



August 5, 2014

Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, D.C. 20220
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To Whom It May Concern:

Earlier this summer, Secretary Lew announced an initiative to help spur the development of a responsible, private label mortgage-backed securities (private-label RMBS) market. Accompanying this announcement were several questions concerning the role and framework of the private-label RMBS market and soliciting views on potential changes. The Mortgage Bankers Association (MBA)¹ convened a group composed of a cross-section of our members to discuss this topic and our thoughts are reflected below. MBA thanks the Secretary for his thoughtful consideration of this important issue, and we look forward to working with him and other stakeholders to remove the remaining structural barriers to a vibrant private-label RMBS market.

MBA has responded to the specific questions below and has attached a list of obstacles we have identified as impeding the return of the private-label RMBS market. However, we have a few general observations. First, it is important to consider the private-label RMBS market in the broader context of housing finance reform. Policymakers have emphasized that private capital should play a larger role in the mortgage market, and MBA shares this view.

Some have argued that by increasing costs in the agency MBS market through increases in guarantee fees, or by limiting the size of the agency market through reductions in loan limits or other means, that policy could drive private capital into the mortgage market. We do not think this approach will be effective without considering the market as a whole. Portfolio lending has been and will always be an important source of investment dollars for mortgages. However, in order to have a consistent supply of fixed-rate financing backed by private capital, we need to ensure that there are not insurmountable obstacles blocking the return of the private-label RMBS market.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

It is also important to recognize that while the private-label RMBS market has not recovered, the markets for commercial mortgage-backed securities (CMBS) and other asset-backed securities (ABS) are showing renewed strength. For that reason, it is key to focus on those structural, regulatory, and economic obstacles which are unique to the single-family mortgage market.

An overriding issue is investors' lack of confidence in the operational, legal, and contractual underpinnings that undergird this market and that are necessary for its operations. In short, many investors do not trust that the existing operational, legal, and contractual frameworks provide sufficient protection for them. This lack of confidence and trust has manifested as a lack of depth in the market for new issue non-agency securities, particularly among the "deal anchors" who invest in the AAA-rated tranches. The lack of trust observed in the market has also resulted in an unduly burdensome process of issuing new private-label RMBS, with the market requiring loan-level due diligence that is very expensive and is not scalable.

Notably, interest remains high in the subordinated tranches. While the correspondingly higher yields certainly play a role in generating greater interest, the key distinction is that these interests have greater exposure to risks outside of the contractual framework of the trust and securities.

Investors and lenders are working together through industry organizations to address these fundamental issues. We believe that market participants can resolve underlying structural challenges through these processes.

However, there is also clearly a role for the government to help facilitate the return of this market. Regulatory issues resulting from recently finalized rulemakings are playing a role in reducing investor capacity. Further, Dodd-Frank's risk retention rule and proposed amendments to Reg AB disclosure rules remain unfinished, increasing uncertainty in this market. Finally, the lack of clarity regarding housing finance reform and the future role of the GSEs remains a roadblock.

Attached are MBA's responses to the questions which accompanied Secretary Lew's announcement, as well as an outline of the barriers to the return of the private-label RMBS market.

Sincerely,



David H. Stevens
President and Chief Executive Officer

Questions

1. What is the appropriate role for new issue PLS in the current and future housing finance system? What is the appropriate interaction between the guaranteed and non-guaranteed market segments? Are there particular segments of the mortgage market where PLS can or should be most active and competitive in providing a channel for funding mortgage credit?

MBA Response: The impact of the CFPB's Qualified Mortgage standard (QM) and the temporary "patch" extended to GSE-eligible loans has created two distinct markets, for which the answer to this question differs. For the conforming QM space, the GSEs are the dominant execution channel and are difficult to compete with directly. In the near-term, the current market dynamic is expected to continue. Private-label securities' primary role currently is serving the jumbo market, which consists of those loans above the GSEs' loan limits. Private-label RMBS can and should also compete on high-balance loans that are eligible for purchase by the GSEs, increasing the liquidity in the jumbo market while at the same time reducing prepayment risk in the GSE market.

Because the GSEs are prohibited from purchasing or guaranteeing non-QM loans, private capital is essential to providing capital and funding to this market. Current credit subordination requirements, approaching 8% on a recent "prime" deal, have left bank balance sheets with an execution advantage relative to private-label RMBS. This is in part due to the structural and regulatory issues highlighted in this letter, including accounting treatment for whole loans versus private-label RMBS and the new constraints of the liquidity coverage ratio (LCR).

2. What are the key obstacles to the growth of the PLS market? How would you address these factors? What are the existing market failures? What are necessary conditions for securitizers and investors to return at scale?

MBA Response: Please see below in Appendix B for the key obstacles MBA has identified as impeding the return of the PLS market.

3. How should new issue PLS support safe and sound market practices?

MBA Response: Regulations currently under consideration by the SEC and other agencies, in particular Reg AB II and the risk-retention rule, can increase market transparency through their disclosure requirements. MBA has expressed significant concerns regarding the scope of these disclosures, and we

incorporate those concerns here by reference.² However, greater use of standardized, transparent disclosures, utilizing market-accepted terms and parameters would greatly improve PLS integrity and likely lead to increased activity in the market.

