Structured Finance Industry Group (SFIG)

Johnson-Crapo Briefing Book

April 21, 2014

Structured Finance Industry Group

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I. Introduction

The Structured Finance Industry Group, Inc. (SFIG) is a member-based, trade industry group focused on improving and strengthening the broader structured finance and securitization market. The 244 member companies of SFIG represent all sectors of the securitization market including issuers, GSEs, investors, financial intermediaries, law firms, accounting firms, technology firms, mortgage insurers, rating agencies, servicers, and trustees.

We thank you for introducing the Housing Finance Reform and Taxpayer Protection Act of 2014 discussion draft. SFIG supports the efforts that Congress, the Administration and regulators have put forth to overhaul our nation's housing finance system, particularly the effort to attract private capital back to the residential mortgage-backed securities (RMBS) market.

With the right legislative and regulatory reforms in place, the private non-GSE RMBS (PLS) market can assume an increasing role in prudently financing homeownership, while also limiting taxpayer exposure. SFIG believes securitization is the tool through which private capital can play the most productive and efficient role in the new housing finance system.

As previously discussed in SFIG's testimony before the Senate Banking committee last September, it is critical that any housing finance reform proposal address the following key objectives:

- Preservation of the To-Be-Announced (TBA) Market, which is the most efficient mechanism to enable consumers to "lock-in" interest rates on a forward basis and help minimize the cost of borrowing;
- Preservation of the 30-year fixed-rate mortgage;
- Creation of a common TBA security to foster a deep and liquid housing market;
- Implementation of a securitization platform for the non-PLS market;
- Preservation of the liquidity of legacy securities; without creating a bifurcated market; and;
- A deliberate and orderly transition from the existing Government-Sponsored Enterprises.

SFIG appreciates the bipartisan efforts of this Committee, and the methodical approach it has taken in considering reforms that are so inherently critical to the U.S. housing market and the economy as a whole. With these objectives in mind, we offer the following recommendations to enhance your efforts to promote a stable, liquid and efficient secondary mortgage market.

Sincerely,

Richard Johns
Executive Director
Structured Finance Industry Group

II. SFIG's Detailed Viewpoints and Recommendations

a. Goals and Purpose

Legislation Summary:

The key purposes of the draft legislation are to facilitate broad availability of credit for eligible single family and multifamily borrowers, monitor consumer and market access to credit, and maintain broad liquidity for the TBA Market while also taking into account the impact of new products on the TBA Market.

SFIG Viewpoint:

The TBA Market and the 30-year fixed-rate mortgage (FRM) are vitally important to the U.S. housing finance system. SFIG has previously urged Congress to ensure that housing finance reform legislation includes appropriate policies to preserve the TBA market and the 30-year FRM. Both markets have provided valuable benefits to borrowers, including the ability to most efficiently lock-in an interest rate early in the mortgage process. The government guarantee provided for in the Johnson-Crapo bill is a key component to preserving the TBA market and the 30-year FRM.

A well-functioning TBA Market and a fixed-rate mortgage are extremely important in the United States as they are major aspects of what separates the American mortgage market from other countries. For example, in the United Kingdom and mainland Europe, many borrowers are subject to floating rate mortgages and potential payment shock because of the inability to lock in rates. Prudent borrowers would have to be extremely conservative when purchasing a house so as to avoid this shock, consequently creating a drag on home prices, while the less prudent borrowers could be subject to "rate shock" and trigger defaults. The TBA Market allows borrowers an efficient mechanism for locking in rates on a forward basis, allowing them to prudently maximize their purchasing power while minimizing the risk of defaults driven by interest rate resets.

SFIG believes the TBA Market is dependent on the following four factors:

1) A government guarantee,
2) Standardization of loans/pools,
3) Market delivery standards, and
4) Confidence arising from an established market history.

We believe that fundamental changes to any of these factors could be detrimental to the liquidity and success of the market.

Position and Recommendation:

We support the legislation's purpose of creating a single security and maintaining broad liquidity in the TBA Market. Therefore, SFIG recommends that the legislation specifically mention that all products in the current TBA Market be preserved including, but not limited to, the 30-year FRM as well as specifically mentioning the goal of having a strong and vibrant TBA

Market. We believe that such language would ensure that simple and easy to understand structures such as the 10, 15, 20; and 30-year fixed-rate mortgages are both allowed and encouraged under the new housing finance system.

SFIG would also recommend that the bill specifically mention "broad liquidity in the TBA market," so as to align with the overall goals of Johnson-Crapo.

We offer the following language changes for SFIG's enhancements in Section 201(b)(1):

(b) PURPOSE.—The purpose of the Corporation shall be to—(1) facilitate a liquid, transparent, and resilient single-family and multifamily mortgage credit market by supporting a robust secondary mortgage market, including as currently exists in the "to be announced" or TBA market and preserving the liquidity of all products that are presently eligible to trade in such TBA Market, including during the transition to the new housing finance system;

b. FMIC Leadership

Legislation Summary:

SECTION 202 states that Federal Mortgage Insurance Corporation (FMIC) would have a five member Board of Directors, led by a Director appointed by the President for a term of five years.

- The Director shall have demonstrated technical expertise in the fields of mortgage securities and housing finance.
- The bill prohibits more than three members from being from the same political party.

SECTION 203 FMIC shall establish an Advisory Committee (composed of 9 members) for the purpose of advising an Office of Consumer and Market Access on developments in the primary and secondary mortgage markets.

SFIG Viewpoint:

SFIG believes that all members of the FMIC should have market expertise. This expertise should come from a diverse number of sources such as investors, secondary/TBA Market participants, and originators of mortgages that would be securitized through the Securitization Platform (Platform).

Position and Recommendation:

SFIG supports the provisions set forth above for FMIC leadership, as it ensures the Board of Directors has the proper knowledge of industry practices and standards in order to become a respected regulators.

SFIG would recommend that the language for the technical expertise of the Board of Directors be enhanced by ensuring that at least one position draw from the experience of issuing or investing in mortgages from the secondary/TBA marketplace.

We offer the following language changes for SFIGs recommendations in Section 202(a)(1)(b):

(B) have demonstrated technical, academic, or professional understanding of, and practical, disciplinary, vocational, or regulatory experience working in, housing and housing finance, including having at least one member that has experience in investing or issuing in the secondary market and/or the TBA Market.

c. FMIC Authority

Legislation Summary:

SECTION 301 states among the principal duties of the FMIC are facilitating access to the secondary mortgage market for small lenders, which shall include the establishment of small lender mutuals; monitoring safety and soundness of regulated entities; ensuring approved entities meet certain requirements; promoting the standardization of the market through uniform securitization agreements, servicing documents and the Platform; and maintaining a national mortgage loan database.

SFIG Viewpoint:

The regulator's mission should not be duplicative of existing regulators such as the CFPB, Federal Reserve, or SEC.

The regulator should not be able to set general mortgage lending, servicing, disclosure, or other standards that apply outside of the government market. It should be able to set standards that relate to access to the government guarantee (in coordination with the regulator of the government guarantee, if they are separate entities) or access to the Platform.

