Testimony of David H. Stevens

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Before the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets and GSEs

Hearing on

"The Private Mortgage Market Investment Act, Part 2"

December 7, 2011

Chairman Garrett, Ranking Member Waters, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA) on the proposed Private Mortgage Market Investment Act (PMMIA). My name is David Stevens and I am MBA's President and Chief Executive Officer. Immediately prior to assuming this position, I served as Assistant Secretary for Housing at the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) Commissioner. My background prior to joining FHA includes experience as a senior executive in finance, sales, mortgage acquisitions and investments, risk management, and regulatory oversight. I started my professional career with sixteen years at World Savings Bank. I later served as Senior Vice President at Freddie Mac and as Executive Vice President at Wells Fargo. Prior to my confirmation as Commissioner of the FHA, I was President and Chief Operating Officer of Long and Foster Companies, the nation's largest, privately-held real estate firm.

The purpose of the PMMIA, as set forth in the draft bill, is "to increase standardization and transparency and ensure the rule of law in the mortgage-backed security (MBS) system." Without reservation, MBA supports these important objectives. The current real estate finance environment — with the federal government owning, securitizing or guaranteeing nearly 90 percent of single-family mortgages underwritten today — is untenable.

Without question, a new housing finance system must attract private capital. Key elements of the PMMIA — facilitating standardization, legal certainty, greater transparency and disclosure — are fundamental to mortgage markets that rely on robust private investment. We commend the chairman for taking steps toward this critical objective.

At the same time, we believe the necessary tools, materials and expertise currently exist to begin building a bridge toward a more sustainable real estate finance system. As the discussion on the future of housing finance continues, MBA recommends that policymakers carefully consider the path by which private capital is brought back into the system — a pathway that maintains market stability while establishing a framework that ensures ongoing liquidity.

Three years ago, MBA emerged as a thought leader on the fundamental components of a stable and liquid secondary market for the long term. We began by exploring the benefits and shortcomings of the current system featuring the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. The benefits from the GSE model include liquidity brought about by the government's support of the MBS issued by the GSEs, and the development of standardized products and practices that have facilitated a deep and liquid secondary market. In turn, this promoted access to mortgage finance for homebuyers and rental housing, regardless of market conditions.

A core disadvantage to the GSE model is that it fundamentally relied upon ambiguity regarding the extent of the government backstop in the conventional mortgage market — an ambiguity that in the end wound up harming the interests of borrowers, investors, and taxpayers. Because the government guarantee was implicit rather than explicit, it was provided at no charge to market participants. Another shortcoming of the GSE model is that Fannie Mae and Freddie Mac were permitted to amass sizeable risk through their retained portfolios that presented substantial systemic risk with limited benefit to anyone but their shareholders. Additionally, the fact that the GSEs were chartered by Congress meant their competition was limited.

Our evaluation of the current system led to the development of three principles that serve as the foundation of MBA's recommendations for the future of the secondary mortgage market.

The first principle, which is in agreement with the goals of the PMMIA, is that secondary mortgage market transactions should be funded with private capital. The second principle is that the importance of housing, whether owner-occupied or rental, to the nation's economic and social fabric warrants a federal government role in promoting liquidity and stability in the core mortgage market. This role should be in the form of an explicit credit guarantee on a class of MBS, and the guarantee should be paid for through risk-based fees. Third, taxpayers and the system itself should be protected through limits on the mortgage products covered, limitations on the types of activities undertaken, strong risk-based capital requirements, and actuarially fair payments into a federal insurance fund. MBA's recommendations were developed in a way that retains the benefits and avoids the shortcomings of the existing GSE framework.

I am pleased to say that there is considerable concurrence between MBA's recommendations and the draft PMMIA. MBA's testimony today will address the elements where commonalities exist between MBA's suggested framework and the PMMIA. Our testimony also will address topics not included in the PMMIA that merit consideration.

Private Capital

The most important common ground we share is that private capital should be the primary source of liquidity for the real estate finance system. Like MBA's proposal, the PMMIA also provides greater clarity on the government's role by establishing that private capital is in the first loss position.

