Statement of Michael D. Berman, CMB

Chairman-Elect,
Mortgage Bankers Association

Before the

Committee on Financial Services

United States House of Representatives

Hearing on

"Housing Finance –
What Should the New System Be Able to Do?:
Part I – Government and Stakeholder Perspectives"

March 23, 2010

Chairman Frank, Ranking Member Bachus, thank you for inviting the Mortgage Bankers Association[1] to testify on the very important issue of the present and future status of the secondary mortgage market. My name is Michael D. Berman, CMB, and I am the Chairman-Elect of MBA. I have been in the real estate finance industry for over 25 years, and I am a founder and principle of CW Financial Services and the President and Chief Executive Officer of CWCapital. Headquartered in Needham, Massachusetts, CW is a national lender to the multifamily and commercial real estate industry, with over 340 employees in 13 offices throughout the United States. My responsibilities include overseeing the strategic planning and operations for all of the company's loan programs, including multifamily programs with Fannie Mae, Freddie Mac and the Federal Housing Administration (FHA). Also, CW has been active in the commercial mortgage-backed securities arena as an investor, lender, issuer of securities, servicer and special servicer for over 22 percent of all commercial mortgage-backed securities (CMBS) in the United States.

In the midst of the turmoil in the housing finance system, MBA advocated a three-step approach to government relief efforts. The key elements of this approach were a) stabilize the markets, b) assist homeowners facing difficulties with their mortgages, and c) prevent a recurrence of the problems that created the current crisis. Congress and the Administration have made great strides in all of these areas. Federal Reserve actions, the Troubled Asset Relief Program (TARP) program and federal support for Fannie Mae and Freddie Mac have brought a level of stability to a system that was in dire need of it. Programs like the Home Affordable Modification Program (HAMP), while unable to help all borrowers in all situations, have assisted many who otherwise would have had to surrender their homes. And regulatory reform and other legislation being discussed by this Committee and others can, if properly structured, provide key safeguards to reduce the chances that the country will face another credit crisis like that of the past two years.

As a result of these and other efforts, signs of recovery are appearing.

But the current dynamic in the secondary mortgage market is unsustainable. We cannot press reverse, and we cannot stay stagnant. Our only choice is to move

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

forward. Congressional action on the GSEs is needed to attract private capital back to the market and to re-establish a self-sustaining mortgage finance system. MBA has specific recommendations for a framework to ensure housing finance liquidity.

I have the privilege of chairing MBA's "Council on Ensuring Mortgage Liquidity." This 23-member council is made up of industry practitioners from the single-family, multifamily and commercial sides of the industry. It includes depository institutions, mortgage banking firms, mortgage insurers and others.

During a House Financial Services Subcommittee hearing, chaired by Congressman Paul Kanjorski last June, I testified that MBA had been considering various approaches to ensuring the long-term viability of the secondary mortgage market. Specifically, the Council on Ensuring Mortgage Liquidity had been evaluating what a functioning market should look like for the long-term.

At that hearing I spoke of the guiding principles the Council had developed to serve as a tool for evaluating proposals that may arise for restructuring the secondary market. Shortly after that hearing, MBA and the Council released a set of concrete recommendations for the future government role in the secondary mortgage market.

Before describing the specific recommendations, I will highlight some of their most important characteristics.

First, the recommendations are based on a key set of principles. MBA's Council on Ensuring Mortgage Liquidity has been examining these issues for more than a year and a half. The group took a deliberate approach to developing its recommendations, building from a set of key considerations to principles to the recommendations themselves. I believe the thoughtful approach is in evidence in the recommendations.

Second, the recommendations are grounded in pragmatism. They were developed by a council of industry practitioners who understand the capital markets and have perspective on what will and will not work. At this juncture, we cannot afford to pursue unworkable plans that do not take account of market realities.

Third, MBA's proposal is distinct in its focus on ensuring an efficient secondary mortgage market, its reliance on private capital and its insistence on multiple layers of protections for taxpayers. Keeping all three of these goals in mind is imperative.

