of the Guarantors as going concerns at the time the government sells its interests in the Guarantors.

Would there be any outer limit on how long the proposed multiyear transition period could last?
Legislation should establish accountability for completing the transition, while also providing flexibility. For example, the legislation could specify a maximum transition period, permitting extensions as necessary permitted to maintain liquidity and stability in mortgage markets, subject

to specified reporting and approval requirements. Legislation should also grant sufficient flexibility to complete transition earlier so long as FHFA or its successor could do so without causing undue disruption to liquidity or stability in mortgage markets.

FAQ's on Affordable Housing Section/Issues

How is the MBA proposal on affordable housing different than what exists today?
We believe that a more dynamic, market-based approach is needed to address affordable housing under a new secondary market regime -- an approach that combines quantitative <u>and</u> qualitative objectives, is complimented by an affordable housing fee, and is designed with a holistic perspective that considers other government efforts to serve the housing continuum.

Todays' GSE affordable housing goals-based regime is based primarily on percentage of business targets. While we support market-based goals, we think a number of key improvements can be made in this area. Also, we support qualitative, activity-based goals as a core part of a Guarantor's overall evaluation. The quantitative and qualitative dimensions should be used in tandem, with each being given proper weight based on a robust and evidence-based assessment of market needs. In addition, we support an affordable housing fee to help meet market needs beyond those traditionally served by the GSEs.

The key lies not in the mere sum of the parts, but in the way these various tools reinforce each other as part of an integrated affordable housing strategy.

How is the MBA proposal different than the approach under Johnson/Crapo?
Johnson/Crapo would have replaced the affordable housing goals with a fee to fund certain affordable housing and community development activities. The Johnson/Crapo approach would have generated significant sums of money for affordable housing, but it was operationally complex and untested. Our approach builds on what currently works in the GSE model, while offering key enhancements. We also call for a more holistic affordable housing strategy that leverages the unique market role of the Guarantors.

Does MBA support affordable housing goals? If so, what should they look like…and how are they set?
We do support affordable housing goals, but believe they need to include both quantitative (market-based) goals as well as qualitative (activity-based) goals that complement each other. (See answer to #1 above.)

Won't affordable housing goals be a disincentive to new Guarantors entering the market, especially with a "regulated rate of return" constraint?
We believe that affordable housing obligations that are realistic and reflect market circumstances can result in expanded business opportunities. The regulator setting affordable housing goals will also be determining the regulated rate of return required to attract capital, implicitly balancing the

relationship of the two. Of course, these goals need to be balanced with prudential risk management. If these factors are properly calibrated, then a business model with access to a government guarantee for certain MBS can be very attractive…even with a regulated rate of return.

How do your recommendations guard against "social engineering" that compromises prudent risk management or creates market distortions?
Prudent risk management needs to undergird any obligations to support affordable housing. Equally important is a realistic assessment of market needs…and a properly designed role for the Guarantors in meeting those needs. Our proposal has a number of guiding principles that are intended to balance support for affordable housing and underserved markets with sound risk management practices and realistic market assessments.

Didn't affordable housing goals help cause the financial crisis? Why would you repeat that mistake in your proposal?
We don't subscribe to the notion that the affordable housing goals were a major factor in the financial crisis. However, our proposal puts a number of safeguards in place to ensure that any affordable housing obligations are balanced by prudent risk management, realistic market assessments, and subject to QM type requirements. (See #5 above.)

Are you proposing an affordable housing fee? How will that fee be used?
We support an affordable housing fee that is assessed on the new business purchases of the Guarantors. The fee should be used to help support efforts along the housing continuum, with monies going to funds similar to the ones that exist today, plus a new "Market Access Fund" as proposed in Johnson/Crapo. Our proposal also outlines several core principles to help guide the size and use of the affordable housing fee.

Who will your affordable housing proposal help?
The Guarantors should serve a market similar to that of the GSEs today. An affordable housing fee would also help support efforts to address underserved markets and other market needs not traditionally met by the GSEs.

Will there still be a duty to serve for the future Guarantors?
Our approach of qualitative goals bears some similarity to the "Duty to Serve" obligations that exist today. However, we envision these qualitative goals being part of a much more robust affordable housing framework -- one which is not only complemented by quantitative goals and an affordable housing fee, but also designed in the context of a holistic approach to the housing continuum. (See #1 above)