# Testimony of

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**"Chairman's Housing Reform Outline: Part 2"**

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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 Bob Broeksmit, and I am the President and Chief Executive Officer of MBA. I am a Certified Mortgage Banker (CMB), and I have over 30 years of experience in real estate finance. Over the course of my career, I have held positions in virtually all aspects of the mortgage business, from loan processing and underwriting to secondary marketing and servicing. These experiences have given me a unique perspective on the complexity of the housing finance system, as well as the importance of ensuring that it operates within the boundaries of a well-calibrated regulatory framework.

MBA is the only national association representing all segments of the real estate finance industry—an industry that employs more than 280,000 people throughout the country. The association works to ensure the continued strength of the nation's residential and commercial real estate markets and to extend access to affordable housing to all Americans. While promoting fair and ethical lending practices, MBA 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 2,200 companies represents all elements of real estate finance, including firms serving both the single-family and commercial/multifamily markets.[1]

MBA welcomed the release of Chairman Crapo's principles for housing finance reform in early February that outlined his views on the appropriate structure of the secondary mortgage market. The outline includes a number of provisions that would improve upon the structural problems in the business models of Fannie Mae and Freddie Mac (the Enterprises), while also preserving many of those elements that work well in the current system.[2] In particular, MBA supports the concept envisioned in the outline of a multi-guarantor market that features well-regulated, privately-owned institutions aggregating loans in a fair, transparent manner and issuing securities with a full-faith-and-credit federal guaranty that stands behind substantial private capital. This concept is a strong foundation upon which to develop legislation. MBA firmly believes that comprehensive legislation is necessary to fully achieve a truly reformed system that ensures stability and liquidity in the mortgage market.

### ***The Need for Congressional Action***

In 2008, the financial crisis threatened the viability of the housing finance system, particularly with respect to the central role that the Enterprises play in the system. The crisis exposed the fundamental problems in the Enterprises' business models, as

[1] For more information, visit MBA's website at: https://www.mba.org.

[2] "Housing Reform Outline," February 1, 2019. Available at: https://www.banking.senate.gov/imo/media/doc/Housing%20Reform%20Outline.pdf.

well as the weaknesses in the regulatory framework that was in place at the time. The result was a breakdown of the secondary mortgage market, $187 billion in taxpayer assistance, and continuing federal support of more than $250 billion.

Over a decade has passed since the Enterprises were placed into government conservatorship, in what was described by then-Treasury Secretary Paulson as a "time out."[3] Despite the intent that conservatorship would serve as a temporary bridge to stabilize the Enterprises, the conservatorship persists, and the Enterprises' long-term status remains unresolved.

During that time, the Federal Housing Finance Agency (FHFA) began implementing some of the necessary reforms in its role as conservator of the Enterprises. These reforms include the removal of volume-based discounts and credit variances for large lenders, new mechanisms for credit risk transfer (CRT) to the private sector, an improved infrastructure for the single-family secondary market, a substantial reduction in the retained mortgage portfolios, and support for continued liquidity in the multifamily rental housing market. These reforms, while critical, are not sufficient to fully address the problems that led to conservatorship. Instead, legislative reform is needed—both to bring about the remaining structural changes to the Enterprises and to "lock in" the reforms instituted by FHFA through its authorities as conservator.

For example, legislation is necessary to improve the existing Enterprise charters, clarify the nature of any federal government guarantees, enhance FHFA's regulatory authorities, and create permanence for the reforms already undertaken by FHFA. Perhaps most importantly, legislative reform is the only outcome that provides the legitimacy and public confidence necessary for long-term stability in both the primary and secondary mortgage markets.

Conservatorship of the Enterprises has already persisted far longer than intended. The U.S. Congress should not allow conservatorship to continue indefinitely, as market participants will suffer in a number of ways. Borrowers will be denied the benefits of a more vibrant secondary market, lenders will face increased uncertainty about the future, and private-label security (PLS) issuers and investors will hesitate to fully engage in the market. In short, the status quo is an unacceptable long-term outcome.

Calls to recapitalize the Enterprises without further structural reforms are similarly misguided. Under such plans, the post-crisis reforms already achieved could be reversed in the absence of a regulator who is not also the conservator. Recapitalization without corresponding reforms would in many ways remove the

[3] "Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers," September 7, 2008. Available at: https://www.treasury.gov/press-center/press-releases/Pages/hp1129.aspx.

existing safeguards that prevent the Enterprises from returning to their flawed pre-crisis business models. Further, an immediate recapitalization is unnecessary from a safety and soundness perspective, as global investors rely upon the ongoing capital support from the U.S. Treasury.[4] Should either Enterprise need to draw on this capital support, there would be no change in its existing book of business, day-to-day operations, or prospective ability to provide liquidity to the mortgage market.

