**U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**
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**"Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets, Part 2"**

**Hearing before the House Committee on Financial Services' Subcommittee on Insurance, Housing and Community Opportunity**
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Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to appear before you today to discuss the future role of Ginnie Mae in the housing market. My name is Ted Tozer, and I am the President of Ginnie Mae. I have been in the housing finance industry for more than 30 years. For more than 25 years, I worked with mortgage-backed securities (MBS), serving as the Senior Vice President of Capital Markets for the National City Mortgage Company. At National City, I managed loan pricing, sales, and delivery and pipeline risk hedging. Securitizing loans with Ginnie Mae was an important part of our business at National City; at times during my tenure, National City was one of Ginnie Mae's top five Issuers. I worked with the corporation extensively and developed a deep appreciation for its role in housing finance.

Further, serving as President of Ginnie Mae during the past year and a half has enhanced that appreciation and increased my understanding of the unique contribution Ginnie Mae makes to financing affordable housing. The corporation is charged with ensuring that adequate capital is available for financing affordable single-family homes and rental housing and with providing liquidity in times of economic stress. The recent financial crisis has highlighted for all of us the importance of having a public utility that continues to finance loans when the private market retreats. That is the role of Ginnie Mae; and it is a role that, due to the housing crisis, Ginnie Mae has been called on recently to perform in a more robust manner than ever before.

**A Stabilizing Force**

As you know, we remain embroiled in the worst housing crisis this nation has endured since the Great Depression. By January 2009, we had experienced 30 straight months of housing price declines, $6 trillion in home equity had been lost, and we were at the midpoint of what would become 22 straight months of job loss.

Congress and the Administration launched a myriad of efforts to stabilize our economy. Loan limits were raised, the Federal Reserve purchased $1.4 trillion in MBS, first-time homebuyers were offered a tax credit, and programs were launched to help homeowners avoid foreclosure.

Although not every initiative was as successful as we might have hoped, as a whole these efforts have made a positive difference. Though still fragile, our housing market and economy are recovering. Although job creation has slowed since May, private-sector payrolls increased at an average rate of about 180,000[1] per month over the first five months of this year, our MBS markets—with significant government support—still function, and more than 10 million[2] families have saved money through refinancing and loan modifications.

Congress and the Administration acted quickly and courageously to strengthen credit markets, stabilize housing prices, and spur job creation. In addition to the actions outlined above, we were able to reduce the impact of this crisis because Ginnie Mae and the Federal Housing Administration (FHA) made it possible for banks and mortgage companies to continue mortgage lending. By providing an outlet for the sale of government-insured products, Ginnie Mae helped stem the tide of economic upheaval that began in 2008, and it has been an essential element of the nation's recovery efforts since then.

**How Ginnie Mae Stepped In**

During this crisis, Ginnie Mae has provided about $1.2 trillion in capital for mortgages, which has financed more than 4.4 million single-family homes and nearly half a million multifamily units. Our multifamily properties include apartment buildings, acute care hospitals, nursing homes, and assisted living facilities. The financing we provide health care facilities helps many communities maintain much needed health care options for elderly and infirm residents. Also, building a new hospital can have a positive and significant impact on the economy of a small community. In April 2009, a Ginnie Mae MBS was used to finance a hospital in New Jersey. The hospital is creating 4,700 jobs during the construction phase, and upon completion, 2,200 permanent jobs will remain.

[1] Chairman Bernanke's June 7, 2011, speech on the economy at the International Monetary Conference in Atlanta.
[2] Administration score card, June 2011

Overall, Ginnie Mae's support of the housing market has been significant. In July 2010, the outstanding balance of our securities topped $1 trillion and now stands at nearly $1.2 trillion. It is the largest outstanding balance in the organization's history. Shortly after the crisis began, in October and November of 2008, Ginnie Mae's market share reached 40 percent.[3] For those months when credit markets were in disarray, lenders shifted nearly 40 percent of their business to Ginnie Mae. At the height of the financial crisis, lenders turned to Ginnie Mae to access capital, and we stepped up our efforts to manage the tremendous volume increase, ensuring that lenders would continue to be able to finance homes.

Lenders were able to access capital through Ginnie Mae MBS because investors highly value our securities. Investors continued to purchase the securities throughout the crisis, providing low cost financing for borrowers using government programs. To achieve the same low rates in the conventional market, the Federal Reserve purchased large amounts of GSE securities. Because of the confidence investors have in Ginnie Mae securities, intervention of the same magnitude was not necessary for the Ginnie Mae program. In fact, Ginnie Mae has weathered this crisis without requesting federal support of any kind.