4. What are the costs and benefits of various methods of investor protection? In particular, please address the costs and benefits of requiring the trustee to have a fiduciary duty to investors or requiring an independent collateral manager to oversee issuances.

MBA Response: We see three primary costs related to investor protection: deal costs; cost of subordination; and loan-level underwriting costs. Each of these are currently excessive and are adding to the barriers holding back the PLS market.

Deal costs refer to the fixed costs of doing a deal – fees to the lawyers, book-runners, and securities underwriters to structure and market a deal. With the mountain of new regulations, including loan underwriting standards, these costs have increased substantially. Time will tell how many of these costs are short-term increases versus long-term structural costs, but they will likely remain high for the foreseeable future – especially once the risk-retention and Reg AB II rules are finalized. Deal underwriting costs add further burdens to the process of securitizing loans. Currently, investors are demanding not only very high credit quality, but are requiring loan-level re-underwriting prior to issuance. This process can cost up to \$900 per loan, making it unfeasible to scale. Finally, subordination costs are much higher than they were pre-crisis. The result is that deals are more expensive to execute and result in less capital to deploy going forward.

5. What is the appropriate or necessary role for private industry participants to address the factors cited in your answer to Question #2? What can private market participants undertake either as part of industry groups or independently?

MBA Response: MBA has identified below what we believe to be the key obstacles impairing the resurgence of the PLS market. Of these, the structural and economic issues, which are partly correlated due to the impact of uncertainty on pricing, are fundamentally private sector questions requiring negotiated solutions. Industry group involvement, on the order of MISMO or other standard-setting organizations, is likely warranted to craft a standard representation &

² MBA has submitted two comment letters on issues related to the proposed Reg AB II disclosure rules. Those comments can be found here, and are dated March 28, 2014 and October 4, 2011: <http://www.sec.gov/comments/s7-08-10/s70810.shtml>

warranty (rep and warranty) and pooling and servicing agreement framework that can be accepted by the marketplace.

6. What is the appropriate or necessary role for government in addressing the key factors cited in your answer to Question #2? What actions could government agencies take? Are there actions that require legislation?

MBA Response: The regulatory obstacles identified in Appendix B are issues that government can resolve, and MBA strongly recommends that the Administration and Congress work together to clarify and coordinate key housing policy initiatives. This includes finalizing rules like Reg AB II and the risk-retention rule, which could eliminate some of the uncertainty that is chilling activity in the securitization market.

On the other hand, Basel III's overly harsh treatment of securitization interests and MSRs is an example where government can revise an existing policy in a way that would reduce the cost of securitization. In particular, the current accounting and risk treatment of these assets makes whole loans substantially cheaper from a capital perspective, removing an economic incentive for banks to invest in private-label RMBS.

7. What are the current pricing characteristics of PLS issuance (both on a standalone basis and relative to other mortgage finance channels)? How might the pricing characteristics change should key challenges be addressed? What is the current and potential demand from investors should key challenges be addressed?

MBA Response: Currently, economic factors are playing a significant role in hampering private-label RMBS activity. A recent prime jumbo containing deal required 7.75% credit enhancement (on a pool with an average FICO of 768 and an average loan-to-value of 71.1%) in order for the senior tranches to receive AAA status. Moreover, large banks, historically large investors in private-label RMBS, have been choosing instead to hold whole loans due to the accounting and capital costs described above. Finally, the increased regulatory burden has made the fixed costs of executing a deal much more expensive.

8. Why have we seen strong issuance and investor demand for other types of asset-backed securitizations (e.g., securitizations of commercial real estate, leveraged loans, and auto loans) but not residential mortgages? Do these or other asset classes offer insights that can help inform the development of market practices and standards in the new issue PLS market?

MBA Response: There are two primary reasons for this strong issuance and investor demand for other types of asset-backed securitizations. First, the other markets cited were less connected to the recent financial crisis than the private-label RMBS market, and thus did not face the type of systemic breakdown in market structure. Second, recent changes to accounting and risk-based capital rules have had a greater impact on private-label RMBS assets than some of the other markets cited, which were less reliant on obtaining off-balance sheet accounting treatment.

The residential housing finance market has undergone a more substantial re-regulation of its primary market than any of the other consumer lending or fixed income markets. These new rules, many of which became effective only this year, have imposed significant compliance burdens on lenders that have led to increased focus on primary market, origination activities at the expense of securitization activities.

Most importantly, these other markets do not have a secondary market dominated by two GSEs, who effectively box out other competitors for single-family securitization of loans below the conforming limit. The uncertainty regarding the future of the GSEs has led many potential issuers to hold back from investing capital in order to avoid having to compete against government-backed institutions.

9. Is there any additional information regarding the PLS market not already addressed that you would like to provide?

MBA Response: Please see Appendix B for a list of key obstacles MBA has identified as impeding the recovery of the PLS market. MBA notes that the regulatory burdens include significant near-term uncertainty.

