

Testimony of
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**“A Legislative Proposal to Provide for a
Sustainable Housing Finance System: The
Bipartisan Housing Finance Reform Act of 2018”**

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Chairman Hensarling, Ranking Member Waters, and members of the committee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA). My name is Bob Broeksmit, and I am the President and Chief Executive Officer of MBA. I am a Certified Mortgage Banker (CMB), and I have over 30 years of experience in real estate finance. Over the course of my career, I have held positions in virtually all aspects of the mortgage business, from loan processing and underwriting to secondary marketing and servicing. These experiences have given me a unique perspective on the complexity of the housing finance system, as well as the importance of ensuring that it operates in accordance with a well-calibrated regulatory framework.

MBA is the national association representing the real estate finance industry—an industry that employs more than 280,000 people throughout the country. The association works to ensure the continued strength of the nation’s residential and commercial real estate markets and to 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. MBA’s membership of over 2,200 companies represents all elements of real estate finance, including firms serving both the single-family and commercial/multifamily markets.¹

MBA commends Chairman Hensarling, as well as Representatives Delaney and Himes, for developing and releasing a discussion draft of the Bipartisan Housing Finance Reform Act of 2018 (BHFRA).² The housing finance system requires structural reforms that will better ensure a stable, liquid secondary market. Comprehensive legislation remains the best vehicle for such reforms, and BHFRA represents a strong step forward in advancing this effort.

The Need for Congressional Action

In 2008, the financial crisis threatened the viability of the housing finance system, particularly with respect to the central role that Fannie Mae and Freddie Mac (the Enterprises) play in the system. The crisis exposed the fundamental problems in the Enterprises’ business models, as well as the weaknesses in the regulatory framework that was in place at the time. The result was a breakdown of the secondary mortgage market, \$187 billion in taxpayer assistance, and continuing federal support of more than \$250 billion.

¹ For more information, visit MBA’s website at: <https://www.mba.org>.

² “The Bipartisan Housing Finance Reform Act of 2018,” September 6, 2018. Available at: https://financialservices.house.gov/uploadedfiles/intro_007_xml_bhfra.pdf.

Over a decade has passed since the Enterprises were placed into government conservatorship, in what was described by then-Treasury Secretary Paulson as a “time out.”³ Despite the intent that conservatorship would serve as a temporary bridge to stabilize the Enterprises, the conservatorship persists, and the Enterprises’ long-term status remains unresolved.

During that time, the Federal Housing Finance Agency (FHFA) has begun implementing some of the necessary reforms in its role as conservator of the Enterprises. These reforms include secondary market pricing parity across lenders, new mechanisms for credit risk transfer (CRT) to the private sector, an improved infrastructure for the single-family secondary market, a substantial reduction in the retained mortgage portfolios, and support for continued liquidity in the multifamily market. These reforms, while critical, are not sufficient to fully address the problems that led to conservatorship. Instead, legislative reform is needed—both to bring about the remaining structural changes to the Enterprises and to “lock in” the reforms instituted by FHFA through its authorities as conservator.

For example, legislation is necessary to alter the existing Enterprise charters, clarify the nature of any federal government guarantees, enhance FHFA’s regulatory authorities, and create permanence for the reforms already undertaken by FHFA. Perhaps most importantly, legislative reform is the only outcome that provides the legitimacy and public confidence necessary for long-term stability in both the primary and secondary mortgage markets.

Conservatorship of the Enterprises has already persisted far longer than intended. The U.S. Congress should not allow conservatorship to continue indefinitely, as market participants will suffer in a number of ways. Borrowers will be denied the benefits of a more vibrant secondary market, lenders will face increased uncertainty about the future, and private-label security (PLS) issuers and investors will hesitate to fully engage in the market. In short, the status quo is an unacceptable long-term outcome.

Calls to recapitalize the Enterprises without further structural reforms are similarly misguided. Under such plans, the post-crisis reforms already achieved could be reversed in the absence of a regulator exerting conservatorship authorities. Recapitalization without corresponding reforms would in many ways remove the existing safeguards that are preventing the Enterprises from returning to their flawed pre-crisis business models. Further, an immediate recapitalization is unnecessary from a safety and soundness perspective, as the ongoing capital support from the

³ “Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers,” September 7, 2008. Available at: <https://www.treasury.gov/press-center/press-releases/Pages/hp1129.aspx>.