MBA'S GUIDING PRINCIPLES

As I noted, before MBA developed its recommendations, it developed a set of principles by which a variety of proposals could be assessed. The full set of principles is attached to this testimony, but let me characterize a number of them in three general points.

First, secondary mortgage market transactions should be funded with private capital.

Second, in order to promote uninterrupted market liquidity for the core of the mortgage market, the government should provide an explicit credit guarantee on a class of mortgage-backed securities. This 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.

A key conclusion of this is that the government's guarantee should be at the security-level, not the enterprise-level. The existing system extended an implied federal backing to all the activities of Fannie Mae and Freddie Mac, including not only their mortgage guarantees, but also their portfolio investments, derivative counterparties and corporate bondholders. Some of those activities were clearly undercapitalized, underpriced and under-supervised. As you will hear, in our proposal the degree of federal backing would be greatly reduced, making explicit what is guaranteed and what is not, and establishing mechanisms to properly capitalize, price and supervise those activities.

MBA'S RECOMMENDED MODEL

Since I testified last June, the MBA and its Council have released a suggested framework for the government's involvement in the single-family and multifamily secondary mortgage markets. I will briefly describe some of the key elements in my testimony. I have attached the full recommendations for further reference. While clearly not the only potential framework for the future, the Council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market.

The centerpiece of MBA's recommendation for federal support for the secondary mortgage market is a new line of mortgage-backed securities. Each security would have two components: a) a security-level, federal government-guaranteed "wrap" (GG); which would in turn be backed by b) private, loan-level guarantees from privately owned, government-chartered and regulated mortgage credit-guarantor entities (MCGEs). The government guarantee would be conceptually similar to that provided by Ginnie Mae by guaranteeing timely interest and principal payments to bondholders and explicitly carrying the full faith and credit of the U.S. government. These guarantees would be supported by a federal insurance fund, capitalized by risk-based fees charged on the supported securities. This government wrap will help provide affordable financing rates, as could risk-based fees. In supporting their own loan-level guarantees, the MCGEs would rely on their own capital base as well as risk-retention from originators, issuers and other secondary market entities such as mortgage insurers. Investors in the guaranteed mortgage-backed securities would face no credit risk, but would take on the interest-rate risk from the underlying mortgages.

It is important to note that while the mortgage-backed securities in this model would be guaranteed by the government, the MCGEs as institutions would not. The corporate debt and equity issued by the MCGEs would be purely private. As with other firms, investors in MCGE equity and debt would accept the potential risk of failure and loss. For this reason, the MBA proposal recommends regulators charter enough MCGEs to establish a truly competitive secondary market, and to overcome issues associated with “too big to fail.”

MBA’s proposal combines an acknowledgement that only a government guarantee can attract the depth and breadth of capital necessary for sustainable market liquidity through all economic cycles, with a reliance on private capital, insistence on multiple layers of protections for taxpayers and a focus on ensuring a competitive, efficient secondary mortgage market.

IMPORTANCE OF THE TRANSITION

Another key feature of MBA’s position on the future of the GSEs is more operational than structural, but it is equally important. Any restructuring proposal must include consideration of, and measures to facilitate, the transition from the current to the future state. This is imperative because the market’s condition is still quite fragile and even the most carefully deliberated plan could destabilize the market further if implemented hastily.

MBA recognizes the need for GSE reform. Further, we recognize the need to keep the market functioning through any transition and to minimize the costs of the clean-up of the GSEs. We believe that there are measures that can be undertaken now to begin moving these companies in the right direction on a number of fronts. For example:

- During the boom, the GSEs, along with all other players in the industry, took on too much credit risk. As a result of the crisis, credit underwriting has become more conservative across the industry, including at the

GSEs. Regulators can look to these tighter standards to gain important lessons with regard to defining "core products" for the market going forward. Now is the time to focus the GSEs on a narrower range of mortgage products, fully documented loans, and underwritten using conservative ratios. This core of the market is what needs to be protected throughout the country at all times.