Standardization

We agree that one way to foster a secondary market that attracts private capital is to provide standards, consistency and transparency for market participants. Features of the PMMIA could help accomplish these goals. For example, the bill authorizes the Federal Housing Finance Agency (FHFA) to develop, adopt and publish standard form securitization agreements for certain classes of mortgages. This provision is important for a variety of reasons. For example, standard forms and terms facilitate predictability and the rapid flow of information. Standard securitization forms streamline the transportation of data and capital in the same way that standard gauge railroad tracks facilitate interstate commerce. MBA, through its subsidiary, the Mortgage Industry Standards Maintenance Organization, Inc. (MISMO®), has been and remains committed to industry-developed voluntary standards for data, forms, and other purposes, as such standardization increases efficiency and lowers costs for consumers and the entire market.

Predictability and consistency are also important because they help investors measure and manage their risk exposure. In fact, standardization is at the heart of the "To-Be-Announced" (TBA) securities market. As the name suggests, the defining feature of a TBA trade is that the underlying mortgage loans have not been identified and may not even have been originated on the trade date. Instead, participants agree only on a defined set of parameters of the securities to be delivered.

This contrasts sharply with non-TBA securities, whose loans are typically originated before trading. The TBA market also significantly lowers the transaction costs associated with originating, servicing, and refinancing a mortgage. In addition, the TBA market provides an efficient way for lenders to hedge the interest rate risk involved in offering borrowers the ability to lock-in a rate for 30 days while closing on a mortgage. TBA prices, which are publicly observable, serve as the basis for pricing and hedging a variety of mortgages that are not TBA-eligible. TBA trading is thus a key link between the primary and secondary mortgage market.

Market participants across the board and around the world value the liquidity and the structure of the TBA market. Any change to the mortgage system would need to retain this structure. It is less than clear, however, that this can be accomplished through either legislation or regulation. The system must be acceptable to originators, who provide the products, and to investors, who provide the funds. The TBA market was the creation of the private sector, although it certainly relies upon the liquidity and homogeneity that flow from government-backed securities.

Core Products

MBA appreciates that the PMMIA provides for the establishment of different classes of standard mortgage products. This provision is similar to MBA's recommendation for the establishment of a core residential mortgage market to set a benchmark for consumers, underwriters, investors and others. For consumers, the presence of well-defined core mortgage products will provide a standard against which other products can be assessed. The core market will also provide considerable stability, ensuring that mortgage products of a known type will be available in all market conditions. For underwriters, the characteristics of the "well-documented, well-understood" mortgages of the core market will provide a known base for modeling and pricing risk. For investors, the core market will establish performance and pricing benchmarks for use in MBS investing, and against which other investment options can be judged.

30-Year Fixed Rate Mortgage

We appreciate that the bill gives consideration to preserving the 30-year fixed-rate mortgage. Homeowners in the United States have come to view this mortgage product as the industry standard. Payments are predictable and borrowers are protected from fluctuations in interest rates. From the borrower's perspective, it is the simplest mortgage product available. If rates rise, payments are unchanged. If rates decline, borrowers typically have the option to refinance at no explicit cost.

Although it is consumer friendly, from the standpoint of an investor, the 30-year, fixed-rate, self-amortizing, prepayable mortgage is actually a very complex product. Borrowers refinance when rates drop, transforming a loan with a nominal 30-year maturity to a short-term instrument. When rates increase, refinances disappear, extending the expected life of the loan. Banks and thrifts that fund themselves with deposits are not natural holders of 30-year, fixed-rate, prepayable loans, because they would inevitably be borrowing short and lending long. With the beginning of the nation's MBS market in the early 1970s, it was discovered that investors were willing to bear the prepayment risk associated with these loans, so long as they were protected from the credit risk. From that point to today, with a few exceptions, most investors either did not have the capacity or the willingness to take on the credit risk, particularly given the uncertainty involved with systemic credit events such as the one we just experienced.

MBA also appreciates that the bill does not attempt to standardize <u>all</u> real estate finance transactions. Instead, it provides room for market participants to negotiate alternative agreements according to their own risk appetites. This leaves open opportunities for innovation and further advancements.

Competition

MBA is grateful that the PMMIA attempts to address a fundamental flaw in the current statutory and regulatory framework regarding the statutory charters of the GSEs. Fannie Mae's and Freddie Mac's congressional charters give them a competitive advantage that no other private MBS issuer has – a government guarantee that at one point was implied, but was made explicit when they entered conservatorship. MBA believes transferring to a federal regulator the authority to charter additional competitors, and approve and disapprove certain MBS, solves the problem of insufficient competition in the secondary market.

