PROTECTING AMERICAN TAXPAYERS AND HOMEOWNERS (PATH) ACT
– EXECUTIVE SUMMARY –

Background and Purpose

Currently, our system of housing finance is dominated in large part by the two housing Government-Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, and other government guarantees supplied by the Federal Housing Administration (FHA) and its loan securitizer, Ginnie Mae. Combined, the GSEs and the FHA guarantee more than 85 percent of all new mortgage originations and were responsible for more than 99 percent of all mortgage securitizations in 2012. Such a system is unsustainable, and exposing taxpayers to liabilities that are measured in the trillions of dollars is unacceptable. Moreover, this unprecedented level of government involvement is crowding out private sector capital, investment, and innovation.

Americans deserve a better housing finance model – one that's sustainable and built to last. Sustainable for homeowners so they can keep their homes; sustainable for taxpayers so they are never again forced to fund another multi-billion dollar Washington bailout; and sustainable for our nation's economy so we avoid the boom-bust housing cycles that have hurt so many in the past.

At its core, the housing market is no different from the market for any other asset – housing is not immune to the laws of supply and demand or risk and reward. Thus, any plan to reform our housing finance system must advance four fundamental goals essential to the development of any free market. First, the role of government must be clearly defined and limited to protect taxpayers, prevent the crowding out of private sector participation, and eliminate moral hazard. Second, artificial barriers to private capital must be removed to attract investment and encourage innovation. Third, market participants must have clear, transparent, and enforceable rules for transactions to foster competition and restore market discipline. Lastly, consumers must be afforded choice in determining which mortgage products best suit their individual needs, free from arbitrary government restrictions that ban options or steer consumers to certain government-preferred products over others.

To accomplish these goals, the reforms contained with the Protecting American Taxpayers and Homeowners (PATH) Act of 2013 are focused on:

- **Ending the Costly Fannie and Freddie Bailout;**
- **Right-Sizing the FHA and Clearly Defining its Mission;**
- **Implementing Market Reforms to Increase Mortgage Competition, Enhance Transparency, and Maximize Consumer Choice; and**
- **Breaking Down Barriers for Private Investment Capital.**

PROTECTING AMERICAN TAXPAYERS AND HOMEOWNERS (PATH) ACT

– EXECUTIVE SUMMARY –

Ending the Costly Fannie and Freddie Bailout

- Set a five-seven year time limit to end the conservatorship of the GSEs that has been in place since 2008, and subject the GSEs to receivership, at which point the GSEs would be stripped of their government charter, liquidated, and any remaining assets would be sold off.
- To increase competition and ensure a smooth transition in the period leading up to receivership, implement the following reforms:
  - Lock in the current GSE dividend payments to compensate taxpayers for the costs of conservatorship and the financial damage the GSEs have caused;
  - Continue shrinking the GSEs' retained portfolios of mortgage-backed securities (MBS) and other assets at a rate of 15 percent per year, down to a floor of $250 billion;
  - To ensure parity with the private sector, eliminate the GSEs' cost of funds advantage by requiring an annual review of and update to the guarantee fees ('G-Fees') being charged by the GSEs for protecting investors against credit risk;
  - Remove the GSEs' ability to subsidize higher cost loans by lowering their conforming loan limits in high-cost areas over a five-year period by $20,000 per year down to $525,500, and prohibiting future increases to those limits;
  - Reduce the risk posed to taxpayers by establishing a credit risk sharing program between the GSEs and private market participants covering at least 10 percent of the GSEs' new business each year;
  - Prohibit the GSEs from purchasing or guaranteeing any mortgages that do not meet the criteria for treatment as "Qualified Mortgages" (QM) under the Dodd-Frank Act;
  - To combat constitutionally-suspect "eminent domain" schemes by local municipalities to seize mortgages out of legally binding securities for purposes of rewriting their terms, prohibit the GSEs from purchasing or guaranteeing loans originated in municipalities where such practices have been employed during the last ten years; and
  - Repeal the GSEs' misguided affordable housing goals mandate and the GSE-funded Affordable Housing Trust Fund.

Right-Sizing the FHA and Clearly Defining its Mission

- Target FHA's mission specifically to first-time borrowers (*eligible regardless of their income nationwide*) and low- and moderate-income borrowers (*individuals below 115 percent of area median income [AMI] nationwide, or 150 percent of AMI in high-cost areas*).
- Preserve FHA's countercyclical role by allowing it to insure loans to any borrower during established periods of significant credit contraction as certified by an independent government credit availability metric.
- Limit taxpayer exposure by setting FHA's maximum insurable loan limit at the lower of 115 percent of area median home price or 150 percent of the GSE high-cost area loan limit (*maximum of $625,500, down from $729,750 under current law*), with a nationwide minimum limit of $200,000 (*down from $271,050 under current law*).
- Encourage greater borrower equity by increasing FHA's minimum down payment requirement from 3.5 to 5 percent for all non-first-time borrowers.
- Reduce the risk posed to taxpayers by establishing a credit risk-sharing program between FHA and the private sector covering at least 10 percent of FHA's new business each year.
- Gradually reduce FHA's mortgage insurance coverage on individual loans over 5 years by 10 percent per year, from 100 percent to 50 percent of the original principal amount of the loan.
- To prevent further mission creep, spin off FHA from HUD as a free-standing agency, and require it to be fully self-sufficient in its operations.
- To make FHA price its coverage more like a private mortgage insurer, require it charge a minimum annual premium on all loans, incorporate administrative costs in all of its premium calculations, and allow it to offer risk-based pricing on its mortgage insurance.
- To make FHA operate more like a private mortgage insurer, require it to issue quarterly financial reports based on Generally Accepted Accounting Principles (GAAP), and maintain a Capital Reserve ratio of at least 4 percent (*up from 2 percent*), with restrictions on new insurance commitments during periods in which the ratio falls below 4 percent.
- Coordinate federal housing policy among FHA and the Rural Housing Service (RHS) and require the two agencies to synchronize their technology and risk management.
- Enhance FHA's ability to manage its insurance portfolio by requiring lenders to repurchase mortgages that are more than 60 days delinquent within the first six months of the loan, and prohibiting borrowers who default from obtaining FHA mortgage insurance within seven years of a completed foreclosure.
- To combat constitutionally-suspect "eminent domain" schemes by local municipalities to seize mortgages out of legally binding securities for purposes of rewriting their terms, prohibit FHA and RHS from insuring loans originated in municipalities where such practices have been employed during the last ten years.