- Many of the GSEs' unnecessary risks stemmed from their portfolio holdings. As originally proposed by former Treasury Secretary Henry Paulson, and as recently reiterated by Federal Housing Finance Agency (FHFA) Director Edward DeMarco, it is important to affirm plans to wind down the GSEs' portfolios to a *de minimis* level. FHFA should direct that effort, being cognizant of market conditions, and the supporting role that the portfolios could play in the near term.

- Clearly defining the path to a new role for the GSEs will have several benefits. Most importantly, we recognize that the GSEs have built valuable infrastructures, relationships, and intellectual capital that the industry needs to retain. Ideally, we would envision the use of a good bank/bad bank strategy to retain the best people, processes, and infrastructure from the GSEs as we move to the new MCGE framework. Identifying and laying out a clear path forward will remove much of the current uncertainty, and ensure that the GSEs' structural, operational and human resources remain of service in some form for the present and the future. MBA is closely studying issues related to the transition, and I would welcome the opportunity to come back and brief you on our work.

OTHER HOUSING FINANCE SYSTEM COMPONENTS

Any model contemplating the roles currently played by Fannie Mae and Freddie Mac must also contemplate how those roles integrate with other public and private components of the housing finance system.

The MCGE framework is not intended to be the entire market. It is meant to focus on a narrowly defined set of core mortgage products that should be available in all market conditions.

Private investors, whether through whole loans, private label securitization, covered bonds or some other means, are vital to a robust, sustainable secondary market. The MBA proposal recognizes this and supports a re-emergence of the private model. It is anticipated the private market will expand and contract with investor risk appetites.

MBA's recommended framework also complements existing government funding channels that provide direct support for affordable housing finance, such as FHA, Ginnie Mae, the Veterans Administration (VA) and Rural Housing Service (RHS). Focusing government subsidies and other affordable housing programs through these channels minimizes market distortions and safety and soundness tensions that existed in the GSEs, while making government support more transparent, as befits such government expenditures. Additionally, as we note in our recommendations, the government guarantee entity could be an appropriate vehicle for an affordable housing fund.

OWNERSHIP OF THE GSEs' SUCCESSORS

In early discussions of the future of the GSEs, former Treasury Secretary Paulson, Federal Reserve Chairman Ben Bernanke and others laid out a spectrum of options for future models – ranging from a fully private mode, to a fully public model. It is important to note that these discussions focused less on what the successors to the GSEs should do, and more on how and by whom they should be owned.

MBA's deliberations focused on what they should do. As such, we have not delved deeply into the specific ownership structures. But in our discussions a few points became clear.

First, the fully private model would be unable to attract the depth and breadth of capital needed to fund the U.S. housing finance system through all market environments. At the end of the day, the U.S. government would still be expected to provide some level of backstop, for which it would have had no advance control, oversight or funding. We concluded this to be unacceptable.

Second, it will be important that any system utilize the private market, and its ability to assess, price and manage risk and efficiently operate within a known set of constraints. While we believe it is essential for a portion of the market to have a government guarantee to retain liquidity, it is also essential that private capital be at risk to ensure that lending is efficient, effective and responsive to market conditions. Additional concerns about capacity, funding, responsiveness and political distraction make it clear that a fully-government-based system would not be optimal.

Our conclusion is that any ownership system going forward must be able to attract private capital to serve as a buffer and reserve against losses. To do that, it must provide a competitive return on equity and debt capital. It must also ensure that those private investors shoulder the vast majority of risks.

CONCLUSION

I appreciate the opportunity to testify today and to present MBA's perspective. MBA's Council on Ensuring Mortgage Liquidity has been studying the issues before this Committee for the past year and a half, but most of the members of the Council and the MBA have been working on them for our entire careers. Our deliberations on these topics continue. As we work on the economics of the business model for the MCGEs and the GG insurance fund, as well as a transition roadmap. I would welcome the opportunity to update you on our work.

In closing, I want to thank the Committee for holding this hearing. The topics before you are sometimes contentious, often complex, and always important. As the Committee continues its work, I would ask that you emphasize three more important concepts. First, recognize the importance of fixing the system. Second, emphasize getting it right. And last, minimize disruptions during the transition.

