Written Statement of:

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Committee on Financials Services

Subcommittee on Capital Markets and Government Sponsored Enterprises

“Facilitating Continued Investor Demand in the U.S. Mortgage Market Without a Government Guarantee”

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BARCLAYS CAPITAL

Good Morning, Chairman Garrett, Ranking Member Waters, and other Members of the Subcommittee. I am Ajay Rajadhyaksha and I run US Fixed Income Research at Barclays Capital in New York, including research on housing finance and the mortgage markets. I appreciate the opportunity to discuss ways for the government to facilitate private investor demand in the US mortgage market.

The state of housing finance in the US, where government sponsored entities (GSEs) account for over 90 percent of all mortgage loans currently made, is problematic. We believe that there are several ways in which the government can help change this to encourage private sector issuance of mortgages. I have broken these proposals into three areas. The first is about how to incentivize the issuers and underwriters of private label MBS; the second is about making life easier for investors who will purchase private label MBS; and the third pertains to establishing a benchmark to help the private sector price mortgage credit.

1.) On the issuance front, there are three specific issues to address:

- Rationalize various regulatory regimes that mandate capital requirements.
  - Currently, certain regulatory regimes depend on ratings, such as the banking system. Meanwhile, others like the insurance industry regulator, National Association of Insurance Commissioners (NAIC), have moved to loss-based models that generate capital requirements. We believe that such industry-wide models are the better way to go than depending on a black box ratings approach.
  - Take into account the investors' cost-basis in the security as well as expected losses when mandating capital requirements.
- Reduce areas of legal uncertainty especially with regard to repo and warranty enforcement mechanisms and the enforceability/transferability of the related mortgage notes.
- Clarify rules around risk-retention and disclosures to reduce regulatory uncertainty. We also recommend that risk retention focus on the point at which the loan is originated, which is where the credit decision is truly made.

2.) There are also several steps that can be taken on the disclosure front to make private label MBS issuance more attractive to prospective investors.

- Create a transparent and timely way to enforce repo and warranties. In the private label transactions of the last decade, in several cases, investors had a hard time even getting access to the loan files unless they owned more than a majority of the deal. Transparency on this issue would help everyone – investors, issuers and regulators.
- Legalize Mortgage Electronic Registration Systems (MERS) and streamline the legal process required to correctly transfer loans. Make this process uniform across states. This will remove uncertainty around the documentation related to proper ownership of these loans.

- Remove uncertainty around servicing by creating servicing standards that are similar to those needed by Federal Housing Association (FHA) and Federal Housing Financing Agency (FHFA).
- Mandate periodic release of standardized information about performance of servicers on loss-mitigation efforts across all loans that they service.
    - On a related note, mandate periodic release of standardized information on repurchase requests/ actual repurchases across all private deals for each securitizer/originator.

- Require the Securities Exchange Commission (SEC) to set up data format and quality standards for initial and ongoing disclosures for asset backed deals (as per Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and some additional issues). These standards should include:
    - Standards for initial disclosures including information on the loans/ the borrowers as well as information around risk-retention. Standards should also cover information on underwriting policies and practice.
    - Mandate that the deal waterfall model be made available to all current and potential investors in an easily usable manner such as an Index CDI. Any corrections made to this model should be publicly disseminated as well. Impose penalties on underwriters for incorrectly modeled securities.
    - Standards for ongoing disclosures at a loan level including information on payment behaviors, re-appraisals on delinquent borrowers, and on loss-mitigation actions taken.
    - Standards for ongoing disclosures at a deal level which mandate a standard format for remittance reports which clearly show the trust cash flows and the sources of the funds and the uses of those funds in paying out the bonds or any other obligations of the trust.
    - Standards for ongoing disclosures of rep and warranty breaches and repurchase information as well as lower barriers for access to information relevant to assessing breaches of reps and warranties.

Taken together, 1 and 2 should go a long way to reducing legal uncertainty, and providing greater transparency to investors. However, we are not convinced that this is enough to jumpstart private label mortgage issuance. Policy makers also need to make an effort to replicate the standardization and uniformity provided by the agency MBS market in one more way – by providing a benchmark that helps the private sector price mortgage credit, which I will discuss in the next section.

