Testimony of
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"Chairman's Housing Reform Outline"

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Chairman Crapo, Ranking Member Brown, and Members of the Committee:

Thank you for inviting me to testify on the Chairman's outline for housing finance reform. My name is Edward DeMarco and I am the President of the Housing Policy Council (HPC), a trade association comprised of the nation's leading firms in housing finance and dedicated to advancing responsible and sustainable homeownership opportunities.

In 2012, in my capacity as the Acting Director of the Federal Housing Finance Agency (FHFA), and conservator for Fannie Mae and Freddie Mac, I issued a strategic plan for the conservatorships titled "The Next Chapter in a Story that Needs an Ending." At that time, I noted that "no clear legislative consensus has emerged [on GSE reform] from the Administration or Congress." That is no longer the case. Since 2012, the debate over housing finance reform has coalesced around a set of key elements. Those elements are: an explicit government guarantee for mortgage securities backed by conventional mortgage loans, the placement of private capital in a first-loss position on those securities before the government guarantee, assurance for fair and equitable access to credit, funding to support affordable housing, and a competitive, transparent marketplace that ensures a level playing field for all sizes and types of industry participants.

The Chairman's outline for housing finance reform reflects this progression in our collective thinking. It is a practical, workable proposal that builds on all previous proposals, and the members of HPC stand ready to work with the Committee to put it in a legislative form that can be enacted into law.

My testimony will address the components of the outline – the elements that we support, the open-ended questions that the outline identifies, and some areas where additional specificity is needed. In addition, I will highlight actions that FHFA and the Administration could take to ensure a smooth transition for new guarantors to enter the housing finance system with no competitive disadvantage relative to Fannie Mae and Freddie Mac. Finally, I will emphasize the opportunity to improve upon the current mechanisms to support affordable housing.

HPC Understanding of Proposed Framework in the Chairman's Outline

A Multi-Issuer, Single-Security

A useful first step in defining housing finance reform is to stipulate what kind of mortgage-backed security (MBS) will be produced. The brevity of the Chairman's outline does not explicitly identify the MBS structure, but the overall framework suggests that it would be a multi-issuer, single-security. This structure is not new. The Ginnie Mae II security is a multi-issuer, single-security. Just last month, Ginnie Mae backed the issuance of over $23 billion in Ginnie Mae II securities.

A multi-issuer security enables more than one lender to contribute loans to the security. Mortgage lenders licensed by Ginnie Mae to put loans into the security are deemed "issuers." In the Chairman's outline, "issuers" may be the reconstituted Fannie Mae and Freddie Mac, new entrants that perform the same functions as the new Fannie and new Freddie, or individual mortgage lenders.

A single-security means that all the various loan pools formed by the multiple issuers go into the same mortgage-backed security, wrapped with a government (Ginnie Mae) guarantee. By bundling loans from various issuers into a single Ginnie Mae security, investors are able to buy a security that is backed by a pool of loans from a variety of issuers. In turn, each of the issuers achieves equal access to the capital markets; there is no benefit for large mortgage lenders over small mortgage lenders or banks over non-banks. This makes the market for securities deeper and more liquid, which results in lower mortgage rates for families.

Historically, the Fannie Mae and Freddie Mac MBS have worked differently. Fannie Mae and Freddie Mac have each been the sole "issuer" of their mortgage-backed securities, and their respective securities were not interchangeable. This June, under the guidance and direction of the FHFA, the GSEs are replacing their separate MBS with a single MBS, the "Uniform MBS," which is designed to make their MBS interchangeable. This is an important step towards the security structure envisioned in the Chairman's outline and other reform proposals.

Having a multi-issuer, single-security, wrapped by a federal agency, creates an opportunity to better distribute, rather than concentrate, both mortgage risk-taking and the operational processes involved in mortgage securitization. This will strengthen the housing finance system while preserving and improving access to sustainable mortgage credit for consumers.

