A LEGISLATIVE PROPOSAL TO PROTECT AMERICAN TAXPAYERS AND HOMEOWNERS BY CREATING A SUSTAINABLE HOUSING FINANCE SYSTEM

HEARING

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A LEGISLATIVE PROPOSAL TO PROTECT AMERICAN TAXPAYERS AND HOMEOWNERS BY CREATING A SUSTAINABLE HOUSING FINANCE SYSTEM

Thursday, July 18, 2013

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 1:04 p.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Miller, Bachus, Royce, Capito, Garrett, Neugebauer, McHenry, Campbell, Bachmann, Pearce, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Cotton, Rothfus; Waters, Maloney, Velazquez, Watt, Sherman, Meeks, Capuano, Clay, Lynch, Scott, Green, Cleaver, Moore, Ellison, Perlmutter, Himes, Peters, Carney, Sewell, Foster, Kildee, Murphy, Sinema, Beatty, and Heck.

Chairman HENSARLING. The committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Before recognizing Members for opening remarks, I want to make a statement about process. We are starting this hearing at 1:00 as opposed to our usual 10:00. That was at the request of the ranking member, who brought to my attention the Nelson Mandela birthday celebration. And certainly, I was in accord with her recommendation. So that is why we are starting at 1:00. The bad news is we will undoubtedly be interrupted by votes. And this is a two-panel hearing. So ahead of time, I wanted to apologize to Members and apologize to panelists, particularly those in the audience who are on the second panel, because I cannot tell you the exact time that the second panel will convene. But, hopefully, you will call this, as I do, an excused tardiness in the beginning of this hearing.

At this time, I will recognize myself for opening remarks for 5 minutes.

Today, the Financial Services Committee meets in its 12th hearing over the last 6 months on the need to create a sustainable housing finance system. By the end of the hearing, our committee will have heard from more than 50 witnesses on the subject since January. Americans clearly deserve a better housing system, one that protects homeowners and taxpayers, so that every American

who works hard and plays by the rules can have opportunities and choices to buy homes they can actually afford to keep. One that protects hardworking taxpayers so they never again have to bail out corrupt Government-Sponsored Enterprises like Fannie Mae and Freddie Mac, whose top managers engaged in extensive accounting fraud to trigger huge executive bonuses for themselves.

America needs a housing policy that is sustainable over time, not one that causes endless boom/bust cycles in real estate which harm our economy. Regrettably, such a commonsense and responsible system is not in place in America today. Today, taxpayers have been forced to pay nearly $200 billion for the bailout of Fannie Mae and Freddie Mac. Today, taxpayers remain on the hook for more than $5 trillion in mortgage guarantees, roughly one-third the size of our economy. Today, the Federal Government has a virtual monopoly on the housing finance system that is unwise, unfair, and unsustainable.

Today, Washington elites decide who can qualify for a mortgage. That puts homeownership out of reach for millions of creditworthy American families. That is not fair. Americans truly deserve better. The proposal we will discuss today will give Americans the better, fairer, and sustainable housing finance system they deserve. It is called the PATH Act because it Protects American Taxpayers and Homeowners. The PATH Act ends the bailout of Fannie Mae and Freddie Mac by gradually winding them down over a 5-year transition period. On their best day, they delivered 7 to 25 basis points interest rate advantage to home buyers and could only deliver a mediocre rate of homeownership.

Contrasted with almost $200 billion of bailout, wrecked lives of those who lost their homes, artificially driving up the cost of principal, and helping bring the economy to its knees, Fannie and Freddie did little to help the home buyer but an awful lot to hurt the taxpayer and the economy.

The PATH Act also protects taxpayers and homeowners by finally codifying what most everyone claims the FHA was designed to do, and that is, an agency that was intended to help first-time home buyers and those with low and moderate incomes. But instead, today they can insure millionaires' mortgages for homes valued as high as $729,750. In many sections of my district, that is a mansion.

The mission creep has overextended FHA. Today, it is broke, unsustainable, and projected to need its own taxpayer bailout, just like Fannie and Freddie. An unsustainable, bankrupt FHA will help no one. The PATH Act puts it on a sound footing.

The PATH Act tears down barriers to private capital and frees home buyers from a government-dominated system that puts again Washington elites in control of deciding who can and cannot buy a home. Washington should not steer our citizens into mortgages that may not be right for them, nor should Washington prevent them from taking out mortgages of their choosing. Reforms in the PATH Act increase competition, enhance transparency, and give consumers more freedom to choose the mortgage that is right for them as long as the terms are fully disclosed and understandable.

Witnesses at our previous hearings have warned that regulations coming down the pike could increase mortgage interest rates 1 to

4 percentage points, lead to fewer home sales, and deter community banks from making mortgage loans. Core logic is that only half of today's mortgages would comply with the bureaucratic Dodd-Frank rules that could go in effect in just 177 days. Again, this is wrong and unfair.

Now, a significant number of Members in this room have said they want to end Fannie and Freddie, they want a new system, but they want to do it up until it is time to actually do it. Nearly 5 years after the bailout of Fannie and Freddie, I asked my friends on the other side of the aisle and in the Administration, if you don't like our plan, where is your plan? Some say the plan will end the 30-year fixed-rate mortgage. But it exists today without a government guarantee, and many of these same naysayers are the ones who said we have nothing to worry about with Fannie and Freddie, let's roll the dice. Thus, their track record on predictions is not an enviable one.

Some say this plan would end the Federal guarantee for the housing finance system. Yet FHA, the Federal Home Loan Banks, the VA, and the rural housing programs are still there. Some say the PATH Act is ideological. But it seems to me that those who defend the status quo of a government-run monopoly, complete with taxpayer bailouts, economic crises, and mediocre rates of homeownership are the ones that are being ideological. It is past time to protect taxpayers and homeowners. It is time to pass the PATH Act today. As I have stated publicly before, it is my intention to mark up the PATH Act before the House adjourns for the August district work period, and I look forward to this hearing.

At this time, I yield 5 minutes to the ranking member.

Ms. WATERS. Thank you, Mr. Chairman.

While I am appreciative that you are holding this hearing today, I am deeply disappointed in the radical and unworkable discussion draft that is before us today as well as the lack of interest in making this a bipartisan effort.

Mr. Chairman, it did not have to be this way. We have on the table a bipartisan housing finance reform proposal in the Senate. During the last Congress, we saw numerous bipartisan reform proposals here in the House. But this bill you have put forward, with zero input from Democrats, is obviously a non-starter among all the individuals who have a stake in a healthy housing finance system. It is an unrealistic proposal based on the notions of ideological academics whose ideas have no real audience or weight outside of certain members on this committee. We Democrats here on this committee have authored principles that guide our consideration of this discussion draft as well as all proposals to reform our markets. To put it plainly, the "Path to Nowhere Act" fails all of them. To take them one by one:

The proposal would be bad for America's middle-class, ending the affordable 30-year fixed-rate mortgage and making it a product only available to a tiny subset of lower-income FHA borrowers, or to the richest households getting jumbo loans.

The proposal would be bad for investors, expecting them to accept all the credit risks on U.S. mortgages, but removing key protections in our securities laws and excluding them from the management of this new utility.

The proposal would be bad for community banks and credit unions, with the new utility presenting them with tremendous challenges, access in the capital markets, and severely undercutting the FHA. The proposal also leaves them in the dust with a big bankcentric covered bond proposal that requires them to pick up the tab if these bonds bankrupt the deposit insurance fund.

The proposal would be bad for consumers, repealing the predatory lending provisions in the Wall Street Reform Act and inviting unscrupulous subprime lenders back in the market.

The proposal would be bad for renters at a time when vacancy rates are at an all-time low and American families increasingly need access to rental options. The proposal abolishes the trust fund, eliminates the GSE's role in multi-family housing, and makes the FHA multi-family program an administrative nightmare in which no lender would want to participate.

And finally, the proposal would be bad for taxpayers, codifying an implicit guarantee on our housing market instead of making the guarantee explicit and paid for by the industry as other bipartisan proposals suggest.

When the Republican experiment in extreme privatization ultimately fails, we will see a future Administration come into Congress asking for us to clean up the mess this bill created. And, finally, your proposal would be a disaster for the American housing market, which drives nearly 20 percent of our Nation's GDP.

Mr. Chairman, I stand ready to work with you if you want to get serious on housing finance reform or regulatory relief for our Nation's community banks and credit unions. But, to be candid, this proposal is a failure on all accounts and for all stakeholders. And given that this draft bill undercuts both the homeownership and rental market, I am not sure where my Republican counterparts expect middle-class American families to live. I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, the Chair of the Capital Markets Subcommittee and the chief author of the PATH Act, for 2 minutes.

Mr. GARRETT. Thank you, Mr. Chairman, for holding this important hearing, and thank you for your hard work and also for the hard work all of the staff put into the legislation. I am very pleased this committee the is addressing one of the underlying causes of the financial crisis: the oversubsidization and misallocation of credit through Fannie and Freddie.

But the hemming and the hawing and the gnashing of teeth by my friends across the aisle maybe is a little bit surprising given all the compromises you will find in this draft. Over the last 2 years, our friends on the other side have set forth a number of demands that must be included in any GSE reform measure. Now that we have listened to them and introduced legislation that specifically addresses each of those concerns, I see it is still not good enough. See, first, they demand that GSE reform be comprehensive. You would be hard-pressed to find anyone who says the package before us today is not comprehensive.

Second, they demanded that reform ensure all financial institutions have access to the secondary mortgage market. So we compromised and ensured that they have access to the mortgage mar-

ket through a different government-sponsored entity, the Federal Home Loan Banks. Included in the bill are several provisions which directly authorize Federal Home Loan Banks to aggregate loans for community banks and credit unions.

Next, they demanded we retain some method for the government to play a countercyclical role in the market to ensure continued access to credit during times of market uncertainty. We compromised again, and included a provision in Title II that allows the FHA to do just that. Then, they demanded that we ensure the government continue to provide direct support for first-time and low- and moderate-income home buyers. So we compromised again, and made changes to FHA to preserve its important role in the marketplace of serving those people most in need.

And finally, they required we preserve the availability of the 30-year fixed mortgage. We compromised yet again and included language to facilitate a new marketplace that will replicate the deep and liquid market enjoyed by investors today that allowed for the continued widespread availability of a 30-year fixed mortgage.

Mr. Chairman, I commend you on your hard work on this legislation, your willingness to compromise and address their concerns, and your moving forward on this important debate.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 1½ minutes.

Mrs. MALONEY. I thank the chairman for starting this important conversation. And while the chairman's bill includes vague language about maintaining the 30-year fixed-rate mortgage, wishing doesn't make it happen. The bill would virtually eliminate the 30-year fixed-rate mortgage by making it unaffordable and inaccessible to middle-class Americans.

According to Moody's economist Mark Zandi, this bill would raise mortgage rates by at least 90 basis points, or $130 a month. That is a great deal of money over 30 years. This is not only unacceptable, it is unnecessary, because there are proposals such as the bipartisan Corker-Warner bill that would reserve the 30-year fixed affordable mortgage, and also protect taxpayers. Under their bill, taxpayers would have multiple layers of protection.

First, private investors would have to take the first 10 percent of any losses. If the losses exceed 10 percent, then an industry guarantee fund similar to the FDIC would kick in and be able to bear losses even greater than the losses Fannie and Freddie suffered during the recent housing bust. Only then, in a catastrophic crisis, worse than 2008, could the government potentially be asked to provide a backstop. And even then, there is a clawback to the industry-guaranteed fund that would reimburse and protect the taxpayer.

The housing market accounts for 20 percent of our overall entire economy. And the affordable home is part of the American dream. So it is absolutely critical that we work together in a bipartisan way to get this right to protect the taxpayer and the affordable home for Americans dreams.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, Chair of the Housing and Insurance Subcommittee, and another co-author of the PATH Act, for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman, for holding this important hearing. And, most importantly, thank you for driving the House finance reform debate on behalf of taxpayers and homeowners.

Today, we are discussing the PATH Act, a commonsense and pragmatic reform measure of which I am proud to be a cosponsor. After 12 hearings and multiple conversations with stakeholders, we have put together a framework for a dynamic, healthy, and stable housing market. The PATH Act is a transformative piece of legislation that will bring our housing markets into the 21st Century and allow our housing finance system to function without the unprecedented government intervention that we have seen in recent years.

The PATH Act will do three things. First, it will end the costly bailouts of Fannie and Freddie by phasing them out over a 5-year period. Second, it will right-size FHA by clearly defining its mission to ensure that the agency is focused on serving first-time home buyers and low- to moderate-income borrowers. And lastly, it will facilitate increased investor interest in the secondary mortgage market by removing impediments to private capital and defining a clear set of rules for securitization in the future.

Now, I know some of my colleagues want to gloss over the cronyism and the Enron-style accounting and the outright financial fraud that allowed Fannie and Freddie to generate a subprime crisis. They would like to extol the virtues and the benefits of GSEs and propose to simply place a Band-Aid on the current government-centric housing system. But these calls remind me of a saying we have back in Texas, “You can put your boots in the oven, but it doesn’t make them biscuits.” This basically means that you can say what whatever you want to about these entities, but they are what they are. Let me remind my colleagues exactly what the system delivered for the American people: $16 trillion in wealth destruction; and $200 billion in taxpayer bailouts, all in the name of homeownership, in which, by the way, we rank 17th in the world. I know that it is human nature to resist change. I get it. Change is difficult. But in the case of housing finance, not to change is fatal. I urge all of my colleagues to support the PATH Act so that we can finally have of a 21st Century housing finance model that protects taxpayers and helps homeowners.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 1½ minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Chairman, while I understand the need to reform the housing finance system, I am extremely troubled by the proposal before us. The PATH Act removes the main source of viability in the multi-family market, the government guarantee. This will unduly impact many New Yorkers who rely on rental housing because of high homeowner costs. New York State is home to very tight rental markets. In fact, vacancy rates in Manhattan decreased to 1.83 percent in the last year. We need more rental housing options to keep up with the demand. Yet this proposal does the opposite: reducing liquidity; increasing building costs; and driving up working families’ rent.

As the ranking member of the House Small Business Committee, I am also concerned about the bill’s impact on small businesses.

Even though my community is a short subway ride to Wall Street, it is our credit unions and community banks that working families rely on for a loan. These are the exact institutions that this proposal will crowd out of the mortgage market.

Mr. Chairman, we need a system that leads to stable, affordable housing. However, this bill is a path to nowhere. It does not protect anyone; indeed, it eliminates housing options for working families and excludes small businesses from the market. Thank you, and I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, the Chair of the Financial Institutions Subcommittee, and also a co-author of the PATH Act, for 1 minute.

Mrs. CAPITO. Thank you, Mr. Chairman. Thank you for the hearing. This an issue that we need to address and we want to address. And I thank the chairman for his hard work.

As we have heard before, the focus of this discussion draft is protecting consumers and protecting taxpayers. I am especially pleased that this legislation reforms the secondary mortgage market and also provides much-needed reforms for FHA that we have discussed time and time and time again in this committee. The FHA is an extremely important component of the Nation's finance system. And the reforms here will focus on first-time home buyers and those with moderate and low incomes and will ensure that the FHA is serving its core mission in future generations.

The PATH Act also will end the bailouts of Fannie and Freddie. As a Nation, we cannot return to a system that allows private entities to enjoy the profits in a bull market and then sticks the taxpayers with the bill in a downturn. Moving towards a privatized security—secondary mortgage markets will prevent this from happening in future housing cycles.

Finally, there are critical provisions in Title IV that ensure small banks and credit unions will have access to the secondary mortgage market. These provisions provide significant release and certainty for these institutions that are extremely important in the relationship banking that they do every day in communities. I yield back. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano, for 2 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. Thank you for having this hearing. Mr. Chairman, look, everybody today is going to pontificate an awful lot. I guess it is pontification day. And I would really rather avoid as much as possible. So for our panel members, here is what I am interested in: What will this bill do to the average person who wants to buy a home? Simple. Please don't talk in basis points or market. Here is what they want to know: Will they have access to an affordable, standard, fixed 30-year mortgage at rates they are currently seeing without massive downpayments? That is really what it is all about. All of this is just hyperventilating to make ourselves sound smarter than we really are.

What we are interested in is does this bill work. And, honestly, I have my doubts. We have only had it for a couple of days, and we are trying to pore through it, trying to get as much information as we can. The information I have at the moment is that the an-

swers to all the questions I just said is probably no. I know full well you won't know it. But they won't have access to a standard 30-year mortgage. There might be 30-year mortgages, but no one I know will be able to afford them.

So, for me, I would like to limit these panel comments to—I know you are all 10 times smarter than I will ever be, but you don't have to prove it today. Speak in small words, words that we understand, words that I can explain to my constituents at home, and to me, to figure out what this bill does to America. And to assuage my fears as I enter this that the 30-year mortgage is gone, the downpayments will skyrocket, and that my average homeowner, based on my brief numbers, would have to pay $40,000 more over the life of a 30-year mortgage, if they could get one, on a $200,000 mortgage, which in my district is a small mortgage. We have high values.

So, my time is up. But please, again, you don't have anything to prove to me. Small words. Thank you.

Chairman HENSARLING. Today, we have two panels of witnesses.

Mr. CAPUANO. Between your accent and mine, we have to have a translator.

Chairman HENSARLING. I concur.

Today, we have two panels of witnesses. At this time, we will welcome our first panel of distinguished witnesses.

Peter Wallison is the Arthur F. Burns Fellow in Financial Policy Studies at the American Enterprise Institute. He previously served as General Counsel to the U.S. Treasury Department, and was a member of the Financial Crisis Inquiry Commission. Mr. Wallison is the author of several books, including a 2004 work on Fannie Mae and Freddie Mac. He holds law and undergraduate degrees from Harvard.

Douglas Holtz-Eakin is the President of the American Action Forum, and is the former Director of the Congressional Budget Office. He also previously served as an economic advisor to President Bush 41. He, too, was a member of the Financial Crisis Inquiry Commission. He earned his Ph.D. from Princeton and holds an undergraduate degree from Denison University.

Adam Levitin is a law professor at the Georgetown University Law Center where he teaches bankruptcy, commercial law, and financial regulation. He earned his law and undergraduate degrees from Harvard, and a master's degree from Columbia.

Mark Calabria is the Director of Financial Regulation Studies at the Cato Institute. We welcome him back as a previous Congressional staffer. He has also served as the Deputy Assistant Secretary for Regulatory Affairs at HUD, and has held a variety of positions at Harvard's Joint Center for Housing Studies, the National Association of Home Builders, and the National Association of REALTORS®. He earned his Ph.D. from George Mason University.

Last but not least, Mark Zandi is the Chief Economist at Moody's Analytics where his research focuses on macroeconomics, financial markets, and public policy. Dr. Zandi also has written a number of books on the economy, including at least one on housing finance. He holds his Ph.D., master's, and bachelor's degrees from the University of Pennsylvania.

I believe all of you have testified before our committee before. You will each be recognized for 5 minutes to give an oral summary of your testimony. And without objection, each of your written statements will be made a part of the record. After each of our panelists have finished—as I warned earlier, votes may interrupt us. But at some point, each Member will be recognized for questioning for 5 minutes apiece.

Mr. Wallison, you are now recognized for your testimony.

STATEMENT OF PETER J. WALLISON, ARTHUR F. BURNS FELLOW IN FINANCIAL POLICY STUDIES, THE AMERICAN ENTERPRISE INSTITUTE (AEI)

Mr. WALLISON. Thank you, Mr. Chairman.

Chairman Hensarling, Ranking Member Waters, and members of the committee, although there seems to be a near consensus in Congress that Fannie and Freddie should be eliminated, there is no agreement on what should replace them. Since the financial crisis in 2008, almost every plan that has been put forward in Washington has involved one or another ingenious way to wind down Fannie and Freddie while keeping the government involved in housing finance. This reflects, in my view, a kind of delusion that Fannie and Freddie were bad but government's involvement in housing finance is somehow good. In reality, Fannie and Freddie did what they did, and became insolvent doing it, because they were backed by the government.

If Congress adopts another plan for the government to back housing finance, we will end up in the same way, with a mortgage meltdown, a major recession, taxpayer losses, and millions of families losing their homes. The last point finally got to a former chairman of this committee, Barney Frank, who said in 2010, "I hope by next year we will have abolished Fannie and Freddie. It was a great mistake to push lower-income people into housing that they couldn't afford and couldn't really handle once they had it."

It is easy to see why government does this. Every Member of Congress wants to do something for his or her constituents. Congress spends because the voters like it. All the better then when the benefits for constituents do not involve spending. Fannie and Freddie are examples of this. Because they were controlled by the government, they could be forced to provide a government guarantee for subprime and other risky mortgages, so that financial institutions and others would buy these mortgages when, in any other world, they would not think of taking such a risk. This was a taxpayer gift to constituents who did not have the financial resources or the credit records to get a mortgage, but the reduced underwriting standards that Fannie and Freddie were compelled to use inevitably spread to the whole market.

There were no appropriations or increases in the debt until the whole system crashed because of risky mortgages in 2008, and millions of surprised and angry Americans lost their homes.

Housing finance is a particularly good example of how Congress likes to spread the government benefits around. In the 2000s, it also made sure that wealthy constituents, people who were buying million-dollar homes, could get the benefits offered by the GSEs and FHA. If Congress adopts another plan for government-backed

mortgages, this will happen again. The Corker-Warner bill is an example of the many proposals that will eliminate GSEs, but put another government program in its place. Investors will be protected, but the government insurance program that would replace Fannie and Freddie will eventually be pressured by Congress to make the same risky mortgages that brought the financial system down in 2008.

We should recall that FHA started its life requiring 20 percent downpayments. Now, it requires 3 percent downpayments and needs a government bailout.

This story should tell all of us that the bill now before this committee makes practical sense. It would take the government out of most of the housing finance market, but it would still provide for a new and very prudent FHA for first-time home buyers. It winds down Fannie and Freddie over 5 years, terminates the affordable housing goals, creates a utility to organize and standardize the private securitization market, and clears away obstacles to the revival of private securitization.

I have some suggested improvements for this bill detailed in my written testimony. But on the whole, it will eliminate the repetitive cycles of failure that have been the story of the housing finance market in the past. Instead of yet another government program and another meltdown in the future, the PATH Act would open the way for the private sector to do for housing finance what it has always done for the rest of the American economy, that is, innovate and cut consumer costs. It is the first hopeful sign that Congress isn't mired in ideology but can learn from history and practical experience. Thank you. I look forward to your questions.

[The prepared statement of Mr. Wallison can be found on page 227 of the appendix.]

Chairman HENSARLING. Dr. Holtz-Eakin, you are now recognized for your testimony.

STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT, THE AMERICAN ACTION FORUM

Mr. HOLTZ-EAKIN. Thank you, Mr. Chairman, Ranking Member Waters, and members of the committee. It is a privilege to be here to discuss the PATH Act today. I look forward to your questions. Let me say four things briefly, with short words, to begin. First, I applaud action. For anyone who has looked at the crisis and watched events since the crisis, the inability of Congress to move forward on genuine reform of the GSEs has been a frustration, and to begin reform is to make a real step toward the ultimate recovery of the U.S. housing market. And so I am thrilled to see the bill under discussion, and I hope we see legislative action and law making in our future.

Second, I think there is a broad consensus that Fannie Mae and Freddie Mac should be phased out. And the winding down on this bill is a desirable action. They were at the heart of poor mortgage origination, which was a key part of the 2008 financial crisis. Their structure guaranteed that the bad mortgages and the mortgage-backed securities were disseminated widely through the financial system, and the interconnectedness guaranteed that taxpayers were required to step in and keep them from failing. Not only are

these facts well understood by experts and by the members of this committee, they are very well understood by the American public. And the evidence from polling and other sources is that the American public believes that they should no longer have a future in American housing finance either. And I am thrilled that this bill would wind them down.

The third thing I think is admirable is the fact that the FHA reforms are taken in a coordinated fashion with the other GSE reforms. In too many efforts on both sides of the Congress, these are done in separate silos and don't recognize that we have, in fact, seen one government backstop substitute for another at different times, and that we ought to have a single, coherent strategy for backstopping the low-income Americans who need help getting into the housing that we believe they deserve. And the coordination, the targeting toward a more appropriate footprint for the FHA, and the steps taken to threaten its solvency and protect it—the taxpayers from its exposures at present are all desirable steps in this legislation.

And then, lastly, I want to applaud the broad array of efforts to bring private capital back into mortgage finance in the United States. We simply cannot go forward with 80 to 90 percent of housing finance running through the Federal Government. The private sector is imminently capable of providing large-scale finance. As Mr. Wallison mentioned, it does so in every other sector of the American economy. We can be relied on to do so and do so in an innovative and consistent fashion in housing finance. The steps taken to clarify, and in some cases slow down, recent rule making will allow that to happen, as opposed to impede it. And I would encourage the committee to keep a focus, 100 percent, on attracting private capital. That in the end will be the best solution to all of the problems we have experienced over the past several years. Thank you for the chance to be here today, and I do look forward to your questions.

[The prepared statement of Dr. Holtz-Eakin can be found on page 141 of the appendix.]

Chairman HENSARLING. Professor Levitin, you are now recognized for 5 minutes.

STATEMENT OF ADAM J. LEVITIN, PROFESSOR OF LAW, THE GEORGETOWN UNIVERSITY LAW CENTER

Mr. LEVITIN. Chairman Hensarling, Ranking Member Waters, and members of the committee, good afternoon.

The housing finance market does badly need reform. But the PATH Act is the wrong path to take. The PATH Act would recreate the worst features of the housing finance market during the housing bubble: predatory lending; unregulated securitization; and too-big-to-fail banks. I detail these and other problems in my written testimony.

My remarks today will focus on the key feature of the PATH Act, a proposal to privatize the housing finance system. Privatizing the housing finance system has several problems. First, there is not sufficient capital willing to assume credit risk on U.S. mortgages. Currently, there is $6 trillion in interest rate risk investment in the U.S. housing finance system. There is no reason to believe that

these rate risk investors will transform into credit risk investors. If they do, the yields they will require will substantially raise mortgage costs, thereby depressing housing prices.

Privatization could leave the housing finance system without sufficient capital. In plain language, that means higher rates and higher downpayments for your constituents. The PATH Act, therefore, is a risky gamble with the entire U.S. economy, based on ideology, not evidence.

The second problem with the private housing finance system is that the products available would change. If the PATH Act were law, it would be difficult for most American families to obtain 30-year fixed-rate mortgages or to lock in interest rates in advance of closing.

The 30-year fixed is not the best product for all home buyers, but it is a consumer-friendly product that is particularly well-suited for financial stability. It has been a bedrock of post-war American homeownership. The availability of the 30-year fixed is also heavily a function of Federal backing of the housing finance system. While it is true that one can find a 30-year fixed in the private jumbo market, as Mr. Wallison likes to note, the truth is that jumbo 30-year fixed-rate mortgages are rare. Jumbo mortgages are a small part of the housing finance market, and most jumbo mortgages are adjustable rate.

Fixed-rate jumbos are less than 4 percent of the entire housing finance market, and not all of those are for 30-year terms. Instead, the massive evidence is that private lending markets do not generate widespread availability of long-term fixed-rate loans. And this is because the interest rate risk is too great, as Mr. Loving from the ICBA explains in his written testimony. Thus, 30-year fixed-rate loans are also a rarity in the totally private commercial real estate market, and they did not exist before the entry of the Federal Government into the housing finance space.

Similarly, the PATH Act would make it difficult for most American families to lock in interest rates in advance of closing. The ability to get a preclosing rate lock is a substantial benefit to the entire U.S. housing market. American home buyers are able to lock in rates in advance because of the To Be Announced (TBA) market. This is a market in forward contracts on GSE MBS. A TBA market requires tremendous liquidity, and that liquidity requires a high degree of interchangeability among MBS. GSE MBS has that high degree of interchangeability because they entail uniform credit risk for investors, namely, none.

The PATH Act would produce private label MBS with all types of variation in credit risk that would make a TBA market impossible. While there is a TBA market for jumbos, it is a—you can get a rate lock on jumbos, it is only because that rate risk can be hedged in the GSE TBA market. The jumbo market piggybacks on the existence of the federally-backed market. Thus, the PATH Act would make it impossible for most Americans to get preapproved for a mortgage at a particular rate before shopping for a home.

The third problem is that the PATH Act encourages riskier lending. Not only does the PATH Act repeal key anti-predatory lending laws, but it recreates the unregulated securitization markets that could produce the housing bubble and financial crisis. The PATH

Act creates an optional, privately owned but regulated securitization utility. It is questionable whether banks will find that the benefits of the utility outweigh its costs. Because the utility is merely optional, the utility will have to compete with unregulated securitization by banks for market share. The result could well be a race to the bottom in underwriting standards that increases the likelihood of government bailouts.

In an ideal world, I would unequivocally prefer to see the U.S. housing finance system financed entirely with private capital. The government's involvement in the U.S. finance system does carry with it serious concern of moral hazard and politicized underwriting. Yet, proposals like the PATH Act that would eliminate any government guarantee from the housing finance system are not a solution. Every developed economy either has an explicit or implicit guarantee of its housing finance system because housing is too important to the economy and social stability for any government to let the market collapse. Accordingly, we need to proceed by thinking about how to structure an explicit government guarantee realistically so as to minimize moral hazard rather than pretending that we can simply have a private market and ignoring the implicit guarantee that will always exist in that market. The PATH Act is not the right act for reforming our housing finance system. Thank you.

[The prepared statement of Dr. Levitin can be found on page 172 of the appendix.]

Chairman HENSARLING. Dr. Calabria, you are now recognized for 5 minutes.

STATEMENT OF MARK A. CALABRIA, DIRECTOR, FINANCIAL REGULATION STUDIES, THE CATO INSTITUTE

Mr. CALABRIA. Chairman Hensarling, Ranking Member Waters, and distinguished members of the committee, I thank you for the invitation to appear at today's important hearing, and I also want to express my delight to be among so many friends on both sides of the aisle. It truly is a pleasure to be back here. The committee will note from my biography that I have spent the last 2 decades involved in various aspects of housing and mortgage finance policy. Let me be very clear that I believe housing is a critical component of our economy; moreover, I believe that housing is one of the basic necessities of life, if not the most important necessity of life. So, to be very clear, I do have a stake in a healthy mortgage finance system.

Without stable, decent, and affordable housing, many other goals in life become quite difficult if not impossible to achieve. With that in mind, I would submit that our current system of mortgage finance has not facilitated the dream of affordable, accessible homeownership. Our current system has largely encouraged families to become highly leveraged and highly indebted, leaving both them and our greater economy at risk.

Our current system has not resulted in long-term gains of homeownership. You can look at the Census data, it is pretty clear. Nor has our current system provided financial stability, which should be obvious. The recent recession and the accompanying 8 million-plus job losses were a direct result of our current mortgage finance

policies along with other policy mistakes. Were we to choose to retain the current system or to make only cosmetic changes, we guarantee, let me emphasize, we guarantee a repeat of the recent recession.

It is far past time we recognize the failures of our current system and move toward a better system that effectively serves homeowners and taxpayers. Fortunately, in my opinion, such a system need not cost the taxpayer nor endanger our economy. Affordable—in contrast to what my good friend Adam has said—fixed-rate financing is available in other parts of our financial system. Jumbo mortgages today trade at rates, and you can get at rates comparable to the conforming, in my opinion, having about 40, 50 percent of the jumbo market is not rare. I think it is actually quite common.

You can get affordable fixed-rate financing in the auto market. And if you look at the recession, auto sales followed a similar trend downward as the housing market, yet auto sales recovered years ahead of the housing market, despite a lack of direct government support from auto purchases, with the exception of Cash for Clunkers.

So, let me be crystal clear. We can't have affordable, long-term mortgages without the support of Government-Sponsored Enterprises. In my opinion, claims to the contrary are pure fiction. Elimination of Freddie and Fannie would also have limited impact on homeownership rates. Let me emphasize that the Nation's homeownership rates reached levels comparable to those today before we witnessed even having a secondary mortgage market. That is a fact. I would be happy to give you cites for the data. In fact, the initial growth period of the secondary mortgage market, between 1982 and 1992, was a time of declining homeownership rates.

Let me turn now to the Protected American Taxpayers and Homeownership Act, the PATH Act. Let me commend the Chair and the committee staff on their efforts. I would also say I have followed the actions of this committee for close to 20 years. And let me say, I think this is without a doubt the most balanced, thoughtful, and logical piece of legislation I have ever seen come before the committee. I recognize it is a low bar. We urgently need to eliminate Fannie Mae and Freddie Mac. The PATH Act charts a course for doing so.

I will note that even if the PATH Act was passed into law as written, our mortgage market would be characterized by extensive government support. Yes, the PATH Act helps create a freer mortgage market, but it does not create a free one. My one complaint would be that the PATH Act does not go far enough and contains too many compromises. For instance, I would suggest to the committee that an additional 5 years of conservatorship for Fannie and Freddie is unnecessary. I think at most, a 2-year lead time for FHFA would give a sufficient time to prepare for a receivership. The reduction in GSE and FHA loan limits should also be accelerated. A loan limit of 525, 500, as ultimately envisioned by the PATH Act, still covers around 90 percent of the U.S. housing market.

In my opinion, a more reasonable number would be closer to 200. Our mortgage finance system has long been a massive, regressive subsidy to America's wealthiest families. And while I commend the new income-targeting requirements for the FHA retained in the PATH, I believe we can do a lot more to ensure that what subsidies are provided are targeted to those in need.

Lastly, I want to commend the committee's inclusion of reforms to stop abuses of eminent domain. While I would extend these provisions far beyond the mortgage market to protect all homeowners from having government steal their homes, I think the included provisions are an important first step.

So, again, let me close by commending the Chair for his efforts to take our mortgage market in a more rational and sustainable direction. I would certainly say I have yet to see a perfect piece of legislation. This is certainly not one. I don't expect to ever see a perfect piece of legislation. I certainly think there are changes that could be made, but I think this is a terrific start.

[The prepared statement of Dr. Calabria can be found on page 104 of the appendix.]

Chairman HENSARLING. The Chair will note the call of votes on the Floor. So, we will listen to Dr. Zandi's testimony, I will take the liberty of taking my 5 minutes to ask questions, and then when we return, if it is acceptable, the ranking member can ask her questions at that time, and then Members may leave when they feel it necessary. I hope everybody stays for Dr. Zandi's testimony.

Dr. Zandi, you are now recognized for 5 minutes.

STATEMENT OF MARK M. ZANDI, CHIEF ECONOMIST, MOODY'S ANALYTICS

Mr. ZANDI. Thank you, Mr. Chairman, Ranking Member Waters, and the rest of the committee for the opportunity to be here. I am an employee of Moody's Analytics, but these are my views and opinions, not those of Moody's. You should also know that I am on the board of directors of MGIC, which is one of the largest private mortgage insurance companies in the country. And I am also on the board of directors of the Reinvestment Fund. That is one of the largest CDFIs in the country, and also has a stake in all of this.

I have three points to make. The first point is, I do want to congratulate the chairman and the other members of the committee who worked on this, particularly the staff. This was clearly a very significant piece of work, with a lot of moving parts and a lot to digest. And to be frank, I haven't been able to digest it all. But it is significant. And I agree with the word "comprehensive." It is a comprehensive effort. And I think that is laudable, because I don't think we can consider solving the problems posed by Fannie and Freddie without considering the housing finance reform system in its entirety. That involves FHA reform, and it involves getting private capital in more through the banking system and through the private residential mortgage securities market. So, that is all good.

The part on covered bonds, I enjoyed that very much. I think that is a very appropriate place to look for additional capital. I think there is a lot more work that needs to be done there to make this a workable proposal, but I think that is a good direction to head.

And as the chairman knows, I have long been skeptical of the QRM rule as currently written. And I am hopeful the Federal Reserve will address those issues before the end of the year. So, this isn't necessary for part of GSE reform. But the first point is, I think this is a significant piece of work.

My second point is that the vision in the PATH for the private mortgage finance, that the private mortgage finance system would be the primary provider of credit, is not viable. It is not viable for three reasons. The first reason is it will lead to much higher mortgage rates. By my calculation, and there are a lot of assumptions, obviously, that go into these calculations; you need to vet them very carefully. But for the typical buyer, home buyer in today's market, and today's market is a pretty tight market, the quality of the borrower is very high relative to the average market. But for the typical borrower today, by my calculation, this will—if the PATH was passed in its entirety, it would raise mortgage rates by 90 basis points. So, that is .9 percentage points, that is $130 per month for the typical borrower. For the borrower who is not as high quality through, say, an edge of the qualified mortgage box which is being used to find eligible mortgages, it will be measurably higher than that. And in times of stress, in times of recession, even typical recessions, it would be even higher than that.

So, this is very costly. One of the key reasons for this is a lack of liquidity in this market that, with no government, explicit government guarantee. The To Be Announced market, the TBA market, this is absolutely critical to a well-functioning housing financial system, this has to be preserved. This will not be preserved under the vision that is in the current PATH plan with regard to privatization. It will not work.

Now, I understand there are other elements of the plan that try to address this issue. You clearly understand this is an issue. The common securitization platform is a good idea. But I am very skeptical that there will be any takeup on that platform. There are some benefits, but there are also costs. And there is no compelling reason for anyone to move to the platform.

The second reason this isn't viable is that the 30-year fixed-rate loan will become marginalized in this system. In our current system, three-quarters of the mortgage loans are fixed-rate. We can debate the merits of fixed-rate loans. But I think Americans like them, and we should preserve that. I think in the PATH, it would be closer to 20 to 25 percent of mortgages would be 30-year fixed.

And finally, when push comes to shove, the government is going to step in. When times are tough, the government is going to step in. And we need to recognize that and charge for that. And if we don't do it up front, it is going to cost taxpayers a lot more.

The third point I want to make, and it is a very quick point, and I will just state it, is I do worry about access in this proposal, access for small banks and community banks. I know you try to address it through the Federal Home Loan Bank System. I don't think it is adequate. And for access for disadvantaged homeowners. I think we need to do more for them in the context of a bill like this.

Thank you for your time. I really appreciate the opportunity.

[The prepared statement of Dr. Zandi can be found on page 240 of the appendix.]

Chairman HENSARLING. The Chair will now recognize himself for 5 minutes for questions. And again, to Members, votes are taking place on the Floor right now.

Dr. Zandi, in listening to your testimony, you said in your opinion, as you have examined the PATH Act, you believe that it could drive up interest rates 90 basis points, 9/10ths of 1 percent; correct?

Mr. ZANDI. Yes, that is correct.

Chairman HENSARLING. And you also mentioned in your testimony your earlier concern about premium capture. You have been on the public record saying that the premium capture reserve account could increase interest rates not 90 basis points, but 100 to 400 basis points. Do you still stand by your earlier statement?

Mr. ZANDI. I do, yes, sir. That is under the—the current way the QRM and premium capital—

Chairman HENSARLING. So one current regulation of the status quo, in your opinion, could drive up interest rates 1 to 4 points in the entirety of the PATH Act, you believe may drive up interest rates 9/10ths of 1 percent. Is that correct?

Mr. ZANDI. That is correct. For the typical borrower, the borrower in the middle of the distribution.

Chairman HENSARLING. Next question: You recently wrote in Moody Analytics, it is dated July 13th, that under the PATH Act the FHA would account for no more than one-fifth of the mortgage market on average, which is 20 percent. Historically, prior to the crisis, it has averaged 10 to 15 percent.

Mr. ZANDI. Right.

Chairman HENSARLING. So what do you consider to be the optimum footprint of FHA if the PATH Act leaves it larger than its historic average?

Mr. ZANDI. I don't have a number for you. And I really—I think the FHA's key role is providing affordable credit to first-time borrowers, lower-income households, as envisioned in the PATH plan. And I also think in the Path plan, one good element to the plan is that it allows the FHA to expand its footprint in times of economic crisis. I think that is appropriate. But I don't have a number for you.

Chairman HENSARLING. Okay. Thank you. I want to read from a Financial Times article dated Tuesday, which is entitled, "U.S. Jumbo Loan Rates as Cheap as Standard Mortgages." "The rates on mortgages for expensive U.S. homes are converging with loans on government-subsidized loans. The difference between the average jumbo rate and the standard rate on a 30-year fixed-rate mortgage—so this is 30-year fixed to 30-year fixed—has been 20 basis points or less, two-tenths of 1 percent, in 6 of the past 7 weeks."

We have heard some who say that under the PATH Act you could still find a 30-year fixed, but the delta would be such that it could not be affordable. What do you make of this Financial Times article, Dr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. These are the facts on the ground. I do think they call into question the blanket claim that we can't have a 30-

year fixed-rate mortgage in the absence of the current government backing.

Chairman HENSARLING. Dr. Calabria, did you want to chime in?

Mr. CALABRIA. Let me say, I very much agree. I am going to disagree with my friend Mark here.

When you look at the jumbo market today, it is 60, 70 percent fixed-rate. So it is not clear to me why would assume that you are going to have 25 percent of it be fixed-rate if you got rid of that government guarantee. So, again, the fact that you can get affordable 30-year fixed-rate financing in the jumbo market is proof that it can be done. It is done.

Chairman HENSARLING. We have observed in 2 of the last 3 decades that we have had serious housing bubble pops that precipitated economic crises. One of the things we are attempting to do with the PATH Act is ameliorate these boom-bust cycles. I know this is something that you had studied, Mr. Wallison. Do you believe that the PATH Act as currently drafted would help ameliorate those cycles?

Mr. WALLISON. I do, Mr. Chairman. Private markets very seldom result in the kind of bubbles that we confronted, for example, in 2007 and 2008. That bubble was 9 times larger than any housing bubble we had ever had. The biggest before that was about 10 percent. In 2008, the bubble was about 90 percent.

Now, that was because of the fact that the government had begun to pour a lot of money into the housing market and the government was not concerned about the risks. In a private market, the lenders become concerned about the risks as the prices go up. The government had no concern about that, and that would be true under any government-backed program.

Chairman HENSARLING. My time has now expired.

Again, votes are on the Floor. With apologies to our audience and our panelists, this committee will stand in recess until immediately after this vote series, approximately 2:30.

[recess]

Chairman HENSARLING. The committee will come to order. The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. I would like to direct my question to both Adam Levitin and Mark Zandi. The question-and-answer document that was released by the proponents of this discussion draft claim that the affordable 30-year fixed-rate mortgage will continue to exist even without a government guarantee. Though they offer little by the way of evidence to support this claim, does the language in the bill specifying that the new mortgage utility needs to include for securitization a 30-year, fixed-rate mortgage actually mean that the middle-class borrowers will have access to their product on affordable terms? The Republican Q and A document then pivots and says that most Americans shouldn't have 30-year fixed-rate mortgages anyway because homeowners typically move after 7 years.

Can you discuss the benefits of the 30-year fixed-rate mortgage, including how the predictable payment helps families with financial planning? Are loans that amortize on a 15-year schedule affordable for most American households?

Let me start with Mr. Levitin.

Mr. LEVITIN. Thank you very much, Congresswoman. In the Q and A that the Majority produced on this bill, they give an example of the difference between a $400,000 30-year fixed-rate mortgage and a $400,000 15-year fixed-rate mortgage, and the example is meant to illustrate that with a shorter mortgage term, principal gets paid down faster, and that is true, but what is not stated in the example is the effect on the monthly payment for that homeowner. Using the numbers from that example, the homeowner's monthly payment would go up almost $1,000 by going from a 30-year fixed-rate mortgage to a 15-year fixed-rate mortgage.

Now, when you figure that the average—the median American family has an income of about $55,000, adding $12,000 in mortgage payments a year just isn't feasible. Even for a family who is earning double the median, $100,000, adding $12,000 in mortgage payments just doesn't work. So, if the availability of 30-year fixed-rate mortgages decreases, that means there are going to be people who are just kept out of the housing finance market and that is really going to be a problem.

Ms. WATERS. Thank you. Mr. Mark Zandi?

Mr. ZANDI. Yes. The debate about the 30-year fixed-rate loan is a legitimate debate. I can see both sides of the argument, but my sense is that at the end of the day, it is a product that is very good for American households. It is really a question of who bears the interest rate risk, the homeowner, the household, or the financial system, the folks making the loans, and I think we decided as a nation, at least since the Great Depression, that it is better that the risk resides in the financial system and it is best handled there, and I think that is appropriate.

So I think we should work really hard to preserve the 30-year fixed-rate loan as a mainstay of the American mortgage finance system. And to second Adam's point, this is very key to affordability. If you can extend the payments over 30 years, it makes the loans much more affordable.

One last quick point: We are unique in the world in having a 30-year fixed-rate loan. The rest of the world does not have a 30-year fixed-rate loan, and that is largely because of the way we have organized our system and because of the government guarantee.

Ms. WATERS. Taking a page out of Congressman Green's book, he has sometimes asked a question of all of the panelists at one time, and it doesn't require everybody to talk but simply to raise your hand. How many think we should preserve the 30-year mortgage? If you think so, would you raise your hand?

[Show of hands.]

Mr. HOLTZ-EAKIN. I don't understand the question.

Ms. WATERS. I beg your pardon?

Mr. HOLTZ-EAKIN. I don't understand what the question means. You can have a mortgage.

Chairman HENSARLING. Microphone, please, Doctor, we can't hear you.

Mr. HOLTZ-EAKIN. Congresswoman, I am not sure I understand what the question means. You can have a 30-year mortgage, it can be at a fixed-rate, you can have no penalties for prepayment, you can have at what rates, there are lots of—

Ms. WATERS. We are talking about a 30-year fixed-rate mortgage. That is what we are talking about. I know that there are lots of products. Some of them sound like 30-year fixed-rate mortgages, but they are not, and I am simply just asking a basic question about the 30-year fixed-rate mortgage. It is not complicated.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. GARRETT. Thank you, Mr. Chairman. So, some people say—and I will direct this to start with Mr. Wallison—that if there is less of a government guarantee in the housing market, there will not be enough investor demand to support the market. That is what some people say. Now, I spent some time digging down into the question, and I want to discuss with you and the panel what I found, and I will use, as been requested, some basic language here as we look at Fannie and Freddie.

I am going to talk about supply and demand. On the supply side, when you wind down Fannie or Freddie and eliminate them, you have to ensure that there are significant pieces to fill the pie that they leave open. Under this legislation, we have a variety of mechanisms, as you know, that have filled the pie. There is a new qualified securitization market that is established under the bill, there is a new U.S. covered bond market under this bill, there is an enhanced and more transparent private label market, there is an initial room on bank balance sheets through regulatory changes provided under the bill, there is an expanded role of the Federal Home Loan Banks provided under the bill, and there is a restructured and a solidified FHA Ginnie government guarantee issue and structure under the bill as well. So when you add all these up, these new and enhanced supply channels, I believe you are getting very close to equaling the current space that Fannie and Freddie occupy.

Now, I heard in regards to the demand side, many supporters of a large government role in the housing market, including on the panel, Professor Levitin, talk about how there are certain so-called rate buyers out there who don't want any credit risk and they won't participate in the market without a government guarantee. And Dr. Zandi mentions that, too, in some of his assumptions.

Mr. Levitin actually, not only in his written testimony speaks to this specifically, and he identifies what he is talking about. He specifically gives examples. He talks about the Norwegian pension funds and states that they are "unlikely to seek to assume credit risk or mortgages in a consumer credit market that they do not know intimately." I am sure you remember that.

The pension fund that he is referring to is the Government Pension Fund Global. It is the largest sovereign wealth fund in the world with roughly $730 billion in assets under its management, and since he referred to it, I thought I would dig it up and see what he is talking about. And I have a part of the Norwegian pension fund here in my hand. This is part of the Partners Group which spells out their guidelines that he is talking about, which I assume he knows about.

What does it say as far as their intentions? They say they will involve themselves with securities such as lower unrated tranches

of pre-existing securitized or structured debt instruments such as mezzanine debt or others that have that feature. In other words, they will engage in credit risk, contrary to your testimony.

Now, to make sure that the Norwegian fund was not an outlier, I examined the next biggest fund that is out there, a sovereign wealth fund. That is the Abu Dhabi Investment Authority, which is over $600 billion in assets under management, and I did some research there on this fund, and one of the things that popped up was a recent article—a Google search is all you had to do—and they have in here that they are basically doing $200 million in Indian real estate. Now, I know that Abu Dhabi is closer to India than it is to the United States, but I assume if they are going to go over there investing it, they will be looking over here as well.

Now, another class of rate investors that frequently gets mentioned by some commentators who won't theoretically buy U.S. mortgage bonds without a government guarantee are foreign central banks, and this in fact is one of the three assumptions that Dr. Zandi uses, that he used in his numbers to get to the 90 basis points.

So, what I did there, I looked up to see whether that is true as well and I found a article from April of 2013 from Bloomberg News that reports that foreign central banks are actually loading up on equities, and as you well know, equities have far more credit risk associated with them than what we are talking about here.

The potential rate investors it mentions also are insurance companies, pension funds and diamonds. So I think if you do an analysis as I have done here—which didn't take too long—of their investments, there are plenty of products with credit risk in their portfolio.

So, Dr. Wallison, or Mr. Wallison, would you like to address that as to whether there is enough appetite to fill the rest of the pie as we seem to see that there is?

Mr. WALLISON. I am glad that you almost called me "Dr." Wallison. I am the only one on this panel who doesn't deserve that. In any event, the way the private market works is there are groups within the economy that do want to buy securities that do not involve credit risk, and of course, they would be clustered around government agencies of various kinds.

So the fact that it is now true that certain banks and foreign banks and so forth are buyers of Fannie and Freddie securities doesn't mean that there isn't an economy out there made up of many other kinds of financial institutions, life insurance companies, private pension funds that need the kinds of private securities that pay good yields to invest in.

Mr. GARRETT. We are—

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you. I would like to ask Mark Zandi some questions on the FHA section of the bill.

Supporters of this bill claim that FHA would play a countercyclical role by increasing lending during times of economic downturn and cushioning the housing market, but under this bill the FHA would only be permitted to lend to a limited segment of the

market and could not backstop the mortgage-backed securities market. Without a government backstop, wouldn't the mortgage-backed securities market be vulnerable to investor runs in times of financial stress? And I am interested in any other comments you may have on the FHA portion of the bill.

Mr. ZANDI. Yes, that is a good point. Another concern about a privatized system as envisioned in the PATH is that it does leave the system open to runs. The banking system was subject to runs, deposit runs, prior to the formation of the FDIC. We established the FDIC to provide deposit insurance, and that has worked marvelously well. We haven't had a run on the banking system since the Great Depression.

My worry would be that in a system which has no explicit catastrophic government backstop, we would see runs in the mortgage securities markets in times of stress, and that would impair the system and result in much higher interest rates, particularly for borrowers with lower credit quality, and it would be quite damaging not only to the housing market but also to the financial system because the U.S. mortgage market is such a large part of the global financial system, and obviously to our economy as well. So, I think that is a very reasonable concern.

The PATH does recognize this as an issue and tries to allow the FHA to help step in the void, and I think there is credit due. It tries to provide that kind of cyclical entry point for the government, but I would be concerned that it is inadequate and would not be sufficient to forestall runs throughout the barter system and we would have problems, yes.

Mrs. MALONEY. All right. You also stated in your testimony that the underlying bill would increase mortgage rates by roughly 90 basis points and that this was a conservative estimate, and I would like to allow you time to respond to some of the issues raised by my colleague, Mr. Garrett, and also, if you use less conservative assumptions, how much could mortgage rates realistically rise under this bill? 200 basis points? 300 basis points? If you could elaborate and comment on this section?

Mr. ZANDI. Sure. The 90 basis point estimate is based on the typical borrower in the current credit environment. That is a borrower with a 20 percent downpayment, that is a borrower with a 750 credit score, which as you know is very high. The median credit score in the Nation is about 720, and it also has a borrower with a debt-to-income ratio, a front-end debt-to-income ratio of 31 percent, so this is a pretty high-quality borrower. So, it is 90 basis points in a normal economic environment for that typical borrower.

For a borrower who is on the edge of the credit spectrum but is still a Qualified Mortgage (QM) loan, let's just say that is the definition of the credit box we are using here, in a stressed environment, let's say a typical recession since World War II, not the Great Recession, say the average typical recession, it could result in interest rates that are almost double that, so it would be quite significant. And it goes to my point about the 30-year fixed-rate loan. At that kind of an interest rate, when you raise rates that much, it is unaffordable, and therefore you won't have borrowers who take on a 30-year fixed-rate loan. They just can't afford it, and

therefore, the share of the market that is 30-year fixed would decline quite substantively.

Now, the question that—would you like me to go on, or would you like me to stop? I can go on for 5 hours or 5 minutes.

Mrs. MALONEY. I want to move on to another issue that you have raised in testimony. You testified that and related industries were 25 percent of our overall economy. Other economists say it is 20 percent. Some make it higher, some make it lower. It is important. How important is this, getting this bill right and making sure that housing is available to middle-class buyers to our overall economy?

Mr. ZANDI. It is vitally critical that we get this right. We can't mess this up because there is $10 trillion in U.S. mortgage debt outstanding. Just for context, there is $40 trillion in credit market debt in the United States. It is a big part of our financial system. If we mess this up, we are going to mess up our financial system and we are going to mess up the barter economy. There is no doubt that we have to get this right, and I applaud this kind of intellectual debate because we are not going to get it right unless we have this kind of debate.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair recognizes the gentleman from Texas, Mr. Neugebauer, Chair of the Housing and Insurance Subcommittee.

Mr. NEUGEBAUER. Thank you, Mr. Chairman, and I thank the witnesses for being here this morning, this afternoon, I guess, now.

Mr. Zandi, you mentioned in your testimony that the cost of FHA insurance would likely rise because of the required changes in the premium policy and the doubling of its reserve fund from 2 to 4 percent. Do you know what the FHA's capital ratio was in 2005?

Mr. ZANDI. In 2005? I don't recall, no.

Mr. NEUGEBAUER. We have a chart. Let me just put that chart up here.

Mr. ZANDI. That was a trick question.

Mr. NEUGEBAUER. And so it was—in 2005, it was 6.5 percent, the capital ratio, and as you can see from there, it went up to 7.38, 6.97, and I guess the other question is, was the premium at that particular time lower or higher than it is now?

Mr. ZANDI. I believe it is higher now, but I don't know for sure, no.

Mr. NEUGEBAUER. So, I guess the question is, do we think that a higher capital ratio is a harmful thing? Or why would a more solvent entity cause the rates to go up when in fact we are asking this entity to go from—actually what we would like for it to do is move away from a minus 1.44 percent capital ratio to a 4 percent, which—and I believe you said that you sit on the board at MGIC; is that correct?

Mr. ZANDI. Yes, I do.

Mr. NEUGEBAUER. Yes. So would MGIC be underwriting any mortgage insurance today if they had a capital ratio of minus 1.44 percent?

Mr. ZANDI. No, they would not, sir.

Mr. NEUGEBAUER. Would they be underwriting anything at 2 percent?

Mr. ZANDI. No, it wouldn't be with us.

Mr. NEUGEBAUER. Yes. So—

Mr. ZANDI. Yes. I don't disagree with you. I am not arguing with you. I would not disagree about your points about the FHA. I would like to stipulate that.

Mr. NEUGEBAUER. But you are saying that you think that the premiums would have to go up to be—to go to that level?

Mr. ZANDI. All I am saying is that under the provisions of the legislation—let me preface this by saying one thing: This is a very complicated part of the bill, with a lot of moving parts, and as I said in my testimony, I have to digest all of it, so I was opaque for a reason. But my sense of it is it would result in higher premiums, but I am not saying that is a bad thing or a good thing. That was just a description of what would happen.

Mr. NEUGEBAUER. The point I would make here is they have had higher capital ratios with lower premiums in the past, and see how that is stopped, so the argument that the premiums are going to go up to reach this goal is not necessarily validated by history.

Mr. ZANDI. And we can go through the arithmetic, but yes, it is possible.

Mr. NEUGEBAUER. This is to Mr. Calabria and Mr. Wallison, we have had 12 hearings and we have heard a lot of perspectives from a lot of different groups about the impact on housing to move to strengthen FHA, the potential impact on housing to—if we begin to wind down Freddie and Fannie, but the people who keep getting locked out of this discussion are the taxpayers. It is the taxpayers who have been making their house payment, and then they ended up making up for the fact that some of their friends and neighbors didn't make theirs, to the tune of $200 billion. As you look at this bill, the two of you, is this going to be a better deal for the taxpayers?

Mr. WALLISON. Yes, I think it is. What this bill does is create a much more prudent FHA, one that has to stand on its own 2 feet without the support of the taxpayers, although the taxpayers are ultimately going to be behind it, but there are sufficient provisions in this legislation that would reduce what the FHA does so that it only is covering low-income buyers of their first home. That would be exactly the right thing that we ought to encourage through this system. And if we can help low-income people to make their first purchase so that we can bring them into the housing market, that would be the way the FHA would be working best without any threat to the taxpayers.

Mr. NEUGEBAUER. Thank you. Mr. Calabria?

Mr. CALABRIA. Let me say, I very much believe that the responsibility of the committee, in my opinion, is to look out for the good of the entire American public, and that doesn't just mean borrowers, renters, lenders, whatever; it is everybody. And as a borrower, if you give me a 90-cent subsidy and then take a dollar out of me as a taxpayer, I am worse off, I am not better off, so that is one point.

The other point I would make is if you pass that subsidy on to me through my friends in the lending industry, the real estate industry, they are not going to give me all of it. They are going to take part of that. If you want to subsidize homeowners, cut them a check directly.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, Mr. Watt, the President's nominee to be Director of the FHFA whose nomination was approved by the Senate Banking Committee earlier this morning, and if the gentleman—in the words of Mr. Cleaver yesterday—would like to be eulogized, I am sure he will let the rest of the committee know.

The Chair yields to the gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman, and I think I am going to—in everybody's interest—pass on the opportunity to ask questions, but I didn't want to pass on the opportunity to commend the Chair for starting this discussion. It is a discussion that is long overdue and there are lots of moving parts we have to get through, and I suppose I am not supposed to say anything facetiously, but Mr. Calabria mentioned the possibility that the FHFA might be put out of business earlier than 5 years. That possibility was mentioned at the Senate hearing also, and a lot of people thought I would be offended by that notion, but the truth of the matter is that would be an indication that we have gotten through this discussion and to a point in the future where we would have a housing system that has been approved in the political process.

So in that sense, I would certainly welcome that. I said that to the Senate, and I say that to Mr. Calabria, also. So with that, I can either yield my time to somebody else or yield back.

Chairman HENSARLING. Since the gentleman yields back and effectively did not use his time, the Chair will instead recognize the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman. Let me ask Mr. Levitin—I believe you testified that an overwhelming majority of investors in the U.S. secondary mortgage market are not credit risk investors. So, do you see any emerging appetite to assume this risk by any major private sector source of capital, and what could be the risk premium or capital charges that could be imposed for assuming this risk?

Mr. LEVITIN. This is one of the really scary unknowns about any attempt to privatize the housing finance system. I would hope that everyone could agree that the first rule of housing finance reform should be to do no harm, and we don't know how much transfer there will be of investors who currently are interest rate investors into being credit risk investors. To maintain current housing prices, to keep the system functioning as it is, we need $6 trillion of rate risk investors to transform into credit risk investors.

It may well be that many rate risk investors are willing to take on credit risk, but if it is only $5 trillion, not $6 trillion, that is going to have a serious effect on housing prices. It is going to push them down. And to the extent that we have that transfer from rate risk investors to credit risk investors, those investors are taking on new risk and they are going to be charging for it. I don't know exactly how much that is going to increase housing prices. Dr. Zandi has some estimates of that, but it is going to cause the cost of a mortgage to go up.

Mr. MEEKS. Speaking of that, Dr. Zandi, let me ask you this: Many small community banks and credit unions rely heavily on the secondary market to sell up to 60 percent of the originated mort-

gage loans, and with the elimination of GSEs and the formation of a national mortgage market utility, what do you think would happen to these institutions' access to a secondary market?

Mr. ZANDI. That is a good question. It is an open question, I think. The PATH Act, from my reading, tries to address this in two ways, this concern you have: the first is to the utility and telling the utility, you have to take all comers on equal terms; and the second is to use the Federal Home Loan Bank System as an aggregator of loans from small banks.

Now, the way the legislation is written, I would be nervous about both entry points. The utility is not compelled to follow through, and there is not—more importantly, there is no—it is not compelled—there is no compelling reason why mortgage companies would use the utility. It is not clear to me why they would do it, and so I don't think you have a lot of people moving through the utility. And using the Federal Home Loan Bank System, it might work, but the Federal Home Loan Banks are not compelled in the legislation to do it, and I think even if they wanted to do it, and maybe it could work, it probably, because the small lenders aren't on the same—there is a potpourri of them, they are all doing different things at different times in different ways, the Federal Home Loan Banks would probably have to backstop the reps and warranties to make it work. They would have to do some other things to make the loans coming to them from the small community banks on the same equal footing with the large banks to make it work in a reasonable way for the small banks.

So, bottom line, I am not sure. I am skeptical that the way it is written would actually work. Maybe the legislation could be rewritten in a certain way to address these concerns and make it more viable, but as written, I would be concerned about it.

Mr. MEEKS. Thank you.

Mr. CALABRIA. If I could only clarify some of the discussion. The special risk about the 30 years, the interest rate risk has been alluded to. It is important to keep in mind that Fannie and Freddie provide a guarantee of the credit risk. Now, more often than not, how it functions is, let's say Bank of America sells 1,000 mortgages to Fannie Mae, buys back the mortgage-backed security holding those 1,000 mortgages, Bank of America brings back that interest rate risk on its own books. It transfers the credit risk to Fannie Mae. So again, what is special about the 30-year mortgage, by and large, in a securitization model, is that interest rate risk is transferred on to the final investor.

So unless we are envisioning a model where Fannie and Freddie maintain very large portfolios, because that is the only time where they maintain interest rate risk, otherwise it is passed on, and what I finally want to end with is the Democrat principles that were released earlier today say, we want to charge a fair price but with adequate revenue to cover the risk, so I think everybody is of a consensus here that this should be paid for one way or another. So even in this, rates go up.

Mr. MEEKS. Is it the concern, though, that based upon this, it seems as though that not only will rates go up, but the individuals would have to have almost 20 to 30 percent down and not able—

and an adjustable rates where we just got out of that problem. I am out of time. I have to yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair recognizes the gentlelady from West Virginia, Mrs. Capito, the Chair of the Financial Institutions Subcommittee.

Mrs. CAPITO. Thank you, Mr. Chairman. This question is for Dr. Holtz-Eakin on how the market utility is envisioned to work as proposed to set uniformed standards for securitization. Do you believe that a standardized platform would provide the market with a certainty that it would need about the terms of an agreement?

Mr. HOLTZ-EAKIN. Frankly, I have some ambivalence about the utility as it is written. I think there is tremendous value to standardization. I think, and there is great role in the legislation for providing that standardization. I am less enthusiastic about government-sanctioned monopolies of any type.

Mrs. CAPITO. Government-sanctioned what? I didn't—

Mr. HOLTZ-EAKIN. Monopolies, single entities of any type, and so I have some ambivalence about how this might play out in practice. The standardization, I wholly applaud. That is a very important step, something that I think would allow securitization broadly to function very effectively.

Mrs. CAPITO. Thank you. This is for Dr. Calabria. I represent a rural area, and my great independent banker is going to be on the next panel, Mr. Loving from Pendleton Community Bank, and he holds his mortgages on the books in his community bank. Do you think that without the government guarantee, more institutions will be moving in that direction, where they keep their mortgages on their portfolio, and is that a bad thing?

Mr. CALABRIA. I generally do think that without the Fannie and Freddie structure, you would have more portfolio lending. Quite frankly, I think that's a positive. I included a graph in my testimony. Before 1980, and again, you need to keep all the failures of the savings and loan industry in mind. We don't want to repeat that either, but I think you get better mortgage modification, for instance, you get a better knowing of the borrower when you have a problem with your mortgage, you can go to your lender, they have it, you have that discussion, you get a workout.

I think a lot of the problems in the most recent crisis was an outcome of the securitization model, which we embraced, and as I mentioned, we previous pretty much had reached the homeownership rates we have today when securitization was irrelevant, so it is hard for me to see the last several decades of securitization as actually having brought a lot of good, other than in my opinion transferring risk to the more highly leveraged parts of the system.

So, I think we should reconsider a broad portfolio model. I will say, I think a private TBA market certainly has a place. I think covered bonds has a place, but at the end of the day, going back to a lender makes it, keeps it, is responsible for it, I think you get better quality lending out of that.

Mrs. CAPITO. Thank you. And this is a bit of a statement and then a question for Dr. Zandi. We talked about the 30-year fixed-rate mortgage. That is important to me. In the place where I live, we have lower incomes, and we have lower property values, and you absolutely gauge whether you are going to be able to do this

or not on whether you can meet your monthly obligation, and in a State like mine which has lower socioeconomics, we do meet our obligations. We have some of the highest homeownership in the entire country, and so that can be achieved.

But my question is—we have had hearing after hearing on this QM. There is a study out there by CoreLogic that says the mortgages that were written in 2010, under the QM, 52 percent of those mortgages would not qualify for a QM. So that is 52 percent of folks who got a mortgage under those standard—under those underwriting, and in this market now, with a QM, would be unable to access the mortgage market. That, to me, is an enormous red flag, and so if—I don't see how we are going to have do no harm and keep a 30-year mortgage rate when we are going to be cutting out half of the people under the Dodd-Frank Act, under the auspices of protecting the consumer when the consumer, many of them are in Mr. Loving's bank who are farmers and rural and folks who don't met the metrics of a QM, they are the ones, those are the families, the young families who aren't going to be able to buy that first house.

There is a bank in Wheeling, West Virginia, which underwrites a program where the first-time home buyer doesn't have to put down a downpayment. It is a charity program that was established by a trust 30 years ago. They are out of it. They are not going to be able to do it. So I would like to know what your response to something—to these folks are going to be, these 52 percent.

Mr. ZANDI. I would say a few things. First, I think the intent of QM is a good intent. We want to make sure that borrowers can afford the mortgages that they are taking on. I think we can all agree.

Mrs. CAPITO. Right.

Mr. ZANDI. And I think that we do want some criteria for determining that, and it would be helpful if they are clearly defined and articulated, and I think that is the intent and purpose of QM.

Second, I would say with regard to its implementation, I think there are some reasonable concerns about how tight QM has been defined. I think actually the Consumer Financial Protection Bureau (CFPB), the keeper of the rule, has relaxed some of the key constraints on QM over time and much of the industry feels comfortable with those.

Mrs. CAPITO. I think I have just lost my time. Thank you.

Mr. ZANDI. I had a third point, but it was the best one actually.

Chairman HENSARLING. Maybe in the next round.

The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano, for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. I actually found your testimony very interesting and intriguing. I didn't disagree with almost anything anybody said. A couple of things you said, Mr. Calabria, but pretty much nothing else. Especially, Mr. Holtz-Eakin, I agreed with pretty much everything you said. The generic goals are the same. The question is, okay, what does this bill do to those goals, and I only have one segment to look at things.

I can't find any models that I think are comparable with the United States today that I can really look at a purely private market, and the only thing I can look at is the United States prior to

1930, 1933, and in that market everything I found, the history is a little vague, tells me that we had about the same rates we have today, give or take, but with a 50 percent down, 5-year payment, which pretty much came out to double any monthly mortgage anybody would have, rough numbers. And in today's world, the average person who qualifies, which I agree, there are fewer people who qualify. And by the way, before I forget, I want to echo 100 percent the comments that were made by the previous speaker. If the QM, the QRM, the ABC, XYZ, anything ends up turning 50 percent of the potential market away, that is a wrong goal, that should be addressed immediately, and I haven't had an answer to that by some people. That is a different hearing.

But under today's market, just based on some work I did today, the average mortgage that is available today to the qualified person, which is most people, most people who are looking to buy a house, for a 30-year fixed is 4½ percent, that comes out to $1,013 a month, which is still out of the range for a lot of people, but it is there.

I can't imagine taking that $1,000 and turning it into $2,000 a month, and so I need to go back to my original opening statement. Mr. Wallison, do you think that this bill, as currently drafted, would provide 90 percent of the people who are currently getting a mortgage today with access to a fixed 30-year mortgage in the 4½ percent range with a 10 percent downpayment, roughly, do you think this bill achieves that goal?

Mr. WALLISON. I think this bill could very easily achieve that goal, and in fact, right now, Wells Fargo is offering a 30-year jumbo fixed-rate mortgage for 4¼ percent—less than the conforming loan.

Mr. CAPUANO. Jumbo.

Mr. WALLISON. A jumbo.

Mr. CAPUANO. Who qualifies for jumbo? Tell me that again.

Mr. WALLISON. A jumbo is a mortgage that is over and above—

Mr. CAPUANO. I understand that, but who qualifies?

Mr. WALLISON. Who qualifies?

Mr. CAPUANO. Could my mother qualify for one of those?

Mr. WALLISON. Of course. I don't know your mother, but I assume she's—

Mr. CAPUANO. I think not, but that is beside the point.

Mr. WALLISON. —a person who meets her obligations.

But the point—

Mr. CAPUANO. Would most of my constituents qualify for that?

Mr. WALLISON. Of course, because when you have—

Mr. CAPUANO. Really?

Mr. WALLISON. When you have a market in which there is a lot of private competition, those rates will be kept low by the competition.

Mr. CAPUANO. The one thing that is interesting to me is that one of your colleagues came in and dramatically demanded that we get rid of the 30-year mortgage in favor of a 20-year mortgage, and if we did that at the same rates, you are basically adding another $300 a month to it, but that is beside the point.

Ms. Levitin, do you think that this bill would allow a typical, as we understand it today, 30-year mortgage to be available?

Mr. LEVITIN. I do not think that under the PATH Act a 30-year fixed-rate mortgage on affordable terms would be available to most home buyers.

Mr. CAPUANO. Mr. Holtz-Eakin, do you have an opinion on this?

Mr. HOLTZ-EAKIN. I do, and respectfully, I don't think it is the right question.

Mr. CAPUANO. You don't have to think it is the right question. I just want you to answer it.

Mr. HOLTZ-EAKIN. But respectfully, you just said there was a consensus that we have to change from where we are now, and so the mortgages that you are comparing to are ones which are vastly subsidized, have all sorts of opaque risks, and have left the taxpayer—

Mr. CAPUANO. That is all well and good. But my average constituents are not interested in that. They just want to know if they can get a mortgage and their kids can.

Mr. HOLTZ-EAKIN. I hope they are interested because it is costing them a lot of money. So the question will be, in whatever new system we have, will they have access to an affordable mortgage, and the answer to that is yes.

Mr. CAPUANO. Are they going to have access to a mortgage that is in the range of what they have now? Because "affordable" is not an objective term. Would you agree with that?

Mr. HOLTZ-EAKIN. "Affordable" is not an objective term, but I believe there will be a well-functioning mortgage market under the PATH Act that will give your constituents the housing finance they need.

Mr. CAPUANO. So, thank you for not answering it, but close enough. I am trying to avoid this ideological philosophical statement so that I can go home and tell people yes or no.

Mr. Zandi, do you think that the mortgage that my average constituents can get today will still be available under the PATH Act?

Mr. ZANDI. No, I don't. Going to the jumbo market, it is—the loans in that market current—especially today are incredibly high quality. I love Peter's—I only have 7 seconds left, so—

Mr. CAPUANO. Use it well.

Mr. ZANDI. I have a good story for you.

Mr. CAPUANO. Thank you, Mr. Chairman.

Chairman HENSARLING. And Mr. Zandi, your timing isn't the greatest.

The Chair now recognizes the gentleman from California, Mr. Miller.

Mr. MILLER. Thank you, Mr. Chairman. Mr. Zandi, I am not going to ask you, because you are wearing some kind of dart on your chest or something out there.

Mr. ZANDI. I am used to that. I grew up in a big family.

Mr. MILLER. It is very tough to determine what is happening in the marketplace because the marketplace is not normal today. The quotes that we had about the jumbo loans being competitive, 70 percent loan-to-value, 750 FICO scores and stable for 3 years, you look at the conforming mortgage, $75 billion is being bought each month by the Fed, so it is almost impossible to look at anything today and say that is the norm and this is where we go from.

My only concern is will financing be available for homeownership. Remember back in 1983, remember how bad that was. I had major lenders telling me that you will never see a fixed-rate 30-year loan again. That proved, thank goodness, not to be true, but the prime rate was 21.5 then. Fannie and Freddie made some horrible, horrible mistakes, but in 2008 the default rate for the jumbo marketplace was greater than Freddie and Fannie's even, so everybody in the marketplace made horrible mistakes. They made loans they shouldn't have made. They made them to people they shouldn't have made them to, and we ended up with a mess on our hands. First, $2.7 trillion lost in mortgage—default market, $180 billion was lost by Fannie and Freddie which they owned a bunch of it, but that is still $180 billion they should not have lost. So there is no excuse for any of it, but what do we do today is my concern.

Mr. Holtz-Eakin, you wrote an article last year stating that should another housing bust occur, Congress will intervene in some way. I think that is probably a reasonable statement, and yesterday, Fed Chairman Bernanke echoed that if we don't define the role of government, won't it cost taxpayers more in the end. So, there are some red flags that we need to look at and say what do we do.

My question to you is without a guarantee, what happens in time of crisis, and we need to worry about crisis. Will investors be there to purchase mortgage-backed securities and will interest rates tend to rise?

Mr. HOLTZ-EAKIN. It is a very good and a difficult question, and I have struggled with it.

Mr. MILLER. Even the committee.

Mr. HOLTZ-EAKIN. A lot of it is an issue of a Federal backstop. The focus today has been on what will a 30-year fixed-rate mortgage look like. That is one way to think about it, but the second way to think about it is what is the cheapest taxpayer protection we can get, because if you do believe that in a—

Mr. MILLER. I think Freddie made a horrible mistake.

Mr. HOLTZ-EAKIN. —major crisis Congress will intervene, will that be more expensive than something that is a backstop price now. That is a fair question—

Mr. MILLER. And my concern is—

Mr. HOLTZ-EAKIN. —that I worry about.

Mr. MILLER. —as your statement here last year and Chairman Bernanke's is the government is probably going to end up being there, and that is a huge concern if we don't define some role and purpose for them. But numbers bother me, and I say, let's look at the market today. What is the private sector doing?

Banks own about $1.5 trillion of wrapped mortgage-backed securities. Foreign holders own approximately 1 trillion of wrapped. The Fed owns $1 trillion of wrapped. Insurance companies, State and local investment funds own about a trillion between them in wrapped. So you have about $4 trillion in residential mortgages to buyers who don't buy unwrapped mortgages, and I am looking at a huge sector of the economy that is buying only wrapped.

Mr. Levitin, you have kind of gotten by unscathed. I will direct this one to you. Can you, as an academic, tell this committee and

the American people that the market participants are wrong in what they are doing today and that some other fashion is right?

Mr. LEVITIN. That they are wrong in only buying wrapped?

Mr. MILLER. Yes.

Mr. LEVITIN. No, I can't say that. I think a mortgage investor right now should rightly have a lot of concern about credit risk on any loans that are being originated, and therefore would want wrapped securities.

Mr. MILLER. Any of you, there is no definition of the TBA market. That is a huge concern for me out there because there is no front and there is no rear. You have your microphone up, go for it.

Mr. CALABRIA. Let's keep in mind that part of the existence of a TBA market is because Fannie and Freddie have 1933 Securities Act exemptions, so you could craft those sort of exemptions for a TBA market that allows you to sell that forward.

Mr. MILLER. But if we don't do that on the front end, the back end connecting the person who wants to buy a house to the person who wants to buy the loan could be problematic.

Mr. Zandi, you touched on that briefly. The bull's-eye is back on you at the conclusion. I have 30 seconds, so what do you think about the TBA market? Is it necessary? Is it something that's—

Mr. ZANDI. Yes, I think that is a very important part of our mortgage housing finance system. It provides liquidity, it keeps rates much lower than they otherwise would be, and we need to preserve that under all circumstances.

Mr. MILLER. So, Freddie and Fannie made huge mistakes, no doubt. I'm not defending Freddie and Fannie, something has to change, but there are some holes that bother me, and TBA is one of them, and the wrapped on the investment side is the other, and Mr. Chairman, thank you for the time. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Zandi and Mr. Levine, I kind of want to direct my questions to you. Is that right, in the middle, is it Levine or—

Mr. LEVITIN. Levitin.

Mr. SCOTT. Levitin. All right. I am really worried about this bill. It sort of reminds me of like a Darth Vader, sort of a dark star that kind of sends us on the dark side, because, Mr. Zandi, you mentioned this because it sends us back, all the way back 80 years to the Great Depression. We have had a need to respond, and I have listened to this discussion, and nowhere in this discussion have we considered the plight of the American people, the struggling homeowner, the person out there, the fact that we need to admit the truth here that this bill not only sends us back past 80 years, back to 1934 when the National Housing Act was put in place, where we knew we needed a government backing for housing.

And now in this rush to declare this war on Fannie and Freddie, we are losing sight of that human quality, the middle-class. And I really would like—I have 3 minutes, and I would like for the two of you to really stress how this definitely, without question, will cause havoc to the 30-year fixed mortgage rate, which is the crucible that allows people to be able to have an affordable payment schedule and how refusal of this will send them into the arms of

predatory lenders, of prime selection, and of some of the very things that caused the trouble in the first place.

Please tell us, without question, that this bill will end for those people, the vast majority, the 30-year mortgage rate and impact of that.

Mr. LEVITIN. Congressman, we have never seen a private mortgage lending market produce long-term fixed-rate mortgages on any scale. We have several examples of these markets. We have the current jumbo market, which does produce some fixed-term, fixed-rate mortgages, but not on a large scale. The much higher percentage of jumbos are adjustable-rate and fixed-rate. We have the commercial mortgage market which generally does not produce loans much longer than 10 years in duration, and we have the pre-depression housing finance market, which was totally private and the standard product there was a 3- to 5-year fixed-rate loan where it was not amortized. It was interest only. They were called bullet loans, because at year 5, you had to bite the bullet. Either you could pay the entire principal or you had to roll it over, and if markets were frozen, if your credit was damaged, or if rates had simply gone up, you might lose your home.

Mr. SCOTT. But I want to—what I am after is, will not this cause havoc to the—I am not worried about the rich folks. They are going to go get their house. They are not worried about that. We have to worry about the middle income and the lower income and will not this, in effect, end that 30-year fixed mortgage for them in large measure? Yes or no? That is what I am after here.

Mr. LEVITIN. It is going to make it much harder for them to get affordable 30-year fixed-rate mortgages.

Mr. SCOTT. All right. Mr. Zandi, your comments on this, please.

Mr. ZANDI. Yes, I would agree with that. It is going to make it a lot more difficult for lower- and middle-income households with lower credit scores, less of a downpayment, more disadvantaged folks who don't fit quite in the box for a 30-year fixed-rate loan.

Mr. SCOTT. And in addition to that, will not it make it more difficult for those poor little community banks and those credit unions who could fill in the gap here under this legislation, would be very, very hurtful to them?

Mr. ZANDI. Yes, but let me just say that I think the legislation is sensitive to that concern. It is just a matter of getting the mechanics right to address that concern, so it is not a matter of intent. It is a matter of can we get this workable in the framework that has been put forward in the legislation.

Mr. SCOTT. But it is the bottom line that you all agree that this bill, as structured, needs to be fixed or else it will do tremendous damage to the middle-class and the lower-income people.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, Mr. McHenry, the Chair of the Oversight and Investigations Subcommittee.

Mr. MCHENRY. Thank you, Mr. Chairman. Thank you for having this important hearing, and for a great panel of witnesses. I think it is a deep ideology we hear from my colleagues on the other side of the aisle that says only government can provide this type of product and otherwise it would simply not exist in nature.

It is wholly ridiculous on its face that that is in fact not what a new market would look like without the government intervention. In fact, Mr. Zandi, to—a quote the chairman referenced before about QRM and the premium capture rule, and you stated before, quote, as a result of the way the premium capture rule is stated, the mortgage rate impact to borrowers would be significant, on the order of an increase of 1 to 4 percent.

Now, I am bringing this up because many of us believe that Dodd-Frank is going to drive up the cost of lending, especially in the mortgage marketplace. And Mr. Zandi, you said as much in the response to the chairman at the beginning. And so, let's talk about that. Walk me through your thinking on this, why the reforms that we have and a part of this legislation actually will end that, right, and that is beneficial in your view, Mr. Zandi, is it not? I am sorry, Dr. Zandi.

Mr. ZANDI. Yes. Specifically on QRM. As QRM and the premium capture rule are written, it would be, I think, a mistake because it would raise mortgage rates considerably, particularly for households with lesser credit scores, more disadvantaged groups, so I think as currently written, it would be a mistake.

Now, having said that, the Federal Reserve, which is the keeper of that rule, understands this and has been working quite hard over the last couple of years—I think it has been at least 2 years since they introduced the rule—to address these concerns, and they are going to rule on this, at least it is my understanding, by the end of the year, so let's take a look at it, and they understand—because I have gone back and forth with spreadsheets and they understand the concerns.

Mr. MCHENRY. Right. So we are dealing with this legislation. Do you think this is a beneficial provision that we have in the bill?

Mr. ZANDI. I think it is almost irrelevant because by the time this bill gets anywhere or any other bill gets anywhere, this will be—

Mr. MCHENRY. No, no, no, but today. We are talking about today. If you are telling us as Congress to hang out for 6 months, we are not Members of the Senate. We don't do that well in the House.

Mr. ZANDI. If I were king for the day, I would say I understand the intent of QRM, I understand the intent, but it does not—it is skin in the game, the logic is straightforward. If you have skin in the game, therefore you are going to make better quality mortgage securities. I am on board with that. I just don't think the QRM rule, as it is currently defined, will accomplish that. That is all.