We simply cannot abide a housing finance system that produces long-term policy uncertainty that keeps taxpayers at risk and private capital sidelined due to the limits imposed by conservatorship. We also cannot go back to a 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, investors, and taxpayers realize the full benefits of a diverse, competitive primary market and a vibrant, liquid secondary market. Reform should therefore proceed without delay.

### *MBA Principles for a Sustainable, More Vibrant Secondary Market*

To address the need for reforms, MBA convened its Task Force for a Future Secondary Mortgage Market (Task Force) in 2016. The Task Force, composed of members covering a broad cross-section of the real estate finance industry, developed a comprehensive set of recommendations for an improved secondary market.[5]

The MBA proposal recognizes the need for any comprehensive 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. It is against these core principles that MBA evaluates any potential reforms to the housing finance system.

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[4] In the 2018 Dodd-Frank Act Stress Test Results, FHFA estimates that, under a severely adverse scenario, the Enterprises would require a combined draw from the U.S. Treasury ranging from $42.1 billion to $77.6 billion. These figures fall far short of the combined $254.1 billion in existing funding commitment from the U.S. Treasury. For more information, see: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2018_DFAST_Severely-Adverse-Scenario.pdf.

[5] MBA, "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," April 20, 2017. Available at: https://www.mba.org/gsereform.

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 guaranty for eligible mortgage-backed securities (MBS) collateralized by single-family and multifamily mortgages;
- Limit the explicit government guaranty to the eligible MBS, while prohibiting the extension of the guaranty to institutional debt;
- Require 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 exist 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 significant amounts 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.

### *The Chairman's Housing Finance Reform Outline*

While comprehensive legislative reforms to the Enterprises have not been enacted by Congress over the past decade, there has been important progress during this time. Numerous ideas, proposals, and bills have been put forward, and in recent years there has been significant convergence toward a future housing finance system featuring well-underwritten loans securitized in the secondary market with ample private capital provided by tightly-regulated entities standing ahead of an explicit, full-faith-and-credit federal government guaranty. The Chairman's outline supports such a structure. Below, I offer MBA's perspectives on key elements of the outline.

Explicit Federal Government Guaranty

Perhaps the most glaring structural flaw in the pre-crisis business model of the Enterprises was that the model perpetuated a widespread belief that the institutions, their debt, and their MBS were the beneficiaries of an implicit guaranty of the federal government. This implicit guaranty allowed the Enterprises to enjoy many benefits, including artificially low borrowing costs and favorable regulatory treatment. In many ways, the implicit guaranty was the embodiment of the Enterprises' ability to accrue private gains while eventually socializing losses to taxpayers.

Because the fundamental purpose of the Enterprises is to increase liquidity in the secondary market by channeling global capital into mortgage finance, investor demand for the securities they issue is critical. Prior to the crisis, the presence of a perceived federal government guaranty increased investor confidence, thereby increasing demand, reducing average mortgage interest rates, and increasing access to credit for American borrowers. During that time, however, the government was not properly compensated for this perceived guaranty.

In any future system, MBA believes that a federal government guaranty on the MBS is necessary to attract the appropriate level of investor demand, and hence liquidity, to maintain products such as the 30-year, fixed-rate, prepayable conventional mortgage. Rather than an uncompensated, implicit guaranty, however, such a guaranty should be explicit, and the government should be fully compensated for it. Further, in a system in which there is robust competition in the secondary market, an explicit guaranty is only necessary at the MBS level—not at the institution level. If MBS investors are shielded from credit risk, it will be possible to attract sufficient demand while allowing for a particular guarantor to fail.

MBA therefore supports the outline's inclusion of an explicit, federal government guaranty on eligible single-family MBS. While the outline does not specify whether this guaranty would also extend to MBS backed by multifamily mortgages, MBA strongly recommends that both types of securities feature an explicit guaranty to better ensure deep, liquid markets.