Issuers and Guarantors: The Chairman's Outline Allows for Both

One of the challenges to housing finance reform has been how to reconcile two competing approaches for securitizing mortgage loans. One approach, which may be called a "bundled" arrangement, is based upon a guarantor that is responsible for several key functions, including loan aggregation, the issuance of the mortgage securities, the master servicing of assets in those securities, and the placement of the credit guarantee on the mortgage loans. That is the approach embodied by Fannie Mae and Freddie Mac.

The other approach, which may be called an "unbundled" or "stand-alone" approach, is based upon the separation of the credit guarantee function from the issuance of the mortgage securities. This alternative approach is employed by Ginnie Mae, which places a federal guarantee on mortgage securities backed by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA) and other government-guaranteed mortgage loans, but Ginnie Mae does not issue the securities or operate as a master servicer of the assets in the securities.

We read the Chairman's outline to permit both approaches to be applied to the securitization of conventional mortgage loans. Under the Chairman's outline, mortgage originators - all mortgage lenders from community banks and independent mortgage banks to large depositories and non-bank lenders - that have established relationships with Fannie Mae and Freddie Mac, would be able to continue to sell their loans to the reconstituted Fannie Mae and Freddie Mac. They also could continue to rely upon those reconstituted companies to issue and master service the mortgage securities, to place a private sector guarantee on the loans, and to acquire an explicit federal guarantee on the mortgage securities from Ginnie Mae.

Alternatively, as we read the outline, both small and large originators would be able to create and issue mortgage securities themselves if they purchase credit protection from an FHFA-approved guarantor.

At HPC, we call the combination of these two approaches in the Chairman's framework "the hybrid model." It is a hybrid model because it allows for guarantors that perform multiple functions, similar to the existing Fannie Mae and Freddie Mae structure, as well as guarantors that specialize in a focused, stand-alone activity of holding and distributing credit risk.

Under a hybrid model, the reconstituted Fannie Mae and Freddie Mae and other FHFA-approved guarantors could serve as whole loan aggregators, acquiring mortgage loans from lenders through "cash windows." These multifunction or "bundled" guarantors would issue mortgage-backed securities formed from the aggregated pools of loans, delivering them into the Ginnie Mae securities. Such guarantors also would be responsible for the master servicing of those loans, relying on and overseeing the work of independent servicers. Finally, these guarantors would guarantee the loans. In support of these guarantees, guarantors typically would perform some level of due diligence to ensure compliance with FHFA and their own underwriting and eligibility standards and receive a commitment from the loan seller called representations and warranties of compliance with applicable rules and standards.

In short, the Chairman's outline preserves the current Fannie and Freddie structure, which also was the structure used in previous Committee reform proposals.

In addition, as we read the outline, it also permits the development of "stand-alone" guarantors that would be responsible for only the credit guarantee function. These FHFA-supervised guarantors would offer the guarantee coverage on loans that meet the credit and eligibility terms set by FHFA and would have contractual agreements with private issuers who request and pay for the guarantee. In other words, the "stand-alone" guarantors would be accountable for, and would manage the credit risk associated with the mortgages while the other functions I have described – loan aggregation, security issuance, and master servicing -- would be the responsibility of a separate issuer. Such guarantors would have a direct business interest in both the quality of the loans they guarantee as well as in the efficiency and effectiveness of the loan servicing. This stand-alone credit management exists in the private market today; for example, private mortgage insurers and participants in credit risk transfer arrangements engage in this activity.

In addition to the guarantor role in providing credit risk protections to the system, HPC recognizes and agrees with the outline's preservation of loan-level credit enhancement in the form of private mortgage insurance on low down payment mortgages. Requiring first-loss coverage at the loan level via mortgage insurance or other loan-level credit enhancement on low down payment loans has been part of the GSE model for years. HPC supports continuing to require this additional level of private capital and credit risk protection.

In the proposed framework, FHFA would be the regulator of all the guarantors, whether they provide bundled or stand-alone services. FHFA also would be required to establish standards for the acceptance of credit risk transfer structures. Thus, FHFA would be the regulator of the credit risk. FHFA would set standards for approving guarantors, including capital and liquidity requirements, as well as the underwriting and eligibility terms for the mortgages that may be pooled in the securities backed by Ginnie Mae. Guarantors would pay a fee into a Ginnie Mae-managed Mortgage Insurance Fund (MIF) to cover losses in the event of the failure of a guarantor. Ginnie Mae also would regulate the business requirements and terms of the securities agreements.