Mr. MCHENRY. Right. Thank you.

Mr. Calabria, when we talk about the impact of Dodd-Frank on mortgage-backed securities, rather than making it a more robust, more liquid market, it actually has the opposite effect; is that your view?

Mr. CALABRIA. I would very much agree. I think the provisions in Dodd-Frank are going to do more to restrict mortgage credit than anything in the PATH Act. I also want to mention to Congressman Capuano's question, 2 or 3 years from now, nobody is going to get a mortgage for 4½ percent under any system because of what the Federal Reserve is going to do. So, you should have raised that yesterday with Ben Bernanke. That is the place to go.

Mr. McHENRY. Okay. So the cost of mortgages has more to do with Federal Reserve policy?

Mr. CALABRIA. And I would also emphasize, if you look at the difference between choices in say Europe between fixed-rates and short-rate financing, it has far more to do with the conduct of monetary policy. We have talked repeatedly about interest rate risk. The prime source of interest rate risk in this country is the Federal Reserve.

Mr. McHENRY. Sounds like a good way to articulate for the Taylor Rule for monetary policy.

Mr. Wallison, when we talk about the PATH Act, in the provisions that are there to entice and attract private capital to the MBS market, do you think that is sufficient, do you think those are proper for us to have in this legislation?

Mr. WALLISON. Yes, I do. The one thing to realize is that in the private sector, people are compensated for taking risks. The idea that there isn't enough capital in the private sector to replace government-supported capital such as with Fannie Mae and Freddie Mac is, of course, wrong, because the rest of our economy is financed entirely by people who do take risks in order to make loans. And if you are looking at institutional lenders, insurance companies and pension funds, have about $13 trillion that they do not invest by and large today in government-backed instruments. They are looking for risk-based instruments.

Mr. McHENRY. And finally, only half of today's mortgage originations would meet Dodd-Frank requirements.

Chairman HENSARLING. You are out of time. The time of the gentleman has expired. The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

I want to thank the panel as well for your willingness to help us out on this. Dr. Zandi, I had an opportunity to read your testimony last night. I think you did a great job. Very balanced. But you have raised some very real concerns about what might happen to mortgage rates if we went through with the PATH bill as is written.

There is a formula here that you have used which describes at least what the minimal impact might be, and that would be, I believe, under certain conditions to raise mortgage rates by 90 basis points. Is that correct?

Mr. ZANDI. That is correct. For the typical borrower in the current mortgage market, it would be about 90 basis points, under the assumptions that are laid out clearly in the testimony.

Mr. LYNCH. But there are other parts of your testimony where you talk about the inability to quantify the tangible risks that might be increased because of the lack of a government backstop. And I was just trying to add that in if there was any sense of what you thought that might bring us to above the 90 basis points.

Mr. ZANDI. I took a crack at estimating that. This brings up a broader point. And that is, we are going to have a debate about the impact of this legislation and other legislation on mortgage rates and the 30-year fixed and mortgage credit availability. It is really an empirical question. It is going to be very difficult to answer. Given that, we have to be very careful that we don't, as Adam said, do anything that harms the current system. It is like—I am not

going to have as good a metaphor as the Congressman from Texas with the boot and the oven, but if you are standing on a cliff, you want to make sure there is some water underneath you if you dive off.

Mr. LYNCH. Right.

Mr. ZANDI. And I am very concerned that under the legislation, we will be diving off a cliff, and we don't know what is underneath us.

Mr. LYNCH. Right. Here is my problem. You are describing a 90 basis point increase under average conditions here with an average buyer when the time at which we actually need the backstop and we need the system to hold firm is under the direst or the most calamitous market conditions. That is when we need the backstop to be there. Have you thought about—in the past, we have seen private capital flee when market conditions are unfavorable. So what does that say about the ability of private capital to replace a government backstop under those conditions?

Mr. ZANDI. That is a very good point. So my sense, just to give you the sense of magnitude, is that if you took a borrower who is at the edge of the QM credit box, that is kind of the box we have defined as we are going to lend into in general, in a stressed environment, let's call it a typical recession, since World War II, not the Great Recession, just a typical recession, that for that borrower the impact on mortgage rates in the vision presented in the PATH plan for privatization would probably be double the 90 basis points, closer to double, so closer to 180 basis points. I am giving too much precision to this because there are so many assumptions. But that kind of gives you kind of order of magnitude, yes.

Mr. LYNCH. Okay. The other—in your testimony you also talk about the covered bond piece of this. And you made some—I think it was your testimony talked about some of the—the use of covered bonds in Europe and how the government backstop there really is what made the covered bond work. Talk about that.

Mr. ZANDI. Yes. The covered bond market works in Europe as well as it does because the financial system is dominated by too-big-to-fail banks. And in Europe, there really is no significant debate about too-big-to-fail. That is taken as a given, very different from here, where we are working really hard, Congress, the Administration, and regulators, to reduce too-big-to-fail risk. But in Europe, if Deutsche Bank gets into trouble—just picking a name of the air—the German population, the policymakers are going to be behind and backstop Deutsche Bank. So the guarantee, in a sense, the government guarantee in Europe is through the banks and the banking system and that is how—

Mr. LYNCH. Right. And large banks, not just—that is not just a bank—the banks are increasingly large there to make that covered bond work.

Mr. ZANDI. Correct, yes.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman. And thank all of you for being here and going through this process.

The CFPB put out a statement trying to tell the consumers about not paying the minimum on a credit card, saying, pay your debt off quicker. Because if you pay the minimum, you are just—the debt is just going to continue to build. And so, they recommend paying the most you can.

If you compare that to if you look at a home loan, let's say of $100,000 at 5 percent interest, a 30-year fixed-rate, it is going to be about $550 a month, and a 15-year would be about $800 a month. You would pay total interest of $93,000 on a 30-year, and $42,000 for the interest on a 15-year. So is this something that you would—is the 30-year fixed something that is making it so easy for people to assume all this debt rather than getting a shorter-term loan? Anybody?

Mr. WALLISON. All right. I will pick that up. Yes, indeed, you are pointing to something very important. And that is the question of leverage. People who take a 30-year fixed-rate loan or any kind of 30-year loan are in a position where they are not actually accumulating any equity or very much equity in the house for the first 6 or 7 years. Most people then move after 6 or 7 years. So they haven't accumulated much.

The question always comes down to this: What is the monthly cost in relation to the size of the home. And what we are doing with 30-year mortgages, by reducing the monthly cost with less amortization, we are encouraging people to buy bigger homes. What people should be thinking about is the same thing you mentioned with the credit card. And that is, they should be buying a house that enables them to get equity as soon as possible, and that is with a shorter term, not with a 30-year term, and to pay as much of the principal as they can in terms of the size of the home.

We don't necessarily have to persuade people to buy the biggest home they can possibly buy with whatever they have available to spend on a mortgage.

Mr. HOLTZ-EAKIN. That was beautifully said. And I just want to emphasize the flip side to that transaction is lenders who have private capital risk are going to take the argument Peter just made and give good counsel to borrowers and say, this really isn't the house you should be buying, it is too much. And in a system that used private capital just to screen risks to make sure wise decisions are being made you will get better information on both sides of that transaction.

Mr. LEVITIN. I would agree with everything that has been said so far. But I would add in this. The credit card analogy is problematic for two reasons. Number one, credit cards are now pretty much all variable rate, and that means that the consumer is taking on the risk that interest rates can go up. With a fixed-rate mortgage, it may be advantageous not to prepay sometimes. On the other hand, you can prepay your credit card whenever you want, you can pay off the whole balance, you don't have to pay the minimum. That gives you an option. That option is really valuable because you might have an unexpected expense in a month when you don't want to have a make a larger payment. The 30-year fixed-rate mortgage basically builds in that option. You can always prepay. You can make that larger payment, pay down the debt. And that

is often the smart thing to do, but you have the flexibility. And that is one of the real consumer benefits of the 30-year fixed-rate.

Mr. CALABRIA. I want to make a broader point about this sort of—all of this takes context in obviously the housing market. So let's even think about the height of the bubble in 2006, 2007. We added less than 2 percent to the total stock of housing. So part of the problem here is that supply is relatively fixed in the short run. And if Adam and I are bidding against the same house and you keep raising the amount we can borrow, one of us is just going to bid higher and higher. This is great for the home seller, great for the real estate industry. It is not so great for Adam and me. And a better world would be Adam and I agree we are not going to bid each other up. Unfortunately, we are in a bad equilibrium. So how do you get past this where people who are struggling don't have to bid higher and higher prices for housing? At the end of the day, a lot of these subsidies in the mortgage market just go to the seller of the house, not the buyer.

Mr. WESTMORELAND. Mr. Zandi, I am not trying to keep you from answering. But I would like to say that if these—if it did come about that the shorter-term mortgages came out, people could still buy houses. They just might not be able to buy as big a house as what they want. And the same thing with credit card debt; it depends on what your limit is.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman. And I thank the panel for being here today.

The discussion draft we are considering today repeals the affordable housing goals and the trust fund, it eliminates the GSE's role in multi-family housing, and it would make the FHA multi-family program an administrative nightmare, making it similar to the Section 8 program by setting income limits and requiring annual recertifications of income.

Can you talk about the cumulative impact this would have on multi-family housing rents across the United States? And wouldn't it be a mistake to undertake such a dramatic divestment to multi-family housing at a time when vacancy rates are at an all-time low in many years and when we expect the demand for rental housing to surge due to demographic trends? Let me start with Mr. Levitin.

Mr. LEVITIN. Let me start with this: There is definitely a need to rethink the affordable housing goals. And I would say in conjunction with that also the Community Reinvestment Act. Both of those are dated in many ways. But rethinking is not the same as getting rid of them. And I am not ready to make prescriptions about what they should look like, but I would say that whatever is done should apply marketwide, not simply to a securitization utility or the GSEs, but duties to serve should apply across the entire housing market, that we should have a level playing field that ensures affordable access to all Americans in that way.

As far as the rental market goes, there is a real concern right now that if we make—if we tighten up credit availability for multi-family, we are going to see real problems in the rental market. As people lose houses in foreclosure, they don't just disappear. Instead,

they become renters. And we are seeing an increase in demand for rental housing as homeownership rates have fallen. And it is very important that we ensure that there is both adequate supply of rental housing and of housing to buy.

Mr. CLAY. Thank you. Mr. Calabria?

Mr. CALABRIA. Let me try and take a couple of these things. First of all, in the trust fund, I am generally a believer that these things should be done through the appropriations process, keeping in mind the various problems that the appropriations process has. But my read of the Constitution is if you want to spend money out of the Treasury, it has to come from appropriations. There is accountability.

Second, in terms of the multi-family FHA, a lot of what this is does mirror, for instance, the low-income housing tax credit. If you want to get a low-income housing tax credit for property, there are income restrictions. Currently, in terms of—we give insurance to multi-family properties and ask nothing from the lender-developer in return. In my neighborhood on U Street here in Washington, I have seen a number of multi-family FHA signs. And I can tell you those properties are not serving low-income poor. So I think they should give back if we are going to give them to get FHA insurance.

Mr. CLAY. So that is why you agree with the annual recertifications of income?

Mr. CALABRIA. I don't think you need to do it on annual basis; 5 years is probably sufficient.

Mr. CLAY. Okay. Dr. Zandi, any comments?

Mr. ZANDI. Yes. I think there is a role for an explicit catastrophic government guarantee for multi-family mortgages for two reasons. One, the multi-family mortgage market is subject to runs, and it does shut down in times of extreme stress. We saw that in the Great Recession. Without Fannie Mae and Freddie Mac's guarantee, the market would have completely shut down, and that would have ended construction activity and caused vacancies to fall, and rents to rise.

Second, and I think also very important, is that the flow of multi-family mortgage capital to rural areas and non-large urban areas is constrained, particularly the lower-income households, and the middle-income households. And I think there is a role to try to help facilitate the flow of credit to those parts of the multi-family market. I think that this is something we need to think about very carefully. I think there are changes that need to be made in how we do this. But I think the principles should be that there should be some backstop there as well, yes.

Mr. CLAY. Thank you for that response.

Mr. Wallison or Mr. Holtz-Eakin, any comments?

Mr. HOLTZ-EAKIN. I would just like to make the point that I think if you look at the multi-family history, the credit risk is probably lower. They performed much more through the crisis and the need for a government backstop and everything is less than whatever you believe it is on the other side in the single-family.

The place where I would express concern, without knowing how—again this is going to be an empirical question—is liquidity in that market after reform. And that will be interesting to watch.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

I think the panel here would agree that one of the reasons we are looking at an alternative model is because we have experience with what happened with the GSE model and how that did help lead to a ballooning of the market and in terms of what it did—and with respect to moral hazard, it was a serious problem. Part of the problem with creating something which is a public-private partnership is in this case, the profits accrue to the benefit of the shareholders and the management at the GSEs, right? Whereas the risks, which you could see coming, which the regulators could see coming, because they came to us. I had legislation in 2004 and in 2005 that tried to regulate those institutions for systemic risk, so that we could do something about the portfolios. The portfolios were then about $1.6 trillion. Fannie and Freddie had moved away from their historic model of securitization. Now they were taking on this enormous new risk, and so much of that was subprime. And the government's stamp of approval on that also bled into the private market. So this was a problem.

So today, what is the proposed solution here? It is to take low- and moderate-income home buyers and keep them in a GSE, have the FHA do and first-time home buyers and so forth, and then try to bring the private capital back into the market by slowly drawing down and making space for private capital to come in. And it would seem to me if we wanted to adequately price risk going forward, we would have to devise something for that end of the spectrum, for people who are better off, where the risk is borne—where the market indicates what the risk should be.

The other advantage of this is we still have $1.2 trillion in those portfolios. And, as you know, economists are still pretty worried about the quality of that $1.2 trillion and what that is going to mean in terms of eventual losses. So the other thing the legislation tries do is slowly ratchet down or at least codify the reduction at 15 percent a year.

There is one thing here that is still missed. In my original legislation, working with the Fed, what we were trying to do was also look at the Federal Home Loan Bank, because that is sort of the forgotten GSE. You can have a problem with some of the largest financial institutions accessing the window there. And basically, you would have some of the same questions that you have here in terms of moral hazard. That is not really addressed in the legislation.

But in terms of what I have laid out here, if members of the panel would like to respond to those observations, I would be happy to hear your thoughts.

Dr. Calabria, would you like to begin?

Mr. CALABRIA. I would be happy to. But let me take just a moment and say I was there at that time and I very much do commend your efforts in the past and think if we had listened to you we would be in much better shape today. So I think that needs to be appreciated. I also remember that at that time, the Federal Home Loan Banks actually received more scrutiny than Freddie

and Fannie and came through this better. So in some sense, I feel like the cooperative structure is probably more stable than Freddie and Fannie, but were you to do a variety of things to the Federal Home Loan Banks, certainly, my ultimate goal would be to get rid of them. In the interim, I think looking at their debt registration, I would certainly put them under the 1933 Securities Act in terms of their debt registration. I think certainly some concerns about the concentration and advances to a small number of lenders is a concern. We all remember the very large advances that were given to Countrywide before it went down. So, there is a very high concentration in advance to a small number of institutions. I think that is something—

Mr. ROYCE. Thank you.

Dr. Zandi?

Mr. ZANDI. I can concur with the spirit of what you said. I really do think this is a very therapeutic process. We need to go down all the paths, and this is a very important path that we need to explore in great detail and just work it out. My sense of it, just based on the work I have done and my experience, is that this isn't going to be viable. But I am not saying we shouldn't go down the path. We should. And you are doing a good job of it.

Mr. ROYCE. Thank you.

Mr. Wallison or Mr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. I can't resist the temptation to say that I concur with your reading of the record on Fannie and Freddie. And I told you so, literally. When I was the CBO Director, we testified in 2003 that it was going to cost the taxpayers about $20 billion a year for 10 years. We were pretty close to right when it went down. So we cannot replicate that structure again. This FHA is not that. It is better capitalized. I think we will survive better than they did. But certainly the thing I would emphasize most is the steady withdrawal to allow private capital to come in. That has to happen.

Mr. ROYCE. Right. Mr. Wallison?

Mr. WALLISON. I think that it is pretty clear that the way Fannie and Freddie worked was troubling. And everything that has been said here is correct. We have to stop that kind of—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Levitin, your testimony indicated that the PATH Act could potentially undermine the TBA market and make it extremely difficult for borrowers to lock in mortgage rates 60, 90 days before closing. Do you believe that the mortgage market will see fewer closings and subsequent sales under these circumstances?

Mr. LEVITIN. I do. The ability to lock in a rate before closing means that a borrower knows what the expense of the loan will be. And when you are buying a house, you have to figure out how much house you can buy and how much loan you can buy, as it were. If you can figure out how much loan you can buy in advance, you then know how much house you can buy. That means when you go out looking for a house, you know what the price range is that you can bid on. If you don't have your rate locked in, in ad-

vance, there is some uncertainty about what that rate will be. And that means you are going to have to lower your bid on the housing price. And the effect of that is going to be to lower housing prices, which have real effects on the economy.

Ms. VELAZQUEZ. Thank you. As the Representative of a number of credit unions, community banks, and CDFIs in New York's 7th Congressional District, I am troubled by the PATH Act's lack of protections for small financial institution access to the secondary mortgage market.

Dr. Zandi and Mr. Levitin, do you believe the proposed national mortgage market utility provides small financial institutions with adequate opportunities to securitize their mortgage portfolios?

Mr. ZANDI. I think that is an open question. My sense is there wouldn't be, as currently written in the legislation, that there would be much take-up on the platform. The key incentive for institutions to go to a common securitization platform is the ability to gain the government reinsurance, the government guarantee. Of course, in PATH, there is no government guarantee, so there is not that incentive. There are additional restrictions, though, and you might call costs to going to the platform. There are data requirements—you have to disclose data. You have to pool—a pooling servicing, all kinds of different things you have to worry about. So the question is, what is the benefit? Here are the costs. So I am very skeptical that the platform as structured would get any take-up, or significant take-up. And if you don't get take-up, you don't get liquidity, the TBA market. So that makes me nervous about the whole structure of the platform.

Ms. VELAZQUEZ. Professor Levitin?

Mr. LEVITIN. I agree. As the PATH Act is written, there certainly is open access to the utility for smaller financial institutions. And I think that is very important. But for all the reasons that Dr. Zandi just outlined, that may not matter. If there isn't enough scale created with the national mortgage utility, it is just not going to be successful, and that will mean that smaller institutions are basically kept out of the market. And critically, I want to underscore for the other financing channel that the PATH Act envisions, covered bonds, smaller institutions are not going to be able to issue—do covered bond programs, that investors simply do not want to take on that type of credit risk on those smaller institutions. They would rather take on the credit risks of the too-big-to-fail banks.

Ms. VELAZQUEZ. Thank you. Dr. Zandi, one of the most important issues for me, coming from New York, is multi-family mortgages, and ending the government guarantee represents a very important issue for us.

Do you think that the private sector effectively taking over the GSE's role as a facilitator of credit for multi-family mortgages with our government guarantee will help meet this growing demand?

Mr. ZANDI. No. I do think there is a role for an explicit catastrophic government guarantee to backstop the multi-family mortgage market. I think the experience of the Great Recession makes that—strikes that point very clearly. The market shut down, and there was no credit. And this is obviously very important to multi-family construction, to vacancies, to rent. And not only in urban

areas but particularly in—especially in rural areas and ex-urban areas. So I do think a role—has to be explicit, it has to be catastrophic, has to be paid for, has to be very clear. But I think there is a role for it.

Ms. VELAZQUEZ. Thank you. Thank you, Mr. Chairman.

Chairman HENSARLING. The gentlelady yields back.

The Chair now recognizes the gentleman from New Mexico, Mr. Pearce.

Mr. PEARCE. Thank you, Mr. Chairman. And thanks to each one of you who are here today.

Dr. Zandi, you have quantified your estimate of the cost of doing what we are considering here today. Is there a quantifiable cost to not doing anything, a quantifiable cost to the government backstop, the explicit guarantee?

Mr. ZANDI. If we do nothing, if we keep the current system?

Mr. PEARCE. If we keep the current system, yes.

Mr. ZANDI. I think that would be a serious and grave error. I think there is no reason why the government needs to be making 85, 90 percent of the mortgage loans in the United States. It is a cost that taxpayers don't need to—

Mr. PEARCE. Does it have to be higher, less—I am back with Mr. Capuano from Massachusetts. Just get it down to the big stuff for us, our constituents. So are the costs going to be greater in the current system or less under the current system?

Mr. ZANDI. I haven't done—I haven't thought through that calculation.

Mr. PEARCE. You are in a better position than me. I could flip a coin, and it might end up heads or tails. But you would come up with a closer guess than I would.

Mr. ZANDI. Can I answer—I am not going to be satisfactory in my answer, but let me answer it this way. I don't like either approach. I wouldn't go down either path at the end of the day. There is a better approach.

Mr. PEARCE. Mr. Wallison, do you have an opinion?

Mr. WALLISON. You have to take everything into account, including the costs that occur when—

Mr. PEARCE. I think that's the point.

Mr. WALLISON. —we make the kinds of investments that Fannie and Freddie made, that is the current system. And when those investments are in poor quality mortgages, we have a loss, a severe loss in the case of Fannie and Freddie, up to almost $200 billion, and the taxpayers had to pay for that. So if you are looking at the costs, if you look at the entire cost, including what it may cost the taxpayers, I think the system that is recommended in this bill in the PATH Act would be cheaper for the taxpayers and still produce a very effective system of financing mortgages.

Mr. PEARCE. When I first came to Congress, I read and heard speculation that the Japanese had damaged their economy to a point that it might never recover in the 1990s. And when I read what they did, they started letting housing prices escalate. And in order to make it affordable, they began to lower interest rates. And then, they began to mix public and private money. And they hurt their economy maybe forever. And we are still short of that year. We have not yet reached forever.

So I would come back to Dr. Zandi, when you are estimating a cost of implementing this, can you now compare it to what the Japanese did, which sounds exactly like what we have done, starting with Mr. Greenspan and now with Mr. Bernanke? Could you quantify the cost of ruining an economy forever versus 90 basis points, or whatever, can you give me sort of an indicator on that?

Mr. ZANDI. Congressman, we are not Japan. We have made a lot of progress—

Mr. PEARCE. I understand. So you are saying we can do things that Japan can't do.

Mr. ZANDI. No. I'm not saying that. I am saying—

Mr. PEARCE. Excuse me, sir.

I view the laws of economics as being one of the really neat things. They don't know boundaries, they don't know anywhere. If you do the wrong thing, the capital is going to get up and leave today. That is really refreshing to me. It is pure. It is beyond human touch. And to say that the Japanese economy is not our economy, I'm sorry, sir, but that says we have different rules. We can print 40 percent of our national budget, and we are okay. I don't think we are okay. But I am sitting here with just some country background from New Mexico. And I am just trying to get a sense—

Dr. Levitin, I see you kind of peering. Do you have an opinion? We only have 47 seconds for your opinion.

Mr. LEVITIN. I am not quite sure where to begin. I think that there is a real problem that we may be locking ourselves into a period of very low interest rates. Lots of homeowners have refinanced into incredibly low rate loans. And when they want to move, when they have to move, if rates are up, we are going to have a problem.

Mr. PEARCE. Dr. Calabria, why don't you finish this up? 20 seconds.

Mr. CALABRIA. I will just say that the biggest problem, in my opinion, having been to Japan, and talked to people there, is every other company is like Fannie Mae, it is such a crony-capitalism society that we want to avoid that, in my opinion, or you will regret it.

Mr. PEARCE. All right, fair enough. Thanks.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the witnesses for appearing.

Let me start with you, Mr. Zandi—Dr. Zandi, excuse me. We have all seemed to make this faux pas today.

Mr. ZANDI. You can call me anything you would like. It doesn't matter really.

Mr. GREEN. I will call you a friend.

Mr. ZANDI. Thank you. I appreciate that.

Mr. GREEN. Dr. Zandi, you have wanted to juxtapose the conforming market to the jumbo market. And each time I think you were not given the opportunity to express yourself. I did step out for a moment, and I don't know whether it occurred while I was away or not. So would you kindly now give us your explanation as to why we cannot anticipate the jumbo market to be indicative of what will happen in the conforming market?

Mr. ZANDI. Thank you. Yes. I don't think the jumbo market is, as I would say, scalable. It will serve a small part of the market, it does serve a small part of the market. Just for context, in a normal housing market it is 10, 15 percent of the market, something like that. These are usually higher-quality borrowers. In many cases, they are not 30-year fixed-rate loans, they are adjustable rate mortgage loans. There's a—Mr. Wallison had in his testimony, go Google, "30-year fixed-rate loan." If you do that, you get to the Wells Fargo site, and you compare a Wells Fargo conforming loan with a jumbo loan, and the interest rates are very comparable. The thing is, you have to assume a 20 percent downpayment. If you put into the calculator a 10 percent downpayment, which is more typical for many Americans, it doesn't calculate, because they don't offer that. So that goes to the point that this is a market that is very specialized.

Now, in a world like PATH, this market will expand. The U.S. economy and financial system are very adept, and they will adjust, and we will see the ability to provide jumbo-like loans to a bigger part of the market grow. But it will never, in my view, be able to offer up 30-year fixed-rate loans to the vast majority of American households. And I think that should be a key working assumption that we want to preserve that as part of our system.

Mr. GREEN. Thank you. I think that was very important for us to have in the record.

Let's move to the covered bonds for just a moment.

What percentage of the covered bond market is contained within the United States, if you can, Dr. Zandi?

Mr. ZANDI. I think it is marginal. There are no covered bonds, or very few covered bonds of which I am aware.

Mr. GREEN. And in Europe, where we do have covered bonds, we don't have, generally speaking, 30-year fixed-rate mortgages. Is that correct?

Mr. ZANDI. That is correct.

Mr. GREEN. Which means—

Mr. ZANDI. Just to be precise, France has a 30-year fixed-rate market. But there are very extensive prepayment penalties. And the Danish have 30-year fixed, but that goes to the very idiosyncratic nature of their system.

Mr. GREEN. But my point that I would like to get to is that if you don't have a 30-year, you have, say, 3, 5, up to 15, maybe, that means that you don't get the asset liability mismatch that you can get when you have a mortgage that will expire in 30 years, matures in 30 years, but your covered bonds, if the pool will mature in 5 to maybe 10 years. And this creates some sort of market value risk that many investors will have a second look at.

Can you just briefly comment on this, please, in terms of how this impacts the market?

And I would also add this: That when this occurs, it seems to have some pressure on the market to avoid the 30-year fixed-rate product because of this mismatch that can occur.

Mr. ZANDI. Yes. That is correct. And that is one of the reasons why you don't see 30-year fixed-rate loans in other parts of the world, including Europe. And the key to the European system, and this is a point we were discussing earlier, is that the European

banks are very large. So if you go to any European country, three or four banks dominate the banking system. And the banking system is where all the credit is provided. That is because they are too-big-to-fail, and Europeans really don't have a problem with that. That is part of their system.

Mr. GREEN. Quick response to this question, please: If we have the FDIC backing in the shadows the covered bonds, would this cause the premiums that banks will pay to go up?

Mr. ZANDI. Okay. That is an interesting, good point. So there is—if we are going to incent more of the mortgage lending to come out of the banking system through, say, a covered bond market, then you are using a government guarantee. It is not the Fannie, Freddie, or the catastrophic guarantee; it is the FDIC. It is just another form of government guarantee.

Mr. GREEN. Yes. So what we have done is sort of move the chairs around.

Mr. ZANDI. Just moving the chairs around, to some degree, yes.

Mr. NEUGEBAUER [presiding]. I thank the gentleman.

Now the gentleman from Michigan, Mr. Huizenga, is recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that. And you interrupted one of my Google searches here. Because I do want to explore this as we were going into this what other countries are doing. But I would be remiss if I didn't bring up a portion of the bill that I have some distinct interest in. My bill, H.R. 1077, having to do with the points and fees that are going to be part of the final QM rules, which are going to be taking effect in January. This is part of it. And I am very concerned about the consequences if Congress doesn't resolve the issue. And I appreciate the chairman and others including that. I don't know if anybody wants to comment on that, but it seems to me that is another barrier for entry as we are looking at that for consumers.

I have a background in construction, real estate. My family has been involved in that for about 60 years. We have an employee, Irv. Irv has worked for my grandfather, my dad, and myself. This is a man who has worked for my family for nearly 50 years. I have an obligation to him as well to make sure what we are doing is getting it right, because he works in and depends on that. And whether it's Irv, Dirk, Mark, or Larry, the guys who work for us are intensely interested in this, as are all of our constituents.

But I think, Mr. Calabria, you hit the nail on the head. Yesterday, when Mr. Bernanke was here, I asked him, only half tongue-in-cheek, whether or not we should refinance. That was a question my friend had. He did quip that he wasn't qualified to give that advice, at which point I was concerned for all of us. And maybe Keynes is right, and in the end we are all dead anyway. But that was very problematic.

My background in real estate started in the late 1980s and into the 1990s, and interest rates were significantly higher than they are now. Downpayments were typically much higher than what they are now. I will never forget when my real estate mentor pulled me aside one day when we had seen interest rates going from 12 percent to 11 to 10 to 9 to 8 and at 7.95 percent, he pulled me aside and said, "Buy a house now, interest rates will never be

this low again." He had been in the industry for about 30 years. And Mr. Miller had talked about the 21½ percent mortgage rates. Downpayments went from 20 percent to 15 to 10 to 7 to 5 to 3 to 2 to 1 to nothing to 20—120 percent loan to value. I will never forget that my first closing was one of those where they are sliding a check across to the purchaser, not just the seller. This is a generational issue. We have seen house sizes increase dramatically. Hey, I am 44 now, and when I was buying my first house about 20 years ago, a little short of that. It wasn't going to have to be long, because I am pretty darn sure I deserve the three-stall garage and the walk-in closet and let's get a pool, and all of those other things. So we have some generational expectations that I have been talking about with my friends.

Part of the problem also has been as we saw equity. Equity didn't rise because people were putting more in, whether it was a 30-year or 15-year or 5-year mortgage. They saw equity increase because of home values. That was why. And you only realized it when you got out. A bubble occurs when people outpace reality. Would you agree with that? That is certainly part of what they are doing.

And that has happened way too many times. I commend the chairman and everybody else who has put time into this because the cycle needs to end. It used to be when I was in real estate getting an FHA loan, there was some sort of stigma to it. It was a bit of a taboo. One, you didn't want to have an FHA deal. And you didn't want to be the buyer or the seller who was having to deal with that. And the taxpayer was a backstop of last resort. And now it seems that taxpayers are the first stop, not the backstop. And we have to get serious about this.

So, 30-year fixes. What is the proper downpayment, Dr. Zandi? You were saying 20 percent certainly isn't it. What is?

Mr. ZANDI. There is no one answer because you have to take the borrower's entire financial situation into account.

Mr. HUIZENGA. 20 percent—

Mr. ZANDI. Are they an owner? Are they an investor? Do they have an 830 FICO score?

Mr. HUIZENGA. All right. Does anybody have anything else other than a government program that is going to help people get into homes? It happened during the 1980s a lot. In my 2 seconds, I will close it with land contracts. The marketplace is going to fill in if and when that there isn't a specific government program-backed mortgage. It might not be ideal. But there are a lot of other things that are going to happen that we can't even predict right now necessarily of what is going to be happening.

Sorry, Mr. Chairman, I filibustered myself. I apologize for that.

Mr. NEUGEBAUER. Now, the gentleman from Missouri, Mr. Cleaver, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. This is primarily a question for Dr. Zandi, but I would like for Mr. Levitin to also become involved.

In your statement, Dr. Zandi, on the fourth page, you state that complete privatization is much more plausible in theory than it would be in practice. Private capital is not limitless and there are

plausible catastrophic scenarios similar to the Great Recession that would completely wipe it out.

On page 8 of your testimony, you state that, "a fully privatized mortgage finance system will have difficulty providing stable mortgage funding during difficult financial times."

I tried to get Mr. Bernanke to respond to this yesterday. I failed. But my question is, the private markets are generally going to bail out in tough times. And if that is the case, and I don't think there is a question we just witnessed that after 2008. This proposal, this PATH Act, can you envision in any way how this would—how we would be able to effectuate this PATH Act in a time of financial crisis? If this bill as proposed is approved, do you think it would hold up in post-2008 to 2012?

Mr. ZANDI. No. I think one of the significant drawbacks to a purely privatized system without any catastrophic government backstop is it would be subject to runs. Investors would lose faith and they would run at just the worst time for the housing market and for the economy. And of course we saw that in regard to deposits. And that is why we have an FDIC that provides a catastrophic backstop to our depositors. The principle is just the same. We apply the same principle to the mortgage market, a catastrophic backstop which would prevent runs. It should be paid for by homeowners. It is a service we are providing. But it is a very valuable service and would ensure that we would not have this problem at the worst possible time.

Mr. CLEAVER. Yes, Mr. Levitin?

Mr. LEVITIN. On its face, the PATH Act would create a private housing finance market. But in reality it would create an implicitly guaranteed housing finance market. There is no such thing as a non-guaranteed housing finance market. It is only whether there is an explicit guarantee or an implicit one. And we know this from our own history. In 2008, we had a statute that said Fannie and Freddie debt is not guaranteed by the government. It was there in bright letters for everyone to see, and we bailed them out. And if you look outside of the United States, Germany bailed out its banks, Denmark bailed out its mortgage banks. We know that there will be bailouts if the housing finance system gets in trouble because housing is simply too important to too many people. Therefore, the question is whether we just kick the can down the road and let some other Administration pay for the costs or whether we prudently try and charge risk premiums now that will—and build up an insurance fund, essentially, against future problems.

Mr. HOLTZ-EAKIN. If I may?

Mr. CLEAVER. Yes, please.

Mr. HOLTZ-EAKIN. I think this is an important question, but there are arguments on the other side. First, it is important to remember as well that one of the things that happens when private capital comes in is there is better scrutiny of risk. So the trouble you are going to get in is going to be smaller. And, second, if you have better scrutiny of risk broadly in the system—the greatest failure we had was poor pricing of risks. If you price risks, you don't get runs because people aren't afraid of the securities. And so the very act of putting the private capital in mitigates the fears they are worried about.

Mr. CLEAVER. I agree with you. But is there any scenario whereby you can envision the government not being a backstop?

Mr. HOLTZ-EAKIN. You can always envision a disaster so bad it is impossible for the private sector to survive. So, let's just stipulate that.

Mr. CLEAVER. We just had one.

Mr. HOLTZ-EAKIN. The question is, how do you want to handle the issue of providing the bulk of housing finance? And we are right now providing the bulk of housing finance on the taxpayers' dime, not on the private sector.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Fitzpatrick.

Mr. FITZPATRICK. I thank the chairman for all of your hard work in reforming a finance system that is in desperate need of reform, and I appreciate the time and patience of the panel as well. It was about 3, 3½ hours ago when you gave your opening statements, and I listened to each one of them. And I have been out of the room since.

But Professor Levitin, you made a statement that I think is important. You said—and I want to make sure I am correct in this, so please correct me if I am wrong—that one of the bedrock principles of housing finance post World War II has been the availability of the 30-year fixed-rate mortgage. Which we are all interested in. Is that correct?

Mr. LEVITIN. That is correct.

Mr. FITZPATRICK. And I have a lot of very specific questions. And I think probably a lot of them have been asked. I am going to write each of you and just ask you to consider some of what I am saying. And if you get a chance, get back to me. And I will share that with my constituents.

But I would like to kind of ask a general question by telling a story. And it is a story of my hometown, Levittown, Pennsylvania. But I believe the story of Levittown is somewhat the story of America. In 1950, in Bucks County, the president of the United States Steel Corporation, Ben Levitt, announced he was going to build a steel mill in Bucks County. And he did. And that mill provided about 10,000 really good jobs to folks who were going to come from the coal mining country of northeastern Pennsylvania, out from Pittsburgh. And jobs for a lot of returning veterans, World War II and Korea veterans.

All those jobs created quite a demand for housing in lower Bucks County. And we being Americans, we met that demand. We figured out how to do it. It is the town where I grew up; I would never have grown up anywhere else. Bill Levitt, from Long Island, New York, who had figured out how to mass produce housing, he came down. He was part of the solution in meeting that demand. He came to Bucks County, and he built 17,311 houses between 1952 and 1957. And if you were a returning veteran from World War II or Korea—my father was a veteran who purchased his first home in Levittown around that time—you could purchase the basic Levittown model for $9,990. If you were a veteran, it was $100 down. And it was a perfectly planned community—some say too planned. Bill Levitt even brought a bank with him from New York, the Bow-

ery Savings Bank, and they provided mortgages for those individuals who—most of whom thought they would never own a home in their life. And so this was described to be their first home. And for many of them, 60 years later, it is still their home, if they are still there. And so this for many is everything that they own in the world. It is their complete retirement, what they will pass on to their children.

But the point of the question is that—and my father and others who settled Levittown, they would build a statue of Bill Levitt in the middle of town, if they could. They were provided that opportunity because of the availability of a great builder, a community willing to accept it, and a fixed-rate mortgage that they could afford, they could figure out what it was.

So my question is today, 21st Century in the year 2013, how would the PATH Act have affected the ability of Bill Levitt to build that community and those veterans to move out of the cities, the first suburban planned community to be able to own that home today, in your view?

Mr. LEVITIN. With the PATH Act, Levittown, Pennsylvania, would not exist. Your father would not have been able to buy a home. That is the sad truth.

Mr. CALABRIA. If I could make a comment on that. Let's be clear. Freddie Mac didn't exist at that time. Fannie Mae's operations in the mid-1940s were approximately zero; about 1, 2 percent of the market. As mentioned, it was a bank that made those loans, and held them on portfolio. There is nothing in the PATH Act that says you can't do this. There is nothing in the PATH Act—nobody here is talking about banning the 30-year mortgage. Again, before the 1980s, we did not have a secondary mortgage market. So I think, going back and looking at some history—I also want to emphasize there is nothing to pass on to your children if you are drowning in debt. Getting people in with 100 percent financing, with nothing in there, there is nothing to pass on. You are leaving them debt to pass on. And that to me, I think, is not what we should be looking for, for our children or our future generations.

Mr. WALLISON. If I could just add something to that. And that is in the 1980s, the technology of securitization was developed. What Fannie and Freddie were initially intended to do was to create a secondary mortgage market and the liquidity that allowed banks to sell the mortgages into the secondary market and make more mortgages. Once we had the technology in the private sector, we didn't need Fannie Mae and Freddie Mac. So if this had existed, if the PATH Act had existed back then, and if the technology of securitization had existed, a private secondary market could have existed. Either of those mortgages could have been portfolioed by the bank that made them or they could have sold them to private securitizers without Fannie and Freddie.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore.

Ms. MOORE. Thank you so much, Mr. Chairman.

I guess I want to start out by asking Mr. Wallison a question. I notice that you served on the Financial Crisis Inquiry Committee, appointed by our Speaker, Mr. Boehner. And there was a minority

report. And then you had a separate report of your own, which it mirrors—I looked it up, I Googled too because I thought it was kind of familiar, kind of a familiar argument with your testimony that you have given here today.

And I guess your testimony here today seems to sort of lay the blame for the entire financial crisis at the feet of these constituents of ours who just wanted a house so badly that we sort of induced, the government induced the bad underwriting and tolerated bad underwriting. These are words that I have sort of taken out of your testimony.

And your minority report, along with the other three commissioners who gave a minority report, didn't mention a word about credit default swaps or derivatives or credit rating agencies. Or we have heard testimony on this committee from people like Andrew Cuomo who said that at the bottom of every single one of these things was a bad appraisal. Predatory lenders. I think Mr. Fitzpatrick made a wonderful point. There are people who are living in the first and only house that they have ever bought. So, how were they supposed to know that they needed to bring certain documentation? Freddie and Fannie weren't doing the underwriting. And so I guess I am curious, particularly in view of your—Freddie and Fannie do need some reforms. They were overleveraged, there were many things done. And you also said maybe CRA was also sort of at fault as well. And what we have found is that only 6 percent of all of these toxic loans were—had a delinquency rate of 2012 of—from the GSEs versus 28 percent for non-GSEs. And of course the CRA was definitely not a factor in subprime lending or the crisis.

And so I am very curious to see—to ask you why you think the GSEs, in view of all these other things that we know happened in the marketplace, why you say that at the centerpiece of it all was the fault of our constituents who the government induced us to give them all these loans.

Mr. WALLISON. In my dissent, I focused on the affordable housing requirements which were put into effect in 1992, when many people came to Congress and said that Fannie Mae and Freddie Mac actually are much too conservative in their underwriting, so many of our constituents cannot buy homes. Congress acted in 1992 and said, okay, Fannie and Freddie, from now on you are going to have to buy a certain number of these loans that are made to people who are below the median income. Fannie and Freddie did in fact control the market. And as Fannie and Freddie reduced their underwriting standards in order to meet the affordable housing requirements, the result was that by the year 2008, we had 28 million subprime loans in this economy—

Ms. MOORE. Thank you.

Mr. WALLISON. —about half of all mortgages.

Ms. MOORE. My time is lapsing. And so, Freddie and Fannie were not—they did not do the—the underwriting was wrong.

Let me ask you a question, Mr. Zandi, in my last 49 seconds.

You keep saying that we are going to have this guarantee, but if we don't, what do you think downpayment and interest rates will be so that the private sector can finance its risk in the marketplace to have this private securitization market?

Mr. ZANDI. The calculation I did in the testimony was for the typical borrower in the current mortgage environment, 20 percent down, 750 credit score, 31 percent debt-to-income ratio. That is the middle of the distribution right now. The PATH Act as currently envisaged would raise the mortgage rate for that borrower by 90 basis points. That is .9 percentage points. That is $130 a month in monthly mortgage payments.

Ms. MOORE. And interest rates, what would it do to interest rates, specifically?

Mr. ZANDI. That 90 basis points, that .9 percentage points, that is the effect on mortgage rates.

Ms. MOORE. Okay. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

I was going to start off by saying I was surprised, but I guess I'm not surprised. I guess I am just disappointed that somehow this debate today has turned into rich versus poor. It strikes me that if you think that Fannie and Freddie and more directly the abuses that we saw in Fannie and Freddie were about somehow helping poor people or helping deal with the plight of the American worker, you are sadly mistaken.

Ms. MOORE. Will the gentleman yield?

Mr. MULVANEY. No, I will not.

The abuses at Fannie and Freddie were designed mostly—

Ms. MOORE. Will the gentleman yield?

Mr. MULVANEY. I absolutely will not. And I would appreciate not being interrupted.

Ms. MOORE. Well, you are talking about me.

Chairman HENSARLING. It is the time of the gentleman from South Carolina.

Mr. MULVANEY. The abuses at Fannie and Freddie were designed to enrich the shareholders and to a great extent the executives, most of whom were heavily connected to both parties. It was never involved, never designed to help the plight of the American workers. We are dealing with—a question that we just asked Mr. Zandi. I heard $150 a month, not $130, so I ran the numbers on $150 of additional payment, the 90 basis points leading to $150 of additional monthly payment. I ran the numbers on that. It is a multivariable equation, so you sort of have to freeze an interest rate. But it looks like that house costs about $325,000. Is that poor? Because that could buy 90 percent of the houses in my district. It is not about rich and poor. What really is telling is that we had testimony today, or at least the chairman mentioned it, that there is currently a regulation that is being considered by this Administration that would raise interest rates 400 basis points. Where is the outrage over that? Where is the concern that this Administration is beating up on poor people and making housing unaffordable for the American worker with a 400 basis point increase in the regulation that we will never see? Where are the demands for a hearing on this regulation from my friend across the aisle?

We are sitting here. We talked about a hundred mortgage points, a hundred—a hundred basis point increase last week in the 30-

year. A hundred interest basis points last week in large part because of the fiscal policies that this government is undertaking. We are hurting poor people. We are hurting the people who are trying to buy houses because we are borrowing money. We are going to the markets and saying, would you please lend us money. They are going to the same markets and saying, please lend them money. And we are driving up the price of them buying their houses. We are doing that. Where is the outrage over that?

Since the outrage today, though, seems to be focused on the 90 basis points and how that is supposedly going to be the end of the world, I will accept for sake of the argument that there is going to be a 90 basis point increase in this, Mr. Zandi.

And I will simply point out the fact that my family has been in this business off and on for the last 50 years, okay. 1970. Does anybody remember—and I had to Bing it, not Google it, since I have friends who work at Microsoft—I Binged it. Do you know what the average interest mortgage rate was in 1970? It was 8 percent, 350 basis points higher than it is today. Did we have a functioning mortgage market in 1970, gentlemen? Does anybody know what the homeownership rate was in 1970—it was 62 percent. In 1980, interest rates, 18 percent, 15 percent, pick a number. 1,400 basis points higher than we are today, than we have today. We still had a functioning mortgage market, and we still had 64 percent of the people living in houses. In 1990, it was 9 percent, 64 percent.

In 2000, it was 7 percent. And we are sitting here today saying that supposedly a 90 basis point increase, just so we can protect the American taxpayer, is somehow going to end the housing market in this country. It is absurd. It is absolutely absurd.

We are trying to have a conversation not about rich versus poor. We are trying to have a conversation that somehow finds a way to protect the American taxpayer, rich and poor. And ends the abuses that fabulously enriched people probably illegally at the expense of the American taxpayer.

I would hope, Mr. Chairman, that is what this debate would be about, and not about class warfare, not about pitting against each other. There are reasons that there are bipartisan bills on the Floor to try and fix this problem, because it needs to be fixed. You may disagree with the fact that this might be the best way to do it, but don't accuse us of going after poor people because that is not what we are doing. We are trying to help the taxpayers. And I would think that would be something on which we could all agree.

With that, I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. I knew somebody would raise my blood pressure on this one. So, the first thing I would like to do is introduce for the record something I always do when we talk about housing and Fannie Mae and Freddie Mac, and that is the Financial Times article of September 9, 2008, where Mr. Mike Oxley hits back at ideologues that—Mr. Wallison, you and I have had this conversation on at least three occasions, if I am counting right, where this was a few days after Fannie Mae and Freddie Mac were placed in conservatorship. Do you recall that?

Mr. WALLISON. Yes.

Mr. PERLMUTTER. Okay. And what Mr. Oxley said in this article was—Congress was taking a lot of criticism about why there wasn't more oversight. And he said, "Instead the Ohio Republican, who headed the House Financial Services Committee until his retirement after midterm elections, blames the mess on ideologues within the White House, as well as Mr. Greenspan, former Chairman of the Federal Reserve. The critics have forgotten that the House passed the GSE reform bill in 2005 that could well have prevented the current crisis." He fumes about the criticism of his House colleagues, "All the handwringing and bedwetting is going on without remembering how the House stepped up on this. What did we get from the White House? We got a one-finger salute."

Okay. So, Mr. Wallison, you and I have had a chance to talk about this on several occasions. And, quite frankly, you and I agree on a lot of the basic points. But we draw very different conclusions. And we have talked about the length of time that Fannie Mae has been in existence, since 1933 or 1934 to today. We talked about the fact that in the period of time from 2004 to 2007, especially the time when no documents were required, no downpayment was required, that time the public sector, Fannie Mae, Freddie Mac, had much less than the private sector in terms of outstanding loans. Then when the market fell apart in the fall of 2008, that is when Fannie Mae and the public sector was the only game in town. The only lender in town. And I would just—instead of me filibustering, which I have already done, let me just ask a couple of simple questions.

How many of you own a home?

Okay. So I assume there is one renter. Do you own a home or are you renting?

Mr. HOLTZ-EAKIN. I am renting.

Mr. PERLMUTTER. For those of you who own a home, do you have mortgages?

The answer is yes. Mr. Levitin, good job.

Okay. Within those mortgages, does anybody have a jumbo loan?

Mr. WALLISON. Yes.

Mr. PERLMUTTER. I just bought a house. We just sold a house, and bought a house. And I know that between the jumbo loan to the loan under $417,000, which is what it is in the Denver area, in Colorado, there is a difference of about a point. So did any of you go looking to try to get under what would be the FHA number of $417,000 or whatever it might be in your locale?

Doctor?

Mr. CALABRIA. If I can make a point where I think you are going with this. Let me—

Mr. PERLMUTTER. I am not sure where I am going, so hopefully you can make a point.

Mr. CALABRIA. Let's have me filibuster for a little while then if that is going to be the case.

Mr. PERLMUTTER. I will interrupt you if you get off track.

Mr. CALABRIA. Please do. So, full admission, I have a mortgage. I got it with Wells. I think they might have sold it to Freddie. I even take the mortgage interest deduction. I, as a citizen, am willing to give up all of those things because I believe our system will

be safer because of that. Will I pay higher mortgage costs? Probably. I will say that I paid more in taxes last year than I made in mortgage payments. Now, that is not necessarily a bad thing because again, it is better to be non-poor.

Mr. PERLMUTTER. One of the points was that you are not building up much equity with a 30-year loan, but I would like to ask Dr. Holtz-Eakin, do you build up any equity by renting?

Mr. HOLTZ-EAKIN. Not in my apartment, but elsewhere.

Mr. PERLMUTTER. Maybe elsewhere, but certainly not in your apartment. These are so simple. And I have to ask a question. Dr. Calabria, we were talking a little bit about auto loans. We are looking at auto loans. So I am looking at your graph which shows that in 2009, basically there were no auto loans. Do you see that?

Mr. CALABRIA. I am going to apologize because the scale of that chart is not zero at the bottom. So, again, that probably is not the best. It is cut off at actually a positive number at the axis. So, my apologies.

Mr. PERLMUTTER. Okay, let's go to the bottom there. At the bottom, there is a spike. I think the spike was the Cash for Clunkers?

Mr. CALABRIA. It was.

Mr. PERLMUTTER. Okay. So that was Federal injection of money, right?

Mr. CALABRIA. Another great policy.

Mr. PERLMUTTER. Okay. But there was a spike. Oh, heck. Thank you, Mr. Chairman.

Chairman HENSARLING. That word would almost be stricken from the record.

The Chair now recognizes the gentleman from Alabama, the chairman emeritus, Mr. Bachus.

Mr. BACHUS. Thank you. In the last few years, I guess since the financial meltdown, the one question I have been asked more than any other question back home is, "How can you justify asking me to pay somebody else's mortgage? I struggle to pay my mortgage. Why does the government take my tax dollars and help someone else pay their mortgage?"

And I think it is almost impossible when you have a government-sponsored entity for it not to subsidize someone else's mortgage with your tax dollar. Maybe that is not the intent, but it always has mission creep and more. And what we have discussed today is that FHA intended to help low-income Americans, and it has morphed into something quite different, where even in attempts to lower the high number of those eligible, we have not been able to accomplish that. Once you start, once you put it out there, it is almost impossible to end it.

Dr. Zandi, you said you liked parts of this bill. I find the parts where it does seem to, the provisions to attract private capital or to lessen some of the barriers to private capital. Do you see those as helpful? And you said you don't believe enough private capital will come into the market, is that right?

Mr. ZANDI. I do like the provisions in the bill that try to attract capital, yes. I like the idea of trying to support and promote a covered bond market. I think that is a laudable effort. I think it is going to be difficult in the context of our current financial system

and some of the issues with regard to the FDIC. But I applaud the effort to go down that path, yes.

I think some of the provisions related to the residential mortgage securities market, we talked a lot about QRM, but there are others, I think that is laudable because we need to get the RMBS market up and going again. It is still dead in the water. So getting private capital is exactly the right thing to do. And there is a lot of good in the bill that I think we really should think through, yes.

Mr. BACHUS. We have the largest and deepest financial system in the world. There are always tremendous amounts of capital looking for more return. And now that the return on Treasuries and other things is not that good, I would imagine there is an immense amount of capital that would love to come in and invest in safe mortgages.

Mr. ZANDI. Can I respond? I agree. You want to design a mortgage finance system, a housing finance system for all times, good times and bad times and everything in between. So in the good times, yes, you will find private capital and people taking chances. But that is not—we can't build a housing finance system for our kids and our grandkids based on that.

Mr. BACHUS. But in the bad times, it creates bad times. I asked the chairman yesterday whether unemployment was structural. He had said it was cyclical. Some of it is structural. But in the bad times, the cyclical, people are losing their jobs. So when you lose your job, it is hard to keep your home.

Mr. ZANDI. Yes, it is. Yes.

Mr. BACHUS. I would just ask Mr. Wallison or Mr. Holtz-Eakin, do you have any comments on anything you heard in the last few minutes or during this hearing on which you would like to further elaborate? Or do you believe—our private markets in the United States are immense.

Mr. HOLTZ-EAKIN. I want to second what Mr. Zandi said about—or I guess I should say Dr. Zandi. I think the provisions to attract private capital are very important. I think it does a very good job of bringing in better scrutiny. I would like to see it be more aggressive about bringing in taxpayer protection, broader, deeper capital.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Delaware, Mr. Carney.

Mr. CARNEY. Thank you very much, Mr. Chairman. Thank you for having this hearing, and thank you to all the panelists for staying so long. I apologize for coming in and out.

Dr. Zandi, you said when I was here about an hour or so ago, that this is a really critical issue and an important decision. We have to get it right. You said we have to get it right not only because we could screw up the housing finance system, but we could screw up the financial—I don't think you used the words "screw up," we could mess up the financial system as well.

What are the risks here? What do I tell my middle-income constituents back in the State of Delaware, are the risks associated with adopting this approach to housing finance? You mentioned some of them in answer to the questions. But in terms that the ordinary guy or gal that I talk to on the street can understand, what are the risks involved in this approach?

Mr. ZANDI. There is no bigger risk I think at this point that—the housing finance system, the mortgage market is the largest market, say, for the U.S. Treasury market on the planet, and if we mess that up, it is going to raise interest rates not only for mortgages, but for every other thing that we borrow, credit cards, auto loans.

The other thing to consider is that the home is the most important asset for most Americans.

Mr. CARNEY. So what is it going to do, in your view, to real estate values and values potentially?

Mr. ZANDI. If the bill is passed as it is and mortgage rates rise as is? It would hurt home sales, it would hurt housing construction, it would lower house prices.

Mr. CARNEY. It would lower house prices and therefore reduce personal wealth.

Mr. ZANDI. Can I make a broader point?

Mr. CARNEY. Sure you can.

Mr. ZANDI. Look, I think we have to put our housing finance system on a more solid ground and it is not going to be free, it is going to cost us.

Mr. CARNEY. I want to get to that. But I want to talk about the risks first. At the end, you said that there is a better approach and I want you to answer that question. But let's focus on the risk first, just so we understand, so I can tell my constituents when they ask me, do you support this piece of legislation or not.

What do I tell them specifically that might be at risk for them? I take a little bit of offense to the insinuations that were made about some of my colleagues on this side of the aisle defending or being concerned about lower-income access to homeownership. Is that at risk here at some level?

Mr. ZANDI. Yes. I think that it means higher mortgage rates for all homeowners with mortgages. It will make it harder for first-time home buyers to become homeowners. It will make it harder to refinance. Particularly in the worst of economic times, when things are going badly, wrong, and when people are losing their jobs and they can ill afford any other financial stress, it means that the asset that they own that is most important to their financial well-being, their home, will be worth less.

So, the housing finance reform is going to cost us, but there are more efficient ways to do it, better ways. We can accomplish all the goals that we have in a different way.

Mr. CARNEY. What about the effect on jobs and real estate and housing, home construction, that kind of thing. Positive or negative effect, big risk?

Mr. ZANDI. It would be negative. Higher mortgage rates, less housing activity, fewer jobs in the housing sector.

Mr. CARNEY. So what is the better approach? You mentioned earlier that there is a better approach. In your view, what is the better approach?

Mr. ZANDI. There is. In my view, I would call it a hybrid system, somewhere between the privatized system that the committee is working on, and the current system that is a nationalized system, the government is making all the loans. It involves an explicit catastrophic government guarantee, private capital in front of the guar-

antee, a lot of private capital. It can be a boatload of private capital. I am all on board with that. It is explicit and it is paid for by mortgage borrowers. And it is fashioned off the FDIC so that it protects us in bad times.

Mr. CARNEY. So a better system, a more prudent system and a big change, but not the kind of risk that we would be taking in going down the approach of the past. It is a pretty serious change as well.

Mr. ZANDI. In my view—I don't know if you were here for my cliff metaphor. With the privatization path, you are diving off a cliff, but you don't know what you are diving into. With a hybrid system, you are diving off the cliff, but you are diving into water. We have a much better sense of what that means and what the implications are.

Mr. CARNEY. So we are looking at a pretty big dive or a big change in any case?

Mr. ZANDI. It is a big change. And by the way, of all the financial and all the economic efforts to address the great recession and the financial crisis, we are addressing each of them, we have addressed each of them except for what we are going to do with Fannie Mae and Freddie Mac.

Mr. CARNEY. And as you say, it is absolutely critically important that we get it right, that we are careful. Otherwise, as you said, we could ruin the financial system. Did I hear you say that right?

Mr. ZANDI. You heard right.

Mr. CARNEY. Thank you, I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman, and thank you, gentlemen, for being with us today. As I assess where we are in terms of our debt obligations, we have about $1 trillion in student loan debt, about $1 trillion in credit card debt, and we have about $5.1 trillion in mortgage guarantees. The American taxpayers have paid now for $200 billion or so of obligations back to Fannie and Freddie for which they were responsible. So in a sense, as Mr. Bachus said, Billy Bob from North Carolina has assumed the obligation of Winston from Connecticut, or vice versa, and he has taken on their debt and their obligation.

Mrs. Maloney and our distinguished body authored a bill, the CARD Act, that put restrictions on interest rates for credit cards, all for the stated purpose of protecting the American consumer. We have, as a body, as a government, according to the testimony of Mr. Wallison a few minutes ago, facilitated the access of credit for homeowners by offering easy credit, by encouraging if not instructing lenders to make credit available to some of those who perhaps were not worthy of credit, but they had that requirement nonetheless.

So the government has, in many ways, been complicit in a way to cause those consumers that we are so concerned about to have an inordinate amount of debt and obligation that has been catastrophic for their lives and their families and enormous displacement for where they are today. And I think the point that I would like your response to is it seems to me that the manager, the gov-

ernment, as the manager of housing financing, we have been an abysmal failure. What we have done, with all good intentions, in all good faith, seeking the best from our position, trying to control it through central planning, has had an adverse effect, has been counterproductive to what we had intended.

Having said that, it would beg the question of have we done anything thus far to correct the problem, to make that change, to protect the taxpayer, to protect that consumer, as well as look at beyond—if we haven't done a good job, what is the alternative? And I would say to you, and I would like your reaction, that markets work, free markets work. And perhaps it is true that a market-driven housing industry would better determine who is worthy of that credit so that we don't create a problem for them in the long run, that they are assuming an obligation that they cannot afford. Maybe that is the reason why some people won't be able to get those loans. Maybe they shouldn't be taking on those loans and maybe we are complicit in causing their own demise.

So I would state to you, and welcome your response in the minute left, that markets can work and they should work. Thank you. I welcome your response.

Mr. WALLISON. Let me try to take that on, and thank you for leaving me a minute. Actually, I haven't had much of that this afternoon. But what we are looking for here is balance, and one of the really wonderful things about this Act as I see it is an attempt to achieve a balance between a social program, which is fundamentally what FHA does, that is, to enable people to get into homes who wouldn't otherwise have the downpayments, for example, to do that, and to eliminate the things that have always caused difficulties in the housing market, which is excessive use of credit for people who ultimately—

Mr. PITTENGER. All right. I have 10 seconds left. Does anybody else have anything they want to say?

Mr. LEVITIN. That we have seen markets not work though in housing finance. In the housing bubble, that was private—

Mr. PITTENGER. We have done it worse though, haven't we?

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from Washington, Mr. Heck.

Mr. HECK. Thank you, Mr. Chairman, and to each and every one of the panelists, thank you so much for the generous presence of your time and your expertise. It is exceptional, even by congressional standards.

Dr. Zandi, I am not quite done with the 90 basis point issue, but I kind of want to turn it on its ear. I am a little taken aback at the prospect that somebody would need to have a credit score of 750 and put 20 percent down to pay 90 basis points more, but I want to turn it on its head.

Under the proposed legislation, what credit score and how much down would you guesstimate would be required for a home purchaser to pay interest rates that are currently available?

Mr. ZANDI. That is a great question.

Mr. HECK. Would you repeat the part about it being a great question?

Mr. ZANDI. That is a great question. That is a nice way of thinking about it. Let me just do the calculation. Obviously, it would be

a very pristine borrower, yes. But I don't want to give a number without—I can run it through my model with you and I will show you what the results are. But it would be a pristine borrower, yes. A very, very interesting way of looking at it.

Mr. HECK. So given that all of these things would occur, higher interest rates and the removal of the mandate to serve all borrowers, I am interested, and I realize that the proposal has only been out a few days, if you have thought about or even begun to do any modeling about what would happen to the rate of homeownership in the country? The rate has been, as best as I can determine, relatively stable over a long period of time, and we are at what now, about 63 percent?

Mr. ZANDI. 65 percent, a little over 65 percent.

Mr. HECK. What would happen to that over what period of time?

Mr. ZANDI. You are asking such precise questions and they are great questions. I just don't have the answers at my fingertips. But they would be lower, obviously. I don't know how much lower.

Mr. HECK. Materially lower?

Mr. ZANDI. Yes, I think it would be meaningful. I guess the bigger point is it is unnecessary.

Mr. HECK. Mark, I actually think the bigger point is whether or not we think homeownership is an inherently good thing on balance. Do you?

Mr. ZANDI. Yes, I think that is a good question. Ultimately, that is a question we have to ask and answer ourselves collectively. Is homeownership something that we want to promote or not? But that is a basic question, yes.

Mr. CALABRIA. If I could make a point?

Mr. HECK. Make it quick.

Mr. CALABRIA. Okay. I love homeownership. I think it is a great thing. I am happy to be a homeowner. I am not sure having somebody drowning in debt—people aspire to be homeowners. People don't aspire to be highly leveraged and drowning in debt.

Mr. HECK. So back to you, Dr. Zandi. Have any of the green eyeshade, sharp-penciled economists ever tried to quantify what the community and societal benefits are of increased homeownership?

Mr. ZANDI. Yes.

Mr. HECK. Does this go beyond just a value that has long held the American dream? Are we let better off when more people own homes when they can?

Mr. ZANDI. You are asking really good questions. Too bad we are 3½ hours in and I am running out of juice. But this is actually a very legitimate discussion and debate we should have.

I think we have come to the conclusion that homeownership—there are costs and there are benefits, and on net, it is a benefit. It is part of the American dream. But it is not—that is not an immutable fact and we should really think about and there are actually a lot of—I am just bringing this up—there is a lot of really good recent research that calls into question just what is the benefit and the cost. And it is worthy of looking at more carefully.

This goes back it a bigger point, broader than housing finance reform that has been brought up, and that is the subsidies we provide to the housing market. They go well beyond the guarantee, right? We are talking about the mortgage interest deduction, we

are talking about FHA. This goes on and on and on. It is very, very significant and we need to ask ourselves is this appropriate, are we getting our money's worth? These are very legitimate and important questions.

It is not a slam-dunk to say, I think, homeownership, this is the number and in every case it is a good thing. It really is much more complicated than that. But, again, I am sorry I am not as articulate as I would aspire to be, but I am literally running out of—

Mr. HECK. My sixth grade teacher, Harry Noonan, God rest his soul, used to say, "That is a really good question. The definition of a good question is one I can't answer."

Mr. ZANDI. Yes, that is exactly right.

Mr. HECK. So I am out of time except to reiterate—

Mr. ZANDI. But I will definitely get back to you. I absolutely will.

Mr. HECK. I hope you will, sir. If I might just reiterate my gratitude. Thank you all.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Kentucky, Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman.

Professor Levitin, you testified that we have a government guarantee of housing finance regardless, that it will either be explicit or implicit. Isn't your assumption proof that moral hazard exists by virtue of the fact that interventionist politicians have, in fact, kind of carried out your point, and then if we had restrained ourselves as an institution, that moral hazard would not exist and market discipline would exist in this world?

Mr. LEVITIN. I don't think that this Congress or any Congress can restrain itself or would in the face of a collapse of the housing market. While I understand that certainly there are Members of Congress who would just let the chips fall as they may, I think we saw proof that two different Administrations, a Republican Administration and then a Democratic Administration, were willing to proceed with a wide-ranging bailout, not just of housing, but of all sorts of sectors of the economy. Yes, ideally, if we could credibly commit never to have bailouts, we would see a better functioning market. But I don't think we can credibly do that.

Mr. BARR. Let me ask any of the panelists who want to comment about the flow of private capital back into the housing finance system. Presumably, the PATH Act would require a great deal more credit risk investors as opposed to rate risk investors. Can you all comment, and Dr. Zandi, in particular, can you all comment on why there are barriers in a more market-driven mortgage finance system? Why credit risk investors are not there?

Mr. ZANDI. In part, it is legacy. We have set up a system, it is the system that has been in place since the Depression, and as a result of that to some degree. Part of it is that credit risk is very difficult to evaluate and assess. It is very idiosyncratic. It depends on the specific credit, and when we are dealing with lots, millions, tens of millions of homeowners, it becomes very difficult to evaluate. And in the case of mortgage securities which are based on the mortgage payments, those securities themselves are quite complex, right? There are all kinds of financial structures, and the rating

agencies obviously didn't get that right when they were trying to evaluate the quality of those structures.

So it is a level of complexity that when you combine it with the interest rate risk makes it incredibly difficult.

The third point is that it is hard to hedge. Interest rate risks, there are mechanisms to hedge it and you can assess and quantify your risk. Credit risk is a lot harder. We have tried to develop mechanisms for doing that. For example, the credit default swap market, the CDS market was an effort to try to hedge credit risk. But as we know, we didn't really get that quite right. It will be better in the future, but that is also a problem, and all those things combined make this very difficult to do.

Mr. BARR. Does anybody else have a comment on that in terms of the availability of credit risk investors?

Mr. WALLISON. Yes, let me try to address that, because a mortgage is a particularly good investment for life insurance companies and private pension funds, because they want long-term assets to deal with their long-term liabilities. The reason they don't invest now in Fannie and Freddies, most of them do not, and they don't put a lot of money into Treasuries either, is because the yields are too low for them. They need a higher yield and they get that higher yield by making prudent investments, taking prudent risks. That is the market that this bill would open up because those investors will be looking for private credit risk that will compensate them for taking those risks and be long-term assets.

Mr. CALABRIA. I want to make an important point because sometimes we talk as if the government is there, then magic, the risk goes away. The credit risk is always going to be there. The interest rate risk is always going to be there.

I would choose to have that risk borne by people who choose to bear it, and I don't believe as a taxpayer—our taxpayers in general are very good at managing credit risk. So I am not going to pretend the private sector is going to do a great job, but I am absolutely certain that the government will do a horrible job at managing that credit risk.

Mr. BARR. Just in the 20 seconds left, does anyone on the panel wish to respond to, I believe it was Dr. Zandi's concern about the utility in the PATH Act? Does anybody wish to respond to the concern that with the utility, there is no requirement compelling use of the utility? Why would people not use the utility for purposes of securitization?

Mr. LEVITIN. They don't want to have to comply—one reason not to use it would be that the utility would have certain underwriting standards with which a bank that is conducting its own private label securitization might not want to have to comply.

Mr. ZANDI. Large lenders would almost assuredly not use it, right, because they have their own platform?

Mr. BARR. I yield back.

Mr. GARRETT [presiding]. The gentleman from California is now recognized.

Mr. SHERMAN. Thank you, Mr. Chairman.

I am glad we are holding these hearings, but I think that we have selected a room that is way too small, because if we were going to put all of the business groups that have come to me and

others and said they oppose the path that we are on in this bill but they don't want to say so on C-SPAN, they don't want to offend the chairman, we would need to be in the large auditorium in the Capitol Visitor's Center.

This is a long hearing, but this is a bill with hundreds of pages, that has taken many years to write behind closed doors, and now in a couple of weeks, we are supposed to go from seeing the bill to moving it out of the committee. I would hope that we wouldn't be marking up this bill until we have a chance to spend August reviewing it.

The old system had a lethal combination of private sector objectives for Fannie and Freddie where there were stock options, large compensation plans, pressures from the stock market, and a desire for market share combined with government credit guarantees and then finally, combined with inadequate oversight. And as the gentleman from Colorado, Mr. Perlmutter, pointed out, when we tried to have oversight and passed it in this committee, Chairman Oxley saw the bill die in the Senate and attributed that to the one-finger salute that he received from the Bush Administration. To this day, Mr. Oxley has not indicated which finger was involved.

What we need is a new system that continues the government guarantee but eliminates the private ownership with stock market pressures, stock options, and enormous compensation plans, and that has adequate oversight and an adequate fee to make sure that the taxpayers are reimbursed for the risks that they are taking.

Now, I realize you can read everything Ayn Rand ever wrote, and you won't see any mention of Fannie, Freddie or the FHA, but just because it is not in "The Fountainhead" doesn't mean it should not exist.

The Chair was here saying that for $729,000, $750,000, you could buy a mansion in his district. I don't know what the houses sell for in Coffman, Texas, but in my area, that is a middle-class home. And I would like to, for the record, point out that there are 10 million Californians who live in counties where the median home price is over $525,500. And I assure the chairman, whom I know will take an interest in reading this transcript, that for $729,000, $750,000, you do not get a mansion in America's best named city, which, of course, is Sherman Oaks, California.

As to auto loans, they were referenced by one of the other Members. You can't get a 30-year fixed-rate auto loan. The private sector will not take both the credit risk and the interest rate risk.

Mr. Zandi, we have been told how well the jumbo loans are working, but let's say you are getting a conforming loan. You are putting about 5 or 10 percent down. Imagine what the interest rate would be. Now, to get that same interest rate on a jumbo, how big a downpayment would you need?

Mr. ZANDI. It depends on all of the other circumstances. I can't answer that question. It would be large. Larger.

Mr. SHERMAN. Does someone else—professor, do you have a comment?

Mr. LEVITIN. No.

Mr. SHERMAN. Doesn't it typically take a 20 percent downpayment on a jumbo, or aren't the vast majority of jumbos at 20 percent downpayment?

Mr. WALLISON. I don't know the answer to that, but whenever you have a mortgage, you have a balancing of the creditworthiness of the borrower, the collateral, the importance of the collateral, as well as the downpayment. So there can be a lot of bargaining over that.

Mr. SHERMAN. Without the government guarantee, and expecting a fixed-rate loan for 30 years, you are going to be putting at least 20 percent down.

Finally, I would like to be concerned about the effect this is going to have on home prices. Keep in mind we have guaranteed $5 trillion worth of mortgages, and if they go underwater, we, the Federal Government, are going to lose a lot of money. What happens, and I will ask Dr. Zandi, if you take 20 or 30 percent of the potential buyers out of the market? What happens to home prices?

Mr. ZANDI. All else being equal, they will decline.

Mr. SHERMAN. Yes. And wouldn't we have at least 20 or 30 percent of the home buyers today unable to put up a 20 percent downpayment or having a 750 FICO score?

Mr. ZANDI. Almost certainly, yes.

Mr. GARRETT. Mr. Duffy is recognized for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman. I appreciate the panel staying here and working so hard, staying so late.

I just want to take a look back to 2008 to Mr. Calabria. Do you know what the cause was of the 2008 financial crisis? Do you have an opinion as to what caused it?

Mr. CALABRIA. I think you have, at minimum, a dozen different factors. It would be nice if there was one thing you could point to and say, fix that, and that was it. So I would certainly put a number of things. According to my opinion, what I think was absolutely reckless monetary policy. I don't think you could have a real Federal funds rate negative for 3 years. You had a situation where because of the Fed, we were paying people to take money. That is all you need to have for a bad situation.

Mr. DUFFY. Did the housing bubble have an impact on the financial crisis of 2008?

Mr. CALABRIA. Absolutely. And I think to really distinguish part of the discussion here and maybe differences between Adam and Mark and myself is the real question of how much of the current system is procyclical versus countercyclical. If you assume that this sort of crisis just happens, and then, of course, you want to say we want a backstop because a crisis happens. So our argument is, how much of the backstop caused the crisis?

Mr. DUFFY. I hear you. And one of the main drivers of the housing bubble, we are talking about monetary policy, but also Fannie and Freddie had a role in that too, didn't they?

Mr. CALABRIA. Absolutely. They helped inflate the housing bubble, and just as importantly they helped transfer losses to the taxpayer, which is the difference between, say, the office market bubble, the hotel market bubble. All of these things bubbled, but you and I did not pick up the check for them in the same way.

Mr. DUFFY. I want to move along a little bit more quickly here, but you would agree in the financial crisis of 2008, we had a housing bubble, and Fannie and Freddie played a role in it. Right? You would agree?

Mr. CALABRIA. Absolutely.

Mr. DUFFY. And have you had a chance to review the Dodd-Frank legislation that passed a number of years ago?

Mr. CALABRIA. I am afraid to say I have actually read it several times.

Mr. DUFFY. Section by section, title, the whole thing?

Mr. CALABRIA. Yes.

Mr. DUFFY. Could you give me the section where Dodd-Frank addresses Fannie and Freddie?

Mr. CALABRIA. I think it is pretty clear that was left out.

Mr. DUFFY. That was left out, that is right. So that is why we find ourselves here today, right, having a conversation about how do we fix one of the main drivers of the 2008 crisis?

Mr. CALABRIA. Right.

Mr. DUFFY. Does anyone on the panel disagree with this? Mr. Levitin?

Mr. LEVITIN. I would say Fannie and Freddie played a role in the crisis, but they were not the leading edge of the housing bubble. The leading edge of the housing bubble was private label securitization—in 2006, over half of mortgages originated ended up getting securitized in private label securitization. I don't think that can be ignored. Fannie and Freddie played a role in creating demand for private label securitization. They are not guiltless. But it I don't think it is quite right to say that they were the main driver of the crisis.

Mr. DUFFY. But my point is they were left out, and that is why we find ourselves here today. And I think that is important to note. We are having a big conversation about this because this wasn't addressed and it should have been addressed, and that is why we are here today having a conversation about what are the right steps forward to make this system work.

I want to talk about the 30-year fixed. We have had a lot of conversation about that. So obviously we have, in our traditional system that exists today, we have the investors in mortgage-backed securities. They take the rate risk, and we have the government take the credit risk, right? And, Mr. Zandi, is it your position that if the investors have to take the rate risk and the credit risk, that they are not going to invest in these products? Is that your position?

Mr. ZANDI. No, they will, it will just be much diminished. So the share of the market that is 30-year fixed would decline significantly.

Mr. DUFFY. How much?

Mr. ZANDI. I think the rest of the world would be a good benchmark. In the rest of the world, 30-year fixed, say Europe probably is the best market, it is about 20 to 25 percent of the market. I would say that is about right.

Mr. DUFFY. Mr. Holtz-Eakin, do you agree with that?

Okay. So we are still saying there is going to be a 30-year fixed-rate. That product will be available, yes?

Mr. HOLTZ-EAKIN. And can I make the point, I think it is an important one, that if we do nothing, we are going to see rates go up, and about 20 percent of mortgages taken off the market by Basel III and QM-QRM, and if we do the hybrid system that Mark de-

signed, there is going to be an explicit charge built into interest rates for the backstop. It is going to raise rates. It is going to lower home prices. It is going to lower the homeownership rate. The notion that there is a freebie out there where we have a better system and these things don't happen is wrong.

Mr. DUFFY. There is no free lunch, right. I think it is a good question for you all. You look at the moderate- and low-income constituents that I have in central and northern Wisconsin, or in any of our districts, were they helped when they lost their home because they were encouraged to buy homes they couldn't afford? Were they helped in that process?

Mr. WALLISON. That was the point that I made in my opening statement, that the people who really got hurt by the policies that we followed during the 1990s and into the 2000s were the people who were induced to buy homes even though they had very low credit scores, and very low financial capabilities, who then found when the market turned that they lost their homes. That was a tragedy.

Mr. DUFFY. Right. And so the status quo of not fixing the system isn't helping poor and moderate-income families—

Chairman HENSARLING. The time of the gentleman has expired.

Mr. DUFFY. So close. I yield back.

Chairman HENSARLING. The Chair wishes to make a process announcement. Again, my apologies. Due to starting 3 hours late in votes, the hour is much later than anticipated. I understand, Mr. Wallison, you need to be excused at this time. My apologies to the second panel as well. We currently have two more Members to ask questions of this panel, in which case we hope to excuse this panel, take a short break, and impanel the second panel, although votes are anticipated sometime within the next 30 to 40 minutes.

So the Chair now recognizes Mr. Stutzman of Indiana.

Mr. STUTZMAN. Thank you, Mr. Chairman, and thanks to each of you for being here and thank you for your testimony and for your answers and for your expertise on this very complex issue.

I would like to touch just quickly, I guess my question kind of maybe comes more from a position of where and why should government be helping. I want to touch on a comment that Mr. DeMarco made: "One thing I would say about 30-year mortgages, it is not necessarily the best mortgage product for a home buyer, especially a first-time home buyer. If you look at statistics and see that the first-time home buyers in this country tend to own their first home for 4 years or 5 years, it may not be the best for their circumstance if they buy that house with that kind of timeline." He goes on to say, "There may be a different mortgage product in which they can build equity at a faster rate than a 30-year fixed-rate mortgage."

I want to ask any of you on the panel, where is the best place for government to guarantee mortgages? Is it a first-time home buyer? Is it a lower- to medium-income household? Where do we start picking, or why do we start picking and choosing who does and who shouldn't? And if you look at the statistics, obviously we are backing a lot of them.

Dr. Calabria?

Mr. CALABRIA. Let me preface with, I wouldn't back any of them. But I do think you have to ask yourself the question of if you are going to have a government intervention, and you have decided to have a government intervention, it should be helping people who would not be helped otherwise. A very large segment of the subsidies that Fannie and Freddie deliver are people who would have become homeowners otherwise, would have gotten a mortgage otherwise. So if you are going to have that subsidy, I would focus it on families who, but for the subsidy, would not be homeowners.

Mr. STUTZMAN. Dr. Holtz-Eakin, go ahead.

Mr. HOLTZ-EAKIN. I think it is important to recognize, and Mark made this point earlier, that we care about people having access to shelter, but a lot of this belongs in the appropriations process where you explicitly have a social program to help low-income Americans.

The second thing I would say is remember there is also a private mortgage insurance market too, so it is not like the government is the only one who can provide guarantees.

Mr. STUTZMAN. Because in the bill, from my understanding, where we are addressing FHA and what FHA's mission really is, it is designed or targets FHA's mission specifically to first-time home buyers, and they are eligible—the eligibility is regardless of their income nationwide. We are helping people out there get into a home.

Mr. CALABRIA. I think that is the right approach, to have an income-based approach where you are making sure that you are targeting somebody who is middle-class or not necessarily having all these subsidies go to the rich.

Let me say as an aside, my approach to public policy questions is often the first thing to ask, is this problem a problem for rich people? If it isn't, then it is an income problem. Rich people have no problem getting housing. I don't care about subsidizing rich people. And if what we care about is that the poor people are poor, the best thing to do is try to give them direct subsidies so they are not poor rather than feed it through all sorts of industries.

Mr. STUTZMAN. Dr. Zandi or Professor Levitin, any comments on that? Isn't that a good approach and shouldn't that be our primary focus?

Mr. LEVITIN. If you started with a blank slate, I think that is a very reasonable approach. The problem is we are not starting with a blank slate. And if you start tinkering with the guarantee too much, it risks pushing down housing prices, and for lots and lots of families, their house is their most significant asset. If housing prices fall, the family's net worth falls, it has a real impact on their financial stability.

Mr. STUTZMAN. But it is a good goal, isn't it?

Mr. LEVITIN. To push down housing prices?

Mr. STUTZMAN. No. No, no, no, I'm sorry. To focus on first-time borrowers—

Mr. LEVITIN. That is definitely an appropriate role.

Mr. STUTZMAN. How much to you—from FHA-guaranteed GSEs, more than 85 percent of all new mortgages originated and were responsible for 99 percent of all mortgage securitizations in 2012.

How much is too much? Where is that line? Is it 100 percent? Would you say that should be 100 percent?

Mr. LEVITIN. Not at all. I think I take a position pretty similar to what Dr. Zandi has articulated, which is that there is a role for a government guarantee, but a limited one, and it should be focused on catastrophic risk.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from Virginia, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman. I certainly appreciate the chairman's leadership on this issue and I certainly thank the members of the panel for spending the time with us this afternoon.

I wanted to follow up on something that Ms. Velazquez was talking about in terms of the national mortgage market utility during her line of questioning. Dr. Zandi concluded and stated that he did not think that there would be much uptake on the securitization platform.

I was wondering if we could hear from Dr. Holtz-Eakin and Dr. Calabria on their take on the platform itself. Do you believe that it will attract the private sector and why? And then the second thing that I was hoping you could address is, do you believe that platform will also have a place there and encourage smaller institutions to be a part of it?

Mr. HOLTZ-EAKIN. I think the utility is an important question and I don't have a bright line answer. I have a couple of thoughts on it. First, I don't see any particular problem with access from the smaller institutions that needs to be fixed. That has come up a couple of times today.

Second, it clearly reflects a problem, which is that currently, Fannie and Freddie have platforms and the FHA is developing another platform, and if you were to simply privatize that, you would give someone a deeply unfair competitive advantage. You can't do that. So this seems so be a halfway house where you turn into a government utility. I am not particularly happy with that approach.

And third, and what I think is the most important aspect, is the degree to which the utility is the mechanism by which you impose standardization, data collection, and some transparency on this market. Those are all absolutely admirable goals, and if you can do that without creating the utility, do it.