The outline also proposes that the explicit guaranty be provided and managed by Ginnie Mae. This structure is viable, as Ginnie Mae is designed to perform this function and has a proven history of ensuring payments on government-guaranteed securities. Defining Ginnie Mae's responsibilities in the new system is essential to determining whether the system will work and whether Ginnie Mae has the capacity and independence to operate as envisioned. If the responsibility for guaranteeing securities in the conventional market is placed on Ginnie Mae, any legislative efforts should also ensure that sufficient resources are provided to Ginnie Mae so that it can adequately perform these duties.

As will be discussed in greater detail, the use of a Ginnie Mae guaranty should not be confused with the use of the Ginnie Mae securitization infrastructure and processes—that is, a system in which lenders issue securities rather than deliver loans to guarantors. MBA has serious concerns regarding the use of a Ginnie Mae securitization model, as it places greater burdens on smaller lenders, which in turn is likely to lead to a system reliant upon larger aggregators. Such a model would be less effective in producing equal access to the secondary market across varying types of lenders. This market access by lenders of all types and sizes results in tangible benefits for homebuyers through broader competition and availability of credit in all markets at all times. In addition, direct access to the secondary market for smaller lenders reduces taxpayer risk by ensuring a broad and diversified base of counterparties for the federally-chartered guarantors.

Upon failure of a guarantor to cover a payment to an MBS investor, MBA recommends that payment of principal and interest to investors be drawn from the Mortgage Insurance Fund (MIF) rather than be assumed by the originator or servicer of the defaulted loan. If lenders were exposed to the credit risk in such a scenario, their ability to offer conventional loans would be hampered significantly, leading to a more concentrated primary market. Again, the negative effects of such a policy would disproportionately fall on smaller lenders. Credit default risk is more appropriately handled by institutions that are structured and regulated to manage this risk, such as mortgage insurers providing loan-level credit enhancement or guarantors providing a security-level guaranty.

In addition, the development of a MIF is an appropriate step to ensure the government is compensated for the credit risk that it holds, as well as to create a buffer to absorb losses ahead of taxpayers in the event that a guarantor becomes insolvent. Legislation should specify the triggers by which draws are made on the MIF, and MBA recommends that such draws occur only upon the failure of a guarantor to pay a required claim. This “waterfall” of losses would better protect the MIF, which stands as the last source of payments ahead of taxpayer funds.

### Eligible Single-Family Loans

Any system featuring an explicit federal government guaranty requires strong underwriting standards for loans that collateralize the government-guaranteed securities. Such standards protect taxpayers by preventing a “race to the bottom” in which guarantors aggressively loosen their credit terms to win market share, thereby taking on excessive credit risk and jeopardizing their ability to survive a future market downturn. Put another way, government-supported homeownership must be sustainable throughout all parts of the credit cycle, and strong underwriting is a crucial element of this process.

The outline defines eligible single-family loans as those that meet requirements substantially similar to the Qualified Mortgage (QM) terms and conditions in place today. Eligible single-family loans must also have loan-level credit enhancement if the loan-to-value ratio is above 80 percent, fall within conforming loan limits set by FHFA, and feature a minimum, as yet unspecified, down payment.

MBA supports the use of loan eligibility criteria that meet a QM-type standard and adhere to accepted industry underwriting practices. There are, however, notable elements of the existing QM standard that require regulatory or legislative modifications, such as the calculation of points and fees, the threshold for smaller loans, and the documentation requirements under Appendix Q. Many of these issues will need to be addressed, particularly given the impending expiration of the “QM Patch.”

The details of any legislative proposal will determine whether material changes should be expected in the “credit box” in the conventional market. To the extent that legislation would result in such changes, policymakers should ensure that there are no disruptions in the flow of credit. For example, credit and underwriting standards could result in a smaller population of loans that can serve as collateral for government-guaranteed securities. Reductions to the size of the government-supported conventional market could be positive for the housing finance system if they encourage greater participation by diverse sources of private capital at an affordable cost to consumers. Policymakers should, however, consider the full market impact of any policy changes that are implemented.

Policy changes affecting the government-supported conventional market should not harm guarantors’ ability to serve countercyclical roles in future market downturns, either. For example, it would be preferable to adjust guarantor pricing or underwriting requirements on certain categories of loans rather than to eliminate their eligibility altogether. Under such a construct, guarantors could better respond to temporary gaps in private financing options, ensuring continued availability of credit through economic downturns or capital markets disruptions. Further, any significant changes to the scope or size of the government-supported conventional market should be undertaken gradually so as to avoid disruptions that impact consumer access to credit.

