HOUSING POLICY COUNCIL
THE FINANCIAL SERVICES ROUNDTABLE

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December 3, 2012

Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street, S.W.
Washington, DC 20004

Re: Securitization Infrastructure

Dear Sir or Madam:

The Housing Policy Council[1] ("HPC") appreciates the opportunity to comment on the proposed framework for a new securitization platform and model pooling and servicing agreement (PSA) set forth in the Federal Housing Finance Agency's (FHFA) paper entitled "Building a New Infrastructure for the Secondary Mortgage Market" (the "White Paper").

I. Introduction

HPC generally supports the goals of the FHFA Strategic Plan, but recommends a more incremental approach to infrastructure reform.

This proposed framework is an outgrowth of FHFA's Strategic Plan for Fannie Mae and Freddie Mac (the "Enterprises"), which was released earlier this year. That plan recommended the development of a new infrastructure that could be used by the Enterprises, and could have a broader application beyond the conservatorship. HPC generally supports this goal. We recognize that the existing infrastructures of the Enterprises are outdated and in need of modernization. We also support a GSE reform model in which private capital stands behind the credit risk associated with conventional mortgage securities and the Federal Government provides a backstop, catastrophic guarantee on those securities.[2]

However, for the reasons cited below, we believe that FHFA should take a more incremental approach to infrastructure reform. We make this recommendation because the proposed framework raises several fundamental questions that must be answered before any comprehensive framework can be implemented. These include questions about the manner in which the framework would interface

[1] The Housing Policy Council of the Financial Services Roundtable is a trade association that represents 29 of the leading national mortgage finance companies. HPC members originate, service and insure mortgages. We estimate that HPC member companies originate approximately 75% of mortgages and service two-thirds of mortgages serviced in the U.S.
[2] *Legislative Proposals to Reform the Government Sponsored Enterprises (GSEs) Before the H. Comm. On Fin. Serv. Subcomm. on Capital Mkt. and GSEs* 112th Cong. (2011) (statement of John H. Dalton, President, Housing Policy Council).

with the private label market, questions about the governance and regulation of the centralized platform, and questions about the impact of infrastructure reform on the design of broader GSE reform. A more incremental approach to infrastructure reform would give FHFA time to address these questions.

We are also concerned about certain pending policy decisions related to our housing finance system that are outside the control of FHFA, but could have an impact on the structure of the framework. These policy decisions include the qualified mortgage rule under development by the Bureau of Consumer Financial Protection and the Basel III capital rules under development by the federal banking agencies. A more incremental approach would enable FHFA to consider the impact of these policy changes when designing and implementing any new infrastructure.

Our proposed incremental approach calls for FHFA to (i) make technological improvements in the existing securitization platforms used by each of the Enterprises that can be implemented in the near-term; (ii) rollout risk sharing for Enterprise securities; and (iii) provide for the issuance of a single security by the Enterprises. We believe that this incremental approach is fully consistent with FHFA's Strategic Plan. It would provide for some real, and tangible, progress on current problems, yet would not prejudge the ultimate design and structure of a centralized securitization platform or model pooling and servicing agreement.

Additionally, we recommend that before proceeding with a new centralized securitization platform, FHFA publish an expanded White Paper that (i) addresses the various questions that remain unanswered in the current White Paper, as well as the implications of some of the pending policy changes that will affect the securitization of mortgages; and (ii) invites public comment on an alternative approach to the creation of a new securitization platform by the private sector rather than FHFA and the Enterprises. We believe that the publication of an expanded version of the White Paper would help to clarify and resolve the unanswered operational and policy questions raised by the current proposal. Also, as discussed further below, we believe there are ample precedents for FHFA to consider a private sector alternative.

The balance of this letter is divided into the following sections: Section II highlights the key features of the proposed framework; Section III lists some additional principles that we believe should guide FHFA in the development of the proposed framework; Section IV lists some of the pending policy issues that should be resolved before any final framework is established; Section V lists some of the significant questions that need to be answered before any final framework is established; Section VI outlines our proposal for a more incremental approach to infrastructure reform; and, finally, Section VII recommends the publication of an expanded White Paper to further the exchange of ideas between FHFA and all stakeholders on these important issues.

II. <u>The Proposed Framework</u>

The White Paper proposes a new framework for securitization that consists of a new securitization platform and a model PSA (the "Proposed Framework"). The securitization platform could take the form of a "utility." This platform would perform certain functions, which, according to FHFA, lend themselves to standardization and automation. These functions include collateral management, master servicing, securities issuance, disclosure management, data validation, bond administration and acting as a trustee. Currently, the Enterprises perform all of these functions, but they do so through separate, proprietary systems.

The utility would not perform certain other functions currently performed by the Enterprises, including the purchase and aggregation of loans from lenders and the placement of a credit enhancement on mortgage-backed securities. Those functions would continue to be performed by each Enterprise, or eventually, other private firms that would use the utility in the securitization of private label securities. The platform would be designed to support the existing agency market, new risk sharing arrangements where the private sector would assume some of the credit risk associated with agency securities, and eventually, the private label market.

