Consumer Federation of America

Comments on Mortgage Finance Reform

Submitted to the Senate Committee on Banking, Housing and Urban Affairs

10/15/2013

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On behalf of the members of the Consumer Federation of America, thank you for the opportunity to comment on pending considerations of mortgage finance reform. Consumer Federation of America is an association of nearly 280 non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, education and advocacy.

Access to affordable and sustainable mortgage credit is a critical consumer concern. CFA has worked to identify and promote responsible approaches to the challenge of rebuilding a durable mortgage finance system for both rental and ownership housing since the collapse of the housing market and the beginning of Fannie Mae's and Freddie Mac's conservatorship. We published a White Paper on this topic in 2010 titled *"Reengineering the Mortgage Finance System,"* [1] which identified a number of different organizational paths that could be followed to achieve the critical objectives that we believe must underlie any government participation in the mortgage market. We posed the critical tests that a new system must meet as follows:

- Will it support the availability of long-term, fixed rate mortgages for consumers?
- Will it offer access to capital by as wide a variety of institutions as possible, from small community banks to large money center institutions?
- Will it foster and spread innovation in mortgage products to insure that helpful and sound new products can be made available widely in the marketplace?
- Will it fulfill a significant duty to serve underserved populations and communities?
- Will it provide financing both for affordable single family homeownership and rental housing?

In addition, the system must continue to support a very deep and liquid market in securities backed by mortgages on residential properties, and continue to support the so-called "TBA" market that allows consumers to benefit from forward rate locks and the lower mortgage costs that a transparent and deep market fosters.

Throughout the intervening years CFA has been a key participant in the Mortgage Finance Working Group sponsored by the Center for American Progress, including significant participation in developing that group's recommendations in 2010. CFA's Director of Housing Policy Barry Zigas is one of the 21 members of the Bipartisan Policy Center's housing commission, whose recommendations for *Housing America's Future"* [2] contained an extensive chapter on mortgage finance reform. These were reviewed by the Senate Committee on Banking, Housing and Urban Affairs earlier this year in hearings featuring one of our co-chairs, former Sen. Mel Martinez.

There are many constituencies whose needs must be met by changes in the current mortgage finance system. These include investors, lenders, securitizers, credit guarantors and enhancers, and banking and finance professionals. But the principal justification for any federal role in mortgage finance policy must be to ensure that everyday Americans continue to be able to enjoy dependable access to sustainable, responsible mortgage products at the lowest possible cost.

Homeownership remains an aspiration for most American households. This dream and affordable rental housing relies on dependable and affordable credit. The current system, in which the federal

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[1] http://consumerfed.org/elements/www.consumerfed.org/file/Reengineering_the_mortgage_finance_system.pdf

[2] http://bipartisanpolicy.org/library/report/housing-america%E2%80%99s-future-new-directions-national-policy

government bears the credit risk for more than 90 percent of the market, is unhealthy and unsustainable. However, a return to the earlier system of private ownership of publicly chartered companies tasked to carry out multiple roles in bringing mortgage credit to the market contained too many conflicts to be restored as it was.

In approaching reform efforts, we believe it is critical for Congress and the Administration to put the needs of consumers above all others, and to identify this objective as the fundamental purpose of creating any new entities, system or process through which capital is attracted to the mortgage market.

There are a number of different structural approaches that could achieve the objectives we have laid out. We have had the opportunity to review S. 1217, co-sponsored by Sens. Corker, Warner and others. Although we realize that the Committee is starting from a clean baseline in developing its recommended positions on finance reform, these comments reference S. 1217 as a useful example of a series of issues that are preeminent for CFA and our members. These recommendations focus on issues that are independent of the structural approach ultimately taken in S. 1217, but are based on the structure proposed there to illustrate how they could be executed under that proposed structure.