### Multifamily Market

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 total includes workforce rental housing, seniors housing, student housing, rental properties that primarily serve low- and moderate-income families, and market-rate rental housing. The Enterprises’ multifamily businesses serve as key capital sources, along with a variety of other capital sources, to finance rental housing and support a crucial element of the housing continuum.

To fulfill their objective of increasing the liquidity of mortgage investments and improving the distribution of investment capital available for multifamily mortgage financing, the Enterprises' respective multifamily businesses have developed distinct multifamily executions. These executions enhance the Enterprises' ability to play their vital role in financing multifamily rental housing within an ecosystem that also includes banks, life insurance companies, commercial MBS, the Federal Housing Administration (FHA), specialty-finance companies, and other market participants.

Given the success of the Enterprises' multifamily businesses in recent years, and the importance of financing of rental housing, MBA believes that, within any reformed system, multifamily mortgages similar to those currently financed by the Enterprises should be eligible to be included in government-backed securities. Further, we believe that any reformed system should also support continuation of the existing multifamily executions of the Enterprises and their CRT and risk share structures, as well as the development of new structures consistent with regulatory guidelines. In this regard, the unique elements of the multifamily market that are distinct from the single-family market should shape the guarantors' role within a reformed system.

In addition, any capital framework under which the Enterprises operate while in conservatorship, as well as in a reformed system, should seek to produce comparable treatment of the multifamily executions of the Enterprises, including the treatment of CRT structures. A level playing field and diversification in available multifamily executions are vital for a competitive and stable market that serves rental households throughout the credit cycle.

The outline suggests that the multifamily businesses of the Enterprises will be sold and operated as independent guarantors. Rather than imposing such a mandate, in order to promote competition and diversity across guarantors, MBA recommends that all guarantors, including any successors to the Enterprises, be allowed to operate solely in the single-family market, solely in the multifamily market, or in both markets. This flexibility should lower barriers to entry, creating more opportunities for competition that, in turn, would lead to a more dynamic environment, benefiting borrowers, renters, and lenders.

As is noted above, MBA also recommends that any legislation clearly provide that eligible MBS backed by multifamily loans be subject to the explicit federal government guaranty. The benefits conferred by such a guaranty in terms of investor demand will sustain liquidity and stability in the multifamily market, along the lines of the explicit guaranty envisioned for the single-family market.

## Affordable Housing

One of the greatest challenges to enacting comprehensive reforms to the housing finance system has been conflicting views as to how best to ensure widespread availability of affordable housing, particularly for low- to moderate-income households. Affordability in the current housing market is hampered by low inventory and home prices that are rising faster than wages in many areas of the country, among other issues.

The MBA framework for affordable housing includes three core missions: 1) expanding access to affordable mortgage credit; 2) preserving and developing affordable rental housing; and 3) improving liquidity for underserved segments of the mortgage market. A housing finance system that targets these missions will better serve the full continuum of households, from low-income households in need of direct rental subsidies to moderate-income households served by the conventional financing and market-rate rental markets to higher-income households that utilize the fully private prime jumbo market.

The outline envisions replacement of the existing Enterprise affordable housing goals and Duty to Serve requirements with enhanced funding of the Housing Trust Fund, the Capital Magnet Fund, and a new Market Access Fund. The funds would collectively provide grants, loans, and other investments to address the homeownership and rental housing needs of underserved communities. While additional funding to support the three funds included in the outline should be a component of any reform effort, MBA's Task Force concluded this was not sufficient to meet the access and affordability challenges facing the housing market today.

The MBA framework includes similar affordability fees on government-guaranteed activity. These fees would be assessed on guarantors and would work in a manner much like the current fees paid to the Housing Trust Fund and the Capital Magnet Fund. They would be assessed as a one-time annual fee on each year's acquisitions and would be set at a level that generates meaningful contributions to a range of affordable-housing efforts without unduly raising the cost of credit for consumers. Once FHFA establishes the fee through rulemaking, it would report to Congress on the uses of the funds collected, providing appropriate metrics to gauge performance and outcomes.

The MBA Task Force did, however, recognize the need for a tangible, achievable set of affordable housing obligations for guarantors that benefit from federal charters and explicit federal guarantees on their MBS. The obligations of guarantors should reflect a more dynamic approach to affordable housing goals that focuses on outcomes. Rather than relying on the historical approach to goals, which uses a blunt instrument of purchases of qualifying loans, the MBA framework includes a combination of quantitative, market-based targets and qualitative, activity-based targets. Under such a system, goals would be transparent, well defined, measurable, enforceable, and frequently reviewed to avoid market distortions.