Thank you.

MBA's RECOMMENDATIONS FOR THE FUTURE GOVERNMENT ROLE

IN THE CORE SECONDARY MORTGAGE MARKET

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INTRODUCTION

Since the creation of Fannie Mae in the 1930s, the federal government has played a key role in providing stability to the secondary mortgage market. The current housing crisis has tested the government's role and led to calls for a fundamental rethinking of how the government plays its part.

To provide information and insights to this rethinking, in October, 2008 the Mortgage Bankers Association (MBA) established the Council on Ensuring Mortgage Liquidity. The Council's mission has been to look beyond the current crisis, to what a functioning secondary mortgage market should like for the long term.

On November 19, 2008, the Council hosted a summit on the future of the secondary mortgage market and the GSEs that brought together leading thinkers from industry, academia and regulators to discuss what fundamental elements would be required for a functioning secondary market. The discussion led to the Council-issued report *Key Considerations for the Future of the Secondary Mortgage Market and the Government Sponsored Enterprises (GSEs),* which was released in January, 2009.

The Council's second task was to develop a set of guiding principles embodying the key considerations mentioned in the primer. The report *Principles for Ensuring Mortgage Liquidity* was released by the Council on March 19, 2009. The principles serve as a tool for evaluating proposals that arise for restructuring the secondary market.

As the policy spotlight has turned to the futures of Fannie Mae and Freddie Mac, the Council has taken on the questions of what an appropriate future government role in the core secondary mortgage market might look like. After thoughtful discussions and deliberations, we now present the Council's *Recommendations for the Future Government Role in the Core Secondary Mortgage Market.*

This report presents the Council's suggested framework for government involvement in the single-family and multifamily secondary mortgage markets, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac. While clearly not the only potential framework for the future, the Council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market. The proposed framework carefully balances the government's ability to ensure liquidity with the need to protect taxpayers from credit and interest rate risks associated with mortgage finance. This and the other Council reports can be found at: www.mortgagebankers.org/CEML.

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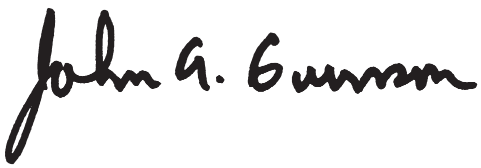
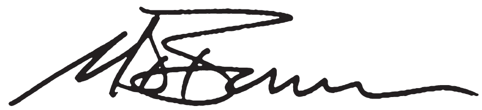
In the coming months, MBA and the Council will continue to study the critical issues related to the future of the secondary mortgage market, and will continue to provide information and insights to regulators, legislators and others involved in the policymaking process. We want to thank the members of the Council for their valuable service, and for helping define a workable model for the future government role in the secondary mortgage market.



John Courson
President and Chief Executive Officer
Mortgage Bankers Association



Michael Berman, CMB
President and Chief Executive Officer, CWCapital
Vice Chairman, Mortgage Bankers Association
Chair, Council on Ensuring Mortgage Liquidity

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COUNCIL ON ENSURING MORTGAGE LIQUIDITY MEMBERS

Council Chairman

Michael D. Berman, CMB
President and Chief Executive Officer
CWCapital

Vice Chairman
Mortgage Bankers Association

Council Members

Richard A. Aneshansel
Executive Vice President and Chief Financial Officer, Finance
U.S. Bank Home Mortgage

Jon K. Baymiller
Executive Vice President
AmTrust Bank

Phillip W. Bracken
Executive Vice President
Wells Fargo Home Mortgage

Garry Cipponeri
Senior Vice President
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Executive Vice President
BB&T

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Senior Managing Director
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Government Lending Executive
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Vice Chairman
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John B. Johnson, CMB
President and Chief Executive Officer
MortgageAmerica Inc.

Richard D. Jones, Esq.
Partner
Dechert LLP

David H. Katkov
President and Chief Operating Officer
PMI Mortgage Insurance Co.