Furthermore, to the extent a rule it promulgates conflicts with a broader rule, such as the CFPB's servicing standards or RESPA, a process should be put in place that ensures coordination among the relevant agencies to avoid duplicate regulation.

The FMIC mandate should be to ensure the function and liquidity of the new conforming market; it should not extend to consumer protection or safety and soundness of participants in the market, aside from the promulgation of qualification standards for various market participants (e.g., insurers, servicers, etc.).

Position and Recommendation:

SFIG generally supports the provisions in the Johnson-Crapo draft regarding the establishment of the FMIC and its role as primary regulator of the system by which covered securities are issued, subject to a qualification that the market be given necessary time to digest a more centralized regulator and this transition be done in a slow and deliberate process.

When an entirely new business line is set up in the private sector, there is usually dual tracking for a period of years to ensure that the market both remains stable and a stable transition occurs. In this case, the entirety of the U.S. housing finance system is at risk. Considering the overall impact that housing finance has on the U.S. economy, any hiccups in transition could be devastating.

Therefore, SFIG recommends that both the existing housing system and the new housing system be allowed to co-exist for a period of time to ensure a stable transition. We believe such dual tracking fits with the goals of the "triggers" present in the Johnson-Crapo draft bill.

SFIG also believes that the FMIC should only maintain the existing regulatory authority of the Federal Housing Finance Agency over the participants, the covered securities and the MIF.

We provide suggested language for a dual system approach in the discussion on winding down the GSEs.

d. FMIC Reporting

Legislation Summary:

SECTION 206 states FMIC shall submit annual reports detailing the activities of the corporation as well as the operating status of the MIF, a fund established to handle incoming claims and backed by the full faith and credit of the U.S. government.

- The report would also include status of private-label market, actions by state attorneys general, and access to consumer credit.

SECTION 609 states that not later than eight years after the enactment of the Act, the GAO will submit a report to the Senate Committee on Banking, Housing, and Urban Affairs and House Financial Services Committee on the feasibility of maintaining the secondary mortgage market and provide its recommendations.

- Six months after the report, FMIC will submit a plan to Congress detailing steps to carry out a transition to a fully privatized secondary mortgage market and how to dissolve FMIC and the insurance model.

SFIG Viewpoint:

SFIG supports reporting on the operating status of the MIF.

Recommendation:

SFIG suggests that the legislation include an initial quarterly reporting requirement on the MIF during the first ten years until the MIF reaches 2.5 percent. We offer this enhancement because the MIF is more precarious initially until it is fully funded. Further, SFIG believes quarterly reporting would allow the Senate Committee on Banking, Housing, and Urban Affairs, and any other oversight bodies, the ability to closely monitor any reasons for any potential under-funding of the MIF and help remediate issues quickly.

We offer the following language changes for SFIG's recommendations to the draft legislation in section 206(a)(1):

(1) IN GENERAL.—After the system certification date, the Corporation shall submit, on a quarterly basis until the Mortgage Insurance Fund obtains a reserve ratio of 2.50 percent and then on an annual basis, to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a written report of its operations, activities, budget, receipts, and expenditures for the preceding quarter or 12-month period, as applicable.

e. MIF Insurance & Funding

Legislation Summary:

SECTION 303 establishes a MIF to fund insurance claims on the principal and interest of the FMIC-backed securities if losses exceed the private market first loss position.

The MIF will be funded by assessments on Fannie Mae and Freddie Mac initially and sustained in the future by fees on the FMIC-backed securities. The target for the MIF reserve ratio is 1.25 percent of the securities guaranteed. By year 10, that ratio should be 2.50 percent.

FMIC shall determine a fee and shall take into account operating expenses of the MIF, risk or credit sharing structure of a pool, operating expenses, economic conditions, reserve ratio goals, and any other factors the FMIC deems important. Full faith and credit of the United States is pledged to support the fund.

SFIG Viewpoint:

Private Capital should be Responsible for covering losses up to a Threshold.

SFIG is of the view that a guarantor should not have to erode its capital completely prior to a FMIC guarantee stepping in. The purpose of capital is to provide a buffer for losses not to completely wipe out guarantors. In a regime whereby the guarantor is on the hook for losses that take out its entire capital, SFIG does not believe many entities would enter the business of being a guarantor, and therefore potentially threatening the structure that Johnson-Crapo contemplates.

Our view is that the Government should provide funds for principal and interest before guarantor entities are no longer able to write new business. Guarantors should be obligated for losses up to a percentage less than or equal to their capital position (5% or 10% as the case may be) but subsequent to that; FMIC would need to step in. We also believe that this needs to be done on a vintage or cohort basis.

A vintage or cohort based guarantee has several advantages. It preserves the ability of a guarantor to write new business as the entire capital of the guarantor would not be wiped out by a limited number of securities. Furthermore, a security based guarantee lends itself to potentially "gaming the system" through adverse selection by putting all poor quality loans in a particular pool. To safeguard against gaming, we suggest that FMIC steps in when losses on a particular vintage or cohort reaches a certain level of losses as opposed to on any one security.

We recognize that a vintage or cohort guarantee lowers the attachment point of the guarantee and suggest that FMIC have an option to collect on a receivable from a guarantor for amounts it is required to pay under a guarantee.

This policy would enhance Johnson-Crapo's goals and could be described as an extraordinary loss protection model (whereby the government guarantee is drawn upon before the collapse of

the guarantor entity), which is different than, and superior to, a catastrophic loss protection model.

This distinction is important because during severe market dislocation catastrophic loss protection would only protect the mortgage securities that have already been formed, not the primary loss coverage provider, leaving entities unable to extend additional credit and provide for the liquidity of new mortgages. It is very likely that due to market conditions, all mortgage guarantors would deplete their capital at that same time.

Furthermore, even if the guarantee remains triggered by insolvency, we suggest language changes to assure the market that payment under the guarantee is without question. We do not believe that the TBA Market will work effectively without an unambiguous guarantee of the covered securities by the FMIC. We offer the suggestion below to address these two issues.

We also support the MIF's ability to borrow from the U.S. Treasury to further re-assure the market in case of shortfalls in funding, a power the FDIC Deposit Insurance Fund (DIF) has today. Finally, we believe that an increase to a reserve of 2.5 percent over ten years be done in a slow and deliberate process so as not to adversely impact mortgage rates.

Position and Recommendation:

In order to provide liquidity to the mortgage market in tirms of crisis, the FMIC must have the flexibility to pay under a guarantee so that market participants are assured that a guarantor will have the ability to take on new business. Such an approach might help avoid a situation like the FHFA putting Fannie Mae and Freddie Mac in Conservatorship.

We suggest language changes to assure the market that payment under the guarantee is without question. We do not believe that the TBA market will work effectively without an unambiguous guarantee of the covered securities by the FMIC. We offer the suggestion below to address these two issues.

