



Frequently Asked Questions on the Mortgage Bankers Association's (MBA) Mortgage Credit-Guarantor Entity Proposal

1. What is a Mortgage Credit-Guarantor Entity (MCGE), as proposed by MBA?

A Mortgage Credit-Guarantor Entity (MCGE) is a private company with a government charter whose sole purpose is to provide a stable source of liquidity for real estate finance. The MCGE would purchase loans from financial institutions, then pool them into mortgage backed securities (MBS) and sell them to investors. The MCGE would guarantee that the principal and interest payments of loans in the MBS would be paid to investors. To fund the guarantee, the MCGE would be required to hold capital, establish risk-based pricing, and take other measures to manage its credit risk exposure. The MCGE's product scope would be limited to core single family and multifamily mortgages.

2. Who will own/operate the MCGEs?

MCGEs will be privately owned and managed companies. Each MCGE would raise capital by selling equity and raising corporate-level debt. Importantly, the equity and debt would explicitly NOT be backed by the federal government. The government guarantee would cover only the MBS rather than the MCGEs themselves. MCGE equity could be publicly traded or held in cooperative form by lender "members." MCGEs would be supervised by a regulator with strong oversight authority.

3. How would the MCGEs operate differently from Fannie Mae and Freddie Mac?

MCGEs would differ from Fannie Mae and Freddie Mac in four key areas:

1. MCGEs would have explicit limits on the product types they can securitize; i.e. core single family and multifamily mortgage products with well-understood and documented risk characteristics.
2. A MCGE would not be permitted to hold more than a *de minimus* portfolio.
3. The government would only guarantee a MCGE's MBS. In other words, the MCGEs themselves would be fully private and no MCGE would be considered too big to fail.
4. Affordable housing objectives would be achieved largely through the Federal Housing Administration (FHA), Ginnie Mae, Rural Housing Service (RHS) and other explicit federal tax and spending programs. Any affordable housing role for the MCGEs would be carefully defined to supplement but not weaken their primary functions.

4. How should we transition from the existing government sponsored enterprise (GSE) model to the MCGE model?

The existing infrastructure of the GSEs would be used as a foundation for establishing MCGEs, by allocating the GSEs' technology, human capital, standard documents and other resources to one or more MCGEs. Every effort should be made to transfer existing origination, servicing and other industry relationships from the GSEs to the new MCGEs so as not to strand originators and servicers with ties to the existing GSEs.

5. Who pays for the MCGE's insurance?

The MCGEs would fund their activities, including the provision of adequate capital to support their guarantees, through the difference between the price they pay for mortgages and the sale price for their MBS. The MCGEs would also manage their credit risk by using risk-based pricing, originator retention of risk (such as reps and warrants), mortgage insurance and other risk-sharing arrangements. These measures would build up a strong capital buffer so that claims against the government's guarantee of the MBS would be needed only in extreme situations. Additionally, the government guarantee would be funded through risk-based charges for the MBS at issuance and on an ongoing basis.

6. Are there any costs to the taxpayer? What are the potential risks to the government/taxpayers given the full amount of principle on future MBS is backed by the government?

The MCGE structure is designed to protect taxpayers. All interest rate risks would be fully borne by MBS investors. Likewise, the MCGEs would be well-regulated and fully capitalized to absorb all but the most extreme of credit risks. Extreme credit losses would be covered by reserves from a federal, risk-based insurance fund supported by fees charged to MBS. In addition, the operational and other costs of the government guarantee program would also be funded through the insurance premiums. Were the insurance fund to be depleted, the government would be called upon to support the MBS guarantees.

7. What is a "wrap"?

A "wrap" is a third-party guarantee that is "wrapped" around a security such as an MBS. In this case, the principal and interest payments to investors in a government-guaranteed MBS would be paid by the MCGE that issued the security. Each MCGE would have sufficient capital to ensure the ability to cover all payments. As an added layer of protection, each security would be "wrapped" with a government guarantee. The government guarantee provides an extra layer of assurance to investors that their MBS investments are safe. The wrap,

would be supported by a risk-based insurance fund. Strong regulatory oversight and control of the products that could be included in the securities also reduces the risk to investors and the government. A lower risk to investors translates into a lower interest rate they demand to invest in the MBS.