S. 1217 proposes a system with the following key features:

- Separation of the aggregation, securitization and credit guaranty functions that historically have been combined in Fannie Mae and Freddie Mac.
- Establishment of an explicit federal guarantee of securities backed by eligible mortgages, administered by a new entity that would charge a fee for this guarantee in order to build up reserves against catastrophic losses suffered by other, private credit enhancers.
- Limiting this guarantee to apply only to buyers of the securities, and not to the shareholders or creditors of any entities issuing securities with the guarantee, servicing those securities, or providing required levels of private risk bearing capital to qualify the securities for the federal guarantee
- A requirement for a deep layer of private risk-bearing capital to absorb losses before any government guarantee to investors is invoked.
- Regulatory authorities in the new public guarantor to determine mortgages eligible for inclusion in securities it will guarantee; requirements for participating private credit enhancers; standardized pooling and servicing agreements for all guaranteed securities; and oversight of the system.
- Creation of an annual fee on mortgage backed securities – in this case only those that are guaranteed by the proposed new authority -- whose revenue would support critical affordable housing and community capital needs, as well as provide funding to support the development of new responsible credit products and to ensure that the new system adequately meets the needs of underserved and hard to serve populations and geographies.

CFA broadly supports these key elements of S. 1217 and urges the Committee to build its recommendations on them. However, we do recommend some changes and additions to the proposed legislation that we believe will strengthen the system and increase its benefits to consumers while limiting its risks to taxpayers, and we urge their inclusion in any further bills whether S. 1217 is adopted as the template for them or not.

Focus on the Consumer and Assuring a Fair and Open Marketplace

Consistent with our comments above, CFA strongly urges the Committee to adopt explicit language outlining the key objectives of a new system and outlining specific responsibilities for it. We recommend the following language to replace that found on page 13, lines 9-15:

> (1) provide liquidity, transparency and standardization for mortgage credit, support a robust secondary mortgage market and the production and efficient trading of residential mortgage backed securities;
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> (2) ensure broad and fair availability of credit for qualified borrowers across all geographies, housing types, mortgage balances within the limits set forth herein, and populations without interruption through complete business cycles;
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> (3) provide liquidity for mortgages that further the purposes of the Community Reinvestment Act and other regulatory or statutory requirements for which primary market originating lenders are responsible and to support access to credit in traditionally hard to serve or underserved markets;
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> (4) provide a guarantee of the full and timely payment of principal and interest on securities backed by mortgage assets approved by the Corporation, and
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> (5) levy such fees as necessary to provide sufficient capital to fulfill the Corporation's guarantee obligations and to protect the taxpayer from having to absorb losses incurred in the secondary market during periods of economic stress.

S. 1217 would establish a new entity, the Federal Mortgage Insurance Corporation (FMIC) to provide the explicit and paid-for guarantee in the new system. FMIC would be governed by a board of directors, and S. 1217 enumerates their number and required areas of expertise. We strongly recommend that any board governing any new authority that issues and oversees a federal mortgage security guarantee be required to include members specifically to represent consumer interests on the board. We recommend that the following language be added at page 18, line 20 of S. 1217:

> Remove period after "multifamily housing development and add ";", then on next line add "(v) 1 of whom shall have a demonstrated technical, academic, or professional understanding of, or practical, disciplinary, or vocational experience with consumer protection and policies and programs to support sustainable homeownership; and
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> (vi) 1 of whom shall have a demonstrated technical, academic, or professional understanding of, or practical, disciplinary, or vocational experience with affordable rental housing."

The structure of the FMIC outlined in S. 1217 would include specific offices led by senior Directors to focus on various aspects of the FMIC's responsibilities. Notably absent from this list of key offices is one dedicated to assuring that the basic purpose of facilitating access to affordable credit to the widest possible universe of credit worthy borrowers and communities is achieved. A major concern in any new system is that it be designed *from the start* to prevent a natural tendency by profit-maximizing entities to "cream" the market by concentrating on the most profitable and low-risk segments of the marketplace, *to the exclusion of others that are profitable and sustainable, but that require more effort and consideration.* Inclusion of the full range of populations and geographic areas never has been the natural outcome of unregulated market tendencies. Rather, full disclosure of data demonstrating how different populations are served, and sensible and enforceable regulation requiring full inclusion of economically sustainable markets is required to assure this outcome.

Under a new system in which the federal government will be guaranteeing mortgage backed securities and setting the *de facto* standards for supplying capital to the mortgage system, it is imperative that ensuring this objective is a specific responsibility of the new federal guarantor. Experience has taught that subsuming this objective beneath specific mandates to support capital markets, protect investors and taxpayers, and reduce risk in the system, as S. 1271 does, leads to market failures for low and moderate income consumers and traditionally underserved communities.