We offer the following language changes for SFIG's recommendations to Section 303 of the draft legislation:

(c) CASH PAYMENTS; CONTINUED OPERATIONS.— (1) CORPORATION TO FACILITATE TIMELY PAYMENT.—The Corporation shall facilitate the timely and unconditional payment of principal and interest on covered securities insured under this Act in ~~the event of any losses that may be incurred as a result of any of the conditions in paragraph (2) by— (A)~~ paying, in cash when due, any shortfalls in payment of principal and interest due on the covered security~~; and (B) continuing to charge and collect any fees for the provision of insurance (in accordance with subsection (d)(8)) relating to the covered security. (2) CONDITIONS.—The conditions referred to in paragraph (1) are— (A) a payment default on the covered security exceeds the first loss position assumed by a private market holder; (B) in the case of a covered security that is guaranteed by an approved guarantor or approved multifamily guarantor of the covered security, the guarantor has become insolvent; or (C) the servicer or guarantor fails to~~

~~transfer to the bond administrator for the covered security funds in amounts necessary to make timely payment of principal and interest due on the covered security.~~ The Corporation shall also use proceeds from the Mortgage Insurance Fund to supplement payments on covered securities when losses by any Guarantor in the aggregate exceeds an amount percentage established by the FMIC, such amount should be set so that the guarantor provides the first loss on any vintage or cohort of covered securities. The FMIC shall also have the ability to ensure the timely payment of principal and interest on any covered security, as needed; prior to any guarantor exhausting its capital for all covered securities.

f. Exigent Market Conditions

Legislation Summary:

SECTION 305 gives FMIC the power to insure securities that do not have a 10 percent first loss position in exigent circumstances.

Initially, this is for six months and for two additional nine month periods within any three-year period.

Need the Corporation, Federal Reserve Chairman, HUD; and Treasury Secretaries to agree.

This aid cannot go to an entity that is in bankruptcy.

After any exercise of such authority, FMIC would establish a normalization timeline for approved entities to meet regular standards and establish a first lost position to the private market to minimize losses to the MIF.

SFIG Viewpoint:

SFIG supports a robust and functioning market that is as consistent as possible during boom periods and slower cyclical periods. We anticipate challenges to mortgage credit during certain cycles, and any future legislation should prepare for that.

Position and Recommendation:

While SFIG believes an exigency provision is necessary to support the market, we believe that, if implemented as drafted, the market may not function efficiently in times of crisis.

We suggest this provision allow greater flexibility for the FMIC to step in as necessary without having to obtain numerous regulatory approvals. We suggest that the Government commit to guaranteeing covered securities until the exigency has been fully addressed. The consequence of this provision, as drafted, is an adverse market reaction if the provision is ever exercised in an untimely and inefficient manner.

SFIG recommends that the language be enhanced to avoid such a situation by allowing FMIC the power to insure securities that do not have a 10 percent first loss position until FMIC declares an exigent circumstance state that such circumstance no longer exists.

Therefore, SFIG recommends the following language to enhance the exigent market conditions provision in the draft legislation to Section 305(a) and we further suggest that subsections (f) and (g) be deleted in their entirety:

(a) IN GENERAL.—If the Corporation, ~~upon the written agreement of the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, and in consultation with the Secretary of Housing and Urban Development,~~ determines that unusual and exigent circumstances have created or threaten to create an anomalous lack of mortgage credit availability within the single-family housing market, multifamily housing market, or entire United States housing market that could materially and severely disrupt the functioning of the housing finance system of the United States, the Corporation may, until such time as the Corporation deems necessary ~~for a period of 6 months~~—

g. Regulatory Exemptions

Legislation Summary:

SECTION 307 exempts FMIC-backed securities from SEC registration, credit risk retention, and the definition of a commodity pool.

SFIG Viewpoint:

Regulations that impede private investment in credit risk (e.g., REIT income and asset tests and Basel LCR rules) or prevent certain forms of risk-sharing structures altogether (e.g., the CFTC's commodity pool rules) should be reviewed and coordinated such that they support the new housing finance system rather than impede it.

To the extent a rule it promulgates materially conflicts with a broader rule, such as the CFPB's servicing standards or RESPA, a process should be put in place that ensures coordination among the relevant agencies.

The exemptions contained in this section are necessary for a well-functioning TBA Market. Additional exemptions may also be necessary.

Position and Recommendation:

SFIG recommends that legislation specifically be deemed to be level 1 highly liquid assets for the purposes of meeting any liquidity requirements including the rules implementing the liquidity coverage ratio and the net stable funding ratio. Furthermore, we suggest that a careful analysis be conducted by the Corporation of the existing TBA Market to confirm that all necessary exemptions have been provided for.

We suggest the following text be inserted in section 307(a)(1). A new subsection (B) shall be inserted as follows and subsection (B) shall be designated subsection (C).

For purposes of any liquidity risk management requirements applicable to any institution regulated by the federal regulatory agencies, including, without limitation, regulations to implement the liquidity coverage ratio or net stable funding ratio standards, covered securities shall be accorded the highest liquidity value given to any other assets which are guaranteed by a U.S. government agency.

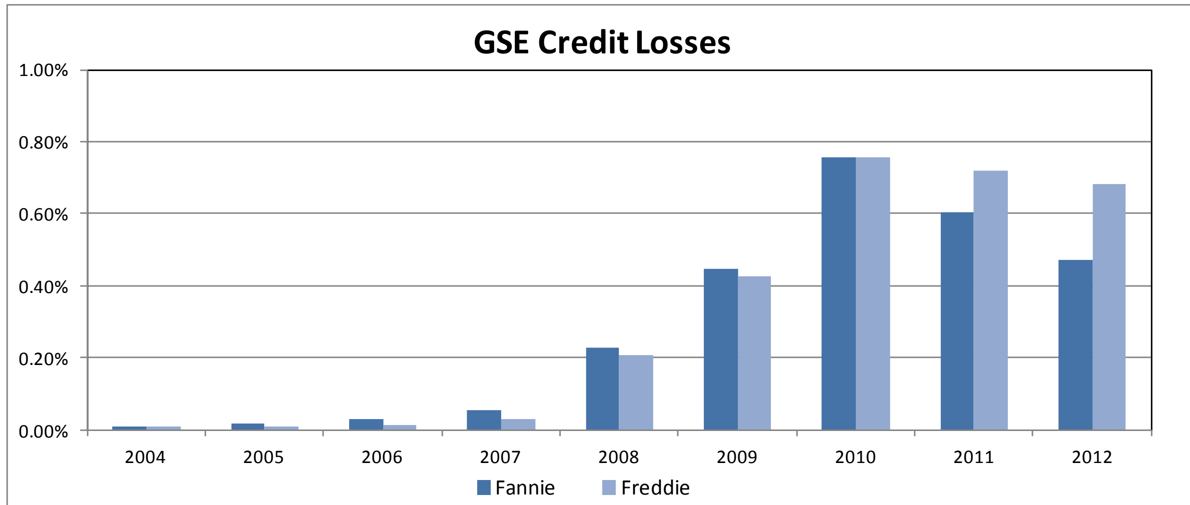
h. 10 Percent Capital

Legislation Summary:

SECTION 311 provides for standards for Guarantors including subsection (g) which requires 10 percent capital.