Mr. HURT. I want to hear from Dr. Calabria, but on that point, that was my follow-up question, had to do with, as you said earlier, talking about the importance of scrutinizing risk and how vital that is to strengthening, strengthening homeownership in this country and preventing future crises, are you satisfied with the way the bill is laid out in terms of providing the transparency and disclosure that will allow investors what they need to be able to get on to the platform or use the platform?

Mr. HOLTZ-EAKIN. I won't pretend to have read every line of it, but it seems to be in the right ballpark. No question about that.

Mr. HURT. Thank you.

Mr. CALABRIA. Let me start from the observation, and it is important to keep in mind, that Fannie and Freddie and the Federal Home Loan Banks all, in my opinion, clearly increase consolidation among originators. They charge different G fees by size. At one

point Countrywide was almost one-third of Fannie Mae's business. So it is hard for me to look at the previous and somewhat existing model and think that was good for small institutions. It wasn't. It drove consolidation in the industry.

I also will say as you are well aware there are estimates across the board, but there are certainly concerns that 1,000 or more small banks will be driven out of business because of Dodd-Frank. So there are a number of things that worry me in terms of consolidation in the industry.

That said, I think the utility is a reasonable start. I have some concerns. Doug mentioned, I think, hours ago that the problem about having a monopoly, I worry about that. I am less enamored of standardization than I think anybody else at the table is. I tend to like a lot of diversity in our mortgage market and lots of different products and lots of different players. So I do worry about that.

I guess to me, the biggest flaw in the previous system was the government put its thumb very heavily in favor of one system. I think that is a mistake. We need to let 1,000 flowers bloom, so to say, and let the market figure that out.

Mr. HURT. On the second part of Mr. Holtz-Eakin's answer, you talked about scrutinizing risk. Do you have a sense of whether or not this bill offers a transparency in the disclosure necessary for investors to see what they are buying and make prudent decisions in allocating risk?

Mr. CALABRIA. I think there is some increased transparency there that is a positive. I think it is also important to keep in mind that this is a minimum level of disclosure. Investors are always free to go back to somebody who is issuing private label securities and say we want more information, and certainly I think there was a lack of transparency in those securitizations pre-crisis. But you are already seeing investors, you look at things like what Redwood has done, there is far more transparency in the private label market, albeit it is a small market, but there is far more transparency today there. So I think it is an adequate floor in which the market will demand more information to distinguish between players.

Mr. HURT. Thank you. I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back the balance of his time. There are no other Members who wish to be recognized. I want to sincerely thank the panel for their patience and for what they have added. Even the witnesses who have difficulty agreeing with the chairman have had much to add today. This panel is excused, again, with our gratitude.

We will take a brief moment as we seat the exceedingly patient second panel.

[recess]

Chairman HENSARLING. If Members could please take their seats. Although we are missing two witnesses, in the interest of time we will go ahead and start the introductions. Votes are, regrettably, expected soon, but perhaps we can start on some of the opening statements. Again, if staff could close the door, please.

I do wish to say for the record that with one exception, this industry panel was invited by the Majority, and even though a number of the witnesses oppose some or all of the provisions of the

PATH Act, even though we have a disagreement, we respect the organizations, we respect their members, and their voices need to be heard, and I am glad they took the opportunity to accept the invitation to testify.

Testifying on behalf of the National Association of Federal Credit Unions is Ms. Janice Sheppard, who serves as the senior vice president for mortgage compliance at Southwest Airlines. It is nice to have somebody from back home.

Testifying on behalf of the Mortgage Bankers Association is its president and CEO, David Stevens, who, as most of us know, previously served as the Assistant Secretary for Housing and as the Federal Housing Commissioner at HUD.

William Loving, Jr., is the president and CEO of Pendleton Community Bank in West Virginia. He will offer testimony on behalf of the Independent Community Bankers of America.

Testifying on behalf of the National Association of Home Builders, we welcome its CEO, Jerry Howard.

We also welcome the testimony of Tom Deutsch, the executive director of the American Securitization Forum.

Our final witness will be Mike Calhoun, the president of the Center for Responsible Lending.

I think most of you have testified in the past. You will have 5 minutes to give your oral testimony.

Mr. Loving, you are now recognized for your testimony.

STATEMENT OF WILLIAM A. LOVING, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, PENDLETON COMMUNITY BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. LOVING. Chairman Hensarling, Ranking Member Waters, and members of the committee, my name is William A. Loving, Jr., and I am president and CEO of Pendleton Community Bank, a $260 million bank in Franklin, West Virginia. I am also chairman of the Independent Community Bankers of America, and I testify on its behalf.

Thank you for convening this hearing on the PATH Act. It is critically important to our Nation's borrowers and the broader economy that the details of any housing finance reform are done right. We appreciate your efforts to advance needed reforms.

Community banks represent approximately 20 percent of the mortgage market, but, more importantly, our lending is concentrated in small towns in rural America which is not effectively served by large banks. Any mortgage reforms that constrain lending by community banks will seriously harm communities like mine.

Access to a robust secondary market is vitally important to community banks as we do not have the scale and resources needed to effectively hedge the interest rate risk inherent with long-term fixed-rate lending. Secondary market sales make it possible for community banks to offer these loans without risk exposure.

ICBA has developed a comprehensive set of principles for secondary market reform which I will summarize as follows: First, community banks must have equal and direct access. We must

have the ability to sell loans individually for cash under the same terms and pricing available for larger lenders.

Second, there can be no appropriation of customer data for cross-selling of financial products. We must be able to preserve the customer relationship after transferring loans.

Third, originators must have the option to retain servicing rights at a reasonable cost. Servicing is a critical aspect of the relationship lending model vital to community banks.

Finally, private capital must protect taxpayers. Securities issued by secondary market entities must be backed by private capital and third-party guarantors. Government catastrophic loss protection, which is critical during periods of market stress, must be fully and explicitly priced in the guarantee fee and loan level price.

Any reforms that are not consistent with these principles could drive further consolidation of the mortgage market, which would harm borrowers and communities and put our financial system at risk of another collapse.

ICBA appreciates Chairman Hensarling drafting legislation to protect taxpayers, enhance the role of private capital and housing finance, and provide needed regulatory relief for community banks. These critical areas of reform are reflected in the PATH Act. We are encouraged by the bill and believe it is something with which we can work.

With that said, we have questions about how the national mortgage market utility, which would serve as a platform for the securitization of mortgages, would perform in a live marketplace inherently dominated by large lenders. These questions include, first, would community banks be forced to sell loans to the large aggregator that would appropriate servicing rights and valuable customer data? Second, would the owners of the utility have the ability to appropriate customer data? Third, while we are encouraged that any Federal Home Loan Bank would be authorized to aggregate mortgages for securitization, nothing in the Act compels them to perform this service, if they choose not to, what direct access will community banks have to the secondary market?

Finally, the majority of community banks that now sell directly to Fannie Mae and Freddie Mac do so through the GSEs' cash window. Can the utility accommodate this option? We hope that the utility can be implemented in a way that does not, despite the intent of the statute, marginalize community bank mortgage lenders or lead to further consolidation of the mortgage market. ICBA looks forward to working with you and the committee to address these and other questions as the PATH Act is debated.

ICBA sincerely appreciates the chairman's effort to protect community banks from Basel III. In addition, the Act's mortgage lending regulatory relief, especially the qualified mortgage status for portfolio loans and repeal of the new credit risk retention requirement, are urgently needed and will facilitate community bank mortgage lending. The Capito-Maloney examination reforms will go a long way towards improving the oppressive examination environment which is impeding the flow of credit in our communities.

Thank you for the opportunity to share our views. We look forward to working with the committee and providing ongoing input into the process.

[The prepared statement of Mr. Loving can be found on page 191 of the appendix.]

Chairman HENSARLING. Votes have been called on the Floor. We should have the opportunity to hear two more opening statements.

Ms. Sheppard, you are now recognized.

STATEMENT OF JANICE SHEPPARD, SENIOR VICE PRESIDENT, MORTGAGE COMPLIANCE, SOUTHWEST AIRLINES FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Ms. SHEPPARD. Good afternoon, Chairman Hensarling, Ranking Member Waters, and members of the committee. My name is Janice Sheppard, and I am testifying today on behalf of NAFCU. I appreciate the opportunity to share our views with the committee on housing finance reform and the PATH Act.

Credit unions have a solid track record of making safe and sound mortgage loans that members can afford. As the committee works on housing finance reform, a primary concern of credit unions is continued unfettered access to the secondary mortgage market, including adequate transition time to a new system. A second concern equally as important is recognizing the quality of credit union loans through a fair pricing structure. Because credit unions originate a relatively few number of loans compared to others in the marketplace, they cannot support a pricing structure based on loan volume, institution asset size, or any other issue that could disadvantage our members.

Credit union mortgage originations have more than doubled between 2007 and 2013 as we helped meet the demand created when other lenders cut back. The portion of first mortgage originations sold into the secondary market also more than doubled over that same period, from 25 percent to 53 percent. While credit unions hedge against interest rate risk in a number of ways, selling products for securitization on the secondary market is vital to our safety and soundness. Small lenders must have continued access to secondary market sources, including Fannie Mae, Freddie Mac, Ginnie Mae, and the Federal Home Loan Banks or any new entity Congress may create. They are valuable partners for credit unions who seek to hedge interest rate risk by selling their fixed-rate mortgages, as credit unions do not have the economies of scale that larger market participants enjoy.

In 2010, the NAFCU board of directors established a set of principles that the Association would like to see reflected in any reform efforts. These principles are outlined in my written testimony. We believe that the unveiling of the PATH Act is an important step in the debate on housing finance reform.

While NAFCU appreciates the serious and comprehensive effort put forth by the PATH Act, we have outstanding concerns with how the elimination of the GSEs and the government guarantee could impact reliable market access for credit unions. We believe that any reforms should focus on the consumer and not disrupt the recovery under way in the housing market. The guaranteed access to the secondary market was a critical component for credit unions being able to continue to meet the mortgage needs of Americans during this recent economic downturn.

We are pleased, however, to see Section 261, to discourage the trend of strategic defaults that some credit unions have seen. NAFCU also believes that the regulatory relief found in Title IV is a very important aspect of the bill. In particular, NAFCU strongly supports Section 403, to address the CFPB's definition of points and fees under the ability-to-repay rule.

Given the tidal wave of new mortgage regulations, we also strongly support the 1-year delay of the mortgage rules found in Section 406. NAFCU also strongly supports Section 409, which exempts from the Qualified Mortgage definition residential mortgage loans held in portfolio. We also support Section 411 that allows 40-year mortgages to be considered for QM and would allow consumers to waive the 3-day waiting period before closing.

In addition to the mortgage-related provisions contained in the draft bill, NAFCU would like to recognize the important changes that would be made with respect to the examination process at credit unions. Finally, we would like to know that if the bill contains provisions relating to Basel III for community banks, we believe provisions implementing risk-based capital for credit unions should also be included.

In conclusion, we appreciate the opportunity to provide our input on this important issue. We look forward to working with Chairman Hensarling, Ranking Member Waters, committee members, and your staff to address our comments as housing finance reform moves forward. I thank you for your time today and I would welcome any questions that you may have. Thank you.

[The prepared statement of Ms. Sheppard can be found on page 196 of the appendix.]

Chairman HENSARLING. We will go to Mr. Howard's testimony, and then we will recess. Mr. Howard, you are recognized.

STATEMENT OF JERRY HOWARD, CHIEF EXECUTIVE OFFICER, THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

Mr. HOWARD. Chairman Hensarling, Ranking Members Waters, and members of the committee, my name is Jerry Howard, and I am the CEO of the National Association of Home Builders and I appreciate the opportunity to testify here today. NAHB is proud to appear here today, Mr. Chairman, and we applaud you for finally beginning the debate on housing finance reform.

The housing finance system has been in limbo for the past several years and we strongly believe that the status of the system has held back the overall economic recovery. We applaud you also for looking at this issue holistically. I have been around here long enough to remember several housing bills, including the Cranston-Gonzalez Act. And I believe that looking at these holistically is a much more effective way of legislating than piecemeal. NAHB is eager to be a constructive partner in this debate as we move forward. There are elements of the PATH Act that we support and there are elements of the Act with which we have serious concerns.

Let me start by touching on provisions that we support. First, many of the provisions for building a new market structure are consistent with NAHB's policy recommendation for reforming the mortgage securitization practices and procedures.

Second, we are very pleased that you included the Capito-Maloney bank examination bill which addresses bank examiners and their actions with respect to commercial real estate lending. We believe that this legislation, if enacted, will add consistency to the regulatory processes that banks undertake on a daily basis when interacting with our members.

Third, we are happy to see you address the QM and QRM rules, and we support the proposed amendment to the Truth in Lending Act for exceptions to the calculation of points and fees.

Finally, addressing the Basel III accords and ensuring that Basel III does not apply onerously to community banks, as has been feared, will go far toward helping banks free up capital that is much needed in the housing finance system.

These four elements alone are very, very important and we are grateful that they are included in the draft legislation.

With respect to the title that addresses FHA, we have to be mindful of the fundamental countercyclical mission of the FHA. While NAHB could support moving the FHA out of HUD, we are concerned that an independent FHA, with the restrictions imposed by the PATH Act, would be ineffective in its countercyclical mission, a mission that to date has served us so very well during the current downturn, despite the financial status of the MMI fund.

With respect to GSEs, I have to tell you that I have been in the game long enough that I remember when President Clinton called the housing industry into a room and said, "Make more Americans homeowners." I also remember 8 years after that when President Bush issued the same edict. I believe that the goals of President Clinton and President Bush, to increase America's homeowners, are valid public purpose goals. And I believe that expending Federal resources to that end is an equally valid public purpose.

Prior to this downturn, which was the fault of the American housing industry itself, the housing finance system as a whole was working fine. To totally dismantle the housing finance system based on this recent short-term though devastating crisis we believe would be a shortsighted and a dramatic departure from the longstanding American housing policy dating back at least to the Housing Act of 1949.

Most significantly, NAHB believes that the future housing finance system must have an explicit Federal Government guarantee. NAHB urges the committee to make changes to the PATH Act to ensure the Federal Government continues to provide a backstop for a reliable and adequate flow of affordable housing credit for both single and multi-family housing and in all economic and financial conditions.

NAHB believes that this Federal support is particularly important in continuing the availability of a 30-year fixed-rate mortgage. We believe that the PATH Act as currently drafted does not provide the Federal support necessary to ensure a liquid and strong housing finance system.

Mr. Chairman, the National Association of Home Builders is eager to begin this debate. We believe that a fundamental goal of the American people is still to own their own homes. And we believe that an abundance of affordable rental housing must be available to provide Americans with housing choice. Unfortunately, we

believe that the PATH Act as drafted would make homeownership unnecessarily expensive for first-time homebuyers, reduce homeownership opportunities for middle-class Americans, and retard the construction of rental housing. NAHB will be a constructive partner in this process. I sincerely thank you for the opportunity to testify, and I look forward to working with the entire Congress that will enact legislation to create a sustainable housing finance system. Thank you, sir.

[The prepared statement of Mr. Howard can be found on page 148 of the appendix.]

Chairman HENSARLING. Thank you.

There are votes on the Floor at the moment. We expect to return in approximately 40 minutes. The committee stands in recess until such a time.

[recess]

Chairman HENSARLING. The committee will come to order.

Mr. Stevens, you are now recognized for your testimony.

STATEMENT OF THE HONORABLE DAVID H. STEVENS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. STEVENS. Thank you, Mr. Chairman. Thank you for holding this hearing and, more importantly, for jump-starting a debate that is long overdue.

Fannie Mae and Freddie Mac have been in conservatorship for almost 5 years now and it is important that policymakers begin defining a long-term plan for the future role of the Federal Government in the mortgage market. Your legislation, coupled with the recent introduction of the Corker-Warner bill in the Senate, and the FHA bill unveiled earlier this week by Chairman Johnson and Ranking Member Crapo, helped set the process in motion and frame the boundaries of this debate.

Over the course of the last year, MBA reconvened our members in two task forces, one for a single family, another for multi-family, to discuss the future of the secondary market and examine the broad range of issues that will be crucial to this debate. Our members identified several key principles necessary for a sound secondary market. We believe any new structure should rely primarily on private capital but must also provide liquidity through economic cycles with an explicit government backstop. Additionally, the new structure should support the availability of a traditional long-term fixed-rate mortgage product with the ability to lock interest rates efficiently and at low cost.

Finally, there must be robust competition supporting multiple business models in both the primary and secondary mortgage markets. We believe these principles will ultimately benefit borrowers and taxpayers through increased competition and lower costs. As we begin to work toward a new secondary mortgage market end state, we must be mindful that this could be a long road.

To that end, the MBA has also developed a series of transitional steps that can be taken now without congressional action that can help bring private capital back and help pave the road for comprehensive housing reform. Each one of these steps, which I outlined in my written testimony, advances healthy reforms to the sec-

ondary mortgage market in a manner consistent with the common objectives shared by the majority of GSE proposals. And each one of these steps can be taken by FHFA and the GSEs through a transparent process without the need for authorizing legislation, thus allowing Congress to focus its efforts on developing the end state.

I want to turn my attention to the FHA. We wholeheartedly share your goal of strengthening FHA's fiscal solvency and protecting taxpayers from future losses, a process I began when I took over as FHA Commissioner at the height of the housing crisis. However, MBA has strong concerns with the overall scope of the FHA changes contemplated in the discussion draft. Each of the policy choices in this bill carries with it the potential for reducing affordable credit options for many otherwise qualified borrowers in the single family and multi-family markets. While we share your goal of reducing FHA's footprint to a more traditional role, we urge the committee to re-examine changes to the single family mortgage insurance coverage, repurchase requirements, and loan limit floor as well as multi-family income limits. The final bill needs to strike a balance between strengthening FHA's fiscal solvency and maintaining flexibility to support homeownership opportunities for both first-time and working-class borrowers as well as a vibrant rental housing market.

Finally, MBA welcomes many of the improvements to Dodd-Frank contained in the discussion drafts. The proposal contains the provisions of H.R. 1077, the Consumer Mortgage Choice Act, which would amend the way points and fees are calculated for purposes of determining the eligibility for the Qualified Mortgage. This will make these safer loan products more affordable and more widely available to qualified borrowers.

The bill also contains a prohibition on Fannie Mae, Freddie Mac, and FHA from purchasing or insuring mortgages in jurisdictions that permit using the power of eminent domain to seize underwater mortgages out of private label mortgage pools. MBA has strongly discouraged local jurisdictions from moving forward with this unprecedented and likely unconstitutional scheme and supports legislation to ensure U.S. taxpayers do not ultimately foot the bill for these unwise programs.

Mr. Chairman, I want to again thank you for beginning this process of reforming our Nation's housing finance system. As I have outlined, we believe there are some key changes that are necessary prior to this legislation being considered by the full House. But we stand ready to work with you, the ranking member, and all other members of this committee to improve the bill as it moves through the legislative process. Thank you.

[The prepared statement of Mr. Stevens can be found on page 212 of the appendix.]

Chairman HENSARLING. Mr. Deutsch, you are now recognized for your testimony.

STATEMENT OF TOM DEUTSCH, EXECUTIVE DIRECTOR, THE AMERICAN SECURITIZATION FORUM (ASF)

Mr. DEUTSCH. Thank you, Mr. Chairman. I very much appreciate the opportunity to testify here today on behalf of the hundreds of

ASF member institutions. We issue, structure, trade, service, and invest in trillions of dollars of outstanding and newly originated mortgage, residential mortgage-backed securities, and asset-backed securities in the United States, including those entirely backed by private capital as well as those guaranteed or insured by public entities such as Fannie Mae, Freddie Mac, and Ginnie Mae.

ASF strongly supports the introduction of the PATH Act as its proposal should continue to fuel what we hope to be a tangible, constructive dialogue to resolve the future of U.S. housing finance reform. For the 5 years since the onset of the GSE's conservatorship, the mortgage reform dialogue has been, in our opinion, far too theoretical. While ASF and others will propose changes to this discussion draft, we believe this bill, along with the recent introduction of the GSE and FHA reform bills in the U.S. Senate, serve as concrete steps towards comprehensively restructuring the currently misguided U.S. housing finance system that relies on the U.S. Government to backstop 90 percent of residential mortgages made in America. We agree this must be done responsibly so that greater dislocation does not occur within our Nation's housing market, the materially reduced access to credit, and/or impairment of the value of outstanding agency and private label RMBS. We believe there are many aspects of the PATH Act that would help achieve this goal.

In our submitted written testimony, we provide substantial detail on seven key views we have on different parts of this proposed bill. One, we are strongly supportive of ratcheting down in the near term the Federal Government's involvement in the U.S. housing finance system, the gradual reductions in GSE loan limits, appropriate increases in guarantee fees, and the GSEs issuing material amounts of their securities that expose investors to credit risk of the underlying mortgages. I point you to a recent White Paper we also issued in April of this year for substantially more detail and steps the Congress, FHA, and all regulators can and should take to increase private capital in the near term regardless of how long or in what form housing finance reform takes.

Two, as many of these near-term steps take effect, the credit risk investor base is rebuilt, heavier competition returns to the RMBS issuance market in the private sector, and crisis era regulations are finalized. Congress and FHFA should push additional volume loans outside of the government guarantees through its various levers in the form of either GSE risk sharing deals and/or privately issued transactions.

Let me take a point here to note that we believe that the 30-year fixed-rate note will by no means disappear at any future state with or without a government guarantee. In our opinion, there is no real debate about the 30-year fixed-rate mortgage disappearing or not existing. Currently, in the existing market, RMBS deals entirely backed by private capital, ones being just issued last month included 30-year fixed-rate collateral. That is not something that is necessary to have a government guarantee to backstop. As I think Mr. Garrett had indicated earlier, the real debate is about filling the entire pie of the outstanding agency asset-backed mortgage-backed securities market out there, is effectively bringing credit in-

terest rate risk investors in to fill this credit risk volume. And that is where a number of the aspects of the PATH bill will look to fill.

Let me go to my third point, which is that ASF is strongly supportive of the FHFA securitization platform and/or any subsequent utility that all market stakeholders have an appropriate say in creating those standards of development that will increase the standardization. The point of that standardization is to create more fungible and liquid securities that will in part attempt to achieve and replicate some of the agency market that exists right now. By creating that fungibility and that standardization, those securities—the hope is that they will trade in a liquid and deep market. But you can't have a liquid and deep market of private label capital when the government guarantees approximately 90 percent of existing mortgages.

Fourth, ASF has supported, and continues to support, a strong legislative covered bond market in the United States that will help create even more demand and more product for these rates investors that are not necessarily looking to create credit risk.

Five, ASF is strongly supportive of targeted corrections to the Dodd-Frank Act, Basel III, and other regulations to remove impediments and better facilitate the origination and capital market sales of mortgages and other securities backed by them. As an example, eliminating the premium cash capture reserve account that many people have noted, if people are concerned that 90 basis points is too much by eliminating the government guarantee, losing 100 to 400 basis points by just one of the aspects of Dodd-Frank seems to be a pretty obvious answer to us.

Sixth, ASF is extremely supportive of the PATH Act's prohibition of the GSEs and FHA from guaranteeing any mortgage out of a jurisdiction that seized mortgages through eminent domain.

And finally, ASF offers some key amendments that would fix some of the Dodd-Frank Act related to swap and margin requirements that got some of the same impacts as the premium cash capture reserve account.

Thank you very much, Mr. Chairman. I look forward to answering questions.

[The prepared statement of Mr. Deutsch can be found on page 126 of the appendix.]

Chairman HENSARLING. And finally, Mr. Calhoun, you are now recognized for your testimony.

STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT, THE CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. I may be popular today as the last witness of the day.

Thank you, Chairman Hensarling, and members of the committee who have stayed for this important hearing. And thank you for your work to address the future of the critically important housing finance system.

The PATH bill raises numerous ideas that add to this important discussion. We are concerned though that as currently drafted, it would lead to unnecessarily more expensive and riskier home loans, reduction of borrowing options for the popular and safe 30-year fixed-rate mortgage, more concentration in what is an already

too concentrated banking and mortgage industry with harm to community banks, and disruption of the housing industry and harm to the overall economy.

Let me first address comments to the quality of U.S. mortgages leading up to the housing crisis because I think it is instructive to look back at those, and it addresses several questions today. Let me start with recognizing the work of the chairman emeritus to try to address that quality issue back in 2006.

Loans in this country were unaffordable without constant refinancing that depended upon unsustainable home price growth and the musical chairs game came to an end when house prices slowed down and then declined. It is important that the quality of our mortgages was very low compared to other countries where there was a housing bubble and prices reduced but people were not in mortgages that they couldn't afford just the basic payments. It is also notable that quality was lowest and defaults and losses were by far the highest on private label security mortgages. They were more than double the defaults, for example, in the severity that you saw for the GSE portfolio.

Ultimately, our housing finance system depends on the quality, transparency, and predictability of our mortgages. And those mortgages were driven by the fee incentives up and down the chain. Those mortgages, for example—people ended up in no-doc loans. Well, those loans carried higher interest rates than a full-documentation loan. So if a borrower walked in, the broker or the lender could earn twice as much money putting the person in a no-doc loan as giving the same borrower a fully documented loan. As we have quoted in previous testimony, one CEO of a mortgage company said, "Wall Street pays me almost double for a no-doc loan versus a full-doc loan. Which ones do you think I am going to write?" That is market incentive.

Importantly, the Dodd-Frank Act has provided incentives and standards, commonsense standards that will dramatically improve mortgage quality and, indeed, overall in response to the crisis, mortgage quality right now is at its highest and, indeed, I think there is consensus if you ask that credit is too tight at this time.

Going forward, the Qualified Mortgage ability-to-repay will prevent the return of the exotic unsustainable mortgages that went from being small niche products to dominating the whole market leading up to the crisis.

I will address quickly a couple of questions that came up. First of all, there have been cites to the CoreLogic data about what is the size of this QM market. Let me clarify again for the record. It has been cited that 50 percent of current loans would fit the QM market, that is, if you do not take into account the compensating factors that the rule explicitly allows. When you do that, depending upon whether you look at 2010 or 2011, 90 to 95 percent of mortgages fit the QM box with no adjustment. There has been talk about the fee level. The fee level for QM loans is 3 points. The average fee on a GSE loan today is less than one point. That was an intentional part because the idea is to align that lenders make money not from the fees, prepayment penalties, and things like that made at closing, but rather from the performance of the loan. It realigns a sustainable loan with a lender's model.

Let me address also very quickly just with community banks. We must preserve the TBA market and the cash window. As the bill is written out, it is very difficult for community banks to compete against the larger banks and we are going to see further concentration in the market.

Thank you for the opportunity to testify. I look forward to your questions.

[The prepared statement of Mr. Calhoun can be found on page 119 of the appendix.]

Chairman HENSARLING. Thank you. And I thank all of the panelists for their testimony.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I was kind of interested that the last panel—I had a lot of comments with regards to some of the things that they were saying. But it would seem to me that back in the 1980s and 1990s, we were able to have a marketplace without a tremendous amount of government-backed securities, yet we had everybody getting into houses that they could afford. And in the interim here, we have had a large run-up of loans which are guaranteed by the government, and yet we haven't increased homeownership. I think 1 percent was one of the statistics that I saw. Which is kind of interesting to see that all we have done is transfer risk basically from the financial institution individuals to the Federal Government and the taxpayers. So, it is just a comment.

Mr. Deutsch, you deal with a lot of the securitization stuff. You mentioned Basel III. How is Basel III going to affect the securitization market here?

Mr. DEUTSCH. There are multiple parts I think of Basel III that are ultimately going to reduce demand for mortgage-backed securities. I would first start with what is called the liquidity coverage ratio. It is a new aspect of Basel III to make sure the banks have sufficient liquid assets to withstand a credit crisis, in effect. The liquidity coverage ratio is an example that allows RMBS—private label RMBS to be eligible as liquid assets. But it says that for nonrecourse States—for nonrecourse loans, they can't be included in any RMBS securities. So for a committee like this where the chairman is from Texas, and the ranking member is from California, I would think this would be anathema to this committee because California and Texas both are nonrecourse States, which means no loans from California or Texas may be included in any RMBS security if that security is ultimately then considered to be a "liquid asset."

Mr. LUETKEMEYER. And therefore, they can't be included in the capital ratio.

Mr. DEUTSCH. Exactly. The United States is one of the few, if any, of the countries around the world that has nonrecourse statutes. Australia, Canada, England, they are all fully recourse. So all of their RMBS will be considered high quality liquid asset as private securities.

Mr. LUETKEMEYER. Okay. So this is going to hurt the ability of people to get loans, is basically what it boils down to, right?

Mr. DEUTSCH. Yes. It only applies to private capital securities.

Mr. LUETKEMEYER. Okay. Is this going to increase the cost then as well?

Mr. DEUTSCH. It ultimately will reduce demand by banks to purchase these private securities which of course means that they are then going to have to charge higher rates to get those securities.

Mr. LUETKEMEYER. One of the problems that we are having here and we are discussing is kind of getting around the edges of it as with the qualified mortgages, qualified real estate mortgages here. We have talked about it a couple of times. But it really is concerning to me because it looks to me like we are having two different markets that are going to be defined here by this rule. We are going to have one market with loans that conform to the rule and one market with loans that don't conform to the rule. How are you going to mesh those two into a securitized situation?

Mr. DEUTSCH. I think the simple answer is that securitizations will include only QM loans generally. You will have securitizations with QM. You may eventually see some securitizations with non-QM loans but I think those are farther down the road compared to—

Mr. LUETKEMEYER. Okay. So, Mr. Stevens, whenever somebody comes to one of your folks and wants a loan, the choices are going to be limited, are they not?

Mr. STEVENS. Absolutely. Yes. The QM rule does a lot of good things. But without question, it is going to limit the capital available for anything outside the QM provision. And there will be some good borrowers on the margin who are caught outside. To Tom's point that common securitizations will be QM only, they will be specifieds or story bonds that get done as non-QM pools. And we are already hearing about companies being started up to enter that space.

Mr. LUETKEMEYER. So there will be somebody that fills the void then?

Mr. STEVENS. They will fill the void but in the early phase it will be for high-wealth clients. And it will provide programs like interest-onlys which are not allowed in the QM provisions. But they are just such wealthy borrowers that the risk is very low. And those will sell as sort of separate story execution—

Mr. LUETKEMEYER. Would you anticipate the rate being higher or lower on those?

Mr. STEVENS. I think the rate differential for the high net worth borrower could be equal or perhaps in some cases even more advantageous. For anybody who is at all on the margin from a risk standpoint, it will be much more expensive. So you are going to have two different markets. The low-downpayment market is going to be much more expensive loans. The high net worth borrower will get you products.

Mr. LUETKEMEYER. Very good. I appreciate your answer. I don't want to cut you off but I only have about 20 seconds left here. And I have one more question I want to ask because I don't think anybody has asked it all day, which is kind of amazing. Does this bill prohibit innovation? Mr. Calhoun, you talked a while ago about all these things are going to go out the window. Products are going to be restricted. And yet I don't see anything in here that prohibits

the private sector from coming up with new financial instruments. Do you see anything in there that prohibits them from doing that?

Mr. CALHOUN. I think the question is, does it allow for innovation that will be widely available? And that is our concern.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the ranking member from California for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

I would like to direct a question to Mr. Bill Loving of the ICBA. Earlier this year, the ICBA released its policy resolutions for 2013. In this document, the ICBA stated that to ensure the continued flow of credit for housing, some type of government tie to the secondary market is necessary. Your testimony today notes that government catastrophic loss protection would provide credit assurances to investors and sustain robust liquidity even during periods of market stress. Your testimony does not provide a view of what happens to community banks in the absence of such protection, as the Republican discussion draft contemplates. Why do you think a government tie to the secondary market is necessary? Does the Republican proposal have such a tie? And what are the consequences of not having this government role?

Mr. LOVING. We believe that there needs to be a catastrophic backstop behind the private capital that will provide for support in the market during times of stress. We haven't changed our position from the earlier policy statement. Looking at the bill as it is in draft form today, it does provide for liquidity through the Federal Home Loan Bank System. And so without the government or the Fannie or Freddie model, then we are looking to the Federal Home Loan Bank System to support that borrowing role.

Ms. WATERS. Does the Republican proposal have such a tie?

Mr. LOVING. Which tie? To the government?

Ms. WATERS. In your testimony, you did not really give us a view of what happens to community banks in the absence of such protection, as the Republican discussion draft contemplates. Why do you think a government tie to the secondary market is necessary? And in looking at this proposal, the question is, does the Republican proposal have such a high a tie?

Mr. LOVING. The proposal we do not see has a tie but we believe that there does need to be backstop for the catastrophic backstop in the plan.

Ms. WATERS. What are the consequences of not having this government role?

Mr. LOVING. At this point, there is uncertainty in the marketplace about how it will function without that catastrophic backstop. Recent history has shown that there has been a catastrophic backstop. We are uncertain how it will perform without that element.

Ms. WATERS. The ICBA took a strong position criticizing the bipartisan policy commission's proposal to reform the market. The main argument against the structure was that it would favor only a few large institutions because it would require community banks to sell their loans to an aggregator in order to access the secondary market. Another argument against it was that the system would add significant costs, as there were several private credit enhancers ahead of the government guarantee.

Given that the Republican discussion draft also appears to favor the largest institutions in spite of a few lines in the bill about fair access and envisions a completely private system, does the ICBA have an equally strong position against the Republican plan?

Mr. LOVING. We have concerns with any model that would provide for one or a few number of mortgage originators and would not allow private access by the community banking industry.

Ms. WATERS. Let me turn to Mr. Stevens.

Mr. Stevens, in your testimony, you explain why the MBA opposes Section 237 of the discussion draft which sets income and occupancy limitations on FHA multi-family properties and requires annual recertifications. It seems to me that the Republican discussion draft is trying to make the FHA multi-family program more like Section 8 and bog it down in the types of onerous rules that I have been trying to provide relief from as I work on Section 8 voucher programs.

In your opinion, will this new requirement restrict multi-family lending? What impact will this discussion draft have on the overall production and availability of multi-family housing, especially during an economic downturn?

Mr. STEVENS. I appreciate the question. The challenges with the multi-family role of FHA—and I respect the concern about trying to ensure that as much multi-family lending is done by private capital. When I came in as FHA Commissioner, the multi-family market had all but evaporated. There were 5-year notes that were coming due and there was no way for these multi-family properties to refinance themselves. FHA became sole source provider during that period of time and the demand became very extensive. And many of you remember that. You probably got calls from multi-family owners and originators who couldn't get their loans through the FHA because the backlog became so strong.

So having that liquidity there, particularly during times when private capital isn't there is extremely important for the rental community. As to income limits, I think that is just an awkward way to deal with people who are paying their rent and market rate finance properties that are profitable to the government but all of a sudden have a threshold that says, if your income goes above it, you are going to have to relocate and move out of this building to another location, creating a vacancy for the owner which creates higher risk on the transaction in the first place, causing stress again to the taxpayer simply as that result. I think there is another way to discuss these multi-family limitations that are a concern of FHA's extensive role. But it is a profitable program. And I think that income barrier, where they would have to ultimately move out of the building just doesn't really make sense for a market rate property—

Mr. NEUGEBAUER [presiding]. The gentlewoman's time has expired. Thank you.

The gentleman from Pennsylvania, Mr. Rothfus, is recognized for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman. I would like to venture into the regulatory burdens imposed by Dodd-Frank and how the PATH Act might alleviate some of the barriers to capital. We know from previous testimony of Dr. Holtz-Eakin, who was actually on

the prior panel, but he testified earlier this year before the Judiciary Committee about how Dodd-Frank had already caused significant compliance costs and paperwork burdens. I would like to ask Mr. Loving, Ms. Sheppard, and Mr. Stevens whether you would agree that Dodd-Frank has put in place significant burdens that if alleviated could improve our housing finance system and attract more private capital; specifically, in particular, are the credit unions, community banks, and mortgage bankers ready to comply with all of these impending Dodd-Frank rules?

Ms. SHEPPARD. I will take that one first.

Mr. ROTHFUS. Sure.

Ms. SHEPPARD. No. The answer is no. I just recently came back from a nationwide participatory program with a national trade association called ACUMA. We spent three different sessions in three major cities. And the concern in the credit union world out there is, no, they are not compliant with all that is expected under the CFPB in January. Everyone is working really hard and diligently to work towards that. But there are major concerns across the credit union industry nationwide about being in compliance in January.

I do see that some of the protections that are in the PATH Act would be beneficial to credit unions regarding the QM exemptions. That is a very attractive consideration.

Mr. ROTHFUS. Mr. Stevens?

Mr. STEVENS. I would just like to say at the outset that I think the CFPB got a lot right in the Qualified Mortgage rule and implementing some of the rules. There are still provisions that have yet to be implemented. QRM is a perfect example of that, that if it is implemented as the proposed rule is structured, it would be extremely prohibitive I think not just to lending overall but particularly to private capital re-engaging in the marketplace and would be counterproductive to that end. So we are very concerned about ensuring that at a minimum, QRM equals QM in the final rule and that would be very helpful as a provision in the PATH Act.

Likewise, the points and fees limitations that came out in the final rule get resolved by incorporating the language from H.R. 1077, which we think would actually be beneficial ultimately to providing access to the market for more institutions to compete for American home purchasers' business and ultimately make rates even more competitive for homebuyers.

So those two provisions are examples of how you can continue to ensure that what is left in Dodd-Frank creates easier access to housing finance.

Mr. ROTHFUS. Mr. Loving?

Mr. LOVING. Yes. We share the concern as well with the regulatory burden. In particular, we appreciate the parts of Title IV that will eliminate QM and provide the opportunity to provide capital to many borrowers across America. The rule designation is a help but we are still concerned that many will not qualify and will be able to meet the requirements of QM.

Mr. ROTHFUS. Have any of your respective organizations calculated compliance costs under Dodd-Frank for your organizations?

Mr. STEVENS. The MBA does a peer group study in which we are looking at the cost of compliance in all areas. And it has definitely added a significant expense to the process which of course we all

know gets passed on to the consumer. I would stress that there is balance in all things. If the industry was processing loans without enough scrutiny, and we were having products that were not sustainable in a previous period, that needed to be corrected. The question is, has the pendulum gone so far as now these costs are overly burdensome, creating less competition and transferring too much cost to the consumer? And I think ultimately that is what the policy debate needs to work on is making sure loans are sustainable, that the process is sound, that it is well-managed, but it doesn't add so much cost and burden to the marketplace that it creates a new level of lack of access for homeownership.

Mr. ROTHFUS. Ms. Sheppard, have you calculated the compliance costs for your organization?

Ms. SHEPPARD. We do not have a specific percentage. But I can tell you, we have had to bring on full-time additional staff and management to handle our compliance costs. So I am sorry I don't have a specific number for you. If you would like, I can take that down and answer your question in writing.

Mr. ROTHFUS. Yes. Thank you. I would appreciate that. I yield back.

[The following response was received for the record:

> "We estimate that Southwest Airlines Federal Credit Union directly spends over $259,000 a year on Federal regulatory compliance."]

Mr. NEUGEBAUER. I thank the gentleman. Now, the gentlewoman from New York, Mrs. Maloney, is recognized for 5 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman. I would like to ask Mr. Howard, in your testimony you state that the Home Builders oppose the FHA title of the PATH Act. And you urge the committee to "make the changes necessary to preserve FHA's vital liquidity mission."

Could you elaborate? What changes would you make to Title II to preserve FHA's historical role in the mortgage market?

Mr. HOWARD. Well, ma'am, I guess the simplest way to answer is to say that we believe that the measures that were contained in the FHA Solvency Act that the House passed last year were much more effective in getting FHA solvent and maintaining its ability to respond to the needs in the marketplace. Specifically, I think there were provisions in that Act that would have called for increased premiums and also would have called for a stronger lender indemnification. Those two things. And FHA is implementing some of those changes on their own. In fact, it is already adding money into the fund already without the legislation. But clearly, a regulatory reform bill more like the Solvency Act we think would be more effective than the provisions in the PATH Act.

Mrs. MALONEY. So basically, you would scrap Title II entirely and replace it with the bipartisan bills that we passed really on suspension twice in two prior Congresses. Would that be what you would say, to scrap it?

Mr. HOWARD. Yes, ma'am.

Mrs. MALONEY. What is your position on it, Mr. Calhoun? Would you scrap it and go back to what we already passed twice in two Congresses?

Mr. CALHOUN. I think everybody agrees that the FHA needs some improvements. But I would second the comments there. I think it is noteworthy that the largest portion of their losses was for loans that they had actually asked Congress to allow them to stop taking and Congress had, up until 2009, required them to keep doing, a so-called seller-assisted downpayment program. Of the $16 billion deficit, about $13 billion of that is from that one program which now they did discontinue and that is why their book is among the more profitable they have ever had at this point going forward.

So yes, I would support that same substitution.

Mrs. MALONEY. What about you, Mr. Deutsch?

Mr. DEUTSCH. I think the existing Act, as you push it out, many of the features that are in this Act can be very helpful to the market and would push forward with what is being proposed.

Mrs. MALONEY. And what about you, Mr. Stevens?

Mr. STEVENS. I think I am consistent with the others. I do believe if you were to reintroduce the FHA Reform Act that there are some minor nuance provision changes that could make it more implementable for the market. But yes, we are in agreement.

Mrs. MALONEY. Ms. Sheppard?

Ms. SHEPPARD. I can't speak to the FHA reform. Our credit union does not do FHA or VA or government loans.

Mrs. MALONEY. Okay. And Mr. Loving?

Mr. LOVING. Yes. We believe that the FHA model does need reform. As it is proposed, there are some good elements, but we do believe there needs to be some further negotiation on the percentage of guarantee, the 50 percent guarantee seems to be a low level and needs to be at a much higher level.

Mrs. MALONEY. Okay. So you are all in agreement. Is it a fair statement to say to go back to the bill that we passed twice in the House? Is that a fair statement?

Mr. STEVENS. If I could add, I think that having worked on that—having been FHA Commissioner when the first bill was introduced, and this was the body that actually approved that bill to begin with and gave us some initial ability to even raise premiums, which made it through the Senate without the rest of the bill, there are some variables that we would love to follow up with you on as to how that bill could be made even stronger.

Mrs. MALONEY. Okay. Mr. Stevens, also in your testimony, you noted that the government role to provide quality regulation of grantors and systems and to provide a clearly defined but limited catastrophic credit backstop is an important component of this ideal system. And you went on to say that it would have a big impact on qualified lower-income households and their access to affordable mortgage credit.

Would you elaborate on how this smaller mortgage market with tighter credit would affect the economy and jobs in our country?

Mr. STEVENS. Look, it is a well-known fact that housing has been actually one of the positive stories of however we view the current economic recovery. Mark Zandi, who was on the previous panel, has stated publicly the role that FHA had played in the housing recovery. The concern I have as we think about the complete lack of a backstop is that private capital is clearly opportunistic. It

comes into markets when markets are strong, and when you are in a recovery market, there is a lot of private capital, spreads between private mortgage-backed securities and guaranteed mortgage-backed securities, narrows. And you can talk about how jumbo fixed-rates are priced very closely to conventional rates.

Mr. NEUGEBAUER. I am not picking on you, but we were trying to keep our time here.

Mr. STEVENS. Okay.

Mr. NEUGEBAUER. I will now recognize myself for 5 minutes. Again, I thank the panel for your endurance here.

Mr. Calhoun, you are the president of the Center for Responsible Lending. So you believe in using market discipline as one of the factors of making sure that everybody kind of has a stake in the lending. That is when lending works best, right?

Mr. CALHOUN. Yes. We support—

Mr. NEUGEBAUER. So the borrowers have responsibilities and the lenders have responsibilities, is that correct?

Mr. CALHOUN. Certainly.

Mr. NEUGEBAUER. Yes. So what about then if a lender can transfer all of the risk, what part of market discipline interacts with the lender if he is going to transfer 100 percent of that risk? What would encourage that lender to have market discipline?

Mr. CALHOUN. One of the concerns that we have—

Mr. NEUGEBAUER. No. I am not asking your opinion about the bill. I am just saying, is there any market discipline when 100 percent of the risk is transferred?

Mr. CALHOUN. If the lender has some legal liability as they do under Dodd-Frank for writing—

Mr. NEUGEBAUER. I am not asking about Dodd-Frank. This is just a simple question: Is there market discipline when somebody can transfer 100 percent of the risk?

Mr. CALHOUN. There may be legal risk. Separate from that—

Mr. NEUGEBAUER. Obviously, you are not answering the question. So the other question here is that I know there is some heartburn about 50 percent. Does anybody know what the guarantee level is on a VA loan? I think Mr. Stevens knows the answer to that question. What is it?

Mr. STEVENS. Yes. It is 90 percent.

Mr. NEUGEBAUER. I don't believe that is correct. It is 25 percent.

Mr. HOWARD. I thought it was 50.

Mr. NEUGEBAUER. Yes. So it is not unprecedented. And we had a gentleman from the mortgage insurance industry here a while back on the last panel. Now there has been a lot of discussion about what to do with FHA. And Mr. Howard, I know that you mentioned in your testimony that you supported the past proposal restructuring FHA. But yet I just heard you say that you want to go back to the previous—

But in your testimony you said you supported restructuring FHA and I believe—and allowing it to be a wholly owned government corporation. Is that true?

Mr. HOWARD. We support FHA—we can support, depending on the concept, Mr. Neugebauer, of taking FHA outside of HUD, yes. But we would still like to see the provisions of the Solvency Act, the FHA Solvency Act be the guiding provisions for its regulations.

Mr. NEUGEBAUER. What is the advantage of having an independent FHA, in your estimation?

Mr. HOWARD. I believe it could be nimbler.

Mr. NEUGEBAUER. One of the things that was brought up about this bill that was passed on suspension—I would remind everybody who was before we knew that they were $16.3 billion underwater. And so it became obvious, the disclosure came after we passed that legislation, that FHA was in a much deeper hole than I think previously folks had represented to us.

The question is then in this countercyclical role that everybody seems to be extremely concerned about, and so the concern then is about the borrowers being able to continue to access credit, but the question is, if we are going to have a balanced housing finance system, we have to make sure that everybody's interest is represented in this process.

So tell me, in this countercyclical role, should we just regard the taxpayers and just say, you know what, we are going to keep plowing. We may have to have some taxpayer assistance here but we are going to keep pushing the ball down the road. Is that the countercyclical role that you anticipate? Jerry?

Mr. HOWARD. No, sir, I think what we are forgetting in the detailed level we are getting in this conversation is it is all about the underwriting, Mr. Neugebauer. And in the past when FHA got into trouble, when the GSEs got into trouble, it was during a time when traditional underwriting standards were just being ignored. I believe that the FHA would not be in the financial condition it is in now, and I am speaking only of the single family fund, had traditional underwriting standards been in place throughout the earlier part of this century.

Mr. NEUGEBAUER. I appreciate that. And I think you are exactly right. I think one of the things I want to make sure as we address this issue, and I appreciate everybody's feedback, is that there is a time to quit lending. If markets are—and that is the reason we need that market discipline in there. If there are too many apartments units or there are too many houses, it doesn't do any good to make a little family a 97 percent loan in a neighborhood where the prices of those houses could be dropping because there is an overbuilt situation. So the countercyclical role isn't—necessarily shouldn't be to counteract market swings.

Now, what I think you are trying to say is that market should come in, in the event that there is a plumbing stoppage in the finance market. Is that true?

Mr. HOWARD. Yes, sir, that is certainly part of it.

Mr. NEUGEBAUER. I see my time has expired. In order to be fair here, we will now go to Mr. Capuano from Massachusetts, the ranking member of the Housing and Insurance Subcommittee.

Mr. CAPUANO. Thank you, Mr. Chairman. I just want you to know I don't understand you any more than I understood the full committee chairman.

Mr. NEUGEBAUER. You and I have to have an interpreter when we talk to each other.

Mr. CAPUANO. I want to thank the panel for being so patient and for sticking around on this important issue. I kind of wish you had been the first panel because the first panel I am sure if you had

watched was very thoughtful, very theoretical. You guys are the hands-on people, and honestly it is about hands on. The theory is wonderful and all that, but I really need to know what it does, how it really impacts the building and buying and selling of homes.

I guess, first of all, some of this stuff that has been talked about, Dodd-Frank, have any of your organizations ever testified in front of Congress to say there was too little regulation? I don't think so. If you have, you can raise your hand.

There you go, there is one. And I don't expect that you did. I understand, I think it is a fair question where the pendulum should be. I think that is a very fair question. We are always asking this. But to ask you if there is too much regulation is almost setting you up a little too easily. And I love you, but not that much.

So I want to move on to the basis of why we are really here, which is to try to figure out what to do with the mortgage financing industry.

Do any of you believe or any of your institutions believe that the United States really can get to a fully privatized home mortgage system as proposed in the PATH bill? Mr. Loving, do you believe we can get to a fully privatized system and still provide the kind of opportunities that we have provided to so many Americans?

Mr. LOVING. We support provisions of the PATH Act but believe there has to be a catastrophic backdrop in the model for this period.

Mr. CAPUANO. Fair enough. Ms. Sheppard, do you believe that we can get to a fully privatized system?

Ms. SHEPPARD. No, sir, I don't believe we can get to a fully privatized system.

Mr. CAPUANO. Thank you. We are having a good time, but thank you. Simple question, simple answer. Mr. Howard, do you believe we can get to a fully privatized system?

Mr. HOWARD. No, sir.

Mr. CAPUANO. Mr. Stevens, do you?

Mr. STEVENS. We need more private capital, but not fully privatized.

Mr. CAPUANO. I agree with that, but we can't get to a fully privatized. Mr. Deutsch, do you believe we can get to a fully subsidized system?

Mr. DEUTSCH. No. We are always going to need FHA to serve a role.

Mr. CAPUANO. Mr. Calhoun, do you?

Mr. CALHOUN. No, we need a catastrophic backstop. And the numbers now show—

Mr. CAPUANO. Fair enough. Because I agree. I am no different than anybody else. I want more private capital in as well, and to me the question is, what is the balance, and again simply some regulation. What is the balance? What is too much? What is too little?

As you know, Mr. Deutsch, actually you said there was far too much theoretical conversation so far. I couldn't agree with you more, even today. But here is my dilemma. We get this bill last week, a nice, long, thoughtful, comprehensive bill that includes everything but the kitchen sink, more than I thought that it would include. That is great. A lot of hard work. I think the staff has been

properly thanked for that. But we don't have time to really comprehensively fully integrate this without talking to people like you. I don't get a chance to talk about what should and shouldn't be. We are kind of beyond that.

You know how this place works. What is likely to happen is that I will soon, within the next week or two, be asked to vote on this bill yes or no pretty much in the form that it is in now. We might be able to amend a few things around the edges. But you all know that to be a fact.

So the question I have for you, if I gave you my voting, come on up, sit up here, next week we go to a markup on this bill, it is an up or down vote, not let's talk about I like this, I like that. There has never been a bill I have ever voted for or against that I didn't like or hate something in it. I was a big supporter of the health care bill, but there are things in there that I don't like. I was a big supporter of Dodd-Frank, but there are things in there I don't like. Though with due respect, I am not interested in the things you like or things you don't like, I get to vote yes or no.

Mr. Loving, would your group suggest that I vote yes or no on the bill as is?

Mr. LOVING. We believe it is something we can work with, but we believe it is an imperfect bill and there still needs to be discussion.

Mr. CAPUANO. I understand that. I appreciate that. I don't mind, but I am going to try again. I think the same thing you just said. It is a great thing to have something to begin with. I get to vote yes or no. Would you vote yes or no?

Mr. LOVING. Again, as I said earlier, we believe it is something that we can support and get behind with additional work.

Mr. CAPUANO. So, that is a no.

Mr. LOVING. We can support it with additional work.

Mr. CAPUANO. I am going to jump to Mr. Calhoun. Would you vote yes or no?

Mr. CALHOUN. No.

Mr. CAPUANO. Mr. Deutsch, would you vote yes or no?

Mr. DEUTSCH. I would vote yes, with changes.

Mr. CAPUANO. No, that is not what I said. I would vote yes with changes too. My definition of how many changes is a different thing.

Mr. DEUTSCH. I think the number one rule of sitting here is answering a question you would like to have asked.

Mr. CAPUANO. I know. And my number one rule is to get you to take a position.

Mr. Stevens, would you vote yes or no?

Mr. STEVENS. I am going to align with Mr. Loving, that I that I think this is—

Mr. CAPUANO. You can't blame me for trying. My time is up. I appreciate these witnesses.

Mr. STEVENS. We have been very clear in our position about—

Mr. DEUTSCH. Thank you for using the gavel, Mr. Chairman.

Chairman HENSARLING. Saved by the gavel. The time of the gentleman has expired. The Chair will recognize himself for 5 minutes. I did have to step out for a few minutes, so forgive me if I am cov-

ering some old ground here that might have been covered when I was out of the room.

Sometimes, I think at certain points, we need to step back from the trees and look at the forest here. And we have been here for many, many hours, you quite patiently, and I want to cover a couple of the concerns that I still hear, particularly from Members on this side of the aisle.

One of the concerns is, again, without some form of government guarantee, private capital will not come in and fill the void and we will not have a 30-year fixed mortgage at something approaching affordability, however that is defined.

So, Mr. Deutsch, will private capital come in, and there is very little private capital today, so will it not come in or can it not compete under the provisions currently of Fannie and Freddie and Dodd-Frank? What is the answer here?

Mr. DEUTSCH. I think there is a simple answer that there is a fallacy in the market that private capital doesn't want to come into the mortgage market. Private mortgage-backed securitizations are not going to compete for $200,000 loans because each and every one of those loans being made are going to be sold to FHA or Fannie or Freddie because it is effectively better execution. It is a better deal for an originator to sell that to Fannie or Freddie than it is to sell it on the open market, in large part many would argue because the guarantee fees are too low, which is in effect a subsidy for those mortgages.

So I think the answer to your question is private capital does and will come back into the market if there is space for it to come back into. But since the crisis, because loan limits went up so much, from $417,000 to now $625,000, there are effectively very few loans you can originate nationwide that are above that $625,000 that private originators then can compete and sell to private label mortgage-backed issuers.

Chairman HENSARLING. Mr. Calhoun, you have been a frequent witness before our committee. I haven't found anything we have agreed on yet, but I haven't lost hope. It may happen one day. But here is something I don't quite get.

I have a 30-year fixed-rate mortgage. I am glad I had the opportunity to get it. The truth is as I look at it a little bit more closely, I am not completely certain, had I spent more time, that it was the right product for myself and my family. I know that you have articulated in the past and your organization, your great concern about low-income people finding themselves awash in debt, and yet I look at the figures, and math occasionally can be a little pesky here, but just the difference on a 15-year fixed-rate mortgage versus a 30-year fixed-rate mortgage, this is a hypothetical, $400,000, a little bit on the high side for my district, but 7 years into a 15-year fixed-rate mortgage you have $143,000 of principal, and 7 years into a 30-year mortgage you have $38,000 of principal. So if the average American is selling their home after 7 years, I want everybody to have the opportunity to have a 30-year fixed, but I am not sure I want my government steering people into a product that may not be right for them. And is it really the purpose of the Federal Government to tell people take on the maximum amount of debt possible?

Then when you talk about concern about homeownership opportunities, I know what you are saying, that somehow these rules and the CFPB is going to get it right, but it seems to me we have gone from extremes here. We have a Federal Government on the one hand through their affordable housing goals helping put people into homes they couldn't afford ultimately to keep. They didn't do them any favors there. And now, it seems like the pendulum has swung the complete opposite direction, and we are about to tell half of America, you can no longer qualify for a home.

And so I don't understand how you can kind of have it both ways. So regrettably, I am leaving you all of 16 seconds to comment, but have at it.

Mr. CALHOUN. The record will reflect that when you were out we discussed—the CoreLogic data shows that when you apply the full QM rule as it exists today, 90 to 95 percent of mortgages fit in that box without any restructuring, and then with restructuring a huge array of mortgages can fit there. And that is what we support.

Chairman HENSARLING. That may be a closely held opinion. My time has run out, which means that your time has run out.

The Chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

We all want to see private capital in these markets. In fact, what we do see now is private capital. That is to say eventually, these mortgage-backed securities are sold for private capital. The question is whether private capital is going to provide the average American family with a 30-year fixed-rate mortgage at a rate they can afford with a downpayment that they can come up with.

The chairman correctly points out that some people might prefer a 15-year fixed. I have a 15-year fixed. I saved 50 basis points. Payments are a bit higher. That is fine. We in Congress make 3 times what the average American family makes, but it turns out it may be a good deal for people in our bracket.

The question I have is without a government guarantee, how much more difficult and how much more expensive are these mortgages going to be and what effect is that going to have on the number of buyers in the market? Have any of your groups—we heard Mark Zandi tell us the 90 basis points, and that is only if you have a very high FICO score. Have any of your groups analyzed what this bill will do to the average home price in the United States?

Mr. DEUTSCH. I will take the first shot. I think a quick answer is I don't think you can possibly model it to come up with a very credible estimate of the basis points.

Mr. SHERMAN. Mr. Chairman, I think that illustrates why we should not mark up this bill until at least after the August break.

Mr. DEUTSCH. But I think the second part of that question—

Mr. SHERMAN. Yes. We are talking about home values in this country totaling between, what, 5 and 10 or 12 trillion dollars. We are going to have a dramatic effect on that, and I would like another month to figure out whether this bill is going to have an acceptable effect. But go on with your answer, Mr. Deutsch.

Mr. DEUTSCH. I think in the last 5 years since the advent of Fannie and Freddie's conservatorship, there has been plenty of time to try to model that and figure that out. I don't think in an-

other 5 years you could get a bunch of rocket scientists in a room who could come up with a credible number as to what that rate differential is. Because you have a lot of other factors moving, Basel III, $85 billion a month currently being purchased right now of mortgage-backed securities by the Federal Reserve. Just the mere whisper by the Federal Reserve Chairman of moving away from that created an 80 basis point jump in one month.

Mr. SHERMAN. Okay. Just by show of hands here, who represents an organization that feels that we can live, and this picks up on Mr. Capuano's question, without a government guarantee playing a role in the mortgage market?

I see no hands going up, and yet that is exactly or pretty much exactly what this bill does.

There has been a lot of discussion of the jumbo market, but the person with the jumbo loan is in the top 5 or 10 percent in terms of their income. Mr. Stevens, wouldn't almost all those jumbo loans involve a 20 percent downpayment, at least?

Mr. STEVENS. Today, they do. We have seen the market shift, Congressman, over the years, and as markets are healthier, and I think we will begin to see that—Wells Fargo just announced a jumbo with a 15 percent downpayment and they are trumpeting that in the marketplace.

Mr. SHERMAN. Yes, and if you have a FICO score of 950, you can probably get that loan.

Mr. STEVENS. I think it goes back and makes the point that as markets improve, I think we will see more private capital competing to finance mortgages. There will be 30-year fixed-rate mortgages, but the risk we run, we have to protect against—

Mr. SHERMAN. Yes. If I could just squeeze in one more question. To oversimplify Dr. Zandi's testimony, it was that this bill would take say 30 percent or more of the buyers out of the market. What effect would that have on not only the value of homes, but the value of mortgage-backed securities in the market today? Mr. Stevens, any comment?

Mr. STEVENS. We have not had the time to calculate that.

Mr. SHERMAN. Would it take you 5 years or 5 weeks?

Mr. STEVENS. I think there are benefits to this bill and there are benefits to driving towards a private capital solution. But as we have said very clearly, we believe there is some work that could be done to make this kind of legislation something that would ensure that there is liquidity as well as private capital.

Mr. SHERMAN. And anybody who thinks we can do that in 5 days does not understand Congress. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

To announce to all Members, I think I understand this right, Ms. Sheppard, you have asked to be excused at 7:30. Is that correct?

Ms. SHEPPARD. Yes, sir.

Chairman HENSARLING. Okay. So for Members who may have questions for her, you don't have too long.

The Chair now recognizes the gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman. Thank you to the panel. I will just digress and follow up with Mr. Capuano's question.

He had asked, Mr. Chairman, who would vote for this legislation as it stands right now. I will just ask rhetorically—not rhetorically, how many people would vote for Dodd-Frank if that bill just came up once again?

Okay, no one, that is as I thought. Good. Should the record reflect that no one on the other side of the aisle raised their hand? Oh, one did. Okay. I see.

So where are we here? Let me just go down this other road for one second. The question was also asked as far as a government involvement or government backstop and I saw your hands or lack of hands on that. Does this panel recognize that with this bill as it reads right now, there will be a variable, significant government involvement in the housing market with FHA, VA, Federal Home Loan Banks, and the Federal Reserve, along with some 87 other housing programs as well, that these make up some additional backstops in the housing market? Does anyone recognize that on the panel?

I see hands nobody wants to raise. Good.

I probably shouldn't go with this question. For those who think we need an explicit government backstop, is there anyone who disagrees with the statement that we also would need, if you had something akin to what we have right now, in other words, keep going with some sort of a mechanism like we have right now, that you need for the government to also therefore appropriately deal with the risk, credit risk, deal with the risk and price that risk appropriately? Does everyone agree if we were to have some other explicit backstop other than what we have in the bill, that we have to price that risk?

Everyone is nodding heads.

Can someone give me just one Federal program where we are currently appropriately pricing risk? I am thinking flood insurance. No, I guess that is not it. Is there any program that you can look to historically where the Federal Government has done an exemplary job of pricing that risk?

And I see no one raising your hand. So you are suggesting that we are going to go forward and create that program going forward.

Do you have a program where we appropriately priced the risk?

Mr. CALHOUN. If you look at what has happened with the GSEs since the passage of HERA, there was no question you had a hamstrung regulator misaligned at center.

Mr. GARRETT. But going back, we haven't seen until the next crisis—okay.

Mr. CALHOUN. But going forward, they are generating enough revenues to repay the bailout within the next year.

Mr. GARRETT. That is clever. So I will ask Mr. Deutsch, here is a question. Is there a benefit, if we were to put something akin to this legislation through and we have the utility, which I should add that we got some of this idea by looking to the Administration where they had three different proposals out there and one of their ideas talked about somewhat of a utility and we sort of copied some of that idea here, if we had this platform set up, is there a benefit to using that utility, the securitization on that platform?

Mr. DEUTSCH. Fundamentally, a key benefit of the utility is the standardization. Investors can go buy a security that has a stamp

that says this is pretty fungible with a separate security that may be issued the next day or the following day. That is, I think, the key benefit of any utility that could create that fungibility.

Mr. GARRETT. We have put other benefits we thought in there. Do you see other benefits with regard to exemption from securitization, registration as well, and the QM exemptions as well. Do you see them as benefits? They are in the legislation for people to say, I am going to go through the utility as opposed to the other market?

Mr. DEUTSCH. Yes. I think investors in the securities, you wouldn't be able to create any kind of TBA without that exemption from the securities laws, so that would be critical to try to recreate any part of the TBA market.

Mr. GARRETT. If we are able to get that homogeneity in the underwriting and the standardization and the securitization, what does that do—maybe you have answered this—what does that do as far as the depth and liquidity of the marketplace under this?

Mr. DEUTSCH. Ultimately what you trying to do is create a bigger swimming pool, and the more water you have in the pool the more liquidity you have, which means that you can interchange the securities. People can trade them in the secondary market almost as if they were cash.

Mr. GARRETT. Got it. Okay.

Mr. DEUTSCH. And the positive impact of that is it ultimately ends up lowering rates for the borrowers because those securities are that much more valuable.

Mr. GARRETT. And in real simple terms that I can understand, what that also means to me as a homeowner is what, maybe someone on the earlier panel, I forget, said that that means I am able to, what, lock in my rates to the TBA, is that right?

Mr. DEUTSCH. Correct. If you as a borrower want to be able to lock your rate in, the TBA market is critical, so that if you go today and say I would like a mortgage, when you actually get the mortgage 90 days from now your rate will be as it was at the day you asked for it.

Mr. GARRETT. In 9 seconds, does that not also mean that through to that depth that you also facilitate the extension of the 30-year mortgage as well?

Mr. DEUTSCH. Correct.

Mr. GARRETT. Great. Thanks for your answers.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. Also, Mr. Chairman, if I may, I would like to thank you for the recognition that we showed earlier today to the former President of South Africa, Mr. Nelson Mandela. I regret that some of you have been detained possibly longer than we wanted you to be detained. It was one of those times when there was a really important event to many of us that was taking place. So thank you for your patience.

To reward you for being so patient, I am just going to ask one question and I will give each person an opportunity to respond, a very simple question. Why, in your opinion, is the 30-year fixed-rate mortgage important? Why is it important to your constituents, the people that you serve or represent here today?

Mr. Calhoun, I will start with you, and I do so with the understanding that you do have a constituency and I am sure you have an opinion.

Mr. CALHOUN. Yes. Quickly, households do not handle interest rate risk well. As you see in today's market, if you had a variable rate loan, they were down as low as 3 percent or less, and within a couple year period we could be easily looking at rates of 5 percent. That is more than a 50 percent increase in the borrower's mortgage payment. Most households don't fully understand that and very few of them have the financial reserve and liquidity to be able to absorb that.

Mr. GREEN. My friend?

Mr. DEUTSCH. I would say what the 30-year fixed effectively provides to a borrower is they are buying insurance on their interest rate risk. Instead of paying, let's say 4½ percent, you are paying 4¾, and that differential between 4½ and 4¾ is effectively an insurance payment, so that 10 years down the road your interest rate doesn't go up. But there is a cost to that and ultimately the capital markets will always provide that service, but, of course, for that insurance price cross.

Mr. GREEN. My friend, Mr. Stevens.

Mr. STEVENS. Congressman, first, not everybody necessarily needs a 30-year fixed-rate loan, but for many families the confidence of knowing that their rate will not go up over time for their shelter is important. But more so as we look forward, it is going to be much more important than in decades past. We have gone from 18 percent back in 1980 to 3 percent several weeks ago. On a forward-looking basis we are going to have rates rising, so having that protection is going to be a stability factor, not just for the family but for the economy overall.

Mr. GREEN. Thank you. My friend from the builders, Mr. Howard.

Mr. HOWARD. In the interest of time, I will associate myself with the remarks of the three previous speakers. They hit the nail right on the head.

Mr. GREEN. All right. And we will move next to my friend, Ms. Sheppard.

Ms. SHEPPARD. The quick answer is that we have a system of long-term fixed-rate mortgages financed through the stable securitization, which helps provide stability in the U.S. economy on the 30-year mortgage. But in addition to that, I would like to mention really quick that this is something our membership asks for. They demand or want this product, the very members that we serve. So because we serve them, we go to meet their demand and we do the 15-year. And it is almost a 50–50 split now.

Mr. GREEN. Thank you. My friend, Mr. Loving?

Mr. LOVING. As well, our customers ask for this product. Not all customers want this product. I think the real issue is the fixed-rate. Depending upon whether it would be 10 years, 15 years or 30 years, it is the knowledge of what the payment will be from the day of origination to the day that they pay the loan off in full.

So I think the key is the fixed-rate component. Again, the 30-year product is something that is asked for by our customers and

is something that allows us as community banks to serve our customers' needs.

Mr. GREEN. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The gentleman yields back. At this hour, Ms. Sheppard, I understand that you wish to be excused from the panel.

Ms. SHEPPARD. Yes, sir. Thank you very much.

Chairman HENSARLING. Thank you. We will excuse you from the panel.

The Chair now recognizes the gentleman from California, Mr. Miller, for 5 minutes.

Mr. MILLER. Thank you, Mr. Chairman.

I keep hearing from investors that they believe we need a vibrant TBA market for the housing finance system. Mr. Deutsch, what changes would need to be made in this bill to ensure a vibrant TBA market would occur?

Mr. DEUTSCH. Currently, the TBA market functions because there is a government guarantee. If you go and you try to take out a mortgage and you want to rate-lock it on a go-forward basis, the originator of that mortgage knows that they can sell it. They have a government guarantee behind it. So fundamentally, what this bill tries to do is evolve that system from being a government guarantee that is a backstop to ultimately the capital markets evolving in some fashion through the utility, through other methods, to where the capital markets will effectively provide that insurance, if you will, in that you want as, a borrower, to be insured that from the time that you ask for the mortgage until the time you take out the mortgage, that that rate doesn't change over time.

So I think like virtually any other financial product, there is always a price that the capital markets will be willing to charge and ultimately offer that product to you to be able to rate lock over time.

Mr. MILLER. If we end the guarantee, will investors continue to buy mortgage-backed securities in the market?

Mr. DEUTSCH. If you end the guarantee—

Mr. MILLER. Will they continue to invest?

Mr. DEUTSCH. Absolutely, but it will and it does require a shift. And I think the first panel hit on it a few different points is that currently, you have a significant amount of rates investors out there, but you need to shift some of those. And not all of them will shift. There will be many investors who are rate investors who won't magically turn overnight into credit investors. But there will be some who will shift some of their product from buying rates products to credit risk products. But ultimately, and I indicated this in my oral and written testimony, we have to start rebuilding that credit risk base to be able to get more investors to buy those credit risk products.

Mr. MILLER. Okay. A question for the panel. Would it be more appropriate to avoid shocks in the market to tie the wind-down of the GSEs to the ramp up of the utility with evidence-based market and structural triggers and milestones? Mr. Stevens?

Mr. STEVENS. Congressman, I think this is the question that has been debated a lot today, is can there be a TBA market without

a guarantee. And I think what Tom alluded to is if the counterparty ultimately isn't backstopped by the U.S. Government, which backs the mortgage-backed security even if the originator fails and can't back up their representations and warranties themselves, it brings a lot of investment capital from around the globe, because then all the investor has to worry about is the interest rate risk. They know what they are buying from a homogenized product standpoint because it is defined, but what they don't know is whether the counterparty will be there to back up that loan, and having that wrap on it has created that capital flow.

So I think there is an opportunity as a pilot to determine whether you really can create a TBA market without the backstop, rather than completely pulling out the supports without knowing yet whether that system will work. And given the size and scope of it, which has been discussed today, I think doing this in a measured way is far more critical to making sure the system could support any shift to that kind of structure.

Mr. MILLER. That seems to be what I am hearing from a lot of sources.

Mr. Howard, would you agree with that?

Mr. HOWARD. I would agree with that, Mr. Miller, and I would suggest that there might be a TBA market without a government guarantee, but I think it would be very, very expensive and it would force a lot of people out of the housing markets.

Mr. MILLER. So you think a wind-down tied to a ramp-up for verification would be most appropriate?

Mr. HOWARD. Yes, sir.

Mr. MILLER. Mr. Calhoun?

Mr. CALHOUN. A real additional concern is the TBA market, even if it does exist, is it available to all lenders based on size at comparable prices? It is a lot easier for an investor to evaluate what the counterparty risk is for Wells Fargo than it is for the local community bank. So the real questions are if you have a TBA market, which is uncertain, it might be available just for the largest lenders, which we think has adverse consequences, and if it is available even at all for the smaller lenders, there is almost certainly a tremendous price penalty that they have to pay.

Mr. MILLER. I don't believe any of us want to see another Countrywide machine who sold these mortgage-backed securities that couldn't be unwound. They couldn't replace the bad mortgages. Investors were just stuck with them. That is why it left a lot of bad taste in a lot of investors' mouths today, and I think you, Mr. Deutsch, what a lot of people who realize that. They thought they were buying mortgage-backed securities from a GSE and they weren't, and they lost tremendous amounts of money.

I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from New Mexico, Mr. Pearce.

Mr. PEARCE. I almost drifted off there, Mr. Chairman. You caught me just before I was going away.

Mr. Calhoun, you had spent adequate time talking about the no-doc loans, and I think you articulated the problems with them. Do you think that the government had any role in those no-doc loans or was that just sheer, greedy capitalism?

Mr. CALHOUN. I think the main role the government had was lifting up the rating agencies, because the rating agencies gave those no-doc loans a rating that created the arbitrage.

Mr. PEARCE. Okay. Just by point of differentiation from that point, I have an article here that talks about Countrywide and doing exactly what you are describing. It also talks about the GSEs buying them straight from them. And I think that if the GSEs had not bought those things, I think when Countrywide began to choke on them in their portfolio, I suspect they would have quit doing it. But I saw Mr. Franklin Raines make $29 million in one year cooking the books, doing things like this, and James Johnson before him, $100 million in 10 years, and they were doing Enron-type stuff, which was cycle the stuff in faster, go get everything you can get. So I suspect that the government had something to do with Countrywide's decision to do that.

Mr. Deutsch, is there a cost to consumers for a 30-year mortgage?

Mr. DEUTSCH. Absolutely.

Mr. PEARCE. What would that cost be?

Mr. DEUTSCH. It is simply an insurance payment cost. It is that if you as a consumer want to lock your rate in for 30 years, the financial institution of some kind has to be on the other side of that. They have to say if rates rise, effectively we are going to take a loss, so we want an insurance payment for that.

Mr. PEARCE. Let me tell you the cost to me. When I bought my first house it was a trailer house for $4,500. My next house was a townhouse, brand new for $55,000 when I was about 30. They asked me 15 years or 30 and they didn't explain there is a difference. I had never considered that question at all. I could have afforded it. It was $400 a month for my $55,000 over 30 years. I could have afforded the $485, but I didn't because I just said, well, I don't know. I hadn't thought about it.

I sold my townhouse 15 years later for $55,000. I owed $55,000 still. I would have had it paid clear. So the cost of the 30-year mortgage to me was $55,000, cash in hand. And so when we are talking about this sacred product, there are instances where it is very costly to the consumer.

Mr. Loving, are there products available in the financial market today that weren't available, say, back in 1970 or something, financial products available to the consumer?

Mr. LOVING. To the consumer? I would say the products that were available then are available today. There has just been a greater utilization of the 30-year fixed-rate mortgage.

Mr. PEARCE. Are there investment mechanisms out there that couldn't have been dreamed about 4 or 5 years ago, 10 years ago, 20 years ago?

Mr. LOVING. I would say there could be, yes.

Mr. PEARCE. Yes. When I look at the problem we got into, I can't dream of my banker back when I was borrowing $2,000 a year for my 4-H pigs when I was 14, I can't dream of my banker having derivatives and stuff like that. Am I correct or maybe—

Mr. LOVING. I think from the community bank perspective, you are exactly correct. Derivatives, swaps, certainly were not in the vocabulary.

Mr. PEARCE. Yes, there is all sorts of stuff moving just like this, because computers make some things available and then we as people can design things as long as there is a demand. So I just see this tremendous demand out there in the private market, and we are being told that the 30-year fixed mortgage would go away. If the demand is that strong, I just can't visualize that with all the magnificent things we do for one-quarter of a basis points for 36 hours that there wouldn't be some product developed out there. Maybe I am wrong, but I just have trouble seeing it.

I am going to wrap up with the idea that is there private capital that will do what we consider to be government functions? And so, I will just take one of the most explicit government functions, which is going into space—one giant step for mankind or whatever that deal was.

Do you think that the private market could or would ever do that? Just a show of hands altogether. Yes? No? No. No, no, no, no, no. So let the record reflect that everybody says no.

Let me tell you that the X Prize was set up just to do that.

Mr. CALHOUN. I would say yes.

Mr. PEARCE. They are all yeses. Okay, I'm sorry.

The X Prize was set up because most people would think there is no way private capital would chase this because there is no investment return. Yet the X Prize put in 2 years something that NASA has never done.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from Wisconsin, Mr. Duffy.

Mr. DUFFY. Thank you, Mr. Chairman, and again, I appreciate the panel staying so late, giving us a long day of your time.

I want to talk about the 30-year fixed-rate mortgage. There has been a lot of focus on that during this hearing. Maybe I will have you all walk me through your thoughts on this. And, again, just to review right now, we have our investors in mortgage-backed securities, they assume the rate risk. The American taxpayer assumes the credit risk.

Is it everyone's position on the panel that if we actually have our investors assume the credit risk as well, they are not smart enough to price that, and then invest accordingly in our mortgage-backed securities? Is that the position of the panel?

Mr. DEUTSCH. I wouldn't take the position that investors are not smart enough to price the credit risk, no, absolutely not representing institutional investors who do it every day.

Mr. DUFFY. All right. Anyone else?

Mr. STEVENS. We do have a history where subprime and no-doc lending was promoting to an excess and private investors went too far. So there are imbalances you can have in a fully privatized market or a fully guarantored market, and it is getting those balances right that I think ultimately creates sustainability.

Mr. DUFFY. But if we get the balance right, the investors can assess that new credit risk, right? If they get a return on their investment to assume that risk, they will make that investment along with the rate risk they are already assuming, correct?

Mr. DEUTSCH. Many can.

Mr. DUFFY. Mr. Loving, do you agree with that?

Mr. LOVING. I think they can, but I think the question is how broadly available will the 30-year fixed-rate mortgage be to the marketplace, and if it is not available, if it is demanded, what impact it would have upon the overall housing market. So it is not a question of if, it is of how much, and how broadly available it would be.

Mr. HOWARD. And how much it would cost if it was available to the consumer.

Mr. DUFFY. But the point you all made earlier to Mr. Garrett, you said should the Federal Government accurately assess the credit risk that the government assumes, and you all I think you shook your head saying, yes, we should all try to accurately assess that risk, and then Mr. Garrett pointed out that the government really hasn't done a very good job of it. But you all agree that we should try to assess that credit risk and pass it on in the form of an interest rate hike, of a G fee.

Why can't the market do the same thing? And why would there be a significant price differential, Mr. Howard?

Mr. HOWARD. In our conversations with investors and potential investors and those that do the securitization, what we are told is that absent the guarantee, the product is viewed as a riskier product, purely and simply, and therefore it will cost more to the consumer to put the product on the market.

Mr. DUFFY. And they are going to price that risk, but those are going to start off at a lower rate because they are not paying G fees right now, right? They are going to start at a lower rate.

Mr. HOWARD. Right.

Mr. DUFFY. They will assess the risk.

Mr. HOWARD. Not necessarily.

Mr. STEVENS. The guarantee fee is the guarantee on that mortgage-backed security that comes where a AAA rating. So the guarantee fee reduction is offset by the fact that the value of the security is greater. In fact, Tom Deutsch was talking about how that is actually crowding out private capital from competing. So that execution difference is legitimate.

Mr. CALHOUN. And can I add just very quickly, I have bought mortgage pools. It is very complex. Mortgages are not cookie-cutter all-alike borrower significant. It is hard to assess the risk on pools that are relatively small. There are huge economies of sale—

Mr. DUFFY. But if you get the standardization right, you should be able to, right?

Mr. CALHOUN. In lending by having large issuances that make the system work. On small deals, there are tremendous price premiums that are added because of the work and the economies of scale.

Mr. DUFFY. Very well. And I guess we have a lot of things, Mr. Calhoun, we disagree on. I don't know that the panel would agree that 95 percent of current mortgages would fit the QM rule, but we will leave that alone right now.

I guess I would just point out, you look at why we are here. Again, I am going to make the same point. Dodd-Frank, massive financial reform, and it left Fannie and Freddie alone, didn't address a significant portion of the cause of the 2008 crisis. I would argue that it hasn't lowered the cost of mortgages, hasn't increased

access to credit, and it is causing a lot of problems in the market that we are trying to also resolve in this bill. So though we are here today, frankly we should be reviewing policies that our friends across the aisle had included in Dodd-Frank and trying to tweak them instead of starting from scratch.

But, again, I want to be clear to all of you here. I want to make sure coming from small town America, rural Wisconsin, that our small community banks and our credit unions have the ability to aggregate and securitize their loans effectively, and I want to make sure we continually work together to make sure that we have a process in place that that will absolutely work for us.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The ranking member?

Ms. WATERS. I have a unanimous consent request. I would like to enter into the record a letter from a number of organizations who have indicated some concerns.

Chairman HENSARLING. It will all come in under general leave, and without objection.

I would like to thank all of our witnesses again today for their testimony, and for their patience.

The Chair notes that some Members may have additional questions for these panels, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

[Whereupon, at 7:50 p.m., the hearing was adjourned.]

APPENDIX

July 18, 2013

Testimony of Mark A. Calabria, Ph.D.

Director, Financial Regulation Studies, Cato Institute

Before the

House Committee on Financial Services

Hearing entitled "A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

Mark A. Calabria, Ph.D. is Director of Financial Regulation Studies at the Cato Institute. Before joining Cato in 2009, he spent seven years as a member of the senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs. In that position, he handled issues related to housing, mortgage finance, economics, banking and insurance. Prior to his service on Capitol Hill, Calabria served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development, and also held a variety of positions at Harvard University's Joint Center for Housing Studies, the National Association of Home Builders and the National Association of Realtors. He has also been a Research Associate with the U.S. Census Bureau's Center for Economic Studies. He holds a doctorate in economics from George Mason University.
http://www.cato.org/people/mark-calabria

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July 18, 2013

Chairman Hensarling, Ranking Member Waters, and distinguished members of the Committee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a non-profit, non-partisan public policy research institute located here in Washington, D.C. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official positions of the Cato Institute. In addition, outside of my interest as a citizen, homeowner and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

Let me first commend the Chairman, and the Committee staff, for their efforts in crafting the "Protecting American Taxpayers and Homeowners (PATH) Act." Rarely does Congress so directly, clearly and accurately identify a problem and craft a solution actually addressing the problem.

Need for Reform

It should be beyond dispute that our nation's system of residential mortgage finance is badly broken. A few tweaks here and there will not suffice. Major structural reform is needed. Never again should the taxpayer be forced to pay tens of billions to bail-out the mortgage finance industry. It is well worth remembering that the most recent bailout is not the first. The Savings and Loan crisis of the 1980s was essentially a taxpayer financed bailout of the mortgage-finance and housing sectors. We cannot leave the taxpayer holding the bag the next time the housing market goes boom and bust, which it will. We have not ended either the business cycle or the related housing cycle. If anything, our current system has made those booms and busts worse.

