FHLBANKS
A NATION OF LOCAL LENDERS

December 3, 2012

VIA E-MAIL TO SecuritizationInfrastructure@FHFA.gov

Office of Strategic Initiatives
Federal Housing Finance Agency
400 Seventh Street, S.W.
Washington, D.C. 20024

Re: Comments – *Building a New Infrastructure for the Secondary Mortgage Market*

To Whom It May Concern:

The undersigned Federal Home Loan Banks ("FHLBanks") appreciate the opportunity to submit this letter in response to the Federal Housing Finance Agency's ("FHFA") Invitation to Comment on its proposed framework for a common securitization platform and a model Pooling and Servicing Agreement ("PSA") entitled, "*Building a New Infrastructure for the Secondary Mortgage Market*," released on October 4, 2012. We fully support this effort to create a common infrastructure for use by the mortgage origination industry that should lay the groundwork for a more rational and sustainable housing finance system that better aligns incentives for mortgage originators.

Our belief is that a new secondary mortgage market infrastructure, if properly structured, will better reward those mortgage lenders, such as community financial institutions, that originate loans with very high quality credit characteristics. Currently, community financial institutions that sell mortgages in the secondary market receive little or no benefit for using traditional underwriting standards to create loans with better credit performance than the average loan. Instead, the secondary market rewards originators through preferential pricing based on the volume of mortgages delivered. Large mortgage originators that deliver large volumes of mortgages are able to negotiate much lower guarantee fees with the secondary market enterprises than smaller volume originators. Therefore, two mortgages, with identical credit characteristics, are effectively priced differently so that the loan originated by the larger lender obtains a higher value.

This difference has disenfranchised many smaller community lenders over the past several decades, deterring or preventing their participation in the mortgage origination market while the largest originators have dramatically increased their concentration of market share. As a result, there is less competition as only a handful of very large financial companies dominate the mortgage origination market, leaving consumers with fewer choices.

The FHLBanks began our acquired mortgage asset ("AMA") programs more than fifteen years ago to provide our community financial institution members with an alternative that better recognizes the superior credit quality of the mortgages they originate. Using a unique risk sharing structure, the Mortgage Partnership Finance® Program and the Mortgage Purchase Program allows lenders to retain the principal credit risk of their own loans and pays them for doing so while relieving them of the interest rate risk associated with long-term, fixed-rate, prepayable mortgages.

These structures have proven very popular. More than 1,400 FHLBank member institutions have used these programs to fund well more than 1 million mortgages worth more than $200 billion. The credit performance of the loans funded through the AMA programs speaks to the credit quality of mortgages originated by community lenders. Both before and during the financial crisis, the portfolio of AMA loans has significantly outperformed the national averages, typically experiencing only one-quarter to one-third the amount of serious loan delinquencies and foreclosures. Based on our experiences with these programs, we offer the following comments.

GENERAL COMMENTS

A key goal for the proposed infrastructure, as stated in the Executive Summary, is to attract "greater participation of private capital in assuming credit risk." Because there is not a single source of private capital sufficient to guarantee the trillions of dollars of American mortgages, multiple parties will need to participate in the market by issuing or purchasing credit enhanced slices or tranches of mortgage credit risk and bearing a first, second or catastrophic credit risk position.

For example, the mortgage originator may retain some risk of loss by providing credit enhancement on individual loans or a pool of loans, while an aggregator retains an additional layer of credit risk, before multiple pools are brought together for securitization. Additionally, there may be supplementary forms of credit enhancement such as individual loan insurance. A platform that allows multiple layers of credit enhancement to be provided and borne by different participants, as their abilities and risk appetites allow, is more likely to attract private capital into the mortgage market.

Also, while the White Paper does an admirable job addressing many issues related to the development of the infrastructure for a new secondary mortgage market, a number of important issues remain to be addressed. For example, how will the costs of the new platform be allocated among market participants? What will be the governance or ownership structure for the new platform? And importantly, how will the platform ensure fair and competitive access to all market participants, including smaller mortgage originators? Undoubtedly, there are other issues to be considered as well.

As the structure of the secondary mortgage market is reconsidered, the FHLBanks support the development of a securitization platform that better aligns incentives and values credit quality over mortgage volume. Given the importance and complexities involved, we urge the FHFA to adopt a collaborative and inclusive approach in its efforts to ensure all valid viewpoints are heard and considered. We recommend the creation of a working group or committee, representing all parts of the mortgage industry, to provide advice and assistance. If such a committee is created, we are willing to participate on such a committee and devote resources to assist in this effort. Given our experiences with the AMA Programs, we believe we can offer a unique perspective and perhaps provide some lessons that would be helpful to the FHFA.

RESPONSES TO QUESTIONS

Below are our responses to the seven questions presented for public input at the end of the White Paper:

1. ***The proposed securitization platform has four core functions (issuance, disclosure, bond administration and master servicing.) Will these core functions provide an efficient and effective foundation for the housing finance system going forward?***

   As stated in the General Comments above, the best way to attract private capital to the mortgage market is by providing an infrastructure that allows multiple market participants to bear credit risk at various points in the securitization process. Therefore, the platform will need to be able to track and report on multiple "waterfalls" of credit risk retention. Also, we anticipate the platform will support the TBA process.