SFIG Viewpoint:

The purpose of capital is to create a first loss buffer prior to the government guarantee being drawn upon. Capitalizing the housing finance system to withstand a 10% loss is not necessary and is substantially more of a buffer than is necessary given loss expectations and historical losses. Since the credit crisis of 2008, not only have losses diminished but underwriting has gotten more conservative. The era of subprime loans and liar loans with no documentation has passed. Accordingly, in a world of a qualified mortgage, we can only expect credit losses to diminish.



While SFIG views the GSEs traditional capital thresholds as too low (historically 1/2 percent), we believe that there is no need to multiply that amount by 20. SFIG favors a system where normal losses (e.g., less than 3 standard deviations from base case assumptions) are absorbed by a private for-profit enterprise, while extraordinary (but still not depression scenario) losses would cause a draw on a government guarantee which would be financed through the collection of guarantee fees.

A capital requirement of 10% may be high enough to serve as a barrier to entry for guarantors to enter the business. Furthermore, if FMIC can continually raise capital on guarantors in times of crisis, and therefore ask the guarantors to effectively provide 100 percent capital before paying under a guarantee, would-be guarantors could be deterred from entering the market because guarantors would not be able to model their maximum exposure. Ideally, the market should have 3 to 5 guarantors to compete while having uniform underwriting and servicing standards.

Overly-stringent capital requirements could prevent the necessary competition that the market needs.

10 Percent Coupled with other Fees Could Increase Cost to Consumers

High capital requirements could impact homeownership rates in the United States. A requirement of 10 percent capital on the guarantors would certainly be passed on to borrowers. Coupled with other expenses such as the affordable housing fund add-on of 10 basis points, we anticipate that rates could rise anywhere between ½ percent to 1 ½ percent. An increase in mortgage rates could adversely impact the housing market as well as the economy. From the chart below, we can see that housing is a major component of the GDP. There is no doubt that an increase in rates will dampen home ownership demand. Mark Zandi stated in his March 2014 Abstract: Housing Finance Reform Steps Forward that eventually a rate increase of just 50 basis points would lead to nearly a 9 percent rate reduction in the homeownership rate. While this number may seem high, it signifies an outer boundary of how much home ownership rates can be impacted.

Housing's Contribution to GDP

	1975	1980	1985	1990	1995	2000	2005	2012	2013	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Constant Dollars (2009, Billions)															
Gross Domestic Product	5,380	6,443	7,586	8,945	10,164	12,565	14,236	15,471	15,761	15,534	15,540	15,584	15,680	15,839	15,942
Gross private domestic investment	624	881	1,160	1,241	1,551	2,376	2,673	2,436	2,566	2,457	2,442	2,470	2,525	2,627	2,643
Residential Fixed Investment	279	333	417	420	495	638	873	434	487	437	458	471	487	499	489
Personal Consumption Expenditures	3,405	3,992	4,812	5,673	6,528	8,182	9,528	10,518	10,728	10,541	10,585	10,644	10,692	10,744	10,832
Housing Services	760	906	1,029	1,179	1,354	1,563	1,768	1,944	1,961	1,956	1,942	1,965	1,965	1,953	1,961
Residential Fixed Investment + Housing Services	1,039	1,239	1,446	1,599	1,850	2,201	2,641	2,377	2,447	2,393	2,399	2,436	2,452	2,452	2,450
Percentage of GDP															
Residential Fixed Investment	5.2	5.2	5.5	4.7	4.9	5.1	6.1	2.8	3.1	2.8	2.9	3.0	3.1	3.2	3.1
Housing Services	14.1	14.1	13.6	13.2	13.3	12.4	12.4	12.6	12.4	12.6	12.5	12.6	12.5	12.3	12.3
Residential Fixed Investment + Housing Services	19.3	19.2	19.1	17.9	18.2	17.5	18.6	15.4	15.5	15.4	15.4	15.6	15.6	15.5	15.4
Contribution to Real GDP Growth															
Gross Domestic Product Growth	-0.2%	-0.2%	4.2%	1.9%	2.7%	4.1%	3.4%	2.8%	1.9%	2.8%	0.1%	1.1%	2.5%	4.1%	2.6%
Personal Consumption Expenditures	1.4%	-0.2%	3.3%	1.3%	1.9%	3.3%	2.4%	1.5%	1.4%	1.2%	1.1%	1.5%	1.2%	1.4%	2.2%
Housing Services	0.3%	0.4%	0.5%	0.2%	0.4%	0.4%	0.5%	0.1%	0.1%	0.2%	-0.4%	0.6%	0.0%	-0.3%	0.2%
Gross private domestic investment	-2.9%	-2.1%	0.0%	-0.5%	0.6%	1.3%	1.2%	1.4%	0.8%	1.0%	-0.4%	0.7%	1.4%	2.6%	0.4%
Residential Fixed Investment	0.0%	0.1%	0.2%	0.2%	0.2%	0.3%	0.2%	0.1%	0.1%	0.4%	0.5%	0.3%	0.4%	0.3%	-0.3%
Government expenditures and investment	0.1%	0.0%	-0.1%	-0.1%	-0.1%	-0.2%	-0.1%	-0.1%	-0.1%	0.7%	-1.3%	-0.8%	-0.1%	0.1%	-1.0%
Net exports of goods and services	-1.2%	-0.9%	-1.0%	-0.2%	-0.4%	-0.1%	0.0%	0.2%	0.2%	0.0%	0.7%	-0.3%	-0.1%	0.1%	1.0%

Source: National Association of Home Builders

Zandi's view might actually be conservative and does not include additional fees such as 10 basis points for affordable housing. He cites in his article approximately ½ percent increase in mortgage rates resulting in $75 more in mortgage interest payments.

How to Calculate 10 Percent

If the legislation continues to require 10 percent capital, we proposed the following compromise view:

Federal Reserve CCAR Standards vs. SFIG Proposal Minimum regulatory ratios and tier 1 common ratio		
Ratio	**Minimum under CCAR**	**SFIG Proposal**
Total Risk-Based Capital Ratio	8 percent	10 percent
Tier 1 Risk-Based Capital Ratio	4 percent	5 percent
Tier 1 Common Ratio	5 percent	5 percent

In short, we propose similar standards to what bank holding companies are held to under the Federal Reserve's Comprehensive Capital Analysis and Review.

Position and Recommendation:

SFIG is of the strong view that the legislation adopt a position of less than 10 percent capital.

However, SFIG understands that the Committee and its members are striking a delicate balance between the needs of a robust housing finance system and the need to ensure future crises are mitigated, if not avoided altogether.

Therefore, we recommend that Johnson-Crapo allow for flexibility in achieving and maintaining a 10 percent capital threshold.

Specifically, SFIG proposes the language options set forth below:

(g) CAPITAL STANDARDS.— (1) IN GENERAL.—Pursuant to the requirement to establish capital and related solvency standards under section 309(b), the Corporation shall establish standards for approved guarantors that require an approved guarantor— (A) to hold ~~10~~ 5 percent capital; and (B) to maintain solvency levels adequate for the approved guarantor to withstand losses that might be incurred by the approved guarantor in a period of economic stress, including national and regional home price declines, such as those observed during moderate to severe recessions in the United States.