Consequently, we recommend that the Committee require the creation of an "Office of Community Investment" in any federal guaranty entity it designs. Specifically, we recommend that at page 103, line 14 of S. 1217 the following language should be added:

p. 103, line 14: insert new Sec. 233: **Office of Community Investment**

(a) **Establishment**: There is established within the FMIC an Office of Community Investment, which shall be headed by the Deputy Director of Community Investment.

(b) **Responsibilities**: The Office of Community Investment shall ensure that the activities of the FMIC comply with the requirements of this Act with respect to ensuring the broad availability of sustainable mortgage credit to all geographies, housing types, mortgage balances and populations in a safe and sound manner. Specifically, the Office of Community Investment shall --

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(1) **Administer the Market Access Fund** -- pursuant to the guidelines set out in section [XX], [etc.]

(2) **Perform Annual Market Analysis** – as part of the FMIC annual reporting process described in section [XX], the Office of Community Investment shall –

(A) Conduct an overall market assessment, including a needs analysis to identify priority and unmet needs in the housing finance market, identify areas that have been underserved by the market as a whole, assess the potential causes of these gaps and evaluate barriers to and opportunities for addressing those gaps.

(B) Examine the characteristics of all securities insured by the FMIC. This examination shall assess and compare the distribution and the terms of mortgage loans contained in the securities insured by FMIC during the previous year with respect to income and racial characteristics of borrowers or rental affordability, income and racial characteristics of census tracts, loan amounts, rural areas, lender size and type, affordable multifamily units, identified priority and unmet and underserved segments, and by risk characteristics of borrowers, across segments within FMIC securities and compared with the overall market as reported in HMDA for the previous 3 years for which data is available.

(3) **Evaluate Issuer and Bond Guarantor Performance** – The Office of Community Investment will establish and implement a process for evaluating whether, and the extent to which, certain issuers and Bond Guarantors have performed with respect to the provision of broad availability of sustainable

mortgage credit to all geographies, housing types, lender sizes, mortgage balances within the relevant loan limits, and populations. Such an evaluation will –

(A) apply to any issuer or bond guarantor that, in the previous year, was responsible for 5 percent or more of all securities insured by the FMIC, and any other issuers or Bond Guarantors on a discretionary basis, and shall take into consideration –

(1) the characteristics of loans in all securities insured by the FMIC for which that issuer or Bond Guarantor was responsible in the previous year, taking into account the factors considered in the Market Analysis and the safety and soundness of all such loans;

(2) the extent of measures taken to assist borrowers to succeed as homeowners, including measures taken to assist borrowers experiencing financial or other distress;

(3) the effective use of Market Access Fund resources;

(4) Compliance with antidiscrimination and consumer protection laws; and

(5) Any other parameters that the Office of Community Investment believes are necessary to a complete and accurate evaluation.

(B) Provide for the submission by each such issuer or guarantor of a strategic plan for addressing unmet needs or underserved markets identified in the market analysis or other weaknesses identified in the evaluation.

(C) Establish a procedure for rating level of performance and applying incentives and penalties corresponding to levels of performance, except that the Office of Community Investment shall not evaluate the issuers or bond guarantors based solely on the volume of loans falling into particular categories.

p. 104, after line 8: insert new office:

"The Corporation shall establish an Office of the Ombudsman to receive complaints from homeowners, homeowners' representatives and other designated third parties concerning their mortgage originator or servicer. The Ombudsman shall have the authority to investigate, including but not limited to the right to obtain information, documents, and records, in whatever form kept, from the servicer, and to resolve disputes between any homeowner and the servicer of a loan insured by the Corporation."