U.S. Treasury eliminates any practical near-term threat to the Enterprises' solvency.⁴ Should either Enterprise need to draw on this capital support, there would be no change in its existing book of business, day-to-day operations, or prospective ability to provide liquidity to mortgage markets.

We simply cannot abide a housing finance system that produces suboptimal results due to the limits imposed by conservatorship, nor can we go back to a system that provides private gains when markets are strong yet relies on support from taxpayers when losses occur. Only by enacting comprehensive legislative reform can borrowers, lenders, investors, and taxpayers realize the full benefits of a diverse, competitive primary market and a vibrant, liquid secondary market. Reform should therefore proceed without delay.

MBA Principles for a Sustainable, More Vibrant Secondary Market

To address the need for reforms, MBA convened its Task Force for a Future Secondary Mortgage Market (Task Force) in 2016. The Task Force, composed of members covering a broad cross-section of the real estate finance industry, developed a comprehensive set of recommendations for an improved secondary market.⁵

The MBA proposal recognizes the need for any comprehensive reform plan to balance three major priorities: 1) taxpayer protection; 2) investor returns; and 3) consumer cost and access to credit. Pushing too far in any one direction may lead to a mortgage market that does not adequately meet the needs of all participants. To achieve the appropriate equilibrium among these priorities, the Task Force developed the following core principles to guide its work. It is against these core principles that MBA evaluates any potential reforms to the housing finance system.

Core Principles:

- Preserve the 30-year, fixed-rate, prepayable single-family mortgage, as well as long-term financing for multifamily mortgages;
- Maintain a deep, liquid to-be-announced (TBA) market for securities backed by conventional single-family loans;

⁴ In the 2018 Dodd-Frank Act Stress Test Results, FHFA estimates that, under a severely adverse scenario, the Enterprises would require a combined draw from the U.S. Treasury ranging from \$42.1 billion to \$77.6 billion. These figures fall far short of the combined \$254.1 billion in existing funding commitment from the U.S. Treasury. For more information, see: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2018_DFAST_Severely-Adverse-Scenario.pdf.

⁵ MBA, "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," April 20, 2017. Available at: <https://www.mba.org/gserereform>.

- Attract global capital and preserve liquidity during times of economic stress through an explicit government guarantee for eligible mortgage-backed securities (MBS) collateralized by single-family and multifamily mortgages;
- Limit the explicit government guarantee to the eligible MBS, while prohibiting the extension of the guarantee to institutional debt;
- Require an effective national affordable-housing strategy that helps meet the needs of low-income and underserved households and communities;
- Support a competitive and diverse primary market for lenders of all sizes and business models;
- Enable a robust, innovative, and purely private mortgage market to coexist alongside the government-backed market;
- Preserve existing multifamily financing executions and permit new options;
- Establish a strong, transparent regulatory framework that promotes liquidity while protecting the taxpayers;
- Ensure that private capital assumes significant amounts of the credit risk;
- Ensure liquidity in the event of a full-blown systemic crisis; and
- Minimize risks to the liquidity and stability of the mortgage markets during the transition to the end state.

The Bipartisan Housing Finance Reform Act of 2018

While comprehensive legislative reforms to the Enterprises have not been enacted by Congress over the past decade, there has been important progress during this time. Numerous ideas, proposals, and bills have been put forward, and in recent years there has been significant convergence toward a future housing finance system featuring well-underwritten loans securitized in the secondary market with ample private capital provided by tightly-regulated entities standing ahead of an explicit, full-faith-and-credit federal government guarantee. BHFRA builds on this emerging consensus with a structure that addresses many of the most important weaknesses of the pre-crisis system. Below, I offer MBA's perspectives on key elements of the proposal.

Purposes of the legislation

BHFRA provides eight statutory purposes for the reforms that it would institute. These purposes focus on liquidity in the conventional and private markets, borrower access to credit, lender access to the secondary market, taxpayer protection, consumer choice, and a smooth transition to an end state.

The BHFRA purposes align closely with the core principles developed by the MBA Task Force. In particular, they recognize that any reforms must meet the needs of the vast array of participants in the housing finance market, including borrowers, lenders,

investors, and taxpayers. Importantly, the concept of competition is also embedded within the BHFRA principles. MBA strongly supports the notion that robust competition in the secondary market promotes a highly competitive primary market, which in turn is necessary to provide borrowers with greater choice at affordable prices.

