

**Comments on the Federal Housing Finance Agency’s Plan for
“Building a New Infrastructure for the Secondary Mortgage Market”**

*Prepared by the Mortgage Finance Working Group
Sponsored by the Center for American Progress*

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Mr. Edward DeMarco
Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street, SW
Washington, D.C. 20024

RE: Securitization Platform White Paper

Dear Mr. DeMarco:

Thank you for the opportunity to comment on the Federal Housing Finance Agency’s plan to build a single securitization platform for Fannie Mae and Freddie Mac that could also be accessible to private securitizers.

This comment is submitted by the Center for American Progress and its Mortgage Finance Working Group—a group of housing finance experts, affordable housing advocates, and leading academics who have been meeting since 2008 to better understand the causes of the mortgage crisis—and joined by the Consumer Federation of America, the National Council of La Raza, and the National Housing Conference.

In January 2011, the Mortgage Finance Working Group released its proposal for reform of the secondary mortgage market entitled, “A Responsible Market for Housing Finance.”¹ Our plan builds off five guiding principles for any effort to responsibly wind down Fannie Mae and Freddie Mac and bring private capital back to the mortgage market:

- **Liquidity.** Provide participants in the capital markets with the confidence to deliver a reliable supply of capital to ensure access to mortgage credit, every day and in every community, through large and small lenders alike.
- **Stability.** Rein in excessive risk taking and promote reasonable products backed by sufficient capital to protect our economy from destructive boom-bust cycles, such as the one we are now struggling to overcome.
- **Transparency and standardization.** Require underwriting, documentation, and analytical standards that are clear and consistent across the board so consumers, investors, and regulators can accurately assess and price risk, and regulators can hold institutions accountable for maintaining an appropriate level of capital.
- **Affordability and access.** Ensure access to reasonably priced financing for both homeownership and rental housing.

- **Consumer protection.** Ensure that the system supports the long-term best interest of all borrowers and consumers and protects against predatory practices.

We believe that the proposed securitization platform could serve as a critical piece of infrastructure for achieving our goals for mortgage market reform. The platform can potentially help private capital return to the market by lowering barriers to entry. Harmonized contracts and clear disclosure and servicing requirements will help standardize products, protect consumers, and bring greater transparency to the secondary mortgage market.

In addition, if designed carefully to preserve the “To Be Announced” market, the platform can help bring liquidity, stability, and transparency to the market and ensure that all borrowers have access to safe and sustainable mortgage products. We believe the TBA market is an important component of any future system of mortgage finance because it supports a highly liquid and transparently priced mortgage finance market, lowers mortgage rates, and enables consumers to get “rate locks” when shopping for a mortgage.

With those goals in mind, we respectfully submit the following broad recommendations:

- Maintain the securitization platform as a government utility (not a privately-owned asset) with strong oversight from FHFA in coordination with other federal agencies.
- Require that all mortgage-backed securities offered in the public securities market be issued through the securitization platform.
- Charge users two fees: one to cover administrative costs and another to fund programs that expand market access.
- Adopt strong, loan-level disclosure requirements for the mortgage-backed securities market.
- Ensure that the new infrastructure can facilitate advanced loan monitoring and loss mitigation activities.

Below we lay out each recommendation in more detail and then answer specific questions posed by FHFA in the white paper.

Recommendations

1. *Maintain the securitization platform as a government utility (not a privately-owned asset) with strong oversight from FHFA in coordination with other federal agencies.*

FHFA appears to be agnostic about who controls the securitization platform in the long term, stating that it could “possibly [be] offered to the market as a form of utility.” We strongly recommend that the platform be maintained as a government utility. In our view, this would facilitate active and responsible management by an impartial and empowered intermediary to avoid conflicts of interest and ensure that all rules are being followed.

The recent crisis demonstrated that private financial institutions are poorly suited to regulate themselves in the mortgage-backed securities market. The private-label securities market encouraged imprudent and even fraudulent underwriting in the primary market, provided investors with inadequate or misleading disclosures, engaged in inadequate data collection and

reporting, and produced pooling and servicing agreements that were opaque, inconsistent, and failed to provide adequate instruction to servicers. As FHFA has noted in the past, it was the poor performance of those private-label securities – not those issued by Fannie Mae and Freddie Mac – that caused the crisis.²

In our view, FHFA has the infrastructure and expertise to provide oversight to the utility for Fannie Mae and Freddie Mac, and it is possible that with more resources and authority, it could potentially play a similar role with respect to private issuers depending on how the system evolves. However, congressional action would likely be required to grant FHFA regulatory authority over market participants beyond the Enterprises.