Let us also make no mistake. The recent recession, from which we are still recovering, was a direct result of the boom and bust in our housing market. This boom and bust was caused by, among other policy mistakes, our current system of mortgage finance. Eight and half million workers lost their jobs in the recent recovery. We are still 2.5 million jobs below the peak, and that excludes population growth. Housing starts fell around 1.7 million units on an annual basis. I could go on, but we are all aware of how painful the recent recession has been. Perhaps the most painful part was that the recession was avoidable. Had we a different system of mortgage finance, we could have avoided much of the pain of the recent years. **If we choose to retain the current system or make only cosmetic changes, we guarantee a repeat of the recent recession**. I believe such would be the height of irresponsibility.

This summer sadly marks the tenth anniversary of the discovery of Freddie Mac's accounting scandal, which led to the recognition of widespread regulatory failings at Freddie, Fannie and at their previous regulator OFHEO. Unfortunately, efforts to reform the regulatory

structure of Fannie and Freddie failed until 2008, which by then was too little, too late. Even what was passed in the Housing and Economic Recovery Act of 2008 (HERA) has been, in part, ignored. HERA established a receivership mechanism that, if used, could have protected the taxpayer from loss. As we all know, it was not used.

While the eventual failure of Fannie and Freddie seemed a foregone conclusion to me by 2004, perhaps others can be forgiven for believing we had defeated the business cycle and that housing prices would soar forever. It is hard to either understand or forgive such a position today. Those who argue for the status quo, or only cosmetic changes to it, would take us back down the painful path of financial crisis and recession.

We should also remember Fannie Mae and Freddie Mac were two of the largest corporate financial restatements in history. These were not innocent companies sunk by a hundred year storm. Both companies were deeply corrupt—a depth of corruption that can only result from their protected, entrenched status. Bear Stearns, Lehman Brothers, and Countrywide are all gone. Fannie Mae and Freddie Mac merit the same fate. In so many ways, Fannie Mae and Freddie Mac have been and continue to be emblematic of what is broken in both Washington and corporate America. If we cannot end entities so obviously broken as Fannie Mae and Freddie Mac, then we have almost no hope in addressing other pressing issues that face our country.

There's no "need" for a guarantee

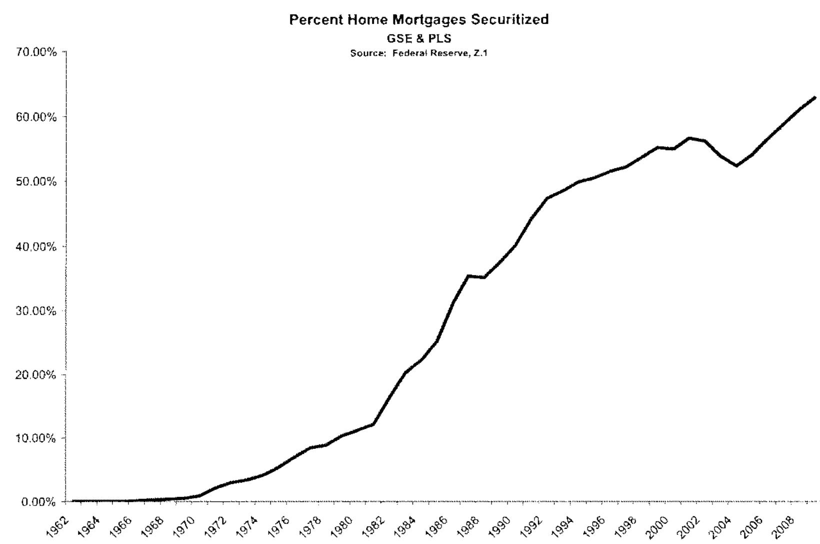
Objections to the elimination of Fannie Mae and Freddie Mac often assert that such would be "dangerous" because our mortgage market needs a government guarantee to function. Such an assertion is false on a variety of fronts. First, our mortgage market is characterized by several government backstops besides Fannie Mae and Freddie Mac. The Federal Reserve has

purchased trillions of dollars in mortgage-backed securities. The Fed's 13-3 powers were also used to support asset-backed commercial paper funding non-mortgage debt during the crisis. In addition, we have the Federal Housing Administration (FHA), Government National Mortgage Association (GNMA), and the Federal Home Loan Banks (FHLBs). One could argue that deposit insurance for banks and thrifts also serves as a backstop for the mortgage market. While I would eliminate or roll back most of these interventions, that does not change the fact they are indeed there. **Even in the absence of Fannie Mae and Freddie Mac, our mortgage market maintains considerable governmental support.**

Further proof of the mortgage market's ability to function without Fannie Mae and Freddie Mac is the existence of the jumbo mortgage market. Thirty-year fixed-rate financing is readily available at affordable rates in the United States without the backing of a government sponsored enterprise. A handful of lenders today offer jumbo rates that do not differ from conventional mortgage rates. If a government guarantee was essential, we would expect the jumbo market to be relatively small compared to the relevant portion of the housing market. It is not. Homes valued above the current FHA high-cost limit are about 4 percent of the overall housing market, whereas the jumbo market is currently around 5 percent of the mortgage market. Homeowners in the jumbo market are actually ***more*** likely to have a mortgage than those whose homes fall under the conforming limit. Families with incomes placing them in the likely category of jumbo borrower are also *more* likely to be homeowners than other families. **The notion that without Fannie Mae and Freddie Mac we would be a nation of renters is simply pure fiction.**

Homeownership rates, with the exception of the recent boom, had stabilized in the low 60 percents in the beginning of the 1960s. By 1969, the national homeownership rate reached 64.3

percent. At this time, the percent of mortgages securitized was in the low single-digits and the secondary market was irrelevant. Over 70 percent of mortgages were held on the balance sheets of depositories, with the remainder largely held by insurance companies. From 1982 to 1992, securitized mortgages increased from around 10 percent to just over 50 percent of the mortgage market. This, however, was a time of stagnating—even declining—homeownership. Even during the temporary boom in homeownership, from 1995 to 2004, the percentage increase of mortgages securitized was relatively modest. **It is impossible to objectively examine the last 50 years of data and conclude that the creation of the U.S. secondary mortgage market has any noticeable long-run impact on homeownership rates.**

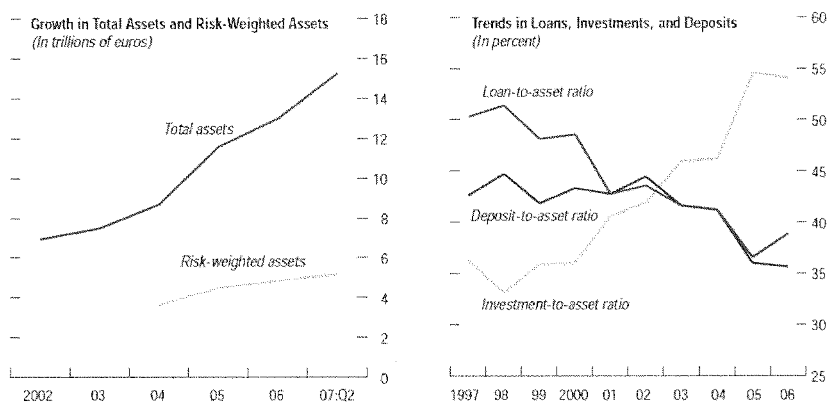


Nor does the data support the notion that the growth of Fannie and Freddie actually lowered mortgage rates relative to Treasuries. In the decade before the growth in securitization,

between 1971 and 1981, the spread of the 30 year fixed over the 10 year Treasury was 1.56. From 1982 until the financial crisis in 2008, that spread averaged 1.72.

One thing that the growth of Fannie, Freddie, and the secondary mortgage market has achieved is a massive increase in the leverage of our mortgage finance system. As illustrated below (from IMF), the growth of securitization , along with development of the Basel capital standards has greatly reduced the amount of corporate equity standing behind our mortgage market.

Balance Sheet Profiles for 10 Large Publicly Listed Banks



Sources: Thomson Financial; and IMF staff estimates.

The combination of Fannie Mae, Freddie Mac, and the Basel capital accords resulted in a mortgage market that in 2006 was leveraged almost 60 to 1 on the part of financial institutions. Even a mortgage market consisting solely of prime, high-quality mortgages would have resulted in losses given that excessive leverage. Had all mortgages been held as whole loans on the

balance sheets of depositories, the system would have included an additional $214 billion in capital in 2006.

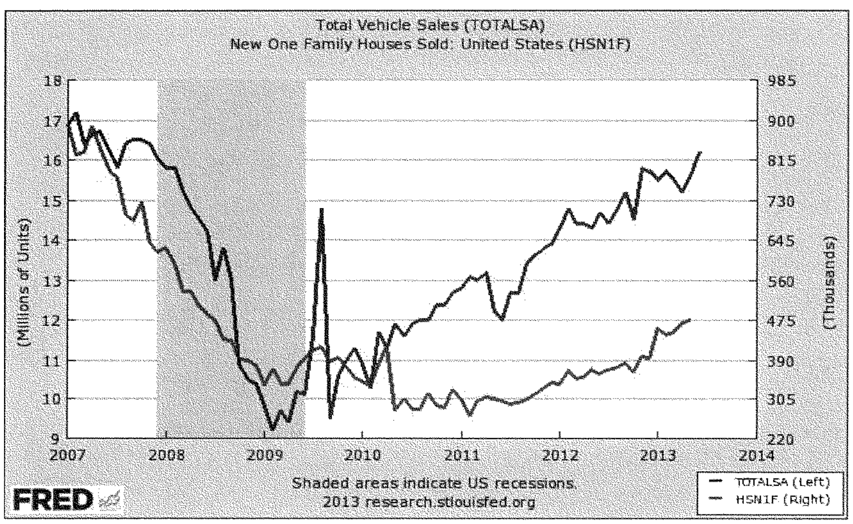
An important lesson gleaned from the financial crisis is that risk will flow to the least-capitalized segment of the market. The fact that Bear Stearns was leveraged over 30 to 1 has received considerable notice by both academic and journalist commentators. Sadly, that the Fannie and Freddie guarantee business was leveraged over 200 to 1 receives far too little attention. This was a system destined to fail, and fail it did.

Another rationale given for the continued existence of Fannie and Freddie is the 30 year fixed-rate mortgage. Let me be very clear: the 30-year mortgage exists in the jumbo market. It would exist without Fannie or Freddie. Borrowers choose mortgages based upon their relative costs. In much of Europe, adjustable-rate mortgages are priced more attractively than fixed rate mortgages. This is due, in considerable part, to the worse record of European central banks on the issue of inflation. For instance, in Italy from 1969 until the adoption of the Euro, inflation averaged nine percent per year with wide fluctuations year to year. With such an erratic macroeconomic environment, lenders will only offer fixed-rate financing at considerable cost. As bad a record as the Federal Reserve has, by the standards of Europe, it has done relatively well. The future of the 30-year mortgage in the United States depends less on Fannie Mae and Freddie Mac and more on the behavior of the Federal Reserve.

One should also recognize that long-term fixed financing is readily available for the auto loan market. Seven year auto loans are readily available at affordable rates without the support of a government sponsored enterprise. They are even available at loan-to-value ratios that mirror

those found in the mortgage market. The notion that such financing would not be made available in the mortgage market absent a government sponsored enterprise is, again, a pure fiction.

It is also worth noting that the auto market, without a government sponsored enterprise, recovered more quickly than the housing market. As the chart below illustrates, vehicle sales followed a similar path to that of home sales. Not surprising, since the decision to purchase a car is made with similar concerns as that of purchasing a home. But where the auto market began recovering in 2009 and 2010, the housing market continued to limp along. While any comparison is imperfect, the performance of the auto market suggests that a government guarantee is not needed, even during a recession.



On other occasions, the Committee has heard how other countries manage to provide long-term fixed-rate affordable mortgage financing without government sponsored enterprises

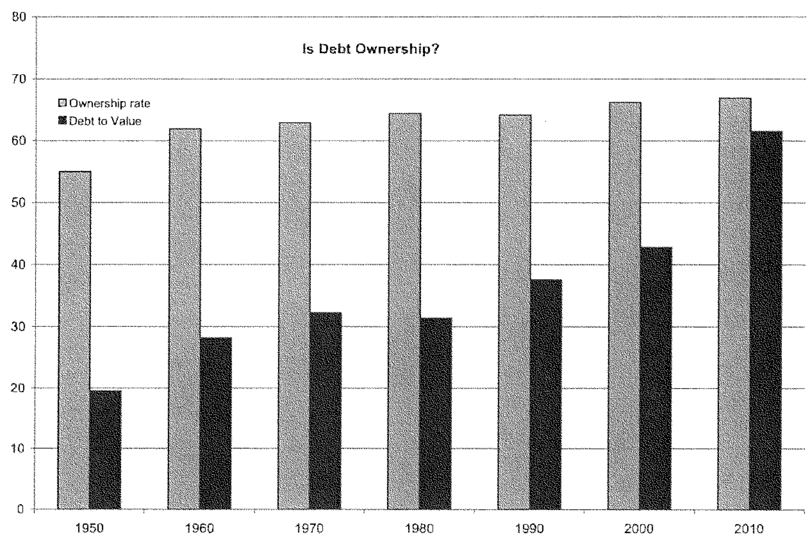
and do so with homeownership rates often above that of the United States. As those facts are clear, I will not repeat them here, only to note many other countries have far better functioning mortgage markets with similar or better results than the U.S. without such an extensive cost to the taxpayer and to the economy.

Of course, that might be the most important point to remember. Despite all the massive subsidies and distortions, the truth is we have very little to show for it. We know one must break some eggs to make an omelet, but at some point it becomes to reasonable to ask "Where's the omelet?" Fannie Mae and Freddie Mac have delivered almost nothing in terms of increasing the long-run homeownership rate. They haven't even narrowed the homeownership gap between white and African-American households. At the height of the bubble in 2007, homeownership rate for whites was 76.5 percent, while that for African-Americans was 54 percent, leaving a gap of 22.5 percent. In 1910, before the creation of FHA, Fannie Mae, or Freddie Mac, that gap was 23.5 percent. In more than one hundred years, the difference in white and African-American homeownership rates has decline a whole 1 percent. I must note that the gap had narrowed to 18.8 percent by 1980—*before* the massive growth of our agency-driven secondary mortgage market. The simple fact is that the growth in Fannie Mae's and Freddie Mac's market share has been associated with a growing (worsening) gap between the homeownership rates of whites and African-Americans. Only if the purpose of Fannie Mae and Freddie Mac was to *worsen* existing economic inequalities could you even try to call these companies "successes".

Nor has the homeownership gap improved by income. In 1994, the gap in homeownership rates for families with incomes above the median, compared to families below, was 30.4 percentage points. In the first quarter of 2013, that gap is 30.0 percentage points. That gap actually worsens during the boom to a high of 32.3 in the first quarter of 2004. Again, our

current mortgage-finance policies have, if anything, *increased* economic inequality in America, not reduced it. Fannie and Freddie have managed to be both inefficient and unjust.

Ultimately what our current mortgage finance polices have wrought is a massive increase in household debt with little to show for it. As the following graph illustrates, the homeownership rate has stagnated since 1960, yet the average mortgage debt to home value has dramatically increased. In 1960, our housing market was one of equity, rather than debt. In fact, before 1960, a majority of owners owned their homes free and clear with no mortgage at all. Today, owners have less than 30 percent equity, on average.



Rather than producing a nation of homeowners saving wealth to pass along to their children, we have created a nation of families drowning in debt. While most families dream of

becoming homeowners, I suspect few dream of becoming highly leveraged. The primary result has simply been to push up home prices beyond the reach of many families.

Ending Too-Big-To-Fail

As the Committee is well aware, the problem of too-big-to-fail financial institutions continues to distort our capital markets. Fannie and Freddie are the poster-children for TBTF. Freddie is close in size to both Citibank and JP Morgan. If we are not willing to resolve Freddie, which is far less complex than either Citibank or JP Morgan, then I believe market participants will continue to view our largest banks as TBTF. In order add credibility to efforts to end TBTF, the place to start is Fannie Mae and Freddie Mac.

PATH Act

Given the urgent need to eliminate Fannie Mae and Freddie Mac, I want to commend the Chairman for putting forth legislation that does so. First a few general comments. Even if the PATH Act were enacted, our mortgage market would still be characterized by considerable and excessive government intervention. A ***freer*** mortgage market, yes. A **free** mortgage market, no.

As someone who has closely studied our housing and mortgage markets for almost two decades, I believe that the long-run impact on homeownership and mortgage rates would be insignificant. That said, there is considerable potential to protect the taxpayer and increase financial stability.

First, the elimination of Fannie and Freddie is essential. Given the ability to "run" the companies while in receivership, I would suggest to the Committee that an additional five years

of conservatorship is unnecessary. A two-year lead would give FHFA more than sufficient time to prepare for a receivership.

The reduction in GSE/FHA loan limits should also be accelerated. According to the Census Bureau's American Community Survey, the U.S. median home value (2011) was $173,600. The Census Bureau reports that only about 25 percent of homes are valued more than $300,000. To be blunt, the loan limit reductions in PATH are modest, at best, and would continue to leave the vast majority of the housing market at the backing of the government. A loan limit of $525,500, as ultimately envisioned by the PATH Act, still covers around 90 percent of the U.S. housing market. A more reasonable number would be closer to $200,000.

I especially want to commend the Chair's inclusion of reforms to stop attempted abuses of eminent domain. While I would like to see such provisions extended beyond the mortgage space and protect all homeowners, the included prohibitions are an important step. According to the Census Bureau's American Housing Survey, between 30,000 and 40,000 families are displaced from their homes every year due to some governmental action. Around a quarter of these families live below the poverty level, and about half are African-American families. When the government takes someone's home, it is disproportionately the home of someone lacking the political power to fight back. I would urge the Committee to consider the issue of eminent domain more broadly in its future deliberations.

FHA Reform

Fannie and Freddie may be the weakest links in our mortgage finance system, but they are not the only weak links. The Federal Housing Administration (FHA) poses a considerable risk to the taxpayer. Eliminating Fannie and Freddie without FHA reform runs the very real risk

that shoddy lending flows from the GSEs into FHA. We already witnessed a migration of subprime from GSEs and private label into FHA after the onset of the financial crisis. Additional FHA reforms are essential. Over two years ago (May 25, 2011), I made a number of suggestions to the Subcommittee on Insurance, Housing & Community Opportunity regarding FHA reform. I refer the Committee to that testimony for my views on FHA reform. I would add only two comments to that testimony. First, it is encouraging to see a few of my suggestions on FHA reform surface in the Chairman's bill. Second, there are a handful of issues on FHA where I believe the Chairman's draft should go further. Foremost among these is the need for greater down-payments in FHA. Under PATH, first-time buyers will still be able to get an FHA loan with only 3.5 percent down. I recognize a number of other needed reforms have been included in the bill, but I would urge the Committee to consider increasing FHA's down-payment requirements beyond those already in the bill. Again, I want to commend the many needed and important changes to FHA contained in the PATH Act.

One must also recognize that our mortgage finance system is a "house of cards"—the GSEs were the largest distortion in this market but certainly not the only one. While the Basel capital changes and other reforms in Title IV are helpful, I believe we would achieve greater financial stability by abandoning the Basel process altogether and adopting flat, but high, capital standards for banks.

Conclusions

I thank the Committee for inviting me to offer my thoughts on mortgage finance reform. As the Committee will note from my biography, I have spent most of the last two decades involved in various aspects of housing and mortgage finance policy. Without a doubt, I believe

housing is a critical component of our economy. Moreover, I believe that housing is one of the basic necessities of life, if not the most important. Without stable, decent, and affordable housing, many other goals in life become quite difficult, if not impossible, to achieve.

With that in mind, our current system of mortgage finance has not helped facilitate the dream of affordable, accessible homeownership. Our current system has largely encouraged families to become highly leveraged, leaving both themselves and our overall economy at greater risk. Our current system has **not** resulted in longer term gains in homeownership. It is far past time we recognize the failures of our current system and move toward a better system that effectively serves homeowners and taxpayers.

Examples of stable reliable long term funding can be found in many contexts, including our jumbo mortgage market. Long-term affordable financing is also found in our auto market, as well as in the mortgage market of other developed countries. This funding is and can be provided without a government backstop. The subsidies provided via Fannie Mae and Freddie Mac were largely captured by the companies themselves and various service providers in the real estate and mortgage industries. I have zero doubt that the existence of Fannie Mae and Freddie Mac has made us considerably poorer as a country. We would have been better off if they had never existed. While it is unfortunate that Washington lacked the foresight to correct that error in the past, we now have the opportunity to chart a path forward that is more efficient, effective and just.

Testimony of Michael D. Calhoun
President, Center for Responsible Lending

Before the House Committee on Financial Services

Hearing: "A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

Good Afternoon Chairman Hensarling, Ranking Member Waters and Members of the Committee. Thank you for inviting me to testify at today's hearing on how to ensure that American families can obtain sustainable mortgages in a future mortgage finance system.

I am President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofit organizations and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

The mortgage finance system should have a balance of consumer protections that prevent abusive lending practices and policies that prioritize access to sustainable credit. The Protect American Taxpayer and Homeowners Act (PATH Act) meets neither of these goals. Instead, the PATH Act would result in affirmative harm on both accounts. My testimony will make the following points:

- **First,** the PATH Act eliminates any government guarantee for eligible mortgages for most families, which would make the 30-year fixed-rate mortgage a product of the past. As a result, families striving to own their own home would face restricted access to credit, and fewer would become homeowners. Those able to obtain mortgages would end up with less affordable, less stable, and shorter-term mortgage financing. The PATH Act's creation of a unified utility to provide a securitization platform for issuers is a constructive contribution to the mortgage finance discussion, but it falls significantly short of sufficient housing finance

reform given the other provisions of the Act. Importantly, small lenders such as community banks would still be squeezed out of the mortgage market under this regime.

- **Second,** on top of curtailing the 30-year fixed-rate mortgage, the PATH Act would fundamentally alter the FHA program and limit the number of families able to obtain FHA-insured mortgages. The PATH Act's approach to FHA reform is death by a thousand programmatic changes, with the cumulative effect being a much more restricted and expensive program that would likely have difficulty fulfilling its mission and meaningfully serving borrowers.

- **Third,** the PATH Act also strikes critical mortgage reforms included in the Dodd-Frank Act, which invites a return to the predatory and abusive lending that proliferated during the late 1990's and 2000's. Instead of learning from the subprime meltdown, housing downturn and foreclosure crisis, this legislation would allow the private label securities market to return to its old, harmful and reckless ways.

I. The PATH Act Would Curtail the 30-Year Fixed-Rate Mortgage.

Middle-class families across the country depend on having a 30-year fixed rate mortgage in order to build wealth and, at the same time, make ends meet. Borrowers with fixed-rate mortgages benefit from having stable mortgage payments for the life a loan. This prevents the kind of payment shock that can happen when borrowers take out an adjustable rate mortgage and interest rates increase. Borrowers also benefit from having mortgage payments spread out over 30-years, which makes the payments more affordable than a 10 or 15-year term. On top of these budgeting benefits, by enabling borrowers to become homeowners, the 30-year fixed rate mortgage helps borrowers build wealth through growing home equity. According to the Pew Research Center, "[a]mong households with net worth of less than $500,000, just 33% of their wealth comes from financial assets and 50% comes from their home."[1]

The 30-year fixed-rate mortgage – and the benefits this product provides to borrowers – would be scare without the availability of a government guarantee. This guarantee makes it possible to securitize mortgages through the so-called To-Be-Announced (TBA) market, which is a standardized system for investors to purchase securities with

[1] *See* Richard Fry and Paul Taylor, *A Rise in Wealth for the Wealthy; Declines for the Lower 93%*, Pew Research Center (April 23, 2013) (available at http://www.pewsocialtrends.org/2013/04/23/a-rise-in-wealth-for-the-wealthydeclines-for-the-lower-93/1/).

mortgages that meet specified underwriting standards. Investors bear the interest rate risk of these investments, rather than the credit risk, which is borne by Fannie Mae and Freddie Mac. Without this guarantee of timely payment of principal and interest investors would likely not purchase these securities. Additionally, without the TBA market, borrowers would be unable to get rate locks on their mortgage, transactions would take more time, and loan prices could vary significantly by geographic location. Not only would borrowers have difficulty getting a 30-year fixed-rate mortgage, but restricted access to credit would make it more difficult to get any kind of mortgage product, and that mortgage would be more expensive.

A future mortgage finance system must include an on-going, explicit, and actuarially sound government guarantee in order to preserve the 30-year fixed-rate mortgage. While systems should be designed to alleviate unnecessary risk as much as possible, government has an appropriate role to play in the event of a housing market crash. Given the reality that the Federal government will bear the risk of stepping in during a housing market crash, this risk should be accounted for up front and priced accordingly.

Yet, the PATH Act would eliminate a government guarantee and require investors to take on credit risk when purchasing mortgage-backed securities. This would have a dramatic effect on access to credit. Instead of expanding access to credit at a time when the average denial on a conforming loan is for a borrower with a FICO score of 734 and willing to put 19% down, the PATH Act, would make credit more scare and more expensive for borrowers.[2] As a result, housing prices would likely decline due to reduced demand. This could ultimately push many homeowners underwater on their mortgages and increase default rates. Additionally, private capital would likely pull even further back – instead of facilitating stable access to credit – during times of economic or housing market stress. The end result would be destabilizing the housing market and limiting homeownership to wealthier households.

Furthermore, although this portion of the bill does not explicitly address down payment requirements, it would result in very restricted access to credit for borrowers with smaller down payment amounts. Given that investors would assume credit risk of securities under the PATH Act, investor capital would prioritize borrowers with very high down payment amounts in an effort to make this credit risk as insignificant as possible. Prioritizing these lower LTV borrowers would box out lower-wealth borrowers – including many borrowers of color – who are capable of being successful homeowners but lack access to reserves. Extensive experience demonstrates that responsibly underwritten lower-down

[2] *See* Kenneth Harney, *Mortgage lenders set higher standards for the average borrower*, The Washington Post (September 28, 2012) (available at http://articles.washingtonpost.com/2012-09-28/news/35495052_1_fico-score-mortgage-lenders-debt-to-income).

payment mortgages perform well and provide critical homeownership opportunities for households.[3]

The PATH Act would also harm smaller lenders. The creation of a utility with a standardized securitization platform is laudable, but it is not sufficient to provide smaller lenders with equal access to the secondary markets. As a result of the PATH Act, smaller lenders would no longer have access to a liquid and efficient TBA market that can provide cash payments to purchase their loans. And, under the PATH Act's utility platform, there is no guarantee that aggregators and issuers will even use the utility, much less purchase from smaller lenders. Instead, aggregators and issuers could purchase from larger originators, because this would streamline the securitization process. Providing the Federal Home Loan Banks (FHLB) with the authority to act as aggregators also is not enough to place smaller institutions on equal footing under this system. First, this authority is voluntary for the FHLBs to use. Second, even when aggregated, securities built with loans from smaller lenders likely will not be as liquid as those aggregators drawing from larger lenders, which would result in unfavorable pricing. Additionally, section 312 of the PATH Act requiring that the privately-owned utility not adopt policies or procedures that disadvantage smaller lenders would be of little value in a system that makes it impossible for smaller lenders to have equal footing with their larger competitors.

Lastly, in the event of a borrower going into default on their mortgage, the PATH Act would make it difficult for borrowers to get a loan modification and likely that investors will face high foreclosure losses. As has been the case throughout the foreclosure crisis, borrowers with mortgages in private label securities are often unable to get loan modifications even though modifications would also provide a better return for the investor compared to a foreclosure.

II. The PATH Act Would Limit FHA Lending and Restrict Access to Credit for Borrowers.

FHA has played a critical role during the housing crisis and the economic downturn by providing credit to families who otherwise would not have been able to buy homes. In 2011, 27% of homes were purchased with an FHA insured mortgage.[4] An even higher percentage of African-American and Latino homebuyers have recently used FHA

[3] *See generally* Quercia, Freeman and Ratcliffe, *Regaining the Dream: How to Renew the Promise of Homeownership for America's Working Families*, UNC Center for Community Capital (2011)
[4] U.S. Department of Housing and Urban Development, *Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund*, (November 16, 2012) (available at http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf).

financing – in 2011, 50% of African-American borrowers and 49% of Latino borrowers used an FHA insured mortgage to purchase their home.[5]

This access to FHA-insured loans during a time of otherwise restricted access to credit has not only helped new home owners, but has also helped stabilize neighborhoods and communities and boost the economic recovery overall. According to 2010 estimates from Moody's Analytics, FHA-insured lending during the housing downturn stopped home construction activity from dropping another 60% and housing prices from going 25% lower.[6] Moody's calculated that the cost of such a retraction would have resulted in an additional 3 million lost jobs and an almost 2 percent reduction in gross domestic product.[7] It is essential that FHA continue to fulfill its role in the housing market, especially as the recovery continues.

There are improvements that should be made to help improve FHA solvency, but that can be done without these harmful reforms. The PATH Act makes a myriad of changes that taken together would unnecessarily restrict who can obtain an FHA-insured mortgage and would result in a limited number of mortgages being originated with FHA insurance. These changes include reducing the FHA insurance level from 100% to 50% over a 5 year period, requiring additional risk sharing, imposing means testing for some borrowers, restricting mortgage amounts eligible for FHA insurance, mandating specified down payment requirements, and imposing added-cost accounting measures that will make FHA mortgages less affordable.

The collective impact of these changes would substantially reduce the effectiveness of the FHA. First, scaling back the guarantee would make FHA mortgages less affordable and less available for borrowers. Instead of providing an efficient and lower-cost 100% guarantee, the PATH Act would impose higher costs on borrowers by requiring investors to determine and bear part of the credit risk of these securities. In addition to affecting pricing, this would also significantly dampen if not all together eliminate investor interest in purchasing securities of FHA mortgages. This change – especially when considered in tandem with the PATH Act's elimination of the government guarantee in place for Fannie Mae and Freddie Mac securities – would result in a mortgage market with radically reduced access to credit.

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[5] *Id.*

[6] *See* John Griffith, *The Federal Housing Administration Saved the Housing Market*, Center for American Progress at 4 (October 11, 2012) (citing Moody's Analytics unpublished estimates from October 2010) (available at http://www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federal-housing-administration-saved-the-housing-market/).

[7] *Id.*

Second, the PATH Act would impose overly restrictive eligibility requirements that provide unnecessary complexity in administering the program. Limiting eligible homebuyers to either first-time homeowners or households below either 115% or 150% of area median income could impact overall FHA pricing and restrict families from obtaining mortgages during periods when access to credit is otherwise restricted. The current mortgage market highlights this very real risk. While the PATH Act includes a provision allowing for countercyclical insurance authority, this structure is not only cumbersome but could be ineffective in meeting its stated goal. Additionally, the PATH Act would also reduce FHA loan limits in a way that could unnecessarily limit home purchases for borrowers. The PATH Act reduces the maximum FHA loan limit to the lower amount of either 115% of the Area Median Home Price or 150% of the threshold established for GSE mortgages in high cost areas, which is currently $625,500.

Third, the PATH Act would require the FHA to use inappropriate, added-cost accounting that uses the private sector's cost of funds instead of the government's to make credit programs appear more expensive than they truly are. This type of "added-cost" accounting results in a misstatement of the agency's true financial position and would under most circumstances make FHA-insured mortgages more expensive for borrowers.

III. Consumer Protections that Will Prevent Future Lending Abuses and Crises Should Not Be Weakened or Eliminated.

In addition to reducing access to credit, the PATH Act would increase reckless lending. Passage of this bill would allow many lenders to originate loans without regard to the borrower's ability to repay the loan and without verifying income, assets and debts. For those loans still subject to the Ability to Repay and Qualified Mortgage standards under the PATH Act, the bill would delay CFPB regulations and create loopholes in the points and fees definition. Eligible borrowers would be restricted in challenging a mortgage where the lender intentionally originated a mortgage the borrower could not afford. High-cost loan protections would be weakened. Requirements for timely mortgage disclosures to borrowers would be undermined. Capital requirements would be delayed. Regulators would have compromised authorities to properly supervise institutions. In effect, lenders and originators could return to lending in a market that would be primed to repeat the failures of the past.

The Title XIV provisions of the Dodd-Frank Act that would be repealed by the PATH Act are critical mortgage reforms that will prevent future mortgage lending abuses and crises. In fact, if the reforms in Title XIV had been in place earlier, there never would have been a lending crisis and subsequent housing market crash, and millions of

Americans would not have lost trillions of dollars of wealth or their jobs. Rather than stifling legitimate lending, these reforms will provide a level playing field and sensible rules of the road so that we will avoid the constriction of credit we're facing now that invariably follows a crisis. These are reforms for the long-term to prevent future abusive lending and foreclosure waves from resurfacing. Undoing these protections through the PATH Act would send borrowers back to a marketplace where short-term gains prevail over the long-term financial stability of both our markets and household balance sheets.

IV. Conclusion

In summary, reform of the housing finance system is certainly needed. However, the PATH Act would unduly reduce mortgage access, raise costs and limit options for American families. It would also disadvantage community banks and other small lenders and produce lower economic growth for the whole economy.

Statement of:

Tom Deutsch
Executive Director
American Securitization Forum

Testimony before the:

Committee on Financial Services
United States House of Representatives

Hearing on:

A Legislative Proposal to Protect American Taxpayers and Homeowners By Creating a Sustainable Housing Finance System

July 18, 2013

One World Financial Center, 30th Floor ▪ New York, NY 10281-0006 ▪ 212.412.7100
Columbia Center ▪ 1152 15th Street, N.W., Suite 100 ▪ Washington, D.C. 20005-1706 ▪ 202.400.3600
www.americansecuritization.com

Introduction & Summary of Testimony

Chairman Hensarling, Ranking Member Waters and distinguished Members of the Committee, my name is Tom Deutsch and as the Executive Director of the American Securitization Forum (the "ASF")[1], I very much appreciate the opportunity to testify here regarding the proposed "Protecting American Taxpayers and Homeowners Act" ("PATH Act"), on behalf of the hundreds of ASF member institutions who originate, structure, trade, service, invest[2] and serve as trustee for residential mortgage-backed securities ("RMBS") and asset-backed securities ("ABS") created in the United States, including those backed entirely by private capital as well as those guaranteed or insured by public entities such as Fannie Mae and Freddie Mac (the "Government-Sponsored Enterprises" or "GSEs") or the Federal Housing Administration ("FHA").

ASF strongly supports the introduction of the PATH Act, as its proposal should continue to fuel what we hope to be a tangible, constructive dialogue to resolve the future of U.S housing finance reform. We strongly advocate that this dialogue culminate sooner rather than later in answering the core question of what the federal government will do with the GSEs. For the five years since the onset of the GSEs' conservatorship, the mortgage reform dialogue has been, in our opinion, far too theoretical. As ASF testified in 2010[3] and in 2011[4] regarding Congressman's Garrett's introduction of the Private Mortgage Market Investment Act, we have been strong supporters of turning this theoretical debate into tangible legislation. While ASF and others all along the political spectrum will likely propose changes to this discussion draft, we believe this bill, along with the recent introduction of GSE and FHA reform bills in the U.S. Senate, serve as concrete steps towards comprehensively restructuring the currently misguided U.S. housing finance system that relies on the U.S. government to backstop over 90% of residential mortgages made in this country. No other country in the world, small or large, has ever put their taxpayers in such an extreme backstop position. We believe Congress must take steps to substantially reduce the government's role in mortgage finance. This must be done responsibly so that greater dislocation does not occur within our nation's fragile housing market through materially reduced access to credit and/or impairment of value of agency and private-label RMBS. There are many aspects of the PATH Act that work toward this goal and that ASF strongly supports.

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[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. structured finance market advocate their common interests on important legal, regulatory and market practice issues. ASF includes hundreds of member firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in structured finance transactions. ASF also provides information, education and training on a range of structured finance market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

[2] The preponderance of investors in the structured finance market are institutional investors, including mutual funds, money market funds, pension funds, banks, insurance companies, hedge funds and sovereign wealth funds. Although these direct market participants are institutions, many of them, such as pension funds and mutual funds, ultimately invest on behalf of individuals and their retirement savings. ASF investor member institutions have outstanding RMBS assets under management measured in the trillions of dollars.

[3] *See* http://www.americansecuritization.com/uploadedFiles/ASF_HFSC_Testimony_09.29.10.pdf.

[4] *See* http://www.americansecuritization.com/uploadedFiles/ASF_Private_Mortgage_Testimony_11_3_11.pdf.

In the testimony that follows, we make the following key statements:

I. **Short-Term Transition to More Private Capital**—ASF is strongly supportive in the near term of ratcheting down the federal government's involvement in the U.S. housing finance system through gradual reductions in loan limits, appropriate increases in guarantee fees and the GSEs' issuing material amounts of their securities that expose investors to credit risk of the underlying mortgages. In an April 2013 ASF White Paper,[5] we provide substantially more detail about appropriate bipartisan steps Congress, the Federal Housing Finance Agency ("FHFA") and other regulators should take to increase private capital in the mortgage market if the broader housing finance reform debate stalls passage of major reform.

II. **Long-Term Transition to More Private Capital**—As the credit risk investor base is rebuilt, heavier competition returns to the RMBS issuance market, and crisis-era regulations are finalized, Congress and FHFA should push additional volume of loans outside of the GSEs and FHA through its various levers in the form of either GSE risk-sharing deals or purely privately-issued transactions.

III. **Market Standards Utility**—ASF is supportive of the GSEs and/or a subsequent utility furthering market standards in the form of mortgage loan level data, representations and warranties, repurchase provisions, etc., though the extent of their usage by private market participants will be bounded by the benefits the Utility offers, as opposed to issuing private-label RMBS outside of the Utility without the associated Utility platform costs.

IV. **Covered Bonds**—ASF has and continues to be a strong supporter of instituting a legislative covered bond framework in the U.S. to provide additional outlets for capital markets sales of mortgages and other assets, which would also keep U.S. institutions on a level playing field with other countries around the world, such as Canada and Australia, who have most recently instituted similar legislated frameworks and whose banks sell billions of dollars to U.S. investors.

V. **Impediments to Mortgage Originations and Sales**—ASF is strongly supportive of targeted corrections to the Dodd-Frank Act, Basel III and other regulations to better facilitate the origination and capital markets sales of mortgages and securities backed by them.

VI. **Use of Eminent Domain**—ASF is extremely supportive of the PATH Act's prohibition of the GSEs and FHA from guaranteeing or insuring mortgages

[5] ASF's April 23, 2013 White Paper constitutes a concise summary of key policy proposals that can be implemented in the short-term to expedite the process of bringing private capital back to the mortgage market by incrementally reducing the government-guaranteed market well below the current 90+%. These tangible proposals are proposed to be addressed in a comprehensive manner to promote a robust private-label RMBS market. *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=9337.

originated in a county that has exercised eminent domain to seize mortgage loans in the past 10 years. The basic premise is simple—governments should not change the rules of the game after a mortgage is originated. Investors buy mortgages and RMBS at prices they believe are appropriate. There is no role for the government to come along later and seize those mortgages for another private firm's gain and then pay the original investors what the government thinks is appropriate, particularly when the exercise of eminent domain does not yield an appropriate public purpose such as building a road or laying water lines. Many would also argue the history of the use of eminent domain has often yielded too low of a price to the owner of a seized asset.

VII. **Suggested Additions to the PATH Act**—Upon initial review, ASF offers additions to the PATH Act to evolve and clarify governance of FHFA and the Utility over time. In addition, we propose to eliminate many of the counterproductive applications of the derivatives section ("Title VII") of the Dodd-Frank Act to RMBS and ABS transactions. In particular, application of swap and margin requirements to securitization transactions could have extremely damaging impacts to the return of RMBS by forcing issuers to effectively strand valuable capital in transactions for long periods of time.

I. Short-Term Transition to More Private Capital

Because broad legislative reform of U.S. housing finance could unfold and eventually pass over the course of several years, the ASF urges Congress and U.S. regulators to continue to move forward with other incremental steps to increase private capital, while the broader reform debate unfurls. Earlier this spring, ASF released a detailed set of policy proposals to increase private capital in the U.S. mortgage finance system, including:

- Increase GSE Guarantee Fees/FHA Premiums
- Reduce GSE and FHA Conforming Loan Limits
- GSE Risk Sharing Transactions
- Align QM, QRM and Basel III Risk Weighting Definitions
- Eliminate QM and Risk Retention Provisions that Favor GSE Execution
- Eliminate Basel III LCR Recourse Requirements
- Establish U.S. Covered Bond Market.

We strongly support the inclusion of many of these proposals in the discussion draft of the PATH Act and would urge Congress to pass them as part of the Act. But many of these proposals, such as the Basel III liquidity coverage ratio ("LCR") requirements, will be implemented by regulators under their own authority or can and should be legislated as stand-alone legislation.

II. Long-Term Transition to More Private Capital

Reducing dependence on public guarantees for new mortgage origination necessarily implies that private capital investment in mortgage originations will have to be reinvigorated. Securitization is the essential funding mechanism for this to occur to move loans in bulk from originators balance sheets to investors who have long-term capital to put to work. This is also evidenced by observing the significant proportion of consumer credit RMBS financed in the U.S. in the last few decades and the growing regulatory emphasis on banks shedding credit risk. Securitization generally refers to the process by which consumer and business assets are pooled into securities that are issued and sold into the capital markets. The payments on those securities depend primarily on the performance of the underlying assets. Over the past 25 years, securitization has grown from a relatively small and unknown segment of the financial markets to a mainstream source of credit and financing for individuals and businesses, representing a vital sector of the financial markets.[6] It is estimated that securitization has funded between 30% and 75% of lending in various markets, including an estimated 59% of outstanding home mortgages.[7]

Since the rapid deflation of the housing bubble beginning in 2007, the question most trade groups are ultimately asked is whether market participants would ultimately support eliminating the government guarantee over an extended period of time, and ultimately what the mortgage market would look like without a guarantee. This is an extremely difficult, if not impossible, question to answer without some initial evolution in the mortgage finance system. Because the U.S. mortgage market has grown up for nearly a century around the presence of a government guarantee, breaking down institutional buildup of demand for government wrapped securities and rebuilding demand for deep and liquid markets for credit risk RMBS products will take time.

There is approximately $10 trillion in mortgage debt outstanding in the US, of which approximately $5.5 trillion has been funded through securitizations guaranteed by the GSEs (with an implicit/explicit government guarantee) or Ginnie Mae (with an explicit government guarantee). Many of those investors who have provided that $5.5 trillion do invest in these mortgage-backed securities in a meaningful way precisely because of the government wrap—banks, sovereign wealth funds, the Federal Reserve, insurance companies, just to name some of the larger holders.

Securitization also helps foster origination of the popular 30-year fixed rate mortgage. We don't believe the question is whether the 30-year fixed rate mortgage will continue to exist without any government guarantee, because it will. Long-term investors have and will continue to invest in RMBS backed by 30-year fixed rate collateral. In fact, a number of the private-label transactions sold in 2013 were entirely backed by the 30-year fixed rate collateral.

[6] For more information on the role and importance of securitization to the financial system and US economy, see ASF's August 2010 Reg AB II Comment Letter, Attachment II, pg. 143-147, at http://www.americansecuritization.com/uploadedFiles/ASFRegABIICommentLetter8.2.10.pdf.

[7] Citigroup, "Does the World Need Securitization?" pg. 10-11 (Dec. 2008), available at http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf.

III. Market Standards Utility

A key goal of the PATH Act appears to be to increase standardization and uniformity within the secondary mortgage market by directing FHFA to establish a National Mortgage Market Utility ("Utility") to develop an open-access common securitization platform and a set of standards relating to servicing, pooling, and securitizing residential mortgage loans. FHFA has previously contemplated the need to establish a single platform for the future issuance of all RMBS that are guaranteed by the GSEs, both during the remainder of the conservatorship period and thereafter, including a standardized form of pooling and servicing agreement ("PSA").[8] ASF supports this initiative, as we have worked with a wide range of industry participants to develop standards and practices that improve overall market functions and thus benefit all participants in the securitization market. Please see ASF's December 3, 2012 comment letter responding to the proposals set forth in FHFA's White Paper for a more detailed explanation of the arguments set forth below concerning the development of a common securitization platform and market standards for private-label securities.[9]

In the context of fully guaranteed Enterprise securitizations, the standardization of loan delivery interfaces and data validation will create efficiencies for lenders. The standardization of disclosure and reporting, in particular if it were based on current market and regulatory efforts, would create efficiencies across the market and ensure that each Enterprise was distributing robust data to investors. ASF also supports the development of a model PSA, which will standardize contractual and governance provisions between the Enterprises. We believe the standardization afforded by a single securitization platform and model PSA could, if effectively implemented over time, ultimately result in substantial efficiencies and reduced costs, and in connection with other efforts by FHFA to further standardize and align business practices of the Enterprises, potentially offer comparable security performance. However, if the guarantee is eliminated and credit risk is sold in a risk sharing securitization, the incentives among lenders and investors will be altered, and individual determinations of contractual and securities law liability may lessen the Enterprises' ability to impose standard terms and documentation.

The proposed standards for qualified securities under the Utility would attempt to replicate much of the liquidity function of the so-called "To-Be-Announced" ("TBA") market, through the establishment of standards for debt-to-income ratio, loan-to-value ratio, credit history, loan documentation, occupancy, credit enhancement, and loan payment term. A TBA is a contract for the purchase or sale of GSE MBS to be delivered at a future, specified date, sometimes

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[8] *See* FHFA's October 4, 2012 White Paper, "Building a New Infrastructure for the Secondary Mortgage Market," at http://www.fhfa.gov/webfiles/24572/FHFASecuritizationWhitePaper100412FINAL.pdf.

[9] ASF's December 3, 2012 comment letter submitted to FHFA in response to their October 4, 2012 White Paper, "Building a New Infrastructure for the Secondary Mortgage Market," details our general support for the development of a single securitization platform with a model PSA for fully guaranteed securitizations issued by the GSEs, as well as our support for the use of the single securitization platform for GSE risk sharing transactions, using either a senior/sub or a synthetic structure. In addition, our letter provides an overview of current factors inhibiting a robust private-label securities ("PLS") market, industry efforts to restart the PLS market through ASF Project RESTART, and a detailed description of how PLS securitization differs from GSE securitization.
Also *see* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6608 for ASF's July 2, 2012 White Paper, "Discussion of a Proposed Single Agency Security," for additional discussion regarding a new infrastructure for the GSEs, including a single securitization platform and the development of a single agency security.

substantially (up to 90 days) in advance of the settlement date. The TBA market makes it possible for borrowers to have the peace of mind of locking in favorable mortgage rates and originators' immediate and liquid sale in the capital markets. The TBA model is valuable and informative because it allows for mortgages to be priced based on general characteristics without loan-level data, which keeps prices down as a standardized product.

However, as the GSEs are gradually phased out in favor of a risk sharing model, TBA eligibility becomes a concern. If a senior/sub structure is implemented in which non-guaranteed subordinate first loss classes evidencing a direct interest in the mortgage pool are issued to investors, the non-guaranteed subordinate classes would not meet TBA guidelines. In addition, prospective investors in these securities may insist on receiving detailed loan-level data prior to purchase, or at a minimum would require robust disclosure of pool characteristics including stratifications, which in either case would not be consistent with how the TBA market currently operates. In a synthetic risk sharing structure,[10] on the other hand, the fully guaranteed RMBS would be very similar to those currently issued by the Enterprises because the structure does not impact the guaranteed securities in any way, and should therefore continue to be TBA eligible. It is also important to consider how these two possible structures for a common securitization platform after the wind-down of Fannie and Freddie relate to ongoing regulatory initiatives, including risk retention, Reg AB II, Basel III, and commodity pool regulations. Any reform of the GSEs which does not accommodate, or suitably replace, the existing GSE MBS TBA market will undoubtedly impact mortgage originators and borrowers both severely and negatively. At the same time, while ASF fully supports the shift towards such a common platform as envisioned by the PATH Act as a mechanism to gradually introduce more private capital into the market, we also urge caution and a recognition that the private and agency markets are inherently different, meaning that if the guarantee is eliminated and credit risk is sold, the incentives among transaction parties will shift, and individual determinations of contractual and securities law liability as well as the simple process of negotiation will result in non-standard transactions that have differences in structure, governance and disclosure.

As indicated above, a shift to a common platform through the National Mortgage Market Utility and the introduction of market standards are worthy goals that will be helpful to the private-label market, but it is also important to understand that such goals will inherently have limits. Private-label market participants have endeavored to create standardization and best practices through ASF's Project on Residential Securitization Transparency and Reporting ("ASF Project RESTART"),[11] which began in late 2007 as an industry-developed initiative to help rebuild investor confidence in RMBS. As part of this effort, ASF developed and finalized loan-level disclosure and reporting packages (the "ASF RMBS Disclosure and Reporting Packages")[12] that have since been largely incorporated by the SEC through proposed Regulation AB II, as well as a set of model representations and warranties (the "ASF RMBS Model Reps")[13]

[10] In a synthetic structure, credit linked notes issued by a special purpose entity are sold to investors, the proceeds of which are held in pledged accounts, and the entity issues a credit default swap to the Enterprise, whereby if losses are incurred on the reference pool of mortgage loans up to certain limits, funds in the pledged account are paid to the Enterprise.

[11] For more information on ASF Project RESTART, *see* http://www.americansecuritization.com/restart.

[12] *See* www.americansecuritization.com/uploadedFiles/ASF_Project_RESTART_Final_Release_7_15_09.pdf.

[13] *See* www.americansecuritization.com/uploadedFiles/ASF_Project_RESTART_Reps_and_Warranties_121509.pdf.

aimed at infusing transparency and comparability across securitization transactions. Our work to date on ASF Project RESTART, with a wide variety of stakeholders in the PLS markets including issuers, investors, financial intermediaries, trustees, servicers, rating agencies, professional firms and service providers, none of whom have the power to unilaterally set standards and practices, has made it clear to us that these markets are very dynamic. Consensus is only achieved over time through an iterative process, and its implementation in new transactions evolves over time. We look forward to working with the regulatory agencies on improving these standards and practices with the help of private and public partnership, as well as continued input and feedback from the buy and sell sides. We are committed to creating liquidity in the market, and believe that increased standardization will help boost liquidity generally, as well as during times of stress, and assist replacing the government guarantee market with private capital. We also propose further governance considerations in Section VII of this testimony.

As stated previously, the PATH Act contemplates the Utility to establish uniform underwriting standards. A clear advantage to having the Utility, or any other government agency, set these standards is that bright-line underwriting guidelines will bring additional clarity and certainty with respect to the underwriting of mortgage loans. However, we have concerns with government involvement in setting underwriting criteria as they could, over time, become susceptible to political interference, such as pressure to achieve increased homeownership in particular segments of the country or access to credit for certain borrowers. If the goal of the legislation is to promote robust private capital without government involvement, then it may be advisable to move some of the standard-setting process to private market participants or leave it to evolving market practice. This could be accomplished in a variety of different ways, including a "standards board" comprised of issuers and investors.

IV. Covered Bonds

ASF has long supported the creation of a legislative framework for covered bonds in the United States. Covered bonds and securitization can and do co-exist in a complementary fashion with one another, as they have for some time in Europe. The PATH Act has the power to create a new channel of efficient credit flow through our financial system while facilitating an accelerated and more orderly exit of U.S. government financial support for the private sector. The economic benefits of a country's covered bond program can be significant. Market research shows that banks issuing covered bonds can save between 20 and 60 basis points per year on interest rates when compared to the rates paid on their senior unsecured issues of comparable maturity.[14] Such savings can be transmitted through society in the form of lower rates on the consumer and commercial credit that finances our economy, stimulates growth, and creates jobs. The ability to issue relatively lower-cost financing, which becomes increasingly relative lower-cost financing during periods of worsening economic and financial stress, is a distinguishing benefit of covered bonds.

The proposed legislation would create a new and disciplined market structure around which free market forces can organize to better balance the flow of money, capital, and credit in our

[14] *Natixis Credit Research*, Cristina Costa and Jennifer Levy, March 2011.

highly sophisticated financial system. The concentrated U.S. banking system market structure invites the creation of new financing channels, so we can better democratize the flow of credit to Main Street in an effort to improve its post-crisis affordability and accessibility to American consumers and businesses. In addition, covered bonds would help extend the balance sheets of banks to fund additional mortgages because they remain on the balance sheet of the corporate issuer. Please click here for ASF's March 14, 2012 joint letter to the Senate, supporting S. 1835, the "United States Covered Bond Act," and here for ASF's March 11, 2011 testimony before the HFSC Subcommittee on Capital Markets and Government Sponsored Enterprises regarding covered bonds legislation.[15]

V. Impediments to Mortgage Originations and Sales

As ASF believes that housing finance reform is critical to the long-term efficiency and sustainability of the housing market, we are strongly supportive of many of the provisions in Title IV of the PATH Act, intended to reduce unnecessarily burdensome regulatory requirements that impede the return of private capital to the mortgage market. In our May 2011 U.S Senate and November 2011 HFSC testimonies,[16] we articulated many of the most pressing regulatory issues currently confronting the securitization industry, and just this past month circulated a list of key proposed statutory changes that, if implemented, would eliminate important impediments to securitization that exist in Dodd-Frank, Basel III and Reg AB II rulemakings.[17] We believe that many of the key policy proposals ASF has articulated over the past several years and that are substantially included in this bill can be implemented as part of the broader PATH Act or, as an alternative, in the more immediate near-term by separate legislative or FHFA action, to expedite the process of bringing private capital back to the mortgage market by incrementally reducing the government-guaranteed market well below the current 90-95%.

Given the success of recent private-label issuers in the market, the time to implement these reforms is now. In 2012, there were approximately $3.5 billion of new-issue RMBS backed by newly-originated mortgage loans. So far in 2013, RMBS issuers have surpassed last year's total, and industry researchers estimate that the total volume for 2013 could be $15-$25 billion. Despite the market's recent success, however, these issuance levels are mere specks when compared to pre-crisis levels, which peaked at approximately $700 billion in 2006, or the approximately $1.7 trillion of mortgages originated in the U.S. in 2012. In order to promote a

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[15] Both ASF's March 14, 2012 letter and March 11, 2011 testimony indicate ASF's strong support for new legislation aimed at establishing a vigorous covered bond market in the United States, which would have the potential to create new credit for American businesses and consumers.
See http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=231757 for more information on the HFSC hearing

[16] *See* testimonies of ASF Executive Director Tom Deutsch delivered to the Senate Committee on Banking, Housing, and Urban Affairs ("SBC") Subcommittee on Securities, Insurance, and Investment ("Securities Subcommittee") on May 18, 2011, available at:
http://www.americansecuritization.com/uploadedFiles/ASF_Senate_Banking_Securitization_Testimony_5-18-11.pdf, and to the HFSC Subcommittee on Capital Markets and Government Sponsored Enterprises on November 3, 2011, available at:
http://www.americansecuritization.com/uploadedFiles/ASF_Private_Mortgage_Testimony_11_3_11.pdf.

[17] *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=9550 for ASF's July 8, 2013 list of proposed legislative fixes.

more meaningful private-label market, policymakers must begin pulling levers to eliminate impediments to private capital that currently exist, and we strongly believe many of the provisions set forth in Title IV of the PATH Act go a long way toward realizing this goal. In the discussion below, we focus on a number of the PATH Act proposals that specifically relate to the PATH Act.

i. *Basel III*

Sections 401 and 402 of the bill delay the implementation of Basel III in the U.S. to allow for further study of its impact and prohibit the imposition of a liquidity coverage ratio ("LCR") that would exclude non-recourse loans from eligibility as high quality liquid assets ("HQLA"). Given the complexity of the Basel III rules recently released by the Board of Governors of the Federal Reserve System ("FRB"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC"),[18] and their potential impact on securitization, ASF advocates a cautious approach to their implementation. For example, residential mortgage loans that are classified as qualified mortgages ("QMs") currently may or may not be considered Category 1 loans under the Basel III capital rules, creating disparate treatment between and among QMs. ASF believes that all QMs should ultimately be required to receive this more favorable capital treatment. In addition, under the current Basel III LCR proposal, higher quality private-label RMBS will only be eligible as HQLAs under the proposed Basel III LCR if all the underlying loans have full recourse back to the borrower's other assets. However, twelve U.S. states, including California and Texas, have non-recourse statutes. If the LCR proposal were to be implemented in the U.S. as proposed by the Basel Committee, no U.S. private-label RMBS (or GSE credit risk RMBS deal) would qualify as a HQLA. Therefore, eliminating the mortgage recourse requirement in the LCR for U.S. private-label RMBS, as the PATH Act does, would greatly improve liquidity and execution for high quality private-label RMBS and level the playing field between U.S. and non-U.S. RMBS. For more information on ASF's positions regarding potential concerns with the Basel III rules, please see page 9 of our July 8, 2013 Proposed Legislative Changes circulated to Members and staff of this Committee and the securitization related sections of ASF's October 22, 2012 joint comment letter to the FRB, FDIC, and OCC regarding the Basel III proposed rules.[19,20]

[18] *See* http://www.federalreserve.gov/aboutthefed/boardmeetings/20130702__Basel_III_Final_Rule.pdf.

[19] On July 8, 2013, ASF submitted a list of key proposed statutory changes that, if implemented, would eliminate important impediments to securitization that exist in Dodd-Frank, Basel III and Reg AB II rulemakings. We also propose federal government involvement to prevent the misguided use of eminent domain to seize residential mortgage loans out of securitization trusts. ASF members have reviewed and commented extensively on these proposals in an effort to hone these proposals into ones that work for all corners and constituencies in the market. These fixes are intended to apply to all securitization markets, including MBS and consumer ABS, where applicable, but the most likely vehicle in this Congress or the next for any of these changes to move is as part of broader housing finance reform discussions.

[20] For more information concerning ASF's advocacy efforts specifically regarding the development of the LCR, *see* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=8739 for the working draft of ASF's LCR study, http://asf.informz.net/ASF/data/images/asf_proposed_revisions_paragraphs_95-97_11.20.12.pdf for ASF's November 20, 2012 proposed revision to Paragraph 97, http://www.americansecuritization.com/uploadedFiles/ASF_Optimizing_LCR_4_22_12.pdf for an ASF presentation on the LCR delivered to American and European regulators on April 23, 2012, http://www.americansecuritization.com/uploadedFiles/ASF_Optimizing_LCR_Spring_2012.pdf for an ASF presentation on the LCR delivered to European regulators in June 2012,

ii. *Dodd-Frank Rulemakings*

a. Volcker Rule

In addition, ASF has long been concerned that many securitizations[21] will inadvertently be brought within the scope of the proposed Volcker Rule[22] simply because they share the same exemptions from the Investment Company Act as traditional hedge and private equity funds, and we strongly support the exclusion of ABS from covered funds under the rule, as proposed in Section 404 of the PATH Act. There is ample evidence that the Volcker Rule is intended to address concerns that have nothing to do with the securitization markets, including the securitization exemption language in Dodd-Frank that explicitly states, "[n]othing in [the Volcker Rule] shall be construed to limit or restrict the ability of a banking entity...to sell or securitize loans in a manner otherwise prohibited by law," which is also included in Section 13 of the Bank Holding Company Act. For this reason, industry participants believe that Congress intended the Volcker Rule to fully exempt securitizations from the regulation, and would advocate making this intention explicitly clear in subsequent legislation.

If a broad exclusion such as that included in Section 404 is not granted for securitization, other provisions of the proposed Volcker Rule, such as the so-called "Super 23A" provisions, which prohibit banking entities from engaging in certain "covered transactions" with securitization entities that are covered funds, may preclude banking entities from engaging in transactions that are integral to various types of securitizations, likely resulting in a substantial decrease in available liquidity in these markets and an increase in transaction costs and market volatility, leading to higher borrowing costs for consumers and corporations. Further, in light of changes to the Commodity Exchange Act ("CEA") and the CFTC's related regulations (notably, the inclusion of "swaps" in the definition of "commodity interests"), we are similarly concerned that without an explicit exemption, many securitizations may be classified as "commodity pools" under the CEA and, therefore, may be brought within the scope of the Volcker Rule simply because they make limited use of swaps for hedging or risk management purposes.[23,24] For a

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http://www.americansecuritization.com/uploadedFiles/Optimizing_LCR_Summary.pdf for two summary slides, and http://www.americansecuritization.com/uploadedFiles/ASF-Optimizing_the_Liquidity_Coverage_Ratio_Europe_Presentation.pdf for a presentation on the LCR delivered to European regulators in February 2012.

[21] Including asset-backed commercial paper ("ABCP") conduits, tender option bonds ("TOBs"), automobile and equipment lease securitizations in which significant residual value of the collateral is financed, corporate debt repackagings, and collateralized loan obligations ("CLOs").

[22] *See* http://www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf.

[23] The CEA and the CFTC's rules thereunder define a commodity pool as an "investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests" and the definition of "commodity interests" will include swaps after the effective date of new CFTC regulations. In its release relating to the elimination or modifications of certain exemptions from commodity pool operator registration, the CFTC indicated that it considers a vehicle with a single swap to be a commodity pool. 77 Fed. Reg. 11252, 11258 (Feb. 24, 2012). In light of the CFTC's historically broad interpretation of its authority with respect to vehicles that own commodity interests, we fear that securitization vehicles that are counterparties to swaps may be swept into the CFTC's interpretation of "commodity pool."

[24] We note that the CFTC has stated that "it is the position of the [CFTC] that a fund investing in an unaffiliated commodity pool is itself a commodity pool." 77 Fed. Reg. 11252, 11268 (Feb. 24, 2012). We also note that the CFTC has taken the position, in connection with controlled foreign corporations wholly owned by registered investment companies, that wholly owned subsidiaries – which by definition have a single equity investor, and thus

more detailed and expansive explanation of why securitizations should not be considered covered funds, please see ASF's February 13, 2012 broad comment letter regarding the Volcker Rule and our August 23, 2012 comment letter specifically regarding the Volcker implications of securitizations being classified as commodity pools.[25]

b. Risk Retention

Furthermore, while there are many investors who generally support the premise of risk retention requirements, and therefore would not endorse the full repeal included in Section 407 of the PATH Act, most industry participants agree that there are certain extremely problematic elements to the proposed risk retention rules that should not be included in the final rule, and ASF supports legislative action to repeal these components. We broadly believe that risk retention can aid in efforts to align the incentives of issuers and originators with investors, and believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer, so long as the requirements ultimately prescribed are appropriately tailored to each class of securitized assets where misalignment of incentives have been demonstrated to have caused substantial losses. We are concerned, however, that the rules put the private markets at an enormous disadvantage vis-à-vis the government-backed market, which will ultimately keep the private markets on the sidelines.

For instance, the premium capture cash reserve account ("PCCRA") requirements of the proposed risk retention rules will eliminate the incentive of securitizers to issue ABS, and we propose prohibiting such requirements. In addition, in order to streamline compliance and ensure that lending standards are not overly restrictive, therefore constraining the availability of credit to borrowers, we believe the QM and "qualified residential mortgage" ("QRM") definitions should be substantially aligned, although many of our members, particularly institutional investors, believe that the QRM definition should also have a down payment requirement. We also propose to allow commingling of QRMs and non-QRMs in the same RMBS pool so that the QRM market does not suffer from unforeseen liquidity issues. Finally, certain aspects of ASF's Project RESTART serve to better align incentives within the industry, and depending on their specific language, representations and warranties and repurchase principles can function as an effective form of risk retention.[26] Please see both ASF's July 8.

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are not collective investment vehicles – can nonetheless be commodity pools. *Id.* at 11260. We believe that these two positions, when combined with a broad interpretation of the effect of hedging swaps on commodity pool status, may lead to illogical results—for instance that a wholly owned subsidiary of a bank could own a mortgage-backed security issued by a trust that included an interest rate swap and thus be treated as both a commodity pool and a "covered fund."

[25] For additional ASF commentary regarding the Volcker Rule, please *see* http://www.americansecuritization.com/uploadedFiles/ASF_CFTC_Volcker_Letter_4-13-12.pdf for ASF's April 13, 2012 comment letter specifically in response to the CFTC's proposal, http://www.americansecuritization.com/uploadedFiles/ASF_Volcker_Supplemental_Depositor_7_27_12.pdf for ASF's July 27, 2012 supplemental comment letter regarding intermediate entities, and http://www.americansecuritization.com/uploadedFiles/ASF_Volcker_Effective_Date_Correction_Request_3_21_12.pdf for ASF's March 21, 2012 letter requesting a correction to the Volcker Rule's statutory implementation date.

[26] *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6705 for ASF's RMBS Model Representations and Warranties and http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6545 for ASF's Model RMBS Repurchase Principles.

2013 Proposed Legislative Changes and ASF's April 23, 2013 White Paper, "ASF Policy Proposals to Increase Private Capital in the U.S. Housing Finance System," for more detail on risk retention issues.

iii. *Regulation AB II*

In a similar vein, ASF is generally supportive of the Securities and Exchange Commission's ("SEC") efforts through the registration, disclosure, and reporting requirements laid out in the Regulation AB II proposals and re-proposals to improve investor protection and promote more efficient asset-backed markets in the wake of the financial crisis. However, since the proposed rule's initial introduction in 2010, ASF has expressed a number of concerns and suggested changes to the proposals in order to ensure an effective balance between the aims of the regulation and the needs of the market. For example, among many other issues, the Reg AB II proposals would require issuers of structured finance products to provide public style disclosures for private transactions offered to highly sophisticated institutional investors. Such a requirement would likely be impossible for many types of structured finance products, including esoteric asset classes such as whole business, timeshares and rental cars, and we would suggest revising these provisions. Many aspects of Reg AB II are, we believe, essential to safeguard the securitization market going forward and have already begun to be incorporated by the industry, therefore making a full-scale suspension of the rulemaking such as prescribed in Section 405 of the PATH Act unnecessary. However, ASF is fully supportive of ongoing legislative oversight to ensure that certain problematic aspects of the proposed rules are fully addressed before they inflict substantial harm on the marketplace. Please see ASF's broad Reg AB II comment letter submitted on August 2, 2010 and ASF's October 4, 2011 comment letter in response to the SEC's Reg AB II re-proposal for significant additional detail on issues concerning Reg AB II.[27]

VI. Use of Eminent Domain

Lastly, I'd like to focus on the prohibition relating to eminent domain to seize mortgages contained under Section 107 of the bill. ASF is strongly opposed to the use of eminent domain to acquire mortgage loans, and we applaud the PATH Act's proscription. While we recognize and appreciate the serious challenges associated with the current housing market, poor policy solutions such as the proposal to seize mortgage loans through eminent domain are not productive, legal, or constitutional answers. Moreover, home prices throughout the country have been steadily increasing, returning many underwater borrowers to positive equity through natural market conditions and mitigating the incentives for undertaking such drastic and ill-conceived measures. Given sustained home price increases throughout the country, borrowers are

[27] In addition, *see*
http://www.americansecuritization.com/uploadedFiles/ASFRegABIIABCPCommentLetter8.2.10.pdf for ASF's August 2, 2010 Reg AB II ABCP comment letter,
http://www.americansecuritization.com/uploadedfiles/asf_reg_ab_ii_auto_abs_comment_letter_8.31.10.pdf for ASF's August 31, 2010 Reg AB II Auto Disclosure comment letter,
http://www.americansecuritization.com/uploadedFiles/ASF_Reg_AB_II_Waterfall_Comment_Letter_8.31.10.pdf for ASF's August 31, 2010 Reg AB II Waterfall comment letter, and
http://www.americansecuritization.com/uploadedFiles/ASF_Equipment_ABS_Letter_(11-2-11).pdf for ASF's November 2, 2011 Reg AB II Re-Proposal Equipment ABS comment letter.

considerably less likely to walk away from their homes and mortgages. The national delinquency rate has fallen to 6.08%, a drop of over 15% since December 2012, which is the largest year-to-date drop since 2002.[28] While many borrowers still remain underwater, the landscape is shifting markedly, and many of these borrowers may reasonably expect to return to positive equity in the coming months and years. In fact, approximately 850,000 properties returned to positive equity during the first quarter of 2013, and 1.7 million homes have emerged from being underwater over the past year, lowering national negative equity rates to below 15%, a decrease of 47% since 2012.[29] According to recent data from the S&P/Case-Shiller Home Price Indices, the 10-city, 20-city, and national composites each increased by over 1 percent since the previous quarter, and over 10 percent over the past year.[30]

Notably, such proposals are *not* set up to help borrowers who are having difficulties making their monthly mortgage payments, and do not take into account these recent market trends. As such, not only would such proposals fail to help those most at risk, they would undermine the national market as a whole, making credit less accessible for homeowners and devaluing the investments of pension funds, mutual funds and other entities that hold mortgage-backed securities. Because these programs would alter the value of Fannie Mae's, Freddie Mac's and the Federal Home Loan Banks' securities holdings, it is imperative that the GSEs be prohibited from purchasing or guaranteeing mortgages in these districts, as the PATH Act does, since such programs would negatively affect both investors and the extension of credit to borrowers. Please see ASF's most recent letter submitted to the North Las Vegas City Council on July 10, 2013 for our full legal and policy argument against the use of eminent domain.[31]

VII. Suggested Additions to the PATH Act

While ASF supports many aspects of the PATH Act, we propose below three additional features that we believe should be included in any final legislation.

i. Dodd-Frank Derivatives Title

First, while we very much support and appreciate most of the regulatory changes already included in the bill, ASF has developed a few other measures that we believe would materially contribute to increasing return of private capital to the mortgage market. Please see ASF's April 23, 2013 White Paper, as well as our July 8, 2013 Proposed Legislative Changes for more detail.

In particular, we consider it essential that certain ABS issuers are explicitly excluded from the swap clearing and margin requirements of the Commodity Exchange Act. The current

[28] *See* http://www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/MortgageMonitor/201305MortgageMonitor/MortgageMonitorMay2013.pdf.
[29] *See* http://www.corelogic.com/about-us/researchtrends/equity-report.aspx#.Ubinh4XbKwA and http://www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/MortgageMonitor/201305MortgageMonitor/MortgageMonitorMay2013.pdf.
[30] *See* http://www.housingviews.com/wp-content/uploads/2013/05/CSHomePrice_Release_March-Qtr1-Results.pdf.
[31] Over the past year, ASF has submitted numerous letters to municipalities around the country urging them to oppose implementing eminent domain programs. *See* http://www.americansecuritization.com/Issues.aspx?taxid=6587 for a complete index of ASF's advocacy efforts concerning this issue.

proposed margin rules may inadvertently require RMBS and ABS to post margin into their securitization transactions, despite the fact that counterparties to a swap entered into by a securitization vehicle typically hold a senior priority position in the asset pool backing the RMBS or ABS. If securitization swaps were forced to be cleared and/or to post margin, many structures would become less efficient and potentially even uneconomical. Essentially, for similar reasons that the mechanics of the risk retention PCCRA provisions of the proposed risk retention rules are so problematic, requiring issuers to put up cash at the outset of the securitization can eliminate the economic incentive to issue ABS.

ii. FHFA Board of Directors

Given the significant amount of authority retained by the sole director of FHFA, ASF proposes that legislators consider shifting control of the conservator to a board structure, similar to those at the SEC and FDIC, where no more than three of the five Board members may be of the sitting President's party. A Director would continue to directly control and oversee the staff of the agency, but would have additional Board members of opposing parties to balance the considerations and actions of FHFA.

iii. Self-Regulatory Authority for National Mortgage Market Utility

We would also suggest that the National Mortgage Market Utility created by the PATH Act function ultimately as a self-regulatory organization ("SRO"), similar, for example, to the Municipal Securities Rulemaking Board ("MSRB") or to the Financial Industry Regulatory Authority ("FINRA"). Such a structure would guarantee the Utility appropriate autonomy, but, depending on how an agency oversight structure is developed, would still allow the federal government to retain appropriate broad oversight.

Conclusion

ASF greatly appreciates the invitation to appear before this Committee to share our views related to these significant policy issues. I look forward to answering any questions the Committee may have.

Thank you.

Comments on:
A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System

U.S. House of Representatives
Committee on Financial Services

Douglas Holtz-Eakin, President*
American Action Forum

July 18, 2013

*The views expressed here are my own and not those of the American Action Forum. I thank, without implication Andrew Winkler for his assistance.

Chairman Hensarling, Ranking Member Waters, and Members of the Committee, thank you for the opportunity to appear today. In this testimony, I wish to make three basic points:

- The legislation being discussed today represents a long-overdue effort to address damaging weaknesses in the U.S. system of housing finance. I applaud the Committee for moving forward,

- The most significant component of the legislation is its commitment to winding down and closing Fannie Mac and Freddie Mac. These government-sponsored enterprises are fundamentally flawed in their design and politically toxic, and

- I am pleased that the Committee is simultaneously undertaking needed reforms to FHA.

Let me provide additional detail on each in turn, as well as comment on other aspects of the draft.

The Need for Reform
Housing finance was at the center of the 2008 financial crisis that visited substantial economic distress on Americans and spawned dramatic government intervention. Yet, over five years later the central actors in the crisis and response – Fannie Mac, Freddie Mac, and the Federal Housing Authority – remain essentially unchanged. Genuine recovery of housing finance will not be complete until this task is done. I applaud the Committee's desire to undertake these reforms.

Fannie Mae and Freddie Mac
Fannie Mae and Freddie Mac need to be wound down and closed as a matter of both policy and politics. From a policy perspective, the government-sponsored enterprises were central elements of the 2008 crisis. First, they were part of the securitization process that lowered mortgage credit quality standards. Second, as large financial institutions whose failures risked contagion, they were massive and multidimensional cases of the too big to fail problem. Policymakers were unwilling to let them fail because financial institutions around the world bore significant counterparty risk to them through holdings of GSE debt, certain funding markets depended on the value of their debt; and ongoing mortgage market operation depended on their continued existence. They were by far the most expensive institutional failures to the taxpayer and are an ongoing cost.

There is vigorous debate about how big a role these two firms played in securitization relative to "private label" securitizers. There is also vigorous debate about why these two firms got involved in this problem. In the end, this debate need not be fully resolved to recognize that while Fannie Mac and Freddie Mac did not by themselves cause the crisis, they contributed significantly in a number of ways.

The mortgage securitization process turned mortgages into mortgage-backed securities through the government-sponsored enterprises, as well as Countrywide and other "private label" competitors. The securitization process allows capital to flow from investors to homebuyers.

Without it, mortgage lending would be limited to banks and other portfolio lenders, supported by traditional funding sources such as deposits. Securitization allows homeowners access to enormous amounts of additional funding and thereby makes homeownership more affordable. It also can diversify housing risk among different types of lenders. If everything else is working properly, these are good things. Everything else was not working properly.

There were several flaws in the securitization and collateralization process that made things worse. Fannie Mae and Freddie Mac, as well as Countrywide and other private label competitors, all lowered the credit quality standards of the mortgages they securitized. A mortgage-backed security was therefore "worse" during the crisis than in preceding years because the underlying mortgages were generally of poorer quality. This turned a bad mortgage into a worse security. Mortgage originators took advantage of these lower credit quality securitization standards and the easy flow of credit to relax the underwriting discipline in the loans they issued. As long as they could resell a mortgage to the secondary market, they didn't care about its quality.

In addition to feeding toxic mortgages into the system, Fannie Mae and Freddie Mac proved to be so deeply interconnected with the broader financial system that policymakers were forced to step in to prevent their failure. In September 2008, the Federal Housing Finance Agency (FHFA) put Fannie Mae and Freddie Mac into conservatorship. Policymakers in effect promised that "the line would be drawn between debt and equity," such that equity holders were wiped out but GSE debt would be worth 100 cents on the dollar.

They made this decision because banking regulators (and others) treated Fannie and Freddie debt as equivalent to Treasuries. A bank cannot hold all of its assets in debt issued by General Electric or AT&T, but can hold it all in Fannie or Freddie debt. The same is true for many other investors in the United States and around the world -- they assumed that GSE debt was perfectly safe and so they weighted it too heavily in their portfolios. Policymakers were convinced that this counterparty risk faced by many financial institutions meant that any write-down of GSE debt would trigger a chain of failures throughout the financial system. In addition, GSE debt was used as collateral in short-term lending markets, and by extension, their failure would have led to a sudden massive contraction of credit beyond what did occur. Finally, mortgage markets depended so heavily on the GSEs for securitization that policymakers concluded that their sudden failure would effectively halt the creation of new mortgages. All three reasons led policymakers to conclude that Fannie Mae and Freddie Mac were too interconnected with the system to be permitted to fail.

As a matter of politics, Fannie Mae and Freddie Mac are extremely unpopular and the public supports winding them down. (This section draws on a recent poll commissioned by the American Action Forum.[1]) The polling shows that a large majority of the voters have a "hard ID" of Fannie and Freddie. They are viewed favorably by only 20 percent and unfavorably by 52 percent.

[1] American Action Forum, "AAF Releases New Poll of Public Attitudes on Fannie Mae, Freddie Mac, & Housing Reform," (July 15, 2013); http://americanactionforum.org/topic/aaf-releases-new-poll-public-attitudes-fannie-mae-freddie-mac-and-housing-reform

This is related to another finding, namely that 52 percent of the voters said that their greatest concern is either no accountability of banks and Wall Street or that Wall Street banks are so big that if they fail the taxpayers will have to bail them out again. By a small margin (11 percent) voters are still unfavorable toward the bank bailouts and TARP. Likely for this reason, a majority favor (52 percent) phasing out both Fannie and Freddie.

Greater information sharpens these views. When informed that Fannie and Freddie played an instrumental role in the housing bubble and received nearly $200 billion dollars in a bailout, voters' opposition to Fannie and Freddie moves to 59 percent. Additionally, the notion that Fannie and Freddie could require more public money in future bailouts is unacceptable to a sizable majority of the voters.

Reform of the Federal Housing Administration

After the housing bubble burst, the Federal Housing Administration (FHA) expanded the scope of its mortgage insurance program in response to the massive loss of private liquidity. The FHA gained significant market share at a time when lending seized up and home prices were still falling. Following its annual actuarial report last November, the critical question became how to ensure FHA's solvency, return it to its original mission, and bring back private capital.[2]

Normally self-funded through premiums, it was announced in April that the FHA may need to draw $943 million from the Treasury Department to cover losses, largely from books of business after the housing bust and the FHA's reverse mortgage program. Previous legislative proposals to bolster the FHA's finances have failed to pass both Houses despite consistent majority support for an overhaul.

There are three critical goals to FHA reform:

- Limit mortgage insurance to a defined group as per the original mission of the FHA,
- Return the FHA to its mandated capital requirement and limit future taxpayer losses, and
- Coordinate reform of the larger housing finance system and the return of private capital with changes to the FHA.

The PATH Act goes beyond legislation passed by the Committee in 2012 in its call for fundamental changes to both the structure and operations of the FHA.

Evaluating on the basis of those three aims, the proposed legislation would accomplish a great deal. The PATH Act would clearly limit mortgage insurance to a defined group, first-time homebuyers and low- and moderate-income homebuyers. With a mix of income-based borrower requirements and revised loan limits, the FHA would more adequately address a demonstrated need while enhancing the role of the private market. By addressing reform of the FHA in

[2] Prepared for HUD by Integrated Financial Engineering, Inc., "Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans for Fiscal Year 2012," (November 5, 2012); http://portal.hud.gov/hudportal/documents/huddoc?id=ar2012_forward_loans.pdf

conjunction with a wind down of the GSEs, the bill is cognizant of how misaligned pricing, limits, and standards can shift market share between government-backed entities instead over drawing in private capital.

Table 1 shows what provisions would help accomplish each of the three broad goals of reform. Additionally, it marks where there is overlap with the discussion draft recently introduced by Senators Johnson and Crapo, the "FHA Solvency Act of 2013."[3]

Table 1. Major Provisions of PATH Act and Effect		
Define FHA Mission	Restore Fiscal Solvency & Prevent Future Losses	Coordinate within Housing Finance System & with GSE Reform
• Income-based borrower requirements (Sec. 232)	• Independent agency (Sec. 211) • Risk-sharing (Sec. 233) • Mortgage insurance coverage of 50 percent of original principal obligation (Sec. 234) • Annual premium floor of 0.55 percent (Sec. 235)* • Annual budget and business plans following GAAP accounting standards (Secs. 252 & 253) • Greater FHFA oversight (Sec. 254) • Capital reserve requirement of 4 percent with triggered restoration plans when undercapitalized, FHFA enforcement, three month assessment by FHFA Director (Secs. 256, 257, & 258)* • Limitation on seller concessions (Sec. 263)* • Lender repurchase requirement (Sec. 264) • Indemnification by mortgagees (Sec. 265)* • Prohibition in eminent domain jurisdictions (Sec. 266) • Residual income requirement (Sec. 267)* • Fair value accounting in cost calculations (Sec. 268) • Phase out of HECM program (Sec. 292)	• Tightened mortgage loan limits based either on appraised value, Area Median Home Price, or GSE single family loan limit (Sec. 232)
* Similarly provisions proposed by Sens. Johnson and Crapo in FHA Solvency Act of 2013		

Other Aspects of the Legislation
In addition to these key reforms, the path legislation contains other desirable elements.

[3] Senate Banking and Urban Affairs Committee, "FHA Solvency Act of 2013," (Discussion Draft); http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=230fb6c1-ffc0-4ea7-bcce-c2b4e6d9d261

Risk-sharing programs.
With respect to both GSEs and the FHA, the PATH act mandates the use of risk-sharing. As a policy matter, it is desirable to draw private capital into a risk-taking role and to place its losses ahead of those borne by the taxpayer.

As a strategic issue, it is desirable to embody such experiments and programs in legislation, as the administrative ability to do so (which is already present) has proven insufficient to prompt actions.