3.) For decades, the GSEs – specifically, Fannie Mae and Freddie Mac – have hedged their interest rate risk actively in the capital markets. But their bigger risk has always been the credit risk in the mortgages that they guarantee. And unfortunately, this was a risk that kept rising on the GSEs balance sheets every year, without being hedged, as the number of loans they were guaranteeing increased.

We recommend that the GSEs sell a portion of the credit risk in their existing guarantee business to the private sector. I will not go into the exact details of this process in the interests of time. But we believe implementing this process should be relatively easy, since it does not require additional Congressional action and the GSEs should already have the needed financial technology. Selling credit risk to the private sector would transfer some of the risk from the taxpayer to the private sector. But perhaps the single most important reason to sell GSE credit risk is to establish a benchmark against which the private sector can price mortgage credit.

What do we mean by that? Consider the 2009 4.5% MBS universe. These are loans guaranteed by Fannie Mae and Freddie Mac that were made in the year 2009 and securitized in the 4.5% coupon. There are more than $300 billion of these GSE guaranteed loans that have been outstanding for more than 2 years. This is a big cohort with a fair amount of uniformity. If the GSEs were to sell the credit risk in this pool to the private sector, it would create a considerably more active market for private mortgage credit. The uniformity, size of the cohort, and the available data of more than 2 years of credit performance would ensure that private sector investors have a benchmark. Such a benchmark, we believe, is important for an active secondary market for mortgage credit. And an active secondary market is in turn important for a return of primary issuance in private label mortgages. At the very least, investors would be able to have a better sense of, and more confidence about, what they should be paying for new purchases in the private label mortgage markets, encouraging primary issuance.

Finally, while I believe that the private label mortgage market needs to be responsible for a greater share of origination, I would caution policymakers to closely watch the pace of any such transition. The availability of mortgage credit is extremely important to the housing market, especially in its current vulnerable stage. Consider for example, the first half of 2007. The unemployment rate was still near 5%, and yet home prices started dropping. One reason was because as secondary market prices for non-agency MBS started falling, it became impossible to issue new loans in the primary markets for private label MBS. As a result, mortgage credit availability suddenly dropped, which in turn hurt housing demand. There were definitely other factors that contributed to the crash in home prices, but one catalyst was a sudden decline in the availability of mortgage credit. To avoid a repeat of this, I would remind policymakers that, even as they work towards increasing the involvement of the private sector in mortgage origination, the government will need to provide support to housing finance, at least in the near-term.

Chairman Garrett, Ranking Member Waters, and other Members of the Subcommittee, I thank you for your time and attention and the opportunity to present in front of this subcommittee.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

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:**
Ajay Rajadhyaksha	Barclays Capital

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.

Please see attached.

7. Signature:

Please attach a copy of this form to your written testimony.

Ajay Rajadhyaksha "Truth in Testimony" Disclosure Form Attachment

Barclays Capital has acted in various underwriting capacities, including as lead manager, co-manager, structuring agent and bookrunner in connection with dispositions of residential mortgage-backed securities ("RMBS") and residential mortgage loans by the Federal Deposit Insurance Corporation ("FDIC") and National Credit Union Administration ("NCUA"). The issue balances of such transactions are reflected below.

2010
FDIC, $1.8 billion
FDIC, $653 million (residential mortgage loans)
FDIC, $160 million
FDIC, $136 million
NCUA, $3.8 billion
NCUA, $5.5 billion
NCUA, $3.5 billion

2011
FDIC, $368 million
NCUA, $1.5 billion
NCUA, $1.3 billion
NCUA, $1.1 billion
NCUA, $1.5 billion
NCUA, $1.2 billion
NCUA, $965 million
NCUA, $2.2 billion (includes non-RMBS assets)

In addition, Barclays Capital has been engaged as advisor by FDIC in connection with various asset dispositions. None of these multi-asset and multi-bank advisory engagements related specifically to RMBS, however, and are therefore excluded here."