Taken together, the funding generated by affordability fees and the activities of the guarantors that support underserved segments of the population should create a more effective affordable housing strategy that improves upon the structure in place today. In addition, the new system should seek to mitigate the challenges created by historical government policies and lending practices that locked entire communities out of homeownership.

Structure and Regulation of Guarantors

One of the contributing factors to the near-collapse of the Enterprises in 2008 was the weak regulatory and supervisory framework under which they operated prior to the crisis. Any comprehensive reforms to the housing finance system must include mechanisms to provide stronger oversight authorities for the secondary market regulator.

MBA believes that an appropriate regulatory and supervisory framework for secondary market guarantors would be akin to a utility-style framework, in which guarantors operate as low-volatility companies with regulated rates of return that pay steady dividends over the long term. Private ownership would better encourage ongoing investment to keep pace with market demands and technological developments, but the regulator must have the authority to ensure the companies do not engage in excessive risk taking.

The outline provides a number of measures by which such a regulatory framework would more effectively be realized. FHFA is granted authority to charter, regulate, and supervise guarantors, as well as to develop and enforce the prudential standards to which guarantors are subject. These standards include requirements pertaining to risk-based and minimum leverage capital, liquidity, CRT structures, stress testing, and resolution planning. MBA recommends that legislation very clearly delineate where existing requirements in place under the Housing and Economic Recovery Act of 2008 would be altered.

Similarly, MBA recommends that reform legislation direct FHFA to set prudential standards that are comparable to those of similarly situated financial institutions. Legislation should not feature numerical capital thresholds in statute, but should instead rely on the regulator to set standards that promote financial stability and reduce opportunities for arbitrage. These standards should also allow FHFA the opportunity to build on and modify its recently proposed capital framework for the

Enterprises.[6] This proposal is an important first step that will help market participants better evaluate Enterprise decision-making in conservatorship, while also facilitating the eventual transition to a reformed secondary market. As MBA and others have noted, though, the proposal could be substantially improved through revisions that would decrease the procyclicality of the standards, avoid unintended consequences in the multifamily finance market, and increase transparency into the assumptions and calculations supporting the framework.[7]

The outline also allows FHFA to place strict limits on the ability of guarantors to build retained mortgage portfolios. These portfolios were used in manners that deviated from the Enterprises' missions in the years leading to the crisis, and they eventually served as a source of significant losses for the Enterprises.

MBA further recommends that legislation mandate that all guarantors serve a national market, as well as grant FHFA authority to adjust its various standards and requirements to ensure that guarantors can play a countercyclical role in the market during (and immediately following) a severe stress event.

Any future regulatory and supervisory framework should also require that when guarantors undertake new activities or offer new products, FHFA complete an analysis of both the charter compliance and the potential market impact of the new activities or products before approving them for broader use. Pilot programs should be strongly encouraged as a means to innovate, but the regulator should be required to ensure some degree of transparency around the nature, duration, and scope of such programs.

Competition in the Secondary Market

As is noted above, MBA believes that robust competition in the conventional conforming secondary market would benefit borrowers, lenders, investors, and taxpayers. Competition among guarantors need not—and indeed should not—result in a push to weaken credit or underwriting standards. Instead, guarantors should compete on factors such as product offerings, technology, and customer service. These are the areas in which competition leads to innovation and/or better execution, which then produces more efficient markets and lower costs for borrowers.

The primary impediment to enhanced competition in the current market is the nature of the Enterprises' charters. Because the Enterprises exist and operate by virtue of

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[6] 83 Fed. Reg. 33312, "Enterprise Capital Requirements," July 17, 2018. Available at: https://www.federalregister.gov/documents/2018/07/17/2018-14255/enterprise-capital-requirements.

[7] MBA, "Comment on Proposed Enterprise Capital Requirements," November 16, 2018. Available at: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15307.

statutory charters, they can be reasonably confident that there will be no new entrants to their market, thereby granting them a Congressionally-sanctioned duopoly. To introduce greater competition (or at least the threat of competition), MBA supports the approach envisioned in the outline, by which FHFA is authorized to approve new guarantors according to established, public standards. This approach is far better suited to encouraging innovation and increasing guarantor responsiveness to the needs of the market.