OR

(g) CAPITAL STANDARDS.— (1) IN GENERAL.—Pursuant to the requirement to establish capital and related solvency standards under section 309(b), the Corporation shall establish standards for approved guarantors that require an approved guarantor— (A) to hold similar capital as is mandated for large financial institutions; and (B) to maintain solvency levels adequate for the approved guarantor to withstand losses that might be incurred by the approved

guarantor in a period of economic stress, including national and regional home price declines, such as those observed during moderate to severe recessions in the United States.

i. Eligible Single-Family Mortgage Loan

Legislation Summary:

An eligible single family mortgage loan

- Must have an 80 percent LTV;
- Can have credit enhancement including mortgage insurance; and
- Require a 5 percent down payment (gradually escalates to 5 percent) with 3.5 percent for first time homebuyers.

SFIG Viewpoint:

SFIG is of the view that underwriting criteria should not be codified in the statute. Setting forth specific criteria that would work across housing cycles and economic environments is not feasible. Instead, underwriting criteria should be developed through the regulatory process and be flexible enough to accommodate changing environments.

Position and Recommendation:

SFIG supports the position that certain minimum standards for underwriting should exist. However, SFIG believes that such standards should be developed by regulation instead of legislation. Underwriting is a highly technical area that raises specific questions that should be analyzed. For example, qualified mortgage standards as currently contemplated have cut offs DTI ratios. Presently, the GSEs securitize loans with higher DTIs. We believe it is prudent that a regulator determine the "box" of loans that can be securitized. This further allows for regulatory flexibility to adjust to changes in both market conditions and economics that legislative language would inhibit. Therefore, SFIG believes the legislation should focus on the mechanics of securitization, and strike specific language focused on underwriting.

Our proposed language for eligible single-family mortgage loan would very simply be a definition that defers to the FMIC to determine such standards in conjunction with other regulators such as the CFPB.

j. Conforming Loan Limits

Legislation Summary:

SECTION 304 Loan Limits: $417,000 for a mortgage loan secured by a 1-family residence, for a mortgage loan secured by a 2-family residence the limit shall equal 128 percent of the limit for a mortgage loan secured by a 1-family residence, for a mortgage loan secured by a 3-family residence the limit shall equal 155 percent of the limit for a mortgage loan secured by a 1-family residence, and for a mortgage loan secured by a 4-family residence the limit shall equal 192 percent of the limit for a mortgage loan secured by a 1-family residence

- Adjusted annually by the housing price index. The limits cannot decrease if the HPI decreases. However, the next time the HPI increases, past decreases must be taken into account.
- Includes adjustments for high cost living areas.

SFIG Viewpoint:

Congress should reduce the upper loan limits for government-guaranteed loans to ensure that the benefits of low-cost mortgage loans are directed at the segment of the population most in need of those loans. For private capital to return to the market, lower limits are generally necessary. As the market moves to more conservative underwriting standards, the only real opportunity for private label securities is to securitize loans that are above the established conforming loan limit.

Position and Recommendation:

SFIG believes that the draft legislation should not maintain the current loan limits as those were promulgated during a time of crisis. We suggest lower loan limits are needed to not only stimulate, but bring back private capital to the market, which is a primary goal of Johnson-Crapo. However, FMIC should, in times of crisis, have discretion to increase limits temporarily on an as needed basis.

Therefore, SFIG recommends that the legislation contain a provision that when an exigency is declared, FMIC can institute higher loan limits. To alleviate the market impact, SFIG also recommends that a review be done of the Federal Housing Administration loan limits at the same time to ensure proper alignment of governmental guarantee programs

We offer the following language changes for SFIG's recommendations on the exigent circumstances provisions in the draft legislation:

In Section 305(i)(1) add the following:

(1) AUTHORITY.—In the event of a significant decline of national home prices, in at least 2 consecutive calendar quarters, the Corporation, by an affirmative vote of 2/3 or more of the Board of Directors then serving, may for a period of 6 months permit the transfer of guarantees of eligible mortgage loans that secure covered securities if such eligible mortgage loans are refinanced, regardless of the value of the underlying collateral securing such eligible mortgage loans. Furthermore, during any exercise of this provision, the Corporation may also permit the

guarantee of eligible mortgage loans without giving effect to the provisions contained in Section 304 and in an amount deemed appropriate by the Corporation.

k. Liability Exemption

Legislation Summary:

SECTION 332 states that any market participant that has taken the first loss position in a covered security or that has otherwise invested in any covered security insured under this title shall have immunity and protection from civil liability under Federal and State law, including under section 131 of the Truth in Lending Act (15 U.S.C. 1641), and no cause of action may be brought under Federal or State law against such market participant, with respect to whether or not eligible mortgage loans that collateralize a covered security insured under this title have complied with the requirements of this Act, including with respect to any underwriting requirements applicable to such eligible mortgage loans, any representations or warranties made by a market participant with respect to such eligible mortgage loans, or whether or not the terms of any uniform securitization agreement have been met.

SFIG Viewpoint:

SFIG concurs.

Position and Recommendation:

SFIG concurs.

l. Affordable Housing

Legislation Summary:

SECTION 501 establishes an initial and incentive-based fee structure to support the Housing Trust Fund (75% of funding), the Capital Magnet Fund (15% of funding), and a newly created Market Access fund (10% of funding). The fee shall average 10 basis points across all outstanding securities, and would be performance-based.

Establishment of Underserved Definitions:

- FMIC shall support the primary mortgage market to help ensure that all eligible borrowers have equitable access to mortgage loan credit, including underserved segments of the primary mortgage market.
- FMIC must issue regulations to identify and define underserved primary mortgage market segments in which lenders and borrowers lack equitable access to the secondary mortgage market. (Section 201)

Multifamily Affordable: 60% of the units financed must be affordable to low-income families.

Regulatory Authority: FMIC creates an Office of Consumer and Market Access which would administer a Market Access Fund, monitor markets to identify underserved markets, and produce an annual report assessing the covered securities market (Section 208).

SFIG Viewpoint:

SFIG agrees that the current system is problematic as it has led to implicit subsidies in the form of purchases of subprime loans to non-creditworthy consumers.

SFIG believes that Congress should explicitly promote affordable housing through a stand-alone program not linked in any way to the secondary mortgage market, and should fund that program through separate legislative mechanisms.

Position and Recommendation:

While SFIG recognizes the importance of affordable housing, we do not believe housing finance reform is the proper venue to address this topic. The addition of 10 bps will be passed on to consumers. Coupled with higher costs already contained in the legislation for capital, the impact to consumers could be significantly higher interest rates thus adversely effecting housing rates and the economy. As set forth in the Capital section above, higher rates would be detrimental to the economy when they begin to impact home ownership rates.

Furthermore, a 10 bps fee may not be sufficient, especially if loan limits are decreased. Very simply, from a mathematical perspective, the amount of funds collected to fund affordable housing may be insufficient from new originations for several reasons. A decrease in loan limits is needed to stimulate private capital. Accordingly, 10 bps on a lower amount would yield a smaller fund. Additionally, given our argument above that higher capital could yield higher rates, we anticipate originations of new mortgages to diminish in a future state again creating a smaller yield for the fund.

