May 30, 2012

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Secretary, Department of Housing and Urban Development
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Washington, DC 20410

The Honorable Timothy Geithner
Secretary, Department of the Treasury
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Washington, DC 20410

The Honorable Tim Johnson
Chairman, US Senate Banking Committee
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The Honorable Richard Shelby
Ranking Member
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The Honorable Spencer Bachus
Chairman, House Financial Services Committee
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The Honorable Barney Frank
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The CMLA * believes that the current state of the government sponsored enterprises Fannie Mae and Freddie Mac (the "Enterprises") have benefited from strong oversight and leadership provided by the Federal Housing Finance Agency ("FHFA") over the past several years. The Strategic Plan for Enterprise Conservatorships issued by the FHFA on February 21, 2012 indicates that credit has remained available in the housing market primarily through the operation of the Enterprises, and that the assets of the Enterprises have been "conserved and preserved" through aggressive loss mitigation strategies and fundamental changes to the operational procedures in each entity.

The efforts of the FHFA are to be applauded; however, its work remains incomplete, and as the FHFA searches for an ending to its involvement with the Enterprises, the housing industry (along with Congress, the Treasury Department, HUD, and the FHFA itself) is seeking clarity on how the Enterprises should perform as conservatorship comes to a close. The CMLA believes that certain fundamental principles of the Enterprises should not be overlooked during this critical time in the history of the Enterprises. In fact, the CMLA believes that the housing industry and the public at large are best served through a sensible and calculated reformation of the Enterprises that reduces their footprint in the industry while at the same time allowing them to serve their historically critical functions.

As indicated in the October 2011 FHFA projections, the balance sheet for each enterprise will gradually recover (as is evident of late). Although the 2012 Plan suggests that taxpayer assistance accumulated by the enterprises may be too great to repay in a short period of time, the CMLA believes that they can and should repay taxpayers fully

through creative and thoughtful planning. Further recovery can be obtained by tailoring an increase in guarantee fees to more accurately price risk over the long term and generate new funds which, if retained in the housing industry, would assist the Enterprises to repay taxpayers[1].

A sensible and calculated reformation of the Enterprises will result in continued liquidity and stability without an unnecessary disruption to the secondary market, or worse, a concentration of the secondary market within a limited number of large banks/servicers[2]. Therefore, the CMLA believes it makes sense for the Enterprises to complete the following within transition times recognizing market realities:

- Pay an explicit backstop fee to the federal government;
- Be prevented by statute from securitizing or investing in risky mortgages which CMLA is working to define as part of Qualified Residential Mortgage Rule contained within the Dodd-Frank Act and its related regulations;
- Be contracted and normalized to sustain roughly 30-35% of the overall secondary market;
- Continue to be required to serve lenders of all sizes and nurture smaller markets where market concentration could lead to higher mortgage prices in the absence of the Enterprises;
- Continue to provide standardization of origination documentation, servicing practices, securitization terms, and modification/foreclosure strategies to help protect consumers from faulty policies and procedures;
- Reduce and maintain portfolios over time, but only as transitional market pricing naturally reduces the portfolios. The portfolios provide a stabilizing influence on mortgage pricing, and the largest holder of MBS today is the Federal Reserve. Given that the FHFA itself has said the portfolios will only cause 9% of overall losses, any forced downsizing seems politically motivated to benefit large banks and Wall Street;
- Establish a governing board to maintain and set a competitive guarantee fee in the model of a public utility, with funds generated from the such fee to be retained in the housing industry for the benefit of taxpayers;
- Regulate post-conservatorship executive compensation through a governing board to prevent excessive risk-taking by top executives.

The CMLA believes that these steps would minimize market disruption, minimize lender concentration, and prevent a recurrence of the financial crisis experienced between 2006 and 2008. Therefore, as Congress, the FHFA and the housing industry at large contemplate the future of the Enterprises, CMLA proposes that the following fundamental principles of the Enterprises be retained.

Thank you for the opportunity for us to express our concerns.

Sincerely,

Mark McDougald
Chairman
On Behalf of the Board

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[1] The 2012 Plan stated that increased guarantee fees would assist in proper risk pricing, but did not contemplate whether these increased fees should be retained within the housing industry for the purpose of repayment of the debt of the Enterprises. Thus, the FHFA overlooked a significant revenue stream that could have a remarkably positive effect on the viability of the Enterprises. Jim Millstein, a former Treasury official, has a detailed analysis showing full taxpayer recovery in this manner.

