Mortgage Financing beyond the GSEs

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Freddie Mac

FannieMae

Public-Private Partnership

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Crony-Capitalism

Additional Capital Requirements

36 Yes – 378 No

Systemic Risk Authority

73 Yes – 346 No

Loan Limits

FHA > GSE

GSE Guarantee Fees

Supposed to….

….Pay for Credit Losses

Actually will….

…..Pay for Tax Cuts

Who Holds the Credit Risk?

1. American Taxpayers

OR

2. Private Investors

If Government is in Control…

- Continue pushing for billions of dollars in taxpayer financed principal reduction

- Continue raiding private investors' securitization trusts

- Continue policies that promote low or negative equity for homebuyers

- Continue promoting the discredited theory of Disparate Impact

- Continue allocating credit to its favored constituencies regardless of the ability to pay

Fundamental Question to Answer

How can you maintain the level of capacity for the U.S mortgage market without having the taxpayer on the hook?

The U.S Covered Bond Act

A robust U.S. covered bond market can:

• Infuse stable, longer term liquidity into the credit markets and reduce refinancing risks,

• Generate less expensive and more available credit for borrowers of all kinds,

• Enable financial institutions to draw liquidity from a separate investor base that would not otherwise make funds available through the unsecured-debt or securitization markets,

• Supply private-sector funding even in distressed market conditions without relying on U.S. taxpayers for support,

• Align incentives relating to loan underwriting, performance, and modification because of the issuer's retention of 100% "skin in the game," and

• Increase transparency and uniformity in the capital markets with their straightforward structure.

The Broad Strokes – The Private Mortgage Market Investment Act

- The goal of this legislation is to promote investor demand in a new residential mortgage-backed securitization market that does not put American taxpayers at risk.

- This legislation achieves this goal in 4 specific ways:

  (1) Creates uniform underwriting standards for mortgages eligible to be securitized in the new market;

  (2) Brings standardization to the securitization process;

  (3) Establishes a clear rule of law that provides investors with legal certainty; and

  (4) Provides investors with greater loan-level transparency and disclosure.

Uniform Underwriting Standards for Mortgages Eligible to be Included in the new Qualified Securitization Market

• Uniform Underwriting Criteria: The Director of the FHFA establishes different classes of mortgages based on various credit characteristics.

• FHFA Sets Transparent Underwriting Standards For Qualifying Loans: The credit risk given to each class of mortgages is based on a mix of the following factors:

- Debt-to-Income;
- Loan-to-Value;
- Credit History (i.e. Credit Scores);
- Occupancy (i.e. does the owner live in the home);
- Credit Enhancement, (i.e. Mortgage Insurance);
- Loan Documentation (i.e. Full v. Low); and
- Other factors the FHFA determines are necessary to promote a liquid secondary mortgage market for investors.

• Different types of investors have different risk tolerances; the transparent standards in the new market will accommodate all of those investors.

Standardize the Documents & Bring Legal Certainty to the Securitization Process

- The Private Mortgage Market Investment Act will:
  - Direct FHFA to standardize the securitization documents including:
    - Pooling and servicing agreements;
    - Purchase and sale agreements; and
    - Trust agreements.

- This new standardized securitization market will :
  - Include uniform definitions;
  - Include uniform representations and warranties;
  - Exempt qualifying securities from SEC registration requirements
  - Establish rep and warrant dispute resolution through mandatory arbitration;
  - Ensure an independent 3rd party acts in the best interests of investors;
  - Address conflicts of interest between servicers and investors; and
  - Clarify the rules around when a borrower can obtain a 2nd lien mortgage.

Uniform Underwriting Standards for Each Class of Mortgages Informs Investors

Highest Credit Borrower

<u>Class A Underwriting Ranges</u>
- DTI
- LTV
- Credit History
- Occupancy
- Credit Enhancement
- Loan Documentation

Mortgage is Created

Class A Mortgage

Mortgage Sold into Securitization

Class A RMBS

High Credit Borrower

<u>Class B Underwriting Ranges</u>
- DTI
- LTV
- Credit History
- Occupancy
- Credit Enhancement
- Loan Documentation

Class B Mortgage

Class B RMBS

Very Good Credit Borrower

<u>Class C Underwriting Ranges</u>
- DTI
- LTV
- Credit History
- Occupancy
- Credit Enhancement
- Loan Documentation

Class C Mortgage

Class C RMBS

NOTE: Under the Bill, FHFA will determine the best workable mix to promote liquidity for each class of loans. FHFA may create more or less than 3 classes of loans.