Our performance is notable given that, just prior to the crisis, Ginnie Mae's market share was less than five percent. The small market share provoked discussions among policy makers about whether the corporation was truly necessary. It is now clear that an entity such as Ginnie Mae is an essential part of a well-functioning housing finance system, especially in times of economic stress.

## The Role We Are Playing Now

Ginnie Mae MBS finances 99 percent of all mortgages insured by government agencies. FHA, the Department of Veterans Affairs (VA), and the United States Department of Agriculture's Rural Housing Service (RHS) create programs targeted to specific borrowers. Ginnie Mae MBS finances the loans insured or guaranteed by those programs. By insuring or guaranteeing these loans, these agencies provide credit enhancement. By guaranteeing payments to security holders, Ginnie Mae ensures that a consistent pool of funding is available for government-insured or guaranteed mortgages.

For more than 40 years, the corporation has served as the principal financing arm for government mortgage products, ensuring that money flows into the domestic housing market. The capital raised by Ginnie Mae MBS serves a variety of Americans. It is especially helpful to low and moderate income families, first-time homebuyers, and minorities.

[3] According to Inside Mortgage Finance, Ginnie Mae's share of the MBS market reached 40 percent in October 2008, November 2008, and January 2009.

Minorities make up a large share of the Ginnie Mae market. According to the 2009 HUMDA data, 81 percent of homes purchased by African Americans and 73 percent of homes purchased by Hispanic Americans were financed by Ginnie Mae with loans backed by FHA, VA, or RHS. Due to our organization, there will always be a consistent flow of low cost funding from the capital markets for financing homes for American families.

**<u>Public-Private Partnership</u>**

Meeting the needs of prospective homeowners would not be possible without the participation of investors. Private investors worldwide purchase FHA, VA, and RHS loans in the form of Ginnie Mae securities. Partnering with investors and lenders, Ginnie Mae leverages private capital to make homeownership possible. These investors eagerly purchase Ginnie Mae securities. In fact, Ginnie Mae securities currently trade at a premium relative to Fannie Mae and Freddie Mac securities. Without us, there would be limited funds for lenders across the country to originate government-insured products, and it would be far more difficult for borrowers to obtain FHA, VA, and RHS loans.

Investors purchase Ginnie Mae securities in what is known as the To-Be-Announced (TBA)[4] market. This large (trillions of dollars), highly liquid, forward trading market in MBS may be one of the most important benefits Ginnie Mae's public-private partnership model has brought to America's housing finance system and homeownership. As you know, Ginnie Mae created the first MBS, and it was the need—identified by securities dealers—to establish standards for the trading and settlement of Ginnie Mae bonds that spurred the development of the TBA market. Now, of course, the TBA market includes all agency securities.

The TBA market defines parameters under which mortgage pools can be bought and sold. The standardization in this market allows lenders to pre-sell loans in securities even though the exact characteristics of the securities may not be explicitly known at the time a trade is initiated. The homogenous nature of agency securities and the government guaranty allows billions of dollars in MBS to be traded in TBA markets every day. TBA markets serve as the benchmark for pricing in all MBS markets—that is non-agency MBS are priced relative to agency MBS. Forward trading in these markets allows borrowers to "lock" rates on mortgages, and the vast liquidity in TBA markets creates efficiencies that give lenders consistent access to capital. Effectively recycling capital allows lenders to finance 30-year fixed rate mortgages at reasonable rates for borrowers.

[4] To-Be-Announced (TBA) – To-Be-Announced trading is a trading convention whereby homogeneous MBS are traded for forward settlement, and the purchasing party does not know the specific identity of the MBS pool to be delivered. Trades are executed based on a limited number of criteria, including Issuer, coupon, term of mortgage collateral, and settlement date.

According to the Securities Industry and Financial Markets Association (SIFMA), $4 trillion in bonds are eligible for trading in TBA markets. Federal Reserve estimates show the average daily trading volume of agency MBS to be approximately $300 billion. TBA markets have clearly evolved beyond the original goal of establishing trading and settlement standards for Ginnie Mae securities, but in part, we can thank Ginnie Mae for spurring the development of a market that has become a crucial element of our housing finance system.