Explicit federal government guarantee

Perhaps the most glaring structural flaw in the pre-crisis business model of the Enterprises was that the model perpetuated a widespread belief that the institutions were the beneficiaries of an implicit guarantee of the federal government. This implicit guarantee allowed the Enterprises to enjoy many benefits, including artificially low borrowing costs and favorable regulatory treatment. In many ways, the implicit guarantee was the embodiment of the Enterprises' ability to accrue private gains while eventually socializing losses to taxpayers.

Because the fundamental purpose of the Enterprises is to increase liquidity in the secondary market by channeling global capital into mortgage finance, investor demand for the securities they issue is critical. Prior to the crisis, the presence of a perceived federal government guarantee increased investor demand, thereby reducing average mortgage interest rates and increasing access to credit for American borrowers. During that time, however, the government was not properly compensated for this perceived guarantee.

In any future system, MBA believes that a federal government guarantee is necessary to attract the appropriate level of investor demand, and hence liquidity, to maintain products such as the 30-year, fixed-rate, prepayable conventional mortgage. Rather than an implicit guarantee, however, such a guarantee should be explicit, and the government should be fully compensated for this guarantee. Further, in a system in which there is robust competition in the secondary market, the explicit guarantee is only necessary at the MBS level—not at the institution level. If MBS investors are shielded from credit risk, it will be possible to attract sufficient demand while allowing for a particular guarantor, or private credit enhancer (PCE), to fail.

MBA therefore supports the BHFRA inclusion of an explicit, federal government guarantee on eligible MBS backed by single-family and multifamily mortgages. In addition, the development of an insurance fund—the Private Capital Reserves—is an appropriate step to ensure the government is compensated for the credit risk that it holds, as well as to create a buffer to absorb losses ahead of taxpayers in the event that a PCE becomes insolvent.

BHFRA also requires FHFA to carry out a risk-sharing program by which it would obtain reinsurance on at least 10 percent of the catastrophic risk assumed by the

Private Capital Reserves. MBA supports the notion of transferring as much risk to the private sector as is economically feasible, though we believe it is likely that private reinsurance on such catastrophic risk may not be viable under most market conditions. BHFRA allows FHFA to reduce the 10 percent reinsurance requirement as needed, though it may be more appropriate to give FHFA even greater discretion in setting the terms of any catastrophic reinsurance by removing specific targets from the discussion draft. Such a change would also better conform this risk transfer requirement to the broader CRT requirements found in BHFRA.

Eligible single-family loans

Any system featuring an explicit federal government guarantee requires strong underwriting standards for loans that collateralize the government-guaranteed securities. Such standards protect taxpayers by preventing a “race to the bottom” in which PCEs aggressively loosen their credit terms to win market share, thereby taking on excessive credit risk and jeopardizing their ability to survive a future market downturn. Put another way, government-supported homeownership must be sustainable throughout all parts of the credit cycle, and strong underwriting is a crucial element of this process.

BHFRA defines eligible single-family loans through many features that are now widely accepted as prudent for the purposes of underwriting. Loans must be fully amortizing, mature within 30 years, fall within conforming loan limits, and meet other general terms and conditions associated with the Qualified Mortgage (QM) standard. Borrower income and assets must also be verified and documented.

Eligible single-family loans under BHFRA do depart from existing conventional loans eligible for purchase by the Enterprises in some important ways, as well. Eligible loans cannot feature an original loan-to-value (LTV) ratio above 95 percent (the Enterprises currently accept LTV ratios up to 97 percent), and the threshold for mortgage insurance or other credit enhancement is an LTV ratio over 85 percent (the Enterprises currently require credit enhancement on loans with an LTV ratio over 80 percent). BHFRA also limits eligible loans to those used to purchase or refinance a borrower’s principal residence. Cash-out refinances with an original LTV ratio above 80 percent, as well as loans on non-owner-occupied properties and second homes, are prohibited from serving as collateral for government-guaranteed securities.

MBA supports the use of loan eligibility criteria that meet a QM-type standard and adhere to conforming loan limits as they are adjusted. There are, however, notable elements of the existing QM standard that require regulatory or legislative modifications, such as the calculation of points and fees, the threshold for smaller loans, and the documentation requirements under Appendix Q.

More broadly, the ways in which the BHFRA definition of an eligible single-family loan deviates from the existing Enterprise standards are likely to shrink the universe of loans that can serve as collateral for government-guaranteed securities in the conventional market. Reductions to the size of the government-supported conventional market could be positive for the housing finance system if they encourage greater participation by diverse sources of private capital at an affordable cost to consumers. Policymakers should, however, carefully and rigorously analyze whether these segments of the conventional market can be supported by the private market before any policy changes are implemented.