Appendix B

Obstacles to the Return of the Non-agency MBS Market

Structural Obstacles

Those with a potential for government action:

- **Uncertainty regarding path of housing finance reform:** Investors are hesitant to put capital at risk until they know the nature of the competition they will face. Historically, it has been very difficult for others to compete head-to-head with the GSEs given their dominant market position and lower cost of funds. Greater certainty regarding the path of housing finance reform will illuminate the potential size and nature of the non-agency market.

Those that require ongoing industry action:

- **Lack of investor confidence in the operational, legal, and contractual underpinnings of the private-label RMBS market**
 - Need to further standardize and ensure the quality of data (work being conducted by MBA and the Structured Finance Industry Group (SFIG) through MISMO).
 - Need to standardize and enhance reps and warranties, pooling and servicing agreements, role of the trustees, and other contractual elements of the private-label market. (work being conducted by SFIG under Project RMBS 3.0, also potential to connect to work done under FHFA for the contractual component of the Central Securitization Platform).
 - Investor lack of confidence in the rating agencies' ability to accurately discern the level of risk remains an issue.
- **Lack of scalability in this market**
 - Rating agencies and investors are requiring 100 percent due diligence at the loan level for every deal.
 - This process is costly, time-consuming, labor-intensive, and difficult to scale up if volumes were to increase.

- Issuers need certainty with respect to their exposure through sunsets on reps and warranties and other features.
- Ongoing discussions regarding these issues among market participants including rating agencies, lenders, and investors are occurring.

Regulatory Obstacles

Those with potential for government action:

- **Substantial increase in regulatory compliance costs across the mortgage market** and resulting uncertainties where rules interact have had an impact on the non-agency market as well. Increased efforts to reduce uncertainty regarding future rulemaking and to better align existing regulations would benefit this market. An example of a conflict in this space is the FDIC securitization rule, which was finalized ahead of other regulations, but included its own risk retention and disclosure requirements.
- **Change of Basel III treatment of non-agency MBS holdings**
 - Many banks carry loans at amortized cost, while securities held in available for sale classification (AFS) are carried at fair value, with the changes in fair value flowing through the accumulated other comprehensive income (AOCI) account in the equity section of the balance sheet. For the largest banks, changes in AOCI now impact regulatory capital under Basel III. This is one factor leading large banks to lean towards whole loans as opposed to security holdings. Changing this treatment to put securities on a more equitable footing with whole loans would benefit the market.
 - Agency MBS are eligible liquid assets for the Liquidity Coverage Ratio (LCR), while non-agency MBS are not, providing another rationale for banks to avoid holding non-agency MBS. As the non-agency market grows and become more liquid, this issue should be reconsidered.
- FAS 167 requires that one of the parties to a securitization will generally be required to consolidate the assets and liabilities of the securitization trust in their consolidated financial statements. Banks in the past have been actively engaged in securitization. However, an amendment to Basel I after the release of FAS 167 requires banks who must consolidate a securitization's assets to hold risk-based capital for those assets. This will discourage many banks from participating as a party to a private-label securitization.
- **Finalization of risk retention/QRM rule**

- The Dodd-Frank Act required issuers to retain five percent of securitized pools unless the underlying loans are qualified residential mortgages (QRMs).
- The industry has advocated that the definition of QRM be aligned with that for QM.
- Finalizing the rule by aligning these definitions would reduce uncertainty for issuers with respect to the marketability of new pools.
- **Completion of Reg AB**
 - The new disclosure framework will require a substantial investment to ensure compliance. Potential issuers are hesitant to move forward until the cost of this regulation are known.

Those that require ongoing industry action:

- **Need for rating agency criteria for non-QM loans** to ensure a secondary market outlet for loans that fall outside of the QM definition with respect to product or other characteristic.
- **Ongoing work to comply with January 2014 regulations:** The ATR/QM, servicing standards, and other regulations have markedly increased compliance costs and uncertainty around these costs. It will take time for lenders and other industry participants to build efficient processes that incorporate these new regulations. And the efforts to comply require resources that might otherwise go towards building a non-agency capability.

Economic Obstacles

“Pricing”

- The banking system is one of the largest potential investors in non-agency mortgage securities. If the underlying economics do not support bank purchases of non-agency MBS, it will be challenging to grow the scale of this market.
- Some market participants have used the shorthand “pricing” to describe this set of obstacles. However, it is important to recognize that the relative pricing of non-agency securitization versus portfolio or agency execution is clearly impacted by the structural and regulatory issues listed above. For example, if Basel treatment of securities no longer led to a preference for whole loans, the relative portfolio bid would change.

- Across the banking system, loan/deposit ratios remain relatively low. Portfolio bids provide a better execution at current time. However, it is unlikely that this will persist over the medium term as the economy continues to recover and rates increase.
- Note that this “pricing” obstacle would not be removed by increasing guarantee fees or other costs of agency execution.

Credit enhancement levels

- The rating agencies have set credit enhancement levels very conservatively. A result of this is that it is only feasible to securitize pristine credit loans economically.
- The rating agencies should continue to revisit their credit loss assumptions to reflect the changing environment.