To address concerns regarding the ability of lenders to engage in anticompetitive behavior by entering the secondary market directly through ownership of a guarantor, the outline prohibits insured depository institutions from operating as guarantors. While any legislation would need to specify whether this prohibition on “vertical integration” is meant to encompass holding companies or affiliates, as well, MBA recommends that legislation instead prohibit any lender—regardless of size or business model—from operating or owning a controlling interest in a guarantor. A broader prohibition would better separate primary and secondary market activities, making it far less likely that particular institutions could gain benefit over their competitors by virtue of blurring (or outright crossing) this divide.

The outline also includes statutory market share targets or thresholds, which are intended to prevent any single guarantor from growing too large and using this size to gain a comparative advantage over its competitors. While MBA supports the spirit of this provision, we remain concerned that it is impractical for policymakers to engineer such specific market dynamics. It is difficult to predict how many guarantors will operate in the system that takes shape following legislative reform, and the outcome will also depend on the nature of the legislative reform (and may not be static over time). As such, it is far more appropriate for legislation to grant FHFA the authority to address market share concerns by requiring prior approval for any mergers or acquisitions among guarantors. If further oversight is necessary, FHFA could also use other tools to mitigate excessive market share.

To further remove barriers to new entrants in the guarantor market, MBA recommends that legislation include a mechanism by which key Enterprise data and technology be made available to the public. For example, the massive quantities of historical, loan-level data housed at the Enterprises provide an immediate advantage over other potential guarantors with respect to evaluating and pricing credit risk. The automated underwriting systems of the Enterprises also constitute a significant barrier to entry, as they provide the technological underpinning of loan-level credit risk analysis that cannot currently be matched by other market participants. Allowing access to these Enterprise assets—developed by virtue of the Enterprises’ federal charters and taxpayer backing—would facilitate improved loan performance analysis across the industry, providing an additional benefit for a reformed system. Legislation would need to specify details regarding the fair transfer of such assets, including the appropriate level of compensation.

Lender Access to the Secondary Market

In the years prior to the crisis, the primary market saw significant concentration, with the market share of the ten largest single-family originators increasing from less than 40 percent in 1998 to almost 80 percent by 2010. Much of this concentration can be attributed to Enterprise business practices, such as offering underwriting variances and reduced guarantee fees for lenders that delivered larger volumes of loans. When smaller lenders struggled to compete in this environment, they were forced to deliver their loans to the secondary market through their larger counterparts, who were also their competitors for consumers. The resulting reliance on an aggregation model increased the prevalence of underpriced guarantee fees and weaker underwriting standards and exposed the Enterprises to concentration risk from a handful of very large counterparties.

MBA's membership represents more than 800 community lenders—independent mortgage banks, community banks, and credit unions—as well as the largest financial institutions in the country. A critical objective of the MBA 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 maintaining close relationships with their customers and leveraging unique knowledge of local markets. The MBA proposal reflects this objective by ensuring equitable access to secondary market programs, prohibiting special pricing or underwriting based on loan volume, preserving cash window, and small pool execution options, and preventing vertical integration.

MBA strongly supports the provision in the outline that prohibits guarantors from offering credit variances or discounts on guarantee fees based on the volume of loans delivered by particular lenders. Similarly, the restriction on vertical integration, as discussed above, should protect against market distortions that disproportionately favor larger institutions.

Another vital component of small lender access to the single-family secondary market is the presence of a cash window, by which individual loans can be sold directly to an Enterprise. While the outline permits guarantors to operate a cash window, any legislation should expressly require all guarantors to operate a cash window on an ongoing basis. In a system that permits but does not require each guarantor to operate a cash window, there can be no assurance that any guarantor will in fact offer a cash window execution. A firm requirement would ensure all lenders the opportunity to access the secondary market directly rather than potentially being forced to sell their loans through an aggregator.

Secondary Market Infrastructure

In the single-family secondary market as it exists today, an important distinction is the structure of the conventional market (served by the Enterprises) relative to the structure of the government market (supported by Ginnie Mae). The conventional market operates under a guarantor model, in which institutions restricted to the secondary market (i.e., the Enterprises) purchase loans from primary market originators before securitizing them and guaranteeing the resulting securities. The government market, on the other hand, operates under an issuer model, in which primary market originators also serve as issuers of securities, with a secondary market institution (i.e., Ginnie Mae) providing the guaranty on these securities.

