



October 28, 2008

The Honorable Henry M. Paulson, Jr.
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Development of a Guarantee Program for Troubled Assets

Dear Secretary Paulson:

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to respond to the U.S. Department of the Treasury's (Treasury) request for comment (RFC)² regarding the development of a guarantee program for troubled assets, pursuant to Section 102 the Emergency Economic Stabilization Act of 2008 (EESA).³ MBA believes Treasury's recent capital and liquidity assistance is critical to offsetting the current shortage of credit in the secondary mortgage market.

The EESA authorizes Treasury to establish a program to guarantee the timely payment of principal and interest of "troubled assets."⁴ MBA believes a properly developed troubled asset guarantee program will maximize the benefits of government funds used to restore liquidity to the housing finance system while minimizing the overall cost to taxpayers. However, MBA also notes that troubled assets comprise a broad range of product types and, by definition, possess elevated risk characteristics. In many cases there is limited performance or borrower data on which actuarial projections can be

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

² 73 Fed. Reg. 61452 (October 16, 2008).

³ P.L. 110-343.

⁴ Section 101 of P.L. 110-343 defines troubled assets as residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability. The statute authorizes Treasury, in consultation with the Chairman of the Federal Reserve, to expand the definition to include other financial instruments.

made. This poses difficulties in setting premiums, and determining coverage levels and other terms of the guarantee program. Nevertheless, MBA believes such a program is necessary in order to restore liquidity and stability to all sectors of the housing finance system. MBA stands ready to work with Treasury in this very important undertaking.

Specific responses to Treasury's RFC are detailed below.

Eligible Product Types

Treasury requests comment on whether purchases of both individual whole loans and mortgage backed securities (MBS) should be covered by the guarantee program. For the reasons mentioned below, MBA suggests Treasury implement the program in stages by first guaranteeing only troubled whole loans. The program can then be expanded to include residential and commercial MBS once the challenges in structuring such a program for securitized products have been addressed. Following the development of adequate underwriting standards, Treasury could expand the program further to loans suspected of mortgage fraud.

MBA believes the key to establishing a program with sound eligibility, pricing and valuation criteria is the availability of accurate, reliable and current data regarding the product to be guaranteed. Performance and borrower data for whole loans is generally more comprehensive and accessible than residential MBS data. Moreover, the dispersion of MBS ownership and administration makes collecting and maintaining actuarially sound information difficult.

MBA also notes that commercial MBS have fewer complicating elements and restrictions than residential MBS. Because of extensive commercial MBS loan level reporting; there is a robust set of performance data for commercial MBS. Therefore, it is likely that information necessary to perform risk analysis and set premiums may be easier to obtain than residential MBS. Therefore, MBA suggests Treasury take a measured, yet expeditious approach in establishing a guarantee program by first gaining experience in the whole loan guarantee program, followed by commercial and residential MBS guarantee programs. These programs could then be used as prototypes for insuring other categories of loans and debt instruments.

MBA further suggests that Treasury consider allocating guarantee program funds relative to the potential size of each troubled asset category (whole loans versus MBS) in order to ensure funds are available to guarantee MBS. MBA also requests that Treasury provide for the fact that the risk profile and other characteristics of troubled assets can vary significantly by product and financial institution.

Underwriting the Guarantee of Whole Loans

MBA also believes that sound underwriting formulae are critical to the success of the troubled asset guarantee program. As mentioned above, the availability and accuracy of current information will facilitate pricing in a way that ensures premiums adequately cover guarantee payouts and operational costs. One way to enhance the accuracy of

data is to validate or update the data used when the troubled loan was first underwritten. For example, Treasury could obtain updated appraisal information and the borrower's current credit score and income. Much of this information is available electronically enabling updates to be performed with minimal delay.

MBA also notes that the purpose of the EESA troubled asset purchase and guarantee programs is to increase liquidity for all housing finance products. For this reason, MBA encourages Treasury to extend the guarantee program to troubled assets with limited data availability in order to improve the fungibility of these asset classes.