Rodrigo Lopez, CMB
President and Chief Executive Officer
AmeriSphere Multifamily Finance, L.L.C

Regina M. Lowrie, CMB
President and Chief Executive Officer
Vision Mortgage Capital, LLC

Peter F. Makowiecki
President and Chief Executive Officer
MetLife Home Loans

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1. OVERVIEW

The importance of housing in the economic and social fabric of the United States warrants a federal government role in promoting liquidity and stability in the market for mortgage debt. The size and scope of the U.S. housing market mean that, except in times of extreme duress, the federal government's role should be to promote liquidity for investor purchases of mortgage-backed securities, not to attempt to provide the capital for or absorb the risks itself.[1]

As a necessary component of this provision of liquidity and stability, a security-level credit guarantee backstop will be needed for the core mortgage market,[2] which should rely on security-level risk-based premiums paid into a federal insurance fund and loan-level guarantees provided by a small number of privately-owned, government-chartered and regulated mortgage credit-guarantor entities (MCGE). The government backstop should be explicit and should be focused on the credit risk and market liquidity of mortgage-related products, not any interest rate risk. The loan-level MCGE guarantee should be such that it absorbs all mortgage-related credit losses and that the federal insurance fund is called upon only in situations of extreme distress.

The centerpiece of federal support for the secondary mortgage market should be a new line of mortgage-backed securities. Each security would have two components: a) a security-level, federal government-guaranteed "wrap" (GG) like that on a GNMA security; which would in turn be backed by b) private, loan-level guarantees from privately owned, government-chartered and regulated mortgage credit-guarantor entities (MCGEs). The GG would be conceptually similar to the Ginnie Mae model and would guarantee timely interest and principal payments to bondholders, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. The MCGEs would in turn rely on their own capital base as well as risk-retention from originators, issuers and other secondary market entities such as mortgage insurers. Through these programs, the credit risk of the underlying mortgages would be removed from the securities issued, while the interest rate risk would remain with the security investor.

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2. MORTGAGE CREDIT-GUARANTOR ENTITIES (MCGE)

The MCGEs should be privately owned, mono-line institutions focused solely on the mortgage credit guarantee and securitization business. This business encompasses both single-family and multifamily residential mortgages. The loan-level MCGE guarantee would be backed by private capital held by the MCGEs which would be overseen by a strong regulator. The MCGEs would be required to manage their credit risk by using risk-based pricing, originator retention of risk (such as reps and warrants backed by sufficient capital to support them), private mortgage insurance (PMI) and risk transfer mechanisms including other risk-sharing arrangements, to ensure that there is a strong capital buffer before the GG and insurance fund would come into play. Loans would not be included in a GG security unless they were guaranteed by a MCGE.

In most cases the MCGEs would own the loans underlying the GG securities they issue, and in the event of foreclosure could own the real estate collateral.

The MCGEs would have standard corporate powers to raise debt and equity. Other than access to the related GG security they could issue, none of the corporate debt or equity the MCGEs issue would be guaranteed, either explicitly or implicitly, by the federal government. The corporate capital levels of the MCGEs must be actuarially sound and the entities should report regularly to the satisfaction of the GG, Treasury and the MCGEs' regulator.

The number of MCGEs should be based on the goals of a) competition, b) strong and effective regulatory oversight, c) efficiency and scale, d) standardization, e) security volume and liquidity, f) ensuring no one MCGE becomes "too big to fail" and g) the transition from the current government sponsored entity (GSE) framework. Initially, the number of MCGEs should be either two or three. The regulator would have the ability to increase that number over time, through the granting of charters, as the market develops. The ownership of at least one of the MCGEs could be in a co-op form with mortgage lenders as shareholders. The governance structure of the MCGEs should adequately represent both the multifamily and single-family mortgage markets.

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Allowable Mortgage Products of the MCGEs

The federally related securitization guarantee should support only "core" mortgage products with well-understood, well-documented risk characteristics. The federally related securitization guarantee should generally support: a) "conventional" single-family mortgage products traditionally supported by the GSEs, including those currently eligible for TBA funding; and b) multifamily mortgage products that fit the GSEs' published underwriting guidelines, including affordable multifamily rental housing mortgage products. If CRA-related loans are included in the definition of core products, the MCGEs and GG should provide a transparent and liquid market into which lenders can deliver them on a pricing and risk-adjusted basis.