Eminent domain. Proposals made by local municipalities to use eminent domain to seize underwater mortgages in partnership with private companies are undesirable. As a general matter, it is past time to create new mortgage modification programs, as these tend to freeze activity and slow recovery. With the specifics of eminent domain proposals, close examination has thrown up numerous legal red flags. Regardless of the legal murkiness, they could also subject taxpayers to losses. It is wise for the PATH Act to preclude this policy.

Fair Value Accounting. The legislation builds upon the foundation of the Federal Credit Reform Act (FCRA) to require "fair value accounting" in identifying the financial condition of government-related housing finance (e.g., the FHA). This is an important step in the right direction. FCRA needlessly restricted analyses to credit risk – the probability of failure to fully repay – while ignoring the fact that the timing of those failures matters enormously. As the past few years have starkly reminded every American, the need to tax, borrow and otherwise deprive the private sector of another dollar has far greater implications during the depths of economic distress than during periods of robust economic growth. Adoption of FVA would rectify this oversight.

Such a significant reform to budget procedures should not be undertaken lightly. However, my views are informed by the fact that during my tenure as Director the Congressional Budget Office undertook a number of studies of the implications of accounting fully for economic risks in the budgetary treatment of financial commitments like credit programs. In example after example (pension guarantees; deposit insurance; flood insurance; student loans; and assistance for Chrysler and America West Airlines) it becomes clear that an incomplete assessment of risks leads to misleading budget presentations and may engender poor policy decisions. Fair value accounting would be a significant step toward improving this informational deficit.

My views are echoed by a wide array of budget experts. In March 2010, CBO issued a new report recommending the use of FVA for federal student loan programs, on the grounds that budget rules do "not include the costs to taxpayers that stem from certain risks involved in lending." In addition, the Pew-Peterson Commission on Budget Reform proposed "fair-value accounting" for credit programs and the President's National Commission on Fiscal Responsibility and Reform advocated for reform of budget concepts that would more accurately reflect costs.

Finally, fair value accounting has already been used successfully as the budgetary treatment of the Temporary Asset Relief Program of 2008 (TARP) and the federal assistance to Fannie Mae and Freddie Mac.

Delay, Limitations and Repeal of Mortgage-Related Regulations. Regulations enacted from the Dodd-Frank Wall Street Reform and Consumer Protection Act (D-F) and Basel III (B3) implementation could severely impact the economy and recovering housing markets. In October 2012, AAF estimated that the bottom line effects of proposed D-F and B3 regulations may include 20 percent fewer loans, resulting in 600,000 fewer home sales. In turn, the resulting tightened lending and reduced sales were estimated to cost up to 1,010,000 housing starts, 3.9 million fewer jobs, and a loss of 1.1 percentage points from GDP growth over the next three years.[4] While some regulations, like QM, have been revised since that time, the reality of tightened credit and its effect on the economy remain largely the same. Additionally, the National Association of Realtors has estimated that D-F regulations could raise mortgage rates 75-125 bp for non-QRM, high LTV borrowers and B3 could raise rates by 80 bp.[5]

Thank you. I look forward to answering your questions.

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[4] Douglas Holtz-Eakin, Cameron Smith & Andrew Winkler, "Regulatory Reform and Housing Finance: Putting the 'Cost' Back in Benefit-Cost," (October 2012); http://americanactionforum.org/sites/default/files/Regulation_and_Housing.pdf

[5] National Association of Realtors, "Recent Lessons for the QRM," (December, 8, 2011); http://economistsoutlook.blogs.realtor.org/2011/12/08/recent-lessons-for-the-qrm/

National Association
of Home Builders

Testimony of Jerry Howard

On Behalf of the

National Association of Home Builders

Before the

Committee on Financial Services

Hearing on

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

Chairman Hensarling, Ranking Member Waters, and members of the House Financial Services Committee, I am pleased to appear before you today on behalf of the National Association of Home Builders (NAHB) to share our views on the *Protecting American Taxpayers and Homeowners (PATH) Act* and the need for comprehensive housing finance reform legislation. We appreciate the invitation to appear before the committee on this important issue.

My name is Jerry Howard and I am NAHB's Chief Executive Officer. NAHB represents over 140,000 member firms involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. Each year, NAHB's builder members construct about 80 percent of all new housing in America.

NAHB commends the Chairman for starting the dialogue in the House of Representatives about long-overdue reforms to the housing finance system. After years of conservatorship for Fannie Mae and Freddie Mac, it is time for Congress to address this critical issue. The PATH Act begins this process, and while the draft bill includes some constructive legislative proposals supported by NAHB, we strongly believe that it diminishes housing as a major policy priority for this nation. Rather than reform and restructure the basic housing finance system, the PATH Act dismantles the Housing Government Sponsored Enterprises (GSEs) and deflates the Federal Housing Administration (FHA) by both removing and diminishing the federal support critical to meet our nation's current and future mortgage liquidity needs.

Past abuses, by nearly all participants in the financial industry, combined to create a tragic impact on the well-being of our country. The early stages of the economic downturn became evident in the housing finance arena due in large part to the origination of excessively risky mortgage products and an overly zealous securitization market. The resulting meltdown of the mortgage finance industry led, ultimately, to the crises in the financial markets as a whole.

Today's mortgage finance system is in a state of uncertainty. There is no clear path for housing finance reform, or agreement on the components of reform. However, nearly all system participants agree that reform is critical to the economic recovery of this nation. NAHB believes that legislation to address the past abuses should be designed to ensure transparency, as well as safety and soundness in the housing finance system, but not so restrictive as to impede viable transactions by home buyers, lenders, and investors.

America's future housing finance system must be designed to ensure that creditworthy borrowers have access to prudently developed and underwritten housing finance options and therefore are provided the opportunities bestowed in the Housing Act of 1949. Directly resulting from the recent negligence and mismanagement in the financial industry, millions in the U.S. are suffering from the loss of employment and are thereby increasing the burden on the national government to extend unemployment benefits and other supports to citizens we can, and should, put back to work. No other industry in the country depends more on the U.S. labor force to manufacture its product than the housing industry. Homes and apartments are not manufactured overseas and shipped to the U.S to sell – we build and sell our products right here in the U.S.A.

NAHB believes that the U.S. housing finance system should be multifaceted with both competing and complementary components, including private, federal and state sources of capital. The system should support a reasonable menu of sound mortgage products for both

single family and multifamily housing, governed by prudent underwriting standards and adequate oversight and regulation.

NAHB supports policies designed to ensure that the United States is the best-housed nation in the world. The Housing Act of 1949 pledged a "decent home and a suitable living environment for every American family." The American dream of homeownership, as well as the availability of decent, safe and affordable rental housing, should continue to be supported by federal policy within reasonable, safe, and sound parameters. NAHB believes this goal should be emphasized in U.S. housing policy and urges this committee to reestablish housing as a national policy priority.

First, NAHB urges the committee to make changes to the PATH Act to ensure that the federal government continues to provide a backstop for a reliable and adequate flow of affordable housing credit in all economic and financial conditions. While NAHB agrees that private capital must be the dominant source of mortgage credit, the future of the housing finance system cannot be left entirely to the private sector. The historical track record clearly shows that the private sector is not capable of providing a consistent and adequate supply of housing credit without a federal backstop.

NAHB has made recommendations to this committee outlining a plan by which Fannie Mae and Freddie Mac would be gradually phased into a private-sector-oriented system, where the federal government's role is explicit, but its exposure is limited. Federal support should be limited to catastrophic situations where carefully calibrated levels of private capital and insurance reserves are depleted before any taxpayer funds are employed to shore up the mortgage market. NAHB believes federal support is particularly important in continuing the availability of the affordable 30-year fixed-rate mortgage, which has been a staple of the U.S. housing finance system since the 1930's. As currently drafted, the PATH Act does not provide the federal support necessary to ensure a strong and liquid housing finance system, and we urge the committee to make the necessary changes.

Secondly, NAHB urges the committee to make modifications to the sections of the bill outlining changes to the Federal Housing Administration (FHA). Taken as a whole, the PATH Act represents a drastic diminishing of FHA's vital liquidity mission. By simultaneously leaving all federal support for housing to the FHA, and then by greatly reducing the overall scope and reach of the FHA's programs, the PATH Act will greatly limit homeownership and rental housing opportunities for many qualified Americans. While we believe that the private market should be the primary source of mortgage financing, that market remains extremely limited.

NAHB has long advocated for reforms to keep the FHA financially solvent and stable, and will continue to support any and all reforms to accomplish this goal. Nevertheless, we strongly support the ability of the FHA to serve a broad group of potential homeowners and renters, especially in times of economic crisis and recovery when private sector lending participants have not yet returned to the marketplace. NAHB urges the committee to make the changes necessary in the PATH Act to preserve FHA's vital liquidity mission.

NAHB looks forward to working with all members of this committee to make these necessary changes.

TITLE I – Wind-down of Fannie Mae and Freddie Mac
GSE Bailout Elimination and Taxpayer Protection Act

Incorporated in the PATH Act is the "GSE Bailout Elimination and Taxpayer Protection Act " that lays out the steps to wind-down Fannie Mae and Freddie Mac (the Enterprises) while encouraging the return of a private market without a federal government guarantee.

NAHB is a strong proponent of housing finance system reform and feels significant changes should occur in the conventional mortgage market, where Fannie Mae and Freddie Mac currently account for almost all activity. NAHB supports steps to increase the role of private capital but does not believe the market can rely exclusively on private sources. Recent experience demonstrates that private players are unwilling or unable to participate in periods of extreme economic and financial distress.

NAHB's priority in housing finance system reform is ensuring liquidity for the housing sector in all markets throughout the economic cycle. This is only possible if market participants know there is a federal government backstop that will maintain stability in catastrophic circumstances. While NAHB agrees that the current degree of government intervention is unsustainable, an ongoing, though more limited, government role must be maintained to avoid future interruptions in the flow of credit to mortgage borrowers.

NAHB recommends establishing a new securitization model for single family and multifamily mortgages where Fannie Mae and Freddie Mac would be transitioned to private housing finance entities that would aggregate mortgages into securities for sale to investors worldwide. Private capital from mortgage originators and securities issuers would be in the first loss position but the principal and interest for investors in the mortgage-backed securities would be guaranteed through a privately capitalized, federally backed insurance fund. Only mortgages with reasonable and well understood risk characteristics would be eligible to serve as collateral for government-backed mortgage securities and the system would be overseen by a strong and independent regulator.[1]

Section 103. Termination of Conservatorship; Mandatory Receivership.

Five years after the enactment of PATH, Fannie Mae and Freddie Mac would be put into receivership and stripped of their government charters. As noted above, while NAHB agrees that Fannie Mae and Freddie Mac should be phased out and the market should transition to a new mortgage securitization system, NAHB does not support removing all government support from the conventional mortgage market. In addition, NAHB believes that a transition must be done in an orderly fashion over time and should not conclude until a viable alternative system is fully functioning. There is no mention of a transition to a new secondary market system in Title I, although the PATH discussion draft offers a plan for transition to a market utility in the third section titled, *National Mortgage Market Utility Act of 2013.* NAHB urges the Committee to carefully evaluate transition issues to ensure that any changes do not cause market disruptions or dislocations.

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[1] The full details of NAHB's housing finance system recommendations are contained in "A Comprehensive Framework for Housing Finance System Reform," published by NAHB on February 9, 2012.

Section 104. Limitations on Enterprise Authority; Section 106. Mandatory Risk-Sharing; Section 110. Authority of Receiver to Repeal Enterprise Charter

Many of the provisions in Title I that are intended to shift the market away from its current dependence on the Enterprises already are taking place through mandates by the Federal Housing Finance Agency (FHFA) and the U.S. Department of Treasury (Treasury). In March 2013, FHFA issued a Conservatorship Scorecard that outlined specific objectives and priorities to implement the agency's own strategic plan for how the Enterprises should operate in conservatorship. The Conservatorship Scorecard directed Fannie Mae and Freddie Mac to: 1) raise guarantee fees to be more consistent with the risk-based pricing as it would be in the private market and, 2) incorporate risk sharing in single family transactions of $30 billion of unpaid principal balance for both Enterprises in the year 2013.

The PATH Act would require similar steps in its strategy to wind down the Enterprises – specifying that a credit risk-sharing program should be established between the Enterprises and the private market covering at least 10 percent of the Enterprises' new business each year; and that the FHFA Director ensure, on an annual basis, that the guarantee fees charged by the Enterprises are equivalent to the amount an Enterprise would charge if it were held to the same capital standards as private banks or financial institutions.

Risk Sharing Program

NAHB supports the exploration of risk-sharing structures for the Enterprises' mortgage securities, since such experimentation can provide valuable information that will be useful in structuring first-loss positions for private capital providers in a reformed housing finance system.

Guarantee Fees

NAHB does not support further increases in Enterprise guarantee fees that are not required to ensure the safety and soundness of Fannie Mae and Freddie Mac. Enterprise guarantee fees (or "g-fees") have doubled since 2011 while their risk exposure has dramatically decreased due to more stringent underwriting standards, improving home prices and declining mortgage defaults. Further g-fee increases would have a major adverse effect on both the affordability and availability of credit while having a very uncertain impact in attracting private capital to the mortgage markets. A recent study by the Office of Inspector General of FHFA raises strong questions on the effectiveness of g-fee increases in increasing the flow of private capital. The study states that "significant guarantee fee increases, under some scenarios, could result in higher mortgage borrowing costs and dampen both consumer demand for housing and private sector interest in credit risk."[2]

NAHB supports appropriate charges to those benefitting from government mortgage market support and looks forward to working with Congress and financial market experts to determine the pricing for insurance premiums to be paid by the issuers of mortgage-backed securities receiving a federal government backstop.

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[2] Federal Housing Finance Agency Office of Inspector General, "FHFA's Initiative to Reduce the Enterprises' Dominant Position in the Housing Finance System by Raising Gradually Their Guarantee Fees," Evaluation Report EVL–2013–005, July 16, 2013

Preferred Stock Purchase Agreements

In October, Treasury modified the terms of the Preferred Stock Purchase Agreements (PSPA) structured between Treasury and the Enterprises in September 2008 at the time the Enterprises were placed in conservatorship. Per the agreements in effect today, the Enterprises are required to transfer all of their profits, on a quarterly basis, to Treasury.

The new Treasury agreement also accelerates the winding down of the Enterprises' portfolios by requiring a 15 percent reduction per year until each portfolio is reduced to $250 billion.

NAHB has not taken a position on these Treasury requirements, both of which are maintained in the PATH Act.

Section 105. Modifications to Increases in Conforming Loan Limits

The PATH discussion draft calls for a five-year phased reduction of the conforming loan limit in high-cost areas, from the current ceiling of $625,500 to $525,500. NAHB is concerned that such a phase down does not consider the fragile state of recovery in many of the affected markets and could result in a reversal of the modest recoveries that have occurred. Furthermore, NAHB believes that it is premature to establish a new high-cost conforming mortgage ceiling without an analysis of such impacts. Conforming loan limits in the new conventional mortgage system that NAHB is proposing would be established based on an evaluation of the condition of housing markets and level of home prices at the time that system is activated. These loan limits would be indexed to a measure of home prices and adjusted as specified in HERA.

Section 107. Limitation of Enterprise Mortgage Purchases to Qualified Mortgages

Effective for mortgages with application dates on or after January 10, 2014, the PATH Act would only allow the Enterprises to purchase, make commitments to purchase, service, sell, lend on the security of, or otherwise deal in a mortgage that is a qualified mortgage as defined by the regulations issued by the Consumer Financial Protection Bureau (CFPB) in January 2013. The CFPB issued the regulation to implement the "ability to repay" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

In fact, FHFA placed this qualified mortgage restriction on Fannie Mae and Freddie Mac on May 2, 2013 with the exception that Fannie Mae and Freddie Mac will continue to be permitted to purchase loans that meet the underwriting and delivery eligibility requirements stated in their respective selling guides. This includes loans that are processed through their automated underwriting systems and loans with a debt-to-income ratio of greater than 43 percent. Loans with a debt-to-income ratio of more than 43 percent are not eligible qualified mortgages under the CFPB's final rule unless they are eligible for purchase by Fannie Mae and Freddie Mac under the special or temporary qualified mortgage definition.

The PATH discussion draft does not address whether or not Fannie Mae and Freddie Mac will continue to be allowed to purchase mortgages loans with a debt-to-income ratio of greater than 43 percent. NAHB recommends a revision to the draft to clarify that such purchases would be permitted.

Section 108. Prohibition Relating to Use of Power of Eminent Domain

The PATH Act would prohibit Fannie Mae and Freddie Mac from purchasing or guaranteeing any mortgage loans that are secured by a structure or dwelling unit located within a county that has invoked the use of eminent domain during the preceding 120 months to seize mortgage loans out of legally binding securities.

NAHB supports this provision. NAHB opposes the use of eminent domain to take mortgages from mortgage-backed securities or financial institution portfolios, which would significantly harm mortgage finance markets, reduce access to credit for borrowers, and undermine efforts to revive the private label mortgage securities market.

TITLE II – FHA Reform

FHA Reform and Modernization Act

The PATH Act lays out a reform plan for the Federal Housing Administration (FHA). The bill would establish FHA as a wholly owned government corporation, removing it from the U.S. Department of Housing Urban Development (HUD), although it would remain as an agency of the United States. The new structure of the agency is defined, along with its purposes and powers, how it would be funded, eligible activities and specific program parameters, among other items. The bill also appoints the Federal Housing Finance Agency as the safety and soundness regulator of the newly reformed FHA and describes how FHA would function during its transition from an agency of HUD to an independent government corporation.

NAHB is supportive of reforms to FHA to ensure that FHA is able to maintain its critical mission of facilitating the flow of mortgage credit to homebuyers and producers of rental housing. FHA has a long track record of achievement in insuring loans for over 37 million American families, many of whom would not otherwise have been able to own a home. FHA pioneered the concept of a 30 year fixed-rate mortgage and low down payments, and the nation still benefits from that program today. FHA maintains strong underwriting criteria to protect the tax payers and is intended to be self-funded through the upfront and annual mortgage insurance premiums that borrowers pay.

Contrary to the belief of some, FHA is not a subprime lender and has never required a federal bailout. Although the single family mortgage insurance program is experiencing shortfalls in its excess reserves due to the effects of the worst economic downturn since the Great Depression, FHA remains an integral part of our nation's economic recovery. Since the downturn in the housing market, FHA has become the primary source of mortgage credit for first-time home buyers, minorities and those with limited downpayment capabilities as other sources of mortgage credit have disappeared. NAHB believes that the private market should be the primary source of mortgage financing, but that market is extremely limited. While these circumstances prevail, it is entirely appropriate for FHA and other federally backed programs to continue to have a larger than historical market share.

FHA historically also has played an important role in the financing of multifamily rental housing and provided critical support during the recent economic crisis. In 2008, FHA endorsed just over $2 billion in multifamily loans (excluding health care programs), which grew to $14.6 billion in FY2012. This unprecedented increase in FHA multifamily loan volume occurred as other

private market sources of multifamily financing withdrew from the market as economic conditions worsened. FHA, along with Fannie Mae and Freddie Mac, are the primary sources of multifamily financing today. Like in the single family market, the FHA multifamily mortgage insurance programs are fulfilling the function and mission for which Congress originally intended. Further, the FHA multifamily programs generate revenue over and above what it costs to administer the program and fulfill claims.

Within this context, NAHB provides the following comments on Title II.

Subtitle A - Organization

NAHB supports the proposed restructuring of FHA as a wholly owned government corporation. NAHB believes, however, that rather than removing FHA from HUD, that reform of FHA can best be accomplished by restructuring FHA as an independent government corporation within HUD, separate from Ginnie Mae. FHA would continue its current mission of supporting liquidity, innovation and continuity in the housing finance markets by providing mortgage insurance backed by the full faith and credit of the U.S. government. In NAHB's view, a restructured FHA would be led by a chief executive officer, appointed by the President, who would report to a presidentially appointed board, chaired by the HUD Secretary.

The PATH Act contains provisions that are similar to NAHB's position on a restructured FHA. For example, NAHB believes that, while under general Congressional oversight, FHA should have the authority, without further Congressional action, to create or alter specific insurance programs in order to have the flexibility to react promptly to changes in market and other conditions. NAHB also supports provisions by which hiring, salaries, personnel management, and procurement would be freed from current, confining federal government constraints in order to be more consistent and competitive with the private sector. Further, NAHB agrees that FHA should be operated in a manner that does not require a federal subsidy and that FHA should be allowed to retain revenues generated in excess of expenses to be used for mission purposes.

Section 212. Purposes

The PATH Act sets forth the purposes of the newly reformed FHA. In the single-family area, FHA is to provide mortgage insurance and other credit enhancements for single-family homeownership for first-time homebuyers, low-and moderate-income (LMI) homebuyers, homebuyers in counter-cyclical markets and disaster areas. While NAHB agrees that FHA should continue to support these homebuyers, we oppose these limitations in FHA's assistance. FHA currently serves a broader group of potential homeowners and is available during all economic cycles, and NAHB believes that it should continue to do so.

The FHA single-family mortgage programs are a unique and vital component of the housing finance system, providing access to homeownership for underserved communities, primarily first-time homebuyers, minorities and those with limited downpayment capabilities. During the recent mortgage crisis FHA demonstrated how invaluable their counter-cyclical role is in providing mortgage market liquidity during the country's unstable housing market system. Although this role has not been without costs to the FHA program, as evidenced by the recent actuarial studies of the FHA's Mutual Mortgage Insurance Fund (MMIF), numerous steps have been taken to address these issues.

Since 2010, FHA has implemented a series of policy changes, including higher mortgage insurance premiums, tighter underwriting requirements, stricter mortgage lender enforcement, and improved risk assessment all intended to strengthen the performance of the MMIF and rebuild the capital reserve ratio. These changes are the most sweeping combination of reforms to credit policy, risk management, and lender enforcement in FHA history. FHA's 2012 Actuarial Report estimates that the changes in credit policy and pricing have added more than $20 billion in economic value to the fund from 2010 through 2012. This year HUD announced even more steps it will take to improve the health of the fund and expects that these measures, coupled with an estimated additional $11 billion in capital from new business in FY 2013, will return FHA's capital reserves to a positive position within the year.

In the multifamily sector, NAHB also agrees that FHA should continue to support the provision of affordable rental housing. NAHB has long-supported the FHA multifamily mortgage insurance programs. These programs, notably Section 221(d)(4) and Section 223(f), have enabled the construction of needed affordable and market rate rental housing units over the years, as well as contributed to the ability of property owners to acquire, refinance, rehabilitate and preserve the nation's existing stock of rental housing. Of importance, FHA financing is often used in smaller markets where Fannie Mae, Freddie Mac and other market participants are less active, and FHA has filled the niche that local banks and thrifts have retreated from in recent years. NAHB does not support a narrowing of FHA's mission as it relates to supporting the multifamily rental housing market.

NAHB also supports as a purpose the engagement in research, development and testing of new products designed to make single and multifamily housing and residential health care facilities available to hard-to-serve markets. Such markets should include rural areas, as well as distressed urban and rural areas.

Lastly, under Section 212(6), NAHB believes that FHA and the U.S. Department of Agriculture (USDA) should jointly consider ways to coordinate related to risk management and loss mitigation for the FHA and Rural Housing Service (RHS) programs. However, FHA should not control the operations and practices of an agency (RHS) within the USDA. NAHB has supported the joint efforts of HUD, USDA, and the Treasury to coordinate and streamline administrative practices and procedures and in some regulations for the multifamily programs, which often are funded in conjunction with each other (such as Low Income Housing Tax Credits, HOME, FHA multifamily mortgage insurance, and rental housing assistance). These efforts show promise in making the use of these programs more efficient and productive.

NAHB believes that all provisions in the draft bill that direct FHA to oversee or set practices for the RHS should be eliminated. NAHB has not supported the transfer of RHS programs to HUD and would not support the transfer or oversight of the RHS programs to a newly reformed FHA. The RHS programs have financed over two million owner-occupied homes and over 500,000 rental units for low and moderate income families living in rural areas. RHS has also provided funding to repair thousands of single family homes, as well as rental assistance to thousands of low-income rural families, many of whom are elderly or disabled, and financing to provide migrant housing. The RHS programs are uniquely structured to address the housing credit needs of low and moderate income persons in rural areas, which are very different from those found in urban and suburban areas. This oversight responsibility could lead to the consolidation of the RHS programs into FHA programs, which NAHB believes would result in the loss of the

important network of state offices that administer the RHS programs, making it more difficult and expensive for persons living in rural areas to obtain an affordable mortgage to purchase a home.

Section 218. Applicability of Laws.

While NAHB supports giving a newly restructured FHA broader powers than it currently possesses as a means to foster more efficient and modern products and services, we believe that FHA must continue to be subject to applicable laws related to notice and comment rulemaking. Section 218 of Title II exempts any matter relating to credit enhancement or other business of the FHA from such laws, which we do not support. While NAHB supports streamlining of the regulatory process, which currently is too time-consuming, it is critically important for purposes of transparency that a newly reformed FHA provide notice and comment opportunities to stakeholders and interested parties. Government agencies become better informed as to the viability of their proposals during the comment and rule making period, and although the end result may not be reflective of all comments, the consequences of government decisions – positive and negative - become more evident as a result of constructive public input.

Subtitle B – Business Authority and Requirements

Section 232. Eligible Single Family Mortgages

Mortgage Amount

The PATH Act establishes limits on the mortgage amount for single family mortgages eligible for FHA insurance as the lesser of: 1) 100 percent of the appraised value of the property and 2) 115 percent of area median income (AMI) or 150 percent of the Freddie Mac limit (currently $625,500). NAHB notes that these mortgage limits are consistent with those in the FHA Modernization Act of 2008 enacted as part of the Housing and Economic Recovery Act (HERA) of 2008 (P.L. 110-289). The current FHA single family loan limits which are the lesser of 125 percent of AMI or 175 percent of the Freddie Mac limit will be rolled back to the HERA limits at the end of this year. While the proposed limits are consistent with current law, we seek clarification on the definition of the Freddie Mac limit once Freddie Mac's charter is repealed pursuant to Section 110 of the PATH Act.

The PATH Act would also reduce the minimum FHA loan limit or "floor" to no lower than $200,000, down from the current floor of $271,050. NAHB estimates that the reduction in the floor would result in lower limits, relative to the HERA limits, in 2,692 counties, which account for 56 percent of the occupied housing units in the country. Given the large impact of affected housing units, NAHB opposes the reduction in the floor and supports continuation of the current formula for the FHA floor as specified in HERA.

Downpayment

The bill also proposes changes to the minimum downpayment required. First-time homebuyers would be required to provide a 3.5 percent downpayment, and a five percent downpayment would be required from other borrowers. NAHB is concerned that increasing the downpayment from 3.5 percent to five percent will create a substantial burden for all American homebuyers,

especially younger buyers and those with strong credit profiles but not enough available funds to make the increased downpayment. Also adversely affected will be current homeowners looking to move up who will not be able to do so because of the reduced number of qualified borrowers.

The increased downpayment burden provides minimal benefits. Research has shown that requiring a higher downpayment does little to reduce risk of default but causes homebuyers to use more of their reserves for the downpayment. This is particularly true for low and moderate-income families seeking to become homeowners. Sound underwriting is the key to minimizing foreclosures and defaults, not downpayments.

Public Purpose Requirement

Section 232 also establishes a public purpose requirement for FHA based on the purposes enumerated in Section 212. The bill restricts FHA single family mortgage insurance to loans that meet one of the following criteria:

(1) first-time homebuyer
(2) low or moderate income homebuyer, defined as a family having an income less than 115 percent of the area median income (AMI) or 150 percent of AMI in high cost areas, which are defined as areas where the median one-family house price exceeds the Freddie Mac limit in effect for that year. (It is not clear what this house price limit might be once Freddie Mac is no longer in existence.)
(3) property is located in a counter-cyclical market (as determined by the FHFA Director and the FHA Chief Risk Officer, CRO)
(4) property is located in a Presidentially-declared disaster area.

As noted previously, NAHB opposes the restriction of FHA's support to these loan categories. Further, NAHB has concerns regarding the counter-cyclical market adjustment specified in Section 232 (C) which would restrict the availability of FHA loans unless:

- there is a joint determination by the FHA Director and Chief Risk Officer that available credit in a specific county or counties has contracted significantly, as measured by a credit availability measure of the Office of the Comptroller of the Currency;
- that house prices in those areas have declined significantly, as measured by the FHFA; or;
- that available credit for purchasing homes or other economic conditions exist that show a significant contraction of capital in the such areas as measured by a metric identified by the Director and Chief Risk Officer in a written notice made publicly available and provided to Congress in advance.

NAHB is very concerned that this process is overly burdensome and the determinations required would take too long to effectively address changing economic conditions. Looking at the dramatic increase of FHA's market share of single-family mortgages over the past few years, it is clear how essential the program is for our nation's economic recovery. FHA's share of the market jumped from 3 percent during the housing boom to a high of almost 30 percent early in the crisis. This dramatic shift is evidence that FHA is performing its mission of providing the federal backstop to ensure that every American has access to a stable mortgage product.

Section 233. Risk-sharing

Section 233 requires FHA to develop a demonstration model and standards for entering into risk-sharing agreements for FHA-insured mortgages. FHA is directed to develop the model within two years of enactment after which FHA would be required to enter into risk-share agreements on 10 percent of its single family business. The risk share portfolio must represent a broad cross-section of single family mortgage products.

The risk-share model is to include guidelines for qualification of persons or entities to participate in risk-sharing agreements and other credit enhancement activities with FHA. FHA is to review the FHFA guidelines that apply to the Fannie Mae and Freddie Mac to determine if they are appropriate for the purposes of FHA. The guidelines must ensure that parties participating in risk-sharing have sufficient liquidity, capital, credit worthiness and are other capable of fulfilling their obligations to FHA.

NAHB believes that dividing the risk with private companies would reduce FHA's loss exposure and could have other operational advantages. However, it would also raise the question of FHA's exposure to adverse selection if the private companies limited their participation to the lowest risk portion of FHA's business. This concept also could reduce or eliminate participation by smaller mortgage lenders, particularly community banks, who would have difficulty meeting the eligibility criteria for the program. A change of this nature would also impact the Ginnie Mae mortgage-backed securities (MBS) program by raising Ginnie Mae's exposure to counterparty risk and would likely require significant changes at that end as a result. The bill does not require FHA to consult with or review Ginnie Mae's guidelines, nor does it mention examining any potential impact on Ginnie Mae.

Section 234. Limitation on Mortgage Insurance Coverage

The bill reduces the coverage of FHA mortgage insurance permitted on a loan over time, from the current 100 percent to 90 percent of the original principal obligation for mortgages insured after the expiration of the one-year period beginning on the date of enactment of this act; 80 percent after two years; 70 percent after three years; 60 percent after four years; and 50 percent after five years. These provisions would become effective upon enactment.

NAHB notes that the Department of Veterans Affairs (VA) has operated its Loan Guaranty Program with a lower insurance coverage with positive results. However, the VA program is restricted to a specific portion of the population, the military, and has operating features that may not be replicable for FHA loans. In addition, as in the case of risk-sharing, Ginnie Mae's counterparty risk exposure would increase, necessitating changes in that program as well. The bill does not provide for a demonstration or study of decreasing the degree of insurance on FHA loans, leaving questions unanswered as to its viability and impact on the programs.

Section 235. Premiums

The bill gives FHA the authority to establish and collect mortgage insurance premiums (MIP). In the case of single-family annual premiums, FHA must charge at least 0.55 percent of the loan balance. The MIP must be sufficient to cover: costs of providing MI; administration, operations, management and technology costs for FHA; capital ratios required for the Mutual Mortgage

Insurance Fund (MMIF) and MI for multifamily mortgages; and, salaries and expenses of FHA personnel.

The bill allows the newly reformed FHA to establish a mortgage insurance premium structure involving a single premium payment collected prior to the insurance of the mortgage or annual payments (which may be collected on a periodic basis), or both. The rate of premiums may vary according to the credit risk associated with the mortgage and the rate of any annual premium for such a mortgage may vary during the mortgage term. The FHA would have the discretion to change this structure, but only for new loans.

NAHB believes that calibrating mortgage insurance premiums to the risk profile of the borrower would allow FHA to better align its revenues with potential claims and thus bolster reserves. However, it would also place FHA in the position of raising the mortgage financing costs of the individuals for whom it has a mission to serve. A key consideration in designing a system of risk-based pricing for FHA is the range and weighting of risk-factors used in determining the schedule of premiums.

Section 237. Occupancy and Rent Limitations for Multifamily Mortgage Insurance

The bill allows FHA to provide mortgage insurance for residential properties having five or more dwelling units – multifamily rental housing – subject to occupancy and rent restrictions which are applied during the life of the mortgages. The bill restricts occupancy to families having incomes no greater than 115 percent of AMI. It allows for higher income limits (up to 150 percent of AMI) in high cost areas. The bill gives FHA the discretion to establish lower occupancy, income and rent restrictions.

The FHA multifamily mortgage insurance program is an important resource for meeting the need for affordable rental housing. The Census Bureau's 2012 Rental Housing Finance Survey shows that an overwhelming majority of tenants in properties with FHA insured mortgages have incomes of 115 percent or less of area median income. However, the FHA multifamily mortgage insurance program is also a key source of liquidity, so the imposition of income limits would impede that portion of FHA's mission, particularly in higher-cost markets.

NAHB does not support setting occupancy and rent restrictions based on AMI for the FHA multifamily mortgage insurance programs. The FHA multifamily mortgage insurance programs are subject to statutory mortgage loan limits, which effectively serve to focus the provision of FHA multifamily mortgage insurance on affordable and workforce rental housing. Imposing burdensome provisions that require developers, lenders and property managers to track and document incomes and rents on unsubsidized properties is costly and unnecessary, given that the proposed targeted population is already being served by the programs.

Subtitle C. Financial Safety and Soundness

Section 251. Authority of Director

The bill provides that the Director of the Federal Housing Finance Agency (FHFA) shall supervise and regulate the safety and soundness of the newly reformed FHA and the programs of the RHS in USDA.

As discussed with respect to our comments on Title I, NAHB has proposed an improved regulatory regime for a reformed housing finance system that would involve replacing FHFA with a new regulator that is better suited to oversee a broader spectrum of responsibilities. Therefore, NAHB does not support assigning FHFA as the regulator over the new independent FHA.

In addition, NAHB does not support giving FHFA the authority to supervise and regulate the RHS. The RHS should continue to be supervised and regulated by the USDA. NAHB does not object, as previously stated, to the coordination of policies and procedures, to the extent appropriate, between FHA and RHS programs.

Sections 256. Mutual Mortgage Insurance Fund (MMIF) Capital Reserve Ratio; Section 257. Capital Classifications and Performance Measures

Section 256 requires FHA to establish separate accounts in the MMIF for legacy loans and for new loans. The FHA must maintain a capital reserve ratio of four percent for new business, double the current two percent statutory capital reserve ratio. Section 257 provides for consequences if the MMIF should become undercapitalized (i.e., a capital ratio of less than four percent) by restricting the degree of insurance provided by FHA. Pursuant to Section 257, the capital classifications and restrictions on new FHA business are:

"Undercapitalized":

- Capital reserve ratio between two and four percent; FHA would be restricted from insuring single family mortgages with a loan-to-value ratio exceeding 90 percent.
- Capital reserve ratio between zero and 2 percent; FHA would be restricted from insuring single family mortgages with a loan-to-value ratio exceeding 80 percent.

"Significantly Undercapitalized":

- Capital reserve ratio less than zero percent; FHA would be subject to enforcement actions determined by FHFA.

In addition, if FHA is classified as undercapitalized or significantly undercapitalized, it would be required to submit a capital restoration plan to the FHFA Director.

NAHB has significant concerns regarding the proposed doubling of the MMIF capital reserve ratio. The increase in the reserve ratio will directly result in higher MIPs for single family mortgages since, pursuant to Section 235, the MIP must be sufficient to cover the capital reserve ratio. Higher MIPs will result in increased costs for the borrowers to be served by the reformed FHA, specifically first-time and low- and moderate-income homebuyers. These homebuyers are the population least likely to be able to bear the brunt of higher mortgage costs and will have fewer available mortgage options other than FHA-insured mortgages.

In addition, NAHB opposes the proposed restriction in FHA business if FHA is classified as undercapitalized. Restricting FHA's ability to serve its core borrowers will not improve the FHA financial position and will harm these borrowers. NAHB has supported past legislative proposals that would require a capital restoration plan, but strongly opposes restrictions in FHA's activities.

Section 259. Capital Reserve Requirements for Other Funds

The bill requires the Director of FHFA to set capital reserve requirements for the General Insurance Fund (GI), the Special Risk Insurance (SRI) Fund, the Cooperative Management Fund, and the Rural Housing Insurance Fund established under Title V of the Housing Act of 1949. The bill does not specify target reserve ratios.

Currently, there are no statutory requirements for capital ratios for either the GI or SRI funds. While NAHB understands that members of Congress and the Administration are focused on strengthening the risk management practices for both the single and multifamily FHA programs, we strongly urge that an in-depth analysis is conducted to determine any impact on the mortgage insurance premiums for the FHA multifamily programs before any reserve requirements are considered. NAHB does not believe that it is appropriate to use the type of capital reserve ratios used for the MMIF for the GI/SRI fund, because the nature of the multifamily portfolio is significantly different from the single family portfolio insured under the MMIF.

The purpose of collecting the mortgage insurance premiums (MIP) for the FHA multifamily programs is to collect sufficient sums to ensure that, in the case of defaults, the government can cover the cost of paying off its financial obligations to the lenders. The Federal Credit Reform Act (FCR) of 1990 directs government agencies to provide a realistic picture of the cost of government loans and guarantees. To comply with the FCR in determining the costs of the FHA multifamily mortgage insurance programs, HUD uses an economic model that takes into account the risks and costs of each program and has traditionally set the MIP for a specific program at a level sufficient to protect the integrity of the insurance fund without overcharging borrowers. The practice, since 2003, has been that the MIPs for Section 221(d)(4) and most other programs are set at roughly breakeven levels.

Thus, the implementation of a capital reserve on the GI/SRI funds could have significant impacts on MIPs. Higher MIPs will lead to higher costs for borrowers and renters who are served by the FHA multifamily programs. A key example is the Section 221(d)(4) program where a higher MIP will raise the required borrower debt service and/or equity contribution, resulting in a lower mortgage amount at a higher rate of interest. These higher costs would be passed along to the low- and moderate income families who use the program in the form of higher rents or could result in properties not being built or rehabilitated because of the higher equity contribution required.

It is also important to note that HUD, over the last several years, has instituted new risk management protocols for the FHA multifamily mortgage insurance programs. The new protocols tightened underwriting requirements and created a national loan review committee. New policies were implemented for large loans, including higher standards for credit worthiness and experience, and new policy was implemented related to concentration of risk from borrowers with large FHA portfolios. Processes and procedures throughout the field offices have been strengthened and standardized, with more to come as the multifamily office restructuring unfolds over the next couple of years. There is closer scrutiny on market strength and FHA presence than before the economic crisis struck. MIPs were increased in FY2012 for the first time in 10 years. All of these actions have been taken to ensure the health of the GI/SRI fund.

NAHB does not support giving the Director of FHFA the authority to set capital reserve requirements for the Rural Housing Insurance Fund. As stated previously, the USDA should be responsible for the oversight and financial safety and soundness of the RHS programs.

Section 263. Limitations on Seller Concessions

The bill prohibits FHA and RHS from newly insuring any mortgage on a one-to four-family residential property with respect to which the seller of the property (or third party or entity that is reimbursed directly or indirectly by the seller) contributes toward the acquisition of the property by the mortgagor any amount in excess of three percent of the total closing costs in connection with such acquisition.

The Discussion Draft uses a different approach to limits on seller concessions than that in current FHA regulations and HUD's changes to FHA seller concession rules proposed in March 2012. The draft bill proposes seller concession limits as a percent of closing costs, while HUD's proposed rules specify limits based on the lesser of appraised value or sales price, which is the measure used in current rules for FHA, Fannie Mae and Freddie Mac. NAHB strongly recommends that the lesser of sales price or appraised value be the base used to determine the limitation on seller concessions.

NAHB opposes limitations on seller concessions below the current FHA limit of six percent of sales price or appraised value. Seller contributions are an important tool for providing access to affordable homeownership by reducing the amount of upfront monies required for mortgage financing. Prudent methods of assisting a borrower to lower the upfront cash needed to purchase a home create more homeownership opportunities and can leave the buyer with reserves after the purchase to absorb economic shocks and unanticipated costs of homeownership.

Seller concessions are critical to many home sale transactions. Changing seller concessions would be a significant blow for financing both resale and new homes now and in the future. A recent NAHB survey found that seller concessions greater than three percent are used on about 60 percent of new home sales with FHA insurance. The survey also found that 44 percent of respondents need a minimum limit greater than three percent on seller-paid concessions to allow them to serve most of their customers.

The current six percent seller concession limit provides the consumer additional tools and flexibility in affordable financing solutions. In addition to covering portions of buyer closing costs, seller concessions can be utilized to buy down the interest rate making the monthly payment more affordable. While buydowns are less prevalent in today's low mortgage rate environment, NAHB believes it is important that this option is available if and when rates move to less affordable ranges.

The proposed three percent limit on seller concessions also does not adequately address high cost areas and areas with high closing costs. FHA has a mission to facilitate affordable housing as well as a counter cyclical mission to support housing when other finance providers are not present. It seems appropriate that consumers living in high cost or high closing cost areas should be provided with the same concessions as those in lower closing cost areas.

Maintaining current seller concession limits will address these markets and the consumers who live there.

Section 266. Prohibitions Relating to Use of Power of Eminent Domain

The bill prohibits the Secretary and the FHA from newly insuring any mortgage that is secured by a structure or dwelling unit that is located within a county that contains any structure or dwelling unit that secures or secured a residential mortgage loan which mortgage loan was obtained by the State during the preceding 120 months by exercise of the power of eminent domain.

NAHB supports this provision. NAHB opposes the use of eminent domain to take mortgages from mortgage-backed securities or financial institution portfolios. NAHB is concerned that this mortgage restructuring proposal would significantly harm mortgage finance markets, reduce access to credit for borrowers, and prevent private capital from returning to the mortgage market.

Section 267. Residual Income Requirement

The bill prohibits FHA from insuring any new mortgages unless the mortgagor meets sufficient residual income requirements to be established by FHA. Residual income is the mortgagor's net monthly income after taking into consideration defined obligations. Currently only the Department of Veterans Affairs Home Loan Guarantee program utilizes residual income underwriting requirements. This method of loan level analysis has produced lower default rates even through the housing finance crisis.

NAHB could support residual income methodologies if they were fair and responsible enabling reasonable guidelines that both protect FHA's MMIF while providing access to credit for homebuyers.

TITLE III – Building a New Market Structure

National Mortgage Market Utility Act of 2013

The PATH Act would set up a new, non-government, not-for-profit entity to restore a robust secondary market for residential mortgage loans. The National Mortgage Market Utility (the "Utility") would be regulated and supervised by FHFA. Specifically, a Division of Utility Regulation would be established within FHFA and led by a Deputy Director.

The Utility would, by statute, perform most secondary market functions of the Enterprises. Generally, the Utility would establish standards for originating eligible residential mortgage loans; develop standard form securitization agreements; develop servicing and servicer reporting standards; create standard data definitions for all aspects of loan origination, appraisals, and servicing; improve transparency related to the performance of residential mortgages; operate a common securitization platform; provide a central repository for mortgage documents and other mortgage-related information; and provide a uniform procedure for default and foreclosure.

Notably lacking is a provision for a federal guarantee of timely payment of principal and interest on mortgage-backed securities. As noted earlier, NAHB believes the absence of a federal backstop for mortgage-backed securities is a significant failing in the design of the PATH Act's housing finance system. NAHB believes a federal government guarantee is critical to ensure an adequate flow of mortgage capital and to avoid highly damaging disruptions in the delivery of affordable housing credit.

The PATH Act provides for the Utility to have significant latitude in developing and adopting standards, processes and procedures to eliminate the weaknesses in the residential mortgage market that were revealed during the financial crisis. Many of the measures called for by the PATH Act to repair and bolster the housing finance system were previously called for by NAHB in its *Comprehensive Framework for Housing Finance System Reform.* NAHB agrees a new framework must be established to prevent excessive risk taking and to ensure the safe and sound operation of the entire housing finance system so the recent crisis is never repeated. NAHB has identified the following components of reform that would correct the operational and structural problems that produced the housing boom/bust:

- Reform the appraisal system
- Prohibit unsound mortgage products
- Ensure the use of prudent mortgage underwriting guidelines
- Require sound mortgage securities structures and full transparency for MBS investors
- Reform mortgage servicing and foreclosure procedures
- Impose adequate oversight on previously unregulated segments of the mortgage and financial markets
- Ensure reforms are undertaken in a balanced and flexible manner so credit worthy borrowers are not disadvantaged

<u>Section 322. Standards for Qualified Securities</u>

Only Qualified Securities, as specified in the PATH Act, would trade through the Utility. Qualified Securities must meet numerous requirements:

- The Utility will establish classifications of residential mortgages based on various risk parameters. Eligible collateral for Qualified Securities must meet the criteria of a defined risk classification and the Utility will allow for the trading of securities collateralized by each classification of mortgages.

- Eligible collateral must use standard securitization agreements that are developed by the Utility and incorporate requirements related to pooling and servicing; representations and warranties; indemnification and remedies; and trustee responsibilities.

- For a mortgage to be eligible for a Qualified Security, all documents related to the mortgage must be registered with the newly-created mortgage data Repository.

- Servicing and Servicer reporting standards developed by the Utility must be applied to eligible collateral.

- Loan origination, appraisal, and servicing data, including data relating to underwriting criteria, would be available for residential mortgage loans that comprise qualified securities.

As noted above, NAHB has been recommending the types of reforms that are specified in the PATH discussion draft, and we commend the Committee for including such measures. One concern, however is the requirement that a Qualified Security must be collateralized with mortgages all having the same risk classification, which could impair the liquidity of the market for specific Qualified Securities.

Section 331. Organization and Operation of National Mortgage Data Repository

The Utility is directed to organize, establish and operate a Repository for mortgage-related data and mortgage documents. The authorized activities of the Utility with regard to the Repository will generally include all activities required to set standards and procedures for submission, registration, validation, publication, etc. of data and documents to be deposited in the Repository. Activities of the Utility also will include determining qualifications for those depositors of data to the Repository and fees for using the Repository.

NAHB has no specific policy regarding a national mortgage data repository, however, the lack of availability of mortgage data and other information in mortgage loan and securities documents was one of the key problems faced by lenders, servicers, investors and consumers during the crisis as they tried to work out problem loans. NAHB commends the Committee for exploring means to improve transparency in mortgage and mortgage securities transactions.

TITLE IV – Removing Barriers to New Investment

Home buyers and builders continue to confront challenging credit conditions, weighed down by strict underwriting requirements and an uncertain future regulatory environment. For home buyers, while mortgage rates have fallen to record lows, access to mortgage credit is limited to those with pristine credit histories who can qualify for government-backed programs. Presently, FHA, VA, Fannie Mae and Freddie Mac account for more than 90 percent of mortgage originations. Access to credit for home builders is even more constricted where, in the current regulatory climate, lenders are very reluctant to make acquisition, development and construction (AD&C) loans.

Since the beginning of the "Great Recession", Congress, the administration and independent agencies have taken significant actions in response to the financial crisis. The result is an avalanche of uncoordinated regulations from multiple federal agencies that will impact the cost and availability of housing credit.

The Dodd-Frank Act contained a number of provisions that initiated this regulatory overload. For instance, Dodd-Frank created the Consumer Financial Protection Bureau (CFPB), which has broad authority over consumer mortgages and has proposed and/or finalized rules on determining a consumer's ability to repay, establishing requirements for servicing mortgages, and revamping mortgage application documentation. Additionally, six other regulators proposed an onerous rule to implement the credit risk retention provisions of Dodd-Frank.

Also in the mix are the new Basel III rules from the federal banking regulators, which have set increased capital requirements for banks along with other provisions.

The cumulative impact of these rules has created overwhelming complexity and heightened compliance risks, which will ultimately increase costs to borrowers or prevent creditworthy and responsible borrowers from accessing mortgage credit.

Sec. 401. Basel III Impact Study

The Basel III regulatory capital final rule, issued by the Federal Reserve Board (Fed) on July 2, 2013 and confirmed by the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) on July 9, increases the quantity and quality of capital for all federally insured banking institutions and imposes additional thresholds for the largest banking organizations. Basel III will be phased in, beginning January 2014 for the largest banks; community banks have until January 2015 to comply.

This bill would direct the Fed, FDIC and OCC to conduct an empirical study of the Basel III regulatory capital rules. The study would provide important insight into the potential impact on the financial services sector, the cumulative impact on US economic growth, and the impact on the availability and cost of credit, and will help the regulators to implement effective capital requirements without obstructing much needed credit.

This bill would require that a final report be made available to the public for a notice and comment period, that Congress hold a hearing on this report, and that the federal banking agencies review the final rule based on the report and public comments. The bill would delay the final Basel III rules for at least two years for some financial institutions until the study is completed.

NAHB supports conducting a study of Basel III bank capital rules and delaying implementation of this rule until the study has been completed. The increased reserve requirements will significantly increase the capital that banks need to hold and may alter their business plans. NAHB is particularly concerned about adverse effects of Basel III on community banks, which are key sources of credit for both home buyers and home builders.

Sec. 403. Definition of Points and Fees

The PATH Act would make changes to certain provisions of the Ability-to-Repay (ATR) standard that was authorized by Dodd-Frank and promulgated by the CFPB.

The Ability-to-Repay standard sets minimum standards for mortgages by requiring lenders to establish that consumers have a reasonable ability to repay at the time the mortgage is originated, and provides that certain high-quality, low-cost loans (defined as Qualified Mortgages or QMs) are presumed to meet this standard. The CFPB issued a final ATR rule that will become effective on January 10, 2014. Since issuing the final rules in January, the CFPB has issued amendments to the ATR rule to clarify or change provisions of the rule in an effort to ensure a smooth transition.

Among other provisions, the final ATR rule limits the points and fees that can be charged to a borrower to 3 percent of the loan amount in order to qualify as a QM loan under the "ability to repay" regulations. Many industry stakeholders believe the 3 percent cap to be overly restrictive and ultimately could reduce the availability or increase the costs of credit to creditworthy borrowers. There are some exceptions to the 3 percent cap, including small loan amounts, but the rule differentiates point and fee calculations for affiliated and unaffiliated companies, including charges from affiliates but not from affiliated companies. This differential also exists for retail lender and brokered loans. These differentiations create competitive disadvantages for different business models for no apparent reason and would restrict consumers' choice of mortgage settlement services.

NAHB supports balancing mortgage credit availability and consumer protections. NAHB believes that loans should be prudently underwritten and adequately disclosed. NAHB also believes that it is critical that mortgage lending reforms are imposed in a manner that causes minimum disruptions to the mortgage markets while ensuring consumer protections. Great care must be taken to avoid further adverse changes in liquidity and affordability.

Therefore, NAHB supports amending the Truth in Lending Act to exempt certain affiliated business arrangements from the calculation of points and fees, as directed in this section.

Sec. 406. Effective Date of Certain Mortgage Reform Regulations

This section would extend the timeline for certain new mortgage regulations that were authorized by Dodd-Frank for an additional year.

NAHB supports this extension as it would provide much needed time for the lending institutions to adapt to the new regulations and would ensure that there is no disruption in the availability of mortgage credit.

Sec. 407. Repeal of Credit Risk Retention Regulations

This section would fully repeal Section 941: Regulation of credit risk retention, of Dodd-Frank, and would prohibit federal regulators from issuing any regulation that would require risk retention, the creation or maintenance of a premium capture cash reserve account, or any similar mechanism unless directed by Congress.
Sec. 941 of the DFA regulates credit risk retention by requiring loan originators and securitizers to hold at least five percent of the credit risk between them, with noted exemptions. Requiring lenders and securitizers to have "skin in the game" was intended to provide an incentive to ensure that loans are sound and borrowers are creditworthy.

In March 2011, six federal agencies (Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Securities and Exchange Commission and Department of Housing and Urban Development) released a proposed Credit Risk Retention rule to implement this DFA provision.

The proposed rule has far-ranging implications across the housing and development sectors. In particular, the rule includes exemptions to the risk retention requirements for Qualified Residential Mortgages (QRM) and Qualified Commercial Real Estate (QCRE) loans. The

regulators very narrowly defined these exemptions and proposed very conservative underwriting standards and requirements (including a 20 percent downpayment requirement) that will limit the number of loans eligible for these exemptions. In addition, the premium capture cash reserve account (PCCRA) provision has the potential to distort the securitization market and create a disincentive for private investors.

As stated earlier, NAHB supports steps to ensure that mortgage lending occurs in a safe and sound manner, with appropriate underwriting, prudent risk management and sound consumer safeguards and disclosure. The housing system and the economy have been affected deeply by the consequences of inappropriate underwriting standards and risky loan features. However, if the credit risk retention rule is finalized as proposed, it could be detrimental to the flow of mortgage credit. Therefore, NAHB supports the repeal of Section 941 of Dodd-Frank as an alternative to the proposed rule.

Sec. 409. Mortgage Loans Held in Portfolio

This provision would exempt mortgage loans held in the portfolio of the creditor that made the loan from the "Minimum standards for residential mortgage loans" ATR rules, mandatory escrow rules, and certain disclosure rules.

NAHB supports the exemption for depository institutions that hold loans in their portfolios from ATR rules and other Dodd-Frank requirements. The costs for community banks to comply with these rules are significant and will potentially limit an important source of responsible mortgage credit for consumers.

Sec. 411. Amendments to the Truth in Lending Act

This bill would amend the Truth in Lending Act, by establishing online and telephone housing counseling and allowing 40 year mortgages to be included in the definition of a QM. This section would also prohibit CFPB from establishing the 3-day rule for closing documents, eliminate the prohibition of prepayment penalties, eliminate single premium credit insurance, eliminate a prohibition of adding arbitration clauses to a mortgage contract, and exempt mandatory reporting requirements for appraisal violations from monetary penalties.

NAHB supports efforts to ensure the availability of sound mortgage products. There should be continued availability of financing for long-term (at least 30-year) fixed-rate mortgages, as well as mortgage products with well understood risk characteristics such as certain standard adjustable-rate mortgages and multifamily products. NAHB believes that mortgage maturities should also be available for longer than 30 years.

Sec. 412. Financial Institutions Examination Fairness and Reform

NAHB is pleased that Section 412 of the PATH Act discussion draft incorporates H.R. 1553, *The Financial Institutions Examination Fairness and Reform Act* to tackle the issue of overly restrictive bank examiner regulation. Introduced by Financial Institutions Subcommittee Chairman Shelley Moore Capito (R-WV) and Representative Carolyn Maloney (D-NY), the language in H.R. 1553 is intended to improve the examination of depository institutions and is strongly supported by NAHB.

NAHB believes that the provisions included in Section 412 of the PATH Act discussion draft would greatly benefit the housing industry and help alleviate the credit crisis that our members have been experiencing since 2008. As NAHB has communicated to this committee on numerous occasions, the home building industry continues to experience a significant lack of availability of land acquisition, land development and home construction (AD&C) loans and builders with outstanding loans often face challenges when seeking to modify their AD&C loans in order to have more time to complete projects and pay off loans. Lenders themselves often cite regulatory requirements or examiner pressure on banks to shrink their AD&C loan portfolios as reasons for their actions. While federal bank regulators maintain that they are not encouraging institutions to stop making loans or to indiscriminately liquidate outstanding loans, reports from NAHB members and lending institutions in a number of different geographies suggest the opposite. We hear that bank examiners in the field have adopted an aggressive stance against AD&C loans.

As a result of this regulatory pressure, the home building industry is having extreme difficulty in obtaining credit for viable projects. Builders with outstanding construction and development loans are experiencing intense pressure as the result of requirements for significant additional equity, denials on loan extensions, and demands for immediate repayment. In short, the credit window is very tight for builders, particularly small-to mid-sized builders, all over the country. NAHB has presented banking regulators with specific instances of credit restrictions, provided data showing no difference in credit access across market conditions; and requested specific changes to current regulatory guidance. To date, these efforts have not produced any tangible results. With the availability for housing production loans so limited, it is clear that congressional action is needed to help expand the flow of credit to home builders. Without such action, there can be no housing recovery, which has major implications for our nation's ability to recover from the current economic downturn.

Section 412 addresses concerns NAHB's members have expressed since the housing downturn with regard to how bank examiners have interpreted guidance from federal banking regulators with respect to performing loans, modified or restructured loans, appraisals where no new funds are extended, and classification of commercial loans where there has been deterioration in collateral value. NAHB specifically supports the examination standards in Section 412 that would require:

- A commercial loan cannot be placed in non-accrual status solely because the collateral has deteriorated in value.
- A modified or restructured commercial loan shall be removed from non-accrual status if the borrower demonstrates the ability to perform on such loan over a maximum period of six months. For loans that are on a quarterly, semiannual or longer repayment schedule such period shall be a maximum of three consecutive repayment periods.
- A new appraisal is not required on a performing commercial loan unless an advance of new funds is involved.
- In classifying a commercial loan in which there has been deterioration in collateral value, the amount to be classified shall be the portion of the deficiency relating to the decline in collateral value and repayment capacity of the borrower.

Moving forward, NAHB would like to work with the committee to include a definition of "commercial lending" in Section 412 that specifies the entire spectrum of such lending activity to

ensure that construction lending is not inadvertently excluded from the provisions of the overall section. Furthermore, NAHB would encourage the committee to consider adding language to eliminate use of the 100 percent of bank capital measurement as a hard cap that banks say federal banking examiners use to prohibit them from making loans to home builders. This provision, included in H.R. 1255, *the Home Construction Lending Regulatory Improvement Act*, would require bank regulators to follow their existing rules and not obstruct financial institutions' lending to our nation's small builders. Bank regulators would be directed to cease implementing a 100 percent of capital bank lending threshold for AD&C loans as a "hard" limit, rather than utilizing the 100 percent of capital guideline as it was intended. NAHB strongly believes that these suggested changes would both clarify and strengthen Section 412 for the home building industry.

Conclusion

Thank you for the opportunity to participate in today's important and timely hearing. NAHB looks forward to working with the Committee to create a sustainable housing finance system that will provide a reliable flow of housing credit under all economic and financial market conditions.

Georgetown University Law Center

Adam J. Levitin
Professor of Law

Written Testimony of

Adam J. Levitin
Professor of Law
Georgetown University Law Center

Before the
House Financial Services Committee

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013
1:00 pm
2021 Rayburn House Office Building

Witness Background Statement

Adam J. Levitin is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in structured finance, consumer finance, bankruptcy, contracts, and commercial law. Housing finance and securitization is a major focus of his scholarship.

Professor Levitin has previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP). Professor Levitin currently chairs the Mortgage Committee of the Consumer Financial Protection Bureau's Consumer Advisory Board.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College. In 2013 he was awarded the American Law Institute's Young Scholar's Medal.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony, and he is not testifying on behalf of any organization. The views expressed in his testimony are solely his own.

Mr. Chairman Hensarling, Ranking Member Waters, Members of the Committee:

Good afternoon. Thank you for inviting me to testify at this hearing. My name is Adam Levitin, and I am a Professor of Law at the Georgetown University, where I teach courses in structured finance, consumer finance, bankruptcy, and commercial law. I also chair the Mortgage Committee of the Consumer Financial Protection Bureau's Consumer Advisory Board and am a member of the Mortgage Finance Working Group sponsored by the Center for American Progress, which has put forth a proposal for GSE reform. I am here today, however, as an academic who has written extensively on housing finance and am not testifying on behalf of the CFPB, the Consumer Advisory Board, or the Mortgage Finance Working Group.

Today's hearing is focused on the Protecting American Taxpayers and Homeowners Act of 2013 (the "PATH Act"), a massive bill that proposes wide-ranging and radical reforms in the housing market. Unfortunately, the PATH Act is a path to ruin. The PATH Act takes us back to the future in the housing finance, encouraging the revival not only of predatory lending practices but also the structural problems that plagued the pre-New Deal housing finance market.

As the PATH Act is such an extensive bill, I do not attempt to address all of it in my written testimony. In particular, my written testimony does not generally address title II of the PATH Act dealing with the reform of FHA. Instead, my written testimony is focused on the PATH Act's provisions for winding down Fannie Mae and Freddie Mac and creating a new secondary market infrastructure.

In the ideal world, I would unequivocally prefer to see the U.S. housing finance system financed entirely with private capital. The government's involvement in the U.S. housing finance system carries with it serious concerns of moral hazard and politicized underwriting. Yet proposals like the PATH Act that would eliminate *any* government guarantee from the housing finance system are not a solution. Despite privatization's ideological appeal, **there is a fundamental problem with privatization proposals for the housing finance system: they don't work. Fully private housing finance systems simply do not exist in the developed world.** Every developed economy either has an explicit or implicit guarantee of its housing finance system, and there is every reason to favor an explicit guarantee, which can be prudently structured and priced, rather than an implicit guarantee.

Following the siren's song of privatization would take us back to the "Head– Wall Street wins; Tails–Main Street loses," world of pre-2008. Privatization would result in most American families being unable to obtain 30-year fixed-rate mortgages or lock in rates before closing. And privatization would place entire U.S. economy in grave peril because there is nowhere close to the sufficient private risk capital willing to assume credit risk on U.S. mortgages. Prudence and reality both dictate what is the consensus position: there needs to be some form of limited, explicit government guarantee in the housing finance market.

The PATH Act ignores this sensible consensus in favor of a bill that is both radical and reactionary:

- The PATH Act proposes a total privatization of the housing finance system despite the lack of private capital to support it. The result could be disastrous.
- The PATH Act makes 30-year fixed-rate mortgages difficult to obtain.
- The PATH Act makes it difficult for homebuyers to lock in interest rates prior to closing.

- The PATH Act breaches the federal debt ceiling.
- The PATH Act recreates the too-big-to-fail problem with covered bonds.
- The PATH Act encourages predatory lending by eliminating key Dodd-Frank anti-predatory lending provisions.
- The PATH Act bullies municipalities attempting to mitigate the foreclosure crisis by threatening to cut them out of the housing finance system.
- The PATH Act radically and possibly unconstitutional federalizes and then privatizes the real property recording system.

For all of these reasons, the PATH Act is the wrong path to follow for housing finance reform.

I. Overview of the PATH Act's GSE Reform Plan

The PATH Act would have the GSEs cease doing new business within five years and instead replace them with a National Mortgage Market Utility (the "Utility").[1] The Utility would be privately-owned and operated, but subject to supervision by the Federal Housing Finance Authority.[2] The Utility would operate an optional Common Securitization Platform that it would have purchased from the GSEs, which are tasked with its development.[3] Significantly, this Utility would not itself actually issue MBS and would be forbidden from guaranteeing MBS.[4] Instead, the Utility would set standards for issuance of MBS. MBS that conform to these standards would be considered "qualified securities" upon payment by the issuer of a fee to the Utility.[5] The Utility would also operate a National Mortgage Data Repository (the "Repository")—basically a giant privately-run national recorder of deeds office.

Thus, what the PATH Act envisions is private financial institutions aggregating mortgage loans and issuing MBS under the platform's rules and standards and using the Repository for recording their mortgage or deeds of trust. "Qualified securities" issued under the Utility's standards would be exempt from the Securities Act's registration requirements,[6] from the Consumer Financial Protection Bureau's Qualified Mortgage (QM) rulemaking,[7] and exemption from state law evidentiary requirements for foreclosures.[8] Significantly, nothing in the PATH Act prohibits financial institutions from engaging in mortgage securitization outside of the Utility.

[1] PATH Act §§ 104(a), 110.

[2] PATH Act §§ 310-311.

[3] PATH Act § 313. The appropriateness of the valuation for the purchase price of the Platform is likely to be questionable. Section 313(a) of the PATH Act requires the FHFA Director to "agree on a valuation of the Platform upon transfer to the Utility." In other words, there is no market test of the valuation of the Platform, but simply a deal in the context of a bilateral monopoly. There is a good possibility that this will result in a sweetheart deal for whatever private party is selected to operate the Platform.

[4] PATH Act § 312(c).

[5] PATH Act § 312(b). This standard-setting function is similar to what Ginnie Mae does. Ginnie Mae does not actually issue securities. Instead, it guarantees securities that conform to its underwriting requirements. Ginnie Mae securities are privately issued.

[6] PATH Act § 343.

[7] PATH Act § 342 (substituting a FHFA QM rulemaking for the CFPB rulemaking).

[8] PATH Act § 332.

The PATH Act would have FHA continue to operate with a focus on underserved markets,[9] but with drastically reduced insurance coverage: the FHA would provide no coverage for the first two years of the loan,[10] then 70% coverage in year three, 60% in year four, and 50% coverage thereafter,[11] instead of its current 100% coverage for the life of the loan. Lenders will likely charge higher rates to offset for this reduced coverage. The reduced coverage combined with potentially risk-based pricing[12] will make FHA loans a much less attractive option for borrowers and means that FHA will likely be a very small part of the market.[13]

II. The Illusion of Wholly Private Housing Finance Systems

The PATH Act represents an attempt to return to a wholly-private housing finance market, with all credit and interest rate risk on mortgages borne by private parties. Unfortunately, a truly private housing finance system is a pipedream. It simply does not exist in any developed country in modern times and never has. Every developed country either explicitly or implicitly guarantees some part of its housing finance system, and in the United States it is government involvement in the market that makes the long-term fixed-rate mortgage widely available. In some countries, like Canada, the guarantee is explicit—and priced—and the market is regulated to protect the government from excessive risk exposure. In other countries, the guarantee is implicit.[14] It is difficult to prove an implicit guarantee; the very nature of it is that

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[9] PATH Act § 212.

[10] PATH Act § 264.

[11] PATH Act § 234.

[12] PATH Act § 235(d).

[13] The PATH Act fails to reconcile reduced FHA coverage with the operations of Ginnie Mae. Ginnie Mae is subrogated to claims on FHA insurance policies when it pays on its bond insurance. Unless Ginnie Mae coverage is reduced to match reduced FHA coverage, Ginnie Mae will end up with the short-end of the stick or have to charge more for its insurance or reduce its insurance coverage, which would make Ginnie Mae MBS significantly less attractive to investors.

[14] Proponents of privatizing the housing finance system and eliminating the government guarantee will generally point to Germany and Denmark as examples of housing finance systems without a guarantee that have widely available long-term, fixed-rate mortgages. E.g., Peter J. Wallison, *A New Housing Finance System for the United States*, Mercatus Center Working Paper No. 11-08, *at* http://mercatus.org/sites/default/files/publication/wp1108-a-new-housing-finance-system-for-the-united-states_0.pdf, at 10 ("Neither Denmark nor Germany backs any part of the mortgage financing system, which seems to work well because of the regulatory assurances of mortgage quality."). Unfortunately, this view of the German and Danish housing finance systems is incorrect. Germany and Denmark both turn out to have been latent implicit guarantee cases prior to October 2010, at which point they became examples of explicit guarantees.

In October 2008, Germany created a Teutonic TARP known as the "Special Fund Financial Market Stabilization," or SoFFin (its German acronym) to bail out its banks. SoFFin provided nearly €150 billion to support ten financial institutions' liabilities, including those of three covered bond issuers and three Landesbanks (another type of German mortgage lender). *See* Bundesanstalt für Finanzdienstleistungsaufsicht, "Annual Report of the Federal Financial Supervisory Authority" (2008), available at http://www.bafin.de/cln_152/nn_720486/SharedDocs/Downloads/EN/Service/Jahresberichte/2008/annualreport__08__complete,templateId=raw,property=publicationFile.pdf/annualreport_08_complete.pdf.

Denmark also announced a broad guarantee of all deposits and senior debt issued by its banks in October 2008. *See* Neelie Kroes, "Guarantee scheme for banks in Denmark," European Commission Memorandum, State Aid NN51/2008 – Denmark," *available at* http://ec.europa.eu/community_law/state_aids/comp-2008/nn051-08.pdf. Denmark has a robust mortgage lending system financed by covered bonds—bonds issued by banks against mortgage collateral held on balance sheet. Formally, the Danish guarantee did not apply covered bonds, only to the deposits and senior debts of the banks that issued them. The functional reality of this arrangement, however, was to guarantee the covered bonds by guaranteeing that the issuers would have sufficient assets and liquidity to meet their

there is no clear proof. One can look at spreads between mortgage debt and government debt, for example, but that is not necessarily conclusive. Indeed, in the United States, GSE debt was explicitly *not* guaranteed by the federal government...until it was.

Try as we may, we cannot escape either history or the reality that the U.S. government will always bailout its housing finance system if it gets into trouble. We did that in 1932-34. We did so in 1970 by letting Fannie Mae purchase conventional mortgages and creating Freddie Mac with conventional mortgage authority. We did it with the S&Ls in the 1980s. We did it again in 2008. Catastrophic risk in housing finance is inevitably socialized, so it is best to recognized that truism and adapt our regulatory system to mitigate the risk. Pretending that is won't happen again is hardly a solution.

We do not have to like the existence of a government guarantee in housing finance. But the choice we face is between an implicit and an explicit guarantee, not between a guarantee and no guarantee. All government guarantees have clear problems—moral hazard because the government holds the credit risk, while private parties hold the upside, and the danger of politicized underwriting.

There are ways to try to guard against both problems. For example, moral hazard can be alleviated through use of deductibles and copayments—have first-loss private risk capital or loss splitting between the government and private capital. Administrative structures can guard against politicized underwriting. Those risk mitigants, however, require an explicit guarantee.

For better or worse, though, we need to accept that *some* form of a government guarantee, even if only for catastrophic losses, is required in our housing finance system. It cannot be confined to an FHA niche, but needs to be system-wide in part because of the serial correlation of housing prices and credit risk. The unique nature of housing finance as an enormous asset class that affects a wide swath of citizens and economic and social stability means that no U.S. government will permit the market's collapse: it would be economic and political suicide. The question then is not whether there should be a guarantee—we have one whether we want it or not—but how it should be structured.

III. The PATH Act Sets the Stage for a Return to Unregulated Private-Label Securitization

The PATH Act aims to create a *regulated* private-label securitization market. To be sure, this regulation is supposed to be done through a privately-owned utility, rather than through the government, but it is regulation nonetheless, just of the outsourced variety, much like the credit ratings agencies.[15] A regulated private-label securitization market is a reasonable approach to housing finance, but it is only as good as that regulation. To the extent that parts of the market are not regulated there will be seepage from the regulated to the unregulated space, much as happened with "shadow banking" and with the disastrous shift from Agency to unregulated private-label securitization in 2003-2007.

covered bond payment obligations so that the covered bondholders would never have to look to their cover pools of collateral for recovery.

[15] It is troubling that the rules affecting such a large swath of the U.S. economy would be exempt from notice-and-comment rulemaking and judicial review.

The PATH Act, however, eliminates the Dodd-Frank Act's regulation of the private-label securitization market—the so-called "skin-in-the-game" credit risk retention requirement.[16] The PATH Act also prohibits the regulatory imposition of credit risk retention requirements[17] and suspends the SEC's Reg AB II rulemaking that is intended to ensure better disclosure of information about securitizations to investors.[18] So far there have been no rulemakings under the skin-in-the-game requirement. While one might debate the wisdom of the particulars of a rule-making, the requirement of some type of skin-in-the-game for some securitizations is reasonable—indeed the market already requires it in some securitizations.[19]

The PATH Act does not substitute improved regulations for the ones it eliminates. Thus the PATH Act would return the private-label securitization market outside of the Utility to a virtually unregulated state, just as it was during the housing bubble.

In place of improved regulations for the entire private-label securitization market, the PATH Act substitutes *optional*, outsourced regulation. The PATH Act does not require that all private-label securitization be regulated, only that securitization done using the Utility be regulated by the privately-owned, but federally overseen Utility. Thus, banks are free to operate their own, unregulated securitization platforms, just as they did during the housing bubble.

The PATH Act attempts to encourage use of the Utility and thus regulated private-label securitization through a set of carrots. None of these carrots are sufficiently appetizing to matter, much less to offset the costs imposed by use of the PATH Act Utility. As a result, no one will use the PATH Act Utility. Banks will simply engage in unregulated private-label securitization outside of the Utility. The PATH Act is building a National Mortgage Market Utility to nowhere.

Of the benefits the come with using the PATH Act utility, the only one of real substance is exemption from the Securities Act's registration requirements, which is a prerequisite for a to-be-announced ("TBA") market.[20] Private label securitization was previously able to compete against registration-exempt GSE securities in the past and to operate without a TBA market (as does the rest of the developed world). The costs and hassle of registration are not large enough to make use of the Utility attractive and offset its fees and mandatory standards.

The PATH Act's other carrots are similarly insignificant. The exemption of "qualified securities" issued using the Utility from the CFPB's Qualified Mortgage ("QM") rulemaking that creates an exemption from the Dodd-Frank Act's ability to repay requirement is not much of a boon for securitization sponsors given that the PATH Act also eliminates the QM enforcement provision for *all mortgages*.[21] Similarly, exemption from state law evidentiary requirements for foreclosures,[22] is not of much consequence, as traditionally foreclosure rates are about 1% and relatively few foreclosures are determined by the technical state law evidentiary requirements. In short, it's not clear why anyone would use the PATH Act Utility. Instead, we are likely to see

[16] PATH Act § 407(a) (repealing Dodd-Frank Act section 941, *codified at* 15 U.S.C. § 78o-11).
[17] PATH Act § 407(b).
[18] PATH Act § 405.
[19] Adam J. Levitin, *Skin in the Game: Risk Retention Lessons from Credit Card Securitization*, 81 GEO. WASH. L. REV. 813 (2013).
[20] PATH Act § 343.
[21] PATH Act § 410 (eliminating section 1413 of the Dodd-Frank Act, which provides the remedy for failure to ensure ability to repay when making a mortgage loan). *See infra* section VIII for discussion.
[22] PATH Act § 332.

the GSEs replaced by unregulated private-label MBS and covered bonds. Both have problems, the foremost of which is the lack of market demand for mortgage credit risk.

IV. Lack of Market Demand for Mortgage Credit Risk

A mortgage carries two types of risks for investors: credit risk and interest rate risk. Credit risk is the risk that the borrower will default on the mortgage. Interest rate risk is the risk that interest rates will either rise—in which case the interest rate the investor earns on the mortgage will be below market—or that interest rates will fall—in which case the mortgage will now be at an above market rate, but with the borrower likely to refinance.

GSE and Ginnie Mae securitization ("Agency MBS") divides the credit risk from the interest rate risk. Investors in Agency MBS assume interest rate risk, but not credit risk. The credit risk is retained by Fannie, Freddie, or Ginnie, which often are insured for part or all of that risk, either through private mortgage insurers or through FHA insurance and VA guarantees.

In contrast, investors in private-label MBS assume both interest rate risk *and* credit risk. Yet in the past few MBS investors truly thought they were assuming more than *de minimis* credit risk: over 90% of private-label MBS were rated AAA at issuance by credit rating agencies. Investors who relied on these ratings understood the credit risk on these PLS to be negligible because of the quality of the underlying mortgages and various credit enhancements to the PLS, such as senior-subordinate credit structures, overcollateralization, excess spread accounts, and various types of insurance.

What this means is that the overwhelming majority of investors in the U.S. secondary mortgage market are not credit risk investors. Investors in Agency MBS are not credit risk investors, and most investors in PLS did not perceive themselves as assuming credit risk. Instead, most investors in the U.S. mortgage market are interest rate risk investors. There is approximately $6 trillion in interest-rate-risk-only investment in the US mortgage market.

Interest rate risk investors are very different types of investors than credit risk investors. Investing in credit risk successfully requires a different kind of diligence and expertise than interest rate risk investment. A large portion of the investment in U.S. mortgages is from foreign investors.[23] Chinese investment funds and Norwegian pension plans, for example, are unlikely to seek to assume credit risk on mortgages in a consumer credit market they do not know intimately. But interest rate risk is something that foreign investors are far better positioned to assume because it is highly correlated with expectations about U.S. Federal Reserve discount rates.

The PATH Act's elimination of the government guarantee (other than for a scaled-down FHA/Ginnie Mae) means that all credit risk on MBS would be borne by investors. There is no evidence that there is a substantial body of capital eager to assume credit risk on U.S. mortgages *at any interest rate*, much less at mortgage rates that would not be prohibitively expensive for borrowers. Even if private-label MBS were structured to remove most credit risk from some securities (thereby concentrating it in others), few investors are likely to trust credit ratings on MBS in the foreseeable future. The only way the Utility would get around this is through an implicit guarantee, which is the worst of all worlds.

[23] Ben S. Bernanke et al., *International Capital Flows and Returns to Safe Assets in the United States, 2003-2007*, Board of Governors of the Federal Reserve System International Finance Discussion Papers Number 1014, February 2011.

There is a frightening implication to this: the privatization of the secondary mortgage market could result in as much as $6 trillion in housing finance investment leaving the U.S. housing finance market rather than assuming credit risk. Even if only a third of this investment left the US market, the result would be an economic collapse on a scale far worse than in 2008, as housing prices would plummet nationwide. The PATH Act is gambling with the American economy based on ideological preferences, not evidence.

V. The Jumbo Market Does Not Provide Evidence of the Viability of a Large-Scale Private Market

Mortgages that are too large to qualify for purchase by the GSEs because of the statutory conforming loan limit are known as "jumbo" mortgages. There is a private securitization market in jumbo mortgages. In the jumbo market, investors assume both interest risk and credit risk. Advocates of privatization often claim that the existence of the jumbo market is proof that a securitization market can function without a government guarantee. This argument ignores the small size of the jumbo market and the numerous ways in which it piggybacks on the Agency market. In fact, the jumbo market in fact indicates that there is a quite limited demand of credit risk on U.S. mortgages, and certainly not enough to sustain the entire market absent a government guarantee.

The jumbo market overall is substantially smaller than the conforming market. The jumbo market overall is only perhaps 10-15% of all originations by either volume or dollar amount. In 2011, there were $203 billion in jumbo originations, when the entire market was $1.35 trillion in originations. This figure is roughly in keeping with pre-2008 ratios, and jumbos have never been more than a quarter of the total market.

What's more, the securitization rate for jumbo loans is substantially lower, which has resulted in a much smaller amount of jumbo mortgage-backed securities issued than GSE MBS. Jumbos' lower securitization rate is itself strong evidence of limited investor demand of credit risk on U.S. mortgages—at least at interest rates less than those borne on subprime loans.

The prime jumbo market does function without a government guarantee, but it also benefits from the existence of a government guarantee indirectly in multiple ways. For example, jumbo portfolio lenders hedge their interest rate risk by investing in GSE securities.[24] Advance rate lock-ins on jumbos are available because jumbo lenders can largely hedge their rate risk using the conforming TBA market. The jumbo market has also long aped the standards set by the GSEs in the conforming market, including amortization, maturity lengths, and appraisal standards. Finally, the jumbo market has benefitted from the stability in housing prices and overall systemic stability created by the government guarantee in the conforming market given the serial correlation of housing prices. Indeed, the virtual disappearance of the jumbo market following the financial collapse in 2008 draws into question whether this market is in fact viable; the spillover benefits from the guarantee in the conforming market have not been enough to resuscitate the jumbo market.

The jumbo market demonstrates that there are *some* investors who are willing to assume credit risk on U.S. mortgages. But investors in the vast majority of the $6 trillion plus in U.S. mortgage securities outstanding are interest rate investors, and it is difficult to imagine them transforming into credit risk investors over several years, much less immediately. Sufficiently

[24] Frank E. Nothaft, *Lessons from the Jumbo Market*, 1996 Mortgage Market Trends 12 (1996).

high yields would no doubt lure some of them into accepting credit risk—but that translates into much higher mortgage interest rates, which in turn increases the credit risk on the mortgages. And even higher yields will not be sufficient to induce investors who have no interest in assuming credit risk to buy into the U.S. mortgage market. The fundamental problem with any housing finance privatization proposal is that there just isn't sufficient capital interested in credit risk on U.S. mortgages. Ideology cannot substitute for market demand.

VI. THE PRIVATE-LABEL SECURITIZATION MARKET WILL NOT PRODUCE WIDELY AVAILABLE 30-YEAR FIXED RATE MORTGAGES

Privatization advocates also claim that the presence of jumbo 30-year fixed rate mortgages ("FRMs") demonstrates that a private market will continue to produce 30-year FRMs.[25] This is a strawman argument. No one claims that the 30-year FRM will entirely disappear with privatization. Instead, privatization will turn it into a niche product that is not widely available to American families.

The fully prepayable 30-year fixed-rate mortgage is a uniquely American and uniquely consumer friendly product that furthers economic stability and monetary policy. The 30-year FRM is the crown jewel of the American housing finance system. Its long amortization period lowers mandatory monthly payments. The fixed rate shields households from inflation and facilitates stabile household budgeting. The ability to prepay enables consumers to take advantage of improved rate environments and to pay down the mortgage faster if they have excess funds. And the prepayment feature greatly facilitates Federal Reserve monetary policy by enabling lower interest rates to easily translate into greater disposable income for consumers and increased consumer spending in the real economy. 30-year FRMs underwritten with full documentation did not blow up in the housing bubble. Any restructuring of the system should start with the question of how to ensure the widespread availability of the 30-year FRM.

History indicates that the private market will not produce 30-year FRMs in any volume. Long-term fixed-rate mortgages were virtually unheard of in the United States prior to the federal government's entrance into the housing finance market during the New Deal. Instead, the pre-New Deal private market produced short-term "bullet loans"—non-amortized, interest-only 3-5 year FRMs that had to be frequently rolled-over before the "bullet payment" of the entire principal came due. If the borrower's credit quality declined, if interest rates had increased, or if the market was frozen, the borrower had to bite the bullet and come up with the cash to pay off the entire principal.