HPC Supports Key Features of the Chairman's Outline

HPC believes that this hybrid model is not only feasible, but also that it reduces the systemic risk associated with the current Fannie Mae/Freddie Mac duopoly by facilitating participation of new market entrants that enhance competition and innovation, while introducing market discipline and ending too-big-to-fail. With the addition of stand-alone guarantors and credit-risk transfers, there will be more channels for private capital to be accessed and deployed in a manner that improves the overall liquidity of the system as well as the distribution of risk across various private market participants - all in front of the government guarantee.

Moreover, by allowing for stand-alone guarantors, the Chairman's framework permits new entrant guarantors that specialize in risk management – including risk evaluation, risk retention, risk mitigation, and risk distribution. With greater focus on core capabilities and the need to compete for business, these companies would strive for innovative ways to increase their effectiveness, continuously improving the means by which risk is assessed and controlled. This would be a benefit for the system. In sum, HPC believes that the permitted separation and specialization of the functions involved in the securitization process– aggregation, issuance, master servicing, and guarantee – is a primary benefit of the Chairman's framework.

Of equal importance, this arrangement preserves and cultivates the historically private-sector role of financial institutions in loan aggregation and issuance. Some smaller and mid-sized lenders like the simplicity of the existing GSE "bundled" model - with "cash window" whole loan aggregation services included. The Chairman's outline retains that option, making it available to lenders of all sizes. However, by allowing the option to separate credit risk management from the other functions, the outline realizes the benefit of dispersing these activities more broadly, attracting additional private capital and stimulating the flow of that capital across various market participants. In other words, *more rather than fewer credit risk guarantors, and more rather than fewer aggregators and issuers, amplifies liquidity and expands the universe of private risk-holders that perform critical risk management functions and moderate risk across the system.*

A second benefit of the hybrid model is that it simplifies the transition from the existing GSE-centric framework to one with multiple private stakeholders engaged in specific market activities. In the hybrid model, companies seeking to become guarantors would not need to invest in the substantial infrastructure required to become "bundled" guarantors, which would require personnel, technology, and policies and procedures to accept delivery of whole loans; fund, hold, and issue these loans into securities; and master service the loans to track payments and monitor loan performance. Fannie Mae and Freddie Mac perform all of these functions. For new entrants to execute all these functions would require more capital and a much longer transition period.

The Chairman’s framework facilitates the transition by permitting guarantors to engage in the full range of functions or only provide the guarantee service. For example, private mortgage insurers already provide credit guarantees by pricing and managing mortgage credit risk and thus would face low barriers to entry in the guarantee function. Other credit risk managers similarly could find an opportunity to compete in this space, thereby distributing risk and creating more channels for private capital to enter and compete. There are several benefits of such competition, including less concentration of mortgage credit risk, lower costs to home buyers, and greatly diminished risk of future foreclosure crises and taxpayer-financed bailouts.

HPC members also support the Chairman’s proposal to rely on Ginnie Mae as the vehicle to place a federal guarantee on the securities. The Ginnie Mae guarantee is recognized worldwide. Ginnie Mae MBS are treated as a permissible and preferred investment option by foreign investors, including foreign central banks and sovereign wealth funds. These overseas investors represent a stable, substantial, and reliable component of the demand for Ginnie Mae MBS, which supports the continuous flow of global capital into the US housing market. Therefore, the Ginnie Mae wrap on these securities offers an efficient strategy to effect a systemwide conversion.

HPC is in favor of the Ginnie Mae wrap but recognizes that resources will be needed to expand and enhance Ginnie’s infrastructure, regardless of how much can be drawn from the existing GSE and Ginnie Mae operations to create new, possibly combined technology systems. For example, although the Common Securitization Platform (CSP) represents state-of-the-art technology and could be migrated to Ginnie Mae, it needs upgrades to enable additional issuers (beyond Fannie Mae and Freddie Mac) to connect and conduct business on the platform. The CSP also needs expanded functionality beyond the limited set of bond administration and disclosure features available today. In contrast, Ginnie Mae’s platform already is set up to handle multiple issuers and additional securitization tasks, but today cannot support a fully digital securitization environment.