The outline appears to envision a construct in which both types of models are supported. Guarantors are permitted to aggregate eligible loans, securitize them through a platform operated by Ginnie Mae, and provide a guaranty on the resulting security. Guarantors are also permitted, however, to provide a guaranty on securities that are issued and securitized by lenders that operate in the primary market. While the latter option—the issuer model—has merits, MBA believes that a guarantor model is more effective in serving a broader and more diverse primary market, particularly smaller lenders.

As is noted above, it is imperative that lenders of all sizes and business models be able to access the secondary market on equal terms. A system that allows for an issuer model, however, would be challenged in meeting this objective. While larger lenders with greater access to ongoing liquidity would have little trouble serving as issuers, smaller lenders would face significant obstacles. This dynamic partially explains why the Enterprises each have over 1,000 sellers, while there are only about 350 Ginnie Mae issuers, many of whom are either housing finance agencies or are relatively inactive as issuers. It also explains why the practice of lenders selling loans to aggregators is prevalent in the government market, particularly given the absence of a separate cash window execution.

In its current form, Ginnie Mae is not configured or equipped to serve a larger role in the conventional market, including through the maintenance of a securitization platform. The outline directs Ginnie Mae to operate the securitization platform for government-guaranteed MBS, which may entail use of the Common Securitization Platform (CSP). Over the past few years, as FHFA and the Enterprises sought to improve the infrastructure of the conventional market, they developed the CSP as a modern, scalable platform rather than rebuilding the Enterprises' antiquated back office securitization systems. Freddie Mac is already issuing securities via the CSP, and both Enterprises will soon be using it to issue Uniform MBS.

By contrast, moving the conventional market to the Ginnie Mae infrastructure would require an entirely new build, as Ginnie Mae's systems are not designed for this purpose, either in terms of scale or the structure of the securities. Ginnie Mae also currently outsources a significant portion of its securitization functions, further calling into question whether it maintains the capacity to support the conventional market. A reformed housing finance system should therefore leverage this considerable investment by requiring the use of the CSP as the platform for issuance of conventional securities. Given that FHFA has been far more deeply involved in the development of the CSP, it is more appropriate that FHFA oversee and regulate the operations of the CSP.

More broadly, with respect to oversight of the conventional market, the outline includes important roles for both FHFA and Ginnie Mae. In the current system, Ginnie Mae relies on other government agencies to cover credit losses and issuers to manage the cash flows of the securities. In terms of institutional capacity, Ginnie Mae does not currently have the budget, technology, or staffing to effectively manage or regulate any significant component of the conventional market.

For these reasons, MBA strongly recommends the use of a guarantor model, in which lenders do not serve as issuers. These concerns regarding Ginnie Mae need not, however, prevent Ginnie Mae from providing the explicit, federal government guaranty that stands behind the private guaranty on eligible MBS. Ginnie Mae can draw on many of its existing capacities and strengths to perform this function, which would not materially change the underlying structure of the guarantor model. In other words, a Ginnie Mae guaranty and a guarantor model are compatible, provided that the Ginnie Mae aggregation, securitization, and issuance functions do not replace the activities that are more appropriately undertaken by guarantors and regulated by FHFA. Clear delineation of these roles and responsibilities will be a key component of effective reform legislation.

Efforts to Attract Private Capital

One of the main advantages of a model based on the use of well-capitalized, privately-owned guarantors is the presence of private capital taking on all but the most catastrophic credit risk in the conventional market. There are, however, other mechanisms by which the sources of private capital in the housing finance system can be diversified. Two such mechanisms are the permanent use of CRTs across guarantors and the development of a robust PLS market that does not feature any government guaranty.

The single-family CRT programs at the Enterprises represent one of the most significant structural reforms of the past decade. As noted above, the Enterprises' multifamily businesses have long used CRT transactions to efficiently transfer multifamily credit risk to the private sector, through both institutional and capital markets structures. Since their inception in 2013, the Enterprises' single-family CRT programs have transferred credit risk to a variety of private sector entities, with a total risk in force of approximately $81 billion.[8] There is ample evidence in favor of ongoing CRTs as a permanent part of the business models of any future guarantors.

The outline grants FHFA the authority to require guarantors to engage in CRTs as a means of lowering their risk profiles and fostering investment by other types of institutions. MBA supports the ongoing use of CRTs in a reformed system, as well as the allowance for discretion on the part of the regulator. The specific details of the CRT requirements should not be locked in through statutory language, but rather should be more easily adjusted as market conditions warrant. Legislation should also require FHFA to set clear CRT approval standards that allow for a variety of structures and instruments.