[2] In its Plan, the FHFA states that the future of the Enterprises is unclear and can only be defined by Congress, which could abolish the Enterprises. The CMLA believes that such an outcome would result in severe market disruption, and would dangerously concentrate the housing finance market in favor of a limited number of large national banks and servicers. The 2012 Plan does not recommend abolishment of the Enterprises, and contains considerable evidence that the FHFA is meeting its goal of stabilizing the Enterprises. See 2012 Plan at p.10.

THE PRINCIPLES FOR A FAIR, AND EFFECTIVE SECONDARY MORTGAGE MARKET
By

COMMUNITY MORTGAGE LENDERS OF AMERICA, INC (CMLA)
GSE TASK FORCE

1. Standardization Reduces Costs

Any modifications to the Enterprises should ensure that the efficient and consumer-friendly nature of a standardized mortgage market is preserved. The Enterprises currently provide a standard mortgage product, process, and servicing process, which allow mortgage products to enter the secondary market without unnecessary delay or difficulty, thus resulting in an efficient housing finance model.

This efficiency is important to the industry in several ways:

- Enhances liquidity in the secondary market by ensuring investors that loans originated within stated parameters will meet widely-accepted standards and therefore enhance transferability in the secondary market;
- Provides standard guides for loans and enables future rating agencies to better rate the risk associated with a group of loans, both of which allow the loans to be traded as a uniform group, more like stocks rather than individual loans with unique underwriting standards;
- Bolsters fair lending goals by ensuring that all loans are processed and presented with the same standards, regardless of the status of the borrower;
- Provides a consumer-friendly loan origination process because standardized loan documents ensure that borrowers will have a better idea of what to expect when obtaining a mortgage loan;
- Reduces geographic disparity in the loan process, and ensures that loans are available in all areas;
- Enhances pricing processes because all similar loans will have the same risk associated with them, thus bringing speed and efficiency to the pricing process, a clear benefit to originators, borrowers, and investors of mortgage-backed securities.

Indeed, the Enterprises have long sought to bring efficiency and fairness to the lending process through the use of standardization. Any future reform of the Enterprises must preserve these important benefits.

2. Liquidity Is Needed

Any modification to the Enterprises should ensure that funding is accessible at all times and in all parts of the country, without delay or interruption, and for purchase and refinance, as well as low-moderate-and-middle income markets. Pricing for similar products and credit scores should not vary between regions of the country.

Fannie Mae was created in 1938 for almost identical reasons, and its existence is necessary today. Stymied and sometimes frozen private funding sources results in lack of liquidity across the United States for residential home loan financing, thus denying borrowers access to funding. Nowhere is this more apparent than in the non-conforming/jumbo market. Beginning in 2007, private capital was driven away from the market due to a lack of clear direction from Congress, political uncertainty, fear of future regulatory sanctions, and vague and uncertain regulatory guidance. As private capital evaporated, even the most creditworthy, fully-qualified borrowers could not find affordable and acceptable loan terms outside of the limits of the Enterprises.

As described by the Chairman of the Federal Reserve and many others, the current financial crisis is trumped only by the Great Depression – which caused Congress to create the original, nonpolitical Fannie Mae in order to create a nationwide, liquid housing finance market. Because private capital is subject to stagnation or unavailability, the Enterprises were given – and must retain – government sponsorship.

With the advantage of history as a gauge to the future and an understanding that private capital sources have been frozen since 2007, it is clear that the current housing and financial crisis may have been far worse than the Great Depression had the Government not supported the Enterprises[3]. Indeed, the basis for creating the Enterprises was sound, and eventually helped foster a healthy and active American economy. Although transparency has been lacking and public accountability was not held in check in recent years[4], liquidity for the mainstream borrower cannot be maintained by rendering the Enterprises as either fully private entities, fully public agencies, or non-existent altogether.

Instead, the public/private partnership of the Enterprises should be continued, albeit re-engineered to serve the true and important mission of the agencies: to assure funding sources are available for those meeting quality agency guides, without regard to geographic region, including low, moderate, and middle income markets.

3. Protect Conventional Lending

Any modification to the Enterprises should assure that the Enterprises are statutorily required to avoid risky products and borrowers. Although the current regulatory structure indicates that the Federal government is well on its way toward preventing a resurgence of risky or creative mortgage products, incentives may always remain for unscrupulous lenders to bend the rules or take advantage of unclear guidelines. The Enterprises should not guarantee, fund or purchase any products that present unusual terms or increased risk.