We believe that an Office specifically tasked with identifying how well any federal guarantee is succeeding in meeting the broadest possible needs in the marketplace is critical. We stress that the office and the requirements for reporting with which it would be tasked is not intended to replicate the housing goals regime adopted for Fannie Mae and Freddie Mac in 1992. The approach we are recommending would build on sensible changes made to the Fannie and Freddie requirements in the 2008 HERA, which eliminated HUD's prior responsibility to set goals based on assumptions of future market outcomes. Instead, like the 2008 amendments, the regime we have proposed would compare the overall system's outcomes and those of its largest customers against well-understood and documented trends in the primary market over time. It assumes that production in the secondary market system as a whole, and among the largest customers of a federal guarantee, will track the market well. Only in instances of persistent failure to demonstrate this would this proposed Office have the authority to step in. It would be tasked in such cases with working with the customer to identify causes of the discrepancies, and strategies for overcoming them. Because no regime is fully effective without genuine enforcement tools, the FMIC should be empowered to reduce access to the guarantee by issuers that fail to demonstrate they are serving the whole market, and resist making changes in their approach to rectify this. This power should include excluding persistent non-performers from the insurance altogether.

We strongly believe that a regime like the one we have described is necessary to produce the outcomes described in the introduction to these recommendations.

The evaluation of both its overall activity and that of the largest issuers should be an integral part of the FMIC's reporting responsibilities. Hence we recommend the following changes to the proposed S. 1217:

> p. 31, line 2: after "securities" insert "including the state and functioning of the TBA market and a detailed discussion of how it has provided these benefits across all income levels, races, ethnicities, genders, housing types, and geographical locations;"
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> p. 31, line 3: insert new subsection (F) "the Office of Community Investment's review of issuers' performance against market standards for including for whom access to insurance has been limited or terminated as a result of the evaluations, and a report on the state and activities of the Market Access Fund [add other housing funds as well to the extent that HUD should be reporting on those;" [and renumber subsequent subsections]
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> p. 31, lines 5-9: end sentence after "market" and strike the remainder.
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> p. 31, line 12: after "housing market," insert "and access to mortgage credit by current homeowners and first time homebuyers and owners of rental housing,".

Further, to assure that issues of affordability and access receive sufficient attention and focus in the new entity, p. 39 line 15 should be changed as follows: before "availability" insert "broad" and before "credit" insert "sustainable" and after "credit" insert "to all geographies, housing types, lender sizes, mortgage balances within the limits set forth herein, and populations".

On p. 40, line 4: before "all geographic locations" insert "all qualified borrowers and"

This focus on assuring access to credit also should be included in the goals against which the first loss credit providers are judged, and against which possible alternative means of providing that credit enhancement are measured. Hence, we recommend the following changes to the text of S. 1217:

> p. 43, line 22: strike "consider how" and replace with "ensure that".
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> p. 44, line 3 and 4: replace "impacts" with "maximizes" and after "credit" insert "on equal and transparent terms".
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> p. 44, line 8: after "consumers" insert "representing a broad range of geographic locations, housing types, income and wealth categories, and racial and ethnic backgrounds".

P. 44, line 9: after "affordability" add "for borrowers across a broad range of geographic locations, housing types, income and wealth categories, and racial and ethnic backgrounds".

P. 44, line 11: after "alternatives" insert "that prioritize the preservation of homeownership when consistent with the interests of investors"

P. 44, Line 12: Replace "interacts" with "supports".

P. 44, Line 15: Strike "and" and insert new subsection, (vii) "promotes credit availability throughout business cycles, and".

This responsibility should extend to the broader market regulation responsibilities of the FMIC. Hence, we recommend the following changes:

P. 88, Line 18: After "market" insert ", as long as such competition does not impair either safety and soundness or consumer protection".

P. 88, Line 22: After "market, insert ",as long as such competitive pricing does not impair either safety and soundness or consumer protection".

P. 88, Line 23, after "and" insert "broad" and after "credit" insert "across all geographic locations, housing types, income and wealth categories, and racial and ethnic background and that there is a robust secondary market for credit extended pursuant to regulatory or statutory requirements for which primary market originators are responsible" [or "necessary to ensure that the purposes of the Corporation as laid out in this Act are met."]

Down Payment Requirement

The bill would require a minimum down payment of 5 percent for any mortgages backing securities insured by the FMIC. We strongly oppose legislating a minimum down payment for a number of reasons.

