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"Are There Government Barriers to the Housing Market Recovery?"

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Chairwoman Biggert, Ranking Member Gutierrez and distinguished members of the Subcommittee, thank you for inviting me to testify on President Obama's plan to spur private capital back into the U.S. housing finance market. My name is Ted Tozer and I am the president of Ginnie Mae. I have served in this position since February of 2010.

Prior to joining Ginnie Mae, I served as senior vice president of Capital Markets at the National City Mortgage Company. For more than two decades, my responsibilities included pipeline hedging, pricing, loan sales, loan delivery, and credit guideline exceptions. My combined experience at National City and now Ginnie Mae gives me a keen perspective on private mortgage market business needs and government expectations.

Today I will discuss Ginnie Mae's unique business model; the value our securities bring to investors, lenders and consumers; and our conservative approach to risk management. I will also spend some time today highlighting efforts we've taken to reduce government support of the housing market, while doing so at a pace that does not undermine the burgeoning economic recovery, and our plans to continue that effort going forward.

Background

I would like to begin my testimony by providing background on Ginnie Mae and its evolving role and function in U.S. housing finance. Ginnie Mae serves as a financing arm for HUD and other government insured or guaranteed mortgage products. We are a self-sustaining, wholly-owned government corporation, charged with supporting the secondary market for insured or guaranteed government loans.

In 1968, Congress created Ginnie Mae by partitioning Fannie Mae into two entities: the Government National Mortgage Association and the Federal National Mortgage Association.

In 1970, Ginnie Mae created and issued the first mortgage-backed security (MBS) in U.S. history. And since its inception, our corporation has issued more than $3.7 trillion in MBS, helping millions of families realize the dream of affordable housing. We have provided liquidity and stability to the U.S. housing market through all economic environments for more than 40 years.

The steep decline of the housing market in recent years placed tremendous stress on lenders, including Ginnie Mae's Issuers, and led to the retreat of investors from the market. As it has before in troubled times, Ginnie Mae has stepped into the market space previously dominated by others to ensure that core customers – Issuers, homeowners and investors – are well served. That is our historic role – to provide counter-cyclical support in times of crisis. In doing so, Ginnie Mae demonstrates its leadership in providing capital and liquidity and supports the Administration's efforts to stabilize the housing markets.

Paving the Way for a Robust Private Mortgage Market

Since the onset of the housing crisis, Ginnie Mae has taken an active role in working with other government agencies involved in stabilizing the credit and housing markets. This includes ongoing discussions with other components of HUD including the Federal Housing Administration (FHA), as well as with agencies such as the Department of Veterans Affairs, the Department of Agriculture, the Treasury Department, the National Economic Council (NEC), and regulatory bodies, notably the Federal Housing Finance Agency (FHFA), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency. In particular, Ginnie Mae worked closely with FDIC to manage the orderly transition of Ginnie Mae's portfolios of depositories placed in FDIC receivership. Additionally, Ginnie Mae collaborates with the Treasury Department, NEC and FDIC, and within HUD on policies to address the financial crisis in the housing market.

More than ever, Ginnie Mae is focused on offering programs that meet the needs of our stakeholders and provide sufficient flexibility to respond to market changes. Over the past several years, Ginnie Mae has made significant upgrades to its technology infrastructure to streamline business processes and to allow its customers to more efficiently address the demands from the surge in volume. Together with expanded enterprise-wide risk management practices, which I will address later, these efforts have strengthened Ginnie Mae programs and increased operational efficiencies. Our practices may also serve as a model – especially in the areas of disclosure and risk management – for the changes that are needed to build a better functioning private label securities (PLS) market.

Business Model

Ginnie Mae works with qualified private mortgage lenders to pool their government-insured or guaranteed mortgage loans and issue Ginnie Mae MBS. Lenders service and manage the MBS portfolio and the underlying loans. Many of these institutions are aggregators, meaning they purchase loans from other lenders and consolidate them into pools of mortgages eligible for a Ginnie Mae MBS. Only loans insured or guaranteed by FHA, VA, USDA's office of Rural Development, and HUD's Office of Public and Indian Housing (PIH) can serve as collateral for Ginnie Mae securities.

Lenders pay a guaranty fee to securitize these government-backed products. For this fee, Ginnie Mae assures the timely payment of principal and interest on MBS to investors. Our guaranty makes our MBS highly liquid and attractive to domestic and foreign investors. In times of crisis, when Ginnie Mae MBS volumes rise, lenders obtain a better price for government-insured mortgage loans when sold as part of a Ginnie Mae security. Although the securities are commonly referred to as "Ginnie Mae's," we are not the Issuer. Private lenders issue the securities. I will discuss more about this aspect of our business model later as it has risk implications. Our MBS allows lenders to recycle the funds obtained by selling Ginnie Mae securities to originate more mortgage loans for single-family and multifamily properties across the country. This ongoing cycle helps to lower financing costs and thus supports accessible and affordable housing.

