Common Securitization Platform: Making it work

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Strictly Private and Confidential
Common Securitization Platform

• Three critical policy decisions which will impact industry acceptance and participation in a common securitization platform
  – Transparency
  – Governance
  – TBA Market
Size of U.S. Securitized Debt

Source: SIFMA; data as of 2012-Q4

1 Interest bearing marketable public debt.
2 Includes GNMA, FNMA, and FHLMC MBS/CMOs; and private-label MBS/CMOs.
3 Includes commercial paper, bankers acceptances, and large time deposits.
4 Includes auto, credit card, home equity, manufacturing, student loans and other; CDOs of ABS are included
5 Contains agency debt of Fannie Mae, Freddie Mac, Farmer Mac, FHLB, the Farm Credit System, and federal budget agencies (e.g., TVA)
What distinguishes RMBS?

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<th>Treasury</th>
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Updated Disclosure on Collateral Quality

YES
Treasury
Corporate
Municipal
Federal Agency
Money Market
Asset-Backed *
Commercial MBS

NO
Residential MBS
Agency & Non-Agency
Disclosure and data transparency will be cornerstones to acceptance of CSP

• Ability to observe, model and manage risk will be elevated to new levels in CSP
• Most regulatory and legislative actions are focused on “issuance” disclosure, and the on-going disclosure of fields related to payment history and status.
  – Payment and status do not by themselves help identify causality
  – Data exists to help define causality—that should be focus
• Need updates to collateral (LTV) and borrower (balance sheet)
• Enterprises have not proven good stewards of this valuable (now arguably public) asset.
  – Created asymmetric information to leverage as guarantor
• Make more data available to market on consumer and losses, and they must be attributable to pools
• Massive amounts of model risk exist without the right data
Better disclosure from CSP will broaden credit risk distribution

- FHFA has done an outstanding job with origination standardization
  - UMDP (ULDD, UAD, UCDP), UMSD
- Securitization investors care about on-going data
  - Quality over quantity
  - Determinants of risk and reward
  - Big data is a big problem
- Technology advances are far ahead of Enterprises in ability to manage, protect and provide needed data
- Focus on dynamic elements that cause risk (Prepay, PD, LGD)
  - Collateral
  - Borrower
- CSP can help level playing field and improve best practices by being a forceful leader in expanding and enhancing data availability
Risk Transfer

• First example in market of how FHFA/CSP would provide more data to securities investors
• Enterprises required to test market for cash or synthetic transactions to transfer credit risk.
• Mortgage credit is no longer a “buy and hold” asset—becomes transactional
• Cannot legislate or contract on every outcome—transparency allows people to make informed decisions
• Stated goal of risk transfer is reducing risk by “reducing the footprint”
• Risk transfer data released in recent weeks infer specific structure in mind
  – Creating structure which continues asymmetric data and information is not best first step for change
  – Private sector can provide valuable feedback loop which can enlighten future actions
Preservation of the “Golden Egg”

- TBA market has been the single most important driver of depth of liquidity in single family RMBS
- Reality check! This isn’t your Father’ TBA market
  - TBA market is purely cheapest to deliver now
- Other markets are highly liquid
  - without TBA execution
  - much smaller size
- SEC exemptions appear to be the key to TBA efficiency
  - Enterprises/Government need not control or monopolize benefit
  - Exemptions can be provided to broader participants
TBA Market of the Future

• Risk exists to TBA future effectiveness due to:
  – Temporary investors dominating activity
  – Economic expansion will reduce refinance activity in 2015 and beyond
  – Cheapest to deliver is way beyond intent
    • In past it was a liquid market of the average delivery
    • Now it is a cesspool of garbage
    • Market pay-ups for specified pools indicate extent of mutation
• Benefits of Enterprises as sole-sponsors of TBA market have diminished
• Common platform should orchestrate ability of non-GSE delivery into TBA market
  – Requires standardization and governance
• CSP, not Enterprise modernization, is best outcome for future market
Governance of CSP

- Governance exists to ensure separation of powers and duties
- Institutions that insure risk should not control the dissemination of data to the public.
  - Natural conflict of interest
  - Empirical challenges as proof
- Industry will not broadly accept market where data is controlled by guarantor of risk
- CSP can ensure that standards are consistent with industry needs while still maintaining flexibility needed to react to changes
- Naming of CEO of new third platform should be an eye-opener for Enterprises
Summary

- CSP is a well thought out concept with many outstanding decisions
- Transparency and data disclosure is paramount issue for CSP success
- Risk transfer transactions need to be more literal relative to “spirit” of “reducing the footprint”
- Liquid mortgage markets (TBA) don’t require one of the existing Enterprises to be successful
- Governance must cultivate adequate separation of duties and broaden industry inclusion