In defining the products covered by the new guarantees, industry participants, the MCGEs, the GG and federal regulators should carefully review current product definitions and classifications to ensure maximum market transparency, efficiency and liquidity. New products would be proposed by the MCGEs, recommended by the GG and would require approval from the regulator. Thus new product development would be measured, prudently regulated and conservatively responsive to market demands.

Portfolio Authority

The key mission of the MCGEs should be to guarantee and securitize mortgages through the program described. The MCGEs should therefore hold only a *de minimus* portfolio of mortgage assets.[3] The portfolios' purposes would be to support securitization by allowing the MCGEs to a) aggregate allowable mortgages for securitization, b) manage loss mitigation through foreclosure, modifications and other activities, c) incubate mortgages that may need seasoning prior to securitization, d) develop new mortgage products through a strictly limited level of research and development prior to the development of a full-fledged securitization market and e) fund highly structured multifamily mortgages that are not conducive to securitization.

Regulator

The MCGEs' regulator should be strong, empowered and adequately funded through the GG insurance premiums.[4] The regulation regime contemplated would be similar to that of a public utility, with the MCGEs earning a conservative return on equity. The regulator should have the power to adequately oversee the MCGEs, specifically with regard to products, pricing and capital adequacy.

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3. FEDERAL GOVERNMENT GUARANTEED "WRAP" (GG) SECURITIES

GG securities would carry a guarantee of timely interest and principal payment, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. Ginnie Mae could potentially take on the responsibilities of the GG.

The GG would be responsible for standardization of mortgage products, indentures and mortgage documentation for the core mortgage market. Minimum regulated fees would be established for ongoing servicing, surveillance and reporting. This would ensure standardization and liquidity throughout the core market. Each MCGE would individually issue GG securities under this standardized regime. These new GG securities could also be issued by private institutions approved by the MCGEs. These securities would also carry the GG security-level guarantee backed by the MCGE loan-level guarantee; accordingly, the MCGEs will have approved and insured the underlying collateral.

The GG is not intended to support the entire mortgage market, but rather only those products needed to keep the secondary market for core mortgage products liquid and functioning through all environments. There would continue to be key roles for FHA, VA, RHS and Ginnie Mae as well as for the fully private market, particularly as such roles evolve in support of public or social housing policy goals and objectives. FHA, VA, RHS and Ginnie Mae would continue to play critical roles in providing government credit support for affordable housing, while the fully private market would provide finance vehicles for mortgages that fall outside of core product profiles. Mortgages made outside of a federally guaranteed framework would rely entirely on private capital and management of risks, in as much as such mortgages may exhibit risk characteristics that would not be well documented or well understood (and therefore would not be allowable products eligible for inclusion in GG securities).

The mission of any federally related mortgage securitization and guarantee program should be explicitly limited to ensuring liquidity in the core mortgage market through the issuance and guarantee of mortgage-backed securities.[5] This important mission should not be distorted by additional public or social housing policy goals. To the degree additional objectives are desired, they should be pursued through FHA, VA, RHS, Ginnie Mae and direct federal tax and spending programs, which should be adequately funded and supported to meet these important objectives. The self-supporting GG federal insurance fund, which is likely to run surpluses in all but the most extreme circumstances, could be a potential source of funds for Congress when considering affordable housing expenditures.

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While the full faith and credit of the U.S. government should mean there will not be a need for a liquidity backstop, in times of extreme market distress, liquidity could be provided to the GG securities market through Treasury and/or Federal Reserve purchases of GG mortgage securities.[6] As a result, there would not be a need for the MCGEs portfolios to be sized and structured to take on the role of "liquidity providers of last resort."