First, we believe such a requirement will unduly restrict credit to low wealth borrowers that have been shown to be good credit risks with strong performance even through the most recent extreme credit cycle. A January, 2012 report by the University of North Carolina's Center for Community Capital and the Center for Responsible Lending[3] found that down payments have relatively less effect than other underwriting factors on loan defaults of standard, fixed rate prime loans with full documentation, but a very large impact on access to mortgages by low wealth borrowers. Between 7 and 30 percent of the borrowers who had such mortgages originated in 2000-2008 and were current on them in 2012 would been excluded from the market if a down payment of between 3 and 10 percent had been required.

The mortgage reforms adopted by the Dodd Frank Act and recently put into regulations by the Consumer Financial Protection Bureau (CFPB) have reestablished basic requirements for lenders that should restore a broad market standard of safe and sustainable mortgages. By requiring lenders to make loan decision based on a the borrower's ability to repay, making them liable for this determination, and providing a safe harbor for compliance with this requirement through the Qualified Mortgage (QM) definition, these regulations have eliminated the mortgage product features that demonstrate the largest historical negative influence on mortgage performance.

Down payments do make a difference in loan performance. But other factors, such as product type, delivery channel, quality of servicing, credit history and overall debt loads have far greater effects. An

[3] Roberto G. Quercia, Lei Ding, Carolina Reid, *Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages*, Center for Responsible Lending and UNC Center for Community Capital (Revised March 5, 2012)

arbitrary legislative requirement for a 5 percent down payment will eliminate many credit-worthy borrowers from the FMIC universe of covered loans. One perverse consequence will be to shift these to the FHA, where the US Government bears *all* of the credit risk, rather than sharing it with private credit enhancers as envisioned in S. 1217.

Establishing the characteristics of eligible loans for securitization with FMIC insurance is one of the most important functions that the FMIC will have to perform. The Committee should not establish any arbitrary limitations on this authority, but instead require the FMIC to take into account the full range of loan and borrower characteristics that influence loan performance when setting its standards. Moreover, leaving this authority with the FMIC, rather than in the statute, will enable the FMIC to respond to changing market conditions, some of which might lead it to *increase* down payment requirements beyond what is proposed in S. 1217. This is the appropriate means to create a durable and market-sensitive system.

Support for New Products and Hard to Serve Markets

Title IV of S. 1217 establishes a new "affordable housing allocation" in the form of a fee levied on all securities receiving insurance through FMIC. We strongly support this provision in Section 401, but believe it should be extended to *all* mortgage backed securities.

To address issues of access and affordability beyond those that must be produced by the system's everyday operations as described in an earlier section, we support the creation and funding of a multi-purpose fund that builds on Title IV of S. 1217 so that the new housing finance system can better serve a range of housing needs. In particular, we support assessing all mortgage backed securities (not just guaranteed securities) a 10 basis point annual user fee (i.e., a "strip") that would be used to support a new Market Access Fund and the two funds created under HERA – the Housing Trust Fund and the Capital Magnet Fund. These funds, each of which uses a different mechanism to serve very different housing purposes, would be administered, respectively, by a separate office within the federal guaranty agency, HUD and the Treasury's CDFI Fund. We strongly suggest that percentage allocations to the three funds provided in Title IV be reconsidered to assure that the allocations more closely reflect the needs that each fund addresses.

A Market Access Fund financed through this fee at the FMIC is needed to ensure that the new system has the means by which it can foster responsible mortgage product innovation; support the provision of affordable credit on responsible terms in hard to serve geographies; for products with more limited volumes that might otherwise be unattractive to private credit enhancers, lenders or securitizers; and to assure that the needs of the broadest possible range of creditworthy borrowers can be met at a reasonable cost.

We believe that the FMIC's ability to share risk, extend credit enhancements, and foster product development, research and testing is critical to the overall success of the model in S. 1217. Separating the funding for such activities and allocating it to another agency like HUD that would then be tasked with collaborating with the FMIC for this purpose is needlessly complicated. There is every reason to make sure that the FMIC can maintain its relations with other risk bearing counterparties on whom it is relying in issuing its insurance and control the terms, funding, evaluation and consideration of potential risk-sharing and credit enhancement arrangements with those counterparties.