Protecting Taxpayers from Risk

Ginnie Mae's business model mitigates the taxpayers' exposure to risk associated with secondary market transactions. We do not originate or invest in mortgage loans or MBS directly so we have no active retained investment portfolio. Additionally, we do not take on borrower credit risk or rely on credit derivative products to hedge. And because we have no need to finance whole loans or MBS portfolios, we don't carry significant long-term debt on our balance sheet.

Furthermore, Ginnie Mae is insulated by several layers of protection before it faces any risk associated with the mortgage collateral underlying the securities. The credit risk on loans in Ginnie Mae securities resides with the Issuer of the security and the respective government insuring agency. When speaking about the Ginnie Mae program, I will often use the term Issuer to refer to the lenders who participate in our program; we often use the term Issuer and lender interchangeably. Ginnie Mae's exposure to risk is limited to the ability and capacity of Issuers to fulfill their obligation to pay investors. Our Issuers are expected to pass through principal and interest payments to investors even when borrowers are delinquent.

In fact, under our program guidelines, Issuers are expected to finance the repurchase of loans out of an MBS in order to foreclose or modify. For example, in the case of a home foreclosure, these institutions continue to make payments to investors until loans are repurchased from the security and the Ginnie Mae guaranty is removed. Generally the Issuer makes payments throughout the foreclosure process. When that process is completed, the Issuer submits a claim to the insuring agency for reimbursement of the payment advances it has made. If the insuring agency does not fully reimburse the Issuer, the Issuer assumes the short fall as a loss.

In rare circumstances, Issuers fail to make the required principal and interest payments. When that happens, Ginnie Mae can seize the portfolio without compensating the Issuer. Failure to make all required payments is considered a default in the Ginnie Mae program.

Ultimately, before Ginnie Mae's guaranty is at risk, three levels of protection must be exhausted: 1) homeowner equity; 2) the insurance provided by the government agency that insured the loans; and 3) the corporate resources of the lender that issued the security. We are in the fourth and last loss position. Only catastrophic circumstances will cause Ginnie Mae to face losses on its guaranty. Again, Ginnie Mae only steps in when all of an Issuer's corporate resources are exhausted, usually accompanied by bankruptcy. Furthermore, when we do step in, our losses are limited to either the cost of transferring the portfolio or to any decline in the servicing value of the portfolio. It is important to note that we are the only entity involved in housing today that is modeled in this manner.

Issuer Monitoring

Issuer approval and ongoing monitoring processes are an important component of our enterprise risk management efforts. We aggressively manage Issuers and their servicing portfolios to mitigate potential losses. Our MBS staff manages potential servicing value deterioration by requiring Issuers to either repurchase excessive amounts of seriously delinquent loans or take other actions that mitigate Ginnie Mae's losses should a default occur. Also, we require the repurchase of defective loans.

To assure continued accountability for our efforts, Ginnie Mae has had a Chief Risk Officer in place for nearly three years. Our CRO monitors the corporation's aggregate risk and compliance with risk policies, develops and maintains corporate-wide procedures for risk management, and provides independent evaluation and oversight of all risk management activities.

Similar to the FHA, Ginnie Mae has implemented industry-leading policies that shore up our risk management and may provide a model for building confidence in private label securitization. We have implemented policies that increase accountability among our Issuer base and disclose more information to investors on the loans that back our securities. This includes increased net worth, capital, and liquid asset requirements for all Issuers across our single-family, multifamily, and home equity conversion mortgage (HECM) business lines. Imposing these requirements reflects Ginnie Mae's commitment to prudent risk management. By requiring Issuers to retain more capital and liquidity to absorb potential losses and advance delinquent payments to investors, we hold them accountable. Our capital and liquidity requirements can be looked at as a different, but very effective form, of "skin in the game."

Corporate Organization and Performance

Ginnie Mae's conservative, well-managed business model and strong risk position is managed by an equally solid staff of 77 employees. I could not be more proud of the performance of our staff during these tough times.

We have two major business units: MBS and Capital Markets. These divisions are responsible for the production and marketing of mortgage-backed and multiclass securities.

Our activities receive no appropriations from general tax revenue. Ginnie Mae's operations are self-financed through the fees we charge to Issuers, which eliminates the need to use taxpayer funds.