Policy changes affecting the government-supported conventional market should not harm guarantors' ability to serve countercyclical roles in future market downturns, either. For example, it would be preferable to adjust guarantor pricing or underwriting requirements on certain categories of loans, such as cash-out refinances, non-owner-occupied homes, or second homes, in order to facilitate competition from the private market, rather than to eliminate their eligibility altogether. Further, any significant changes to the scope or size of the government-supported conventional market should be undertaken gradually so as to avoid disruptions that impact consumer access to credit.

Multifamily market

While BHFRA does not contain specific legislative text regarding its application to the multifamily housing finance market, it does provide a forward-looking set of principles that recognizes the important role the Enterprises play in financing multifamily rental properties.

Multifamily rental housing is a critical part of the U.S. housing market and our communities. More than 18 million households live in multifamily rental housing—a development with five or more units—and this total includes workforce rental housing, seniors housing, student housing, rental properties that primarily serve low- and moderate-income families, and market-rate rental housing. The Enterprises' multifamily businesses serve as key capital sources to finance rental housing and support a critical element of the housing continuum.

To fulfill their objective of increasing the liquidity of mortgage investments and improving the distribution of investment capital available for multifamily mortgage financing, the Enterprises' respective multifamily businesses have developed distinct multifamily executions. These executions enhance the Enterprises' ability to play their vital role in financing multifamily rental housing within a multifamily finance ecosystem that also includes banks, life insurance companies, commercial MBS, the Federal Housing Administration (FHA), specialty-finance companies, and other market participants.

Significantly, the BHFRA principles reflect an intention to preserve what works well in the Enterprises' current multifamily businesses. The principles also express an expectation that the Enterprises' current multifamily businesses will continue to function within a new multifamily housing finance market, with an explicit federal government guarantee on their MBS provided under the reformed system. In this regard, it is notable that the Enterprises' multifamily businesses are performing well and have long used CRT transactions to efficiently transfer multifamily credit risk to the private sector, through both institutional and capital markets structures.

MBA supports these forward-looking multifamily principles, which align closely with those developed by the MBA Task Force. Given the success of the Enterprises' multifamily businesses to date, and the importance of financing of rental housing, MBA believes that, within any reformed system, multifamily mortgages similar to those currently financed by the Enterprises should be eligible to be included in government-backed MBS guaranteed by PCEs. Consistent with BHFRA's multifamily principles, we believe that any reformed system should also support continuation of the existing multifamily CRT structures and the development of new structures consistent with regulatory guidelines. In addition, PCEs under a reformed system should have flexibility to guarantee multifamily MBS in addition to single-family MBS, or to guarantee only single-family or only multifamily MBS.

Structure and regulation of private credit enhancers

One of the contributing factors to the near-collapse of the Enterprises in 2008 was the weak regulatory and supervisory framework under which they operated at the time. Any comprehensive reforms to the housing finance system must include mechanisms to provide stronger oversight authorities for the secondary market regulator.

MBA believes that an appropriate regulatory and supervisory framework for secondary market guarantors would be akin to a utility-style framework, in which guarantors operate as low-volatility companies with regulated rates of return that pay steady dividends over time. Private ownership would better encourage ongoing investment to keep pace with market demands and technological developments, but the regulator must have the authority to ensure the companies do not engage in excessive risk taking.

The BHFRA provisions detailing FHFA authority with respect to the PCEs move the system much closer to such a utility-style framework. FHFA is granted authority to develop PCE approval standards and ownership limitations, as well as to oversee the prudential operations of the institutions. These authorities include responsibility for setting both risk-based and minimum leverage capital standards, which are to be comparable to those of similarly-situated financial institutions. These parameters

should promote financial stability and reduce opportunities for arbitrage. They also allow FHFA the opportunity to build on its recently proposed capital framework for the Enterprises.⁶ This proposal is an important first step that will help market participants better evaluate Enterprise decision-making in conservatorship, while also facilitating the eventual transition to a reformed secondary market. As MBA and others have noted, though, the proposal could be substantially improved through revisions that would decrease the procyclicality of the standards and increase transparency into the assumptions and calculations supporting the framework.⁷

BHFRA also allows FHFA to place strict limits on the ability of PCEs to build retained mortgage portfolios. These portfolios were used in manners that deviated from the Enterprises' missions in the years leading to the crisis, and they eventually served as a source of significant losses for the Enterprises. Provisions empowering FHFA to manage PCE conflicts of interest and resolve PCEs that are insolvent should also improve the functioning—and the safety and soundness—of the housing finance system.