Also, charging borrowers 10 bps on conforming loans in effect taxes middle class borrowers. Wealthier borrowers would purchase more expensive houses and therefore have jumbo loans which would not be covered securities and would not have a 10 bps charge associated with them so long as they do not use the Platform.

Finally, we are concerned about the mechanics of the current structure and the ease of implementing operationally Section 501.

Accordingly, SFIG would recommend deleting Section 501 in its entirety.

m. Collateral Risk Manager

Legislation Summary:

SECTION 327 states that FMIC must develop, adopt, and publish standards for the use of collateral risk managers who may work with the Platform, as well as trustees and servicers of mortgage-backed securities to manage mortgage loan collateral, including standards with respect to:

1. Tracking mortgage loan repurchases;
2. Compliance with obligations under any applicable securitization documents; and
3. Managing any disputes and the resolution process.

The standards required must include the review of foreclosure loss mitigation programs established for approved servicers.

SFIG Viewpoint:

SFIG believes that collateral risk manager should not be mandated for private label securities in legislation that reforms the GSEs. This is a matter for securities law and negotiation between parties to a transaction. Regulation AB II, as proposed by the SEC, contains a provision that contemplates similar and SFIG believes that is the appropriate forum for discussion.

Position and Recommendation:

The purpose of the legislation is to reform the GSEs. It is unclear if this provision is intended to apply just to covered securities or to other issuances in the private label securities space.

The Collateral Risk Manager conceptually should not apply to guaranteed securities. An investor in a guaranteed security does not take credit risk as does an investor in private label securities. Accordingly, there is no need for a Collateral Risk Manager in a guaranteed deal.

Regulation of private label securities is best left to the securities laws and to negotiations between market participants to ensure consistency between different issuances of private label securities. Presently, the private label securities is in the nascent stages of returning and SFIG is very involved in this return of private capital mortgages. We observe that to legislate additional requirements on this precarious market would be counterproductive. Instead, the parties in a transaction should discuss the necessity of a Collateral Risk Manager.

SFIG's suggested view is that this not be included in the legislation but rather handled through existing securities regulation and our legislative suggestion would be delete Section 327 in its entirety.

n. Mortgage Registry

Legislation Summary:

Mortgage Database: SECTION 333 states that FMIC is required to establish and maintain a database of uniform loan level information on eligible mortgages. This database will be built off of the existing database created by FHFA and the CFPB, and transferred to the FMIC. FMIC would be required to work with the CFPB to minimize conflicts and duplication.

Rulemaking: The FMIC, along with the SEC; would be required to issue a rule to enable private mortgage investors, in connection with the first loss position on a covered security, to have access to documents relating to mortgages backing said security, as well as any servicing reports. Market participants would be required to disclose material information.

Electronic Registration of Mortgage Loans: Within 6 months, the FMIC would be required to form a working group to study the possibility of a national electronic mortgager registry and other alternatives. Within 5 years, the FMIC can issue a rule to create such a mortgage registry.

SFIG Viewpoint:

SFIG agrees that disclosure is key to a functioning and liquid residential mortgage-backed securities market.

SFIG also supports the absolute protection of consumers' personally identifiable information.

SFIG also believes that it is appropriate for such disclosures to be housed on a mortgage database. However, such disclosures should be limited, per Johnson-Crapo, to covered securities.

Position and Recommendation:

SFIG supports this provision as disclosure is a key component to a transparent market. We suggest that parties that provide information to the registry or to any investors specifically have a safe harbor from liability due to privacy concerns. We note that the SEC recently released for comment Regulation AB II and asked for input on privacy matters in connection with loan level disclosures. A safe harbor would enhance market confidence in providing information in connection with this section as well as loan level disclosures.

o. Securitization Platform

Legislation Summary:

SECTION 321 FMIC would establish a securitization platform owned and operated for the benefit of its members that may be a cooperative or a nonprofit. FHFA can transfer GSE development on a platform to the new entity.

SECTION 322 FMIC Board of Directors shall appoint 5 initial platform directors to carry out the functions of the Platform. After 1 year (unless extended by the FMIC) an elected board consisting of 9 board members shall administer it.

SECTION 323 Platform directors shall establish membership standards for approved entities.

SECTION 324 Platform directors shall establish, assess, and collect fees to operate the Platform. They may uses tiered usage fees.

SECTION 325 This section provides the general purposes, powers and functions of the Platform including issuing a covered security, developing standardized documents for securitization, standardized servicing and loss mitigation documents, verifying that the mortgages are eligible for purchase, performing bond administration functions, data validation and reporting.

SFIG Viewpoint:

Any new infrastructure for the trading of government-guaranteed securities will necessarily include requirements for areas such as disclosure, documentation, data collection and overall standardization of government-guaranteed MBS transactions. SFIG believes standardization of documents (e.g., standard government loan forms), structuring and underwriting (e.g., conforming loan limits, document verification, etc.) is critical to the TBA Market because it increases the fungibility and liquidity of government-guaranteed MBS.

These requirements should be very transparent, take into consideration the needs of all parties to the transactions, and include investor protections that apply to the private market.

Important to this standardization of the market will be establishing common infrastructure in the form of a securitization platform that will lower barriers to entry for new participants into the system and enable different entities to issue a single security without variation.

Position and Recommendation:

SFIG supports the general framework of the Platform in the legislation for the purpose of creating covered securities. We agree in principal with its efforts to achieve standardization in the reformed housing finance system.

We believe that the Platform should be limited to covered securities. The legislation focuses on reforming the GSEs which is a very different market from the private label securities market. The private label securities market is re-establishing itself and to create even an option of using the Platform could be problematic for this very different market. Optionality would encourage standardization in a market dependent on negotiations between parties to a transaction in order

to achieve maximum market efficiencies. Furthermore, SFIG is concerned that optionality may cause the FMIC to begin regulation of the private label securities market, which would be duplicative regulation given the fact that the SEC has proposals such as Regulation AB II to regulate such market (where the transactions otherwise do not qualify for an exemption).

We would suggest that the legislation be limited to securitizing only eligible single family mortgages so as not to harm the nascent private label securities market.

We also suggest that the Platform should be tested in small increments while the existing system is still functional. Its use should be gradual and deliberate so as not to completely dismantle the existing infrastructure without knowing it works.

In order to achieve the objectives outlined above, SFIG proposes the following legislative changes:

(1) IN GENERAL.—On and after the system certification date, if the Corporation determines that operational or other problems with the Platform do not permit the Platform to operate in a manner that allows the Platform to achieve the purposes and obligations of the Platform under section 325, the Corporation shall have the authority to permit the Platform Directors to use entities, including, but not limited to, the infrastructure of Fannie Mae and Freddie Mac, other than the Platform to perform issuance functions required to be performed by the Platform and that are necessary for the proper functioning of the secondary mortgage market.