This sort of bullet loan structure is exactly what the private-label securitization market returned to during the bubble years: loans with short 2-5 year teaser rates, sometimes interest-only or even negatively amortizing, before a major rate reset. These loans were expected to refinanced before the rate reset. We know the result.

Similarly, the fully private commercial mortgage market—which operates using both portfolio lending and securitization—rarely produces fully amortized 30-year FRMs. Instead, the standard commercial mortgage product is a 10-year interest-only loan. Prepayment penalties or yield-maintenance clauses are common, and it is rare to find fixed-rates for commercial loans

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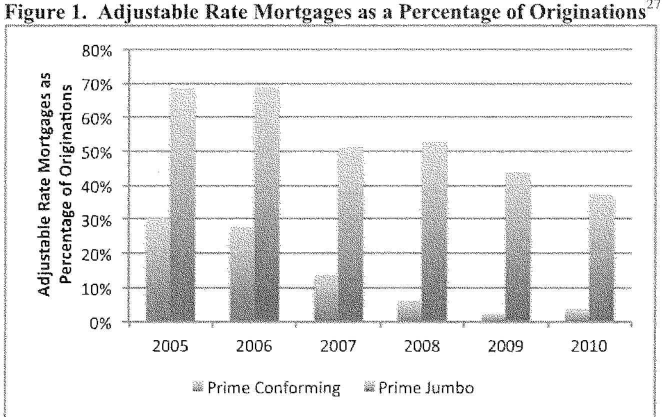
[25] *See, e.g.*, Testimony before the Senate Banking Committee, Peter Wallison, Arthur F. Burns Fellow in Financial Policy Studies, American Enterprise Institute (Mar. 2013) (noting that there are Google results for the search "30-year jumbo fixed rate mortgage.")

of periods beyond 10 years. Left to its own devices the private market eschews long-term fixed-rate loans.

The jumbo market does produce 30-year FRMs. But it only produces a very small number of them. Jumbos are only a small percentage of the market overall, and only a minority of jumbos are FRMs, and not all of those are 30-year maturities. Even in the extreme low-rate environment of 2009-2010, over a third of jumbos were adjustable rate mortgages ("ARMs"), compared with less than 5% of prime conforming loans. As Figure 1, below, shows, the jumbo market (Prime jumbos) contains a considerably higher percentage of ARMs than the GSE market (Prime Conforming). The private jumbo market simply does not produce very many 30-year FRMs. In fact, ***in recent years jumbo FRMs have been only 4% of the entire mortgage market.*** 30-year jumbo FRMs may be advertised on websites, as privatization proponents have noted,[26] but in practice they are rare. The existence of a small number of FRMs in the relatively small jumbo market is not a basis for assuming that the market will produce 30-year FRMs on any scale absent a government guarantee.

Figure 1. Adjustable Rate Mortgages as a Percentage of Originations[27]



VII. THE PATH ACT WILL MAKE IT IMPOSSIBLE FOR HOMEBUYERS TO LOCK IN RATES IN ADVANCE AND WILL RESULT IN GEOGRAPHICAL PRICE DISCRIMINATION

One of the marvels of the US housing finance market is the ability of homebuyers to lock in rates as much as 90 days prior to closing. This is a feature that is unheard of elsewhere in world. The ability to lock in rates in advance is a considerable benefit to both buyers and sellers. It allows buyers to be pre-qualified for a mortgage and thus know in advance how much they are able to spend on a home purchase. This certainty allows sellers to maximize sale prices because prices do not need to be discounted for the uncertainty of financing rates. The result is to enhance the liquidity of the US housing market and boost housing prices accordingly.

[26] *See* Wallison, *supra* note 25.

[27] Emanuel Moench, James Vickery, & Diego Aragon, *Why Is the Market Share of Adjustable Rate Mortgages So Low?* 16 CURRENT ISSUES IN ECON. & FIN. 1, 3 (Fed. Reserve Bank of N.Y. 2010).

Homebuyers are able to lock in rates in advance because lenders are able to do so themselves by selling advanced commitments in the form of forward contracts on the "To-Be-Announced" ("TBA") market. The TBA market is a market of forward contracts in MBS. The TBA market exists only for GSE MBS; jumbos and other private-label MBS do not trade in the TBA market.[28] Thus, to the extent that a borrower can lock in a jumbo rate in advance, the lender must assume the rate risk in this duration. Lenders are willing to do so in part because they can largely hedge the rate risk on the jumbo through offsetting sales in the TBA market.

The TBA market is able to function solely because the GSEs' MBS are exempt from the registration requirements of the federal securities laws. Because the TBA market involves the sale of MBS *before the MBS have been created*, it is impossible for those MBS to be registered with the SEC.[29] Section 343 of the PATH Act would create an exemption from the registration requirements of the Securities Act of 1933 for "qualified securities" that are issued using the Common Securitization Platform.

Despite the Securities Act exemption, the PATH Act is still likely to destroy the TBA market by destroying the high degree of fungibility that exists between GSE MBS. There is variation among the GSE securities that trade in the TBA market, but they also all share three key features that help homogenize the GSE MBS: (1) all credit risk is held by the GSEs; (2) all are pass-through securities; and the (3) geographic composition of the pools cannot be determined by investors. The variations among GSE MBS that trade TBA are relatively minor.

None of these common features would exist for the "qualified securities" issued using the Common Securitization Platform, and there would be even less fungibility among the covered bonds that the PATH Act authorizes. Credit risk on "qualified securities" would be held by the MBS investors and would vary in part based on the financial strength of the issuer that makes the representations and warranties about the quality of the securitized mortgages. As a result, these securities are very likely to be structured for create credit enhancement, rather than pass-throughs. Structuring would destroy fungibility, as the credit enhancements would vary between individual MBS. And because investors would bear credit risk, they would demand to know information such as geographic composition of pools, as they already do for private-label MBS.

The result will be geographic price discrimination, with higher interest rates experienced in parts of the country that are perceived of as riskier, either in terms of credit risk or in terms of prepayment risk (such as states with greater population mobility). Almost assuredly, the result of the PATH Act would be that the South and West would face higher mortgage rates, just as they did before the entry of the federal government into the housing finance market. The PATH Act will undermine the TBA market and make it extremely difficult for borrowers to lock in mortgage rates 60-90 days before closing.

VIII. The PATH Act Would Have Extreme Ramifications for the Federal Balance Sheet and Would Result in the Government Breaching the Debt Ceiling

Currently the GSEs' enormous books of assets and liabilities are not on the federal balance sheet, as they only have *de facto*, not *de jure* backing from the federal government.

[28] So-called "conforming jumbos" or "high balance" conforming loans have traded in the TBA market since 2008, after the conforming loan limits were temporarily raised under the Economic Stimulus Act of 2008, but these loans are guaranteed by the GSEs and should not be confused with traditional Jumbos.

[29] 12 U.S.C. § 1455(g) (Freddie Mac exemption); 12 U.S.C. 1717(c) (Fannie Mae exemption).

Accordingly, the GSEs' liabilities are not permitted to appear on the federal balance sheet.[30] The PATH Act, however, pledges the full faith and credit of the United States to repay the GSE's debt securities, MBS, and other financial obligations.[31] The effect of doing so would be to put all of those outstanding GSE obligations on the federal balance sheet. The PATH Act will cause $6.1 trillion in debt to appear on the federal balance sheet.[32] While the federal debt ceiling was raised in May 2013 to $16.699 trillion, placing the GSEs' outstanding obligations on the federal balance sheet will cause the government to breach the debt ceiling.[33]

IX. The PATH Act Encourages Too-Big-to-Fail via Covered Bond Programs

The PATH Act seeks to supplement private-label securitization through broader authorization of covered bonds. Covered bonds are simply bonds are secured by a "cover pool" of mortgages. The cover pool is over-collateralized relative to the principal due on the bonds and must be periodically refreshed if it becomes insufficiently collateralized. If the cover pool proves inadequate, the covered bondholders have recourse to the other assets of the issuer, typically a band. Covered bond programs are used widely in Europe for housing finance.

The key problem with covered bond programs is that they reinforce the too-big-to-fail problem that plagues the US financial services industry. (Covered bonds also reduce assets available to satisfy the FDIC's claims in a receivership.) Covered bonds basically recreate Fannie Mae and Freddie Mac. Investors in covered bonds assume the rate risk on the bonds, but the credit risk on the covered bond issuers, just like Fannie/Freddie MBS investors. This risk allocation structure has two implications.

First, it means that covered bond issuers are likely to be bailed out by the federal government. This is because the failure of one covered bond issuer could set off a panic throughout covered bond markets, much as we saw with the SIVs in the summer of 2007 and with thrifts in the summer-fall of 2008. To be sure, the PATH Act provides for the separation of cover pools from failed covered bond issuers, but investors are still likely to incur losses in those separated cover pools.

In fact, in 2008-2009, covered bond issuers were bailed out in the world's largest covered bond market, Germany. Germany provided support to three large covered bond issuers "leading to perceptions that the German authorities are prepared to offer systemic support to the *Pfandbrief* [covered bond] bank."[34] Germany was not prepared to allow even one of its covered bond issuers to fail, even though arguably no single issuer was a systemically important financial institution. As the International Monetary Fund has observed, "the relevance of *Pfandbrief*

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[30] 31 U.S.C. § 1501(a).

[31] PATH Act § 109 (29:22-30:2).

[32] Indeed, even if the provision were only to go into effect five years after the effective date of the PATH Act (it is not currently so drafted), it would still have a large effect on the federal balance sheet.

[33] Similarly, the PATH Act's deficit reduction provision is entirely illusory. Section 110 proposes that after five years all GSE guarantee fee revenue would be diverted to Treasury with an earmark for deficit reduction. Section 110, however, would also end all new GSE business within five years. If the GSEs are not doing any new business, there would not be any guarantee fee revenue to divert to Treasury. The PATH Act's deficit reduction is entirely illusory.

[34] International Monetary Fund, *Germany: Technical Note on the Future of German Mortgage-Backed Covered Bond (Pfandbrief) and Securitization* Markets, IMF Country Report No. 11/369, Dec. 2011, at 30.

[covered bond] issuance for bank funding may make it difficult to resist call for the bailout of a distressed issuer if authorities are determined to keep this important market open."[35]

Second, the risk allocation structure means that larger financial institutions will have a funding advantage for covered bonds because they are too-big-to-fail. Investors will perceive covered bonds issued by too-big-to-fail banks as implicitly guaranteed by the government, just as they viewed Fannie/Freddie securities. Larger covered bond issuers are more likely to be bailed out than smaller ones. Unless one truly believes that the Dodd-Frank Act ended bailouts, then covered bonds will merely recreate Fannie and Freddie in the guise of the nation's largest banks. Covered bond issuance on any scale reinforces too-big-to-fail.

X. The PATH Act Encourages Predatory Lending

Some of the most concerning provisions of the PATH Act are those that repeal key anti-predatory laws.[36] The centerpiece of the federal anti-predatory lending provisions is the prohibition on the origination of mortgages without verification of the borrower's ability to repay.[37] Relatedly, federal law also prohibits the payment of yield-spread premiums to mortgage brokers.[38] Yield-spread premiums were payments to brokers for steering borrowers into more expensive loans, and were paid by lenders out of the additional loan charges. The CFPB has already promulgated a widely-praised, balanced rulemaking [39] for the ability-to-repay requirement, known as the Qualified Mortgage or QM rulemaking.[40] The rulemaking is set to become effective on January 10, 2014. Section 406 of the PATH Act, however, would postpone its effective date under January 10, 2015, resulting in another year's delay of the QM rule.

Section 410 of the PATH Act would eliminate *for all mortgages* the remedy provision for failure of verification of the borrower's ability to repay and for the payment of a yield-spread premium on a broker.[41] It provides a recoupment or setoff defense to foreclosure in the event that the lender failed to verify the borrower's income or paid a yield-spread premium. By deleting this remedy provision, the PATH Act renders the ability-to-repay requirement and yield-spread premium prohibitions toothless.[42]

PATH Act section 408 would exempt "qualified securities"—private-label MBS issued using the Utility—from the ability-to-repay requirement, while PATH Act section 409(b) would exempt all loans held in portfolio from the ability-to-repay requirement. Thus, only private-label securities not issued through the Utility would be subject to the ability-to-repay requirement, but for these loans the ability-to-repay requirement would have little import because PATH Act section 410 would eliminate the remedy provision for the ability-to-repay requirement. In short, no one would have to bother verifying borrower's ability to repay under the PATH Act.

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[35] *Id.* at 5.

[36] Relatedly, section 107 of the PATH Act would restrict the GSEs to purchasing only "qualified mortgages," as that term is defined under Consumer Financial Protection Bureau regulations. It is not clear what this provision is intended to accomplish, as the CFPB has defined QM to incorporate GSE underwriting standards. 12 C.F.R. § 1026.43(e)(4)(ii)(A)(1)-(2). The result is the legislative equivalent of an infinite loop.

[37] 15 U.S.C. § 1639c.

[38] 15 U.S.C. § 1639b(c).

[39] Rachel Witkowski, *CFPB Hits Home Run on Mortgage Rule Revisions*, AM. BANKER, May 30, 2013.

[40] 78 F.R. 6407-6620 (Jan. 30 2014), *codified at* 12 C.F.R. pt. 1026.

[41] PATH Act § 410 (repealing Dodd-Frank Act section 1413 (*codified at* 15 U.S.C. § 1640(k))).

[42] Arguably there could still be regulatory enforcement of the ability-to-repay requirement, but that will do little to help the individual homeowners who have been harmed.

PATH Act sections 409(b), 410, and 411 are similarly aimed at enabling predatory mortgage lending. The Home Owners Equity Protection Act (HOEPA) has long tagged certain high-cost mortgage loans for extra regulation because of a concern that these loans are likely to be predatory and taking advantage of the borrower's lack of sophistication or bargaining power. In addition to gutting the ability-to-repay requirement, PATH Act section 410 repeals Dodd-Frank Act's amendments to HOEPA. The expanded the definition of a HOEPA loan[43] and prohibited balloon payments on HOEPA loans.[44] The PATH Act would thus permit balloon payments on possibly predatory mortgage loans and narrow the definition of these HOEPA loans.

PATH Act section 409(b) would eliminate tax and insurance escrow requirements for high-cost loans for portfolio lenders. Mandatory escrow accounts for taxes and insurance are also required under the Dodd-Frank Act for high-cost loans.[45] This requirement is to protect homeowners from losing their home and their equity investment shortly after purchase because of failure to pay taxes or insurance. The CFPB currently has explicit regulatory authority to exempt portfolio lenders from the high-cost loan escrow requirement, but chose not to grant an exemption to portfolio lenders as part of its escrow requirement rulemaking.[46] The CFPB did grant an exemption to certain rural mortgage lenders.[47] Rather than defer to regulatory expertise, section 409(b) of the PATH Act would give a green light to predatory lenders failing to escrow for taxes and insurance, which often paves the way for foreclosure.

In a similar vein, PATH Act section 411 permits borrowers to waive the additional disclosures required for HOEPA loans. This is a particularly pernicious provision because the unsophisticated or desperate borrowers HOEPA seeks to protect are precisely the type who would be likely to waive its provisions. With provisions like sections 408, 409, 410, and 411, the PATH Act is encouraging a return of the predatory lending.

XI. THE PATH ACT BULLIES MUNICIPALITIES LOOKING FOR A SOLUTION TO THE FORECLOSURE CRISIS

The PATH Act includes a pair of provisions, sections 108 and 226, that would prohibit the GSEs or FHA respectively from purchasing or insuring mortgages in municipalities that had exercised their legal eminent domain power to seize a mortgage in exchange for its fair value for a public purpose within the previous five years. These provisions are in response to the proposal considered, but not adopted by several municipalities, to use eminent domain to seize and restructure distressed mortgages. The thinking behind the eminent domain proposals is that by forcing such a restructuring, the municipalities may be able to prevent unnecessary foreclosures and bypass incompetent and conflicted mortgage servicers and avoid the serious externalities that foreclosures impose on neighboring homeowners, on tax bases, and on communities.

The wisdom and ultimate economic feasibility of eminent domain proposals are debatable. Yet two things are clear. First, the use of eminent domain in this context is hardly "constitutionally-suspect" as has been alleged. There are well-established Supreme Court precedents that indicate that eminent domain proposals would neither violate the 5th Amendment

[43] 15 U.S.C. §§ 1602(aa)(1), 1602(dd) (Dodd-Frank Act § 1431).
[44] 15 U.S.C. § 1639(e) (Dodd-Frank Act § 1432).
[45] 15 U.S.C. § 1639d.
[46] 15 U.S.C. § 1639d(c)(3); 78 F.R. 4725-4757, *codified at* 12 C.F.R. pt. 1026.
[47] 78 F.R. 4725-4757, *codified at* 12 C.F.R. pt. 1026.

Takings Clause or the Contracts Clause.[48] No serious legal analyst would conclude that eminent domain proposal is on anything but solid legal ground. In any case, Congressional action is unnecessary, as the courts will police the constitutionality of the proposals.

Second, as the PATH Act itself recognizes, there are serious problems in mortgage servicing, including conflicts of interest between mortgage servicers and mortgage investors. Section 414 of the PATH Act prohibits mortgage servicers from having an interest in junior liens on the properties on which they service the first mortgage. It is only reasonable for municipalities to seek a solution to this problem, as they bear some of its costs, and they have no tool other than eminent domain. There are better solutions to dealing with the foreclosure crisis than eminent domain, but Congress has repeatedly failed to pass legislation alleviating the foreclosure crisis, not least because of the concerted opposition of some of the sponsors of the PATH Act.

It is unreasonable to recognize the dilemma faced by municipalities with a provision like section 414, and then threaten them with provisions like PATH Act sections 108 and 226 when the municipalities try to use the only tool they have for dealing with the foreclosure crisis. It may also be unconstitutional by depriving the municipalities of their 10th amendment rights.[49] PATH Act sections 108 and 226 are a distraction from the serious work of GSE reform.

XII. The PATH Act Would Recreate MERS and Engage in a Radical Privatization Land Records

The PATH Act would create a National Mortgage Data Repository—a privately owned and operated national recorder of deeds office. The concept behind the Repository is at once radical, pernicious, and unconstitutional.

Since 2007 there have been thousands of court cases contesting foreclosures on the basis of mortgage lenders' inability to prove that they have standing to foreclose.[50] These cases are ultimately about conflicting and competing laws governing the transfer and enforcement of notes and security instruments. Much of the confusion is the mortgage industry's own fault. The mortgage industry muddied the law on the transfer and enforcement of mortgages and was less than punctilious in its paperwork practices. To wit, the mortgage industry created a private mortgage registry, known as the Mortgage Electronic Registration System (MERS), in order to avoid paying local mortgage recording taxes. Unfortunately, MERS is often a poor fit with state law and the MERS database is replete with inaccuracies.[51] Moreover, the mortgage industry pushed through changes in Article 9 of the Uniform Commercial Code that have created confusion as to what is required to transfer and enforce mortgage notes. Compliance with Article 9's provisions cannot be proven for many securitization deals.

These are problems that are getting worked through in the courts and state legislatures. They are not always being resolved the way the mortgage industry likes, however, so now with

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48 *See, e.g., Kelo v. City of New London*, 545 U.S. 469 (2005); *Home Building & Loan Association v. Blaisdell*, 290 U.S. 398 (1934).

49 There may also be privileges and immunities clause problems with the provision penalizing innocent residents who moved to municipalities in the five years after the eminent domain was exercised.

50 *See* Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 DUKE L.J. (forthcoming 2013).

51 I served as a Volunteer Deputy Attorney General for the State of Delaware for a suit against MERS for violating Delaware's unfair trade practices statute. The suit resulted in a settlement.

the PATH Act we see an attempt to solve the problem by creating a new federally-authorized MERS in the form of the proposed Repository.

There are several problems with the Repository. First and foremost is the motivation for its creation. There is a reasonable case to be made for having solely federal regulation of mortgage finance. That would be a rational way to design the system from scratch (although it may not work within the Constitution).[52] But that is not what is motivating the PATH Act's proposal for a Repository. Instead, the sole purpose of the proposal is to help mortgage lenders avoid dealing with pesky things like state law rules of evidence. Thus, PATH Act section 332 provides that a "proper demonstration of registration with the Repository" is sufficient to satisfy various state law evidentiary requirements for prosecuting foreclosures. In other words, mortgage lenders are exempt from the state law evidentiary rules. This is the wrong reason to create a federal mortgage registry.

The second problem with the Repository proposal is that it would functionally prohibit county level land recordation or render it of limited value. Section 316(b) of the PATH Act bans other private mortgage registries and also bans state registries to the extent they conflict with Repository. The effect is necessarily to put county land registries out of business. In roughly half the states (so-called "title theory" states) a mortgage is considered a sale of a property. Accordingly, mortgages and mortgage assignments need to be recorded in county land records for chains of property title to be clear. It is hard to see how these states could continue recording deeds to property without running afoul of section 316(b) of the PATH Act. In the other half of the states (so-called "lien theory" states) a mortgage is considered merely a security interest, but even so the Repository's separation of mortgage recordation from land title recordation makes it impossible to determine who has clear title to real property from the county land records.

The effect, then, of the PATH Act, would be to privatize what has long been a core governmental function, namely the maintenance of title to real property. This is an unprecedented and ill-advised step and a third problem with the PATH Act Repository. We do not have records to vehicles, boats, airplanes, patents, trademarks, or even household goods operated privately. We trust government and only government as an honest steward of these records. We do have regulated private registries for securities—especially the Depository Trust Company (DTC)—but a system that works for sophisticated investors against the backdrop of uniform law is not the type of system that should be adopted for dealing with rights in people's homes that vary based on state. What's more, the PATH Act would exculpate the Repository from private liability for mistakes, meaning that there would be no meaningful relief for homeowners who were harmed because of the negligence of a private party.[53] If we have learned anything from the experience with MERS it is that private parties should not be trusted to run mortgage registries.

A fourth problem with the Repository relates to its treatment of state and local real estate recording taxes and fees. It is also unclear whether transfers of mortgages in the Repository would be subject to state and local real estate recording fees and taxes. If so, the benefits of the Repository are quite small: the Repository's only purpose would be to exempt mortgage lenders

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[52] A federal mortgage registry should be operated by a government entity (probably housed within the CFPB), and would need to address the local to federal revenue transfer.

[53] PATH Act § 334.

from state law rules of evidence for proving debts. There is no reason that mortgage lenders should not have to follow the law like all other creditors.

If transfers of mortgages in the Repository are not subject to local, however, the creation of the Repository would represent an enormous expropriation of local government revenue for the benefit of a privately-owned Repository (which would charge its own fees). Local governments around the country depend on revenue from real estate recording fees and taxes.

Finally, the creation of a federally-authorized mortgage Repository may in fact not be Constitutional, as it arrogates to the federal government a traditional state function that is arguably among the rights reserved to the states under the 10th Amendment. The PATH Act Repository is the wrong solution to a mess of the mortgage industry's own creation.

XIII. Moves in the Right Direction

The PATH Act is the wrong blueprint for reforming the housing finance market. It does, however, get a few critical things right and these features should be incorporated in any reform of the housing finance system.

First, the PATH Act recognizes the importance of standardization in MBS and attempts to encourage it. Greater standardization of MBS—from loan underwriting and documentation to aggregation and securitization practices and documentation to securitization structures—should be a major goal of any housing finance reform bill, as standardization will make the housing finance market more liquid and also facilitate investor diligence.[54] The PATH Act's Utility would create standardized MBS,[55] but unfortunately they would have to compete with non-standard private-label MBS.

Second, the PATH Act creates only a single government-sponsored securitization platform. While I disagree with the powers and structure of this platform, the PATH Act is correct to have a single platform, rather than multiple competing platforms. The existence of multiple competing platforms could easily result in a race to the bottom in credit standards as platforms compete for market share. Indeed, this is a very possible outcome of the Dodd-Frank Act's mandate for derivatives to clear through clearinghouses.[56]

Third, title III of the PATH Act recognizes the need for improvements in servicing standards and trustee standards and rightly defers to provisions of the Trust Indenture Act of 1939. Section 414 of the PATH Act, prohibiting servicers of first liens from having an ownership stake in second liens secured by the same properties, is a first step in dealing with servicer conflicts of interests, and section 322(d), (e), and (h) anticipate improved servicing and trusteeship standards. The servicer and trustee problems in structured finance are serious ones,

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[54] Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177, 1252-58 (2012).

[55] PATH Act § 322(b).

[56] *See* Adam J. Levitin, *The Tenuous Case for Derivatives Clearinghouses*, 101 GEO. L.J. 445 (2013). Contrary to popular belief, the current Fannie-Freddie system did not evolve because Congress believed there a need for competition to Fannie. It evolved in 1970 when Fannie was permitted to purchase conventional mortgages. Previously, Fannie had only dealt with FHA/VA mortgages, and its sellers were primarily mortgage banks. The conventional market was dominated by savings and loans, which feared that Fannie would be too solicitous to the mortgage banks, so the S&Ls demanded their own secondary market utility. In short, there is not a competition story, but a political interest group story. *See* Adam J. Levitin & Susan M. Wachter, *The Public Option in Housing Finance*, 46 U.C. DAVIS L. REV. 1111, 1160 (2013).

and I appreciate that the PATH Act attempts to address them. The steps proposed by the PATH Act may themselves be insufficient to deal with the problem that securitization trustees get their business from issuers who are affiliate with servicers, not from investors and therefore are not incentivized to vigorously police issuers or servicers, lest they bite the hand that feeds them. I would urge the Committee to pursue investors' servicer-trustee problem further.

Finally, and relatedly, the PATH Act recognizes the problem of "silent seconds," namely the subsequent creation of junior liens on a property without the knowledge of the first lienholder. The creation of a junior lien negatively affects the first lienholder by making the borrower riskier. I am pleased that the PATH Act recognizes this problem and attempts to address it via section 413, which requires the servicers of junior liens to inform the servicers of senior liens of the existence of the junior liens. Unfortunately, the Section 413 does not solve the problem as it has no timing requirement for the notice and no enforcement provision or remedy for failure to notify.

Prior to the enactment of the Garn-St. Germain Act in 1982, "due on sale" clauses in mortgages would often make the encumbering of a property with a junior liens an event of default, allowing the first lienholder to accelerate the loan and demand immediate repayment. The Garn-St. Germain Act prohibited due on sale provisions triggered by the creation of junior liens.[57] The result was that first mortgage lenders lost control of the combined loan-to-value ratio on the property. This proved disastrous during the housing bubble. Notably, Texas avoided the worst of the bubble despite having a large population of subprime borrowers because state law severely restricted junior mortgages.[58]

The inability of first lien lenders to control the total LTV on a property is a major problem, and one solution that Congress should consider is repealing the Garn-St. Germain provision to enable senior lienholders to protect themselves from subsequent over-leveraging of collateral properties. Section 413 will not solve the silent seconds problem, but is a step in the right direction.

CONCLUSION

The PATH Act is the wrong path for reforming our housing finance system. The PATH Act encourages the worst practices of the housing bubble: predatory lending, unregulated private-label securitization, and MERS. The PATH Act is a reckless gamble with the American economy based on a naïve faith in private markets that have repeatedly failed in the past.

We need to acknowledge that the importance of housing finance to the economy and social stability means that no government will ever let the market collapse. There will be a guarantee one way or another, explicit or implicit. The housing finance market needs to be reformed. But rather than flirting with an unrealistic and dangerous privatization of the housing finance market, there needs to be a serious and sober consideration of how best to structure and price the government guarantee of the housing finance system while ensuring the widespread availability of the long-term, fully-prepayable, fully-amortized, fixed-rate mortgage.

[57] 12 U.S.C. § 1701j-3(d)(1).
[58] Texas Constitution, art. XVI, § 50(a).

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

William A. Loving, Jr.

President and CEO of Pendleton Community Bank

Franklin, WV

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representative

Committee on Financial Services

Hearing on

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

Washington, D.C.

Chairman Hensarling, Ranking Member Waters, and members of the committee, my name is William A. Loving, Jr., and I am President and CEO of Pendleton Community Bank, a $260 million asset bank in Franklin, West Virginia that serves four rural markets in West Virginia and one Virginia community. I am also Chairman of the Independent Community Bankers of America and I testify today on behalf of the 7,000 community banks we represent. Thank you for convening this hearing on the Protecting American Taxpayers and Homeowners (PATH) Act. ICBA appreciates your thoughtful and diligent efforts to improve our mortgage financing system. Community bankers and their customers have a great deal at stake in the future of housing finance. Any changes to housing finance must preserve equal and direct access to the secondary market to safeguard the role of community banks in providing mortgage credit in the communities we serve. It is critically important to borrowers and the broader economy that the details of any reform are done right. We look forward to working with the Committee and providing ongoing input into the reform process from the community bank perspective.

Community Banks and the Housing Market

Community bank mortgage lending is vital to the strength and breadth of the housing market recovery. Community banks represent approximately 20 percent of the mortgage market, but more importantly, our mortgage lending is often concentrated in the rural areas and small towns of this country, which are not effectively served by large banks. For many rural and small town borrowers, a community bank loan is the only mortgage option.

A vibrant community banking sector makes mortgage markets everywhere more competitive, and fosters competitive interest rates and fees, better customer service, and more product choice. The housing market is best served by a large and geographically-dispersed number of lenders. Five years after the financial crisis, an already concentrated mortgage market has become yet more dangerously concentrated. We must ensure any reform supports beneficial competition and avoid further consolidation and concentration of the mortgage lending industry.

Secondary market sales are a significant line of business for many community banks. According to a recent survey, nearly 30 percent of community bank respondents sell half or more of the mortgages they originate into the secondary market.[1] While many community banks choose to hold most of their mortgage loans in portfolio, robust secondary market access remains critical for them to support mortgage lending demand. This is particularly true for fixed-rate lending. For a community bank, it is prohibitively expensive to hedge the interest rate risk that comes with fixed-rate lending. Secondary market sales eliminate this risk.

While many community banks remain well-capitalized following the financial crisis, others are being forced by their regulators to raise new capital above minimum levels. With the private capital markets still largely frozen for small and mid-sized banks, some are being forced to contract their lending in order to raise their capital ratios. In this environment, the capital option provided by selling mortgage loans in the secondary markets is especially important. Selling mortgage loans into the secondary market frees up capital for additional residential lending as well as other types of lending, such as commercial and small business, which is critical to supporting credit flow in small towns and communities.

[1] ICBA Mortgage Lending Survey. September 2012.

While Pendleton Community Bank holds most of its mortgage loans in portfolio, in recent years we've sold an increasing volume of loans into the secondary market. In 2013 to date we've sold 30 loans with a value of $3.9 million, which is already more in number and value than we sold all of last year or in any prior year. We would sell more loans but for the challenge of identifying "comparable" sales in our rural markets where properties have unique characteristics.

Pendleton's secondary market sales are driven by customer demand for 30-year fixed rate loans. As a relationship lender, meeting this customer demand is critical to our broader customer relationships and to our business model. As the housing market recovers, I expect that we will continue to sell an increasing number of loans into the secondary market. Secondary market access is critical even for a bank such as Pendleton that is primarily a portfolio lender.

Key Features of a Successful Secondary Market

The stakes involved in getting housing-finance market policies right have never been higher. If the terms are not right, the secondary market could be an impractical or unattractive option for community banks. Below are some of the key features community banks seek in a first-rate secondary market.

Equal and direct access on a loan by loan basis. To be sustainable and robust, a secondary market must be impartial and provide equal access and equal pricing to all lenders regardless of their size or lending volume. A secondary market entity must have an appropriate structure to ensure it does not offer favorable terms to only the largest lenders. Such an outcome would drive further industry consolidation, reduce competition, increase systemic risk and disadvantage the millions of customers served by small lenders. Further, small and mid-sized lenders must continue to be able to access the secondary market directly without selling through a financial institution that competes with them on a retail basis. This access must include the ability to sell individual loans for cash rather than be forced to aggregate loans and securitize them. Most small or mid-sized lenders do not have the ability or the scale to securitize loans and sell those securities in the capital markets.

Financial strength, reliability and liquidity. A secondary market must be financially strong and reliable enough to effectively serve mortgage originators and their customers even in challenging economic circumstances. It must be able to generate the volume of securities necessary to quickly achieve the levels of liquidity needed to ensure the "to-be-announced" (TBA) market for mortgage-backed securities (MBS) continues to operate smoothly, thereby driving the most competitive interest rates for mortgage borrowers. Strong regulatory oversight is needed to ensure the secondary market operates in a safe and sound manner.

No appropriation of customer data for cross-selling of financial products. When a community bank sells a mortgage to a secondary market entity, it transfers proprietary consumer data that would be highly valuable for the purposes of cross selling financial products. Without large advertising budgets to attract new customers, community banks seek to deepen and extend their relationships with their current customer base. Secondary market entities must not be allowed to use or sell this data. Community banks must be able to preserve their customer relationships and franchises after transferring loans.

Originators must have option to retain servicing and servicing fees must be reasonable. Originators must have the option to retain servicing after the sale of a loan. In today's market, the large aggregators insist

the lender release servicing rights along with the loan. Transfer of servicing entails transfer of customer data for cross-selling, the concern identified above. While servicing is a low-margin business, it is a crucial aspect of the relationship-lending business model, providing the opportunity to meet the additional banking needs of mortgage customers.

Limited purpose and activities. The resources of any secondary market entities must be focused on supporting residential and multifamily housing. They must not be allowed to compete with originators at the retail level where they would enjoy an unfair advantage. The conflicting requirements of a public mission and private ownership must be eliminated.

Private capital must protect taxpayers. Securities issued by the secondary market entities must be backed by private capital and third party guarantors. Government catastrophic loss protection must be fully and explicitly priced into the guarantee fee and the loan level price. This guarantee would provide credit assurances to investors and sustain robust liquidity even during periods of market stress.

The PATH Act

ICBA appreciates Chairman Hensarling introducing legislation to protect taxpayers, enhance the role of private capital in the housing finance system, and provide needed regulatory relief for community bank mortgage lenders. These critical elements of reform are reflected in the PATH Act.

The core feature of the PATH Act is the National Mortgage Market Utility (Utility), a non-government, not-for-profit entity that would serve as a platform for the securitization of residential mortgages. ICBA appreciates that the Utility is intended to provide open and impartial access to all lenders, to prevent discrimination based on size or lending volume, and to maximize the participation of community banks. We also appreciate that the Utility will be prohibited from competing with lenders in the origination market. These features of the Utility reflect ICBA principals enumerated above.

That said, we are keenly interested in how the Utility would perform in a live marketplace dominated by large lenders wielding outsized market power. We believe there is uncertainty in this regard and the potential for unintended consequences. Below are some of the questions we have with regard to the proposed secondary market structure:

- As mentioned earlier, community banks generally do not have the level of loan production or scale to safely and economically securitize mortgage loans. We are concerned that in order to compete with the largest lenders, community banks would be forced to either hold more loans on balance sheet to create larger pools or sell them to a large aggregator that would require the bank to give up servicing rights, appropriate customer data, and compete for our customers.
- Would the owners of the Utility have the ability to appropriate customer data? This would be a concern for community banks for the reasons noted above.
- We note that the Act would authorize any Federal Home Loan Bank (FHLB) to aggregate mortgages for securitization. This is a promising option, though nothing in the Act compels the FHLBs to perform this service. If they choose not to, most community banks would have no access to the securitization channel.

- FHLB aggregation should not be the only option for community banks. The majority of community banks that now sell directly to Fannie Mae and Freddie Mac do so through the GSE's cash window. Can the Utility accommodate this option?

We hope that the Utility can be implemented in a way that does not, despite the intent of the statute, marginalize community bank mortgage lenders or lead to further consolidation of the mortgage market. ICBA looks forward to working with you to address these questions and concerns as the PATH Act advances.

Finally, ICBA would like to express our strong appreciation for the mortgage lending regulatory relief provided by the PATH Act. In particular, ICBA supports the provision of "qualified mortgage" status for all loans held in portfolio, thereby shielding them from legal liability under the new ability-to-repay rules. This commonsense provision, which mirrors a provision of ICBA's Plan for Prosperity, is based on the natural incentive of lenders to ensure that loans held in portfolio are properly underwritten. We also applaud the PATH Act's repeal of the new credit risk retention requirement. The credit risk retention and ability-to-repay requirements have the potential to stunt community bank participation in the mortgage market and drive further consolidation of that market. Additional regulatory relief provisions of the PATH Act will also help to keep community banks in the mortgage market to the benefit of their customers and communities.

As the PATH Act is debated, ICBA requests that you consider adding relief from new servicing standards that are overly prescriptive and reduce community banks' flexibility to use methods that have proved successful in holding down delinquency rates. Community banks' small size and local presence in the communities we serve make many of the new requirements unnecessary. The CFPB's recent servicing rule provides a small servicer exemption for banks that service fewer than 5,000 loans. Many community banks service larger portfolios that should qualify for an exemption because they use the community bank servicing practices and obtain the strong performance results. ICBA's Plan for Prosperity calls for raising the small servicer exemption threshold to 20,000 loans. To put this proposed threshold in perspective, the average number of loans serviced by the five largest servicers subject to the national mortgage settlement is 6.8 million.[2] An exemption threshold of 20,000 would demarcate small servicers from both large and mid-sized servicers. It would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation which is harmful to borrowers.

Closing

Thank you again for the opportunity to testify today. We look forward to working with this committee to reform our mortgage finance system. Private entities must play a more robust role in the mortgage securitization market and taxpayers must be more effectively insulated from any market failures. That much is settled. But it is critically important that the details of reform are done right to ensure that community banks and lenders of all sizes are equally represented and communities and customers of all varieties are served.

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[2] Source: Office of Mortgage Settlement Oversight (www.mortgageoversight.com).

NAFCU

Testimony of

Janice Sheppard

Senior Vice President of Mortgage Compliance at Southwest Airlines Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

Before the

United States House Financial Services Committee

July 18, 2013

Introduction

Good afternoon, Chairman Hensarling, Ranking Member Waters and Members of the Committee. My name is Janice Sheppard, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I appreciate the opportunity to share NAFCU's views with the committee on housing finance reform and the, "Protecting American Taxpayers and Homeowners (PATH) Act." NAFCU appreciates Chairman Hensarling's leadership in releasing comprehensive draft legislation that addresses the future of the Government Sponsored Enterprises (GSEs) and the Federal Housing Administration (FHA), as well as a number of mortgage-related regulations. The unveiling of the PATH Act is an important part of the housing finance reform debate. Accordingly, we thank you for holding this important hearing on the draft legislation today.

Throughout my career in financial services I have had a deep focus on consumer and home loan production, the secondary mortgage market, and servicing and loss mitigation in addition to building compliance guidelines. At Southwest Airlines Federal Credit Union (SWAFCU), I serve as Senior Vice President of Mortgage Lending and Compliance. Prior to my work for SWAFCU I was the Mortgage Production Manager at Community Credit Union in Plano, Texas where I oversaw underwriting at 17 office locations. In addition to my work at SWAFCU, I am an active member of the American Credit Union Mortgage Association (ACUMA) which brings together the shared real estate lending and financing interests of thousands of credit unions. I have also been past president of the Texas Credit Union Real Estate Network, a state-based group of credit union mortgage personnel that work to enhance the expertise of its members and provide continuing educational and professional development.

Headquartered in Dallas, Texas, SWAFCU also has branches in Houston, Texas and Phoenix, Arizona. Serving more than 37,500 members with assets totaling over $295 million, SAWFCU provides diversified financial services including mortgage origination and servicing.

As you know, NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU-member credit unions collectively account for approximately 68 percent of the assets of all federally chartered credit unions.

NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding housing finance reform.

Background on Credit Unions and Credit Union Mortgage Lending

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 96 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). While nearly 80 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

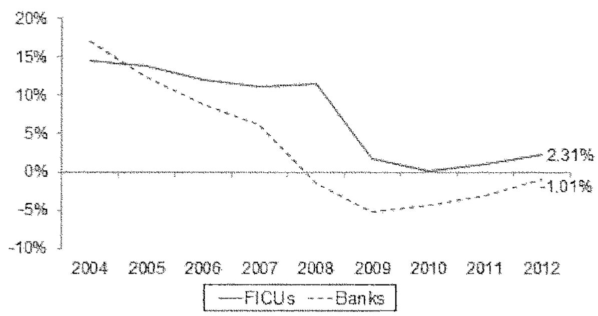
The nation's approximately 6,800 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks

and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

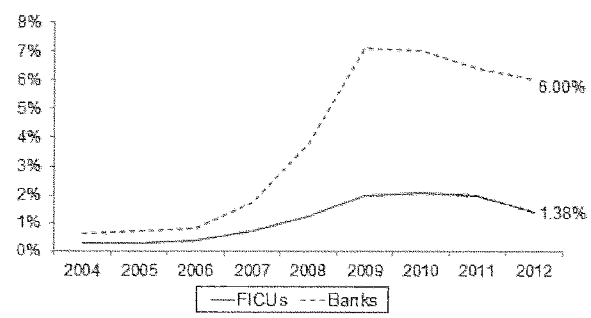
As has been noted by Members of Congress on all points of the political spectrum, credit unions were not the cause of the recent economic crisis, and examination of their lending data indicates that credit union mortgage lending has outperformed bank mortgage lending during the recent downturn. This is due in part to the fact that credit unions were not the cause of the proliferation of sub-prime loans, instead focusing on placing their members in solid products they could afford. The graphs below highlight how credit union real estate loan growth has outpaced banks during the downturn, and how credit unions have fared better with respect to real estate delinquencies and real estate charge-offs. The fourth graph demonstrates how credit unions are holding more long-term real estate loans as a percentage of total real estate loans than banks.

Real Estate Loan Growth



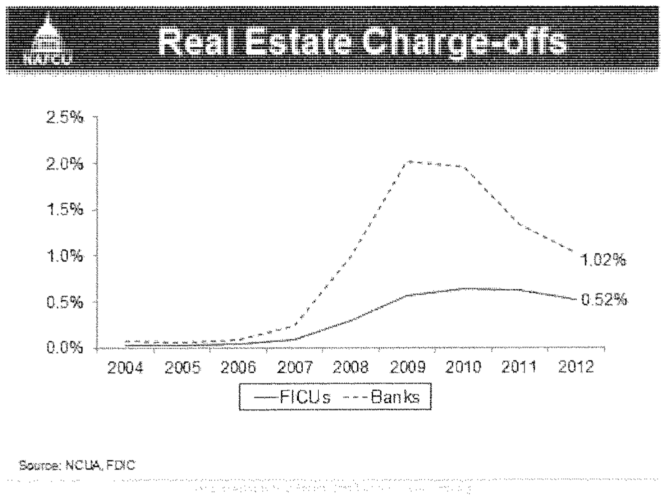
Source: NCUA, FDIC

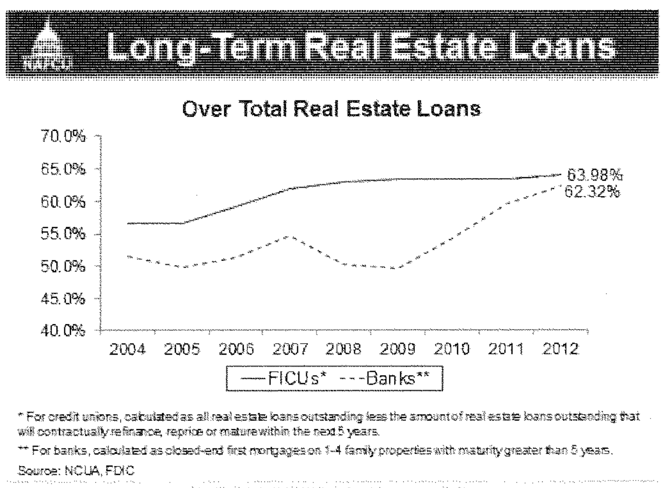
Real Estate Delinquencies*



FICU delinquencies are 60 days or more late; bank delinquencies are 90 days or more late

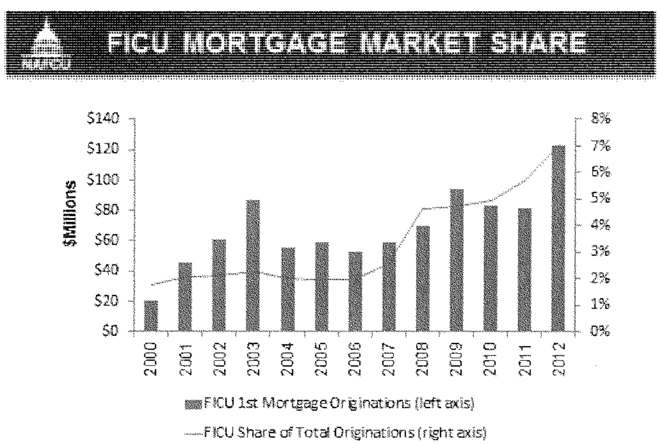
Source: NCUA, FDIC





While the housing market continues to recover from the financial crisis, and Congress works to put into place safeguards to ensure such a crisis never happens again, credit unions continue to

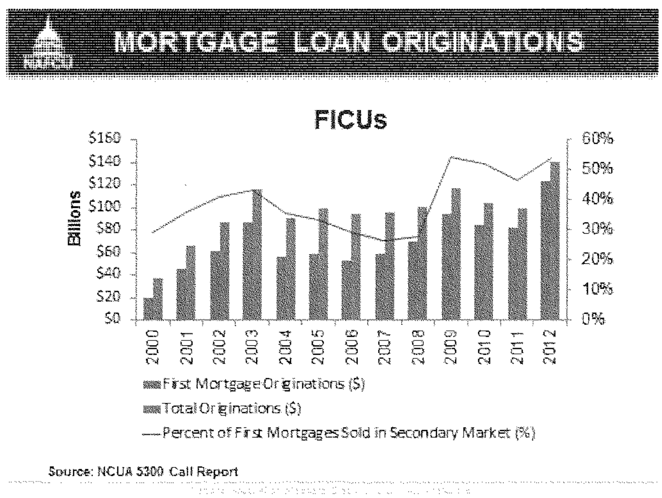
be focused on providing their member-owners with the basic financial products they need and demand. Credit unions have a solid track record of making safe and sound mortgage loans their members can afford. As the Committee works on housing finance reform issues, a primary concern of credit unions is continued unfettered access to the secondary mortgage market including adequate transition time to a new system—should lawmakers see such a change necessary. A second concern, equally as important, is recognizing the quality of credit union loans through a fair pricing structure. Because credit unions originate a relatively few number of loans compared to others in the marketplace – federally insured credit unions had about 7 % of the first mortgage originations in 2012 (see chart below) – they cannot support a pricing structure based on loan volume, institution asset size, or any other geopolitical issue that will lend itself to discrimination and disadvantage their member-owners.



Source: NCUA 5300 Call Report

Recent trends in asset portfolios, coupled with the current interest rate environment, present a unique challenge to credit union management. In the past few years, interest rates have fallen to record lows, credit unions have experienced vigorous share growth and credit union participation in the mortgage lending arena has increased to historic heights. Credit union mortgage

originations more than doubled between 2007 and 2013, and the credit union share of first mortgage originations expanded from 2.5 to about 7 percent. The portion of first mortgage originations sold into the secondary market also more than doubled over that same period, from 25.7 percent in 2007 to 53.6 percent in 2012, according to National Credit Union Administration (NCUA) call report data (see chart below).



While credit unions hedge against interest rate risk in a number of ways, selling products for securitization on the secondary market remains a key component of safety and soundness. Lenders must have continued and unfettered access to secondary market sources including Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Home Loan Banks (FHLBs) as they are valuable partners for credit unions who seek to hedge interest rate risks by selling their fixed-rate mortgages to them on the secondary market. Not only does this allow credit unions to better manage risk, but they are also able to reinvest those funds into their membership by offering new loan products or additional forms of financial services. A 2012 NAFCU real estate survey highlights the growing use of GSEs among credit unions. More than three-quarters of

respondents indicated that credit union board policy restricted the percentage of real estate loans that could be held on their balance sheet, with a median limitation of 35 percent. Simply put, without these critical relationships, credit unions would be unable to provide the services and financial products their memberships demand and expect.

It should also be noted that the government plays an important role in helping to set standards and bring conformity to the housing market. Changing standards to eliminate or make conformity difficult could make it harder for credit unions to sell loans onto the secondary market as they do not have the economies of scale larger market participants enjoy.

Key Credit Union Concerns in Housing Fiuance Reform Efforts

In 2010, as the future of housing finance became a focal point in Congress, with the Administration, and among the regulatory agencies, the NAFCU Board of Directors established a set of principles that the association would like to see reflected in any reform efforts. These principles were aimed to help ensure that credit unions are treated fairly during any housing finance reform process. They are outlined below:

- NAFCU believes a healthy, sustainable and viable secondary mortgage market must be maintained. Credit unions must have unfettered, legislatively-guaranteed access to such market. In addition, in order to achieve a healthy, sustainable and viable secondary market, NAFCU believes there must be healthy competition among and between market participants in every aspect of the secondary market. Market participants should include, at a minimum, multiple Government Sponsored Enterprises (GSEs), Federal Home Loan Banks, Ginnie Mae (as insurer of FHA, VA, and other government-backed loans), and private entities.
- The U.S. government should issue explicit guarantees on the payment of principal and interest on MBSs. The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in the MBSs and facilitate the flow of liquidity.

- During any transition to a new system (whether or not current GSEs are to be part of it) credit unions have uninterrupted access to the GSEs, and in turn, the secondary market.

- Credit unions could support a model for the GSEs that is consistent with a cooperative or a mutual entities model. Each GSE would have an elected Board of Directors, be regulated by the Federal Housing Finance Agency, and be required to meet strong capital standards.

- A board of advisors made up of representatives from the mortgage lending industry should be formed to advise the FHFA regarding GSEs. Credit unions should be represented in such a body.

- While a central role for the U.S. government in the secondary mortgage market is pivotal, the GSEs should be self-funded, without any dedicated government appropriations. GSE's fee structures should, in addition to size and volume, place increased emphasis on quality of loans and risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of many agency securities.

- Fannie Mae and Freddie Mac should continue to function, whether in or out of conservatorship, and honor the guarantees of the agencies at least until such time as necessary to repay their current government debts.

- NAFCU does not support full privatization of the GSEs at this time because of serious concerns that small community-based financial institutions could be shut-out from the secondary market.

- The Federal Home Loan Banks (FHLBs) serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Reform of the nation's housing finance system must take into account the consequence of any legislation on the health and reliability of the FHLBs.

NAFCU's Views on the PATH Act

As the country recovers from the worst financial crisis since the Great Depression, and Fannie Mae and Freddie Mac continue to operate in conservatorship, NAFCU appreciates the emphasis Chairman Hensarling has placed on ensuring a sustainable housing finance system moving forward. Over the past five months, the Financial Services Committee has held 11 hearings on the state of housing finance and how public policy decisions will help shape the future in this regard. This kind of robust discussion and debate is welcomed by our nation's credit unions. The unveiling of the "Protecting American Taxpayers and Homeowners Act of 2013" (the PATH Act), the most comprehensive proposal put forward to date, is also an important step in the debate.

As discussed above, our primary concerns in the housing finance reform debate are continued credit union access to a healthy and viable secondary market and pricing recognition for the high quality of credit union loans. NAFCU believes the current system, with a government guarantee to investors on timely payment of principal and interest on mortgage backed securities, is an important element at this time. The current system helps to ensure credit unions have the access to the secondary market they need to thrive and continue to meet the mortgage needs of their member-owners. NAFCU members are not wedded to a system with a government guarantee on mortgage backed securities, if our concerns can be addressed through a different approach. Still, credit unions need to be guaranteed that a future system will address the basic primary concerns they continue to have as small yet reliable players in the marketplace. Furthermore, private capital can be fickle and is never guaranteed to be available to the marketplace. That is why the GSEs act as such a stabilizing force today.

While NAFCU appreciates the serious and comprehensive effort put forth by the PATH Act, we have outstanding concerns with aspects of the proposal in Title I that call for an immediate wind-down of the GSEs, and the impact the omission of the GSEs and a government guarantee could have on reliable market access for credit unions.

We believe that any reforms should focus on the consumer and not disrupt the recovery underway in the housing market. The guaranteed access to the secondary market was a critical component of credit unions being able to continue to meet the mortgage needs of Americans during the recent economic downturn. When banks and others stopped lending, credit unions were there to step in. Maintaining this guaranteed access is an important hedge against the next economic downturn.

It should also be noted that without a government role in the secondary market, the 30-year fixed-rated-mortgage may still exist, but it could have higher cost to the consumer and scarcer availability. Credit unions have found that when members got into trouble it was often not from a particular first mortgage product; rather, it was likely from one of the following two factors: 1) loss of a job or unemployment; and 2) a decline in home value after a large amount of equity was pulled out in a line of credit. The system of long-term fixed-rate mortgages financed through stable securitization has helped provide remarkable stability in the US economy, as well as strong and sustainable homeownership.

We are pleased to see the provisions in the bill that would address the growing trend of local communities obtaining mortgages by the power of eminent domain.

We support the inclusion of Section 261, which extends the time that those who have had previous mortgages foreclosed upon have to wait for an FHA-loan from 3 years to 7 years. Enactment of this provision would discourage the trend of strategic defaults on mortgages that some credit unions have seen, while the waiver provision included would ensure that those who were foreclosed on due to hardship have the opportunities that they need.

In regards to the establishment of a market utility in Title III, we would note that NAFCU's primary concern is guaranteed equitable access for credit unions to the secondary market and guaranteed equitable pricing. The concept of the FHFA's securitization platform (transferred to the utility in this proposal), in and of itself, may not adequately address these concerns. In our comment letter to the FHFA, we expressed appreciation that the platform is designed to accommodate a market with or without a government guarantee. While we remain optimistic about the possibilities of the platform, especially in terms of improving efficiencies, we are

concerned that the fundamental question of guaranteed access remains to be an uncertain proposition, especially with the winding down of the GSE's without suitable replacement as prescribed in Title I of the draft bill.

NAFCU believes that Title IV "Removing Barriers to New Investment" is a very important aspect of housing finance reform and the PATH Act and is pleased to see its inclusion in this proposal. There are many beneficial provisions in this section to credit unions, some of which I outline below.

In particular, NAFCU strongly supports Section 403 of the discussion draft to address the Consumer Financial Protection Bureau's (CFPB) definition of 'points and fees' under the 'ability-to-repay' rule set to take effect in January next year. NAFCU has taken advantage of every opportunity available to educate and weigh in with the CFPB on aspects of the ability-to-repay rule that are likely to be problematic for credit unions and their members. While credit unions understand the intention of the rule and importance of hindering unscrupulous mortgage lenders from entering the marketplace, it is time for Congress to step in and address unfair and unnecessarily restrictive aspects of this CFPB rule. Accordingly, NAFCU supports Chairman Hensarling's efforts incorporating into the PATH Act provisions from Rep. Huizenga's bipartisan *Consumer Mortgage Choice Act* (H.R. 1077).

Making important exclusions from the 'qualified mortgage' cap on points and fees will go a long way toward ensuring many affiliated loans, particularly those made to low- and moderate-income borrowers, attain 'qualified mortgage' status and therefore are still made in the future.

As NAFCU has testified in the past, the CFPB's new mortgage regulations released in January are a prime example of the growing compliance burden our nation's credit unions face. Covering everything from the scope of coverage under the *Home Ownership and Equity Protection Act*, comprehensive changes to mortgage origination and servicing, amended rules associated with the *Truth in Lending Act* and *Financial Institutions Reform, Recovery, and Enforcement Act*, changing requirements for escrow accounts and issuing rules under Dodd-Frank relative to what constitutes a "qualified mortgage"-- the breadth and pace of new

requirements is daunting. The less than 12 month timeframe for implementation of the rules should cause serious pause for lawmakers and regulators. NAFCU strongly supports Section 406 of the PATH Act that recognizes the irrationality of this timeline and delays the mandatory implementation of all Dodd-Frank related mortgage rules for one additional year.

The inclusion of Section 407 to repeal the credit risk retention regulations from Section 941 of the *Dodd-Frank Act* is also a positive addition to the proposed legislation. While credit unions are technically exempt, the rule's impact will nevertheless ultimately be felt by all participants in the mortgage market. NAFCU also strongly supports Section 409 of the PATH Act which exempts from the 'qualified mortgage' definition residential mortgage loans held in portfolio, and Section 413, which requires notice of a junior mortgage or lien.

NAFCU also remains very concerned about CFPB's proposed rule integrating mortgage disclosures under the *Real Estate Settlement Procedures Act* (Regulation X) and the *Truth in Lending Act* (Regulation Z) requiring that borrowers receive final Closing Disclosure three business days prior to consummation. While the rule may be well intended, it does not allow for the kind of flexibility necessary to accommodate the nature of real estate transactions and could even discourage the borrower from making reasonable changes to their purchase. Accordingly, NAFCU strongly supports Section 411 of the PATH Act that would allow consumers the ability to waive the 3 day requirement. NAFCU is also pleased that this section permits mortgages financed through a 40 year product to also be considered as a 'qualified mortgage.'

In short, the mortgage-related provisions in the PATH Act described above would have a positive effect on credit unions. Enacting these provisions would help to ensure that we can continue to serve the mortgage needs of our nearly 96 million member-owners rather than focus on misguided regulations that will cause unprecedented compliance and legal burdens. NAFCU lauds Chairman Hensarling for his foresight by including these important provisions in his bill. We look forward to providing additional feedback on these much needed reforms as the committee continues to look for common-sense ways to cut down on the ever-increasing regulatory burden credit unions face.

Moving forward, NAFCU is hopeful that the committee also considers, whether in this bill or others, directing the CFPB to revise aspects of the 'ability-to-repay' rule that dictates a consumer have a total debt-to-income (DTI) ratio that is less than or equal to 43 percent in order for that loan to be considered a 'qualified mortgage'. NAFCU believes this arbitrary threshold will prevent otherwise healthy borrowers from obtaining mortgage loans and will have a particularly serious impact in rural and underserved areas where consumers have a limited number of options. We believe that the CFPB should either remove or increase the DTI requirement on qualified mortgages.

In addition to the mortgage related provisions contained in the draft bill, NAFCU would also like to recognize the important changes that would be made with respect to the examination process at credit unions. NAFCU has long supported Chairman Capito's *Financial Institutions Examination Fairness and Reform Act* (H.R. 1553) and believes it is important step forward in ensuring that the supervisory environment financial institutions face is fair and timely.

We would note that as Title IV contains provisions relating to Basel III for community banks, we believe provisions implementing risk-based capital for credit unions should also be included and paired with these provisions for community banks. Including the risk-based capital language introduced as part of H.R. 2572, the *Regulatory Relief for Credit Unions Act*, introduced by Committee Vice-Chairman Gary Miller, would be one way to accomplish this.

NAFCU also supports Section 502 of the *PATH Act* that permits insured depository institutions to treat a non-accrual loan as an accrual loan if the loan is current, no monthly payment has been more than 30 days delinquent during the previous 6-month period, and loan payments are being made according to contract terms and all parties agree to any refinances and modifications. This bipartisan provision is appropriate for a recovering economy, as it would ensure community based financial institutions aren't penalized for working with borrowers to modify their loans.

Finally, we are also pleased to see Section 504, preserving attorney-client privilege for information provided to the FHFA, included in the proposal.

Conclusion

We appreciate the opportunity to provide our input on this important issue. Chairman Hensarling deserves credit for putting forward the most comprehensive proposal on housing finance reform to date. We look forward to working with Chairman Hensarling, Committee Members and your staffs to address our comments as housing finance reform and the PATH Act proposal move forward.

I thank you for your time today and would welcome any questions that you may have.

Statement of
David H. Stevens
President & CEO
Mortgage Bankers Association

Committee on Financial Services
U.S. House of Representatives

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

Chairman Hensarling, Ranking Member Waters, and members of the committee, thank you for the opportunity to testify today on behalf of the Mortgage Bankers Association (MBA). My name is David H. Stevens and I am the President and CEO of MBA. From 2009 to 2011, I served as Assistant Secretary for Housing and FHA Commissioner at the U.S. Department of Housing and Urban Development (HUD). I have over 30 years experience in real estate finance.

The release of the PATH Act represents an important step in defining the boundary of the debate over the government role in housing finance. Fannie Mae and Freddie Mac have been in conservatorship for almost five years now, and it is important that policymakers begin defining a long-term plan for the future role of the federal government in the mortgage market. I compliment Chairman Hensarling for introducing his approach to begin this discussion. MBA also appreciates the Chairman's efforts to tackle other key housing finance concerns in the bill, including the long-term financial viability of the Federal Housing Administration's single-family programs, and welcome many of the much-needed reforms to the Dodd-Frank Wall Street Reform and Consumer Protection Act that are contained in the PATH Act.

We are eager to work with the Chairman, the Ranking Member, and all other members of the House Financial Services Committee to improve the bill in a way that ensures a vibrant housing finance system that works for lenders of all sizes and business models and provides consumers with affordable mortgage financing.

MBA's Goals for Secondary Market Reform

MBA believes that the future secondary market should address the needs of borrowers, lenders, investors, and taxpayers. Private capital should be the first line of defense against losses, with no institution too big to fail. The ideal system should:

- promote liquidity and stability by connecting global pools of capital to the U.S. mortgage market;
- provide certainty in mortgage transactions for all borrowers:
- provide competitive pricing for a consistent offering of core products including the 30-year, fixed-rate, prepayable mortgage and well-underwritten multifamily mortgages;
- provide an efficient means of hedging interest rate risk, i.e., a TBA market; and
- support vibrant, dynamic, and competitive primary and secondary markets composed of lenders with a wide range of sizes and business models, with this competition ultimately benefitting homeowners and the broad owner-occupied and multifamily rental markets.

The government role, to provide quality regulation of guarantors and systems and to provide a clearly defined, but limited, catastrophic credit backstop is an important component of this ideal system. Without this government backstop, the mortgage market would be smaller and mortgage credit would be more expensive, meaning that qualified lower and middle class households would have less access to affordable mortgage credit and be less able to qualify to achieve sustainable homeownership and the multifamily rental market, which predominantly serves those of modest incomes, would be adversely impacted.

It is important to recognize that today's market and MBA's vision of the future secondary market are composed of three segments, ranging from fully private to fully government-insured:

- *A sizeable fully private market that is not limited by loan size or by the Qualified Mortgage (QM) definition.* Fully private loans will still be required to meet the ability to repay standard and all other applicable regulations, and may be held on balance sheets or securitized through non-agency channels. The fully private market will overlap and be competitive with the core market in terms of execution during normal market conditions.
- *A conventional conforming market with a government backstop.* Working class households need access to a market that has private capital taking the first loss, but an ultimate government backstop to ensure ongoing market liquidity. Only traditional, well documented loans that qualify as QMs should be able to enter this core market. This portion of the market should be comprised of originators that bring pools of significantly credit enhanced core mortgages to a central platform for issuance and government reinsurance.
- *A government market.* The FHA/VA/RHS should continue in their present roles performing critical social policy functions. These programs are directly backed by the government and are targeted to support lending to first-time homebuyers and others who could only access homeownership through a low downpayment product. MBA views these programs as critical to the health of the U.S. housing market, but recognizes that certain changes may be necessary to ensure their long-term financial stability.

Market shares among these segments should not be fixed, but should vary over time with economic conditions. The government-backed or supported markets will be countercyclical, increasing in times of market stress, decreasing when credit is widely available.

Why is a government backstop needed for the conventional conforming market?

The American mortgage market has long been dominated by 30-year, fixed-rate, fully amortizing loans, with no penalty for refinancing the loan. The advantage for borrowers is that it protects them against increases in interest rates while providing a long period over which to amortize the loan principal, thus providing more affordable monthly payments than would be available under a shorter amortization schedule.

The advantages for borrowers, however, are offset by the risks posed to depository institutions trying to hold 30-year fixed-rate mortgages in portfolio, given the short duration of most bank deposits and other liabilities. When interest rates rise, banks may end up earning negative spreads on the mortgages they hold. This funding mismatch can be dangerous for financial institutions.

For example, the thrift industry debacle of the 1980s largely grew out of the removal of interest rate ceilings on bank and thrift deposits for many years. The resulting spike in the interest rates on the deposits funding long-term, fixed- rate mortgages essentially wiped out the capital at many thrifts. Similarly, funding mortgages with long-dated fixed-rate deposits can be a problem if rates fall and borrowers exercise their options to refinance their mortgages at lower rates. The bank then faces low or negative interest rate spreads when it reinvests the funds from the paid-off mortgages at lower rates. Thus, relying on bank portfolios to fund 30-year fixed-rate mortgages places tremendous risk on the existing government support of the mortgage market through the FDIC.

Securitization developed as a means of removing this interest rate risk from depository balance sheets, while providing a long-term, fixed-rate asset for investors that had a better capacity to manage such cash flows. However, securitization relies on a steady presence of private investors willing to take on the risks of mortgage-backed securities. We have seen repeatedly over the last twenty years that while investors are generally willing to buy guaranteed MBS, even during a market disruption, they are unwilling to take on uncertain credit risk during these times.

When depositors or security holders become concerned over the health of the assets supporting their investments, they want to liquidate their positions and hold on to their cash until the situation settles. In the case of banks, this is a run on deposits. For securitization, it is a panic sale of the securities with a large drop in price. It is as if bank depositors were forced to sell their deposits to another investor at a deep discount rather than attempting to redeem them at par at the bank. Because those who sell first suffer the smallest losses, there is an advantage to sell quickly before a panic, thus helping fuel a panic. Even if they do not sell, mark-to-market accounting rules do not distinguish between normal price drops and those caused by panic selling, causing large losses for investors

The question is not whether a government guarantee will limit the potential damage of periodic panics in the securities. The benefit is clear. The real question is how to go about limiting the risk to the taxpayers that comes with any sort of government support. Adequate private capital in a first loss position, the establishment of an insurance fund, and a limited, clearly defined credit box (such as has been accomplished with the QM rule) all would be strong steps in this direction.

In summary, the U.S. mortgage market is unique in the degree to which 30-year fixed-rate mortgages play such a large role in financing home purchases. To date, however, that market has been supported by securitization and the implicit and explicit support the taxpayers have given to that market. MBA believes that such a guarantee can be put in place in order to reduce the volatility that would exist in a purely private market, but that would be implemented in such a way as to limit the exposure of the taxpayers.

Getting private capital into the mortgage market: key transition steps that can be taken today

Let me turn now to the current market situation and steps we can take in the short term to move towards a market more in line with these goals.

Fannie Mae and Freddie Mac have recently reported substantial profits, leading some to ask whether the business models of Fannie Mae and Freddie Mac have regained credibility that was lost during the financial crisis. Record GSE profits do not tell the whole story. In their current form, GSE profits are dependent in large part on three factors:

- Guarantee fees, which have more than doubled in recent years.
- Remarkably low- risk business, a sign of tight credit.
- Their ability to shift legacy costs back to lenders

This current status is not sustainable over the longer term, and MBA believes that we should begin moving toward a more sustainable environment. While the legislative process will continue to refine the desired end state, MBA has proposed a set of transition steps designed to move in the direction of the developing consensus regarding the shape of the future secondary

market. The steps we propose, none of which require legislation, create an even greater competitive landscape for all originators beyond where we are today, and provide better value to borrowers. Further, they are consistent with the vast majority of end-state proposals.

- FHFA and the GSEs should move to a common, fungible MBS to improve liquidity in the market. The discount on Freddie Mac's security represents a loss to the taxpayer, as it is being implicitly subsidized by lower guarantee fees resulting in lower dividends to the Treasury. We should act now to remove this distortion by moving to a common, fungible security.
- FHFA should mandate that the GSEs accept deeper credit enhancement on pools from lenders in exchange for reduced guarantee fees in order to lower costs and increase access to credit for consumers. The PATH Act includes language to this effect, which we would support as a means of bringing additional private capital into the market. Importantly, we believe that lenders should have "front-end" credit enhancement options in addition to the "back-end" options, as we believe the former have the potential to produce greater cost savings for consumers.
- Regardless of which end state Congress decides upon, we need to ensure that lenders of all sizes have securitization options to directly access the secondary market in order to level the playing field.
- FHFA should impose a well-regulated and fully transparent credit framework with clear representation and warranty protections to increase transparency in the system and enable lenders to responsibly expand access to credit.
- FHFA should continue to seek stakeholder input regarding the Common Securitization Platform to lay the groundwork for a more efficient market in the future. The PATH Act also contains plans for a new market Utility that would perform many of the roles and functions envisioned for the platform, with the exception that the bill would not permit the Utility to securitize government-backed loans. While we appreciate the agreement that such a central, operationally focused utility is needed, we do believe that some level of government backstop is needed for the conventional conforming market.

MBA also supports provisions in the PATH Act that create a framework and regulatory structure for financial institutions to issue covered bonds. Covered bonds are used by financial institutions as a vehicle for attracting private funds to support homeownership, affordable rental housing and commercial real estate.

Adopting covered bond legislation is necessary to provide certainty and clarity with respect to the rights and obligations of parties to covered bond transactions. Covered bonds so far have been limited to large financial institutions, but MBA believes added legal and regulatory certainty would make it cost-effective for smaller ones as well.

Additionally, MBA believes serious consideration should be given to expanding Federal Home Loan Bank membership eligibility to include access for non-depository mortgage lenders. These lenders are often smaller, community-based independent mortgage bankers focused on providing mainstream mortgage products to consumers. In exchange for membership in the FHLB system, these institutions could be required to hold a limited class of stock with appropriate restrictions. Expanding FHLB access to these institutions would enhance market liquidity and ensure a broader range of mortgage options for consumers.

GSE Multifamily Programs

Future of the Multifamily Housing Finance Market

Our views on the multifamily housing finance market run parallel and are consistent with our views on the single-family residential market.

More than one in three American households rent their home, and more than 16 million[1] of those households live in multifamily rental housing, a development with five or more units. Renters include workers who want to live near their jobs, young professionals, empty-nesters, retirees on a fixed income, families with children, students, and households who value the convenience and mobility that renting offers. Notably, the vast majority of multifamily rental housing provides homes for households earning modest incomes, with 93 percent of multifamily rental apartments having rents affordable to households earning at or below the area median income.[2]

Recognizing the unique attributes of the multifamily market as a key component of the broader housing finance system, we believe that policy makers should pursue the following principles in shaping the government's role in the multifamily housing finance system.

Key Principles for Multifamily Housing Finance Reform

First, our nation's housing policies should reflect the importance of multifamily rental housing, the range of capital sources that support this market, and the need for liquidity and stability in all market cycles. The number of renter households in multifamily housing is expected to grow from the current estimate that exceeds 16 million. A broad range of capital sources support the multifamily finance market, including private capital sources. The roles of the GSEs and FHA in financing multifamily mortgages have been substantial, but other market participants – including life insurance companies, banks and other lenders – have maintained a strong presence as well. With respect to the GSEs' multifamily activities, credit performance has been strong during the recent market downturn and, with government support, the GSEs have served a countercyclical role that provided liquidity when private capital sources largely exited the market.

Second, private capital should be the primary source of financing for multifamily housing with a limited, government-backed insurance program ensuring that the market has access to liquidity in all cycles. The risk insurance program would provide support at the mortgage-backed security, rather than at the entity, level. The role of private capital is vital in several respects: (1) the deployment of private capital through market participants that have historically supported multifamily finance, such as portfolio lenders and CMBS investors; (2) the private capital that is already embedded within existing market executions (e.g., DUS, K-Deals) through risk-sharing structures; and (3) the investment of private capital in entities that would be permitted to issue government-backed securities. We believe that a focused role for the federal government through a government-backed risk insurance fund, with a federal catastrophic backstop, would ensure continuous liquidity and stability in all market cycles. Eligible mortgage-backed securities would have a government wrap. The insurance fund, paid for through risk-based premiums, could be modeled after FDIC programs and would support such mortgage-backed securities, not at the level of the issuer, as is the case today.

[1] 2011 American Housing Survey
[2] Joint Center for Housing Studies tabulations of 2009 American Housing Survey, US Census Bureau.

Third, entities eligible to issue government-backed securities should be funded by private capital, be focused on securitization, serve the workforce rental market, and be regulated in a manner that protects taxpayers and ensures robust competition among capital sources. A strong government regulator with market expertise would provide oversight regarding the issuing entities, including their safety and soundness, risk-based capital requirements, and products offered. The entities, which would not be limited to potential successor entities to the GSEs, also would assume a significant risk position by providing an entity-level buffer, placing private capital at risk ahead of any government backstop. Risk-based premiums would be deposited into a federal insurance fund, to be drawn upon only if and when the entity becomes insolvent. The pricing of the premiums would be structured in a manner that allows robust competition. Importantly, the issuing entities would need to attract private capital and maintain financial viability. We believe, however, that they should be mono-line institutions limited to secondary mortgage market activities and the housing finance sector, with a focus on workforce and affordable rental housing.

Fourth, stewardship of existing GSE assets and resources on behalf of taxpayers should be a core consideration for any action – during the current period of conservatorship, any transition period, and in the future state of multifamily finance. The talent and expertise at the GSEs, their existing books of business, their market executions and any profits generated by their multifamily businesses are valuable to U.S. taxpayers and should be deployed in a manner that supports the future state of multifamily housing finance. Preserving and dedicating such resources would support an orderly transition to a new mortgage finance system and optimize potential returns to taxpayers. Fundamentally, the "do no harm" principle should govern, particularly in light of the stability and successes of the multifamily market overall.

We wish to underscore that as policy makers deliberate the future of the government's role in multifamily housing finance, it is vital they ensure that capital continues to be available to support this essential source of housing.

Federal Housing Administration

Single Family

The PATH Act proposes major changes to the structure and programs of FHA that fundamentally alters the agency's future and its ability to serve American families. MBA appreciates that the legislation recognizes the significance of the FHA to the housing finance system and affirms that FHA should continue to have an important role in providing affordable lending options to first-time and low- and moderate-income homebuyers. The key to a vibrant FHA, however, is to strike the appropriate balance between strengthening the agency's fiscal solvency and maintaining its traditional role as a critical source of affordable credit for first-time homebuyers and working families.

Since the onset of the financial crisis, FHA has taken a series of steps to protect the fiscal health of FHA. It has raised premiums, tightened credit standards, and banned seller-funded downpayment assistance programs from participating in the program. The credit profiles and performances of the FY2010 to 2012 portfolios show these changes are working: the average FHA credit score for FY2011 was 696[3] and the serious delinquency rate was 2.07 percent in the

[3] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 18. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

fourth quarter of 2012.[4] The economic value of these books of business is positive three percent compared to the negative seven percent economic value of the 2007-2009 books of business.[5]

MBA applauds the recent actions of FHA Commissioner Carol Galante to address programmatic issues that could continue to damage the Mutual Mortgage Insurance (MMI) Fund, including increasing the annual mortgage insurance premium (MIP), requiring that most loans charge the MIP for the life of the mortgage, requiring that borrowers with credit scores under 620 must be manually underwritten, and consolidating the HECM Fixed Rate Standard Program and the HECM Saver Program. These changes were appropriate and necessary, given that the MMI Fund's capital ratio is well below its two percent statutory requirement. Overall, MBA believes that FHA loans are more appropriately priced and its programs have significantly better risk management policies than they did before the economic crisis.

FHA's market share has declined since the height of the crisis, a trend MBA believes should be encouraged through the re-entry of private capital into the housing market. We have supported policies that are intended to reduce the government's share of the mortgage market – currently at 28 percent and comprised primarily of FHA loans – such as FHA's recent proposal to lower the maximum loan-to-value (LTV) on loans over $625,500 from 96.5 percent to 95 percent. MBA would consider supporting other policy changes and reforms that ensure FHA maintains its focus on serving its targeted population and continues on a path to solvency.

MBA has strong concerns, however, about proposed changes in the PATH Act we believe would have substantial negative consequences for consumers in four key areas: reducing FHA's guarantee, risk-sharing, indemnification, and loan limits.

Reducing the 100 Percent Loan Guarantee

The PATH Act would reduce FHA's mortgage insurance coverage from 100 percent to 50 percent over a period of five years. MBA has serious concerns with the implications of such a significant policy change for the price availability of mortgage credit through the FHA program. Even if it were well constructed, such a change could significantly reduce the number of lenders willing to participate in FHA, given the increased risks to the lender. Such a decrease in competition would necessarily reduce lending and increase costs for consumers.

Mortgage lenders are accustomed to managing representation and warranty risk, but are not structured to take on large amounts of credit risk. If they were forced to take on this risk through a reduction in the coverage of FHA insurance, it could potentially cause them to restrict credit or go out of business.

Lenders who choose to hold FHA loans as investments would also be disadvantaged. Because of the 100 percent guarantee, FHA-insured loans held in lenders' portfolios receive a 20-percent risk weight. Reducing the FHA guarantee could lead to different accounting and bank capital treatment for holding or servicing FHA-insured loans, further impacting the cost and availability of credit to American homebuyers.

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[4] Mortgage Bankers Association, National Delinquency Survey 2012 Fourth Quarter.

[5] U.S. Dept. of Housing and Urban Development, Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans for Fiscal Year 2012 (November 2012) at p. 32-33. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=ar2012_forward_loans.pdf.

Finally, decreasing insurance coverage would necessitate that Ginnie Mae increase its guarantee fees. Ginnie Mae relies upon a full credit guarantee from FHA. Reducing FHA's guarantee would simply move risk from one government entity to another.

FHA and Risk-Sharing

Many policymakers and industry participants have suggested the private sector should have a role in sharing risk with the FHA. The PATH Act would establish a risk-sharing pilot program that would give FHA two years to set the parameters of a new program. FHA would then be required to enter into risk-sharing agreements on ten percent of its business.

MBA supports exploring options for FHA to enter into risk-sharing agreements with the private sector as a way of offsetting some of the agency's current risk and reduce the size of the government's footprint, thus strengthening the MMI Fund and better protecting taxpayers. MBA agrees that the option of third-party risk-sharing should be tested before being offered on a wide scale. FHA should have adequate time to construct, test, and revise any risk-sharing policy options via a pilot program and then determine if risk-sharing is appropriate for the agency, lenders and consumers.

MBA recommends that FHA consider scenarios where first-loss private capital is ahead of the government guarantee. The risk-sharing could be at the individual loan level, such as by including private mortgage insurance, or at the pool- or vintage-level. Proponents suggest that risk-sharing not only protects taxpayers, but also could increase the quality of underwriting either by the private mortgage insurers or by lenders who will have an increased incentive to verify the borrower can afford the loan. Others are concerned that private insurers would be able to adversely select FHA, providing insurance only on lower-risk loans, while leaving the government to fully insure higher-risk loans.

Beyond the concerns about adverse selection, the details of any risk-sharing proposal will be critical; it is imperative that any structure not provide an advantage to lenders with certain business models over others. MBA would advocate that any risk-sharing proposal be economically viable for diverse lender business models, particularly community banks and independent mortgage bankers.

Indemnification

MBA has consistently supported high standards for all lenders that participate in FHA programs in order to protect consumers, the agency's fiscal soundness, and the reputation of our industry. MBA members recognize and accept accountability for instances of fraud and negligence within their control. Moreover, lenders take full responsibility for underwriting mistakes that lead to loan delinquencies and incorporate sophisticated quality control systems to minimize the possibility of costly indemnifications.

MBA is pleased to see that the PATH Act contains indemnification provisions that protect consumers while providing lenders with certainty and a mechanism for arbitrating disputes. Under the proposed bill:

- FHA can require a lender to indemnify a loan if a lender *knew or should have known* of a serious and material violation of FHA's mortgage underwriting standards and FHA pays an insurance claim with respect to the mortgage within reasonable period, and the violation was a materially contributing factor to cause the mortgage default.

- A "serious and material violation" is defined as a mortgage loan that should not have been approved and endorsed for insurance.
- For instance of fraud or material misrepresentation, FHA can require a lender to indemnify a loan if a lender knew or should have known of the fraud or material misrepresentation such that the loan should not have been approved and endorsed for FHA insurance, if the fraud or misrepresentation was a material contributing factor to the loan default.

MBA especially appreciates the inclusion of an appeals process that allows lenders the opportunity to present their case against a disputed indemnification determination. In addition to the appeals process, MBA urges the committee to include an arbitration process and a clear limit defining how long after a loan's origination FHA can require indemnification – not including instances where there is lender fraud or misrepresentation. These changes would help provide assurances to lenders that indemnification requirements would be issued within a reasonable timeframe and that they would be given a fair opportunity to dispute an adverse decision.

MBA , however, strongly opposes Section 264, which requires lenders to automatically repurchase an FHA loan that is more than 60 days past due in the first two years of the mortgage. This inflexible provision fails to take into account the varied reasons why loans default within the first two years, such as job loss, and family death or disability. It also does not address fraud against the lender. Requiring lenders to enter into a binding agreement that includes such a "take-back" requirement as a condition of FHA approval would drastically reduce the number of lenders who offer FHA-insured loans and force lenders to add substantial credit overlays on top of FHA's requirements.

Loan Limits

Although loan limits are not the major driver of FHA's market share, they have historically been used as a way of targeting the program to the lower half of the housing market. Congress recognized FHA's important countercyclical role during the financial crisis and temporarily raised loan limits to mitigate the sharp decline in private capital in the marketplace. Those limits have been extended multiple times and are currently scheduled to expire on December 31, 2013.

Importantly, the most recent extension only applied to FHA loans, which has resulted in an upper limit of $729,750 for FHA and $625,500 for the GSEs. According to MBA data, less than one percent of FHA-insured loans are between $625,500 and $729,750. FHA lending above $625,500 is most prevalent in the following areas: Washington D.C. (12.9 percent); California (3.4 percent); Virginia (3.2 percent); and New York (3.1 percent).[6]

There is evidence that the demand for larger loans is growing and that these borrowers will be adequately served by the private sector. According to MBA's Weekly Application Survey Data, there was a 22 percent increase in the number of loans between $625,000 and $729,000 from 2011 and 2012. As the demand for this market grows, the private sector will expand its offerings to qualified borrowers.