In addition to overseeing the bond issuance, bond administration, data validation, and disclosure processes, FHFA should also have some control over how the mortgages are pooled. Without some authority over pooling, it will be difficult to maintain liquidity in the market even if certain practices are standardized. Large, uniform pools that are issued on a regular basis promote liquidity and lower mortgage rates. Private actors often prefer illiquid markets. In addition, small lenders will need a method for selling mortgages into a liquid market in order to remain competitive. The platform will need to facilitate this aggregation across small lenders and this will necessitate some control over pooling.

2. Require that all mortgage-backed securities offered in the public securities market be issued through the securitization platform.

To the extent possible, we recommend that all mortgage-backed securities offered in the public securities market be issued through the government-run platform, regardless of the issuer. Issuing all securities through the platform would promote an efficient, stable, and liquid mortgage market and would prevent the development of a “shadow banking” system that could circumvent the standards set for the platform.

A single platform would also help level the playing field among large and small issuers of private MBS, promoting responsible competition. Access to the capital markets through MBS executions for lenders of all types and sizes – including community banks, credit unions, and community development financial institutions – is critical to fostering competition in the originations market and sharing cost efficiencies across the market. A single securitization platform should be designed to foster, rather than restrict, competition and access.

At the very least, FHFA must work closely with the SEC, FFIEC, CFPB, and other relevant agencies to ensure that the rules governing the new securitization platform align with the rules for the broader asset-backed securities and primary mortgage markets.

3. Charge users two separate fees: one to cover administrative costs and another to fund programs that expand market access.

The proposed securitization platform has the potential to be a very valuable asset. When fully operational, the platform could bring significant savings to future MBS issuers, guarantors, and

investors by offering uniform contracts, reliable bond administration, advanced data management, and responsible monitoring.

The federal government must be adequately compensated for these services. Clearly, all participants should have to pay a fee—which could be charged either one time at securitization, or as a strip paid over the life of the bond—to cover administrative and other costs associated with creating and maintaining the platform, ensuring that the platform is self-sustaining and does not depend on congressional appropriations.

We also believe that broad access to affordable and sustainable mortgage credit must be a primary goal of any reform effort. The natural tendency of originators, guarantors and issuers is to serve borrowers with the highest volume and the lowest administrative costs. As a result, certain groups of creditworthy borrowers and certain types of profitable housing have not been well served by the system of the past, often due to misperceptions of risk, smaller deal sizes, or higher origination costs.

In the Mortgage Finance Working Group’s plan for market reform, we propose the creation of a Market Access Fund to help test new products and promote access to mortgage finance for traditionally underserved populations. The proposed platform could capitalize this fund through an assessment on all MBS issuances with a separate, small strip on all mortgages bundled through the platform. We estimate that a 10-basis-point “access premium” strip on bond assets would eventually generate \$4 billion for every \$1 trillion of securities issued through the platform, assuming a 4-year average life of MBS and a 5-year phase in of the program.³

4. Adopt strong loan-level disclosure requirements for the mortgage-backed securities market.

During the housing bubble, regulators and investors were often kept in the dark about the risks in private-label MBS due to flawed and often fraudulent data. In the future market, more granular and reliable information on product pricing and loan-level risk will force all market participants to do their business in the light of day, while helping FHFA and other regulators mitigate fraud and abuse.

We commend FHFA for proposing more robust security- and loan-level disclosures as part of the securitization platform, and we urge loan-level disclosures whenever feasible. In a perfect world, this loan-level information would be delivered to all users at the time of issuance, although we know that is not always practical. Furthermore, if FHFA controls the pooling, as discussed above, the agency can help ensure that securities have similar prepayment characteristics, which would ameliorate concerns that more detailed disclosures could harm the TBA market.

We recommend that all essential loan-level disclosures be available to the first-loss entity at the time of delivery of the security (or as soon as practically possible), including information on loan amount and terms, house value and location, borrower debt and income, and credit scores. Other investors, researchers, and regulators should receive more detailed loan-level disclosures, including loan performance data, during regular performance reporting on the security, as laid out in the FHFA white paper.

We also recommend that information on borrower race, gender, nationality, and geography be collected by the utility and that regular reports eventually be made available at no cost to the public in an analyzable format (at least to researchers upon request). This will help regulators, researchers, and concerned citizens track whether market participants are creaming, discriminating, or otherwise denying certain creditworthy borrowers from mortgage credit. As mentioned above, such openness and transparency is critical to a well-functioning and equitable mortgage market.