## Corporate Performance

Ginnie Mae serves as an excellent example of smart and efficient government. Through our organization, the U.S. government attracts private capital into the U.S. housing market and finances government-insured products without raising the national debt <u>and</u> while minimizing taxpayer risk exposure. Ginnie Mae is very efficient; its small staff of 85 employees manages a portfolio of approximately $1.2 trillion, which earns hundreds of millions of dollars for the government every year. In fact, nearly every year since its inception in 1968, the corporation has earned profits for the U.S. government. Even during this crisis, Ginnie Mae, in contrast to many other MBS entities, earned profits: $906 million in 2008, $509.6 million in 2009, and $541.5 million in 2010. And for the first three quarters of this year, the corporation has already earned approximately $650 million. Fiscal year 2011 is expected to be our best year ever; Ginnie is likely to earn a billion dollars.

## The Business Model

This remarkable performance can largely be attributed to its business model. Ginnie Mae manages a carefully designed MBS program. In fact, the corporation pioneered this market, creating and guaranteeing the first mortgage-backed security in the United States in 1970. Freddie Mac followed the next year, and Fannie Mae issued its first security in 1981. Pioneering the MBS has given Ginnie Mae more than 40 years to refine and enhance its program.

The Ginnie Mae business model avoids exotic products and business lines. The corporation does not buy or sell securities or loans for investment purposes. Ginnie Mae only accepts loans insured or guaranteed by other government agencies as collateral for its securities. This ensures that it does not take on borrower-related credit risk. Ginnie Mae's risk is limited to the performance of its Issuers. Thus, the government's full faith and credit guaranty is only at risk when an Issuer in our program is unable to pay the principal and interest due to investors. When an Issuer does fail to meet its obligations, Ginnie Mae may not lose money because it assumes control of the portfolio and can either sell or manage it in-house in the most profitable manner. We choose to sell or manage the portfolio based on the best way to minimize the cost to the guaranty fund. Keep in mind, there is only a cost to the guaranty fund if the defaulted servicing portfolio has negative economic value.

As other MBS businesses struggle, Ginnie Mae stands out for its ability to effectively manage its MBS program. A conservative approach to management that rests on a solid, inherently risk-averse business model has allowed Ginnie Mae to thrive during this economic crisis. The foundation of the Ginnie Mae business model is the simple pass-through security backed by government-insured loans issued by private lenders. These private lenders play a crucial role in the MBS process: they protect Ginnie Mae and taxpayers from risk.

In the Ginnie Mae program, private lenders remain financially responsible for the securities they issue; their capital stands in front of the Ginnie Mae guaranty. Although the securities carry Ginnie Mae's name, lenders serve as the securities'-Issuers-of-record and as such are responsible for making all payments to investors. Ginnie Mae does not buy loans nor create and issue securities as is done in the GSE programs. The role of private lenders in the Ginnie Mae business model is a critical difference that distinguishes our operation from that of the GSEs.

Private lenders pay Ginnie Mae a fee to wrap the security in our guaranty. Ginnie Mae is essentially a re-insurer; the security and the payments due to investors remain the responsibility of the lender as long as there is an outstanding balance on those securities. If borrowers are delinquent in making their payments, lenders must pay the difference to investors, and lenders must continue advancing these funds until they are bankrupt or are defaulted by Ginnie Mae.

These loans are insured so when borrowers become delinquent and the foreclosure process is complete, Issuers can seek reimbursement from FHA, VA, or RD. While most of those expenses will be reimbursed by the insuring agency, rarely are all of the expenses reimbursed. In fact, our Issuers consistently report that they lose between $5,000 and $10,000 on every FHA claim and even more on VA claims. The risk of these losses means lenders must have sufficient capital to absorb them when necessary.

Our program is designed so that the capital of the lenders who issue Ginnie Mae securities is available to assume losses before Ginnie Mae or taxpayers do. Having lenders act as the Issuer of the security has the added benefit of ensuring that lenders have "skin in the game." This provides an incentive for lenders to originate well-performing loans. If loans do not perform well, the lender must pay investors on behalf of the borrower. I cannot emphasize enough how important this extra layer of capital is in mitigating the taxpayer risk exposure associated with secondary market transactions.

Under the Ginnie Mae business model the risk of paying out on the guaranty is remote. There are actually several layers of capital that must be exhausted before the guaranty is at risk of losses. The first layer of protection is the homeowner's equity, the second is the credit insurance, and the third is the capital held by the lender.

This third and final layer of protection, which I previously described as skin in game, may be the most important as it means Ginnie Mae Issuers must absorb all losses. It bears repeating that by focusing solely on guaranteeing securities payments due to investors, avoiding exotic lines of business, insulating itself from risk, and requiring skin in the game, Ginnie Mae has created an MBS program that thrives even during the most challenging economic times.