The model PSA would be based upon the existing selling and servicing guides used by the Enterprises, and would include a "thin" trust agreement. This legal structure would be designed to address perceived shortcomings in the PSAs used in the private label market.

III. Principles for Reform

The White Paper states that the Proposed Framework is intended to (i) promote liquidity; (ii) attract private capital; (iii) benefit borrowers; and (iv) operate flexibly and efficiently, while minimizing market disruption. HPC agrees that these are sound principles upon which to base the Proposed Framework. However, we believe that there are some additional principles that should guide this effort.

Specifically, we propose that in designing the Proposed Framework, FHFA also be guided by the following principles, which would supplement, and are not inconsistent with, the principles set forth in the White Paper:

- Priority is given to changes in mission critical functions;
- The operations of the Enterprises remain fully functional throughout any transition period;
- Technology upgrades are subject to a robust cost-benefit analysis that ensures continued public support for the development of the Proposed Framework;
- The role of private firms in the securitization process is preserved, to the maximum extent possible;
- The Proposed Framework is designed to adapt to new technological developments and to promote innovation;
- The Proposed Framework accommodates different legal agreements; and
- The Proposed Framework promotes competition.

IV. Pending Policy Changes

It is premature to settle on an infrastructure framework until pending policy changes are finalized.

In response to the recent financial crisis, policymakers have proposed a number of changes in the regulation of housing finance. These changes include a risk-retention requirement for certain mortgages, an ability to repay standard for lenders (the qualified mortgage provision), and heightened capital requirements for residential mortgage loans (the proposed Basel III rules). These proposals, especially the risk retention requirement and the Basel III rules, would have a material impact on the securitization of mortgages. As proposed, both the risk-retention rule and the Basel III rule would favor the securitization of agency securities over private label securities. Until it is known precisely how these regulatory proposals will impact mortgage finance and securitization, it seems premature to move forward on an infrastructure framework that is based, largely, upon prior regulatory policies.

The organizational design of the platform could, inadvertently, influence the GSE reform debate.

Additionally, we anticipate that the larger issue of GSE reform will receive heightened attention in the coming year, and we would prefer that any decisions on the infrastructure framework not impact the direction of that reform. We recognize that the White Paper is intended to be agnostic on the shape of GSE reform, but we would suggest that one of the likely reform options is to convert the Enterprises into a public utility, and the creation of a utility to provide administrative services for securitizations could, inadvertently, influence the outcome of the GSE reform debate.

Furthermore, the work to develop this new utility and its infrastructure would be led by FHFA and, we expect, significant resources would be drawn from the Enterprises to complete the work. With the future of the Enterprises so uncertain, we believe there would be a strong tendency to design a utility that is not agnostic and, instead, is created in a way to ensure that the Enterprises in some modified form play a key role in operating the utility.

V. Unanswered Questions

While the White Paper explains a general framework for a centralized securitization platform and a model PSA, it leaves unanswered several questions, which must be answered before any framework can be implemented. The following are some of the more significant questions.

Who would control the utility?

The White Paper proposes that the centralized platform be organized as a utility. There is some logic to this to the extent that the functions of the platform are purely administrative. However, the White Paper leaves unanswered questions about the ownership and governance of this utility. These are fundamental questions that impact the manner in which the entity would operate, including how responsive it might or might not be to changes in technology and other market developments. Our preference would be for any such entity to be owned by the industry or, at a minimum, have significant industry representation on its governing board in order to ensure that it is responsive to market developments. Any utility that is created and implemented by FHFA in conjunction with the Enterprises would likely be controlled and governed by FHFA, an outcome which appears likely to result in a utility that heavily favors the Enterprises. Thus, we believe FHFA should only focus on developing a platform that fits the needs of the Enterprises under their current authorities.

How will sellers interact with the utility versus the Enterprises or any successors to the Enterprises?

It is not clear how current sellers to the Enterprises will interact with the utility. Is the utility a shared "back office" technology platform that sellers will not interact with? Will current technology "pipes" to the Enterprises remain as they are, or with the utility will there be a third entity to whom sellers will have to build "pipes?" Or will the utility become the central point to which sellers will connect and they will no longer have to maintain separate "pipes" to the Enterprises? If there are going to be more than two Enterprises, will sellers then have to build "pipes" to all the different entities that exist, given the (presumed) existence of the utility platform? These are critical questions which should be answered in an expanded White Paper before commencement of platform development.

What is FHFA's role?

What is FHFA's role in the supervision of the proposed utility or the review and approval of the proposed PSA? Today, the relevant regulator for the private label market is the Securities and Exchange Commission ("SEC"). How would FHFA and the model PSA interface with the SEC and SEC's disclosure requirements? These questions are not addressed and should be resolved before the proposed framework is finalized.