Net Revenues

For more than 20 years, Ginnie Mae has generated profits. In Fiscal Year 2010, Ginnie Mae's net income was $541 million. Total revenues were $1.01 billion; total expenses were $92.5 million; and gains were $352 million. We earned $541 million in profit despite increasing our loss reserves by more than $700 million to $1 billion. And in FY 2009, our performance was just as strong; we earned $510 million. To put all of this in perspective, over the last two years, through the worst sustained housing decline since the Great Depression, we *earned* profits each year on behalf of the U.S. taxpayer. And, yes, we are also well-positioned to deal with any future market volatility, with more than $14.6 billion in retained earnings. Ginnie Mae's sustained profitability and strong capital position demonstrates that its operations pose no financial risk to the federal government and taxpayers.

To put our increasingly important role in perspective, at the close of FY 2008, Ginnie Mae's portfolio stood at $577 billion. In June 2010, the portfolio reached $1 *trillion*, and it currently stands at $1.1 trillion. This trillion dollar portfolio has financed more than 7.2 million single-family homes and 1.1 million rental housing units; in FY 2010 alone, we financed nearly 1.9 million households.

Indeed our growth has provided benefits to taxpayers and the economy as it has allowed lenders to continue the business of making loans to prospective homeowners. In 2006, Ginnie Mae's market share was four percent. In FY 2010, Ginnie Mae's market share was approximately 30 percent. Despite this incredible spike in volume, the delinquency rate of the Ginnie Mae portfolio is among the lowest in the industry.

The present outstanding MBS balance is the largest since the inception of the organization. Our growth is a direct result of the current economic downturn, but these levels are neither desired nor sustainable.

The Current State of Ginnie Mae

The extraordinary growth in volume is challenging for our organization; we approved 43 new Issuers last year. Prior to the present economic crisis, we approved five or six new Issuers per year. The staff at Ginnie Mae has managed the tremendous volume increases and its expanded role by asking more of themselves. This, as well, is unsustainable. This is why the President's 2012 budget proposes to authorize a significant increase in Ginnie Mae salary and administrative expenses – still to be funded from fee income alone. Increased salary resources will allow Ginnie Mae to bring more functions in-house and reduce our reliance on outside contractors. I believe this is the right direction, and given Ginnie Mae's continued profitability and strong risk management practices, it is time to use our fee resources to ensure we run as efficiently and effectively as possible.

Restoring Trust and Integrity in the Broader Housing Market

The challenges in housing finance have an impact not just on the mortgage industry, but on the national and global economies as well. Falling home values, high rates of mortgage delinquencies and foreclosure and the loss of millions of jobs strain families and communities. The economic problems in the United States extend beyond our shores and have led to the erosion of global investors' confidence in all but the most secure investments.

These factors have perpetuated credit constraints for consumers and businesses alike and are further hampering recovery. Uncertainty and volatility in the economy and the aftermath of the unnecessary risk-taking has limited investor appetites for any MBS other than those insured or guaranteed by the U.S. Government or the GSEs. This has resulted in a lack of private capital and corresponding financing, which is reflected in the low rate of issuance of private label securities over the past three years.

Towards a New System of Housing Finance

We *must* revive the PLS market. Going forward, the Administration is committed to ensuring that private capital markets – subject to strong oversight and standards for investor protection – should be the primary source of mortgage credit and bear the burden of losses. It is crucial that this transition away from government's oversized role is measured and doesn't upset a still fragile housing market. The task before us will not be easy as the MBS market has long relied on government involvement. Much is needed in the way of change if we are to create an environment attractive to private capital. Ginnie Mae stands ready to help with these efforts.

A Path Forward

The Administration believes the securitization market should continue to play a key role in housing finance. That market, however, requires meaningful reform so private investors can confidently participate in the housing market and provide an alternative funding source for mortgages outside of the traditional government-supported institutions.

Increasing Transparency, Standardization, and Accountability in the Securitization Chain

As I mentioned, we are the financing arm of HUD and other government insuring agencies, so the levels of MBS we guarantee are directly related to the levels of mortgage loans other government agencies insure. Commissioner Stevens has outlined plans to reduce FHA's imprint in the market, and our MBS volume will decrease accordingly.

Ginnie Mae MBS consistently trades with tighter spreads to Treasury than those of the GSEs and significantly better than private label securities. This directly contributes to government-insured borrowers obtaining the lowest interest rates possible for consumers during a crisis. For example, a review of a mortgage calculator from a major lender revealed that a 30-year fixed-rate FHA-insured mortgage is approximately 25 basis points less than a 30-year fixed-rate mortgage on a $160,000 conventional loan. Transparency and full disclosure are critical elements in attaining the best execution. The Administration believes increased disclosure on underlying mortgage collateral is key to increasing standardization and accountability in the securitization chain. Our efforts to expand loan disclosures in our securities have been well received in the market.