Plain "vanilla" conventional mortgages have historically have performed well. Although every borrower is subject to unexpected life events such as unemployment or sudden financial crisis, these "vanilla" mortgages were not flawed from the outset, as many subprime originations were. Thus, the secondary market must ensure these safe loans are priced appropriately, and supported appropriately via a robust securities overflow market/retained portfolios.

4. Retain and Enhance Loss Mitigation Procedures

Any modification to the Enterprises should continue the trend toward increased loan modifications, debt forgiveness, and foreclosure alternatives. Successful reform requires that losses related to existing and future mortgages be minimized through (1) establishment of a clear and efficient loan modification procedures to be fully administered by the seller/servicer, and (2) an increase in the practical availability of alternatives to foreclosure such as short sale, loss mitigation, "cash for keys" and deed-in-lieu of foreclosure.

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[3] See also, the 2012 Plan at p.8: "Because the private mortgage securitization market had already retreated and there were no other effective secondary market mechanisms in place, the Enterprises' continued operations were necessary for most Americans to obtain a mortgage or refinance an existing mortgage."

[4] The 2012 Plan suggests that these issues have been largely resolved through a replacement of the management of the Enterprises and the establishment of new daily operational procedures.

To date, there has been some progress toward advanced loss mitigation efforts. The FHFA reports that the Enterprises have completed more than two million foreclosure prevention actions, including more than one million loan modifications[5]. On April 17, 2012, Fannie Mae unveiled a procedure for streamlined short sale transactions, and the Enterprises have renewed their focus on similar foreclosure-avoidance mechanisms.

However, these efforts are incomplete and should be examined for methods to expand their impact. For example, the Enterprises report that the Home Affordable Refinance Program (HARP) has been a successful loss-mitigation tool, but the FHFA does not acknowledge that this program is only available for borrowers with loans originated prior to June of 2009. CMLA believes that the HARP program wrongfully and arbitrarily excludes borrowers who would otherwise qualify for relief due to the mere date of their origination. HARP and other loss-mitigation programs should be examined for arbitrary and senseless qualification guidelines so that the Enterprises may minimize their losses and, if possible, rehabilitate non-performing loans.

5. **Make Risk Explicit**

Any modifications to the Enterprises should require some kind of explicit government backing for qualified mortgages. Long term, fixed rate mortgages were made possible through explicit government backing, and it is commonly known that most Americans do not desire the uncertainty of an adjustable rate mortgage. Instead, consumers prefer the simplicity and affordability of long-term, fixed mortgages.

Yet most financial intermediaries will not assume the risk of hedging large sums of a long-term asset that can be pre-paid, such as a mortgage, with relatively shorter-term funding (deposits and/or short term debt). Therefore, explicit government backing is essential to ensuring that long term, fixed rate mortgages remain commonly available.

The CMLA believes that the prior model of "implicit risk" did not work well, and recommends that some form of explicit premiums be submitted to the federal government in return for the secondary market structure that allows the proper hedging of these assets. These premiums represent an additional source of income for the Enterprises to repay their debt to the American taxpayers, after which time they could be held by their regulator as a buffer against future downturns.

6. **Reduce Market Concentration**

Any modifications to the Enterprises should refrain from further hastening market concentration among a limited number of originators/servicers, and should instead encourage participation among a wide variety of parties.

Small lenders serve a valuable local market niche, and help grow local economies. They should be encouraged to obtain secondary market and liquidity directly from the Enterprises and not through their larger, direct competitors. This would create a vibrant, competitive housing finance market that will provide consumers with a range of lending choices. The reality is many Americans prefer to deal with locally-based institutions with local community leadership. Thus, the secondary market should preserve these locally-owned and run institutions, which maximize consumer care and choice while keeping costs low.

Market concentration leads to dangerous reliance on the dominant banks, and creates a lack of innovation and stifling of customer service. Already, the home mortgage market is dominated by three of the largest U.S. banks, which account for more than 51% of residential mortgage originations. The top two alone account for a stunning 43% of the market.

In February of 2011, the U.S. Department of Treasury and Department of Housing and Urban Development released a white paper related to the Enterprises, which identified further market concentration as a very real risk. On pages 27-8, the white paper states that "*small lenders and community banks could have a difficult time competing*

[5] See 2012 Plan, p.8.

for business outside of the FHA segment of the market, which may in turn impact access to lending in communities they have traditionally served more effectively."[4]

This sentiment is echoed by Dr. Phil Swagel in an analysis dated October 2011, wherein he describes his proposal as "*along the lines of the third option put forward by the Treasury Department,"* and broadly similar with proposals put out by select trade groups and the Center for American Progress, such that "*large banks would benefit from this proposal, and this new model would further narrow the role of community banks."*[5]

The secondary market should not be capitalized, whether directly or indirectly, by the large seller/servicers. These entities have the same "Too-Big-to-Fail" attributes of those entities that accepted "bailout" funds and created economic havoc. Small community lenders, by and large, did not accept "bailout" funds and cannot be characterized as systemically dangerous.