What is the application of the model PSA?

The White Paper proposes a model PSA based, largely, upon the existing selling and servicing guides used by the Enterprises, and other legal documents used by the Enterprises. Would this model become a mandatory template for all securitizations? The White Paper is not clear on this point. Our preference would be for the model to serve as a guide, but not be mandatory. This question needs to be resolved.

Can a centralized platform serve agency and non-agency securities?

It is not clear how the proposed platform would evolve from serving the Enterprises to serving the private label market. For example, all of the functions proposed for the platform seem appropriate for the securitization of agency securities because those functions currently are performed by the Enterprises. In private label securitizations, however, various parties perform these functions. Our operating assumption is that the platform should not absorb functions that could otherwise be performed by the private sector. However, the larger question is whether a single platform can serve both agency and non-agency securities. That question requires more consideration than has been given in the White Paper.

Why are functions already in the private sector included in the proposed platform?

HPC has serious concerns with the proposed functions of the securitization platform. As noted above, we believe that any changes in the existing infrastructure should acknowledge the functions currently performed by the private sector. More specifically, we question the inclusion of several of the functions, such as issuance, master servicer and bond administration in the proposed platform. These functions are currently performed by private parties. We also question the inclusion of the collateral management and trustee functions. Reserving certain functions for the private sector will help to minimize the taxpayer costs associated with the design and development of a comprehensive platform.

What steps are being contemplated to ensure uninterrupted flow to the Enterprises during system development, testing and initiation?

The Enterprises have a history of mixed results in building large scale systems. Given the criticality of maintaining legacy technology that is currently in place, HPC would be concerned if the Enterprises were to build the system in-house rather than use an external central contractor. HPC would prefer to see industry standard mortgage software packages used for the different modules contemplated by the White Paper. Importantly, we would request that the FHFA engage with the industry to develop a list of potential software vendors that represent best practices and build support for the selection of the final vendor(s). HPC encourages the selection of an external contractor to develop any system apart from the Enterprises in order to maintain fidelity of current mortgage flows in the marketplace. A central contractor can also maintain greater control over standards. This is particularly important given that both Enterprises currently are working on data initiatives that were supposed to standardize and harmonize data provided to them by sellers, but instead, sellers are already seeing divergences in the data requirements. We are concerned that a similar situation could arise without an external contractor.

VI. A More Incremental Approach to Infrastructure Reform

For the reasons given above, we believe it is premature to design and implement a comprehensive, centralized securitization platform. At the same time, we acknowledge that the current systems used by the Enterprises are outdated and in need of modernization. We also recognize that it would be a misuse of taxpayer’s funds to develop two completely new systems.

Near-term improvements to existing systems and procedures

As an interim step toward a more comprehensive system, we propose that FHFA work with each Enterprise on some practical improvements to the existing systems and procedures, which could be implemented in the near term, and at a reasonable cost. These improvements could focus on issues such as the interface between lenders and servicers, loan documentation, standardization and validation of data, loan tracking, and reporting. FHFA also should look for ways to minimize differences in the basic policies and procedures used by each Enterprise.

Risk sharing and single security

We also would urge FHFA to move forward as quickly as possible on the risk sharing and single security features of the Strategic Plan. These would be beneficial to markets and consumers, and be implemented without a centralized securitization platform.

VII. Republication of the White Paper

While implementing the incremental steps outlined above, we urge FHFA to publish, for public comment, an expanded version of the White Paper that addresses the issues left unanswered in the current paper, as well as the implication of some of the pending regulatory policy changes that will impact the securitization of mortgages. A continuing, open dialogue with stakeholders on these issues would then enable FHFA to move forward with other, appropriate reform.

Republication of the White Paper also would enable FHFA to seek input from other financial regulatory agencies. We assume, for example, that the Federal Reserve Board and Treasury may have views on whether the proposed utility contributes to or detracts from financial stability. Likewise the SEC may have a view on whether the proposed PSA contributes to or detracts from investor protection. We urge FHFA to use republication as a means to collect input from other financial regulators.

A private sector alternative

Finally, we recommend that a republished White Paper invite public comment on an alternative approach to the creation of a new securitization platform – namely the design, construction, and operation of the platform by the private sector. The private sector has a proven record of designing and operating sophisticated technology systems. Examples include: (i) the payments systems for credit cards, which were created by the banking industry and evolved into the VISA and MasterCard networks; (ii) the Clearinghouse Payments Company, which is owned and operated by the nation's largest banks and which clears almost $2 trillion daily; and (iii) the nation's ACH network, which is one of the largest, most efficient, and safest payment systems in the world. Additionally, a private sector alternative may be more consistent with the FHFA's mandate as conservator, since the costs of the system would be borne by industry, not taxpayers. We urge FHFA to seek public comment on such an alternative.

With best wishes,

John H. Dalton

John H. Dalton
President
Housing Policy Council