Under my direction, Ginnie Mae began releasing the number and dollar value of modified loans, FHA short-refinance loans, and HECM Saver loans contained in our pools. The new disclosure initiatives are designed to spur more efficient pricing of our securities. As part of our continuing efforts to strengthen transparency and disclosure, Ginnie Mae also began releasing monthly disclosure files on outstanding MBS approximately two weeks earlier each month.

And during FY 2010, we announced two important operational changes that will allow small lenders to more easily and efficiently do business with Ginnie Mae; this will help to ease liquidity strains. To reduce interest costs associated with carrying loans until they can be securitized and settled, Ginnie Mae implemented program changes to allow daily issuance of multiple-Issuer pools. These changes should allow Issuers to use warehouse lending lines more efficiently. And we also recently allowed Issuers to securitize single loans in multiple-Issuer pools.

And I insisted that Ginnie Mae work with Fannie Mae and Freddie Mac to implement a Uniform Loan Delivery Data set. Use of the data set will *standardize* the definitions of the data elements lenders are required to provide when issuing securities. This means loan delivery information will be standardized across the industry, further increasing transparency.

Improving Mortgage Servicing and Foreclosure Processing

An important matter to help stem the tide of foreclosures is establishing national standards for mortgage servicing. The Administration supports several immediate and near-term reforms to correct problems in mortgage servicing and foreclosure processing. One immediate step is to reform servicing compensation to align with industry incentives. We are working with the FHFA to explore alternative servicing compensation structures. A more efficient servicing compensation model could provide for better servicing of non-performing loans and could help address some of the nation's foreclosure problems. Given the positive impact a resolution to this issue could have on the mortgage industry, we are excited to join the FHFA in addressing this matter. I have significant experience in loan servicing compensation and capital markets, and I look forward to contributing leadership towards this initiative.

Winding Down Fannie Mae and Freddie Mac

Clearly, the current market in which Fannie Mae, Freddie Mac, and Ginnie Mae guarantee 95 percent of all securities is unsustainable. It exposes taxpayers to too much risk. For investors, uncertainty about the future of the GSEs impacts decision making. It is difficult to plan production and identify appropriate secondary market outlets when pending legislation looms. Also, as long as the GSEs offer a secondary market outlet for mortgage loans with below market pricing based on a government-supported cost of capital, PLS transactions will be disadvantaged. The Administration proposal to increase GSE guaranty fees, increase the capital ahead of their guarantees, and wind down their investment portfolios will end uncertainty and create space for greater private sector investment. Having participated in developing the Administration's recently released White Paper on GSE reform, I believe the options laid out form the foundation for a thoughtful discussion moving forward.

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Restoring Trust and Integrity in the PLS Markets

The current private label securitization process works with limited oversight. A neutral party is needed to ensure accountability and transparency. The role of bond trustees may need to be expanded. Bond trustees are currently responsible only for distributing monthly principal and interest payments to investors. We should consider whether bond trustees need the ability to make sure loans are serviced properly, have the authority to require repurchase of defective loans by Issuers and give guidance to servicers on loan level loss mitigation issues. Additionally, providing authority to bond trustees through private label securities contracts to require Issuers to cover some or all catastrophic loss could help restore confidence in our securities markets. Bond trustees are an obvious choice for this expanded role, but there may be other options; the point I want to make is that a strong well capitalized entity is needed to assume some of these responsibilities.

Addressing Fannie Mae and Freddie Mac alone will not give rise to a housing finance market that meets the needs of investors. Nor will it guarantee that private markets can effectively play a more dominant role in the mortgage market. We must work together to map our way forward by looking at some of the recommendations provided above.

In recent years, fundamental flaws occurred at almost every link in the mortgage process. We are now all well aware of the advantages and disadvantages of securitization. When securitization is managed appropriately, it is a very efficient conduit for capital. However, when insufficient attention is paid to the quality of the collateral or the end product is so complex that no one understands the risk, the consequences can be disastrous. Significant reform is needed to help address the flaws that led to the crisis and to rebuild trust and integrity in the mortgage market. This is especially true for the securities markets. Many investors in private label securities believe that investing in today's market often requires them to take excessive and unpredictable risk. Restoring their faith in the markets will require greater transparency, standardization and accountability in the securitization process. As someone who has worked in the capital markets for more than 30 years, I welcome the opportunity to work with Congress to develop a solution that meets the needs of homeowners, investors, and taxpayers. Thank you for giving me the opportunity to testify today, and I look forward to answering any questions you may have.