

Congress Should Consider MBA's Proposal for Reforming the Secondary Mortgage Market and Ensure a Smooth Transition

MBA Recommends

As other sectors of the economy have begun to stabilize, the debate intensifies over how to configure the nation's housing finance system and the support it receives from the federal government. The administration has provided Congress with its recommendations for restructuring the level and type of government support for housing. MBA was at the vanguard in developing a comprehensive set of recommendations for what a fully functioning secondary mortgage market should look like in the long term.

Background

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.

Structure of the Government Chartered Entity

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

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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.

Key Benefits of MBA's Recommendations

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 are Well-managed

- A strong regulator oversees the MCGEs.
- Only well-documented, well-understood "core" products are eligible for MCGE securitization.
- The MCGEs cannot expand their portfolio beyond the level needed for securitization.
- MBS issued by the MCGEs are backed by the government, but MCGEs are 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 are 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 is 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 Federal Home Loan Bank System, the Veterans Administration and the Rural Housing Service.

Action Needed

Congress should consider MBA's recommendations for the future government role in the secondary mortgage market, including measures to facilitate the transition from the current to the future state.

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