Finally, another element of the Ginnie Mae business model that has been an important part of its success is that we have only one objective: financing affordable housing. Ginnie Mae is a wholly-owned government corporation whose only mission is to serve taxpayers. We do not have that fundamental conflict between executing the nation's housing policy and earning a return for shareholders. We serve only one master: taxpayers, and as a result there is no motive to increase market share or earnings. This has allowed to us navigate the crisis in a manner that is beneficial to all.

## **Ginnie Mae's Priorities**

In addition to maintaining a strong efficient business model during my tenure, I have focused on three things at Ginnie Mae: creating an organization that is more customer-centric, enhancing our risk management practices, and increasing our resources.

### *Customer-Centric*

One of my first priorities when I took office at Ginnie Mae was to establish an environment that is very focused on serving our customers. At Ginnie Mae, we are working in a manner that better serves our Issuers, provides value to investors, and protects taxpayers. We are renewing our efforts to listen and develop solutions for our business partners. We are providing new disclosure information about the loans backing our MBS to spur more efficient pricing of these securities. We have also moved to reduce interest costs associated with carrying loans until they can be securitized by allowing the daily issuance of MBS. And we created an enhanced manufactured housing securitization vehicle to recognize the vital role that manufactured housing plays in affordable housing for millions of families.

### *Risk Management*

As the market fluctuates and lenders face increasing risk, we've made several changes to our program to strengthen our risk management practices. To assure continued accountability for our efforts, Ginnie Mae has had a Chief Risk Officer (CRO) in place for more than three years. One of my primary goals has been to expand our risk analysis capability by establishing a more comprehensive Enterprise Risk Office.

Our CRO and his team monitor corporate risk and compliance with risk policies, develop and maintain corporate-wide procedures for risk management, and provide oversight of all risk management activities.

Additionally, we have implemented policies that strengthen the financial capacity of our counterparties. This includes increasing net worth requirements, and for the first time, establishing capital and liquid asset requirements for all Issuers across all of our business lines. The liquid asset requirements are especially important as they ensure our counterparties have the funds available to meet their investor payment obligations.

Specifically in our program, we increased the base net worth requirement for single-family program participants from $1 million to $2.5 million. For multifamily lenders, we increased net worth requirements from $500,000 to $1 million. And for the home equity conversion mortgage business line we increased the requirement from $1 million to $5 million. When we launched the new manufactured housing program in October 2010, we established net worth requirements of $10 million. The HMBS and Manufactured Housing programs require more capital as these products expose the organization to greater risk. Imposing these requirements reflects Ginnie Mae's commitment to prudent risk management.

*Increasing Resources*

Increasing resources at Ginnie Mae is another top priority. We have embarked on a multi-year hiring initiative designed to appropriately staff the organization. Although Ginnie Mae has managed the increased business volume extremely well, rising to the challenge posed by this economic crisis has been difficult given our limited staff and resources. Ginnie Mae needs additional resources to effectively manage the risks and provide customer service in the current economic environment. The President's 2012 budget addresses this need by proposing a significant increase in Ginnie Mae salaries and administrative expenses (S&E) and a fund from which all salaries and expenses would be paid. The fund would be financed with Ginnie Mae's commitment and multiclass fee income. This financing approach enables greater capacity, service, and protection to taxpayers, without requiring any taxpayer support[5]. More importantly, the proposal would allow Ginnie Mae to increase its staff level to strengthen risk management and oversight. It is critical that Ginnie Mae have the additional resources and flexibility to effectively respond to market needs and to continue responsibly bringing global capital into the American housing finance system.

[5] Ginnie Mae is a self-financing organization. All of its expenses are paid from the fees its collects on securities. However, its salaries and expenses, though funded from fees, are part of the appropriations process.

**Comments on the Qualified Residential Mortgage Rule (QRM)**

As President of Ginnie Mae, I have had the opportunity to evaluate the impact of regulation from the perspective of securities Issuers and investors and realize that finding the right balance between protecting investors and not unduly hampering the flow of capital is challenging. The Dodd-Frank legislation appropriately recognizes that risk retention is an important part of creating a sustainable housing finance system. It is no secret that lack of "skin in the game" led to poor underwriting decisions resulting in placing people in homes they could not afford. The impact of these decisions has rippled through our financial system, disrupting every element of the mortgage process. It has had an especially negative impact on the securities markets. Private MBS investors have left the market almost entirely and will now invest only in MBS backed by the government. This is reflected in the current private label market share of less than 10 percent.

