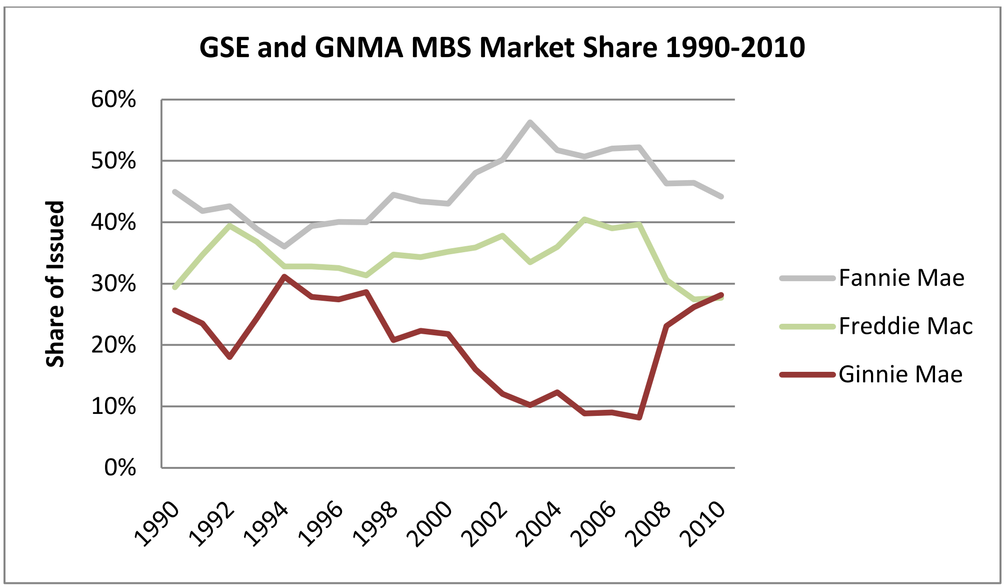
SIFMA Comments on "FHA-Rural Regulatory Improvement Act of 2011"

May 24, 2011

The Securities and Financial Markets Association (SIFMA) agrees with the general principles of this legislation. It is important to review the government's current role in the housing market and to clarify its role for the long term. It is clear that the government's involvement in the housing market should be reduced and efforts should be made to encourage private sector investment in non-agency securitization. SIFMA agrees that appropriate funding of the Federal Housing Administration (FHA) insurance fund is critical to ensure the protection of taxpayers, and to ensure that FHA lending guidelines promote sustainable, responsible lending practices.

FHA and Ginnie Mae (GNMA) have grown to be key components of the US financial system. GNMA's market share of mortgage-backed securities issued has grown from below 10% to over 30% and is the second largest component of the Mortgage-Backed Securities (MBS) market behind Fannie Mae.[1] Below is a chart that demonstrates these historical trends.



According to the Department of Housing and Urban Development (HUD), in 2010 FHA loans provided funding for 20.1% of all home purchases, and importantly, 31.02% of new home purchases.[2] The Government-sponsored enterprises (GSEs) have significantly tightened underwriting and credit standards. Below are some statistics from 2010 that demonstrates that GSEs are servicing high credit borrowers.

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[1] http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-Agency-MBS-Issuance-SIFMA.xls
[2] http://www.hud.gov/offices/hsg/comp/rpts/fhamktsh/fhamkt0110.pdf

2010	Fannie Mae[3]	Freddie Mac[4]
Wgt. Avg. Original LTV Ratio	68%	67%
Loans with LTV >90%	6.8%	3%
Wgt. Avg. FICO	762	758

Given the lack of private market funding for lower-down payment products, and the significant increase in credit underwriting standards for GSE products, FHA and GNMA currently provide an essential avenue to credit for home purchasers, especially first time home buyers, who do not have 20% or 30% of their home's value in cash as a down payment. FHA and GNMA also provide an avenue for borrowers with credit scores that do not reach the levels of "average" GSE loans (which are currently quite high). FHA's data points to 68% and 60% of borrowers in 2010 FY and 2009 FY, respectively, with loan-to-value (LTVs) exceeding 95%.[5] The FHA has also recently increased certain premiums, and most lenders tend to "overlay" their own standards on top of FHA's minimum criteria (such as the 580 minimum credit score guideline).

In order to reduce the role of FHA, the discussion draft would increase the down payment requirement for FHA loans to 5%, and would also prohibit the financing of closing costs. The prohibition on financing of closing costs effectively increases the amount of money a consumer must bring to the closing table. There are a number of other ways to reduce FHA/GNMA's currently outsized role in mortgage lending. The first would be the use of insurance fees and the other would be the use of credit underwriting criteria. Both should be considered viable options.

SIFMA believes it is important to note that reforms to the U.S. mortgage finance system should be done on a holistic basis. SIFMA does not believe that the system can be changed in a piece-meal fashion, because all of the various components of the mortgage finance system are interconnected – from the mortgage lender to the capital markets that provide the funding for the loans. For example, the proposed credit risk retention rules are out for comment and have not been finalized. The types of loans that will be classified as qualified financial mortgages (QRM) rules will significantly impact the availability of credit and directly impact FHA lending. In addition, the types of mortgages which will be classified as qualified mortgages (QM) is also not completed. The QRM and QM criteria need to be finalized in a coordinated fashion. Only after these rules are set will private markets be able to determine long-term business models and have some real "skin in the game."

The resolution of the GSEs, and whether or not there will be a similar role for government insurance of a broader class of MBS, is uncertain. This too will significantly impact the provision of credit to mortgage borrowers and the lending activities of large and small banks. Currently, private securitization markets remain dormant. We note that the few transactions that have been issued in the last two years have funded extremely high quality, jumbo loans. It is likely to take some time for this prime jumbo market to recover, and even longer for a market that provides a meaningful alternative for FHA/GNMA.

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[3] http://www.fanniemae.com/ir/pdf/sec/2011/q1credit_summary.pdf
[4] http://www.freddiemac.com/investors/pdffiles/investor-presentation.pdf
[5] http://portal.hud.gov/huddoc/DOC_16569.pdf, page 50

This is why whatever reform that takes place provides for sufficient time for the markets to fill in the holes.

We also note the current condition of housing markets. Given the role of FHA in home purchases and especially first-time home purchases, raising the down payment requirement on FHA loans will cause some would-be home purchases to be unable to obtain credit. This would tend to depress home purchase activity further in the near term. It is unclear to SIFMA whether or not a significant increase in credit performance of FHA loans would be engendered by raising the down payment requirement from 3.5 to 5%, and forbidding the financing of closing costs. We have not had time to do in-depth analysis of this proposal.

Therefore, we believe that any changes must be carefully considered, in terms of their costs and benefits, and their overall impact on housing markets. We look forward to providing additional comments on this proposal after our in-depth analysis has been completed.