4. TRANSITION

The infrastructure of the existing GSEs should be used as a foundation for new MCGEs, with the technology, human capital, standard documents and existing relationships that the GSEs have developed available to one or more MCGEs. Every effort should be made to transfer existing origination, servicing and other industry relationships from the GSEs to the new MCGEs so as not to strand originators and servicers with ties to the existing GSEs. Historical performance data and other information should be made available to originators, the MCGEs, regulators, rating agencies, investors and providers of credit support to enhance the efficiency of the market.

Decisions regarding the futures of the GSEs should be made expeditiously so as to reduce continued losses of talent at Fannie Mae and Freddie Mac. This will be important both to maintain the ongoing management of the GSEs' existing books of business as well as to fully leverage their infrastructures for use by the new MCGEs.

In order to facilitate a more rapid transition, to maximize the usefulness of the existing infrastructure of the GSEs and to allow the federal government to continue to use that infrastructure to address the current housing market challenges, a good bank/bad bank resolution of the GSEs, their assets and liabilities should be considered.

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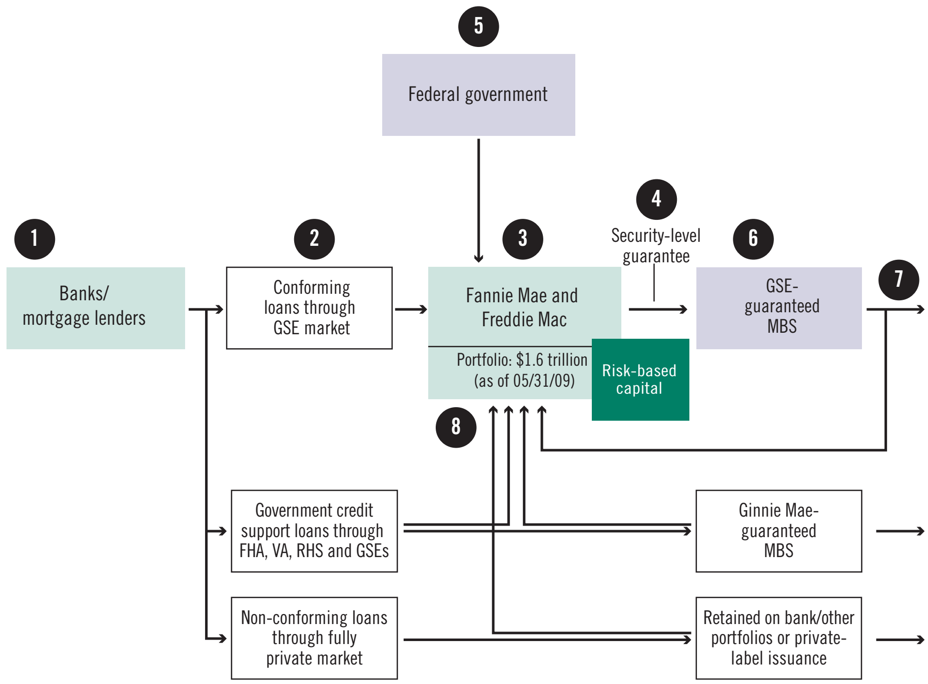
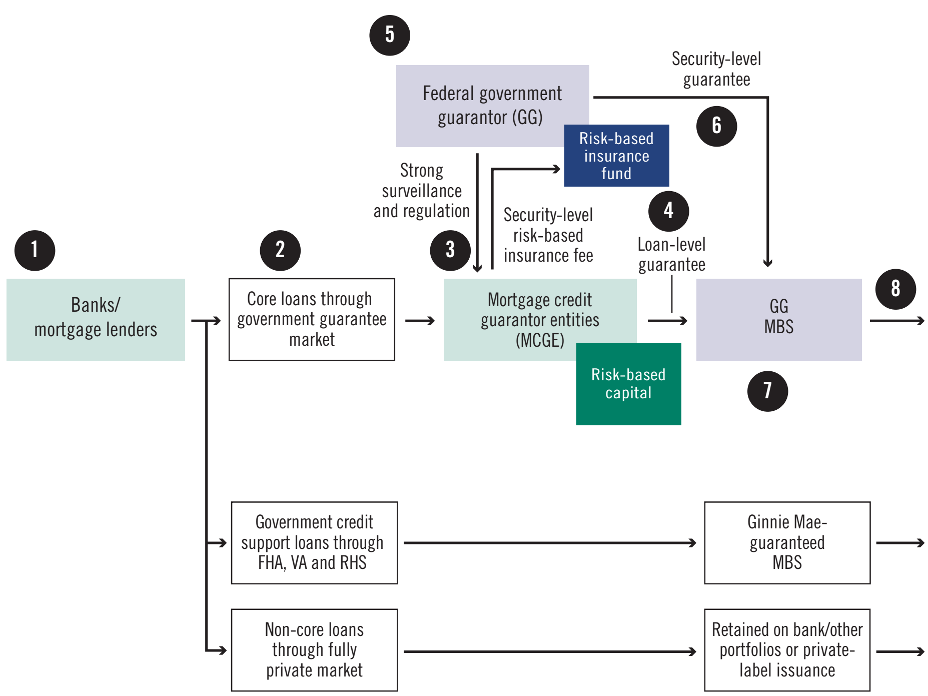
HIGH-LEVEL VIEW
CURRENT STATE: FANNIE MAE, FREDDIE MAC AND THE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are sold to Fannie Mae or Freddie Mac (FM).
3. FM prices and holds capital for the credit risk of the loans. FM either holds the loan in portfolio or includes it in MBS.
4. FM guarantees timely payment of principal and interest on MBS.
5. Federal agency provides oversight and regulation.
6. FM or mortgage lender issues FM-guaranteed security to the market.
7. Based on special status of the GSEs, security trades at a premium to other MBS.
8. FM may also purchase their own or other GSE-issued, Ginnie Mae or private label MBS as well as non-conventional government credit support loans to hold in portfolio, taking both the credit and interest rate risks.