If we are to reform our housing finance system, it is critical that we get this right. We strongly support developing a rule that brings discipline to the markets. Issuers and originators must have an incentive to make sustainable loans. Without it, we risk another crisis. The QRM rule seeks to define those mortgages that would not be subject to risk retention. It considers many factors, among them down-payment, credit history, and the borrower's capacity to repay. Our challenge is to craft a rule which balances these factors in the manner that protects borrowers and allows for a robust flow of capital. There are always trade-offs in this equation; higher down-payments protect against risk, while at times making it harder for some to purchase a home. We must weigh protecting our housing finance system against the goal of ensuring robust liquidity. It will not be an easy task, but I assure you that HUD and the regulators are committed to releasing a rule that accomplishes this goal.

**Comments on Legislative Discussion Draft**

I appreciate the opportunity to share comments on the initial discussion draft. The legislation includes a provision that would give the Chief Financial Officer (CFO) the ability to offer independent views on matters concerning Ginnie Mae. While we understand the committee's desire to maintain a close review of Ginnie Mae's financial condition, we respectfully believe that this provision is not necessary. We are a relatively small agency, my staff and I are directly responsive to inquiries from Congress and this committee, and HUD's Office of Inspector General provides independent oversight. To the extent that the committee believes additional oversight may be necessary, we would recommend that the focus be placed on the role of the agency's Chief Risk Officer, because the major risks to Ginnie Mae center on the capacity of its Issuers to meet their obligations to investors and deterioration in portfolio servicing values. Thus, potential problems at Ginnie Mae are likely to be identified through our risk management practices and Issuer monitoring activities long before they impact our financial condition.

I would like to call your attention to one additional issue regarding this provision. The discussion draft would substantively alter the accounting and budgetary requirements currently applicable to Ginnie Mae. The Ginnie Mae CFO currently maintains an independent financial accounting system that supports a business type budget. To support this budget, the CFO adheres to Generally Accepted Accounting Principles (GAAP) whereas many federal agencies, including HUD, use budgetary accounting. The CFO is responsible for maintaining this budget and the supporting accounting system pursuant to the Government Corporation Control Act, 31 U.S.C. § 9103.

The proposal which requires the CFO to comply with the section 902 of title 31 of the United States Code would establish new requirements for Ginnie Mae. The maintenance of the new system would require additional staff and create unnecessary costs without significant benefit since Ginnie Mae has prudently managed its programs and finances under the requirements of the Government Corporation Control Act. Therefore, we recommend citing the Government Corporation Control Act rather than the statute cited in the legislation.

## Conclusion

Madam Chair and Ranking Member Gutierrez, our housing finance market remains fragile. Congressional action, Administration efforts, and government programs have stemmed the tide of economic and housing upheaval, provided needed liquidity, and helped keep the market from complete collapse. The Administration has introduced plans for housing reform to correct fundamental flaws in housing finance, create a foundation for sustainable homeownership, and bring an appropriate balance of smart government and private market participants to housing finance.

The Ginnie Mae business model successfully balances the role of the private market with that of government. During this crisis, through Ginnie Mae, 4.4 million homeowners have obtained low cost financing for mortgages, lenders have maintained access to the capital markets at a reasonable cost, and billions of dollars have been earned in profits for taxpayers. Indeed, while it is clear Ginnie Mae has been a stabilizing force in the housing market during this volatile period, the market requires meaningful reform so private investors can confidently participate in the housing market and provide a funding source for mortgages outside of the traditional government-supported institutions. Until then, Ginnie Mae will continue to provide the necessary funding to keep government-insured products available for families across the country.

Madam Chair, I hope my testimony today has contributed to a greater understanding of Ginnie Mae and the value it contributes to our housing finance system.

As someone who has worked in the capital markets for more than 30 years and who now oversees a mortgage securitization program that has served its constituents efficiently and effectively, I have become a passionate believer in Ginnie Mae's role and function. By pioneering the MBS, Ginnie Mae forever changed the way housing is financed. It is because of the Ginnie Mae MBS that an investor in Asia can make it possible for a family in Texas to own home. I am committed to strengthening this unique organization so that it continues to make a sound contribution. I welcome the opportunity to work with Congress on these efforts. Thank you for giving me the opportunity to testify today, and I look forward to answering any questions you may have.