With respect to the PLS market, its virtual disappearance following the financial crisis did not reverse course as the housing market recovered, and PLS issuance continues to represent only a sliver of the secondary market. In order to increase secondary market competition and reduce reliance on taxpayer support, MBA believes that the structural impediments preventing a revival of the PLS market must be removed. In addition to uncertainty regarding the path of housing finance reform, these impediments include a lack of investor confidence in the operational, legal, and contractual underpinnings of the PLS market. Reform efforts, however, should ensure that future PLS issuance does not suffer from the same problems that were present in the years preceding the crisis. For example, loans collateralizing PLS must meet ability-to-repay standards and include disclosures that protect against excessive risk taking and consumer abuses.

Legislation can also address some of the obstacles hindering stronger PLS issuance. The development of standard pooling, securitization, and servicing practices, and development of data exchange standards through MISMO, the industry standards body, should generate greater certainty and confidence on the part of both issuers and investors. Increased availability of Enterprise historical data should also lower costs and other barriers for institutions seeking to enter the market. Broad access to the CSP for all issuers of residential MBS should make PLS issuers more competitive relative to the Enterprises and address some of the post-crisis challenges associated with standardization of terms and conditions. Finally, appropriate revisions to the QM

[8] FHFA, "Credit Risk Transfer Progress Report – Second Quarter 2018," November 1, 2018. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Progress-Report-2Q18.pdf.

standard would allow for an expiration of the “QM Patch” for loans eligible for delivery to the Enterprises, which would in turn reduce execution advantages for the Enterprises (and potentially future guarantors) relative to PLS issuers. These measures should all be considered as part of comprehensive, legislative reform efforts.

Transition Mechanics

Perhaps the most difficult element of housing finance reform from an operational perspective is the transition from the current system to the reformed end state. The complexities associated with all of the elements of the system covered above affect the transition, often in overlapping or difficult-to-understand ways. The objective of any transition plan, though, is to account for these complexities to the greatest extent possible, while also allowing sufficient flexibility should problems arise.

To this end, the MBA Task Force developed transition principles meant to better ensure that policymakers and market participants execute the steps necessary to move to a reformed system while preventing and mitigating any potential adverse impacts to liquidity and the availability of mortgage credit. These principles include the need for a clear road map and end state, preservation of existing assets and infrastructure where possible, regulatory flexibility, and a gradual, multi-year phase-in period.

MBA supports the construct in the outline, by which timelines and milestones are provided in legislation, but with authority granted to FHFA and Treasury to extend or otherwise alter these timelines and milestones as needed. Given the uncertain nature of any such transition, the market may not be prepared to make the switch to a system reliant on new institutions or subject to new requirements by the desired date. To account for this potential situation, regulatory flexibility is necessary. For example, FHFA should be authorized to engage “safety valves,” which could essentially serve as extensions of the timeline for various components of the transition, based on market conditions. The outline also appropriately calls for accountability to Congress when such extensions are granted.

As is noted above, MBA has concerns regarding the use of explicit market share targets or thresholds in legislation. It is virtually impossible for policymakers to effectively force a particular market dynamic or quantity of new entrants, which in turn makes market share targets or thresholds both unachievable and unenforceable. Instead, the transition should be structured to foster new entrants and create as level a playing field as possible.

Any legislative reform must also ensure that the transition process does not disrupt the flow of credit. As such, relevant provisions must specify any potential changes to the Enterprises' charters, the rights and obligations of existing Enterprise MBS and debt holders, and the conditions by which the Enterprises will be removed from conservatorship. Together, these provisions should bolster investor confidence and promote continued liquidity through the early years of the transition.

* * *

As the Enterprises continue into their second decade of government conservatorship, it is critical that policymakers tackle the remaining work of housing finance reform. Access to affordable, sustainable housing is a necessity for all Americans, and as such, it requires a system of financing that is robust in all parts of the country, in all segments of the housing continuum, and through all parts of the credit cycle. Legislative reform of the Enterprises offers the best path to reach this desired end state. To that end, I once again thank Chairman Crapo for his thoughtful contributions to this effort, as well as his ongoing dedication to this important issue.

I appreciate the opportunity to present this testimony, and I reiterate MBA's long-standing commitment to working with the committee on all elements of housing finance reform.