The difference between these dominant banks and the Enterprises is simple: the large seller/servicers have a direct economic stake in removing small community lenders from the marketplace, whereas the Enterprises operate to preserve the economic future of small community lenders. Congressional action that further concentrates the mortgage markets and starves small lenders and small communities can hardly be called "reform."

7. **Encourage Portfolio Flexibility**

Any modification to the Enterprises should include an option that grants the Enterprises and their participants the flexibility to hold mortgages in portfolio to keep prices from rising during market contractions. Congress should not statutorily mandate the limits of Enterprise portfolios.

While Enterprise portfolios have moderated and even shrunk in recent periods, the Federal Reserve's portfolio holdings have ballooned despite former Federal Reserve Chairman Alan Greenspan advising that such activity is risky. Today, the single largest holder of Enterprise mortgage-backed securities is the New York Federal Reserve Bank. Thus, it seems clear the market will suffer if Enterprise portfolios are artificially reduced by statute.

Further, interest rate losses failed to materialize in the retained portfolios, despite critics' warnings. The FHFA itself has predicted total Enterprise losses from the portfolios to be just 9% of the Enterprises' total losses. While the CMLA agrees that the portfolios need to be strictly regulated for product types, reduced when market pricing favors such reduction, and need not grow at the rate they once did, the CMLA does not favor any harmful, forced, and arbitrary portfolio reduction for the sake of political expediency.

8. **Require the Proper Use of Guarantee Fees**

Any modification to the Enterprises should maintain the integrity of mortgage risk-based pricing while at the same time repaying American taxpayers in total for past economic support. Accordingly, income derived from the guarantee fee should be retained in the industry which created it – the housing industry.

The CMLA opposed Congress' decision to fund a two-month payroll tax holiday through higher Enterprise guarantee fees. That legislation set a new precedent for using the mortgage market's price hikes to fund unrelated parts of the federal budget. While the independent regulator had signaled that prices were increasing, these price hikes should have been used to re-price credit risk and repay taxpayers for their assistance into the U.S. mortgage market. Yet the money is now being used for the Congressional budget's "flavor of the month."

The legislation not only raises mortgage costs while doing nothing to help repay taxpayer assistance to the Enterprises, but also raises long-term costs should the rating agencies downgrade the Enterprises' debt. Further,

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[4] See Treasury and HUD's report to Congress, "Reforming America's Housing Finance Market," February 2011, pages 27-8.
[5] Swagel, Phil, "The Future of Housing Finance Reform," University of Maryland School of Public Policy, October 2011, page 13.

this two-month band aid saddles the American borrower with thirty years of increased debt, thus hindering the housing industry for 30 years to come. This mistake would be exacerbated should Congress return again to this ill-advised funding solution.

The CMLA does not oppose an adjustment of guarantee fees, and even recommends adjustment of those fees provided that the income derived from the fee is used within the housing industry to price credit risk accurately and help repay taxpayers for their investment in the Enterprises. The CMLA strongly opposes the transfer of this income into the general U.S. Treasury for unrelated purposes.

9. Create Standards for the Non-Enterprise Secondary Market

The CMLA applauds the efforts of Representative Scott Garrett in regard to his sponsorship of the Private Mortgage Market Investment Act, which seeks to set appropriate standards for the secondary marketplace not served by Fannie Mae, Freddie Mac, or Ginnie Mae. The CMLA foresees a future marketplace where the majority of securitized loans flow outside of government-sponsored or government-controlled organizations, and our organization will work with those members of Congress who are interested in this forwarding this effort. The CMLA cautions that, just as with the Enterprise securitization marketplace, any non-Enterprise securitization platforms should not hasten further mortgage market concentration.

CMLA Mission: *was founded out of concern that emerging federal policies threaten to severely diminish community based lending, while increasing concentration among the nation's largest financial institutions, to the detriment of competition and consumers. CMLA members include community banks and non-banks. CMLA members survived the mortgage crisis because of close attention to prudent and traditional underwriting standards with a strong commitment to sound lending.*