The PATH Act proposes setting FHA's maximum loan limits at the lower of 115 percent of the Area Home Price or 150 percent of the GSE single-family loan limit for high cost-areas (maximum of $625,500). MBA believes this change would help sharpen FHA's focus on serving low-to-moderate income and first-time homebuyers. The expiration of the higher loan limits

[6] Data Compiled from MBA Weekly Application Surveys.

would not greatly affect national FHA lending and would expand the opportunity for private lenders to serve higher-income borrowers.

MBA has concerns, however, that lowering FHA's nationwide "floor" – the loan limit for portions of the country that are not high-cost areas – to $200,000, as proposed in the PATH Act, would have a dramatic impact on the number of borrowers who would be eligible for these loans. Currently, FHA's loan limit for much of the country is $271,050. This includes 1,351 out of 1,376 non-metropolitan counties, 569 out of 582 "micropolitan" areas, and 340 out of 387 metropolitan areas.[7] The average size of an FHA-insured loan in January 2013 was $185,353.[8] Lowering the floor for FHA-insured loans to $200,000 would greatly limit mortgage financing options to the average FHA borrower and could harm the housing recovery in areas of the country where FHA lending is most needed by first-time and low-to-moderate income families. Therefore, MBA supports maintaining the current nationwide floor of $271,050 because it preserves an important credit option for FHA's core constituency and supports the housing recovery.

FHA Multifamily and Healthcare Programs

FHA is an essential source of the long-term, fixed-rate debt needed to build and refinance multifamily rental housing for working families, seniors, and underserved populations, as well as for affordable, quality healthcare facilities. Not only have multifamily and healthcare loans performed well with low default rates, but the programs generate significant revenue to the federal government in the form of a negative credit subsidy.

- *Prevent disruption to the multifamily and healthcare financial markets.* The Multifamily and Healthcare financial markets must remain stable. FHA performs a key function by guaranteeing the loans made by approved lenders, which are then securitized by Ginnie Mae. On June 28, 2013, FHA notified the multifamily industry that it would run out of its FY2013 commitment authority before the end of the current fiscal year. MBA had supported the authorization of an additional $5 billion in FHA FY 2013 commitment authority. FHA multifamily and healthcare programs now face very serious disruptions as loans that could rate lock soon now must wait until October. In a rising interest rate environment, unnecessary costs are added to the operations of these properties for the life of the loan.

- *FHA's multifamily programs are performing well.* In May, 2013, FHA published data that established the positive performance of the multifamily and healthcare loan programs.[9] Through good program design and partnership with mortgage bankers, borrowers and managers, FHA has annual claim rates below one percent in each major program since 2011 on both a loan-count and dollar basis. Despite low claims risk, as demonstrated by HUD's recently published data, the mortgage insurance premiums for most FHA multifamily/healthcare programs rose in FY2013, further strengthening the fiscal soundness of these programs.

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[7] U.S. Department of Housing and Urban Development, CHUMS Data Files. Can be accessed at http://www.hud.gov/pub/chums/file_layouts.html.
[8] U.S. Department of Housing and Urban Development, FHA Single-Family Outlook (January 2013). Can be accessed at http://portal.hud.gov/hudportal/documents/huddoc?id=ol0113.pdf.
[9] Federal Housing Administration, Multifamily and Healthcare Claim Rates, FHA Business Trends, May 9, 2013. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=mfahcanclarat5-15-13.pdf

- *No need for across the board income limits for renters.* The proposed legislation would require unit level occupancy and rent restrictions on an annual basis in properties with FHA multifamily loans for the life of the mortgage (at Section 237). We respectfully request this provision be removed for the following reasons. The vast majority of all multifamily rental housing serves families earning up to 93 percent of median income, and, in FHA's multifamily portfolio, in particular, nearly half of FHA's approximately 10,000 multifamily loans in portfolio already have affordability provisions.[10] To add annual personal income verification or rent certification where one is not needed for subsidy eligibility purposes adds a significant government reporting burden to individuals and over-reaches the requirements of the Community Reinvestment Act. Such a certification process, even if for only new FHA multifamily mortgages, would add significant and unnecessary costs.

  The variety of loans in the FHA program, originated by nearly 90 FHA lender firms, with funding from private investors, represent a significant, stable source of capital for properties that might not be served by other capital market sources. We therefore believe that it is not necessary to add an income limitation to the FHA multifamily programs because the current program already serves this need. Further, the resource-intense nature of affordable housing production should be balanced with market rate finance activities.

- *Efficiency and markets served.* FHA has restructured its business operations to make them more efficient and currently has a major restructuring effort underway in the Office of Multifamily Housing. According to the FHA Annual Management Report for FY 2012 released by HUD on November 15, 2012, refinances accounted for 73 percent of the FY 2012 FHA multifamily originations, thus stabilizing multifamily housing resources.[11] During the credit crisis, FHA provided stability and liquidity when other capital sources for refinancing evaporated. Most non-FHA multifamily loans have much shorter terms and thus must be refinanced to avoid default at maturity of the loans. Had FHA been blocked from this sector through income limitations, there would have been more devastation in the market. Also, FHA has been able to accommodate much smaller loans than most other capital sources particularly in refinancing existing FHA loans. Meanwhile, FHFA has constrained Fannie Mae and Freddie Mac by reducing their maximum 2013 volumes by 10 percent from their 2012 volumes. There is a volume of non-discretionary loan refinances which must occur in the next couple of years. Such factors are exacerbating stress on rental communities. It is important to maintain FHA as a resource for multifamily and healthcare markets.

- *FHA's Healthcare loan programs are necessary.* More than two thirds of FHA healthcare loans are for nursing homes, including assisted living facilities. Many of FHA's hospital loans are made pursuant to the Critical Access Hospital program which is targeted to rural communities where FHA's program may be the difference in the ability to fund new construction of a clinic or needed wing to an existing medical facility.

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[10] Federal Housing Administration communication to Multifamily and Healthcare industry, May 15, 2013
[11] Federal Housing Administration, FHA Annual Management Report, Fiscal Year 2012 (November 2012) at p. 29. Can be accessed at:
http://portal.hud.gov/hudportal/documents/huddoc?id=FHAFY12AnnualMgmntRpt.pdf.

Regulatory Relief

The PATH Act contains a number of regulatory relief provisions that will help aid our nation's mortgage markets in their recovery and ensure consumers have access to safe and affordable mortgage credit.

The Ability to Repay rule and Qualified Mortgage (QM)

MBA strongly supports enactment of H.R. 1077, the Consumer Mortgage Choice Act. Introduced by Representative Bill Huizenga (R-MI) and a bipartisan group of eight members of the Financial Services Committee, the legislation would modify the definition of "points and fees" used to determine whether a loan meets the QM test.

The Dodd-Frank Act establishes a Qualified Mortgage (QM) as the primary means for mortgage lenders to satisfy its "ability to repay" requirements. Dodd-Frank also provides that a QM may not have points and fees in excess of 3 percent of the loan amount. As currently defined, "points and fees" include (among other charges): (i) fees paid to affiliated (but not unaffiliated) title companies, (ii) salaries paid to loan originators, (iii) amounts of insurance and taxes held in escrow, (iv) loan level price adjustments, and (v) payments by lenders to correspondent banks, credit unions and mortgage brokers in wholesale transactions.

As a result of this problematic definition, many affiliated loans, particularly those made to low- and moderate-income borrowers, would not qualify as QMs and would be unlikely to be made or would only be available at higher rates due to heightened liability risks. Consumers would lose the ability to choose to take advantage of the convenience and market efficiencies offered by one-stop shopping.

MBA appreciates that the provisions of H.R. 1077 have been incorporated into the PATH Act. We hope the continued bipartisan support for this Dodd-Frank fix leads to its enactment before the Ability to Repay rule takes effect in January of 2014.

MBA also appreciates that the PATH Act delays the implantation of the Ability to Repay rule for an additional year. While our members are moving forward to make the changes necessary to comply in time, we remain concerned about the limited timeframe for complying with what is undoubtedly the most significant mortgage rule in a generation. The complexity of this rule, as well as the many remaining questions for the CFPB, warrants an additional year to ensure a seamless transition and minimal disruptions to the mortgage markets. The additional year will also provide more time for the CFPB to make the necessary changes to the "points and fees" calculation, as discussed above.

Risk Retention

Since the CFPB finalized the QM definition in January, MBA has urged the six federal regulators responsible for drafting the risk retention rules to synchronize the QRM definition with the QM definition.

Creating separate and inconsistent definitions for QM and QRM was always a flaw in the Dodd-Frank Act. Both provisions were intended to promote safer lending and sounder underwriting. And a safe loan for a borrower being a sound investment for an investor, the goals of these two rules naturally align.

While MBA continues to have concerns with the Ability to Repay rule, we would note that the QM designation has eliminated many of the loan-level factors that contributed to the mortgage crisis. Indeed, seasoned loans underwritten to standards similar to QM have performed far better than even traditional prime loans, even during the recent financial crisis. Drafting the QRM exemption more narrowly than QM will further tighten credit for loans nationwide, and eliminate any opportunity for private capital to compete with federally-subsidized, taxpayer-supported loan programs.

MBA has also strongly objected to the proposed premium capture cash reserve account (PCCRA) proposal embedded in the risk retention rule and recommends its elimination. As proposed, we believe that it would be exceedingly disruptive to the CMBS market, and effectively would remove the financial incentive to issue CMBS, possibly eliminating CMBS as a potential source of permanent mortgage capital for commercial/multifamily real estate borrowers.

Because of the harm the PCCRA would do to our nation's commercial real estate markets, and because the QM is a superior construct for defining safer residential mortgage products, MBA believes the Dodd-Frank Act's risk retention requirements have been rendered largely unnecessary and, barring significant improvements in the final rule, would favor their complete elimination.

Eminent Domain

MBA sympathizes with the plight faced by many homeowners across America, especially those in communities hardest hit by the housing crisis. Since 2007, the mortgage industry has completed more than six million permanent loan modifications, including more than one million loans through the Treasury Department's Home Affordable Modification Program. Combined with the more than one million short sales, the total number of permanent, foreclosure-avoiding solutions now stands above 7.2 million.

Recent efforts, however, to use the power of eminent domain as a means to reduce homeowners' monthly payments will only serve to harm our nation's mortgage markets.

MBA is concerned by recent proposals by municipal governments in various parts of the country to use the power of eminent domain to seize the mortgages of underwater homeowners who are current in their payments, reduce the principal to market value, refinance the loan through FHA and resell it to new investors.

This unprecedented use of eminent domain would constrict the availability of mortgage credit, as mortgage investors would likely refuse to purchase mortgages in participating communities due to expected lending losses and collateral risk. As investors withdraw from these markets, fewer creditworthy borrowers would be able to purchase a home, depressing demand below its current levels. The result could be many more homeowners pushed underwater by further declines in home values. Mortgage rates and/or downpayment requirements would rise to compensate for the added eminent domain risk and in turn, price many prospective homebuyers out of the market, particularly in distressed communities.

MBA believes these proposals are not constitutional. Transferring mortgages from their current holders to a privately-owned refinancing entity violates the "public use" requirement for affecting a taking under eminent domain. Moreover, owners of a seized mortgage would not receive the

"just compensation" required under eminent domain, since performing mortgages would be revalued at some percentage of the value of the collateral. The proposals likely also violate the Contracts Clause of the Constitution, in that they would substantially impair existing contractual relationships. Finally, the proposals take advantage of the federal government's current refinance programs, and as a result would significantly increase taxpayer exposure. This risk prompted the FHFA to issue a statement on August 9, 2012, expressing "significant concerns" with the proposals and stating that "utilizing eminent domain in this way could undermine and have a chilling effect on the extension of credit" to prospective homeowners.

MBA strongly supports the provisions of the PATH Act that would bar Fannie Mae and Freddie Mac from purchasing or guaranteeing mortgages that are within a jurisdiction that has exercised the power of eminent domain to seize a mortgage loan during the preceding 10 years. We also support the provisions that prohibit FHA from insuring and the U.S. Department of Agriculture's Rural Housing Service from guaranteeing, making, or insuring mortgages that are within a jurisdiction that has exercised the power of eminent domain to seize a mortgage loan during the preceding 10 years.

Basel

Section 401 of the PATH Act would require the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency to conduct an empirical study of the impact of the final Basel III rules on the financial services sector, the cost to implement the complex rule, change in capital required, the potential of capital volatility, economic growth, and availability of credit to consumers and businesses. The final Basel III rule many not take effect until at least two years after the legislation is enacted.

MBA believes the final Basel III rule approved earlier this month continues to have significant flaws including the harsh treatment of servicing assets and the change in capital requirements for warehouse lines of credit. The treatment of servicing assets will likely drive a large amount servicing assets from depositories to less regulated non-depositories. Removing residential mortgages from the definition of financial collateral will increase the pricing and/or reduce the availability of warehouse funding to independent mortgage bankers who often serve rural and other under-served markets. MBA believes such a study is important and supports the proposed delay in the implementation of the final Basel III rule.

Conclusion

Thank you for the opportunity to testify on the PATH Act. MBA remains committed to its key principle that a successful secondary market should rely primarily on private capital, but will also require a limited, but explicit, government backstop to maintain stable liquidity through all market cycles. We also want to ensure that any changes to FHA ensure this important program remains a vital source of affordable mortgage financing for the targeted populations it was created to serve.

While a good starting point for the debate, we believe key changes will be necessary prior to this legislation being considered by the full House. I want to reiterate that MBA remains eager to work with Chairman Hensarling, Ranking Member Waters, and all other members of the House Financial Services Committee in the coming days to improve the bill in a way that provides consumers with affordable, sustainable mortgage credit and creates a vibrant secondary market that works for lenders of all sizes and business models.

American Enterprise Institute
for Public Policy Research

Statement before the House Committee on Financial Services
On "A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

Testimony on the Protect American Taxpayers and Homeowners Act

Peter J. Wallison

Arthur F. Burns Fellow in Financial Policy Studies

American Enterprise Institute

July 18, 2013

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Testimony to the House Financial Services Committee

Peter J. Wallison
Arthur F. Burns Fellow in Financial Policy Studies
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July 18, 2013

Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

Thank you for this opportunity to testify on the Protecting American Taxpayers and Homeowners Act of 2013. This act is particularly well-named; by taking the government out of our housing finance system we will create a stable system for financing homes in the future while protecting taxpayers from further bailouts and homeowners from the dangers of foreclosure.

Although there seems to be a near-consensus that Fannie Mae and Freddie Mac should be eliminated, there is no consensus on what should replace them. Since the financial crisis in 2008, almost every plan that has been put forward in Washington has involved one or another ingenious way to wind down Fannie and Freddie while keeping the government involved in the housing business.

This reflects a kind of delusion—that Fannie and Freddie were bad but the government's involvement in housing finance is somehow good. In reality, Fannie and Freddie did what they did, and became insolvent doing it, because they were backed by the government. If Congress adopts another plan for the government to back the housing finance system we will end up the same way—with a huge mortgage meltdown, a major recession, taxpayers on the hook for billions of dollars, and millions of families losing their homes.

The last point finally got to a former chairman of this committee, Barney Frank, who said in 2010, "I hope by next year we'll have abolished Fannie and Freddie. It was a great mistake to push lower-income people into housing they couldn't afford and couldn't really handle once they had it." And he added, "I had been too sanguine about Fannie and Freddie."

It's easy to see how government-induced declines in underwriting standards happen. Every member of this committee knows how hard it is to cut spending. That's because every member of Congress wants to do something for the people who elected him or her. Congress likes to spend because the voters like it.

All the better, then, when the benefits for constituents do not involve spending. Fannie and Freddie were and are examples of this. Because they were controlled by the government, they could be manipulated to give subprime and other low quality mortgages what was in effect a

government guarantee, so that financial institutions and others would buy these mortgages when in any other world they would not think of taking such a risk.

This was a gift to constituents who did not have the financial resources or the credit standing to get a mortgage. It was no different from the usual spending program, except that it did not involve appropriations or increases in the debt—until the whole system crashed because of low-quality mortgages in 2008.

Housing finance is a particularly good example of this process because Congress also saw fit to extend the benefits of the GSEs and the FHA to wealthy constituents, allowing people who were buying million dollar homes to get the benefits of FHA insurance or a GSE mortgage.

What makes anyone think that this won't happen again if the government is going to back mortgages? The Corker-Warner bill, which has received a lot of favorable attention because it is bipartisan, is an example of the proposals that will eliminate the GSEs but put another government program in its place. Investors would be protected, but the government insurance program that would replace Fannie and Freddie will eventually be pressured by Congress to make the same risky mortgages that brought down the financial system in 2008. We should recall that FHA started its life requiring 20 percent downpayments. Now it requires 3 percent or less—and needs a taxpayer bailout.

This history should tell all of us that the bill now before this committee is the way to go. It would take the government out of most of the housing finance market, although it would provide for a new and more prudent FHA for first time low-income home buyers.

I have some suggested improvements for this bill—detailed in my written testimony—but on the whole it shows the way out of the repetitive cycles of failure that have been the story of the housing finance market under the government's control since the end of the Second World War.

Instead of yet another government program—and another meltdown in the future—the PATH Act would open the way for private securitization to become a major source of housing finance.

In this, the draft is following the views of former Fed chair Paul Volcker, who said in 2011:

> There is one very large part of American capital markets calling for massive structural change that so far has not been touched by legislation. The mortgage market in the United States is dominated by a few government agencies or quasi-government organizations. The financial breakdown was in fact triggered by extremely lax, government-tolerated underwriting standards, an important ingredient in the housing bubble. The need for reform is self-evident and the direction of change is clear. We simply should not countenance a residential mortgage market, the largest part of our capital market, dominated by so-called Government-Sponsored Enterprises.
>
> The residential mortgage market today remains almost completely dependent on government support. It will be a matter of years before a healthy, privately supported

market can be developed. But it is important that planning proceed now on the assumption that Government-Sponsored Enterprises will no longer be a part of the structure of the market.

Before turning to the specifics of the bill, I'd like to address a number of fallacies that are used to support the idea that government must be involved in the housing finance market.

The government is necessary for 30 year, fixed rate mortgages. Anyone can prove this is a fallacy, simply by going to Google and typing in "30-year jumbo fixed rate mortgage." The word "jumbo" is mortgage market jargon for loans that are too large to be bought by Fannie or Freddie, or insured by the Federal Housing Administration. That means a jumbo mortgage is not backed in any way by the government. Still, a Google search will return many offers of jumbo fixed rate 30 year loans. I found one offered by Wells Fargo last Friday at 4.5%, which was *less* than the 4.625% offered by Wells for a conforming (Fannie and Freddie) 30 year fixed rate loan.[1]

The idea that government backing is required for a 30-year, fixed-rate loan has some surface plausibility. Many people who don't follow the financial markets might assume that lending money for that long a period at a fixed rate would be too risky for the private sector. However, our flexible and innovative private financial markets offer hedging opportunities that make this possible.

Just about everyone in Congress seems to have been visited by a representative of the Government Mortgage Complex—Realtors, homebuilders and community activists—claiming that the 30 year mortgage would not exist without government backing. If that's what they're telling you, keep a copy of the rate sheet I've cited below in your desk and ask them to explain how it could be that Wells Fargo is offering a 30 year fixed rate mortgage without government backing.

The investors in MBS are rate buyers; they do not want to take credit risks. Without government backing and the assurance of a risk-free investment, it is argued, we would not be able to find investors for MBS in the US and around the world.

This argument confuses cause and effect. It is true that most of the buyers of GSE and Ginnie MBS today do not want to take credit risk, but that's only because these government-backed securities *attract* investors who do not want to take risks. According to the Fed's Flow of Funds data, the principal buyers of Ginnie Mae and GSE mortgage-backed securities (MBS) are US banks, foreign central banks, and Federal, State and local pension funds. If there were no Ginnie or GSE MBS, they would be buyers of Treasuries.

Virtually the entire private sector, however, is financed by the private bond market, where institutional investors like insurance companies and private pension funds are willing to take prudent risks in order to gain the higher yields than they can get on government securities. In the private sector, investors are compensated for taking these risks. Privately securitized mortgages would be a perfect investment for financial institutions like life insurers, private pension funds and mutual funds, which have about $13 trillion to invest. This would be a win-win for our economy, providing long term high quality and stable assets for life insurers, pension

[1] Wells Fargo, Today's Mortgage Rates, accessed on July 12, 2013, https://www.wellsfargo.com/mortgage/rates/

funds and others looking for long term assets while also providing a long term source of financing for mortgages.

The government will step in anyway, so it should charge in advance to protect the taxpayers. Almost all the proposals for a government backstop for mortgages are premised, implicitly or explicitly, on the idea that if there is ever a problem in the housing market the government will step in. Accordingly, the argument runs, we should have a system in place that compensates the government in advance and sets up the mechanism for the government's inevitable intervention. There are many problems with this argument, including the fact that the government recently stepped in to rescue two automobile companies, one of them for the second time. This means that the government is liable to step in whenever there is a serious problem in any market where large numbers of people are employed, or where something is manufactured or where a service is performed that is widely used. If the argument in support of government backing for housing is correct, we should also have a similar system for every other part of the economy. The moral hazard consequences of that can hardly be imagined.

But the history of housing finance makes clear that the government's role in the housing market—even if only as a brooding presence ready to act if the market collapses—will so distort the market that the government is eventually *required* to step in. This is a repeating pattern. For one example, the government had to rescue the S&Ls in the late 1980s and early 1990s because the government's own support for and regulation of the S&L industry had made it impossible for the industry to survive the changes in market structure that are inevitable in an evolving financial system. Similarly, the reason we are here today, and considering what to do about the GSEs, is the result of government housing policies that forced Fannie Mae and Freddie Mac to degrade their underwriting standards.

Government backing of the housing finance market cannot be separated from government policies that will weaken mortgage quality. The government is in the business of providing benefits to its constituents—that is, US voters—and when it controls a sector of the economy it makes sure that the maximum number of people receive the benefits of the government's support. This is normal in a democracy, but it is devastating to markets. It means that mortgage quality will inevitably be reduced so that more borrowers can qualify for mortgages, and that in turn is what brought on the great housing bubble, the mortgage meltdown of 2007 and 2008 and the financial crisis.

We should have learned by this and earlier experience that government intervention in the housing finance market is made more *likely* by government's backing of the housing finance market. So if we want a stable market we are more likely to get it with one that does not rely on government support—much like every other industry in the US—than one in which the government is involved.

Without government backing there would be no TBA market and interest rates for all mortgages would rise. This is also incorrect. The TBA (To Be Announced) market is a hedging mechanism, which allows lenders to hedge the possibility of interest rate changes between the time they lock in a rate for a borrower and the time the loan actually closes. This is done by selling the pool of mortgages forward, just as a farmer might sell his wheat or corn crop forward. Then, if the price falls, he is protected. The buyer is speculating that wheat will be

worth more when delivered than it is on the date of the forward sale. So in the same way, the mortgage lender sells its pool of mortgages forward to a buyer who is speculating that the mortgages will be worth more in the future when they are ultimately delivered.

There are two keys to the effective operation of a TBA market—market liquidity and a general agreement on the principal terms of the mortgages in a MBS pool. In the current TBA market, in which the GSEs are the principal players, liquidity is created by a convention among market participants about what they will accept as sufficient information about a particular mortgage pool that is offered for sale. The agreement covers six factors—issuer, maturity, coupon, price, par amount and settlement date. Participants in the market agree to buy a pool of mortgages that all fall within these previously-agreed parameters. It's the agreement on these parameters—so hedging counterparties know what they are buying—that creates the hedging opportunity, not a government guarantee of the credit risk. The credit risk is occasionally a factor, but the purpose of the TBA market is to hedge interest rate risk, not credit risk.

Once the private market becomes active enough so that there is a liquid market for the purchase and sale of mortgage pools a TBA market will function. The independent platform's utility, proposed in section 322 of the PATH Act, should make this happen sooner than it would in a fully private market, but there is no question that TBA would develop in a fully private market just as it would in a market dominated by a government agency.

Without government involvement, a steady flow of credit to housing cannot be guaranteed. This idea raises an important question: why should housing, as distinguished from any other industry, be guaranteed a steady flow of credit? Every other industry has to live with the prospect that interest rates will rise and credit will tighten. This encourages prudence and care in making commitments, reduces overbuilding and the use of leverage that has contributed to housing bubbles in the past. A steady flow of credit to housing has, ironically, been the cause of much of the volatility and instability in the housing market in the past. It would be better, accordingly, if the housing market were not guaranteed a steady flow of credit. If credit in the market in general is insufficient for any reason, the Fed has the necessary resources to address the problem. A separate system for housing is not necessary and would be affirmatively harmful.

The Protect American Taxpayer and Homeowners (PATH) Act

The act has four Titles, and my comments on the most important elements in each title follow.

Title I

Title I covers the wind-down of Fannie and Freddie. This is an important objective of the act. There are many technical issues that should be discussed with the committee's staff, but the following discussion addresses what I think are the most significant issues.

Section 104. This section winds down the GSEs over a five year period, ending with a receivership that presumably wipes out their stock. This is a good idea for several reasons. It assures the private sector that Fannie and Freddie will disappear in a known period of time and thus encourages the private market to begin making the capital investments and other

preparations for a return of private securitization. However, winding down the GSEs to a conforming loan level floor of $250,000 is not a rapid enough decline. It will leave a very large portion of the available housing finance business still within the GSEs' conforming loan limit and thus in competition with the private sector. This slow withdrawal of the GSEs will slow the entry of private securitizers and the liquidity available to those private securitizers who have already entered, keeping their rates somewhat higher than they would be if they had a larger proportion of the market to work with. It could also create a cliff-like effect on rates when the five year period ends, and that might induce a future Congress to postpone the elimination of Fannie and Freddie. In my view, the conforming loan limits for Fannie and Freddie should be steadily reduced to $100,000 or less at the end of five years.

Section 104 (c) repeals the housing goals adopted in 1992. The affordable housing goals, which sought to increase mortgage lending to moderate and low income borrowers, required Fannie and Freddie to radically reduce their underwriting standards between 1992 and 2008. Because they were the dominant players in the housing finance market, when the GSEs reduced their underwriting standards everyone else had to follow suit. It was not possible to limit the reduced standards to low and moderate income buyers. Eased credit terms and more buyers built the largest housing bubble in US history between 1997 and 2007. By 2008, half of all mortgages in the US market—28 million loans—were subprime or Alt-A, and when the bubble deflated these mortgages defaulted in unprecedented numbers, bringing on the mortgage meltdown, the financial crisis and the resulting recession. During and after this period, many families lost their homes. By eliminating the affordable housing goals, the PATH Act prevents this from happening again by preventing the government from taking control of and reducing mortgage underwriting standards. This is one of the act's major contributions to future housing finance market stability.

Section 106. Mandatory risk-sharing with the private sector could work well for the GSEs while they are being wound down. It will help the FHFA properly price the risk of securitized pools by providing a private sector estimate of the risk of a particular pool. However, for the system to work most effectively, private risk-sharers should take the first loss, with the GSEs taking any losses above that level. Risk-sharing in which the risk-sharer takes the first loss may not work well in other contexts, such as the Corker-Warner proposal, where it may force the government insurer to reduce its insurance premiums in order to keep mortgage costs low.

Section 107. The requirement in this section that the GSEs may only purchase "qualified mortgages" as defined by the CFPB could have a very serious adverse effect on mortgage quality in the future. The CFPB's QM regulation assumes, incorrectly, that if a lender ascertains that a borrower can repay the mortgage at the time the contract is written that is a sufficient indicator of the mortgage's quality. Then it compounds the problem by providing that if the automated underwriting systems (AUS) of the GSEs or another government agency approves or accepts the mortgage the lender gets a safe harbor against the penalties that the Dodd-Frank Act has written into TILA and the defenses to foreclosure in Sec 1413 of Dodd-Frank. Requiring compliance with the QM rule implies that this is the standard of mortgage quality that Congress expects. That would be a very troubling result. With the exception of a debt-to-income (DTI) ratio limitation of 43 percent, the QM rule requires no underwriting standards; a loan can qualify under QM even if it has no downpayment and is made to a borrower with a credit score of 580 or 600.

The fact that the borrower can repay the loan at the moment it is agreed to does not mean that the borrower has the *intention* or will have the *capacity* to repay the loan in the future, despite the many financial problems—loss of employment, divorce, illness, etc.—that are part of life and have the effect of changing a borrower's priorities. A dataset recently released by Freddie Mac and involving over 15 million fixed rate, fully documented loans since 1999 shows that a home purchase loan like that described above (30 year fixed, fully documented, home purchase, no downpayment and a 600 FICO score) had an incidence of default of 26%, even if the DTI is 42%. Compare this to a 1% default rate on a loan with 20% down, a DTI below 38%, and a FICO score of 720, which is about the median FICO score in the U.S. Section 107 should make clear that the objective of the GSEs' lending should be to return to an incidence of default of 1% or less in normal times—the rate that prevailed before the adoption of the affordable housing requirements in 1992. This will create the stable mortgage market that the bill correctly seeks.

Title II

Title II provides a new charter for the FHA, turning it into a corporate body (**Sec 211**) that will function outside the control of the Department of Housing and Urban Development (HUD). This is a very good idea, especially when combined with some of the safeguards that are built into the proposal to keep the new entity from becoming a cost to the taxpayers. However, there are a few areas where additional provisions are necessary or where existing provisions should be improved.

Sections that contain excellent ideas are **211(d) and 235 (c)** that require FHA to be self-supporting by covering its own costs, including its administrative costs; **Sec 234**,which reduces FHA's insurance 10% per year until it reaches 50%; **Sec 235**, which sets a minimum premium of .55%, allows risk-based premiums or risk-based underwriting, and requires a statement for borrowers at the time the loan is originated telling them of the likelihood of default and foreclosure; **Sec 251**, providing for FHFA to act as prudential supervisor of FHA; **Sec 253**, requiring that FHA use GAAP accounting (although the language should specify private sector GAAP in order to exclude federal GAAP); **Sec 256**, which establishes a capital reserve of 4% (but it should not include net present value of inflows and outflows, which FHA has shown are susceptible to manipulation); **Sec 263**, which imposes a 3% limitation on seller concessions (I assume this is 3% of mortgage cost, not "closing" costs as stated in draft); and the **Sec 267** requirement for a review of a borrower's residual income.

The sections that should be improved are **214 and 215**, which provide for the board of directors and officers. If FHA is to be independent of HUD, the HUD secretary should not be the chairman of the board. The chairman normally establishes the agenda, and that alone can keep the FHA from addressing key issues. In addition, although the draft says that there should be a president and vice president their duties are not specified. Since the duties of the chief risk officer are specified, this sets up a conflict with the president, who has no assigned duties. All these problems can be solved by providing that the president is the CEO and giving him or her the power to set the agenda (as well of course as running the organization), even though the chairman of the board is the HUD secretary. I would even suggest removing the HUD secretary as the chairman of the board and providing only that HUD and the Department of Agriculture have representatives on the board. I understand why the chief risk officer is made independent

of the board, but that's not a good idea. Every decision involves some risk, and the reason to have a board is to make balanced decisions on risk based on the issues the chief risk officer brings to them.

Sec 232 is probably the most important provision in this title, and it is inadequate. There is a considerable risk that the FHA and RHS, as the only government agencies authorized to insure mortgages under the bill, will become competitors for private securitizers to the same extent that they and the GSEs are today. That's why both the house price and income restrictions in Sec 232 have to be very tightly drawn. The bill does not do this; in fact, in Sec 232(a)(1)(B)(i) it prescribes the *highest* median price level in any metro area (the median price level in the highest priced county) as the standard to be used for determining what is 115% of the median housing price in the metro area. Within any metro area there can be high priced and low priced counties. 115% of house prices in the highest priced county would mean that houses in the counties with the lowest house prices could have most houses qualifying for 115% of median, and most mortgages in that county would end up going to FHA or RHS, even though Congress intended that only home purchase mortgages for low-priced homes would be eligible for insurance from the FHA. This provision has to be modified if a robust private securitization market is to come back on anything but the jumbo level.

The same problem occurs with the income restrictions in Sec 232. There are none for first time buyers and those turn out to be 75% of FHA's home purchase loans today. This in itself is a huge loophole. Many first time home buyers will be able to get the benefit of FHA insurance, even though they are not low-income, and that could take a large chunk of the market away from private securitizers. Non-first time buyers are subject to a limitation of 115% of area median income, but again without a tighter definition of this standard in the statute FHA would be able to compete with the private sector for the business of many borrowers who are not low income and do not need the help of FHA insurance. In this respect, the income eligibility restrictions in the bill refer back to the house price provisions of 232 (a)(1)(B)(i). That would make large numbers of higher-income borrowers in lower-income counties—who would otherwise go to the private markets—eligible for the favorable terms at FHA, such as the 5% downpayment, that Congress intended only for low-income borrowers.

One way to deal with both the housing price and income definition problems is base both of these determinations on median incomes by county not metro areas. FHFA should have this data, or can produce it. That would not a perfect solution, but it would help to cabin FHA and restrict the competition that FHA would provide for the private market that the bill is intended to revive.

Beyond these two issues, it is necessary to consider how FHA will be able to provide the benefits it should to low-income borrowers and still remain a self-sustaining independent firm. There is a difficult balance here. It is possible for FHA to avoid losses and still provide benefits to low-income borrowers. In this connection, downpayments of 3.5% and 5% are certainly the kind of benefit that FHA should provide, but not if they are layered with slowly amortizing 30-year terms, low FICO scores, and high DTIs. Based on FHA's experience, a 30 year fixed rate FHA mortgage with a downpayment of 3.5% has a 20% likelihood of default if accompanied by a FICO score of 640 and a DTI ratio of more than 43%. The purpose of the FHA can be served by using a balanced approach, which employs various elements of good underwriting to

compensate for the weaknesses in the insurance applications of some low-income borrowers, such as a low FICO score. For example, although a 30 year fixed rate loan with a downpayment of 3.5%, a FICO score of 640, and a DTI of 43% would have a 20% likelihood of default, the same loan with a loan term of 20 years would have a 10% likelihood of default. Combining the effect of other changes in this bill, such as reducing coverage to 50% over 5 years and limiting seller concessions to 3%, could reduce the default rate to an estimated 7%.

Sec 232 also makes some reference to pro-cyclicality, since it eliminates FHA income limits when the market is declining. But a declining market is literally only half the story. The financial crisis was caused by the opposite—a bubble in housing prices. It is necessary for the bill to have countercyclical provisions for both abnormal rises as well as abnormal declines in market prices. My colleagues and I at AEI would be pleased to have the opportunity to work with the committee staff on this. One way for such a system to work would be to require decreases in LTV ratios when housing prices exceed certain predetermined limits, but other ideas are also feasible.

Sec 257. Finally, the stress testing provision in sec 257 is an excellent idea, but it isn't carried out well enough. First, the stress cannot simply be downturns of "average severity" since 1950. This may be a drafting question. The downturns of average severity during that period may not have resulted in any significant decline in house prices. A better test would in some way include the severity of the most recent downturn, which was 30 percent, by including it in the average. Another way to do it is to assume that, if house prices are above a long-term trend as established by FHFA, they will revert to trend. The FHFA has already done substantial work in this area. A properly structured stress test along these lines could serve as a countercyclical device applicable to FHA when the market is booming, but it is also necessary to have a countercyclical device that applies to the broader market in these circumstances, and there is none in the bill. Second, while a 4% capital requirement is appropriate, the test should assume that the FHA has 4% capital *after* the stress event, not that it has something above 0 capital.

Title III.

The Utility is a good idea, but the committee should be concerned about giving an independent company control over something as vital as the private securitization system without any control by participants in the market it is affecting. We have not had good experiences with government- created monopolies, oligopolies or monopsonies like Fannie and Freddie, FINRA, and the rating agencies, all of which have profited excessively from the fact that the government provided them with a special license to perform services in a particular field. Even though the Utility is to be a not-for-profit organization, it has a position that could be profitable for its management. One way to address this problem would be to provide for the Utility's board of directors to consist of a majority from the housing and housing finance businesses. That isn't a perfect solution, but it would have some effect in assuring that what the Utility does is in the interests of the industry and not in the interests of the Utility's management.

Sec 322 appears to be designed for assisting the development of a TBA market. If so, that ought to be expressed somewhere in the language. Right now, the language could be interpreted to give the Utility control of "underwriting criteria," –very broad term that could be abused unless its use is circumscribed for a particular purpose.

Sec 322(j) provides for mandatory arbitration, but it doesn't provide that the result of the arbitration is the exclusive remedy for the complainant. Without that, the arbitration provision may simply create an expensive hurdle before getting to litigation.

Sec 343 adds qualified securities to the list of securities exempt from the application of the Securities Act. It might be better to provide that qualified securities are eligible for shelf registration with the SEC—with descriptions of the underlying mortgages limited to the six elements now disclosed—which will facilitate the development of a TBA market.

Title IV

Some of the most important changes in law necessary to stimulate the development of a robust securitization market are already included earlier in the bill, but Title IV contains some provisions of major importance. **Sec 407**, for example, repeals the risk retention provisions in section 941 of the Dodd-Frank Act. This provision required securitizers to retain 5% of the risk of an issue of securities unless all the mortgages in a securitized pool were qualified residential mortgages (QRMs). QRMs were intended to be very high quality mortgages, but the regulators who were to design this mortgage have not up to now been able to agree on what the QRM was supposed to look like. In any event, the requirement for risk retention was impossible for smaller securitizers to meet, and virtually guaranteed that all the business would go to the large banks with balance sheets large enough to hold 5% of their securitizations for an indefinite period. In addition, FHA and probably the GSEs were exempt from risk retention, which would make them the preferable place for mortgages to be securitized. If the GSEs were difficult for the private sector to compete with in the past, this provision would have made competition nearly impossible unless all the mortgages the private sector securitized were QRMs.

Sec 408. The bill contains provisions that protect lenders who portfolio loans or who are securitizing qualified securities (as defined) against liability under the CFPB's QM rule. This is appropriate because that rule creates a harsh system of penalties for very little purpose. As noted above, complying with the QM and TILA requirement that the lender establish the buyer's ability to repay (ATR) the loan at the time the mortgage is agreed to is not a significant underwriting standard. It allows loans with no downpayment and 580 FICO scores, which will always produce high rates of default and return the housing finance system to the condition it was in when the mortgage meltdown occurred in 2007 and 2008. At that time, at least half of all mortgages in the US financial system—28 million loans—were subprime or Alt-A.

However, the penalties under the QM rule did have one valuable element. If it were not for the fact that the CFPB's rule confers safe harbor protection on a lender who gains the approval or acceptance of the loan under the AUS of the GSEs or another government agency, the penalties under TILA would have created a strong incentive for lenders to use traditional underwriting standards in order to reduce as much as possible the likelihood of defaults by borrowers.

However, by eliminating the penalties in the QM rule for certain mortgages and securities, the bill does not itself create any new incentive for lenders to use traditional underwriting standards. The Freddie dataset cited above demonstrates that when traditional underwriting standards are used to create prime mortgages the likelihood of default is reduced to

1% or less. As was true before the enactment of the affordable housing goals, prime loans are consistent with a homeownership rate of 64 percent. A predominance of prime loans in the housing finance system is what would create the stable market that the bill seeks.

One way to encourage this outcome would be to require that the GSEs only acquire prime loans or approve prime loans through their AUS. Prime loans could be defined in the bill or in regulations by FHFA under guidelines established in the bill. No one should object to this, because the GSEs are now operating on the taxpayers' dime and should not be taking any risks on mortgages. This would shut the loophole created by the CFPB's rule, which would still apply to loans that are not portfolioed or run through the Utility's platform. If the GSEs were limited to acquiring only prime loans, and the mortgages eligible for FHA and RHS were limited as described above, lenders would then have an incentive to use traditional underwriting standards.

Sec 413. This provision requires that a second lien creditor notify the servicer of the senior lien of the existence of the new mortgage. This is insufficient. When a junior lien is added to an existing mortgage it changes the quality of the mortgage for the first lien holder. A mortgage that once might have had a downpayment of 20 percent now, in effect, has none. The homeowner has eliminated his or her equity in the home, which was seen by the first lienor as protection against default. A sensible compromise would be to allow second liens, but if they occur within 6 months of the date of the mortgage the holder or servicer of the first lien can recognize the additional risk by increasing the rate on the mortgage. This provision would protect investors in privately securitized mortgages, who currently have no protection against second liens added after a mortgage is securitized.

Other Provisions that May Adversely Affect Private Securitization

Volcker Rule. Although justified as preventing the use of insured deposits for risky trading, this rule, enacted in the DFA, prohibits "bank related entities" from engaging in proprietary trading and thus extends far beyond the insured banks it was intended to cover. The term "bank related entities" includes bank holding companies and their subsidiaries, which do not have access to insured deposits. In addition, "proprietary trading" is so difficult to define that the most recent draft regulation covers almost 200 pages and poses over 1000 separate questions to assist the regulators in drafting the final rule. Hedging is a regular and important element of every securitization because it is necessary to protect the issuer against a change in interest rates between the time a mortgage rate is "locked in" with the borrower and the time a complete pool can be assembled for a securitization. Hedging transactions involve buying and selling of securities for the issuer's own account, and could be interpreted to be proprietary trading. Until there is a bright line definition of proprietary trading, it is unlikely that many banks or bank-related entities will take the risk of engaging in a securitization. It is unlikely that the complexity associated with proprietary trading can be adequately defined in a statute, and it may not be possible to define it clearly enough in a regulation. Accordingly, the Volcker Rule may stand permanently as a serious obstacle to private securitization. There are two ways to solve this problem: repeal the Volcker Rule, or apply it solely to insured banks and not the broader "bank-related entities." This will enable bank holding companies and their affiliates to engage in securitization without fear of violating the highly technical Volcker Rule when the regulation is ultimately finalized.

Provisions for Community banks. Community banks generally originate high quality mortgages, but their ability to sell those mortgages through the securitization system is restricted. First, they do not want to sell their mortgages to the large banks that are serving as aggregators and securitizers. They regard these large banks as competitors and argue that the large banks use the information on borrowers to steal the customers of community banks. The bill should address this problem directly. I think it is possible for community banks to create a jointly-owned conduit for their mortgages that will enable them to securitize their mortgages directly, without going through a large bank. The best way to determine whether this is possible would be to assign to the FHFA the task of studying this issue and suggesting the mechanism for how this might be done at the least cost to the community banks.

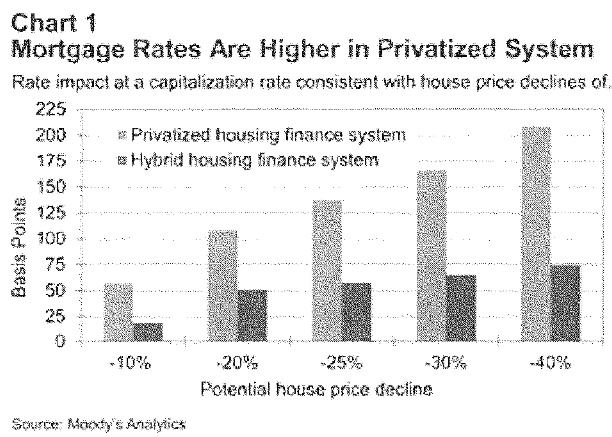
Written Testimony of Mark Zandi
Chief Economist of Moody's Analytics

Before the House Financial Services Committee

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing System"

July 18, 2013

The Protecting American Taxpayers and Homeowners Act is the most recent legislative effort to reform the nation's dysfunctional housing finance system.[i] The PATH contains a comprehensive but ultimately unviable proposal to wind down Fannie Mae and Freddie Mac and privatize the nation's housing finance system. If fully implemented, the PATH would lead to significantly higher mortgage rates, particularly in tough economic times, and would put 30-year fixed rate mortgage loans out of reach for most Americans (see Chart 1).[ii]



PATH plan

The PATH does three key things. First, it puts Fannie and Freddie into receivership and sells off their assets. Second, it reforms the Federal Housing Administration. Third, it privatizes the rest of the housing finance system.

Winding down Fannie and Freddie is the least controversial aspect of the PATH, although it is not without controversy. Fannie and Freddie's footprint in the mortgage market would be steadily reduced by lowering conforming loan limits and requiring the two agencies to make only qualified mortgage, or QM, loans. Fannie and Freddie would also raise guarantee fees, engage in risk-sharing with private investors, and steadily reduce the size of their retained portfolios. Save for the change to conforming loan limits, all of this is more or less already happening. Fannie and Freddie's affordable housing goals would also be formally eliminated, and they would provide no subsidies to disadvantaged groups. Fannie and Freddie would be put into receivership and dissolved within five years of the PATH's passage.

The act would also limit the FHA's footprint in the mortgage market, permitting it to insure mortgages only for first-time homebuyers and for low- and middle-income households.[iii] The FHA would have to reduce its insurance coverage on mortgage loans from the current 100% to 50%, while sharing the risk with private investors. The cost of FHA insurance would likely rise because of required changes in its premium policy and the doubling of its reserve fund from 2% to 4%. The FHA would be spun out of the Department of Housing and Urban Development and reconstituted as a separate agency.

Most controversially, the PATH would privatize most of the nation's mortgage market. The legislation encourages development of the private mortgage market by establishing a securitization platform that would be a nongovernment, nonprofit utility open to all mortgage security issuers. Like the common securitization platform that the FHA, Fannie and Freddie are currently working on, the PATH platform would help set standards for mortgage origination, servicing, pooling and securitization. The PATH also provides a legislative and regulatory framework for covered bonds, another financing mechanism currently used mostly by large European banks. Various parts of the Dodd-Frank financial regulatory reform and Basel III international banks standards would also be either repealed or delayed, with the goal of encouraging more private mortgage lending.

If the PATH becomes law, the FHA would account for no more than one-fifth of the mortgage market on average through the business cycle. The rest of the market would receive no government support.

Plaudits for PATH

The PATH is laudable in its effort to reform Fannie and Freddie along with the FHA while making other changes to the banking system and private securitization market. Most proposals to resolve Fannie and Freddie do not consider the rest of the mortgage market, which could leave significant inconsistencies in the system. Balancing the FHA's role with other sources of government support and the private market is difficult unless the system is considered as a whole. Of course, this balancing is easier for the PATH since it gives the government no additional role beyond the FHA. The task is greater for those reform efforts that include a catastrophic government guarantee.

The promotion of risk-sharing among Fannie, Freddie, the FHA, and the private mortgage market is also a positive step. Risk-sharing reduces taxpayers' exposure to mortgage risk and fosters the development of financial instruments that can handle that risk in the private market. With guidance from the Federal Housing Finance Agency, Fannie and Freddie are already moving in this direction, while the FHA appears to be considering it.[iv] The PATH would formalize this effort.

Fostering development of a securitization platform is also worthwhile. Without a common securitization platform, the blizzard of mortgage securities could reduce liquidity and significantly raise mortgage rates. It is difficult to see how a "to-be-announced" (TBA) market would survive in the PATH, but without a securitization platform there would be no prospect for one. The TBA market is vital to reducing transaction costs and mortgage rates.

Yet while a securitization platform is a good idea, it is not clear why mortgage security issuers would use the version created under the PATH. Other reform proposals allow those who use a securitization platform to receive a catastrophic government guarantee for their securities. Not so under the PATH. Issuers would presumably receive some benefit from the greater liquidity gained from using the platform, but this would be offset by the extra cost of agreeing to the platform's terms. It is not clear that issuers would find that the benefits outweigh the costs.

The PATH's effort to develop a covered bond market is also a positive step. Covered bonds are used in Europe, where big banks issue securities backed by loans, including mortgage loans. Investors in those securities are protected from losses by the structure of the securities as well as by the banks' capital. The banks backstop the securities. For various institutional and regulatory reasons, there is no covered bond market in the U.S. The PATH addresses these constraints to help jump-start this market. This is important, since without any form of government guarantee in the PATH, banks will need to provide much more capital to the mortgage market. The PATH's authors hope a well-functioning covered bond market will allow this to work better.

Yet it will be very difficult for a covered bond market to attain significant scale. Covered bonds work in Europe in significant part because large banks there are treated as too big to fail and are backstopped by their governments. There is no doubt that German or French taxpayers would support Deutsche Bank or BNP Paribas if they got into trouble. In the U.S., regulators are moving rapidly in the opposite direction. Big U.S. banks are under pressure to reduce leverage, eliminate riskier activities, and reduce their wholesale funding needs. It is hard to reconcile all this with the PATH's reliance on a large covered bond market that would require big banks to get bigger.

The PATH also correctly aims to make the private securities market more competitive. In this vein, it eliminates the Dodd-Frank qualified residential mortgage, or QRM, rule, which demands a lender hold 5% of any nonqualified loan, and share the losses if it later goes sour. The approach makes sense in principle, but the details are quite complicated, reflecting the Federal Reserve's fear that lenders will try to circumvent any rule.[v]

Complexity adds to costs, however, and non-QRM loans threaten to have meaningfully higher mortgage rates than QRM loans.[vi] The Fed is expected to issue a final ruling on QRM by the end of the year, which will hopefully address these concerns, ensuring it is no longer a significant issue by the time housing finance reform legislation comes up for a vote.

Assessing privatization

The PATH's main goal is privatization of the housing finance system. The federal government would have no role outside of the FHA and some modest regulation by the much-diminished FHFA.

The principal advantage of a privatized system lies in its stronger incentives for prudent mortgage lending. Mortgage originators, issuers, rating agencies and investors would understand that if things go badly and defaults rise, they will suffer the consequences. Of course the incentive depends on how strongly investors believe that the government will not intervene, even in bad times. Moreover, the collapse of the private-label securities market during the recent housing bust demonstrated that imprudent risk-taking can occur in a private market, even where enormous losses are possible.[vii]

A privatized system would also protect taxpayers by restricting the government's ability to provide implicit subsidies to the mortgage and housing markets. The FHA would still be a potential source of subsidy, but this would be explicit. There is thus less risk that capital would be misallocated toward housing and away from more productive activities.

The systemic risks borne by taxpayers should also be reduced, at least in theory. In a truly competitive private market, Fannie's and Freddie's roles would presumably be filled by smaller institutions that would not threaten the system if they fail. However, given scale economies in mortgage lending and servicing and historical precedent, it is very possible that the market would become more concentrated, with greater too-big-to-fail risks.

Complete privatization is much more plausible in theory than it would be in practice. Private capital is not limitless, and there are plausible catastrophic scenarios, similar to the Great Recession, that would completely wipe it out. At that point, the government would have little choice but to intervene, or the system would collapse. Regardless of what policymakers say, global investors will almost surely continue to believe the U.S. government would step in if housing foundered. This was amply demonstrated in the financial panic when the government rescued Fannie and Freddie, after saying for years that it would not do so. After Congress' approval of the Troubled Asset Relief Program and the bank bailouts, investors believe Washington will inevitably act if the broader financial system is in danger.[viii]

The potential advantages of privatization would also be overwhelmed by disadvantages in the form of much higher mortgage rates and a much less stable source of

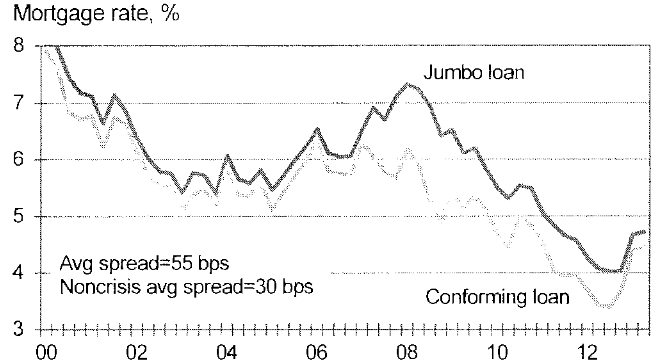
mortgage funding across the economy's ups and downs. The 30-year fixed-rate mortgage, the bedrock of mortgage lending since the Great Depression, would also be significantly diminished.

Under the kind of system envisaged in the PATH, providing the system with enough capital to withstand a mortgage default loss rate of 5%—about the system's current capitalization level—would drive mortgage rates nearly 90 basis points higher than they currently are.[ix]

The estimated mortgage rate impact of privatization depends on three important assumptions. First, it assumes that financial institutions providing capital to a privatized mortgage system will require a 25% return on equity. This is greater than the 15% ROE that the private mortgage insurance industry has typically obtained during times of normal market conditions with a government backstop, but less than the 30%-plus return that unsecured credit card issuers have traditionally sought. Investors providing capital to a fully privatized system will need a higher return to compensate for greater risks when the government is not backing them up.[x]

A second assumption is that investors in a privatized market would assess a liquidity-risk premium of 10 basis points. A private system will likely feature a greater variety of securities, resulting in a smaller, shallower market. The benefit of a deeper market is evident in the interest-rate spread between jumbo and agency-backed mortgage securities, which has ranged from 10 to 30 basis points in normal periods (see Chart 2). In times of stress, the spread has been much greater.

Chart 2
A Privatized Market Would Be Less Liquid
Mortgage rate, %



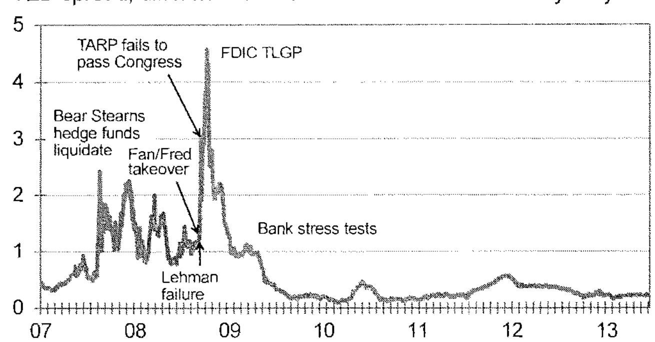
Sources: Bankrate.com, Moody's Analytics

If anything, a 10-basis point liquidity premium is too low, as it is hard to see how the TBA market would function in the absence of some form of government guarantee. The TBA market is critical to liquidity in the current market for Fannie and Freddie securities, and the market in turn depends on the willingness of investors in mortgage securities to accept any security backed by a pool of loans delivered with a given coupon and maturity.[xi] This is acceptable as the government guarantee gives all pools the same credit risk, leaving prepayment behavior as the only potential difference. Thus without a government guarantee, investors would be required to analyze the credit risk of each mortgage pool, including any differences in their credit-enhancement structures. Some investors, such as global central banks, are not able to take on any credit risk, and many others are not equipped to do so. The TBA market would likely fall apart.

A third assumption is that investors in a privatized market would require a financial market risk premium of 25 basis points. Investors would want some compensation for the additional risk of investing without a government backstop. Just how much compensation is difficult to determine, but it is instructive that the TED spread—the difference between three-month Libor and Treasury bill yields—surged from 25 basis points just prior to the financial crisis to a peak of almost 400 basis points at the height of the financial panic, when investors were seriously questioning whether the government would support the financial system (see Chart 3).[xii] After the TARP and other government interventions, the TED spread came full circle, reflecting the widespread belief that the government would not allow major financial institutions to fail.

Chart 3
The Cost of No Government Backstop

TED spread, difference between 3-mo Libor and Treasury bill yields



Sources: Federal Reserve Board, Moody's Analytics

To further test this assumption, a vector autoregressive model of the 30-year fixed mortgage rate was constructed (see Box below). The mortgage rate is explained in the model by the 10-year Treasury bond yield, house price growth, and the TED spread—the difference between three-month Libor and three-month Treasury yields. The model was simulated under the assumption that the TED spread narrows by 100 basis points, which is not quite the average TED spread over the model's estimation period back to the mid-1970s. The exercise effectively simulates the impact on mortgage rates of the counterfactual in which the entire financial system is nationalized. Since money-center banks are part of the government in this scenario, they are willing to lend to each other at the risk-free Treasury interest rate. The 30-year fixed mortgage rate narrows by an average of nearly 50 basis points in this simulation of the model. The assumption that investors will require only a 25-basis point financial market risk premium in a fully privatized system seems conservative.

Box: Description of VAR model of fixed mortgage rates

A vector autoregressive model of the Freddie Mac 30-year fixed mortgage rate was constructed to quantify the impact on mortgage rates of eliminating the federal backstop for the financial system. The model was estimated on monthly data from 1977 to 2012 and includes the 10-year Treasury yield, TED spread (the difference between three-month Libor and three-month Treasury bill yields), the difference between current 10-year Treasury yields and a five-year moving average of 10-year Treasury yields to capture the impact of prepayment risk, and house price growth.

Vector Autoregressive Model of Fixed Mortgage Rates

Dependent variable is the Freddie Mac 30-yr fixed-rate mortgage
Model is estimated on monthly data from 1977 to 2012

Explanatory Variable	Coefficient	t-statistic
Constant	2.34	2.28
10-yr Treasury yield	1.011	9.5
TED spread	0.242	6.99
Difference between 10-yr Treasury yield and 5-yr MA of 10-yr Treasury yield	-0.45	4.23
House price growth	-1.377	-1.78
AR(1)	0.973	78.93
MA(2)	-0.254	-1,400.05

Source: Moody's Analytics

This assessment of the mortgage rate impact of privatization is also conservative, as it does not account for the institutional constraints impacting investor demand in global fixed income markets. Some global institutional investors, mutual funds, and pension funds are not able to invest in assets with credit risk because of their charters or even by law. These investors, who are willing buyers of government-backed mortgage securities, would be unable to purchase mortgage securities issued in a fully privatized system. These barriers may or may not come down in the future. To the degree they do not, mortgage rates would be necessarily higher in a privatized system. Given the difficulty in quantifying and categorizing the variety of mortgage securities investors, we recognize the impact these restrictions could have but are unable to measure them.

Looking overseas for guidance to determine the impact on mortgage rates of a privatized mortgage finance system is not very helpful. While few advanced economies provide direct government support to their mortgage finance systems, many provide substantial indirect support through their banking systems. Mortgage lending is dominated by the banking system, which is generally very concentrated, and in most of the rest of the world, much too big to fail. Also common overseas is the widespread use of prepayment penalties and recourse mortgages with lenders routinely pursuing deficiencies against defaulting borrowers. This keeps mortgage rates much lower than in the U.S., where such practices are much less common.

A fully privatized mortgage finance system will have difficulty providing stable mortgage funding during difficult financial times. Mortgage securities markets are prone to investor runs, much like the bank runs that occurred before FDIC deposit insurance.[xiii] It is all too true that investors are willing buyers of securities and providers of capital in good times, but will run for the door in bad times. Risk premiums and interest rates spike in a financial crisis, and lenders will make only the highest quality loans for their own portfolios. The resulting credit crunch further undermines housing demand, driving down prices and unleashing a vicious cycle.[xiv] The PATH attempts to address this concern by allowing the FHA to expand its lending in times of crisis. But this would likely happen only after significant damage had been done, and it is unclear whether the FHA could quickly fill the void.

The 30-year fixed-rate mortgage would become much less prevalent in a fully privatized mortgage finance system. Financial institutions have historically found it very difficult to manage the interest rate risk inherent in such mortgages: As the cost of funds changes, the rates received from homeowners remain fixed. The savings and loan industry collapsed largely because it mismanaged this interest rate risk during the 1980s, and even Fannie and Freddie got into trouble using inappropriate interest-rate hedging techniques to manage their earnings in the early 2000s.

It thus is not surprising that 30-year fixed-rate mortgages are very uncommon in other countries, where interest-rate risk resides with lenders and not in securities markets. Indeed, fixed-rate mortgages are common only in the U.S., Denmark and France.[xv] Fixed-rate mortgages persist in the U.S., because of the government's support of the mortgage finance system; in Denmark, because of that nation's very unique "principal of balance"

framework that equates individual mortgages and bonds; and in France, because of restrictions on prepayment.[xvi]

A privatized U.S. market would come to resemble other nations' mortgage markets, where adjustable-rate mortgages are the primary offering. Based on international comparisons, use of fixed-rate mortgages in the U.S. would decline to between 10% and 20% of the mortgage market compared with a historical average of closer to 75%.[xvii] ARMs are not inherently bad loan products, but they do shift interest rate risk to homeowners. This would be a significant adjustment for many U.S. homeowners who are not well equipped to handle such risk.[xviii]

Access problems

The PATH also fails to provide adequate access to the privatized mortgage market to small lenders and disadvantaged households. For small lenders, the PATH envisages the Federal Home Loan Banks serving as aggregators of their loans. It is unclear how or whether this would work to give small lenders access similar to that afforded large lenders. A key assumption is that the FHLBs would be able to obtain similar terms for pools based on loans from a potpourri of small lenders, as large lenders would receive from the securitization platform. At the very least, the FHLBs would have to backstop small lenders' reps and warranties.

Government support for disadvantaged households seeking affordable single-family and rental housing would also be limited under the PATH. This is more important in the wake of the Great Recession, which destroyed trillions of dollars in homeowners' equity, and in light of quickly changing demographics. Under the PATH, the FHA would continue to support these households, but the statutory program definitions under which the FHA operates make innovation difficult, and there would be no additional dedicated funding for experimentation. Experimentation is challenging for the private housing finance system, in part because good ideas take time to prove but once proven are easily replicated. Maintaining a supply of unsubsidized affordable rental housing made up of small properties will also require innovation. Such housing accounts for the bulk of unsubsidized rental units and a high percentage of all affordable units, and often needs refinancing, renovation and repair, but has limited access to private capital.

Conclusions

The recent flurry of congressional activity on housing finance reform is encouraging. The status quo, with Fannie and Freddie in conservatorship, is a growing problem. Taxpayers are on the hook for potential losses on most of the nation's mortgage loans, worth hundreds of billions, that Fannie and Freddie insure each year. This is not necessary: Private investors are willing to take on much of this risk, and with some safeguards are capable of doing it.

The housing finance system needs reform. But reform's success depends on striking the appropriate balance between the benefits of the private market and the backstop of the

federal government. Finding the right balance will strengthen the housing market, stabilize the financial system, and lead to a healthier economy.

The PATH as currently written does not find that balance. The housing finance system it envisages is largely privatized, providing no government backstop under any economic circumstances. The result will be measurably higher mortgage rates, the marginalization of the 30-year fixed-rate mortgage loan, and a less stable housing market. Larger lenders will likely grow larger in the PATH, and disadvantaged households will have less access to affordable housing.

[i] House Financial Services Committee Chairman Jeb Hensarling (R-TX) is the principal author of the PATH, which can be found at http://online.wsj.com/public/resources/documents/Timiraos.pdf. The PATH legislation became public in early July. Senators Bob Corker (R-TN) and Mark Warner (D-VA) introduced housing finance reform legislation on June 25, 2013, which can found at http://www.corker.senate.gov/public/_cache/files/1bc94e87-5a8a-4f07-a709-30bb19f15873/06-25-13%20BILL%20TEXT.%20Housing%20Finance%20Reform%20&%20Taxpayer%20Protection%20Act%20.pdf. For an assessment of the Corker-Warner plan, see "Evaluating Corker-Warner," Moody's Analytics white paper, July 2013, Mark Zandi and Cristian deRitis. http://www.economy.com/mark-zandi/documents/2013-07-08-Evaluating-Corker-Warner.pdf

[ii] The mortgage rate impact shown in Chart 1 is based on a privatized system like that proposed by the PATH. The hybrid system includes a catastrophic government guarantee, similar in structure to that proposed in Corker-Warner, although Corker-Warner requires a 10% attachment point compared to 5% in the hybrid system shown in the chart.

[iii] In most places, lower-to-middle income includes households with incomes below 115% of an area's median household income.

[iv] Risk-sharing is part of the FHFA's strategic plan and scorecard: http://www.fhfa.gov/webfiles/25025/Scorecard2013.pdf

[v] This includes the premium capture rule, which the PATH would also eliminate.

[vi] See "A Clarification on Risk Retention," Moody's Analytics special report, Zandi and deRitis, September 20, 2011 at http://www.economy.com/mark-zandi/documents/2011-09-21-Zandi-A-Clarification-on-Risk.pdf and "Reworking Risk Retention," Moody's Analytics special report, Zandi and deRitis, June 20, 2011. http://www.economy.com/mark-zandi/documents/Reworking-Risk-Retention-062011.pdf?src=MZ

[vii] According to Moody's Analytics data, the loss rate on private-label mortgage-backed securities originated in the housing boom have had loss rates of more than 20%.

[viii] The $700 billion Troubled Asset Relief Program, established during the height of the financial panic in late 2008, committed as much as $250 billion to provide capital to troubled banking institutions.

[ix] This is for a typical full-doc mortgage loan to a borrower with an 80% LTV, 750 credit score, and 31% debt-to-income ratio on average through the housing and business cycle. This is based on a guarantee fee calculator described in detail in "Evaluating Corker-Warner," Moody's Analytics white paper, July 2013, Mark Zandi and Cristian deRitis. http://www.economy.com/mark-zandi/documents/2013-07-08-Evaluating-Corker-Warner.pdf. A 5% loss rate is also consistent with the loss rates experienced by Fannie, Freddie, and the private mortgage insurers in the Great Recession.

[x] To gauge the sensitivity of the results to this assumption, consider that if the ROE required by financial institutions in a privatized system was 15%—the same as the private mortgage insurance industry in normal times—privatized mortgage rates would be 65 basis points higher than now.

[xi] See "TBA Trading and Liquidity in the Agency Market," Vickery and Wright, Federal Reserve Bank of New York Staff Report 468, August 2010. http://www.ny.frb.org/research/staff_reports/sr468.pdf

[xii] Libor is the interest rate large money-center banks charge for borrowing and lending to each other. The TED spread is a very good proxy for anxiety in the global banking system. The 25-basis point TED spread that prevailed just prior to the crisis was a record low, as the period was characterized by substantial euphoria and even complacency regarding global financial conditions.

[xiii] See "An Analysis of Government Guarantees and the Functioning of Asset-Backed Securities Markets," Hancock and Passmore, Federal Reserve Board Finance & Economics Discussion Series, 2010-46, August 2010. http://www.federalreserve.gov/pubs/feds/2010/201046/201046abs.html

[xiv] This concern is well-articulated in "The Future of Mortgage Finance in the United States," a speech given by Federal Reserve Chairman Ben Bernanke at the University of California Symposium, "The Mortgage Meltdown, the Economy, and Public Policy," Berkeley California, October 31, 2008. http://www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm

[xv] A very good survey of mortgage lending internationally is provided by "International Comparison of Mortgage Product Offerings," Lea et al, Research Institute for Housing America, September 2010.

[xvi] The Danish system allows borrowers to prepay their loans when rates fall, as in the U.S., and allows them to buy back their bond when rates rise. This feature allows the borrower to adjust to interest rate

increases and decreases and facilitates deleveraging when rates rise, reducing the incidence of negative equity.
[xvii] This is based on data from the FHFA available since 1985.
[xviii] The implications of this lack of experience are evident in the extraordinarily high default rate on subprime mortgages, most of which were two-year ARMs. According to Equifax credit file data, nearly one-fourth of subprime loans originated in 2005 defaulted when they hit their first payment resets two years later. These defaults ignited the financial crisis and Great Recession.

July 18, 2013

Statement for the Record

On behalf of the

American Bankers Association

For the Hearing

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

Before the

Financial Services Committee

United States House of Representatives

American Bankers Association

Statement for the Record

On behalf of the

American Bankers Association

before the

Financial Services Committee
United States House of Representatives

July 18, 2013

The American Bankers Association appreciates this opportunity to submit comments for the record regarding the Protecting American Taxpayers and Homeowners Act of 2013 (PATH Act). We commend House Financial Services Committee Chairman Jeb Hensarling for crafting this legislation which includes provisions addressing a wide range of issues confronting our nation's housing finance system.

The ABA supports a number of the provisions of this legislation, which are sorely needed to return some balance to the regulatory environment facing mortgage lenders. We also applaud the Chairman's efforts to begin serious debate over the reform of the Federal Housing Administration (FHA) and the termination of the conservatorship of the housing Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac. We do, however, have concerns with the approach taken in the bill with regard to both the GSEs and the FHA, and note at the outset that the bill differs markedly from longstanding, banker developed, positions advocated by the ABA. We will detail these concerns below.

BACKGROUND

Congress, the Bush and Obama Administrations, and the regulators have all taken a number of actions since the financial crisis to address problems in the housing finance system and to stabilize that system. These have included the passage of stringent and complex new regulations included in the Dodd-Frank Act, establishment and exercise of authority to place the GSEs into conservatorship, and the vast expansion of FHA as a resource to help make mortgage credit available. The end result is a housing finance system that is dominated by federal-controlled entities, with FHA and Fannie Mae and Freddie Mac backed loans accounting for the vast majority of the current secondary mortgage market. Such a system may have been a necessary short-term

expedient, but we agree is not sustainable or desirable for the longer-term, nor for the American taxpayers. It is also a system that has been radically transformed by underwriting and lending changes, many undertaken by the market in response to the crisis, and many more having been mandated by Dodd-Frank. The Dodd-Frank changes, including new Ability to Repay and Qualified Mortgage rules, and the still pending Qualified Residential Mortgage (QRM), have the potential to permanently alter who will qualify for a mortgage and reduce credit availability going forward. There is no doubt that some potential borrowers, despite being good credit risks, will find themselves unable to qualify or afford a mortgage as a result of unintended effects of the new regulations. Therefore, it is essential that we begin the process of reforming the housing finance system, putting it on a sustainable foundation not primarily dependent on taxpayer backstops, and correcting features of the new regulatory structure likely to decrease availability of credit and increase cost to consumers.

GSE REFORM

The PATH Act would wind down Fannie Mae and Freddie Mac within five years, and would not provide for any federal guarantee on any loan in their absence. Instead, this legislation would authorize the creation of a "public utility" which would oversee the creation and maintenance of a single platform for the sale of mortgages by originators to investors who would then securitize the mortgages. The public utility would be charged with ensuring equitable access to the secondary market for participants regardless of size or geographic location.

This approach differs from ABA's longstanding policy positions. While ABA believes that the federal role in mortgage finance needs to be significantly reduced, we continue to support a fully priced and fully paid for guarantee by the federal government for a class of well underwritten loans within clearly defined and targeted loan limit boundaries. While we envision a transition to a marketplace with a large and perhaps predominate component that is not dependent on federal guarantees, a targeted federal role is essential to progress from the present reality toward that goal.

Furthermore, a carefully targeted federal role can contribute to market stability, more directly and assuredly maintain equitable market access for originators of all types, sizes and geographic locations, and provide a fully operational and effective "safety valve" for instances of market failure to ensure that mortgage credit remains available in all economic conditions. Though ABA regrets that progress toward resolving the GSE conservatorships was not made in a timely manner,

nevertheless the conservatorships played an essential role by providing a governmental guarantee in a time of crisis. While Fannie Mae and Freddie Mac engaged in policies and practices which precipitated their failure and contributed a large part to the overall financial crisis, the conservatorships played an important stabilizing role.

Although we differ with the PATH Act's complete phase out of federal involvement in the secondary mortgage market, we do agree with many of the reforms incorporated into the discussion draft. Specifically, ABA supports:

- Reducing the maximum mortgage amount eligible for sale to Fannie Mae and Freddie Mac.
- Efforts to review and revise guarantee fees to ensure that the federal government is being adequately compensated for the risk it is taking when providing a guarantee.
- Development of risk-sharing transactions including first loss agreements with private sector participants.
- Prohibiting the GSEs (or any successor) from purchasing or guaranteeing mortgages that are within a jurisdiction that has exercised eminent domain to seize a mortgage loan during the last 120 months.

ABA also supports the creation of a utility or other entity to operate a new securitization platform (such as the one currently being developed by the Federal Housing Finance Agency). This utility would be tasked with operating the securitization platform in an open access manner and would ensure that eligible loan originators, aggregators and issuers would have equitable access to the platform, regardless of size, geographic location or market served. In contrast with the position taken in the draft legislation, however, we maintain that such a utility or similar entity should also be the vehicle for providing a well-targeted and purposed federal guarantee that is fully priced and paid and maintains prudential standards and capital requirements for all market participants.

While a utility lacking a federal guarantee (such as that proposed in the PATH Act) could still be a mechanism for government intervention during a market failure or other crisis, it would be difficult at best to quickly implement any federal support under such a regime. Absent an ongoing role in the secondary market, it would be difficult for the government to intervene in a timely

manner, resulting in a potentially long period without secondary mortgage credit and the attendant harm to the overall economy.

A targeted federal guarantee provides the solution to this problem. It provides a mechanism to enforce the regulatory function, and a safety valve allowing necessary and limited (in both time and scope) governmental intervention in times of crisis or market failure. It must be fairly and appropriately priced to fully compensate taxpayers for the risk undertaken, and it must be limited only to a segment of the market targeted to ensure mortgage credit for low- and moderate-income borrowers not otherwise being served by FHA or other government programs.

FHA REFORM

The draft legislation would re-target FHA to serve first-time homebuyers and low- and moderate-income borrowers—goals that ABA strongly supports. We also believe that the allowance for FHA to be employed in markets experiencing counter-cyclical mortgage conditions and Presidentially-declared disaster areas is prudent. We support the intent of the draft legislation to revise the premium structure for FHA insurance and to create new risk sharing pilot programs.

The PATH Act discussion draft also would significantly alter the structure of the Federal Housing Administration, making it an independent entity outside of the Department of Housing and Urban Development. While the ABA has not advocated for such a sweeping change, we do believe the idea has merit and should be explored further.

One aspect of the discussion draft that is of concern is the proposed reduction of the FHA's mortgage insurance coverage to only 50 percent of the mortgage being insured. ABA continues to advocate for full coverage of the outstanding balance of a loan insured under FHA. It is our view that with appropriate down payment amounts, more prudential underwriting standards, and reasonable premiums for the insurance being provided, there is no reason not to continue full insurance coverage of FHA loans. Further, given the re-targeted role envisioned by the bill for FHA to be primarily targeted to first time and low- and moderate-income borrowers, it is appropriate for the program to provide full insurance coverage as a public policy matter to encourage lending to qualified borrowers in this market segment.

Finally, we have concerns with the draft legislation's repeal of the Home Equity Conversion Mortgage (HECM) program. The HECM program has experienced losses and must be reformed,

but it should remain available as a tool, with federal government oversight and regulation, for qualified homeowners with sufficient equity. An aging population will likely increase demand for such programs and improved federal regulation and insurance of such programs will protect consumers and lenders alike.

COVERED BONDS

Subtitle B of the draft bill, comprising Sections 351 through 356 would authorize the creation of a covered bond market in the United States. The ABA supports the creation of a covered bond market as one of several sources of liquidity for the mortgage market. Noting that covered bonds function in a similar fashion to the Federal Home Loan Banks, we would encourage the committee to make clear that in developing a covered bond market there should be no restrictions placed on use of either covered bonds or participation in Federal Home Loan Bank membership. Some have proposed limiting covered bonds to one segment of the market based upon asset size while restricting Federal Home Loan Bank membership as well. We would strongly oppose any such restrictions and would oppose any legislation which included such restrictions.

REGULATORY IMPROVEMENTS

Title IV of the PATH Act draft includes many provisions which ABA strongly supports. These provisions will help to rebalance the regulatory environment from regulatory overreach that occurred in response to the financial crisis and will help to ensure a more vibrant, safe and effective mortgage market. Specifically we support:

- Section 401 - the mandatory delay of Basel III implementation and study of Basel III impact;
- Section 402 - Basel III liquidity coverage ratio amendments;
- Section 403 - changes to the definition of points and fees under the Qualified Mortgage rule;
- Section 404 - the exclusion of asset-backed securities from the proposed definition of "covered funds" in which banks are restricted from investing;
- Section 405 - the suspension of the Security and Exchange Commission's Reg AB rulemaking regarding asset-backed securities;
- Section 406 - the extension of the implementation date of Dodd-Frank Act mortgage regulations for one year;

- Section 407 - the repeal of the Qualified Residential Mortgage and the Premium Capture Cash Reserve Account rulemaking, and
- Section 410 – the repeal of sections 1413, 1431 and 1432 of the Dodd-Frank Act.

The sections referenced above all provide significant needed relief, without which investments in the mortgage market and credit availability will be seriously constrained. With regard to Basel III, we continue to be concerned about the punitive restrictions that agencies have placed on bank mortgage servicing assets under the final Basel III capital rules. Such capital treatment of mortgage servicing will drive a wedge between mortgage borrowers and lenders, potentially pushing such activities into the nonbank sector. ABA pledges to work with the Committee on this and other capital issues arising from Basel III implementation that are expected to have adverse impacts on credit availability and would be pleased to work with you on expanding these provisions in the bill.

Section 403 includes changes to the points and fees definitions for the Qualified Mortgage rule which were also included in H.R 1077, introduced by Representative Bill Huizinga. We strongly support these changes which are of particular import to community banks who serve as mortgage brokers when serving their customers. Without the changes in this section, these banks will find it harder to make a Qualified Mortgage and to provide mortgage servicers to their local communities.

The extension of the implementation date of the Dodd-Frank Act mortgage regulations included in Section 406 is essential. These rules will dramatically refocus the entire lending process. Every participant in that process, from lenders to borrowers, and service providers, appraisers, escrow agents, title agents and all others will be impacted by the changes, and must come into compliance in the next six months. Between now and then banks must fully review all of the final rules, implement new systems, processes, and forms, train staff, and test changes for quality assurance, as well as work with all these other providers to ensure that they too are compliant. That effort is made even more complicated when factoring in the fact that to manage year-end regulatory and tax reporting requirements, many institutions have an information technology "freeze" between November and early January. Because it is not possible to test or revise the new mortgage compliance systems during the lock-down period, the compliance deadline is effectively November of 2013.

Regulatory implementation is further complicated by the fact that many banks commonly rely on vendors for software and system upgrades. Many banks report that their vendors are not yet

ready to provide the necessary updates to the individual institutions and some vendors may not do so until late summer or early fall. Given these time constraints, and the fact that CFPB continues to issue modifications to the rules, it will be virtually impossible for most lenders to achieve full compliance by January. That lack of confidence in the ability to comply will likely lead to a reduction of credit as lenders pull back from lending until such time as they have confidence in their ability to comply. It is a far better approach to delay implementation to ensure that the entire industry can comply than to meet an arbitrary deadline that will further disrupt the mortgage markets and harm credit availability.

In addition to the regulatory corrections made in the sections delineated above, we also strongly support Section 409 which exempts from the Dodd-Frank Act the ability to repay requirements those residential mortgage loans originated by a creditor and held in portfolio. Those provisions of Dodd-Frank were intended to reform the securitization process to prevent lenders from originating loans without consequence and then passing the loans through the securitization chain. Portfolio lenders, willing to make a loan to a borrower who they view as a reasonable credit risk and willing to hold those loans on their own books, should not be required to meet the Dodd-Frank requirements. A portfolio lender's own self interest in maintaining a safe and sound portfolio, along with safety and soundness regulation and supervision, provide adequate regulation in this area. Further, the imposition of the Dodd-Frank requirements on portfolio lenders will make it impossible to serve some otherwise creditworthy customers and will significantly harm certain borrowers and populations which would otherwise be well served by portfolio lenders.

As referenced above, we support Section 410 of the bill which would repeal three sections of the Dodd-Frank Act, including the defense to foreclosure provision. The defense to foreclosure provision has created a concern that prudential regulators will severely restrict the ability of banks to keep non-QM safe harbor loans in their portfolios. This would make QM the effective requirement for safety and soundness and risk mitigation purposes. Section 410 will help to ensure that lenders are able to offer mortgages to borrowers who do not meet all of the QM standards but who nevertheless have the ability to repay a mortgage loan.

ABA also strongly supports Section 412 which incorporates provisions of the Financial Institutions Examinations Fairness and Reform Act introduced by Representative Shelley Moore Capito. Our members are concerned that bank regulators are making decisions during the examination process that have effectively and unnecessarily reduced the amount of capital available

for lending—particularly to small businesses. These decisions hinder banks' ability to help local businesses grow and create jobs. The changes included in H.R. 1553 and incorporated into Section 412 of the PATH draft address this critical issue by establishing clear examination standards and creating an independent Examination Ombudsman to ensure the consistency of all examinations. These provisions would also ensure that financial institutions receive timely examination reports that include full documentation of the information the regulators used to make their determinations, and would create an expedited process for banks to appeal examination decisions without fear of reprisals.

ADDITIONAL AREAS OF CONCERN

In addition to the provisions we specifically support, there are provisions of the PATH Act draft which are of concern and which ABA cannot support in their current form. Specifically, we have concerns over Section 414 which would prohibit a mortgage servicer of a residential mortgage from holding an interest in any other security interest on the same dwelling. This provision would prohibit a lender who holds or services a mortgage loan from offering their customer a home equity loan or line of credit.

We also have concerns with Section 502 which incorporates provisions of H.R. 927, the Common Sense Economic Recovery Act. These provisions would permit certain current loans that would otherwise be treated as non-accrual loans as accrual loans. We are concerned about legislating changes in accounting standards, even if they are only intended to be for regulatory use. Banks are issuers of financial statements – upon which our investors rely – as well as heavy users of financial statements of our borrowers. We need to make sure that all parties can rely on the accuracy of financial statements. We appreciate the motivation behind this provision and support requiring the Financial Stability Oversight Council (FSOC) to conduct a study of how best to prevent contradictory guidance from federal banking agencies, but the other aspects of this provision should be reconsidered. We also believe that Section 412 provides a more effective and less disruptive means to address the objective of preventing classifications of performing loans.

CONCLUSION

We appreciate this opportunity to submit comments on the PATH Act discussion draft. We recognize that provisions of the bill may change and others may be added or altered. We hope that these comments are helpful in further refining this legislation and in moving the process forward and we again applaud Chairman Hensarling for crafting this important legislation to begin the process of reforming our nation's housing finance system.