Bring Transparency & Disclosure to The Securitization Process

- Increase the quality of individual loan disclosure & allow for ongoing updates to individual loan information.

- Ensure investors have sufficient time to review and analyze the loan level information and disclosures before making an investment decision (i.e. a "cooling-off" period).

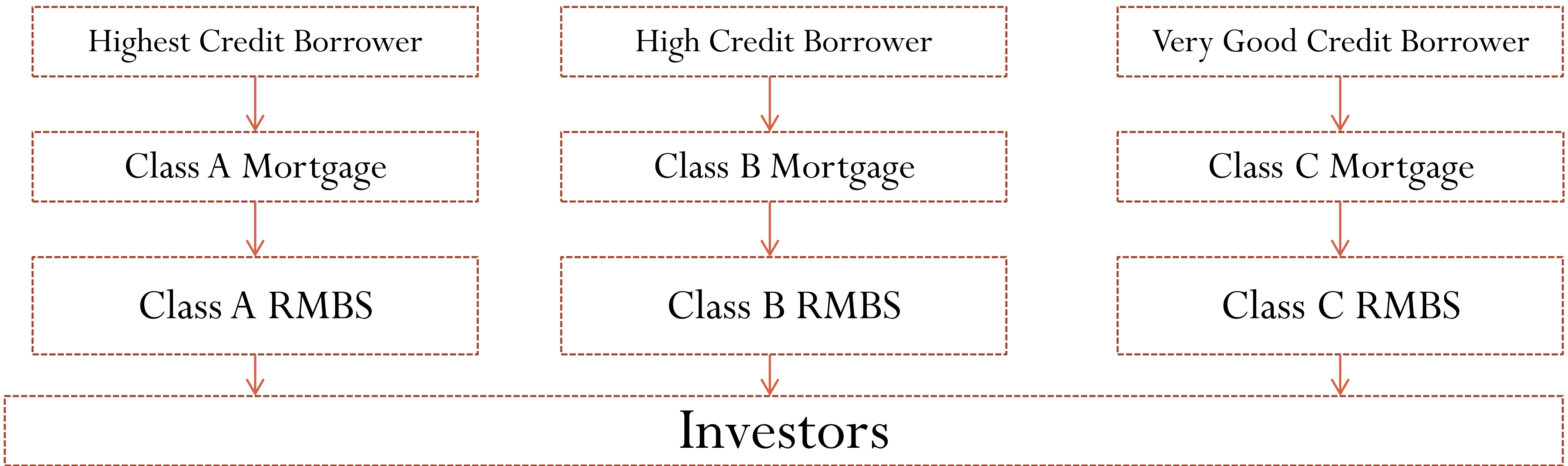
- Increase pricing transparency through the dissemination of post-trade pricing of residential mortgage-backed securities.

- Require the creation of an individualized tracking number to attach to each loan within the securitized pool of mortgages.

Other Necessary Reforms

- Repeal Section 941 of the Dodd-Frank Act ("QRM").
  - Risk retention will exist through standardized "put-back" liability set forth in the representation and warranty language.
  - Market participants, homebuilders, and realtors alike have uniformly complained about the implementation of Section 941.
- Prevent regulators from unilaterally forcing investors to reduce the principal of the loans they invested in (stop a "government cram-down").
- Strengthen the Qualified Mortgage ("QM") safe harbor by repealing the ability for additional legal liability on loans made in a good faith effort to ensure the borrower has the ability to repay.

The 21st Century Securitization Market



- Facilitates Transparent Market Pricing: It is not necessary to know the exact characteristics of a loan before it is sold into the securitization as long as it meets the class requirements; Promotes continuation of the TBA market.

- Promotes Liquidity: Investors know the credit risk in each standardized class of mortgage and the settlement terms before they buy the security. The additional liquidity will allow investors to easily move in and out of this market which will further increase investor demand for this product.

- Transparent Credit Risk: Investors can buy a securitization of the class of mortgages that suits their risk appetite. This also lessens the reliance on the rating agencies in this new securitization market.

- Clear Rules of the Road: Investors know their rights and have mechanisms to ensure their rights are honored.