Implementing Market Reforms to Increase Mortgage Competition, Enhance Transparency, and Maximize Consumer Choice

- To increase competition and transparency, establish a new non-government, not-for-profit National Mortgage Market Utility (Utility) regulated by the Federal Housing Finance Agency (FHFA) to develop common "best practices" standards for the private origination, servicing, pooling, and securitizing of mortgages, and operate a publicly accessible securitization outlet to match loan originators with investors.
- To preserve its impartiality, explicitly prohibit the Utility from originating, owning, servicing, or guaranteeing any mortgage or MBS.
- Require the Utility to develop standard-form mortgage agreements and guidelines covering loan level data disclosures; pooling and servicing; representations and warranties; indemnification and remedies; and trustee responsibilities.
- To remove the mortgage securitization process from government control, require the FHFA to transfer ownership of the proprietary securitization platform currently being spun-off from the GSEs to the Utility as an open-access common securitization platform (Platform).
- To foster robust private sector competition, require the Utility to maintain and operate the Platform as a voluntary securitization outlet with non-discriminatory access for all loan originators, aggregators, security issuers, and investors.
- Require that all users of the Platform adhere to the standard-form agreements and guidelines set forth by the Utility as a condition of participation.
- To curtail litigation risk, require that all users of the Platform consent to resolve all representation and warranty disputes via mandatory arbitration.
- To maximize the unique role played by community banks and credit unions in the residential mortgage market, allow all QM and non-QM loans of any size to be eligible for securitization through the Platform, and prohibit discriminatory fees based on the size, composition, business line, or loan volume of an originator.
- To level the playing field for small financial institutions, authorize the Federal Home Loan Banks to serve as loan aggregators to compile pools of mortgages originated by community institutions for securitization through the Platform.
- To encourage transparency and standardization, direct the Utility to create a system of designated "Qualified Security" categories with uniform underwriting standards to help investors determine which level of credit risk matches their specific risk tolerance.
    - A Qualified Security is defined as a residential mortgage security issued through the Platform based on standard terms <u>without</u> a government guarantee. Qualified Securities are also exempt from the registration requirements imposed by federal securities law.
- Require the Utility to develop a new national mortgage data repository as a searchable database for the recordation and transparent disclosure of basic mortgage industry documents.
- Create a legislative framework and regulatory structure for financial institutions to issue Covered Bonds, a form of debt commonly used internationally as a financing alternative to mortgage securitization and portfolio lending.

Breaking Down Barriers for Private Investment Capital

- To ease the regulatory burden on community financial institutions that originate residential mortgage loans, institute a mandatory study of the impact, cost, and complexity of the implementation of the Basel III capital rules. For community banks, delay the effective date of this rule until two years after date of enactment or one year after the federal banking agencies promulgate revised rules following the study.
- Prohibit regulators from imposing a Liquidity Coverage Ratio under Basel III that discriminates against residential MBS collateralized by non-full recourse mortgages as a condition for status as a high quality liquid asset.
- To encourage lower costs and greater options for consumers and to ensure that community financial institutions can continue to offer a diverse array of mortgage products:
  - Provide targeted regulatory relief for mortgages securitized through the Platform as Qualified Securities from certain onerous requirements imposed by the Dodd-Frank Act; and
  - Provide additional targeted regulatory relief from the Dodd-Frank Act for banks, credit unions and other financial institutions that elect to hold mortgages they originate in their portfolios and bear the credit risk of the loan.
- To ensure that community financial institutions have time to comply with the thousands of pages of new mortgage restrictions, delay the mandatory implementation of the Dodd-Frank Act's mortgage rules until at least January 2015.
- Repeal the Dodd-Frank Act's credit risk retention requirement and prohibit the Dodd-Frank Act-inspired "Premium Capture Cash Reserve Account" rule that issuers set aside the profits from sales of securities as an additional reserve for the life of the MBS from going into effect.
- Incorporate provisions from bipartisan legislation (*H.R. 1077*) to prevent discrimination against lenders with affiliates in the calculation of loan points and fees in determining QM eligibility.
- Regarding implementation of the Volcker Rule, exclude issuers of asset-backed securities (ABS) from the proposed definition of "Covered Funds," the list of private investment funds and vehicles in which banks are restricted from investing.
  - Adoption of a broad definition for Covered Funds that includes ABS issuers would render it impossible for banks to execute many beneficial types of securitization.
- Ensure that the SEC's implementation of its Regulation AB II rule, which imposes requirements for the registration, disclosure and reporting of all publicly registered asset-backed securities, does not negatively impact issuances including MBS.
- Incorporate provisions from bipartisan legislation (*H.R. 1553*) to give Main Street financial institutions a voice by providing a more stable and fair examination environment, which would promote economic growth and increase financial institutions' willingness to extend consumer loans, including mortgages.