Statement

of

Basil N. Petrou

Managing Partner

Federal Financial Analytics, Inc.

For

The Committee on Financial Services

United States House of Representatives

Hearing on

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

It is an honor to submit this statement for the Financial Services Committee as it considers the discussion draft of the Protecting American Taxpayers and Homeowners (PATH) Act as released by Chairman Hensarling, Rep. Capito, Rep. Garrett and Rep. Neugebauer. I am Basil N. Petrou, managing partner of Federal Financial Analytics, a firm with a longstanding practice advising financial institutions on the business-strategy implications of federal policy. We do not lobby or represent clients and the views I herein provide are mine. They reflect testimony I was honored to provide this Committee on February 6th on Establishing the Proper Role for the Federal Housing Administration (FHA) in the U.S. Mortgage-Finance System, and I am very pleased to see that the discussion draft includes several of my recommendations to better target the FHA program to moderate income borrowers while at the same time reducing its risk to U.S. taxpayers. I am also strongly supportive of the legislation's effort to promote a full-scale return of private capital to mortgage securitization.

However, as I shall discuss below, I fear that the proposed approach to FHA will, in combination with that proposed for the government-sponsored enterprises (GSEs), pose a serious risk of a wholly unintended consequence: creation of a government monopoly for wide swaths of the residential mortgage market. Thus, I shall here outline what I believe would be a balanced approach to both FHA and GSE reform without the risk of this unintended consequence. In summary:

- The proposed approach to FHA reform has many strong features that will protect the taxpayer and promote FHA's mission. However, these reforms address only federal insurance at the loan level and, for as long as Ginnie Mae securities bear a 100% full-faith-and-credit guarantee, Ginnie Mae-guaranteed MBS comprised of FHA loans will drive out other potential providers of private capital for FHA-eligible mortgages unless the combined FHA premium and Ginnie Mae guarantee fee is significantly higher than that offered by the totally private market. Alternatively, the Committee could choose to provide the same Ginnie Mae guarantee to private credit enhancers of FHA-eligible mortgages or provide an alternative explicit federal guarantee that backstops targeted mortgages securitized through the new securitization platform created in the legislation.

- The proposed reforms to mortgage-securitization practice, in concert with the liquidation of Fannie Mae and Freddie Mac, are designed to create an alternative path to the secondary market. However, the new private structures are complex, untested and likely to prove impractical not just for community banks, but indeed for any regulated U.S. bank and bank holding company. Thus, to the extent the proposed approach succeeds, it may well

advantage only "shadow" institutions, posing unintended, but severe, systemic risk.

FHA Reform

As noted, I strongly support many aspects of the proposed approach to FHA, which I believe will simultaneously better target the program to under-served market segments and reverse FHA's financial deterioration and taxpayer risk. These sections of the bill would:

- income target the program for all but first-time homebuyers, promoting delivery of a full-faith-and-credit guarantee from the U. S. Government (USG) only to Americans who need continued access to a low downpayment mortgage which historically has been provided through a thirty-year, fixed-rate mortgage (FRM) without a prepayment penalty that may remain difficult to obtain without a USG backstop;
- reduction in the amount of the FHA guarantee to 50%, which will align lender and USG interests at the loan level (although not at the mortgage-backed security or MBS level as I shall discuss below);
- reduction in the base limit for FHA loans better to track actual U.S. house prices (although the high-cost limit remains so high as to promote USG dominance in key markets); and
- the goal of risk-sharing with the private sector, including with private mortgage insurance (MI). Again, however, I am concerned that the limited risk share between FHA and private credit enhancers as proposed will not address the expansion of the FHA's role that results from the interaction between FHA and GSE reform proposals.
- I also believe the restructuring of FHA into a government corporation is an approach with the potential for better delivery of service to defined market segments. However, I strongly urge Congress to track the approach taken in other government corporations (e.g., the Overseas Private Investment Corporation) to stipulate clearly and strongly that the new corporation must price its services and structure its products at all times only to support borrowers not adequately served by private capital, with this determination made through the use of robust and transparent analytics.

GSE Reform

As noted, the measure's reforms at the FHA loan level do not solve for the problem of returning private capital throughout U.S. housing finance because FHA-backed loans are still packaged into MBS backed by Ginnie Mae and, thus, afforded a 100% full-faith-and-credit USG guarantee structured and priced in a manner that drives out potential alternative MBS backed by private capital. One need look only at the execution advantages now enjoyed by Ginnie Mae versus the GSEs – backed now by an "effective" USG guarantee – to see the gulf that will quickly occur if the bill does not address risk-sharing and other reforms throughout the mortgage-securitization structure, going beyond the loan level addressed in the FHA-related provisions.

The measure would liquidate Fannie Mae and Freddie Mac and replace them with a new system (including covered bonds) in which newly structured, better-regulated MBS would meet market needs. These are worthy goals, but I fear they cannot be accomplished as proposed.

In summary, my caution derives from the following concerns:

- The proposed replacement mechanism for private mortgage securitization (a "securities-based approach") is premised on complex MBS structures that have been tried only once with success in the market, when they structured subprime MBS with catastrophic systemic consequences. The measure seeks to solve for this with new regulation, but I do not believe regulation can conquer perverse incentives sure to be resurrected in highly-engineered financial products that, given the size of the U.S. mortgage market, will pose serious risk even if confined to a fraction of the market. I believe that the hard lesson of the financial crisis is that simple is safe and complex can prove cataclysmic because regulators are always at least one step behind the market. A simple guarantee by a regulated, capitalized private entity across the entire scope of an MBS is a transparent, safe, sound and proven approach to mortgage securitization.

- Under the new Basel III rules, banks will need to hold penalty levels of regulatory capital (more than dollar-for-dollar) if they hold the riskiest tranches of MBS. Regulators have decided that complex securitizations are simply too risky for regulated banks for the reasons noted above, especially if markets demand that banks hold the highest-risk tranches in hopes that this cures incentive-alignment risk. Under the new rules, tranched securitization is effectively barred for banks large and small. The bill's two-year delay of the rules might create a window in which this is not true, but all of the risks in

complex, structured securitizations still remain and, perhaps, are magnified if there is a rush to a high-risk market during any such opening.

I note that the measure may hope to compensate for these problems by authorizing covered bonds. This structure has promise. However, even in nations with mortgage systems akin in some ways to the U.S. – e.g., Canada – they are small portions of the total mortgage market. Under appropriate prudential regulation, covered bonds are highly difficult prudently to offer because of the capital cost of the remaining asset and significant potential interest rate risk. The need for "substitute" assets in a covered bond also poses serious challenges to banks seeking – as they should – to bolster liquidity through larger holdings of high-quality assets.

Conclusion

While I am deeply concerned that the proposed approach to GSE reform has unintended risks, I strongly support the goals of the legislation:

- A stronger, better targeted FHA;
- A revitalized private secondary mortgage market; and
- Transformation of Fannie Mae and Freddie Mac.

I would be pleased to provide the Committee with answer to any questions you may have on the points made in this statement and to provide detailed recommendations on specific ways better to achieve these objectives. I hope that strong FHA and GSE reform can quickly become law, as continuation of the conservatorships and uncertainties in the current structure stalls long-overdue economic recovery.

CUNA
Credit Union National Association
cuna.org
BILL CHENEY
President & CEO

601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 | PHONE: 202-508-6745 | FAX: 202-638-3389

July 17, 2013

The Honorable Jeb Hensarling, Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Hensarling:

On behalf of the Credit Union National Association (CUNA), I am writing to submit for the record our thoughts on the discussion draft entitled: "Protecting American Taxpayers and Homeowner (PATH) Act of 2013." CUNA is the largest credit union advocacy organization in the United States, representing America's state and federally chartered credit unions and their 96 million members. We appreciate the opportunity you afforded us to discuss our interests and concerns with respect to housing finance reform in general and this legislation in particular, as it was being developed. We also appreciate the thoughtful consideration you have given to our concerns which have been reflected in many of the provisions of this legislation.

The PATH Act seeks to minimize government involvement in the secondary market, limit taxpayer liability, foster innovation and allow for more private sector capital in the marketplace. Additionally, your bill strives to provide equal access to all financial institutions regardless of asset size. The bill provides a new framework for a housing finance system, and, in so doing, provides for many provisions that credit unions appreciate. Our letter today highlights the many positive aspects of your legislation, some initial comments to consider in Committee discussions, and some reservations we have about the legislation. It should be noted at the outset that we continue to study the legislation, and these preliminary views remain subject to a more careful consideration of these difficult policy questions.

Credit Unions Strongly Support Relief from the Enormous and Complex Regulatory Burdens of the Dodd-Frank Act's Mortgage Related Provisions and Rules

The legislation includes many regulatory relief provisions for credit unions, including changes to recently finalized rules by the Consumer Financial Protection Bureau (CFPB). In particular, CUNA strongly supports Section 406, which would delay the mandatory implementation of all Dodd-Frank mortgage rules for an additional year. As the Committee is well aware, the new mortgage rules impose many thousands of pages of

regulatory burden on credit unions and other community-based financial institutions that did not cause the mortgage crisis and have, throughout history, employed the strong underwriting principles the rules are designed to require.

The compliance obligations imposed by the mortgage rules are simply overwhelming to many credit unions, especially America's smallest credit unions, and the tight timeframe for compliance puts the availability of mortgage credit—and thus America's nascent housing recovery—at risk. Another year would ensure that mortgage credit remains available to millions of credit union members while credit unions all over the country continue to understand how to implement the most sweeping regulatory changes to mortgage lending in U.S. history, and would be welcome relief to credit unions.

Section 409 exempts any residential mortgage held on the balance sheet of the originating creditor from the Home Mortgage Disclosure Act, eliminates the requirement to set up an escrow account for higher-priced mortgage loans held in portfolio, and relieves credit union portfolio loans of many of the requirements of the Dodd-Frank Act that would be very burdensome and costly to implement. This importantly includes the ability-to-repay and Qualified Mortgage or "QM" requirements. These changes would provide extraordinary relief for credit unions. Historically, credit unions have been portfolio lenders, holding 60-75% of the mortgages they write on the books in most years prior to the financial crisis. The incentives of portfolio lenders are different from those that sell into the secondary market, given that the lender bears the entire risk of default. Portfolio lenders have strong incentives to pay close attention to the borrower's ability to repay, and credit unions, given that their members are also their owners, have especially strong incentives to employ sound underwriting practices. We appreciate that the PATH Act recognizes that portfolio lending should not be treated the same for purposes of designing a regulatory framework for a housing finance system.

Section 409 is especially powerful when read together with Section 410, which repeals three sections of the Dodd-Frank Act, including the defense to foreclosure provision. The litigation risk created by the defense to foreclosure provision has caused many credit unions to worry that prudential examiners will severely restrict the ability of credit unions to keep non-QM loans that do not enjoy the QM rule's safe harbor in their portfolio after the rule goes into effect. This would make QM the effective requirement for safety and soundness and risk mitigation purposes. Together, sections 409 and 410 do a great deal to alleviate the very real concern of credit unions that they will not be able to offer mortgages to their members who do not meet all of the QM standards but who nevertheless have the ability to repay a mortgage loan. These changes will also help facilitate the kind of creative products that are possible through portfolio lending that individualize the process of getting a mortgage based on the individual circumstances of each member.

CUNA also supports the sections of the PATH Act that incorporate Congressman Huizenga's legislation, H.R. 1077, the "Consumer Mortgage Choice Act." CUNA supports H.R. 1077, and appreciates that this needed legislation is included in the PATH Act. In particular, one area of

the CFPB's ability-to-repay rule that is of concern to CUNA is the definition of points and fees, which includes affiliate title charges. H.R. 1077 excludes from the definition "all title charges, regardless of whether they are charged by an affiliated company, provided they are bona fide and reasonable." Defining points and fees in this way will maintain a competitive marketplace, prevent over-pricing or limited choice in low-moderate income areas, and allow consumers to enjoy the existing benefit of working through one entity for their new mortgage or refinance. A statutory revision would make this definition clearer and stronger than the CFPB's amended rule.

In addition, H.R. 1077, and the PATH Act, both address the inclusion of loan level price adjustments, an upfront fee that Fannie Mae and Freddie Mac charge to offset loan-specific risk factors such as the loan-to-value ratio or a borrower's credit score, in the definition of points and fees under the CFPB's ability-to-repay rule. This fee works much like a guarantee fee and does not constitute revenue to the loan originator. It is especially important for moderate-income consumers to obtain affordable mortgages and including this adjustment fee in the definition of points and fees impairs the availability of credit for some of our members. Credit unions appreciate that the PATH Act excludes this fee from the calculation of points and fees under the rule.

CUNA also welcomes many other provisions of Title IV of the PATH Act, including Section 407, which would repeal credit risk retention requirements and the requirement for rulemaking for "Qualified Residential Mortgages." In addition, CUNA supports Section 411, which permits a 40-year mortgage to be considered a Qualified Mortgage, and allows the consumer to waive the requirement that mortgage disclosures be provided to the consumer 3 business days before closing. We also support Section 412, which includes needed provisions to reform the examination process for financial institutions.

We look forward to working with the Committee to develop additional ways to remove barriers to the investment of private capital in the mortgage marketplace and allow credit unions to provide efficient, fair lending to their 96 million members and continue America's housing recovery.

Credit Unions Appreciate Provisions Ensuring Equal, Open Access to Secondary Market

Although credit unions traditionally are portfolio lenders, the secondary market has become increasingly important to credit unions. Over the past several years, as credit unions have learned to operate in the low interest rate environment of the post-financial crisis world, credit unions have been increasing sales of mortgages into the secondary market as a way to manage interest rate risk and shield themselves from hazard. In the first quarter of 2013, a record 58% of mortgages originated by credit unions were sold to the secondary market, up from the historic average of 25%-40%.

The creation of an efficient, effective, and fair secondary market with equal access for lenders of all sizes is a critical component of any housing finance reform effort and a primary focus of credit unions. Very simply, as evidenced by the historic performance of credit union loans before, during and after the recession, we believe that credit union mortgages are more valuable

to investors than those of banks due to much lower net charge-off rates.[1] CUNA very strongly believes credit unions should be able to sell one loan at a time and not be discriminated against in the marketplace merely because the volume of loans an individual institution can annually sell may be smaller.

CUNA appreciates the Committee's sensitivity to this issue, and notes the provisions designed to help credit unions in the marketplace. For example, the bill allows all QM and non-QM loans of any size to be eligible for securitization through the Platform. The bill seeks to prevent discrimination against eligible loan originators, aggregators, or qualified issuers, including in fees based on the size, composition, business line, or loan volume of an originator. CUNA is also supportive of the Federal Home Loan Bank system and thinks that it is a positive step FHLBs are authorized as aggregators, and generally believes that the FHLB model is something that could be useful for Congress to consider in any new housing finance system. As you are aware, some credit unions find it difficult to become members of a FHLB; in fact, privately insured credit unions are not permitted by law to become members of a FHLB. As this legislation moves though the House we would appreciate that more thought be given as to how credit unions can more easily gain membership to the FHLB system, including the addition of language permitting privately insured credit unions to join a FHLB.

Preliminary Credit Union Concerns with the Legislation

Credit unions strongly believe that any new system of housing finance must include consumer access to products that provide predictable and affordable mortgage payments to all qualified borrowers. Traditionally, this has been delivered through fixed-rate loans; such as the 30-year fixed-rate mortgage. CUNA has serious concerns that the PATH Act may not provide credit union members with a sustainable secondary market that can provide the necessary liquidity and structure which will ensure the continuation of long term fixed rate mortgage products. This is of particular concern for credit unions because more than 83% of credit union mortgages issued since 2008 have been fixed-rate mortgages; this signifies particularly strong member demand for a fixed-rate mortgage product. Moreover, due to the inherent risk of keeping long term products in portfolio and the significant price increase associated with these loans due to a privatized market, many credit unions may opt not to provide long term fixed rate mortgage products,

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[1] Prior to the Great Recession, annual net charge-off rates on residential mortgage loans at both banks and credit unions were negligible, less than 0.1%. However, as the recession took hold, losses mounted. At credit unions, the highest annual loss rate on residential mortgages was 0.4%, based on NCUA data. At commercial banks, the similarly calculated loss rate exceeded 1% of loans for three years, reaching as high as 1.58% in 2009, based on FDIC data.

leaving only the largest of banks to offer long term fixed rate loans which inevitably serves to only further increase the size of the largest financial institutions that have been deemed, too big to fail.

In addition, there are several reservations we have regarding the PATH Act's model that we call to the committee's attention which may not lead to the most efficient market and/or may have difficulty working in practice. We question how an independent, non-governmental, not-for-profit entity which would seem to function as a regulator with authority to set mortgage-related standards could be adequately supervised by FHFA. It is also unclear how the standards that the new entity would set would actually be enforced. Credit unions appreciate the understanding that a transition period is necessary, but worry that a five-year transition period may be too short a time to ensure that the housing market continues to function efficiently as we move to the new system of housing finance.

In addition, credit unions are concerned about requirements for the GSEs to purchase only QM loans during the five-year transition period. This requirement makes it virtually impossible for a viable secondary market to exist for non-QM loans during this period. If the secondary market will not accept non-QM loans, credit unions may not write them, especially if this environment of historically low-rates continues. In addition to interest rate risk, credit unions are concerned that our prudential regulator will not look favorably on non-QM loans being held in portfolio. To the extent that happens, credit unions will not be able to meet the mortgage lending needs of a segment of their membership. CUNA encourages the Committee to consider other approaches to managing the secondary market during the transition period.

Although credit unions are exempt from the Basel requirements, NCUA is currently considering its own risk-based capital requirements.[2] In order to ensure the continued availability of mortgage credit for credit unions, the PATH Act's delay of the Basel requirements should be met with a similar delay in NCUA's efforts to risk-weight capital standards for the credit union system.

CUNA also has governance concerns in connection with the bill. Section 311 of the PATH Act establishes a Board of Directors for the utility that includes two representatives from larger institutions and two from smaller ones. Credit unions would appreciate statutory language that establishes that one of these directors should come from credit unions. In addition, during the transition period, Section 283 establishes an advisory board with representatives of the mortgage finance industry. CUNA hopes the Committee would consider establishing that some of these representatives come from NCUA or the credit union system.

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[2] *See, e.g., Remarks of NCUA Board Chairman Debbie Matz at the 46th Annual Conference of the National Association of Federal Credit Unions, July 12, 2013, available at http://www.ncua.gov/News/Pages/SP20130712MatzNAFCU.aspx.*

The Honorable Jeb Hensarling
July 17, 2013
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Conclusion

CUNA recognizes that establishing a new system of housing finance requires the balancing of an extraordinarily complex series of policy choices, and appreciates your leadership and the leadership of others on the Committee in tacking these difficult questions. America's credit unions remain supportive of reforming the GSEs and increasing private capital in the mortgage marketplace in ways that allow consumers to borrow at affordable rates with payments that keep housing attainable to 96 million credit union members. We look forward to continuing to work with the Committee on these issues going forward.

Best regards,

Bill Cheney
President & CEO

Statement for the Record of

Teresa Bryce Bazemore

on behalf of

The Mortgage Insurance Companies of America

House Committee on Financial Services

Hearing on

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

July 18, 2013

MICA Statement for Submission to House Financial Services Committee on the Protecting American Taxpayers and Homeowners (PATH) Act of 2013

Mr. Chairman and Ranking Member Waters, thank you for the opportunity to submit this statement on the critical subject of housing finance reform. I am Teresa Bryce Bazemore, President of Radian Guaranty, Inc., and President of the Mortgage Insurance Companies of America (MICA). I am submitting this statement on behalf of MICA, the trade association representing the private mortgage insurance industry. Private mortgage insurance helps qualified low downpayment borrowers obtain affordable mortgages and provides credit enhancement to lenders, expanding the mortgage market responsibly. Housing finance reform is a subject that has an impact on all American families, including not only the majority of households who own their own homes, but the many others who aspire to do so. For this reason, I commend you for holding this hearing and addressing an issue so central to the fiscal health of American families.

The discussion draft of the PATH Act is an important step in moving forward on much-needed legislation to ensure that the U.S. has a stable and sustainable housing finance system that affords qualified borrowers the opportunity to own their own homes.

Title II of the PATH Act (FHA Reform) addresses reform by proposing new requirements that improve the solvency and strength of the FHA Single Family Mutual Mortgage Insurance Fund which ultimately ensures the ability of the FHA to succeed in its mission of serving low-to-moderate income homebuyers and first-time homebuyers.

MICA is supportive and encourages the Chairman's effort where the bill:

- Restores FHA to its historical mission of serving low-to-moderate income borrowers and first-time homebuyers. By resetting loan limits and establishing income-based eligibility for FHA insurance, these reforms can prudently conserve FHA resources and minimize the risks to taxpayers.

- Increases the downpayment requirement to five percent for existing homeowners who are purchasing a new home. This will allow FHA to better allocate its limited resources to first time homebuyers.

- Increases the capital requirements and strengthens the FHA Mutual Mortgage Insurance Fund so that the FHA is better positioned to serve its mission across economic cycles.

- Subjects the FHA to clear and actionable consequences designed to restore financial soundness in the event capital reserves fall below designated levels.

- Improves underwriting standards and provides new authority to enforce adherence thereto.

- Establishes a risk-sharing pilot program that has the potential to give the FHA access to best-in-class risk management, technology, processes and procedures of the private mortgage insurance industry. However, we believe the program should be on an accelerated timeline for implementation (six months rather than two years) and we support increasing the proportion of FHA business that is risk-shared from 10 percent to 50 percent over the course of 5 years.

Reorganizing the FHA as an independent agency is a proposal that requires careful consideration. In particular, MICA is concerned that scaling back and eventually dissolving Fannie Mae and Freddie Mac without an explicit role for private mortgage insurance as the loan level credit enhancement poses two unique dangers: first, it endangers the goal of preserving FHA resources to serve low-to-moderate income and first-time homeowners; second, it exposes the housing finance system to unacceptable levels of risk concentration through vertical integration.

Without a clear requirement for the use of private credit enhancement in the form of private mortgage insurance for qualified securities under the Mortgage Market Utility, low downpayment borrowers will be driven to the FHA. Market forces will dictate that the only viable resource for low downpayment lending is that which has explicit authorization in the legislation. By requiring private credit enhancement for the loans in the new mortgage-backed securities, the proposed legislation creates a fulsome marketplace in which FHA and private mortgage insurance serve the entire spectrum of the low downpayment homebuyer population, while also minimizing credit risk for investors.

Private mortgage insurance remains the most viable and reliable alternative to the FHA program. Since 2007, private mortgage insurers have assumed responsibility for over $35 billion in claims paid to the GSEs alone, losses that otherwise would have been borne by taxpayers. Reform must include an ongoing role for the private sector to promote prudent lending standards and shield taxpayers from losses, especially during times of market stress.

Furthermore, without explicit recognition of an independent, well-capitalized, regulated and financially sound credit enhancement for low downpayment mortgages in the new mortgage-backed securities, the entire system is vulnerable to unacceptable levels of risk concentration. Including private mortgage insurers in the housing finance market serves to provide a necessary independent party in the housing finance market chain that connects loan originators to

aggregator, to servicers, to issuers, and MBS investors. As an independent and monoline business, private mortgage insurance's presence in the transaction helps avoid unwanted risk concentration as well as helps avoid conflicts of interest while also introducing a stable counter-cyclical element.

As one of the few private, counter-cyclical elements in the secondary market, MICA believes that all proposals to reform the housing finance system should recognize the important role of private mortgage insurance in mitigating the risk of default and placing private capital in a first loss position.

In closing, MICA looks forward to working with Congress on these issues.

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

July 18, 2013

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

The National Multi Housing Council (NMHC) and the National Apartment Association (NAA) are writing to thank you for the Committee's commitment to housing finance reform in the 113th Congress, and the opportunity to provide comment on the Protecting American Taxpayers and Homeowners Act (PATH Act) as part of the July 18, 2013, hearing entitled, "A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System."

NMHC/NAA represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships engage in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. NAA is a federation of 170 state and local apartment associations comprised of approximately 60,000 multifamily housing companies representing more than 6.6 million apartment homes throughout the United States and Canada.

NMHC/NAA support housing finance reform efforts to achieve the following goals:

1. Ensure mortgage liquidity in all markets at all times;
2. Ensure capital availability for the wide range of properties, sponsors and renters;
3. Expand private capital participation;
4. Limit/mitigate market disruptions; and
5. Insulate the taxpayer from losses.

While policymakers are understandably focused on reforming the GSEs' single-family programs, they must avoid a "one size fits all" approach to housing reform. The distinctions between single-family and multifamily, which include private capital participation, underwriting (including legal framework, term, rate, borrower requirements, and servicing), risk sharing, and loan performance, underpin the essence of real estate finance, and require that reform to each market be approached separately.

The July 11, 2013, draft of the PATH Act contains dramatic changes for residential real estate finance. However, the bill does not distinguish between targeted reforms or anticipated outcomes for the wide variety of residential real estate groups, including single family, multifamily, student housing, seniors housing, affordable housing and military housing. These distinctions are noteworthy, particularly for

1850 M Street, NW, Suite 540 ▪ Washington, DC 20036 ▪ 202 974 2300 ▪ FAX 202 775 0112 ▪ www.nmhc.org ▪ info@nmhc.org

the multifamily segment, which uses commercial mortgage debt products. The absence of dedicated references to multifamily real estate in Title I (GSE Wind-Down) or Title III (New Market Structure) has the effect of imposing all single-family market reforms on the multifamily market as well as other classes of residential real estate.

The "square peg, round hole" dynamic endangers a well-functioning market that did not contribute to the housing crisis and performed well through the recent recession. If reform efforts are to succeed in their stated mission, policymakers must give dedicated, thoughtful and separate consideration to the multifamily finance system. Legislative reform solutions that only address the challenges or structural failures in one real estate class would make the multifamily industry collateral damage.

We encourage policymakers to continue to engage with the multifamily industry to develop workable solutions to the issues the PATH Act seeks to address as the Committee advances consideration of housing finance reform. To further clarify the need for a separate multifamily title, we are including an attachment that outlines in more detail the reasoning. We thank you again for the opportunity to participate and provide comment on this critical issue.

Sincerely,

Douglas M. Bibby
President
National Multi Housing Council

Douglas S. Culkin, CAE
President
National Apartment Association

Attachment: Reasons for Including a Multifamily Title in PATH Act

National Multi Housing Council and National Apartment Association
Attachment to July 18, 2013, Letter

Reasons for Including a Multifamily Title in PATH Act

On July 11, 2013, House Financial Services Committee Chairman Jeb Hensarling (R-Texas) released the Protecting American Taxpayers and Homeowners Act (PATH Act), which proposes to eliminate government guarantees for multifamily and single-family mortgage products, wind down government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, overhaul the Federal Housing Authority's (FHA's) multifamily loan products, delay changes in Basel III bank capital standards and repeal real estate-related portions of the Dodd-Frank Act.

While policymakers are understandably focused on reforming the GSEs' single-family programs, the unique needs of the multifamily housing sector cannot be overlooked. The two sectors operate differently, have divergent performance records and require distinct reform solutions. For the PATH Act to better deliver on its goal to provide a comprehensive, balanced housing finance reform solution, **the bill should include a separate multifamily title.** Here's why.

The bill stops short of adequately addressing or acknowledging the multifamily industry, despite the fact that the sector drives one-third of the housing market.

- Roughly one in three Americans chose rental housing, and economists expect that number to grow in the coming decade. As many as half of all new households this decade will rent.
- Despite this sizeable role in the housing market, the bill references multifamily just 11 times. Furthermore, 10 of the 11 references fall in the FHA Reform title, which addresses a fraction of the multifamily mortgage market. While an important program, FHA represents 7.2%, or $74 billion, of the existing multifamily debt outstanding, according to the Federal Reserve.

The bill imposes single-family mortgage market reforms on the multifamily industry, although the two have fundamental differences.

- The absence of dedicated references to multifamily real estate in Title I (GSE Wind-Down) or Title III (New Market Structure) effectively impose all single-family market reforms on the multifamily market despite fundamental distinctions between single-family and multifamily financing.
- Unlike single-family mortgage financing, multifamily financing uses commercial debt products, which have different standards for private capital participation, underwriting (including legal framework, term, rate, borrower requirements, and servicing), risk sharing, loan performance and investor engagement.
- Moreover, the provisions establishing the structure and function of the new Utility reference "residential mortgages" to the exclusion of multifamily. Subsequent provisions establishing qualified securities, roles for market participants, market structure and regulation make similar exclusive references to residential debt, as does a provision amending the role of Federal Home Loan Banks in securitization.
- This approach puts in jeopardy roughly 34%, or $309 billion, of the mortgage market for the multifamily industry through implication or omission.

The bill fails to recognize or address the impacts of the legislation on the multifamily market.

- Given the role the GSEs play in multifamily finance, the bill's proposed changes could have a destabilizing effect on the roughly $862 billion multifamily debt market.
- According to industry experts, academics, and governmental bodies, without specific multi-family provisions, some of the provisions in the bill could cause mortgage interest rates to rise, decreasing the availability of debt for the multifamily industry by 10-20%. Multifamily property values could also decline.
- This combination could decrease the rental housing supply by as much as 27% and affect much-needed new apartment development, according to an independent report commissioned by the Federal Housing Finance Agency (FHFA). NMHC projects that the multifamily industry needs to produce at least 300,000 new apartment homes—and possibly as many as 400,000—each year to meet demand; in 2012, only 157,600 new apartments were built.
- This decrease in supply could result in rent increases nationally; however, tertiary geographic markets could see more significant rent spikes of between 11-26%, according to the FHFA-commissioned report.

NATIONAL ASSOCIATION of REALTORS®
REALTOR®

500 New Jersey Avenue, N.W.
Washington, DC 20001-2020

Gary Thomas
2013 President

Dale A. Stinton
CAE, CPA, CMA, RCE
Chief Executive Officer

GOVERNMENT AFFAIRS
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Jamie Gregory, Deputy Chief Lobbyist

STATEMENT OF

GARY THOMAS
2013 PRESIDENT
NATIONAL ASSOCIATION OF REALTORS®

TO THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE
ON FINANCIAL SERVICES

HEARING TITLED

A LEGISLATIVE PROPOSAL TO PROTECT AMERICAN TAXPAYERS AND HOMEOWNERS BY CREATING A SUSTAINABLE HOUSING FINANCE SYSTEM

JULY 18, 2013

Introduction

The one million members of the National Association of REALTORS® thank Chairman Hensarling for introducing a comprehensive financial reform bill, the "Protecting American Taxpayers and Homeowners Act of 2013" (PATH ACT). However, NAR must oppose this draft. Most significantly, our opposition is twofold: 1) We strongly oppose the end of federal guarantee for a secondary mortgage market; and 2) the dramatic restructuring of FHA.

Without a federal guarantee for the new utility, and a removal of Title II regarding FHA, we cannot support this discussion draft.

Wind down of GSEs and Creation of New Market Utility

As indicated on a number of occasions, NAR supports a comprehensive approach to restructuring the secondary mortgage market, including winding down Fannie Mae and Freddie Mac (the government sponsored enterprises, or GSEs), but believes any new secondary market entity replacing the enterprises must have an explicit government guarantee. The drastic changes and timeline outlined in the PATH Act, ultimately, doesn't take into consideration the dramatic destruction of wealth that many middle class Americans would experience as the result of falling home prices should the $10 trillion dollar mortgage market lose a functioning secondary market that includes what has been a long-standing role for the federal government.

REALTORS® are supportive of a self-sufficient infrastructure whereby safe, sound, transparent, and insured MBS may be packaged and sold. NAR believes the Utility will bring standardization, stability and confidence in the mortgage market space to facilitate the return of private sources of capital to the housing finance system. Additionally, we believe the improvement of loan level and mortgage pool disclosures to market participants will enhance opportunities for private capital participation. This data is an essential foundation for investors to efficiently analyze and price mortgage credit risk.

REALTORS® agree with lawmakers that taxpayers should be protected, private capital must return to the housing finance market, and that the size of government participation in the housing sector should decrease if the market is to function properly. However, REALTORS® believe that it is extremely unlikely that any secondary mortgage market structure that does not include government backing could support the existing mortgage funding needs of the United States housing sector. Make no mistake; the tremendous size of this systemically important market can neither be supported solely by lending from insured bank deposits nor from private investors that would be required to take on additional risk.

Legislation that relies only on private capital to operate the secondary mortgage market will find that, in extreme economic conditions, private capital will retreat from the market. A federal guarantee is essential to ensure borrowers have access to affordable mortgage credit.

Without government backing, creditworthy consumers will pay much higher mortgage interest rates and mortgages may at times not be readily available —as has happened in jumbo and manufactured housing real estate loan markets in the aftermath of the crisis.

In both instances, mortgage capital became nearly non-existent, which prohibited qualified borrowers from access to the funds required to purchase a home. Although private capital is now returning to these markets, it has taken many years.

Share of Mortgage Securitization Market By Segment

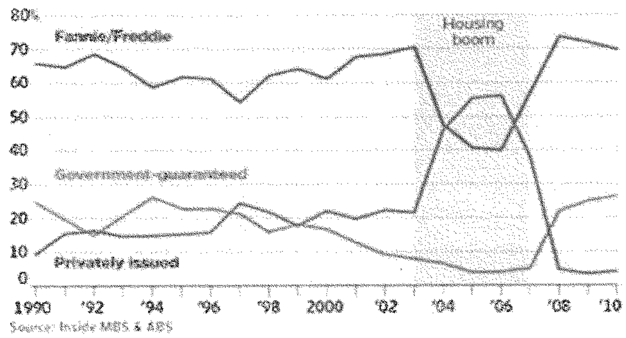

Figure 1

Over the last 5 years, FHA has raised its insurance premiums, the GSEs have raised their upfront fees (including loan-level pricing adjustments), and the lending industry as a whole has tightened underwriting standards to the point that only those with pristine credit histories have access to reasonably priced mortgage credit. The lack of financing put downward pressure on home values, increasing the number of homeowners whose mortgages exceed the value of their home, and increasing foreclosures. As can be seen from Figure 1, if no government-backed entity existed as private mortgage capital fled to the sidelines in recent years, the housing market would have come to a complete halt and thrown our nation into a deeper recession, or even a depression.

When the economy turns down, private capital rightfully flees the marketplace, and should that occur in the residential market it would come to an abrupt and complete halt. Should that happen in the residential mortgage market space, the results for the entire economy – because of the plethora of peripheral industries that support and benefit from the residential housing market – would be catastrophic.

REALTORS® believe that full privatization is not an effective option for a secondary market because private firms' business strategies will focus on optimizing their revenues and profits. This model would foster mortgage products that are more aligned with the business' goals

(e.g. based upon significant financial risk-taking) than in the best interests of the nation's housing policy or the consumer.

Homeownership is a cornerstone of our economy. As such, it is a significant driver of employment opportunity. Jobs are created in the numerous businesses that are all part of the housing industry (e.g. home renovation, remodeling, and furnishing). We must endeavor to support this founding pillar of our society and economy so that our nation can begin to move toward recovery, instead of lingering in our current economic malaise.

Loan Limits

PATH proposes to lower the conforming and FHA loan limits. Lowering the loan limits restricts liquidity and makes mortgages more expensive for households nationwide. Without the additional liquidity created by maintaining loan limits at current levels, families will have to pay more to purchase homes, face the possibility that they will not be able to obtain financing at any price or find it more difficult or impossible to refinance problematic loans into safer, more affordable mortgages.

Many argue that the loan limit increases benefit only the higher cost areas, but this is not the case. According to a recent HUD report, only 3 percent of FHA loans are above $362,750, and less than 2 percent are above $417,000. The majority of markets that would be impacted by the loan limit decline are NOT high cost. If the limits were to fall, more than half of all existing homes nationwide will be ineligible for FHA mortgage financing. If families cannot obtain financing to buy, sellers will need to further reduce the price on their home. This will further erode the wealth of American families and will prolong the nation's economic recovery.

The 30-Year Fixed-Rate Mortgage

Unique to the U.S. housing finance sector is the availability of affordable, long-term fixed-rate mortgages. The 30-year fixed rate mortgage is the bedrock of the U.S housing finance system. And now, more than ever, consumers are seeking fixed rate 30-year loans because they are easily understood and offer a predictable payment schedule.

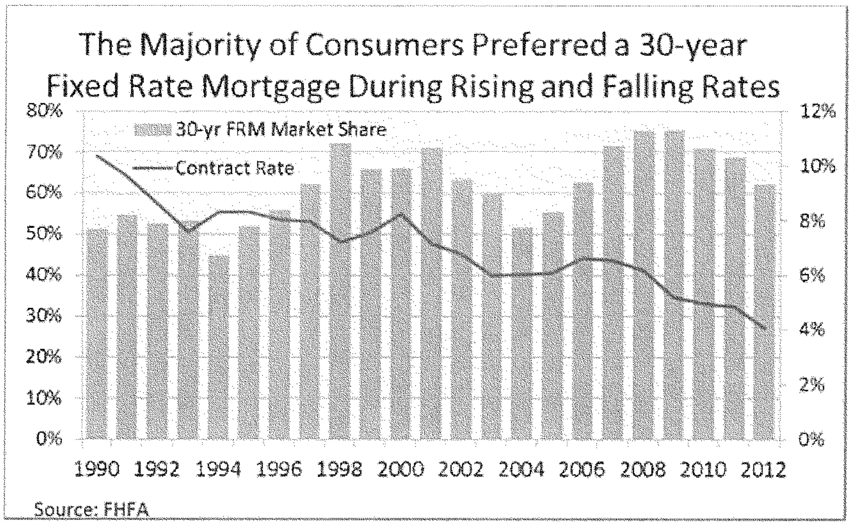

Figure 2

As discussed above, REALTORS® believe that full privatization is not an effective option for our secondary mortgage market because private firms' business strategies will focus on optimizing their revenue/profit generation. This model would foster mortgage products that are more aligned with these business' goals (e.g. based upon significant financial risk-taking) than in the best interest of the nation's housing policy, or the consumer. We believe that this would lead to the elimination of long-term, fixed rate mortgage products (e.g. 30-year fixed-rate mortgage), and an increase in the costs of mortgages to consumers. At this time, when our economic recovery teeters on the edge of full recovery, activities that force further constriction of economic activity should be resisted.

According to research by economist Dr. Susan Woodward, there is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without government urging. Dr. Woodward points out that a few developed countries have encouraged the use of amortizing long-term loans, but in all instances (save for Denmark) where they do exist, the loans have adjustable rates and recast every 5 years. She goes on to point out that the United States is unique in having a residential mortgage that is long-term, amortizing, fixed-rate and pre-payable, and that Americans have come to view this product as one of their civil rights. Dr. Woodward points out that in early 2000, when Former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he eagerly abandoned that position.

We are particularly concerned by data that suggests that, should the 30-year fixed rate mortgage cease to be available, older owners who tend to stay in their home longer, would

be the most effected. A future scenario of rising interest rates to a group of homeowners on a fixed income would see higher payments. The absence of availability of a fixed rate mortgage payment for this group would create a similarly outcry:

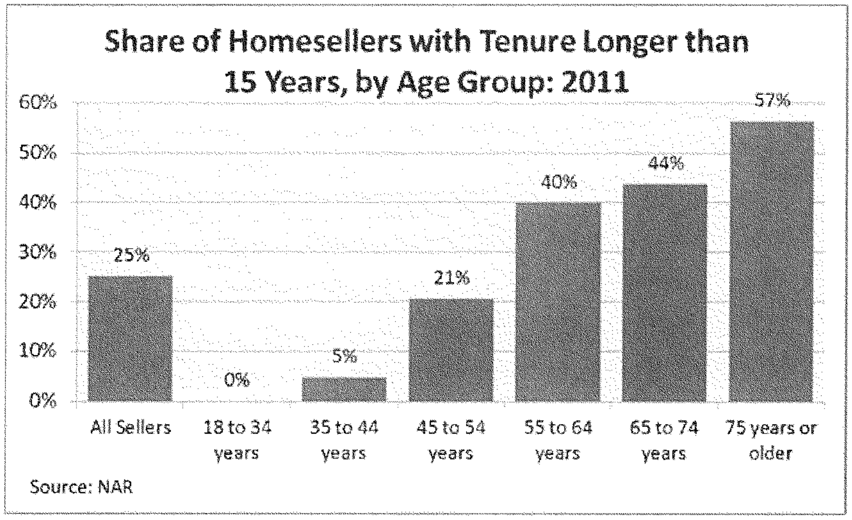

Figure 3

Additionally, others have suggested that a 30 year mortgage builds equity slower, however, borrowers forced into a mortgage with a shorter duration face a significant loss in purchasing power. Consider an individual earning approximately $52,000 who is purchasing a $208,000 home (May 2013 median home price) with 10% down:

Duration	Interest Rate	Payment (PITI)
30 year	4.07%	$1,160
15 year	3.17%	$1,540

With a 30-year mortgage, the consumer's total mortgage debt to income (DTI) would be 26%; with a 15 year mortgage, this measure of affordability jumps to 36%. To achieve the same DTI with a 15-year mortgage, the purchase price would have to be reduced to $144,444.

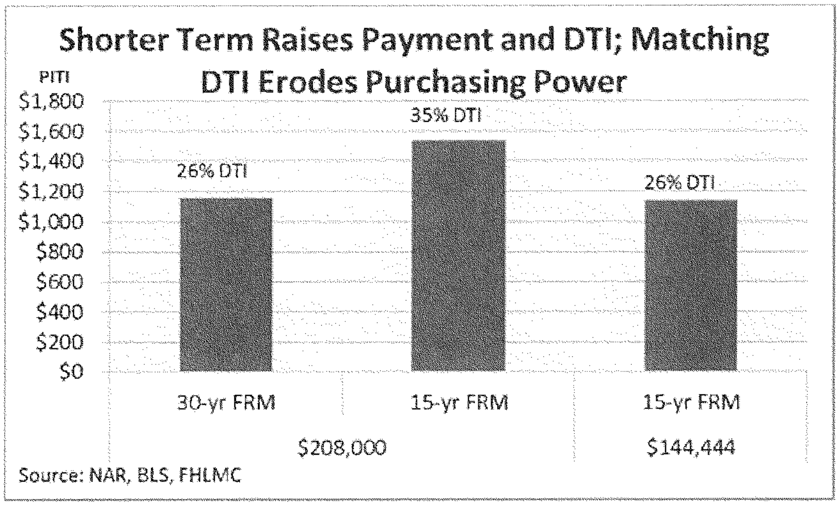

Figure 4

FHA Restructuring

With the collapse of the private mortgage market, the importance of the Federal Housing Administration has never been more apparent. As liquidity has dried up and underwriting standards have been squeezed tight, FHA is one of the primary sources of mortgage financing available to families today. Without FHA, many families would be unable to purchase homes and communities would suffer from continued foreclosure and blight.

The PATH Act would define a much difference mission for the FHA by limiting it to first-time homebuyers and those making less than 115% of area median income. The bill would make other significant changes to the program including increasing downpayments, lowering loan limits, and increasing premiums.

We strongly oppose these changes, and instead support reforms to address solvency issues, as was the approach taken in the bill that was passed in the House by a vote of 402-7 last year. We strongly believe that the reforms included in this Title will disenfranchise millions of qualified families from purchasing a home of their own, with equally significant ramifications for local communities. We believe that a total restructuring of the sort proposed in the Act is unnecessary, and will severely and unnecessarily disrupt recovering housing markets.

FHA, like every other holder of mortgage risk, has incurred financial losses as a result of high foreclosures during the housing crisis. More than $70 billion in claims that FHA has filed can be attributed to the books of business made in 2007-2009. In addition, the Home Equity Conversion Mortgage (HECM) has experienced severe losses. This program, as it has been structured, is very sensitive to volatile housing prices. According to recent HUD testimony, "the budget estimates that the use of the HECM program results in a negative value of $5.248billion and a disproportionately negative impact to the fund."[1]

But FHA has sustained housing markets nationwide during the worst economic crisis of our lifetime. As private lenders fled and financial institutions went out of business, FHA remained in the market and provided mortgage insurance to more than 4 million families since 2008. In a time when many large private banks, investment firms, and other financial institutions have needed bailouts or have even collapsed, FHA has weathered the storm very well.

Limiting Eligible Borrowers

The discussion draft proposes to limit FHA to first-time borrowers (regardless of income) and those borrowers with incomes below 115% of area median income. We strongly oppose this dramatic refocusing of the FHA. When designed in 1934, the program was intended to

"to improve Nation-wide housing standards, provide employment, and stimulate industry; to improve conditions with respect to home mortgage financing, to prevent speculative excess in new-mortgage investment, and to eliminate the necessity for costly second-mortgage financing, by creating a system of mutual mortgage insurance and by making provision for the organization of additional institutions to handle home financing . . . ." [2]

From the beginning, there was no requirement limiting participation to first time buyers or "low income households". In fact when the program began, the upper limit for a FHA loan was $16,000. While this loan amount may seem exceptionally small today, the national median home value was only $4,778.[3] Furthermore, in 1930 only 3.2 percent of homes were valued between $15,000 and $20,000.[4] The majority of homes were valued between $2,000 and $7,500, with the largest number falling between $3,000 and $5,000.[5] So an upper limit of $16,000 was more than 330% of the median American home value then and was sufficient to finance roughly 96% of all homes.

Of course, the $16,000 loan limit does not paint the entire picture of FHA's initial demographic. To better understand this, we need to look at how the program was used by borrowers. In its third annual report to Congress for 1936, FHA's statistics showed that

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[1] Testimony of Carole Galante before the Senate Appropriations Subcommittee on THUD, June 4, 2013.
[2] H.R. Rep. No. 1922, 73d Cong., 2d Sess. 1 (1934)
[3] Id. at 18
[4] 15th Census of the United States, Population, Volume VI: Families, U.S. Census Bureau, 1930, P. 17
[5] Id.

most of the homes insured were valued in the $3,000 to $6,000 range and the average single-family home value for an insured mortgage was $5,497, more or less reflecting the average costs of homes at the time.[6] Only 2.8 percent of FHA-insured homes were valued below $2,000, and only 2.1 percent above $15,000.[7] This is strong evidence that FHA was not originally targeted to any income group, but rather was intended to help families across the spectrum get financing to purchase homes. These statistics varied slightly from year to year, with the size of insured mortgages somewhat lower in 1937 (median $4,288), and then higher in 1938 (median $4,491).[8] In general, these trends have followed income levels of FHA-insured borrowers.[9]

What can be said is that FHA was designed to serve underserved markets. That market does not always match an income or first-time homebuyer status. While the vast majority of FHA's borrowers are first-time homebuyers, other borrowers often struggle to find lenders active in their areas or particular submarket, i.e. condos; they should not be prohibited from access to safe, affordable mortgage financing.

Furthermore, the definition of "first time homebuyer" provided in the bill is very restrictive. Title 24[10] of the Code of Federal Regulations defines a first-time homebuyer as an individual who has had no ownership in a principal residence during the 3-year period ending on the date of purchase (closing date) of the property. It also includes any individual that only owned with a former spouse while married; and an individual who has only owned a principal residence not permanently affixed to a permanent foundation, or a property that was not in compliance with State, local, or model building codes and cannot be brought into compliance for less than the cost of constructing a permanent structure. The definition in the PATH Act is significantly more restrictive, and would disenfranchise many qualified borrowers. Under this definition, many current FHA first-time buyers would be disqualified.

Being underserved does not only relate to income or first-time homebuyer status. FHA has been a leader in providing home financing for minority families. Half of African-American homebuyers and nearly the same percentage of Hispanic and Latino buyers who purchased in 2011 used FHA financing. This has been true regardless of economic conditions. These are not all first-time homebuyers.

Income is not an indicator of need for FHA. According to recent FHA endorsement data, more than 25% of FHA borrowers in 2013 had incomes above 120% of are median income.

[6] Third Annual Report of the Federal Housing Administration for the Year Ending December 31, 1936. U.S. Government Printing Office. 1937. P.35

[7] Id.

[8] Fourth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1937. U.S. Government Printing Office. 1938. P.58; Fifth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1938. U.S. Government Printing Office. 1939, P.85

[9] Fourth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1937. U.S. Government Printing Office. 1938. P.61; Fifth Annual Report of the Federal Housing Administration for the Year Ending December 31, 1938. U.S. Government Printing Office. 1939. P.91

[10] 24 CFR 92.2

While we expect this number to decrease (historically it is about 17%) as the private market returns, there are reasons why some buyers may need FHA to finance their home – even if it's not their first home purchase, and even if their income is greater than 115% of area median income. These include the type of housing unit, type of employment, or a lack of lenders actively in the market.

Counter-Cyclical Role of FHA

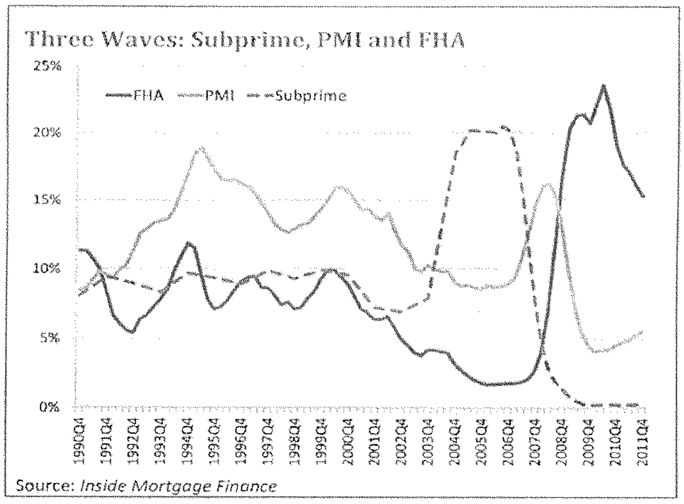

Figure 5[11]

As private lending constricted (and in some markets, disappeared altogether), FHA's role in the market grew. As recently as 2006, FHA's share of the home mortgage market was to 3 percent, as unscrupulous lenders lured FHA's traditional constituent to risky exotic mortgages with teaser rates and little to no underwriting criteria. As the housing market began to collapse, private lenders fled or went out of business. As is seen in Figure 5, FHA's share of the loan market began to grow, as the private market's share plummeted. This demonstrates the counter-cyclical role FHA plays in the market.

Mark Zandi of Moody's Analytics has pointed out that "If FHA lending had not expanded after private mortgage lending collapsed, the housing market would have cratered, taking the economy with it."[12] Moody's has estimated that without FHA, housing prices would have

[11] Quercia, Roberto G. and Park, Kevin A, Sustaining and Expanding the Market: The Public Purpose of the Federal Housing Administration, UNC Center for Community Capital, December 2012.
[12] Zandi, Mark, Obama Policies Ended Housing Free Fall, *The Washington Post*, September 28, 2012.

dropped an additional 25 percent, and American families would have lost more than $3 trillion of home wealth. By the time a counter-cyclical trigger could be activated, housing prices would likely already have plummeted.

FHA helped stabilize housing prices in thousands of communities by providing access to home financing when few others would. A recent University of North Carolina study noted that "Private mortgage insurers implemented 'distressed area' policies making it almost impossible to obtain conventional mortgages with LTV ratios greater than 90 percent in some regions of the country. In contrast, FHA does not vary its insurance premiums by region, creating an automatic regional stabilization policy."[13] This counter-cyclical role of FHA helped stabilize markets and slowed the downward spiral of housing prices and economic decline (see Figure 6).

Exhibit IV-3: Self-Perpetuating Home Price and Default Spiral

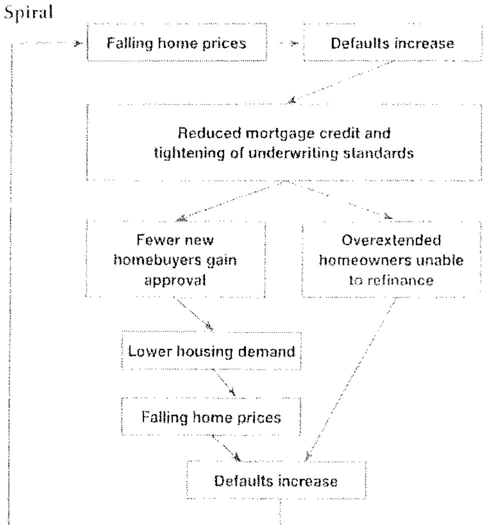

Figure 6[14]

Had FHA not stepped in and filled this mortgage insurance void, many neighborhoods would have been devastated and our economy will still be in a recession.

[13] Quercia, Roberto G. and Park, Kevin A, Sustaining and Expanding the Market: The Public Purpose of the Federal Housing Administration, UNC Center for Community Capital, December 2012.
[14] Szymanoski, Edward; Reeder, William; Raman, Padmasini; and Comeau, John "The FHA Single-Family Insurance Program: Performing a Needed Role in the Housing Finance Market", PD&R Working Paper No. HF-019, December 2012.

While the PATH Act provides language lifting some restrictions in the bill during a contraction of the market, we do not believe there is a leading indicator that could reflect a downturn in time to stop a significant impact on the market. In retrospect we can find many things that should have alerted us to a crisis, but they all have one significant flaw – data lags. The most reliable data triggers – changes in price, tightening of liquidity, rise in unemployment, housing defaults – all lag reality. If forced to wait until the data shows we are in a housing downturn, we will be so far into it that it will be very difficult to get out. Generally a recession is only declared after four quarters of economic decline. This country debated for more than a year about whether or not we were in a recession during the most recent crisis.

Increased Downpayment

NAR opposes increasing FHA's minimum downpayment for certain borrowers or during times of financial crisis for FHA. While the size of the downpayment does have an impact, increasing the downpayment doesn't add revenue to FHA's reserves. Increasing the downpayment, however, does have a significant impact on the ability of households looking to buy a home to do so. In theory, it should help to protect the agency against the potential default by requiring more "skin in the game" from the buyer. However, loans with higher downpayments performed marginally better during the housing boom, but that effect has diminished in the wake of stronger underwriting, stable employment and changes implemented by the agency.

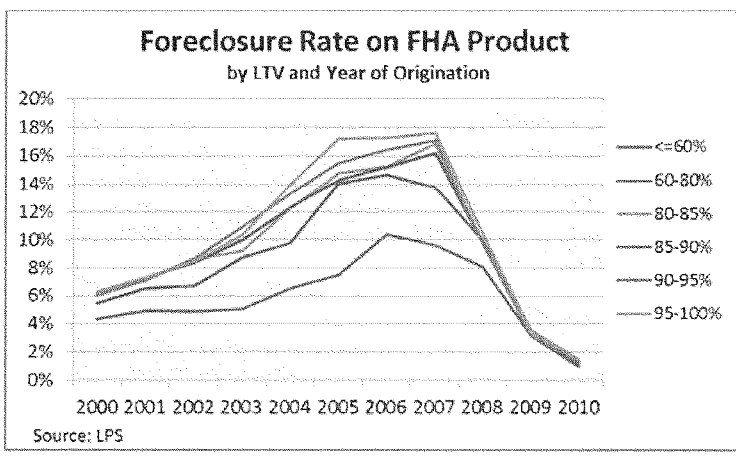

Figure 7

As demonstrated in Figure 7, the performance of loans with higher LTVs (greater than 80) was in a relatively tight band prior 2005. The performance of high downpayment mortgages deteriorated for mortgages originated between 2005 and 2007 before improving sharply, relative to larger downpayments in subsequent years. Performance by LTV on the 2009 and 2010 cohorts was nearly indistinguishable by the end of 2012.

FHA estimates that increasing the downpayment to 5% would disenfranchise 345,000 borrowers a year – more than 43% of all FHA buyers. Borrowers already must commit 3.5% cash at closing in addition to closing costs, which range from $3,000 to more than $5,000 on an average home sale. Increasing the downpayment will remove homeownership options for many American families, and would be counter to FHA's historic mission.

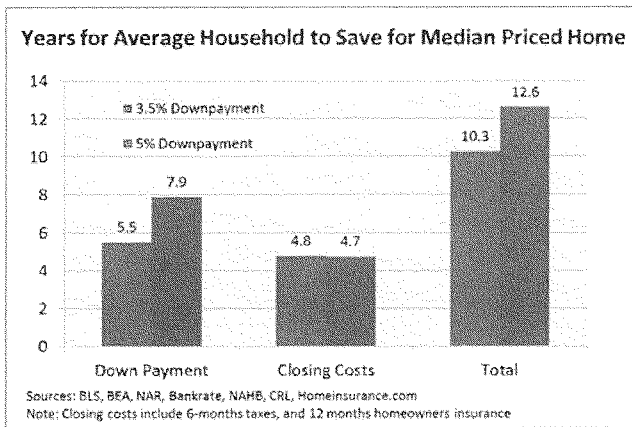

Figure 8

The size of the required downpayment also has a significant impact on the timing of a family's home purchase. At a 3% downpayment, the average buyer has to save 10.3 years to come up with the necessary downpayment for a median priced home. A simple increase in required downpayment from 3.5% to 5% will require the average buyer to save for an additional 2.3 years (from 10.3 years to 12.6 years). This estimate assumes that life events like having children, or taking care of family members don't divert their savings. (See Figure 8)

Homeownership is an important means for building wealth through structured equity payments for most households. However, recent trends towards higher downpayment in the traditional market have resulted in a higher share of home buyers using funds designated for retirement (such as IRAs, pensions, and 401ks) as a means of funding their downpayment. (See Figure 9)

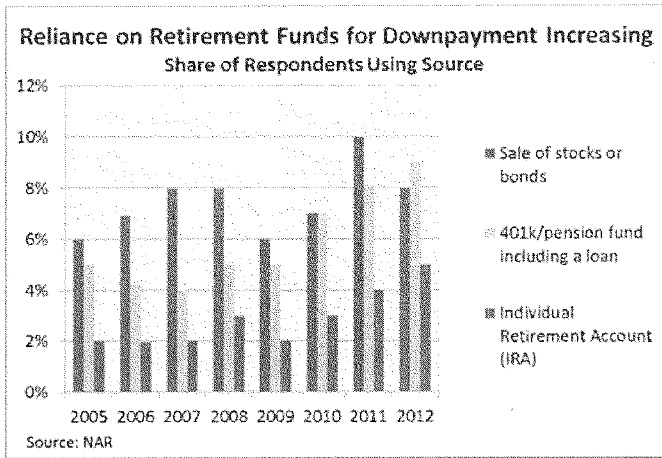

Figure 9

The impact of increasing the downpayment is greater on minorities than on whites, who are more likely to have received an inheritance or assistance from their family. Recent studies have shown that for loans made during 2004 – 2008, a 10% down payment would have made a mainstream mortgage out of reach for 60% of African-Americans and 50% of Latino borrowers who were current on their mortgage (Center for Responsible Lending). More than 52% of African Americans and 45.8% of Hispanics relied on a downpayment less than 5%, compared to only 33.4% of other purchasers. (See Figure 10)

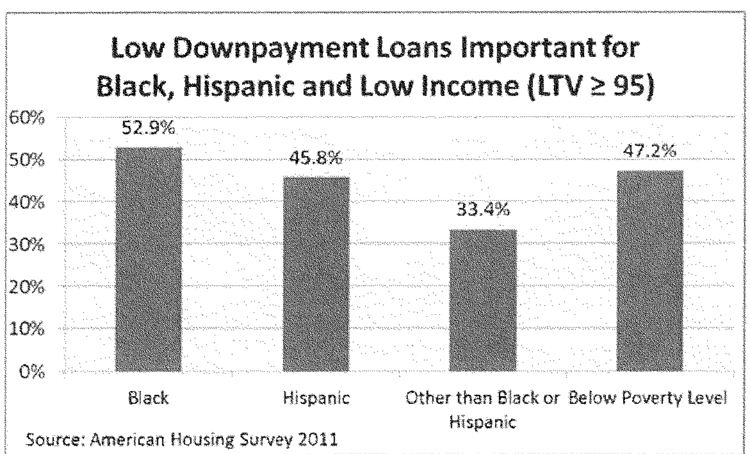

Figure 10

Low downpayments are not just important for first-time buyers. Repeat buyers also use low-downpayment loans, and could also be disenfranchised by this legislation. (See Figure 11)

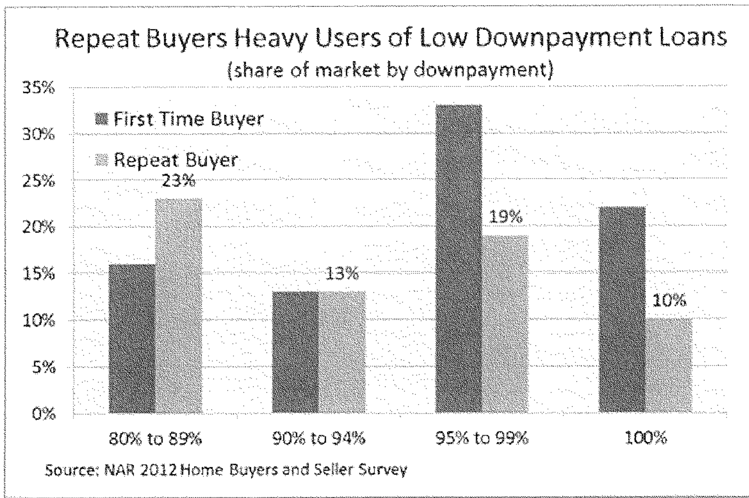

Figure 11

Reducing the FHA Loan Limits

Our concerns with the language in PATH to lower the limits have been enumerated above.

We would point out, there is no financial solvency argument for reducing the loan limits. In fact, higher balance FHA loans perform better than lower balance ones. As has been indicated in recent actuarial reports, "FHA experience indicates that more expensive houses tend to perform better compared with smaller houses in the same geographical area, all else being equal." So despite arguments that FHA higher limits put taxpayers at risk, these loans actually add strength to the program, and reduce risk to the fund.

Premiums

The PATH Act would codify a recent FHA policy to require borrowers to pay the annual Mortgage Insurance Premium (which is paid monthly) for the life of the loan. Previously, borrowers could cancel that premium when their LTV reached 78%, as they can in the private market when their LTV reaches 80%.

This policy change has already caused significant problems in mortgage markets, because the lifetime pricing of the MIP has moved many FHA loans into the High Priced Mortgage Loan (HPML) status. An HPML loan is defined as a loan that exceeds the APOR (Average Prime Offered Rate) by 1.5% or more on first liens. The APOR is a rate issued weekly by

the Federal Reserve Board. Many lenders do not originate loans that are fall under HPML rules. Making this recent policy change permanent will result in far fewer lenders being willing to originate FHA loans.

While NAR supports risk-based priced premiums for FHA borrowers, the related provisions in the PATH Act go significantly further. The bill will allow the premium rate to vary for individual borrowers during the mortgage term, based on pre-disclosed criteria. We strongly oppose this provision, which could dramatically change the borrower's payments over time, and for reasons beyond their control.

FHA's Role in Multifamily Markets

As in the single-family market, FHA's role in multifamily mortgage markets has never been more critical. More than 1/3 of American families rent their homes, and keeping a sufficient supply of affordable rental housing is essential. Without the liquidity provided by FHA multifamily mortgage insurance, these markets would be stalled.

In recent years, FHA's role in the multifamily market has increased dramatically – nearly 4 times its size from just several years ago. As lenders remain slow to provide financing for construction loans, FHA is the primary source of construction for multifamily developers and owners. Again, this demonstrates FHA's ability to step up and fill the gap when private markets will not or cannot act.

FHA's multifamily loan program has performed very well. Their annual claim rate on each of the major programs has been less than 1% since 2011. The premiums are high and have risen in the last year, further strengthening the fiscal soundness of these programs.

The PATH Act would target the FHA multifamily loan program by creating income limits for tenants in properties financed with FHA multifamily loans. The vast majority of FHA's multifamily portfolio serves low-to moderate income borrowers, and more than half those properties already have affordability provisions. Placing significant burdens on property owners and tenants alike to require rent certification is unnecessary and would add costs to the operation of these properties.

Other Concerns

We have concerns with a number of other provisions of the legislation which we will briefly note here:

- Guarantee Fees: Guarantee fees should appropriately reflect risk, and not be subject to other factors, as suggested in the Act.

- Affordable Housing Goals: The affordable housing goals have provided qualified borrowers with access to mortgage finance, and some form of goals should be included in the new entity.

- Risk-Sharing Requirements: We have concerns about the risk-sharing requirements under the GSE title and FHA title. NAR supports a risk sharing model, but has continues to have concerns that mandated levels may be hard to reach if the private sector elects not to participate.

- FHA Guarantee Reductions: The legislation would reduce the FHA guarantee in half over a five year period. All studies to date have shown that any reduction of the guarantee would result in significant increases in loan prices and decreases in lender participation. Again, increased loan prices and lender participation will have a significant impact on borrowers and markets.

- FHA Capital Reserve Ration: Doubling of the FHA capital reserve ratio and the related increases in premiums will have a dramatic negative impact on FHA borrowers.

- Seller Concessions: We support the FHA proposed rule on seller concessions that allows for the greater of 3% of acquisition costs or $6000, whichever is greater. We believe this approach better reflects differences in closing costs nationwide.

- Lender Repurchase Requirements: We believe the lender repurchase provision of PATH's FHA title will negatively impact lender participation to the detriment of the program.

- Fair Value Accounting: NAR opposes the use of Fair Value Accounting for FHA. Such an approach is only appropriate when assets are being disposed of in the near term and not for the long-term holding as under the FHA program.

Provisions We Support

Covered Bonds. We believe a covered bond market can be an additional tool for mortgage liquidity. Exacerbating the pullback in bank lending, another key source of commercial real estate credit — the CMBS market — is only beginning to recover from near-zero levels in 2009. As this market struggles to rebound, the creation of a covered bond market in the U.S. will be essential to address ongoing commercial real estate refinance challenges. Already successfully used in Europe and Canada, covered bonds allow banks to raise funds by issuing a pool of high-quality assets (typically real estate loans) to investors, which are backed both by the bank's promise to repay and by the assets pledged as collateral. This dual recourse nature is attractive to investors. Therefore, banks who issue bonds have a stake in assuring the long-term viability of the mortgages underlying the bond.

3% Cap for Affiliate Fees (HR 1077). As currently defined by Dodd Frank and in the Consumer Financial Protection Agency's (CFPB) final regulation implementing the "ability to repay" requirements, "points and fees" include (among other charges): (i) fees paid to affiliated (but not unaffiliated) title companies, (ii) salaries paid to loan originators, (iii)

amounts of insurance and taxes held in escrow, (iv) loan level price adjustments (LLPAs), and (v) payments by lenders to correspondent banks and mortgage brokers in wholesale transactions.

As a result of this problematic definition, many loans made by affiliates, particularly those made to low-and moderate-income borrowers, would not qualify as QMs. Consequently, these loans would be unlikely to be made or would only be available at higher rates due to heightened liability risks. Consumers would lose the ability to choose to take advantage of the convenience and market efficiencies offered by one-stop shopping.

Regulatory Relief. NAR appreciates the language in the bill attempting to provide regulatory relief to the mortgage market. We believe uncertainty in financial markets about regulations exists and this bill attempts to address that.

Basel III. We support a study of the Basel III rules to conduct a cost-benefit analysis. This will help identify any provisions in the final rule that would unnecessarily harm the housing and commercial recovery. In addition, these rules cannot be considered in a vacuum. The cumulative impact on the real estate finance market and consumers of the layering of the proposed Basel III on top of the myriad of other rules including QM and QRM should be fully assessed by the regulators.

Manufactured Housing. NAR also supports language that will preserve the manufactured housing industry without deterioration of important consumer protections. The provision clarifies the difference between manufactured housing manufactures and loan originators; it also ensures that small manufactured housing loans are exempt from HOEPA standards.

Common Sense Economic Recovery Act (HR 927). We support inclusion of this bill, which directs federal banking agencies to not place a commercial real estate loan in non-accrual status solely because the collateral for such loan has deteriorated in value. This will create more financing options for maturing commercial real estate loans and allow financial institutions to play a significant role in revitalizing our nation's economic recovery.

Summary

The National Association of REALTORS® recognizes the Chairman for his desire to introduce comprehensive reform of housing finance. However, the National Association of REALTORS® must oppose this discussion draft.

CALIFORNIA ASSOCIATION OF REALTORS®

July 18, 2013

Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Re: California Association of REALTORS® Opposition to the Protecting American Taxpayers and Homeowners Act of 2013

Chairman Jeb Hensarling and Ranking Member Maxine Waters;

I am writing on behalf of the 155,000 members of the California Association of REALTORS® (C.A.R.) to express our strong opposition and concerns regarding the discussion draft of the Protecting American Taxpayers and Homeowners Act of 2013 (PATH). C.A.R. appreciates the opportunity to comment on the important issues raised in the discussion draft. We are deeply concerned that passage of the Act would have dire consequences for the recovery of the real estate market, and cause irreparable harm to the nation's future homebuyers and housing market.

C.A.R. and its members are first and foremost focused on the promotion and support of homeownership. For over 100 years C.A.R.'s members have worked to help their family, friends and neighbors experience the American dream of homeownership. The benefits of homeownership, not just to individual households, but to the community and nation as a whole are well documented. Since the Great Depression, the nation has understood that while economic markets, and even housing markets are cyclical, qualified homebuyers must not be held hostage to the whims of Wall Street. For almost eighty years the nation has moved its home finance policy along those principles, principles which we believe PATH would reverse.

FHA Reform Should be Removed from PATH

C.A.R. supports efforts by Congress to make necessary improvements to the FHA program; however, we believe any discussion on FHA reform should be separate from efforts to "wind-down" Fannie Mae and Freddie Mac, and the creation of a replacement for them.

Executive Offices 525 South Virgil Ave. Los Angeles, CA 90020 Tel (213) 739-8200 Fax (213) 480-7724 www.car.org

C.A.R. is strongly opposed to many of the FHA changes proposed in PATH. In response to specific provisions of Title II:

- C.A.R. is opposed to changes in the role and mission of the FHA. Limiting the FHA program to only first-time homebuyers and low- and moderate-income homebuyers is a drastic departure from the historic mission of the FHA and the very purpose for which it was created.
- C.A.R. is opposed to the decrease in the FHA loan limits. Equal access to affordable and safe mortgage financing is a continuing problem for high-cost states like California, and C.A.R. is opposed to any and all rollbacks of FHA's current loan limits.
- C.A.R. is opposed to the increase in the downpayment amount from 3.5 percent to five-percent. This change hurts homebuyers and will disqualify many otherwise worthy buyers; sufficient evidence has not been presented that increasing the downpayment to five-percent will improve a loans performance more than proper underwriting.
- C.A.R. is opposed to the reduction in FHA mortgage insurance coverage from 100 percent to 50 percent in only five years. The impact of reducing FHA's coverage is unknown and a large rollback of this coverage in such a short timeframe without any knowledge of its impact is reckless, and guaranteed to decrease the availability of funding to qualified buyers.
- C.A.R. is opposed to the creation of a new definition of "first-time homebuyer" that differs from the definition used under other HUD programs.
- While C.A.R. is not opposed to a risk sharing program for the FHA, we are concerned about mandating the program without understanding the private market's willingness to participate in such a program during various market conditions.

C.A.R. echoes the comments of the National Association of REALTORS® in asking for FHA reforms that address solvency issues similar to what was passed in the House (by a vote of 402-7) last year.

A Government Role in the Mortgage Market

While C.A.R. has supported the reform or replacement of the government sponsored enterprises (GSE), Fannie Mae and Freddie Mac, we do **not** support the manner in which the GSE are wound-down in PATH, or the creation of a replacement entity, such as the Mortgage Market Utility (Utility), without an explicit government guarantee. In response to specific provisions of Title I and Title III

- C.A.R. is opposed to the continued increase in the GSE guarantee-fee (G-fee). Most recently the Office of Inspector General of the FHFA issued a report skeptical of this G-fee increase policy which mistakenly believes private capital can be priced back into the market. In actuality, the continued increase in G-fees fails to adequately reflect the true risk of borrowers who are punished by paying higher interest rates than they should. The proposed G-fee is really an undisclosed tax on the mortgage that runs in perpetuity.
- C.A.R. is opposed to the decrease in the loan limits. As stated above in our concerns regarding the lowering of FHA's loan limits, C.A.R. believes the high-cost states loan limits are necessary to ensure equality for California's homebuyers in obtaining safe and affordable financing. In C.A.R.'s most recent June 2013 home price report, no less than 10 counties in California had **median** home prices above the proposed high-cost loan limit.
- C.A.R. is opposed to the "mandatory" risk sharing of the GSEs. Fannie Mae and Freddie Mac have not yet executed a single pilot risk sharing transaction to determine the appropriate structure and market demand. While C.A.R. is not opposed to exploring risk sharing, codifying a mandatory risk sharing program regardless of market conditions is "testing the depth of the water with both feet" and is something C.A.R. cannot support.
- C.A.R. believes the PATH draft must provide an explicit government guarantee for the Utility—or any entity—that is intended to replace the GSE. C.A.R. has seen no evidence that the private sector can provide adequate capital to the nation's $11 trillion mortgage market in all market conditions. The last time private capital was a majority of the market was during the '03-'06 bubble, where subprime and Alt-A loans, which did not have government guarantees, had the most relaxed underwriting standards in history so the private sector could gain that market share.

C.A.R. appreciates the Chairman putting this issue before Congress for debate. The PATH draft does have provisions that C.A.R. is supportive of, and glad to see included, such as addressing the use of eminent domain for seizing mortgage notes, an attempt to address the counter cyclical issues surrounding mortgage capital availability, and the acknowledgement of the importance of maintaining the 30-year fixed rate mortgage. However, C.A.R. must strongly oppose PATH as currently drafted.

Congressional supporters of PATH are not alone in wanting to see private capital return to a larger role in the real estate finance industry, C.A.R.

along with the rest of the industry supports that belief. The reality however is that won't happen until confidence in the rating agencies return, rep & warrant issues between issuers and investors are addressed, investors are comfortable with transparency on loan level data, and most importantly real estate is seen as a better investment than competing sectors investors currently are invested in. Draconian legislation and policy attempting to force the mortgage market to become privately capitalized will not only fail because it addresses none of these issues, but in the process will harm homebuyers, the real estate industry and the nation as a whole.

Thank you for your consideration of our comments. C.A.R. believes there is nothing more important to the housing recovery than availability of mortgage financing. For the last 80 years homebuyers, and the industry as a whole, have taken for granted that if they walk into their corner bank and can qualify for a mortgage, that lender will have money available to make a home loan. C.A.R. believes that should Congress pass the PATH legislation in its current form there will be times when qualified homebuyers will no longer be able to count on their lenders being able to provide a home loan.

Sincerely,

Don Faught

Don Faught
President of the California Association of REALTORS®

Cc:
California Members of the House Financial Services Committee

American Hospital Association

Liberty Place, Suite 700
325 Seventh Street, NW
Washington, DC 20004-2802
(202) 638-1100 Phone
www.aha.org

July 17, 2013

The Honorable Gwendolynne Moore
The Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Representative Moore:

On behalf of our nearly 5,000 member hospitals, health systems and other health care organizations, and our 43,000 individual members, the American Hospital Association (AHA) appreciates this opportunity to provide comments on the discussion draft of the *Protecting American Taxpayers and Homeowners Act of 2013*. The AHA opposes Section 292(a)(2) of the proposal, which would repeal, two years after date of enactment, the Federal Housing Administration's (FHA) Hospital Mortgage Insurance Program (Section 242).

Since the inception of the Section 242 program in 1968, 400 mortgage insurance commitments totaling more than $15 billion have been issued for hospital projects in 43 states and Puerto Rico, ranging from small, rural and critical access facilities to some of the nation's top urban teaching hospitals. The 242 program is often a last resort for communities seeking to maintain access to urgently needed hospital services when no other source of affordable financing is available.

The Section 242 program maintains one of the best claim records in the FHA mortgage insurance portfolio, and because program revenues historically have significantly exceeded program insurance claims, the program's federal credit scoring remains "negative," meaning that annual appropriations for insurance claim payments are not required. In fact, due to strong underwriting and diligent asset management, the program operates at no cost to the taxpayers and consistently maintained a cumulative net claim rate of less than 1 percent.

CAPITAL INVESTMENT AND ACCESS TO HEALTH SERVICES

Meeting the health care demands of the future will require significant capital investment. Raising capital at a reasonable cost is more difficult than ever for the majority of America's hospitals. Capital markets for non-profit hospitals still have not fully recovered from the 2008 recession. Moreover, three temporary federal financing options that helped ease the credit crunch expired in 2010.

The Section 242 program has been the key to keeping vital hospital services available to many communities. State and local governments otherwise would be called upon to provide these necessary services. If that were the only alternative, the resulting increased borrowing cost to state and local governments would be borne by taxpayers and ratepayers in every local jurisdiction through the imposition of increased taxes and fees (e.g., ad valorem property taxes, special assessments, sales taxes, toll charges and utility rates) or through service cuts. These taxes or fees, including sales taxes, tolls or user fees, would fall disproportionately on lower- and middle-income households, as would service cuts.

If hospital access to the mortgage guarantees under the 242 program is eliminated entirely, the result could be devastating for both patients and their communities. The financial unraveling of a hospital has the potential to impact a community more profoundly than the unplanned closure of nearly any other institution. Patients will suffer as hospitals struggle to survive. Prices will rise, equipment will wear down without being replaced, and physicians will leave the service area. Ultimately, the health of the entire community will suffer. Furthermore, closure may result in reduced specialty services and overcrowding in other hospital emergency departments, while patients may delay treatment if services are not readily available.

Americans rely heavily on hospitals to provide 24/7 access to care for all types of patients, to serve as a safety-net provider for vulnerable populations and to have the resources and skills needed to respond to disasters. Emergency department visit volume has increased by nearly 26 percent since 2000, and will continue to grow.

Aging baby boomers and an increasingly diverse population create demand for new and different services. The promise of expanded health insurance coverage will add to demand. Clinical procedures continue to evolve, as do diagnostic techniques and communication technologies.

Over the past 15 years, market, economic and regulatory forces have led hospitals and physicians to explore new ways to better align their interests and achieve greater integration in order to both reduce costs and improve the quality of care. With an eye on the future, hospitals across the country are in a constant state of renovation and improvement in order to provide the latest treatments and services to meet the increasing and changing needs of their communities. Access to the Section 242 program for these needed upgrades is crucial for hospitals with sound track records that are unable to secure capital to operate a financially stable facility at reasonable interest rates.

Building a continuum of care is the future. The forces that make it imperative include the need for hospitals to respond to powerful financial incentives for meeting performance objectives and avoiding penalties for failing to do so. According to a recent Moody's report, "[t]he ability to demonstrate lower costs while providing higher quality will be the key driver in government and commercial reimbursement going forward." One estimate is that 6 percent of hospital revenue could be at risk from penalties from government and commercial payers for lack of coordination.

Hospitals are faced with unprecedented demands for capital to invest in new technology such as electronic health records – as much as $50 million for a mid-size hospital – implement new modes of delivering care such as telemedicine, and build new and improved facilities. Hospitals with current Section 242 commitments that need to invest in new technology and equipment that benefits patients would no longer be able to avail themselves of its refinancing and supplemental loan programs. To fund such expenditures outside the program will result in far higher costs, which in some cases, may be prohibitive. Without needed upgrades and renovation, hospitals also may find it more difficult to recruit top physicians and other staff.

At a time when hospital revenues are already strained, hospitals must respond to rapidly changing market and government forces, including: (1) reimbursement reductions and changes; (2) an increasing necessity to provide access to a broad range of health services to a growing population; and (3) limited access to capital. These market forces are driving an urgent need for hospitals to make significant capital investments while reducing costs, both of which require continued access to low-cost capital through the hospital mortgage insurance program. As you work to reform the nation's housing finance system, the AHA strongly recommends retention of the FHA's 242 program.

Sincerely,

Rick Pollack

Rick Pollack
Executive Vice President

FINANCIAL TIMES

September 9, 2008 7:25 pm

Oxley hits back at ideologues

By Greg Farrell in New York

In the aftermath of the US Treasury's decision to seize control of Fannie Mae and Freddie Mac, critics have hit at lax oversight of the mortgage companies.

The dominant theme has been that Congress let the two government-sponsored enterprises morph into a creature that eventually threatened the US financial system. Mike Oxley will have none of it.

Instead, the Ohio Republican who headed the House financial services committee until his retirement after mid-term elections last year, blames the mess on ideologues within the White House as well as Alan Greenspan, former chairman of the Federal Reserve.

The critics have forgotten that the House passed a GSE reform bill in 2005 that could well bave prevented the current crisis, says Mr Oxley, now vice-chairman of Nasdaq.

He fumes about the criticism of his House colleagues. "All the handwringing and bedwetting is going on without remembering how the House stepped up on this," he says. "What did we get from the White House? We got a one-finger salute."

The House bill, the 2005 Federal Housing Finance Reform Act, would have created a stronger regulator with new powers to increase capital at Fannie and Freddie, to limit their portfolios and to deal with the possibility of receivership.

Mr Oxley reached out to Barney Frank, then the ranking Democrat on the committee and now its chairman, to secure support on the other side of the aisle. But after winning bipartisan support in the House, where the bill passed by 331 to 90 votes, the legislation lacked a champion in the Senate and faced hostility from the Bush administration.

Adamant that the only solution to the problems posed by Fannie and Freddie was their privatisation, the White House attacked the bill. Mr Greenspan also weighed in, saying that the

House legislation was worse than no bill at all.

"We missed a golden opportunity that would have avoided a lot of the problems we're facing now, if we hadn't had such a firm ideological position at the White House and the Treasury and the Fed," Mr Oxley says.

When Hank Paulson joined the administration as Treasury secretary in 2006 he sent emissaries to Capitol Hill to explore the possibility of reaching a compromise, but to no avail.