



Building a Mortgage Infrastructure for the Future

Remarks as Prepared for Delivery

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Introduction

Good afternoon. I want to thank Richard Dorfman for inviting me to speak today and SIFMA for hosting this important discussion.

In the four years since Fannie Mae and Freddie Mac, or the Enterprises, were placed into conservatorship, we have made major strides towards rehabilitating the mortgage market and keeping borrowers in their homes, but there is still much to be done.

Today, the government touches more than 9 out of every 10 mortgages. With this in mind, it is essential that we transition the mortgage market to a more secure and sustainable and competitive model.

The conservatorships of Fannie Mae and Freddie Mac were never intended to be long-term solutions. They were primarily meant as a “time out” for the rapidly eroding mortgage market -- an opportunity to provide some stability while Congress and the Administration decided on how best to rebuild our housing finance system.

It is vital to the long-term health of our country's housing and financial markets that our elected leaders seek to bring the conservatorships to a conclusion, and to define the government's role and requirements for housing finance in the future.

Members of SIFMA are uniquely positioned to contribute to policy discussions about the future of the housing finance system. There are many views to consider as part of this process of ensuring that we have an efficient housing finance market in the future. There are important issues about access to credit and fair treatment for borrowers. There are important issues about fostering a competitive primary and secondary mortgage market. But if we really are serious about expanding the private sector's role in housing finance, we must consider what types of changes are necessary to bring private capital back to the housing finance market.

Today, I am going to review the work that FHFA has undertaken as part of the “build” component of our strategic plan for the Enterprise conservatorships. I will also leave you with some key questions that should be considered as we move forward.

Before I get into all that though, I would like to share a few thoughts about the big picture as I see it.

The United States has long had, and must continue to have, robust, competitive financial markets and institutions. Our economic system depends on private sector decision-makers efficiently allocating capital through market competition. This capital allocation process is essential to finance economic activity that produces jobs and economic growth.

Our regulatory infrastructure sets and enforces certain rules of the road, in part to ensure that fraud or poor business decisions by certain players don't create large spillover costs to the rest of the system. The regulatory infrastructure can also add certainty and

transparency, protect consumers and promote access to credit. But the country needs owners of private capital making informed resource allocation decisions to promote economic growth and prosperity.

In the mortgage market, that means we need established rules by which everyone abides. But we also need competitive markets and market participants operating within those rules to ensure that credit is available to help families purchase homes and rent houses and apartments. A competitive private market system also ensures that such capital is efficiently allocated between housing and all other sectors.

The secondary mortgage market infrastructure that served this country for many years is broken. The description of FHFA's activities that I am about to provide should be understood in this context. Our goal is to energize the rebuilding of the secondary mortgage market so that market participants may again compete with each other to ensure an efficient flow of credit for housing, confident in the knowledge of the risks involved and the rules in place. Making progress on essential infrastructure development, improving standardization, and generating meaningful discussion about rebuilding our housing finance infrastructure should help policymakers tackle critical questions about the government's role in housing finance.

Building a New Infrastructure and the Future of Housing Finance

As we think about building a new infrastructure for the secondary mortgage market, we know the nation will need a healthy and efficient secondary mortgage market regardless of the final resolution of the conservatorships. That is why FHFA set out to develop a new framework -- one that will work for the Enterprises in the near-term, and also have broad application in the future.

Today, the Enterprises' operations perform many functions. In addition to their familiar role as a credit guarantor, they also help to establish various standards in the mortgage industry. These standards include those related to: data submissions by originators; servicing mortgages; and various other processes in the mortgage market. The Enterprises also perform many of the basic operational functions of transferring funds from investors to borrowers and back.

In FHFA's recently issued white paper on a new securitization infrastructure, we divided the project into two components. The first component is the "physical" infrastructure or the securitization platform, which comprises the technology that drives much of the Enterprises' current secondary market operations. The second component is the "virtual" infrastructure, or the set of contractual provisions that govern transactions in the secondary market.

Securitization Platform

Let me start with some of the basic motivation behind establishing a common

securitization platform. First, the Enterprises' outmoded proprietary infrastructures need to be updated and maintained, and any such update should provide enhanced value to the mortgage market with a common and more efficient model. The Enterprises' infrastructures are not the most effective when it comes to adapting to market changes, issuing securities that attract private capital, aggregating data, or lowering barriers to market entry. In short, there must be some updating and continued maintenance of the Enterprises' securitization infrastructure, and to the extent possible, we should invest taxpayers' dollars to this end once, not twice.

We also have undertaken this effort with the goal that it will have benefits beyond the Enterprise business model. Therefore, this new infrastructure must be operable across many platforms, so that it can be used by any issuer, servicer, agent, or other party that decides to participate.