The “bright-line distinction” in BHFRA is an important step towards ensuring that PCEs do not use their secondary market roles to influence or otherwise distort the primary market. A reformed system should directly and explicitly prohibit PCEs from engaging in primary market activities of any kind. Only through such prohibitions could market participants be certain that PCEs would support rather than supplant lenders and other institutions operating in the primary market.

Similarly, any future regulatory and supervisory framework should require that when PCEs undertake new activities or offer new products, FHFA complete an analysis of both the charter compliance and the potential market impact of the new activities or products before approving them for broader use. Pilot programs should be strongly encouraged as a means to innovate, but the regulator should be required to ensure some degree of transparency around the nature, duration, and scope of such programs.

Competition in the secondary market

As is noted above, MBA believes that the lack of robust competition in the conventional secondary market is driving suboptimal outcomes for borrowers, lenders, investors, and taxpayers. Competition among PCEs need not—and indeed should not—result in a push to weaken credit or underwriting standards. Instead,

⁶ 83 Fed. Reg. 33312, “Enterprise Capital Requirements,” July 17, 2018. Available at: <https://www.federalregister.gov/documents/2018/07/17/2018-14255/enterprise-capital-requirements>.

⁷ MBA, “Comment on Proposed Enterprise Capital Requirements,” November 16, 2018. Available at: <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15307>.

PCEs should compete on factors such as product offerings, technology, and customer service. These are the areas in which competition leads to innovation or better execution, which then produces more efficient markets and lower costs for borrowers.

The primary impediment to enhanced competition in the current market is the nature of the Enterprises' charters. Because the Enterprises exist and operate by virtue of Congressional charters, they can be reasonably confident that there will be no new entrants to their market, thereby granting them a duopoly that is officially sanctioned by Congress. To introduce greater competition (or at least the threat of competition), MBA supports the BHFR approach, by which FHFA is authorized to approve new PCEs according to established, public standards. This approach is far better suited to encouraging innovation and increasing PCE responsiveness to the needs of the market.

Lender access to the secondary market

In the years before the crisis, the primary market saw significant concentration, with the market share of the ten largest single-family originators increasing from less than 40 percent in 1998 to almost 80 percent by 2010. Much of this concentration can be attributed to Enterprise business practices, such as offering attractive guarantee fees and underwriting variances for lenders that delivered larger volumes of loans. When smaller lenders struggled to compete in this environment, they were forced to deliver their loans to the secondary market through their larger counterparts. The resulting reliance on an aggregation model only increased the prevalence of underpriced guarantee fees and weaker underwriting standards.

A critical objective of the MBA Task Force—and one that has been the subject of intense debate during past reform efforts—was to ensure that secondary market reform fosters a competitive primary market that is served by lenders of all sizes and business models. In particular, the Task Force recognized the important role that smaller lenders play in strengthening the system for consumers by maintaining close relationships with their customers and leveraging unique knowledge of local markets. The MBA proposal reflects this objective by ensuring equitable access to secondary market programs, prohibiting special pricing or underwriting based on loan volume, preserving cash window and small pool execution options, and preventing vertical integration by the largest market participants.

MBA supports the numerous BHFR provisions that prohibit discrimination based on lender size or business model, including those pertaining to Ginnie Mae issuer fees, PCE pricing, CRT requirements, Federal Home Loan Bank (FHLB) cash window pricing, access to the Common Securitization Platform (CSP), access to the Enterprises' historical loan-level data, and access to the Enterprises' underwriting

technologies. Similarly, the restriction on vertical integration preventing Ginnie Mae issuers from also operating as PCEs should protect against market distortions that favor larger institutions, though this restriction could be enhanced by expanding it to include a clearer prohibition on any entity simultaneously undertaking both primary and secondary market activities.

Another vital component of small lender access to the secondary market is the presence of a cash window, by which individual loans can be sold directly to an Enterprise. While BHFRA contemplates the potential for a PCE or an FHLB to operate a cash window, the discussion draft could be improved by requiring all approved PCEs to operate cash windows on an ongoing basis via a guarantor model (discussed in greater detail below). Such a requirement would ensure all lenders the opportunity to access the secondary market directly rather than potentially being forced to sell their loans through an aggregator. Further, an FHLB cash window as developed through BHFRA would only be accessible to lenders that are FHLB members, a group that accounts for less than half of total single-family originations today. Instead, a permanent cash window offered by PCEs would better mirror the features that work well in the current market.

