MBA's Recommendations on the Future of the Secondary Mortgage Market

MBA RECOMMENDS

Congress should restructure the government role in the core secondary mortgage market by establishing government chartered and regulated mortgage credit guarantee entities and providing an explicit credit guarantee of selected mortgage-backed securities issued by these entities.

BACKGROUND

Since the creation of Fannie Mae in the 1930s, the federal government has played a key role in providing stability to the secondary mortgage market. The current housing crisis has tested that role and led to calls for a fundamental rethinking of how the government plays its part. MBA developed a comprehensive set of recommendations for what a fully functioning secondary mortgage market should look like in the long term. In MBA's recommendations, the government's role in providing stability and liquidity is made explicit with clearly defined parameters that are sufficient to attract capital from private investors with minimal risk to taxpayers.

MBA's proposed model has two primary components — a government chartered entity and an explicit credit guarantee.

GOVERNMENT CHARTERED MORTGAGE CREDIT-GUARANTOR ENTITY

Under MBA's proposed model, a small number of privately-owned, government-chartered and regulated entities would take the place of the current GSE framework. Loan originators would sell mortgages to these new Mortgage Credit-Guarantor Entities (MCGEs) that would then pool the mortgages into a new type of mortgage backed security (MBS). The MCGEs would guarantee the timely payment of principal and interest of loans in the loan pool. The entities would have a strong regulator and be required to manage their risk exposure with a capital cushion as well as mortgage insurance or other risk mitigation techniques.

GOVERNMENT CREDIT GUARANTEE

The second component of MBA's proposed framework is an explicit government guarantee of the MBS issued by the MCGEs. The MCGE would pay a fee for the government guarantee based on the level of risk of the MBS. The fees would be paid into a federal insurance fund which would be used to pay MBS investors in the event a MCGE failed. The insurance fund provides an extra level of protection against the need for government intervention; i.e. taxpayer funds would not be needed except for situations of extreme market duress.

STRUCTURE OF THE GOVERNMENT CHARTERED ENTITIES

MCGEs would be privately-owned and focused solely on guaranteeing and securitizing a narrowly defined, core segment of single-family and multifamily residential mortgages. Initially, there would be two or three entities, but the regulator would have the ability to charter additional MCGEs as the market develops. Unlike Fannie Mae and Freddie Mac, the MCGEs' portfolios would not be permitted to expand larger than is necessary to support their securitization activities. To the extent possible, the existing resources of Fannie Mae and Freddie Mac would be utilized for at least one new MCGE.

While not the only viable framework, we believe the recommendations represent a clear, concise and workable approach to ensuring liquidity in the mortgage market, carefully balancing the government's ability to ensure the liquidity of the secondary market with the need to protect taxpayers.

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KEY BENEFITS OF MBA'S RECOMMENDED MODEL

Attractive to the Full Range of Investors Needed to Support the U.S. Mortgage Market

- MBA's recommended model provides unambiguous, explicit federal credit support.
- This support provides investors the assurance of constant liquidity in the core market segment during any market environment.

Attracts Private Capital, Not Taxpayer Dollars

- The MCGEs would be responsible for assessing, mitigating, guaranteeing and holding capital against mortgage risks, subject to rigorous risk-based capital requirements.
- The MCGEs would take on credit risk, not interest rate risk. Interest rate risk would be held by the MBS investors.
- The MCGEs would pay a risk-based fee for the government guarantee.
- Government intervention is needed only if a MCGE fails AND the insurance fund is insufficient to pay existing MBS holders.

Risks of the System Would be Well-managed

- A strong regulator would oversee the MCGEs.
- Only well-documented, well-understood "core" products would be eligible for MCGE securitization.
- The MCGEs would not be able to expand their portfolio beyond the level needed for securitization.
- MBS issued by the MCGEs would be backed by the government, but MCGEs would not. Neither their equity nor their debt would be backed by the government in any way.

MCGEs Operate Only in the Core Secondary Mortgage Market

- Core products would be well-documented, well-understood, standardized and conventional single-family and multifamily mortgage products.
- This limitation is important not just for safety and soundness reasons, but also because these products are central to the housing finance lending pipeline and key to preserving a baseline level of liquidity.
- The private market would be expected to provide products outside of "core" product types.
- MBA's recommended framework also complements existing government funding channels that provide direct support for affordable housing finance, such as the Federal Housing Administration, Ginnie Mae, the Veterans Administration and Rural Housing Service.

See the Council on Ensuring Mortgage Liquidity Resource Page for more information: www.mortgagebankers.org/ceml

For more information visit www.mortgagebankers.org or call (202) 557-2700.

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