That brings us to one of the most important issues we raised in the white paper -- the scope of the securitization platform. One approach we outlined is that the focus of the platform could be on functions that are routinely repeated across the secondary mortgage market, such as issuing securities, providing disclosures, paying investors, and disseminating data. These are all functions where standardization could have clear benefits to market participants.

One way to think about this effort is that the new securitization platform could become a form of a market utility. For example, if policymakers decide that there should be some type of federal guarantor of mortgage-backed securities, such guarantors will need these functions performed. In addition, even without such a guarantor structure, I would think that the private-label mortgage-backed securities market could benefit from such a utility. Providing standardization across key mortgage market functions should add depth and liquidity to the market.

The formulation for the securitization platform we put forth in the white paper envisions what would likely be the minimum scope for a securitization platform. It is certainly possible that other standard functions that enhance efficiency could be added to the platform scope.

Contractual Framework

Now let me turn to the second component of the securitization infrastructure – the contractual framework. In today's Enterprise securitization model, the contractual framework is governed by the Selling and Servicing Guides of the Enterprises. These Guides set forth the rules that sellers must follow for the Enterprises to guarantee mortgages. The guides also set forth the rules for servicing mortgages, including the procedures that must be followed to address delinquent loan servicing.

A similar contractual framework is in place in the private-label securitization market – the Pooling and Servicing Agreement or PSA. The PSA is the legal document that lays out the responsibilities and rights of the servicer, the trustee, and others over a pool of

mortgage loans. The PSA covers some of the same issues as the Enterprise Selling and Servicing Guides, but in general more variation has existed in terms of individual PSA agreements than in the Enterprises' Guides. On one hand, variation in terms can lead to the tailoring of transactions to meet particular investor requirements. On the other hand, greater standardization in certain contractual terms could add more liquidity and more certainty to the market. In addition, as became evident during the financial crisis, the responsibilities of various parties in the PSA agreements may have made resolution of issues more difficult and added to the losses of many investors.

In the white paper we put forth some broad ideas on creating a model pooling and servicing agreement. Similar to the securitization infrastructure effort, the focus of this effort is to identify areas where greater standardization in the contractual framework would be valuable to the mortgage market of the future.

As I will discuss in more detail shortly, the Enterprises are moving toward harmonizing requirements that are contained in their respective Seller and Servicing Guides. Much can be learned from these efforts, but given that the ultimate outcome of housing finance reform remains uncertain, this is an optimal time to further consider how best to address contractual shortcomings identified during the past few years. Much work has already been done in this area by market participants, and additional input from all of you will be exceptionally valuable. If we are going to achieve the collective goal of bringing private capital back to the market, a collaborative effort between market participants, regulators, and policymakers will be necessary. We look forward to reviewing the comments that we have received on the white paper and continuing further interaction with market participants in 2013.

FHFA's Efforts in Promoting Market Standards

In addition to the specific efforts on building a new infrastructure that I described, FHFA and Fannie Mae and Freddie Mac have been working on several other initiatives that are directly related to improving the mortgage market of the future. These initiatives fit into various parts of a new infrastructure for housing finance. Let me review several of these.

Data Quality

Standardizing data is a key building block as we seek to rebuild the housing finance system. The Uniform Mortgage Data Program is improving the consistency, quality, and uniformity of data collected at the beginning of the lending process and for servicing data. Developing standard terms, definitions, and industry standard data reporting protocols will decrease costs for originators and appraisers and reduce repurchase risk. It will allow new entrants to use industry standards rather than having to develop their own proprietary data systems to compete with other systems already in the market. Common data definitions, electronic data capture, and standardized data protocols will improve efficiency, lower costs and enhance risk monitoring.

Servicing Alignment Initiative

Settling on servicing standards will be an important component of the future mortgage market as investors or guarantors will need clarity on how troubled loans will be serviced. FHFA's Servicing Alignment Initiative produced a single, consistent set of protocols for servicing Enterprise mortgages from the moment they first become delinquent. This initiative responds to concerns about how delinquent mortgages have been serviced and it simplifies the rules for mortgage servicers by giving them just one set of procedures to follow -- whether a mortgage is owned by Fannie Mae or Freddie Mac. These new requirements were developed in consultation with the federal banking agencies and state attorneys general. And while there are continuing discussions about various aspects of national servicing standards, our hope is that the work under the Servicing Alignment Initiative will provide a basis for that work.