Secondary market infrastructure

In the secondary market as it exists today, an important distinction is the structure of the conventional market (served by the Enterprises) relative to the structure of the government market (supported by Ginnie Mae). The conventional market operates under a guarantor model, in which institutions restricted to the secondary market (i.e., the Enterprises) purchase loans from primary market originators before securitizing them and guaranteeing the resulting securities. The government market, on the other hand, operates under an issuer model, in which primary market originators also serve as issuers of securities, with a secondary market institution (i.e., Ginnie Mae) providing the guarantee on these securities.

BHFRA envisions a system that functions more like an issuer model, with lenders acting as security issuers, though private sector guarantors would provide credit enhancement ahead of a federal government guarantee. While the issuer model has merits in the government market, MBA believes that a guarantor model is far more appropriate for the conventional market.

As is noted above, it is imperative that lenders of all sizes and business models be able to access the secondary market on equal terms. A system based on an issuer model, however, would be challenged in meeting this objective. While larger lenders with greater access to ongoing liquidity would have little trouble serving as issuers, smaller lenders would face significant obstacles. This dynamic explains why the Enterprises each have over 1,000 sellers, while there are only about 350 Ginnie Mae

issuers, many of whom are either housing finance agencies or are relatively inactive as issuers. It also explains why the practice of lenders selling loans to aggregators is prevalent in the government market, particularly given the absence of a separate cash window execution.

BHFRA also allows for, but does not require, the use of the CSP for issuance of government-guaranteed conventional securities. Over the past few years, as FHFA and the Enterprises sought to improve the infrastructure of the conventional market, they developed the CSP as a modern, scalable platform rather than rebuilding the Enterprises' antiquated back office securitization systems. Freddie Mac is already issuing securities via the CSP, and both Enterprises will soon be using it to issue Uniform MBS. By contrast, moving the conventional market to the Ginnie Mae infrastructure would require an entirely new build, as Ginnie Mae's systems are not designed for this purpose, either in terms of scale or the structure of the securities. A reformed housing finance system should therefore leverage this considerable investment by requiring the use of the CSP as the platform for issuance of conventional securities.

Similarly, Ginnie Mae in its current form is not configured to take on the role granted to it in the BHFRA system. Ginnie Mae relies on other government agencies to cover credit losses and issuers to manage the cash flows of the securities. In terms of institutional capacity, Ginnie Mae does not currently have the budget, technology, or staffing to oversee the conventional market.

Finally, it is unclear why BHFRA contemplates an end state in which the successors to the Enterprises could emerge from receivership as Ginnie Mae issuers operating in the primary market. The Enterprises have long-standing experience as secondary market guarantors, which their successors should leverage as PCEs in a reformed end state. The ability of successors to the Enterprises to serve as Ginnie Mae issuers also raises concerns regarding the blurring of primary and secondary market functions, which would be harmful to the health of the overall market by inhibiting vigorous competition.

For these reasons, MBA strongly recommends that BHFRA adopt a guarantor model, in which lenders do not serve as issuers, but rather sell loans to PCEs or other purely secondary market entities, which then securitize them and guarantee the resulting securities.

Availability of Enterprise assets

Given the expected benefits of the CSP in creating a more efficient and liquid secondary market for conventional, single-family loans, it is natural to consider the potential benefits the CSP could bring to the PLS market. Regardless of the outcome

of housing finance reform efforts, MBA recommends that once issuance of the Uniform MBS commences in June 2019, FHFA and the Enterprises begin taking steps to allow PLS issuers to use the CSP for securities that do not have any government backing.

As such, MBA supports the BHFRA provisions that make the CSP available to all issuers of residential MBS and require Common Securitization Solutions and the Mortgage Security Market Exchange (Exchange) to develop interoperable technology and standards for the CSP to accommodate all users. These provisions should serve the dual purpose of promoting competition among issuers in the secondary market for conventional loans by reducing infrastructure-related barriers to entry, while also furthering the continued revival of the PLS market by addressing some of the post-crisis challenges associated with standardization of terms and conditions.

Similarly, MBA supports the BHFRA requirement that the Enterprises transfer to the Exchange their historical loan-level data and underwriting technologies, both of which would then be made available for public use. Much like the transfer of the CSP, the broader availability of these Enterprise assets would help reduce the barriers to entry that are protecting the existing Enterprise duopoly. These Enterprise assets would also facilitate improved loan performance analysis across the industry, providing an additional benefit for a reformed system.