Consumer Protection in Mortgage Servicing

The recent crisis has demonstrated how critical uniform serving standards are to the proper functioning of the market in times of stress. S. 1217 would appropriately require all securities receiving insurance to include standard pooling and servicing agreements. We fully support these requirements.

In order to strengthen consumers' protections in such standard PSAs, we recommend the following:

> P. 95, Line 22: Strike "covered securities which are insured under" and replace with "any securities which are securitized through the common securitized platform established by".
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> P. 96, Line 13: Insert new subsection (2):
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> > "(2) loss mitigation, including the development of uniform standards and practices
> >
> > > (A) requiring servicers to offer homeowners affordable loan modifications consistent with a publicly available net present value determination as defined by the Corporation; and
> > >
> > > (B) requiring servicers to refrain from initiating a judicial or non-judicial foreclosure, or where a foreclosure has been initiated, from taking any additional steps in the judicial or non-judicial foreclosure, once an initial request for loss mitigation has been made by the homeowner, until completion of the review of any loss mitigation application, including written notice to the homeowner documenting any denial and a requisite appeal process;"
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> P. 97, Line 9: Insert after "investors": ", and community stakeholders and representatives of homeowners".

Reliance on Private Credit Enhancers

S. 1217 would authorize a structure for secondary mortgage market finance that relies heavily on private credit enhancers bearing the primary risks of mortgage performance. The federal guarantee that would be provided by the FMIC only would provide for a "catastrophic" layer of insurance for bond investors after these private credit enhancements are exhausted.

Section 202 defines the level of risk for which primary credit enhancers are expected to be responsible as adequate to withstand adverse markets through a range of cycles over the last 100 years, and, in section 202(a)(2), "is not less than 10 percent of the principal or face value or the covered security." This language seems to qualify the broader liability described in Section 202(a)(1), and suggests that it would be possible for the private credit enhancer's losses to be stopped at 10 percent of the face value of the principal they have guaranteed, bringing the federal insurance into play after that. We strongly oppose any form of "stop loss" insurance that would limit the primary credit enhancer's responsibility for absorbing losses ahead of the government. We recommend this subsection be removed because it suggests such a stop loss arrangement.

Elsewhere, the bill sets a requirement that private credit enhancers retain sufficient capital to represent at least 10 percent of their obligations for any insured securities. While we strongly support the intention that these credit enhancers are sufficiently well capitalized to withstand complete market cycles, including extreme events like those of the 2008-09 period, we do not believe it is appropriate for Congress to try to establish this level through legislation. This is a responsibility that should be lodged with the FMIC in its role as regulator and counterparty to these primary credit enhancers. Thus we recommend the following change in the bill:

> **P. 42, Lines 20-21: Strike this subsection (2) and instead permit the FMIC to set the percentage based on their assessment of what is required by subsection (1) above. "Is sufficient to meet the conditions of paragraph (1) above, and which shall be adjustable at the discretion of the FMIC to account for changing economic circumstances and the type of institution(s) standing in the first-loss position."**

The bill also authorizes the use of both monoline credit insurers or bond guarantors and capital markets executions like senior subordinated bonds, credit linked notes, etc. We strongly urge the Committee to restrict primary first loss providers to well capitalized insurers and guarantors and not to authorize the use of capital markets structures.

Because the system envisioned by S. 1217 assumes that there will be sufficient capital available to absorb losses before FMIC insurance is needed it is imperative that these credit risk bearers be well regulated, fully capitalized, and monitored on an ongoing basis. Moreover, because the foundation of the proposed system is primary risk bearing on a broad portfolio, for which the insurer would be responsible across issuers and securities they insure, the use of capital markets executions that are pertinent only to one issue reduces the amounts of capital actually available when needed and does not encourage broad assessment by the credit enhancer of market trends and circumstances. In addition, such executions are pro-cyclical in nature, inasmuch as the private capital needed for lower-rated tranches or higher risk portions of a security will be the most sensitive to broader liquidity and capital cost factors outside of the mortgage market. One of the important justifications for the federal government to have a role in the mortgage system is to foster stability and liquidity through full market cycles. Capital markets structures inherently undermine this objective.