Joint Servicing Compensation Initiative

How servicers will be paid is also an important consideration for the mortgage market of the future. FHFA established the Joint Servicing Compensation Initiative to consider alternatives for future mortgage servicing compensation for single-family mortgage loans. Broadly, the goals of the initiative were to consider changes to the servicing compensation structure that would improve competition in the market for mortgage servicing and which could be replicated across any form of housing finance reform. FHFA published a set of discussion papers to provide perspective on the issues and options. FHFA, Ginnie Mae, and the Enterprises also engaged in a significant amount of industry outreach. Thus we have already completed a substantial amount of groundwork on this subject. It remains for me an important part of the work ahead.

Representations and Warranties

It should be clear to everyone that the representation and warranty model needs reform. Fannie Mae and Freddie Mac have long operated under a representation and warranty model that relied on monitoring at the back-end of the process after a mortgage defaulted or the borrower missed payments. That is, they did relatively few reviews of mortgages sold to them unless or until the mortgage went into default. Then, if they found the loan was originated outside the terms they had set, they could demand a repurchase. While that model may have worked reasonably well in stable credit conditions, it has not worked so well under stressed conditions.

For the market to reclaim the strength it once had, the representation and warranty model needed to be improved. Lenders want more certainty about their risk exposure and the Enterprises want to ensure the quality of the loans delivered to them.

That is why in September FHFA and Fannie Mae and Freddie Mac announced that the companies are launching a new representation and warranty framework for conventional loans sold or delivered on or after January 1, 2013. This is a major step toward

transitioning from the secondary mortgage market of the past to the secondary mortgage market of the future.

The new framework will clarify lenders' repurchase exposure and liability on future deliveries. In addition, lenders will be relieved of certain repurchase obligations for loans that meet specific payment requirements.

While this new framework may not be exactly what would be needed in a new infrastructure without a dedicated credit guarantor, I think we can all agree that additional upfront monitoring of data quality, clarifying the exposure of originators, and defining the rights of investors are all important elements of a sound housing finance system and for improving credit availability in the near-term.

Disclosures

Finally, for private capital to return to the mortgage market, I believe that investors will demand more data on mortgage characteristics and performance. The Loan-Level Disclosures Initiative we announced last year is aimed at producing loan-level investor disclosures on Enterprise MBS, both at the time of origination and throughout a security's life. Improving MBS disclosures will help establish consistency and quality of data. With better information, private investors can more efficiently measure and price mortgage credit risk, which will likely be essential to attract private capital back to replace the government's enormous footprint in the market today.

Conclusion

Clearly there is no simple path to rebuilding the country's housing finance system. In addition to fundamental questions about the end state of housing finance reform, there are also difficult transition issues to consider. At FHFA, through efforts toward building a new infrastructure and establishing greater standardization in the mortgage market, we are working to help pave that transition to whatever end state policymakers ultimately choose.

Also part of any transition are steps that FHFA is taking to contract the Enterprises' operations – whether it is increasing guarantee fees or pursuing risk sharing alternatives. These initiatives have the potential to transfer some credit risk to the private sector, a goal that most policymakers seem to agree with. We will continue to try to make progress in this area, but if policymakers are serious about limiting the government's role, more direct action may be needed to have significant near-term effects.

As we think about the end state of housing finance reform, at the most fundamental level, the key question is what, and how big, should the role of the federal government be? This is clearly where there are diverging policy and political views, but we must start to think through this process.

As part of thinking through this process, I suggested last week that perhaps it will be

easier to break this question up into component parts. In doing so I am not suggesting a particular legislative strategy, but rather a defined ordering of how to think about housing finance reform.

I suggested that one potential place to start is to think about what the role of the traditional government mortgage guarantee programs, like the Federal Housing Administration or FHA, should be. If policymakers begin by defining the role FHA should play in the future in terms of which borrowers would have access to this program, than it should be easier to consider the government's role in the remainder of the mortgage market.

If the government's role in the traditional guarantee programs is clearly defined, then we can look at the rest of the market and consider questions like:

What is the capability and capacity of private market participants to intermediate credit for single-family housing? What functions are necessary to have an efficient market?

How should standards be established and updated in the market to enhance efficiency, risk assessments, and liquidity, thereby lowering costs to borrowers and investors alike?

Where do we think the market system requires prudential government oversight or limits? Have we ensured that any oversight or limits act to foster, not inhibit, competition, including fostering the full participation of small and mid-sized firms in the mortgage market?

Are there remaining public policy concerns about potential market failures and, if so, are those concerns about market stability and liquidity or about social policy goals regarding homeownership?

As these fundamental housing policy questions are debated, FHFA will continue making progress on building a new infrastructure for the future. We look forward to carefully analyzing the comments provided on the white paper. Many interesting issues were raised, and we look forward to continued dialogue with SIFMA and other market participants.

Thank you.