Disclosure and Securities Registration

The disclosure provisions of the PMMIA are generally consistent with MBA's support for efforts to increase the transparency and reliability of investment product information. MBA is mindful that the financial services system has witnessed a tremendous increase in the level of complexity and sophistication in financing options, investment products and liquidity channels. We believe it is vital for investors to have sufficient information so they can adequately assess whether a particular investment matches their level of risk appetite. At the same time, the secondary market is remarkably fluid. As a result additional securities registration requirements could cause unnecessary delays in MBS execution. Accordingly, we support the PMMIA's exemption for certain securities from securities registration requirements.

Clarification of Qualified Mortgage Exemption

MBA strongly supports efforts to clarify the "ability to repay" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Dodd-Frank authorizes the Bureau of Consumer Financial Protection (CFPB) to establish a "Qualified Mortgage" (QM) category of mortgages that will have been deemed to satisfy the law's "ability to repay" provisions. Some have expressed uncertainty regarding whether the QM category is a safe harbor or rebuttable presumption of compliance.

Having considered this issue carefully, MBA urges that adoption of a safe harbor with objective bright line standards serve as the best construct for the QM. Such an approach:

- Is clearly within the powers of the CFPB under the Truth in Lending Act as amended by Dodd-Frank;
- Will provide the strongest incentives for lenders to operate within its requirements, given the severe penalties resulting from non-compliance, and at the same time offer sustainable mortgage credit to the widest array of qualified consumers;
- Will allow efficient and less costly litigation to determine whether the safe harbor requirements have been met;
- Will prevent lenders who conscientiously meet the requirements from being dogged by endless and costly litigation including meritless claims that would be encouraged by anything less than a safe harbor;
- Will avoid saddling qualified borrowers with the costs of legal uncertainty in the form of lack of access to credit, or, if credit is made available, higher interest rates and fees (which is the only way the industry will be able to support the costs of litigation); and

- Will help maintain competition in the marketplace by reducing the burden on smaller lenders.

The rebuttable presumption of compliance, in contrast, would:

- Cause lenders to act more conservatively and potentially use the more restrictive "Qualified Residential Mortgage" (QRM) standards (under Dodd-Frank's risk retention section) as a "safe harbor";
- Result in the denial of credit at a higher rate and/or increase costs to many borrowers;
- Have the most serious effects on the availability and costs of credit for minority, low- to moderate-income and first-time borrowers who, though qualified, may present greater credit risks;
- Invite more extensive litigation than necessary, resulting in greater costs being borne by all borrowers;
- Eliminate competition from the marketplace by creating a level of risk makes compliance too costly for smaller lenders; and
- Diminish the recovery of the housing market and the nation's economy.

For these reasons, MBA believes it is imperative to unequivocally clarify that Dodd-Frank provides a bright line safe harbor for QM purposes.

Other Considerations
While there is much in the PMMIA that aligns with MBA's recommendations, we believe a properly designed real estate finance system must be capable of operating in times of extreme conditions. Unfortunately, we know all too well what can happen in a liquidity crisis. MBA believes the past few years have given us perspective on how to design a new system that addresses the current system's shortcomings while preserving its many benefits. We hope you will consider the following recommendations as you continue discussing the issue of housing finance reform.

The Federal Government's Role in Housing Finance
The financial crisis proved that some form of government support is necessary to keep the mortgage market operating during times of severe distress. The current dearth of activity outside of government-supported liquidity channels exemplifies the risk averse nature of private capital. Foreign investors are flocking to Ginnie Mae securities for the sole reason that they are backed by the full faith and credit of the United States.

More importantly, even in good times, investors will remember the experiences of the recent crisis. If they doubt their ability to sell mortgages during a crisis, they will be less apt to buy them outside of a crisis.

The size and scope of the nation's housing market means that, except in times of extreme duress, the federal government's secondary market role should be to promote liquidity for investor purchases of MBS, not to attempt to provide the capital for or absorb the risks itself.

Without a government backstop, the market will be limited to investors willing to take on catastrophic risk. While such investors may exist, they are much fewer in number than those who willingly trade more than $200 billion daily in the agency MBS market. Without these investors, the market is susceptible to a "run" during times of financial turmoil. Practically, this means that middle-income homebuyers seeking core products would lose access to the market during crises.

It is important to note that the absence of an explicit guarantee does not mean the government will not step in during a crisis. In fact, GSE securities have always been mandated to state that they are explicitly not backed by the government. The last crisis showed that the government will step in to support even institutions that were not perceived to have an implicit guarantee. The taxpayer is better protected, and the market will operate more efficiently, if the rules of the road are stated clearly upfront, and government guarantees are clearly delineated and paid for before the crisis occurs.