Credit risk transfer

Another one of the most significant structural reforms of the Enterprises in their decade of conservatorship has been the development of robust, single-family CRT programs. As noted above, the Enterprises' multifamily businesses have long used CRT transactions to efficiently transfer multifamily credit risk to the private sector, through both institutional and capital markets structures.

Since their inception in 2013, the Enterprises' single-family CRT programs have transferred credit risk to a variety of private sector entities, with a total risk in force of approximately \$81 billion.⁸ There is ample evidence in favor of ongoing CRTs as a permanent part of the business models of any future guarantors.

As with many of the post-crisis reforms of the Enterprises, however, the use of CRTs is not guaranteed to continue if the Enterprises were to exit conservatorship. BHFRA therefore mandates the ongoing use of CRTs as a means of lowering the risk profile of the PCEs and diversifying the sources of private capital in the market. The relevant provisions in BHFRA would require FHFA to set minimum levels of CRTs in which the

⁸ FHFA, "Credit Risk Transfer Progress Report – Second Quarter 2018," November 1, 2018. Available at: <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Progress-Report-2Q18.pdf>.

PCEs engage, and would also require FHFA to set CRT approval standards that consider a variety of structures and instruments. MBA supports the allowance for discretion on the part of the regulator, as the specific details of the CRT requirements should not be locked in through statutory language, but rather should be more easily adjusted as market conditions warrant.

While the Enterprises currently transfer a meaningful amount of credit risk to the private sector, they generally retain the first loss position in these transactions. BHFRA appears to require a very different approach, as it defines “credit risk transfer mechanism” to include only those transactions for which a private entity (other than a PCE) assumes at least a portion of the first loss position. MBA supports the increased use of structures that transfer first loss risk away from the Enterprises (or the future PCEs). We would, however, caution that it may not always be economically feasible for the Enterprises or PCEs to transfer first loss risk, and in such situations, it is still preferable that some portion of the credit risk be transferred where it is viable to do so. Again, the use of regulatory discretion is beneficial when setting specific CRT terms, conditions, and requirements.

Another factor influencing the long-term success of the single-family CRT programs is the diversity of the investor base. As market conditions change, CRTs may be more or less attractive investments for different types of investors. To better ensure investor demand through all parts of the credit cycle, a reformed system should enable participation by a wide variety of institutions. To this end, MBA supports the BHFRA provision that CRTs be treated as “real estate assets” for the purposes of real estate investment trust (REIT) eligibility. REITs are important sources of private capital in the mortgage market, and in many ways they are well-suited to invest in CRTs. Reforms that explicitly improve their ability to do so should be welcomed.

The private-label securities market

As the crisis took hold a decade ago and private capital retreated from the mortgage market, the Enterprises and government programs operated by FHA and the Department of Veterans Affairs played their countercyclical roles and grew rapidly in market share.⁹ The virtual disappearance of single-family PLS issuance, however, did not reverse course as the housing market recovered, and such issuance continues to represent only a sliver of the secondary market.

In order to increase secondary market competition and reduce reliance on taxpayer support, MBA believes that the structural impediments preventing a revival of the PLS market must be removed. In addition to uncertainty regarding the future path of

⁹ Urban Institute, “Housing Finance at a Glance: A Monthly Chartbook, October 2018,” October 29, 2018. Available at: https://www.urban.org/sites/default/files/publication/99256/october_chartbook_2018_0.pdf.

housing finance reform, these impediments include a lack of investor confidence in the operational, legal, and contractual underpinnings of the PLS market. Reform efforts, however, should ensure that future PLS issuance does not suffer from the same problems that were present in the years preceding the crisis. For example, loans collateralizing PLS must meet ability-to-repay standards and include disclosures that protect against excessive risk-taking or consumer abuses.

MBA supports the various BHFRA provisions that are intended to address some of the obstacles hindering stronger PLS issuance. The development of pooling, securitization, and servicing standards should generate greater certainty and confidence on the part of both issuers and investors. The creation of a central data repository and broad access to the CSP should also lower costs and other barriers for institutions seeking to enter the market.

Given the authorities granted to the Exchange in developing these standards and operating the CSP, it is worth exploring the ownership structure of the Exchange. BHFRA requires that the Exchange be organized as a not-for-profit entity and allows any institution to apply to establish the Exchange. For institutions already engaged in the primary or secondary markets, however, there may be inherent conflicts of interest in operating the Exchange. There are also competitive concerns that would be raised by an active market participant operating the Exchange. As such, there may be benefits to instead establishing the Exchange as a government corporation to avoid any actual or perceived conflicts or unfair practices.