Modify Section 325(a)(1) as follows:

(a) PURPOSE.—The purposes of the Platform established under section 321 are to—(1) purchase and receive from its members only eligible mortgage loans or securities collateralized by only eligible mortgage loans for securitization as covered securities;

Delete Sections 325(b)(8) and 325(b)(9)(B) in their entirety.

p. Uniform Securitization Documents

Legislation Summary:

SECTION 326 The Platform should develop standard uniform securitization agreements for all covered securities addressing issues such as pooling, servicing, loss mitigation, representations and warranties, indemnification and remedies, and others.

SECTION 336 FMIC shall coordinate with CFPB that eligible mortgage loans match ability to repay standards set forth by the CFPB.

SFIG Viewpoint:

The new infrastructure in the legislation for the issuance of government guaranteed securities will necessarily include requirements for areas such as disclosure, documentation, data collection and overall standardization. Those requirements should be very transparent, take into consideration the needs of all parties to the transactions and include investor protections that apply to the private market.

Position and Recommendation:

SFIG supports uniform documentation so as to provide the market with a standard so as to aid in the facilitation of a TBA Market.

q. Small Lender Mutual

Legislation Summary:

SECTION 315

Creation: A Mortgage Securities Cooperative will be created to serve as the sole issuer for covered securities. More than one may be created.

Eligibility:

- An insured depository institution having less than $500,000,000,000 in total consolidated assets at the time of the initial participation of the institution in the small lender mutual;
- Non-depository mortgage originator that (1) has a minimum net worth of $2,500,000; (ii) has annual eligible mortgage loan production of less than $100,000,000,000, and (iii) was already approved to sell mortgages to the GSEs;
- CDFIs;
- Housing Finance Agencies; and
- Mission-based non-profits.

Governance: Will be on the basis of one-member, one-vote. The Issuer may use the common securitization platform established by the GSEs to issue covered securities that are subject to the guarantee, subject to such requirements as the Director of the FHFA and Secretary of the Treasury shall establish.

SFIG Viewpoint:

A utility, cooperative, private corporation or government corporation may be the appropriate corporate form for entities that are critical to the functioning of the mortgage market. If multiple entities are participating in the securitization process, it may offer incremental protection beyond having two entities.

However, if a seismic market event occurs, even multiple entities will likely suffer the same fate. Prudence in risk and credit management during stronger markets may be the only way to limit the impact of adverse cycles and avoid the issue of having one or two entities being “too big to fail.”

Position and Recommendation:

SFIG supports the creation of small lender mutuals. We do, however, suggest that the provisions on asset maximums not be required (e.g. $500,000,000,000) and that the mutual be open to any party wanting to participate.

r. Aggregator Approval

Legislation Summary:

SECTION 312 FMIC shall approve standards for aggregators. Some of these institutions may be FDIC regulated already.

FMIC may require reports on conduct examinations of such aggregators.

Similar to guarantors having over $10 billion in assets, they will be subject to stress tests and it can act as receiver or conservator for an entity not regulated by the FDIC.

SFIG Viewpoint:

SFIG supports the ability of entities to be able to deliver to the Platform.

Position and Recommendation:

SFIG supports this provision.

s. Servicer Approval

Legislation Summary:

SECTION 314 FMIC shall establish approval standards for servicers of eligible mortgage loans and the approval process shall not disadvantage small servicers.

FMIC must conduct an on-site examination every two years. FMIC can require that servicers not meeting servicing standards transfer servicing.

Fannie Mae and Freddie Mac approved servicers are grandfathered.

This section also raises the small servicer exemption threshold for both CFPB and FMIC servicer standards and requires FMIC to conduct a study on servicer compensation standards for non-performing single family mortgage loans.

SFIG Viewpoint:

Uniform standards for servicers in the new conforming system will encourage predictable performance among differing servicers.

Servicing rights should be transferable in any new system. The ability to transfer servicing is supportive of the function of the market. It allows existing servicers to manage their operations in the most efficient and safe and sound manner, and cope with changes to the broader environment (e.g., Basel III's limitations on MSRs in Tier 1 capital). Servicing transfers also promote competition and new entrants in a market, as they allow smaller servicers and specialty servicers, to grow their business. Voluntary transfers should be limited to transfers to eligible, approved servicers, and be subject to review by guarantors and the regulator. Becoming an approved servicer should be based on having adequate capital, investor reporting, operational capabilities and experienced management. We note that the CFPB has recently released guidance on servicing transfers.

The regulator or guarantors should have the ability to compel a transfer of servicing responsibilities.

The regulator of the new government-guaranteed system should be charged with developing servicing compensation standards for the new conforming loan market, in consultation with mortgage market participants. Work is needed on assembling the appropriate fee structure and aligning incentives between servicers, borrowers and investors.

Position and Recommendation:

SFIG believes that the CFPB is already the primary regulator of servicers, and therefore FMIC regulation would be duplicative. We suggest removing section 314 as a result. Furthermore, we believe that servicers be given the flexibility by any regulator to enter into transactions which allow the ability to hypothecate servicing rights as needed.

t. Private Mortgage Insurers

Legislation Summary:

SECTION 313 FMIC shall approve and issue standards for private mortgage insurers (PMI) who guarantee eligible mortgage loans and conduct an on-site examination every two years.

SFIG Viewpoint:

While PMI can play an important role in housing finance by providing credit guarantees on higher LTV loans, it is critical that such corporate guarantees by PMI companies be based on adequate capital of the entity providing the guarantee or as a collateralized credit enhancement supported by specific eligible assets or cash.

Further, these PMI companies should be able to enter into secondary market transactions that facilitate risk-sharing to eliminate some of the counterparty risk.

Position and Recommendation:

SFIG supports the provisions in the legislation regarding standards for approved private mortgage insurers. We also suggest that PMI insurers presently eligible to conduct business with the GSEs be grandfathered as approved with FMIC. Such a provision would be consistent with other grandfathering provisions contained in the draft legislation.

u. Multifamily Housing

Legislation Summary:

SECTIONS 209, 701-707

Requires the establishment of multifamily subsidiaries within the GSEs that would later be spun off, preserving the current product line. The FMIC would regulate by approving multifamily guarantors, who can then issue securities with an FMIC-guarantee as long as 60% of the units financed meet the affordable goals for low-income tenants.

The FMIC Office of Multifamily Housing would be charged with regulatory authorities, establishing eligibility criteria for the guarantee, as well as testing new programs and products to increase secondary market access. (Sections 209, 701-707)

SFIG Viewpoint:

Multifamily Housing is an Essential Piece of the U.S. Housing System: Roughly 15 million U.S. households live in multifamily rental housing, representing more than 13% of all U.S. households and nearly 43% of U.S. renters.

The U.S. Rental Population is Growing: American households have increasingly turned to the rental market for their housing. From 31 percent in 2004, the renter share of all US households climbed to 35 percent in 2012, bringing the total number to 43 million by early 2013.

The GSE model for Multifamily Housing has Performed Well: As of 2009, during the height of the crisis, the GSEs' multifamily mortgage and Mortgage Backed Securities (MBS) portfolios had distress rates of less than 1%.

Position and Recommendation:

Considering the multifamily model has performed well and is well suited to address the needs of a growing rental market, SFIG is generally supportive of the language in Johnson-Crapo.

v. Regulatory Transition and GSE Wind Down

Legislation Summary:

SECTION 402 FHFA shall become an independent office within FMIC.