Guarantee Program and Consumer Relief

MBA requests Treasury consider the taxpayer exposure not only in terms of the direct costs of the program, but also in current and future borrowing costs. Even though the EESA requires premiums to be paid by financial institutions participating in the troubled assets purchase program, it is likely that financial institutions would recoup these charges in the form of higher consumer borrowing costs. MBA therefore requests that Treasury develop the troubled asset guarantee program in a way that minimizes the likelihood that relief to present day borrowers comes at the expense of future ones.

Contractor Assistance

MBA believes that one method of implementing the guarantee program as expeditiously as possible is by hiring vendors to perform certain aspects of the program. Mortgage insurance companies and mortgage servicers have vast amounts of loan performance data, and underwriting, pricing and administration protocols. Other entities, which are adept at performing forensic financial analytics, have the resources, skills and expertise necessary to review existing loan and MBS documentation.

Pricing Should be Asset Specific

In the RFC, Treasury also seeks input on how a guarantee program could be designed in a way that minimizes adverse selection and whether there is a way to limit adverse selection that avoids individual analysis of each covered troubled asset. MBA believes this is one of the most critical aspects of the program. It is MBA's experience that pricing accuracy is directly proportional to the accuracy of the underwriting performed. Therefore, MBA suggests the pricing of troubled asset MBS or other loan pools be based on as much loan specific data as possible.

Model the GSE Premiums with a Standard Payout

MBA believes that the premiums for the guarantee program should follow the model used for insurance programs generally, whereby premiums are set along a continuum corresponding to expected losses. In other words, MBA believes that premiums should be set according to the troubled asset's risk characteristics. This would conform to what the industry has been accustomed to for some time.

Liability

MBA further requests Treasury resolve all liability and recourse issues associated with the guarantee program prior to its implementation. For example, it is imperative for Treasury to clarify the extent to which a financial institution remains liable for a loan's performance even though the loan's principal and interest payments are guaranteed by Treasury? MBA believes it is likely that these issues can be resolved with specific representations, warranties and declarations. However, it is important that investors, borrowers, and other troubled asset program participants have a clear understanding of their rights, duties and obligations. MBA also suggests Treasury consider establishing penalties for instances of fraud such as when a borrower is harmed by being coerced into becoming delinquent on a loan for the sole objective of triggering a guarantee payout to the financial institution.

MBA further suggests that the guarantee program and other EESA programs can be used to distinguish between salvageable troubled assets and assets whose performance is unlikely to improve. Examples of assets in the latter category include prima facie predatory loans or loans obtained fraudulently or for a fraudulent purpose. This bifurcation step would prevent assets with inherent flaws from perpetuating the current disruptions in the system, thus boosting lender and investor confidence.

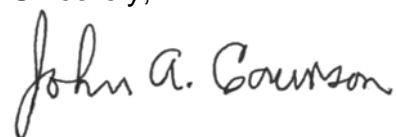
Certain Institutions May Prefer the Guarantee Program

Treasury also seeks comment on whether Treasury's guarantee of troubled assets has more appeal financial institutions than Treasury's purchase of troubled assets, as authorized by EESA. MBA believes that a financial institution with capital constraints would prefer the guarantee program because the program would cover losses above and beyond the institution's capital level. On the other hand, financial institutions with liquidity challenges would prefer to sell its troubled assets to Treasury in order to maintain its balance sheet.

Conclusion

Thank you for the opportunity to provide MBA's input regarding how to establish a guarantee program for troubled assets. MBA looks forward to working further with the Treasury in all aspects of EESA's implementation. Should you have any further questions please do not hesitate to contact Michael Carrier, Associate Vice President of Secondary and Capital Markets, at (202)-557-2870 or mcarrier@mortgagebankers.org.

Sincerely,



John A. Courson
Chief Operating Officer