8. Fannie Mae or Freddie Mac owns my mortgage. What will happen to it if the current Fannie Mae and Freddie Mac system converts to a MCGE?

As the MCGEs ramp up their business, one or more may take on a managerial role for certain activities currently performed by the existing GSEs. However, it is not anticipated that they will take on the financial obligations of Fannie Mae and Freddie Mac. As a result, relationships, contracts and decisions related to existing loans would continue to be with Fannie Mae, Freddie Mac or their successors, not with the new MCGEs.

9. What about all the money Fannie Mae and Freddie Mac owe the federal government?

Fannie Mae's and Freddie Mac's obligations to the government are large and need to be carefully considered in any transition to a future state. One approach may be to consider the use of a "good bank/bad bank" model.

Fannie Mae's and Freddie Mac's past obligations also need to be clearly delineated from the equity, debt and other funding activities of the MCGEs going forward. In order to raise private capital for their activities, the MCGEs cannot be encumbered with the past obligations of today's GSEs.

10. Will the MCGE model prevent future housing busts?

We cannot be sure that the MCGE model will protect against every unforeseen market disruption. The system does, however, seek to minimize the taxpayer's risk exposure by coordinating the strengths of the market with those of the government. The private markets would be responsible for assessing, mitigating, pricing and managing risks, and a strong regulator would oversee that process and ensure that participants hold adequate capital. By making explicit where the government does and does not hold risk, and building an insurance fund for the risks it does hold, a significant share of the recent challenges posed by Fannie Mae and Freddie Mac should be avoided.

11. What kinds of mortgage products should be supported by the MCGEs?

The MCGE-model should support only "core" mortgage products with well-understood and documented risk characteristics. For example, eligible products could include conventional single-family mortgage products traditionally supported by the existing GSEs, and multifamily mortgage products that fit the

GSEs published underwriting guidelines, including affordable multifamily rental housing mortgage products.

12. Will the MCGEs be allowed to buy subprime loans or predatory loans?

No. The MCGEs would support only “core” mortgage products with well-understood and documented risk characteristics. In defining the products covered by the new guarantees, industry participants, the MCGEs, the government guarantor (GG) and federal regulators should carefully review current product definitions and classifications to ensure maximum market transparency, efficiency and liquidity. New products would be proposed by the MCGEs, recommended by the GG and submitted to the regulator for approval. Thus new product development would be measured, prudently regulated and conservatively responsive to market demands.

13. How many MCGEs does MBA propose to be created?

MBA recommends that the initial number of MCGEs be either two or three. However, the regulatory agency would have the ability to issue additional charters over time. The number of MCGEs should be based on the goals of a) competition, b) strong and effective regulatory oversight, c) efficiency and scale, d) standardization, e) security volume and liquidity, f) ensuring no one MCGE becomes “too big to fail” and g) the transition from the current government sponsored entity (GSE) framework.

14. What kinds of assets should the MCGEs hold in their portfolios?

The key mission of the MCGEs should be to guarantee and securitize mortgages through the program described. The MCGEs should therefore hold only a *de minimus* portfolio of mortgage assets. The portfolios' purposes would be to support securitization by allowing the MCGEs to a) aggregate allowable mortgages for securitization, b) manage loss mitigation through foreclosure, modifications and other activities, c) incubate mortgages that may need seasoning prior to securitization, d) develop new mortgage products through a strictly limited level of research and development prior to the development of a full-fledged securitization market and e) fund highly structured multifamily mortgages that are not conducive to securitization.

15. How should the MCGEs be regulated?

The MCGEs' should be supervised by a strong regulator with adequate funding through the government guarantee insurance premiums. The regulatory framework would be similar to that of a public utility, with the MCGEs earning a conservative return on equity. The regulator should have the power to oversee such areas as the MCGEs' products, pricing and capital adequacy.

16. Do you envision any truly private secondary market in the future? Will private label MBS return?

Yes. The MCGEs and the MBS they issue are intended to provide support for a core set of mortgage products. Past experience tells us that these core products will not cover the entire market or be the optimal product for every homeowner or apartment investor. The private market will provide alternative products, for example jumbo mortgages, and will likely use private-label MBS, or something similar to it, to raise capital for these products through the secondary market.