Affordable housing

One of the greatest challenges to enacting comprehensive reforms to the housing finance system has been conflicting views as to how best ensure widespread availability of affordable housing, particularly for low- to moderate-income households. Affordability in the current housing market is hampered by low inventory and home prices that are rising faster than wages in many areas of the country, among other issues.

BHFRA does not contain specific legislative text, but it does include principles regarding the provision of affordable housing. These principles focus on targeting and delivering aid to those most in need of assistance, funding existing programs such as the Housing Trust Fund and the Capital Magnet Fund, utilizing an affordability fee for government-guaranteed activity, and providing broad access to credit where needed throughout fluctuations in the credit cycle.

MBA supports these principles, as they align closely with those developed by the MBA Task Force. The MBA framework for affordable housing includes three core missions: 1) expanding access to affordable mortgage credit; 2) preserving and

developing affordable rental housing; and 3) improving liquidity for underserved segments of the mortgage market. A housing finance system that targets these missions will better serve the full continuum of households, from low-income households in need of direct rental subsidies to moderate-income households served by the conventional financing and market-rate rental markets to higher-income households that utilize the fully private prime jumbo market.

The MBA Task Force also recognized the need for a more dynamic approach to affordable-housing goals that focuses on outcomes. Rather than relying on the historical approach to goals, which uses a blunt instrument of purchases of qualifying loans, the MBA framework includes a combination of quantitative, market-based targets and qualitative, activity-based targets. Under such a system, goals would be transparent, well defined, measurable, enforceable, and frequently reviewed to avoid market distortions.

In addition to affordable-housing goals, the MBA framework envisions affordability fees on government-guaranteed activity. These fees would be assessed on PCEs and would work in a manner similar to the current fees paid to the Housing Trust Fund and the Capital Magnet Fund. They would be assessed as a one-time annual fee on each year's acquisitions and would be set at a level that generates meaningful contributions to a range of affordable-housing efforts without unduly raising the cost of credit for consumers. Once FHFA establishes the fee through rulemaking, it would report to Congress on the uses of the funds collected, providing appropriate metrics to gauge performance and outcomes.

Transition mechanics

Perhaps the most difficult element of housing finance reform from an operational perspective is the transition from the current system to the reformed end state. The complexities associated with all of the elements of the system covered above affect the transition, often in overlapping or difficult-to-understand ways. The objective of any transition plan, though, is to account for these complexities to the greatest extent possible, while also allowing sufficient flexibility should problems arise.

To this end, the MBA Task Force developed transition principles meant to better ensure that policymakers and market participants execute the steps necessary to move to a reformed system while preventing and mitigating any potential adverse impacts to liquidity and the availability of mortgage credit. These principles include the need for a clear road map and end state, preservation of existing assets and infrastructure where possible, regulatory flexibility, and a gradual, multi-year phase-in period.

MBA supports the various BHFRA provisions that are in place to help promote a smooth transition that does not disrupt the flow of credit. For example, the discussion draft is clear that holders of Enterprise MBS or debt will continue to exercise their rights under the Enterprise charters. Further, a full-faith-and-credit federal government guarantee is placed on all existing Enterprise MBS or debt obligations. Together, these provisions should bolster investor confidence and promote continued liquidity in the early years of the transition.

BHFRA is also clear that the Enterprises' charters must be terminated within five years of enactment, with FHFA acting as receiver. Given the uncertain nature of any such transition, though, the market may not be prepared to make the switch to a system reliant on PCEs and/or a new Ginnie Mae market within five years. To account for this potential situation, regulatory flexibility—a key principle identified by the MBA Task Force—should be enhanced during the transition period. For example, FHFA should be authorized to engage “safety valves,” which could essentially serve as extensions of the five-year window for charter revocation based on market conditions.

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As the Enterprises continue into their second decade of government conservatorship, it is critical that policymakers tackle the remaining work of housing finance reform. Access to affordable, sustainable housing is a necessity for all Americans, and as such, it requires a system of financing that is robust in all parts of the country, through all parts of the credit cycle. Legislative reforms of the Enterprises offer the best path to reach this desired end state. To that end, I once again thank Chairman Hensarling and Representatives Delaney and Himes for their thoughtful contribution to this effort.

I appreciate the opportunity to present this testimony, and I will reiterate MBA's long-standing commitment to working with the committee on all elements of housing finance reform.