One of the important features of the current mortgage market is the so-called "To Be Announced (TBA)" market in mortgage backed securities. Because of the federal guarantee behind Ginnie Mae and GSE securities, and the exemptions they have from SEC registration, securities can be marketed to investors before loans that will back them are actually originated and pooled. Consumers benefit from this market in numerous ways. Most notably, the TBA market makes it possible for consumers to obtain forward rate locks. Also, the depth of the TBA market and the fungibility of the securities that are approved for good delivery into these pools narrow the bid-ask spread on mortgage backed securities and reduces the costs of mortgage funding through greater participation in the market and reduced friction in their sales.

We believe that the use of capital markets structures to provide first loss coverage will weaken the TBA market. Such structures require extensive disclosure to investors in order to enable them to price the risk they are assuming in different tranches under such transactions. Greater disclosures erode the homogeneous and fungible characteristics that are essential to the functioning of the forward traded TBA market.

Bond guarantors also will need to understand the composition of risks in the securities they guarantee. But this information would not need to be disclosed to securities purchasers because they will be looking to bond guarantor, and ultimately the federal guarantee for their expectations of repayment. This is similar to how the current system under Fannie and Freddie functions and it has provided a deep, liquid and stable market for decades. This is the model that should be adopted in a new system.

We would expect credit insurers to use various means to secure and maintain the capital necessary to meet their obligations. Capital markets structures that reinsure and spread this risk are likely to be one of the ways in which this is done, and we support the availability of such structures to primary credit enhancers. But we strongly urge the Committee to restrict the providers of first-loss credit enhancement in this system to only well regulated credit insurers.

The statute should give the FMIC stronger regulatory oversight authority over primary credit enhancers, in terms of capital, safety and soundness, and their effectiveness in achieving the other functions of the system. It is more feasible for the FMIC to soundly regulate approved institutional credit insurers than to effectively monitor a large number of issuers and structured transactions.

Access by Smaller Lenders

It is very important that any new mortgage finance system is available to the widest possible universe of mortgage originators. Under the system proposed in S. 1217, this will require specific attention and action by the FMIC, because otherwise the natural tendency of the market to aggregate issuance functions into a relatively small number of very large institutions will shut out smaller banks, credit unions, and CDFIs that cannot or choose not to develop the warehousing, back office and other infrastructure necessary to manage a securities issuance capacity. Fannie Mae and Freddie Mac are able to purchase whole mortgages from such entities through their portfolios. For many smaller lenders, the ability to retain servicing rights to the mortgages, and thereby retain contact with their customers is a critical factor. Most large commercial aggregators only acquire mortgages if they convey with the servicing rights, which provide a source of long-term fee income, along with the potential for acquiring and cultivating customers for other purposes. They also can make other demands on originating creditors using them as conduits to the market, including integration of automated underwriting systems and other essential business processes that can limit the choices credit originators ultimately have in choosing among different products and secondary sales outlets.

S. 1217 would require the FMIC to develop standards and guidelines that will reduce any artificial barriers to participation by smaller lenders. This includes the provisions in the bill that bar differential pricing of the federal guarantee based on either volume or the size of the issuing institution. It also requires the FMIC to "facilitate securitization of eligible mortgages originated by credit unions and community and midsize banks without securitization capabilities." We support these requirements.

There are other means to achieve this goal, as well. Foremost among them is the Federal Home Loan Bank System, which is identified in the bill as a potential solution. We strongly support taking advantage of the existing mutually owned FHLB system for providing liquidity for smaller lenders. The bill leaves this as a option for each of the 12 regional FHLBs, but would not require any of them to provide this function. We strongly support including provisions that would require the FHFA, in its capacity overseeing the FHLBs, or its successor, to promulgate regulations that would require the FHLB system to provide this function, either through all banks, or through a selection of one or more of them that would serve this function for *any* member of *any* of the FHLBs. This would solve the problems of small bank access that the proposed new mutual corporation is designed for without setting up a new entity with a further implicit federal guarantee, as we believe S. 1217 does. It would reestablish an important role for the FHLBs. And it would build on a well-established, well regulated system that withstood the financial crisis in very good shape.

Thank you again for the opportunity to comment on the Committee's work. Please do not hesitate to follow up with any questions about these recommendations with Barry Zigas, CFA's Director of Housing Policy, at bzigas@consumerfed.org