In the past Fannie Mae has had some having trouble accurately matching first and second liens on its loans, mostly due to incomplete data and system limitations, according to a report last year from the Government Accountability Office.⁴ To the extent possible, we urge FHFA to focus on solving this problem by requiring that disclosures include information on second liens, both “piggy-back” loans taken out at the time of origination of the primary mortgage and any subsequent liens taken out after origination.

In addition, to the extent possible or necessary, FHFA should require that data collection by the utility coordinate with other efforts underway, including Reg AB, Reg AB II, and the joint FHFA/CFPB National Mortgage Database. Ideally, the platform could serve as the basis for regulatory reporting, thereby reducing the cost of reporting and promoting consistency and ease of aggregation. For example, any information collected as part of the platform could become part of National Mortgage Database.

It will be critical for FHFA and the other federal agencies responsible for the collection and disclosure of such extensive datasets to carefully assess the risks to borrower privacy posed by such granular data, especially when combined with other commercial databases. FHFA should be cautious in assessing the potential abuses that such detailed disclosures could make possible, such as targeted solicitations for refinances or second loans, or other misuse of highly sensitive financial information to which the consumer has not authorized access.

5. The new infrastructure should be sophisticated enough to facilitate advanced loan monitoring and loss mitigation activities.

When FHFA rejected the Treasury Department’s offer to help pay for principal reductions on Fannie- and Freddie-backed loans, the agency cited system limitations as a key factor.⁵ According to FHFA’s principal reduction white paper released in July:

“Related new operational controls, validation processes, investor reporting, and exception tracking would be required. In addition to making these changes to support [the Home Affordable Modification’s Principal Reduction Alternative], the Enterprises would have to develop and publish new servicer guidance, train servicers on the new guidance, and establish new monitoring protocols to ensure compliance with program requirements and combat fraud.

These operational complexities and their associated costs are not trivial. The Enterprises report that HAMP PRA implementation would affect multiple systems in their

technology infrastructure, including major applications, supporting models, databases and servicer interfaces. The master servicing, finance, accounting, credit loss management and data warehouse functions would also be affected, and extensive internal and servicer integration testing would be required.”⁶

Many of the systems related to these operational complexities, including servicing standards, technology infrastructure, data management, and monitoring protocols, will be revamped as part of the proposed securitization platform. Since FHFA is already planning to make these investments, the agency should devote any additional resources necessary to address the aforementioned system and operational limitations, with a particular focus on loss mitigation.

This need extends beyond HAMP or the proprietary modifications currently in place at Fannie Mae and Freddie Mac. As a general rule, any new infrastructure must be flexible and sophisticated enough to adapt to creative new approaches to loss mitigation, such as deed-for-lease agreements, “earned” principal reductions, and shared appreciation modifications.⁷

Administrative burden should no longer be able to serve as an excuse for neglecting critical foreclosure prevention activities. The proposed platform is a promising opportunity for FHFA to take steps to meet its stated conservatorship goal to “maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.”⁸

Answers to Specific Questions

Question 2: The platform should independently verify that underwriting, loan eligibility, and pooling rules were followed, but should not set those rules for the entire market.

Sound underwriting in the primary mortgage market is essential to a well-functioning secondary market. The Dodd-Frank financial regulation law wisely required that mortgage originators offer credit based on a reasonable belief in the consumer’s ability to repay it on the terms offered, and the Consumer Financial Protection Bureau is currently finalizing rules related to that requirement. Meanwhile, other financial regulators are working on rules implementing Dodd-Frank’s risk retention requirements for mortgage securitization, which will likely define what types of mortgages will be packaged into private-label MBS in the future.

Assuming that these two rules are finalized and enacted, we do not see a need to add new underwriting and loan eligibility standards through the proposed securitization platform at this time. However, the platform should be robust and flexible enough to accommodate the changes in the mortgage finance system likely to occur in the near future. To the extent that the Enterprises’ Automated Underwriting Systems interface with the platform, there may be some blurring of these lines.

Moreover, as part of its oversight of the securitization platform, FHFA should coordinate with supervision and enforcement activities related to underwriting and loan eligibility requirements. The agency should do this in close cooperation with CFPB, SEC, HUD, and other regulators in charge of enforcing ability-to-repay, risk retention, and fair lending laws.