HIGH-LEVEL VIEW
TARGET STATE: POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN THE CORE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are submitted to MCGE for credit underwriting and pooling.
3. MCGE prices and holds capital for the credit risk of the loans.
4. MCGE guarantees timely payment of principal and interest of the loans.
5. Federal agencies provide oversight, regulation and security-level guarantee in exchange for risk-based fee.
6. GG guarantees timely payment of principal and interest of the security.
7. MCGE or mortgage lender issues GG security to the market.
8. Based on the GG guarantee, security trades in equivalence to full faith and credit of the U.S. government; security buyer takes all the interest rate risk.

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NOTES

1. The Mortgage Bankers Association's Council on Ensuring Mortgage Liquidity. *Principles for Ensuring Mortgage Liquidity*. March 2009. "1.a. Except for times of extreme market stress, and except for the availability of a credit guarantee program as described in section 7 below, secondary market transactions should be funded by investors seeking market returns and who take on the credit, interest rate and / or other associated market risks for market-derived yields."

2. Ibid. "7. There is a role for a government credit-guarantee program to help attract investment to the residential secondary mortgage market."

3. Ibid. "7.c. Any government sponsored entity or program should preclude the creation of a GSE-like investment portfolio assembled for the purpose of arbitrage profits. A GSE or GSE-like entity may require a portfolio to support its securitization activities (i.e. aggregation, incubation, innovation), to accommodate limited amounts for highly structured products not conducive to securitization and /or to maintain an infrastructure for serving as a liquidity backstop for the market."

4. Ibid. "5.c. The regulator of any government sponsored / owned entity and other secondary mortgage market regulators should be strong, empowered and adequately funded."

5. Ibid. "8.a. The government should balance and coordinate any pursuit of social policy goals through the secondary mortgage market operations of government sponsored / owned entities with their implications for safety and soundness, the efficient operation of the secondary mortgage market and their consistency with primary mortgage market and / or other requirements. Such policy goals should be limited to residential housing in a way that does not contain market distortions."

6. Ibid. "10.a. In times of extreme market stress, the government should provide a mechanism to step into the secondary mortgage market as a liquidity provider of last resort by providing a liquidity backstop." MBA is currently developing a working brief discussing the merits of this approach.

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1331 L Street, NW
Washington, DC 20005
www.mortgagebankers.org