Securitization is an alternative liability structure for funding mortgages and as such is subject to the same volatility problems that have historically made bank deposits unstable and subject to bank runs. When depositors or security holders become concerned over the health of the assets supporting their investments and have imperfect information regarding the future performance of those assets, they want to liquidate their positions. In the case of banks, this is a run on deposits. For securitization, it is a panic sale of the securities with a large drop in price. It was the macroeconomic effects resulting from those bank runs that precipitated the Great Depression and lead to the creation of the Federal Deposit Insurance Corporation (FDIC) in 1933.

This FDIC-type liability insurance structure is essentially the system MBA recommends establishing for MBS. Except in extreme instances, the private capital of the insuring entities will be adequate to pay any losses on MBS. However, in order to mitigate the panic sale of MBS resulting from the imperfect information that always exists regarding asset quality, a back-up insurance structure should be established to pay any losses if the capital of a first-level insurance/guaranty entity proves inadequate. This is precisely how the FDIC fund works. Just as is the case with the FDIC, the support of the government and the potential exposure of the taxpayers would come into play only if the capital of the securitizing entity proved inadequate and the insurance fund was exhausted. As with the FDIC, however, taxpayers' funds would be returned as the insurance fund is replenished. The role of the regulator, therefore, would not be to oversee the pricing of the risk attributes of individual mortgages, any more than federal bank regulators oversee the pricing of individual loans held by banks. Instead, the regulator will look at the capital, earnings and management of the guarantor entities with an eye toward overall risk to the insurance fund, just as regulators do for the overall health of banks.

Questions have been raised as to whether the government can price a guarantee correctly. Certainly the FDIC has mispriced the deposit guarantee in the past, with taxpayer funds needed to meet interim cash needs until the fund is replenished. The key point is that there exists within the FDIC structure a mechanism for repaying the taxpayers and correcting for any overpricing or underpricing. We expect a similar mechanism to be put in place with MBA's structure. Perhaps more important, the government is providing a backstop guarantee against the risk of an institution failing and is forced to price only that institutional guarantee, not guarantees on individual loans.

Transition
MBA believes it is important to provide for the careful execution of a transition from the current to the future state of the housing finance system and to retain as much of the public goods as possible. It is important that any action take place in a careful and deliberate manner. Ignoring the consequences of interim actions and the pace of economic recovery could shock a still-fragile housing market, severely constrain mortgage credit for American families, and expose taxpayers to unnecessary losses on loans the institutions already guarantee. During the transition, it is also important that the operations of Fannie Mae and Freddie Mac continue to serve the market and the American people, including retaining the human capital necessary to effectively run both institutions.

MBA believes it is inefficient, if not wasteful, to dismantle portions of the existing infrastructure, which are the result of decades of effort and public investment coupled with billions of dollars of private capital. Many aspects of this infrastructure (data, systems, market practices) are essentially public goods at this point and should be retained.

While a gradual transition to a new housing finance system is desirable, there are strong reasons to lay out a clearly defined future for mortgage finance as soon as possible. The uncertainty over the future policy environment is deterring the recovery by inhibiting the ability of businesses and investors to plan and move forward.

Regulatory Oversight
One of the strengths of MBA's model is that while all approved MBS issuers would have access to a government backstop for catastrophic insurance, they would have the ability to compete with respect to how they manage the first loss credit risk. For example, they

might set different parameters with respect to loan guidelines (within the proposed Dodd-Frank "ability to repay" rule's QM credit box). They might also have different risk sharing arrangements with originators, mortgage insurers, and other counterparties. Each approved issuer would make a tradeoff between the risk they retained and held capital against, versus sharing the risk and returns with counterparties. Competition along these dimensions would add choice and flexibility to the market place. It would also reduce systemic risk, as credit decisions would be dispersed, rather than concentrated, in the hands of just one regulator or two GSEs. MBA believes the concentration of risk within one regulator is an aspect of the PMMIA that should be addressed.

Risk Retention

MBA has mixed emotions with respect to the PMMIA's provision to eliminate Dodd-Frank's risk retention requirements. We firmly support and understand the goal of risk retention as a means to bolster accountability for real estate finance market participants. At the same time, we believe the current proposed regulations issued by federal regulators would do far more damage than good. Given the choice between a deeply flawed rule and no risk retention requirements, it is fair to say it would be better not to have them at all. On balance, therefore, MBA believes it would be better to eliminate Dodd-Frank's risk retention requirements than implementing the law in a poor or misguided fashion.