Questions 3 and 4: The framework for a PSA is a sound one, but core components of a standardized PSA should be required rather than just suggested.

The most effective way to improve servicing is to make the process as similar as possible across all securities. Standardization helps servicers train their staffs and provides both investors and homeowners with clear rules. For this reason, while some tailoring of PSAs may be necessary, we recommend that certain core components of the PSA be standardized, particularly as relates to loss mitigation.

We commend FHFA, Fannie, and Freddie for strengthening and aligning their servicing standards in recent years, and we would hope that the uniform pooling and servicing agreement for the securitization would include all the components of the Servicing Alignment Initiative as well as the Contract Harmonization initiative. Such an undertaking should be done in close cooperation from CFPB, which is currently working on its own set of servicing standards for the entire mortgage market.⁹

Standards should include defining when a non-performing loan is required to be or can be purchased out of the trust and when it is required to be or can be transferred to a specialty servicer. Specifically, the PSA should provide clear guidelines for when and how current loans at imminent risk of default can be pulled out of the pool. In addition, rules for transferring servicing should be as clear as possible, especially with respect to transfers being initiated due to inadequate servicer performance.

Next steps

We believe that FHFA is on the right path with its plan to establish a single securitization platform and appreciate FHFA's stated goal to design a platform that is "consistent with multiple states of housing finance reform" and "capable of working well with or without various degrees of government involvement."

However, this white paper is very general, and we know it is just the beginning of the process. We recommend that development is staged so that core functions can begin sooner rather than later, and then additional functionalities can be added and improvements made. It is crucial for FHFA to continue to involve a broad range of stakeholders as the process moves forward.

Again, thank you for the opportunity to comment. If you have any questions or would like more information on any of our recommendations, please contact John Griffith, Policy Analyst at the Center for American Progress, at jgriffith@americanprogress.org or 202-481-8158.

Sincerely,

Center for American Progress
Mortgage Finance Working Group
Consumer Federation of America
National Council of La Raza
National Housing Conference

ENDNOTES

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- ¹ Mortgage Finance Working Group, “A Responsible Market for Housing Finance,” (Washington: Center for American Progress, 2011), available at <http://www.americanprogress.org/issues/housing/report/2011/01/27/8929/a-responsible-market-for-housing-finance/>
- ² Adam Levitin and Susan Wachter, “Explaining the Housing Bubble,” *Georgetown Law Journal*, 100 (4) (2012): 1177-1258, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669401.
- ³ Mortgage Finance Working Group, *A Responsible Market for Housing Finance*, 2011.
- ⁴ Government Accountability Office, “Troubled Asset Relief Program: Treasury Continues to Face Implementation Challenges and Data Weaknesses in its Making Home Affordable Program,” GAO 11-288, Report to Congressional Committees, March 2011, available at <http://www.gao.gov/assets/320/316715.pdf>.
- ⁵ The Mortgage Finance Working Group has long been a proponent for targeted principal reductions at Fannie Mae and Freddie Mac. For more on our response to FHFA’s current position, see John Griffith, “Time to Make An Offer FHFA Can’t Refuse,” *Center for American Progress*, August 2, 2012, available at <http://www.americanprogress.org/issues/housing/news/2012/08/02/12004/time-to-make-an-offer-fhfa-cant-refuse/>
- ⁶ Federal Housing Finance Agency, “Review of Options Available for Underwater Borrowers and Principal Forgiveness,” (2012), available at http://www.fhfa.gov/webfiles/24108/PF_FHFApaper73112.pdf
- ⁷ For more on how shared appreciation mortgage modifications could work at Fannie and Freddie, see John Griffith and Jordan Eizenga, “Sharing the Pain and Gain of the Housing Market,” (Washington: Center for American Progress, 2012), available at <http://www.americanprogress.org/issues/housing/report/2012/03/29/11251/sharing-the-pain-and-gain-in-the-housing-market/>
- ⁸ Federal Housing Finance Agency, “Preparing a Foundation for a More Efficient and Effective Housing Finance System (Strategic Plan for Fiscal Years 2013-2017),” (2012), available at <http://www.fhfa.gov/webfiles/24576/FinalFHFAstrategicPlan10912F.pdf>.
- ⁹ Comments submitted by the Center for American Progress to the Consumer Financial Protection Bureau, RE: 2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal, October 9, 2012, available at <http://www.americanprogress.org/issues/housing/news/2012/10/09/45117/strengthening-the-consumer-financial-protection-bureaus-proposed-mortgage-servicing-standards/>.