SECTION 404 This section establishes a transition committee to develop a comprehensive plan for transition to a new housing finance system as well as to advise the FMIC.

SECTION 601 GSEs would not engage in new business once FMIC Board of Directors certifies that FMIC is able to undertake its duties and certain minimum housing finance system criteria have been satisfied:

- one small lender mutual is operational,
- sufficient number of guarantors, approved aggregators, approved PMI, and approved servicers exist to assume first loss positions, and
- multiple multifamily guarantors exist.

This certification must come within 5 years after enactment which can be extended.

SECTION 602 Transition Committee must develop a comprehensive transition plan within 12 months of enactment. Transition plan must include:

- estimated timeframes by which to achieve the minimum housing finance system criteria within five years of enactment;
- detailed actions that FMIC will take to achieve the minimum housing finance system criteria;
- estimated timeframes and detailed actions that FMIC and FHFA will take to provide an orderly wind down of the GSEs;
- detailed plans for utilizing infrastructure;
- updates on FMIC;
- updates on multifamily;
- updates on the Platform; and
- plans to increase credit risk sharing.

SECTION 604 Provides full faith and credit for both GSE legacy debt and legacy MBS.

SFIG Viewpoint:

The transition process should be carefully implemented, and to avoid severe market disruption should allow for:

- a clear and transparent plan for transition;
- a determination that market conditions are appropriate for the transition;
- the fulfillment of existing commitments (including contracts for future delivery);
- a determination that issues relating to legacy securities have been appropriately handled;
- time to generate eligible loans;
- testing or piloting the new structure in a real market environment; and

- continuation of the TBA Market.

SFIG also believes that all market participants would benefit to the extent that the current and new infrastructures operate in tandem for some period of time, or, in the alternative, appropriate portions of the current infrastructure are utilized by the new infrastructure.

In addition, a final wind down of Fannie Mae and Freddie Mac should happen only after the new framework has been sufficiently tested and we can all be confident that it will facilitate the continued functioning of the TBA Market.

We believe that these and other operational and delivery issues that will arise from the winding down of the existing framework and the ramping up of the new framework should be minimized by actively engaging directly with the relevant industry participants to determine the appropriate balance of regulatory discretion and legislative guidance regarding how the transition should proceed, as well as maintaining consistency (to the extent feasible) among the MBS issued across the platforms.

The GSEs' existing guarantee obligations should be maintained by an entity with similar or better credit strength such as the Treasury.

Policy and Recommendation:

SFIG believes that the existing GSE framework should co-exist for a period of time so that the new system can be tested. The new infrastructure should be tested to make sure it is workable prior to completely terminating the previous structure. The risk of implementing a system that will need to be tested on the job is too great to the housing market and by extension to the economy.

We suggest the following modifications to the text to section 604(d)(1)(A) and to 604(d)(2)(A)

(A) NEW BUSINESS PROHIBITED.—~~Effective on the system certification date~~ On a date determined by the Corporation, the Federal National Mortgage Association shall have no authority to conduct new business under the Federal National Mortgage Association Charter Act.

(A) NEW BUSINESS PROHIBITED.—~~Effective on the system certification date~~ On a date determined by the Corporation, the Federal Home Loan Mortgage Corporation shall have no authority to conduct new business under the Federal Home Loan Mortgage Corporation Act.

w. Credit Risk Sharing

Legislation Summary:

- SECTION 302 FMIC shall create standards for first loss credit risk-sharing which is not less than 10 percent of the principal of the single family covered security.
- FMIC can consider a variety of options, including the current credit risk transfer provisions set forth by the GSEs.
- Such structures should not disrupt the TBA market.
- Note exemptions exist for commodities and securities laws.

SFIG Viewpoint:

SFIG generally supports the approach of private capital taking on credit risk, while also having a government guarantee that is explicit and priced in a reasonable manner. Any risk-sharing structure should be carefully reviewed to ensure that the TBA Market is not disrupted. Furthermore, we believe that private capital should be placed in the first-loss position, with the private credit enhancement being calculated to cover reasonable risks presented by the market.

SFIG favors a system where normal losses (e.g., less than 3 standard deviations from base case assumptions) are absorbed by a private for-profit enterprise, while extraordinary (but still not depression scenario) losses would cause a draw on a government guarantee which would be financed through the collection of guarantee fees. Please see our discussions on Capital and Guarantee above.

SFIG supports a variety of mechanisms to bring private capital into the mortgage market, including corporate guarantees and capital markets transactions. We believe that various forms of capital should be allowed to compete on a level playing field.

Furthermore, in addition to the absolute sizing of the first loss position, SFIG would highlight some potential issues with the execution options inherent within a "capital markets" structure and as contemplated in the legislation. Our concern is that parity may not exist between the two executions which could be disadvantageous to the market as a whole. It is unclear as to which option will prevail between a capital markets execution and a guarantor execution and intrinsically that suggests a lack of parity between the two options.

It should also be understood that the very complexity associated with the capital markets options tend to lend competitive advantage to those firms with a capital markets expertise and presence in the market. This is not a volume argument nor a loan quality argument – simply because of the level of expertise employed within an aggregator with strong capital markets staff presence, we would expect those firms to obtain more efficient market execution

We would further highlight that the capital markets alternative currently sits as a free option. Inevitably, to the extent the option is exercised, it will only happen when the option is of value (i.e. cheaper). In other words – no one exercises an option when that option is out of the money.

Policy and Recommendation:

We encourage parity between the two options:

i. *Encouraging guarantors to pre-fund risk transfer by accessing markets in advance of pool funding, with a clear pass through of the capital markets cost to the originator;*
ii. *Express more parity between the capital markets and guarantee model execution (formulaic/incentive pricing), taking care not to create disincentives for a capital markets execution; and*
iii. *Establish FMIC monitoring to ensure parity is achieved.*

III. Glossary of Terms

***SFIG*:** Structured Finance Industry Group, Inc.

RMBS: Residential Mortgage-Backed Securities

GSE: Government Sponsored Enterprise

PLS: Private Label Securities

TBA Market: To-Be-Announced Market

FRM: Fixed-Rate Mortgage

FMIC: Federal Mortgage Insurance Corporation

MIF: Mortgage Insurance Fund

CFPB: Consumer Financial Protection Bureau

SEC: Securities Exchange Commission

RESPA: Real Estate Settlement Procedures Act of 1974

FHFA: U.S. Federal Housing Finance Agency

GAO: Government Accountability Office

MBS: Mortgage-Backed Securities

Fannie Mae: Federal National Mortgage Association

Freddie Mac: Federal Home Loan Mortgage Corporation

HUD: U.S. Department of Housing and Urban Development

REIT: Real Estate Investment Trust

LCR: Liquidity Coverage Ratio

CFTC: Commodity Futures Trading Commission

bps: basis points

LTV: Loan-to-Value

DTI: Debt-to-Income

HPI: Housing Price Index

CDFI: Community Development Financial Institution

PMI: Private Mortgage Insurers

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