In particular, MBA advocates removing the proposed borrower debt-to-income (DTI) and loan-to-value (LTV) requirements from the "qualified residential mortgage" exemption from risk retention, in order to align it with the original intent of Congress. MBA also emphasizes that the alternative QRM proposal, mandating a 10 percent LTV, would be as bad or potentially even worse (in terms of negative impact for first-time homebuyers) than the 20 percent LTV requirement, as it would fracture liquidity in the market. The proposed Premium Capture Cash Reserve Account is likewise unworkable.

Even though the PMMIA would overturn Dodd-Frank's risk retention requirements, other provisions of the PMMIA could be interpreted as authorizing a similar framework, or worse. Specifically, PMMIA instructs FHFA to establish MBS risk classes and underwriting requirements, including DTI, LTV, borrower credit history and other elements similar to the QRM criteria. Moreover, the PMMIA bestows this authority on a single regulator rather than the six regulators authorized to establish risk retention requirements under Dodd-Frank. Apart from objecting to specific regulatory underwriting requirements, MBA questions whether a single regulator has the necessary expertise and capacity to undertake this initiative.

Mortgage Servicing
MBA is concerned about the mortgage servicing provisions of the PMMIA. As a result of the unprecedented volumes of non-performing loans during the current cycle, single-family mortgage servicers have experienced difficulties in their ability to adjust systems and work processes quickly to meet the ever-changing regulatory environment, including changes to loan modification programs, and the time required to hire and train employees for these new processes.

We believe a voluntary national residential mortgage servicing standard would be beneficial to streamline and eliminate overlapping requirements. A national servicing standard, however, must be truly national in scope and not simply another standard layered atop the already overwhelming number of servicer requirements.

In developing servicing standards, we must pay careful attention to the interdependence of servicing and the impact that changes to the system will have on the economics of mortgage servicing, tax and accounting rules and regulations, and the effect of the new requirements on Basel capital requirements and on the TBA market. Servicing does not operate in a vacuum; instead it is part of the broader ecosystem of the mortgage industry. When making changes to the current model we need to be mindful of unforeseen and unintended consequences that could result ultimately in higher costs for consumers and reduced access to credit.

While we support the development of a consensus set of national servicing standards, MBA believes the topic is sufficiently complex to merit its own separate discussion rather than as an adjunct to secondary market reform. Moreover, mortgage servicing is of such a dynamic nature that it could be seriously impaired by static statutory mandates.

National residential servicing standards should start with a full analysis of existing servicer requirements and efforts to standardize state laws on foreclosure. The new standards should be promulgated in a process that includes open dialogue with all stakeholders, including federal regulators, state regulators, consumer advocates, servicers, and investors in mortgages and MBS. MBA continues to welcome the opportunity to participate and play a constructive role in such a process.

Financial regulators and other enforcement authorities are engaged in separate efforts pertaining to national standards that address numerous mortgage servicing issues including customer service, the processing of payments, foreclosure processing, operational and internal controls, and servicer compensation and payment obligations. This effort is the proper venue to deal with servicing standards. Assuming a balanced approach is taken, this effort will ensure uniformity in application, reduce regulatory burden and risk for mortgage servicers, and provide certainty to the secondary market while ultimately achieving the objective of comprehensive, consistent enforceable standards.

Multifamily Housing Finance
MBA wishes to underscore that the secondary mortgage market supports the financing of single-family and multifamily properties, and that both serve critically important roles in housing our nation. MBA's recommendations address both parts of the market. The same principles apply to the federal role in the core single-family and multifamily secondary mortgage markets, including the importance of the federal government guarantee in ensuring liquidity. Even though the multifamily market had much lower default rates and stronger performance than the single-family ownership market during the recent downturn, ensuring liquidity in this market would be equally important in a new real estate finance system.

Conclusion
I am pleased to reiterate that MBA agrees with many aspects of the Private Mortgage Market Investment Act, particularly its strong reliance on private capital. We look forward to assisting this subcommittee, the full Financial Services Committee, and other congressional leaders as this debate continues and you develop a framework that ensures liquidity and stability in the marketplace at all times.

United States House of Representatives
Committee on Financial Services

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
David H. Stevens	Mortgage Bankers Association
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☒ No	☐ Yes ☒ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	
David H. Stevens	

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