   As much as possible, the platform should adopt a rules-based structure where the rules are defined by the underlying legal agreements and the platform is tasked with carrying out and enforcing those rules. The platform should be highly adaptable to various collateral payment methods and loan types. It should allow for a wide variety of credit structures and focus on having as many private credit guarantors/investors as possible. A system that disburses credit risk widely will be more sustainable and better able to continue normal functioning during economic downturns.

2. ***Are there additional functionalities that should be considered as core functions of the platform? For example, should the platform independently verify or determine the following or rely on an issuer or guarantor:***

   a. ***Underwriting and loan eligibility rules?***
   b. ***Pooling rules?***

   In order to attract multiple sources of private capital, the underwriting and loan eligibility rules need to be broadly crafted so that each underwriter is able to design the product according to the risks it is willing to absorb. Rather than prescribing narrow underwriting rules that will become the industry standard, the platform should allow for flexible underwriting practices.

   The role of the platform should be to provide clear and transparent information to investors about the specific parameters of both the security and the underlying collateral. Such a platform would allow community financial institutions, who know their customers better than other secondary market entities, to use traditional underwriting practices to create high quality mortgages. The market will then determine the value of those high quality loans.

There should be options for the platform to perform the collateral verification role, for a fee, and for the platform to accept the issuer's or guarantor's certification. Depending on the issuer or guarantor, a better execution may be achieved using the platform as a backstop. In other situations the issuer or guarantor may have the stature and reputation to get better execution on their own.

The pooling rules, in contrast, need to be fairly strict in so far as insuring products of similar structure are contained in each pool. For example, there should be significant penalties for fraudulent reps and warranties from trustees or servicers to prevent the kind of abuses experienced during the height of the housing bubble.

3. ***Will the framework for a model PSA described in this paper provide the foundation for standardized contractual framework for the housing finance system going forward?***

The model PSA should be flexible and not prescriptive, and allow for multiple credit enhancement structures. Because the market's perception of these parameters could change over time, the PSA should not dictate specifics but rather allow the individual participants bringing the securitization to market to determine how best to handle these and other parameters. For example, a customized PSA may be required to accommodate a Private Label market.

While this framework will accommodate a variety of participants, there remains the open issue of how the thousands of community financial institutions individually can participate when their volumes are unlikely to allow cost effective utilization of this platform. While there may be alternatives ultimately designed through the private sector, it is important to evaluate how this platform can be utilized by smaller community financial institutions.

4. ***Are there additional elements/attributes that should be included in a model PSA? For example,***

   a. ***Should the model PSA define when a non-performing loan is required to be purchased out of the trust?***
   b. ***Should the model PSA define when a non-performing loan is required to be transferred to a specialty servicer?***

It is critical that the credit responsibilities and all activities that are not a sale or refinancing be explicitly stated in the PSA, to ensure transparency and clarity. However, the model PSA must allow flexibility as well. For example, servicers should be allowed to determine when a non-performing loan is required to be purchased out of the trust.

As private capital is brought back into the market, there will be differing structures regarding the treatment of non-performing loans. While this information needs to be gathered and shared with the investors transparently, the PSA should not define when a non-performing loan should be purchased out of the trust. Through price discovery, investors will drive the benefit of best execution to a "standard set" of definitions. However, the definitions could morph over time as collateral product and economic conditions change. The market should be allowed to drive these parameters. Similarly, the PSA should allow flexibility as to when a non-performing loan should be required to be transferred to a specialty servicer.

5. ***If the framework for a model PSA is a good contractual foundation, how should compliance with the PSA be monitored in the future?***

The platform should be responsible for upholding the rules of the securitization, ensuring a disinterested party is responsible for the compliance functions. The experience of the recent financial crisis has demonstrated that trustees may not act as independently as presumed. Often securitization trustees have loose affiliations with mortgage originators that could compromise their independence and impact their vigilance.

Similar to the GNMA structure, there should be approved seller-servicer arrangements and compliance through those seller-servicers should be monitored closely by the Master Servicer.

6. ***What enhancements to the role of trustee should be considered in order to better attract private capital to the housing finance system?***

Similar to the monitoring of compliance of the PSA, the trustee responsibilities should be closely monitored. However, the trustee should be independent of the originator or investor in the performance of their duties to ensure no conflicts of interest.

From a data reporting aspect, in order to enhance transparency, the Trustee and/or Master Servicer should require much more detailed information about the performance and characteristics of the underlying loans than they do presently.

7. ***How should document custodial and assignment responsibilities be handled in the housing finance system going forward?***

Pre-approved custodial and assignment responsibilities should be established and then monitored for compliance, preferably by an independent third party.

Thank you for your consideration of our views. We welcome the opportunity to assist the FHFA in its efforts on this important project.

Sincerely,

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