In addition to the technology upgrades required, Ginnie Mae will need more personnel, which have been requested for years by Ginnie Mae’s leadership, to fulfill the larger role for Ginnie Mae. That said, the core functions of Ginnie Mae are scalable, as evidenced by the significant growth in Ginnie Mae’s business over the last decade. This clearly indicates that Ginnie Mae can take on more responsibility, provided it is given the necessary resources to do so.

In summary, the Chairman’s framework, with enhanced guarantor options, credit risk transfers, and Ginnie Mae multi-issuer securities, would give lenders, both large and small, choices. A lender could rely on the aggregation and issuance services of a “bundled” guarantor, just as they do today with the GSE cash windows. Alternatively, a lender could choose to issue securities using their own loans, after obtaining the guarantee from a “bundled" or “stand-alone” guarantor by simply delivering those loans into the multi-issuer Ginnie Mae security. Still a third option would be for lenders to sell their loans to another issuer, whether that be another lender or an entity such as a Federal Home Loan Bank. Such options give lenders, big and small, the ability to retain or sell the servicing on their loans.

Again, HPC believes that it is *the array of options and opportunities presented by the Chairman's framework that provide for stronger, more distributed risk management and liquidity across the marketplace. Improved competition also should lower mortgage rates for consumers and maintain the ability of lenders of all sizes and charters to serve their mortgage customers.*

Identified Issues for Stakeholder Input

The Chairman's outline includes a few topics that need additional input. These topics are: market share limitations for all guarantors; capital standards for the guarantors; and down payment requirements for eligible loans. In each case, HPC recommends that Congress authorize the regulator, FHFA, to establish appropriate requirements and standards.

A market share cap is intended to prevent significant concentration of risk in any guarantor. This is an appropriate goal, especially given the systemic risk posed by the GSE duopoly. However, rather than an arbitrary and fixed market cap, we recommend that the Committee consider market-based incentives to drive the distribution of risk and volume of business across guarantors. For example, the guarantee fee paid by guarantors could be scaled to increase along with the market share of a guarantor. This would place some risk-based check on the size of guarantors. Similarly, the affordable housing fee could be scaled to increase along with the market share of a guarantor. This would produce a pricing differential that would account for the systemic risk inherent in excessive risk concentration in a single guarantor, thereby reducing the likelihood of that outcome.

As for the capital standard for guarantors, we believe that Congress should follow the approach taken in federal banking statutes and give general direction to FHFA, but not fix specific capital charges. The correct amount of capital will vary based upon the business structures and eligible activities of the guarantors as well as the relative systemic risks posed. For example, a "bundled" guarantor that is aggregating and issuing securities in addition to providing the guarantee will need adequate capital and liquidity to perform the first two functions, as well as capital to cover the risk of credit loss. In contrast, a "stand-alone" guarantor will need enough capital simply to cover the credit risk associated with its guarantee business, based on the volume, composition, and profile of loans guaranteed.

In either scenario, the guarantor will be able to lay off some portion of the risk through a variety of risk-sharing arrangements that take into account specific attributes of the structures and counterparties involved, which also must be factored into the applicable capital standards and related capital relief. In other words, it would be inappropriate to create, by law, a single capital standard for all guarantors. HPC recommends that the Committee direct FHFA, as the regulator of guarantors, to establish an activities-based standard that creates a level of comparability and consistency in the capital treatment across the distinct and unique guarantor business models. Congress also could require that such standards address systemic risk and be counter-cyclical.

Moreover, there is another element of capital regulation that we urge the Committee to include in housing finance reform legislation. The capital standards that FHFA develops should not be divorced from the capital standards applied to banks or mortgage insurance companies. A critical weakness of the pre-crisis capital standards set for Fannie Mae and Freddie Mac was the materially lower capital requirements imposed on the GSEs relative to the capital bank regulators required for the same risk on the same loans. We recommend that Congress direct that the various prudential regulators achieve some reasonable standard of comparability in their capital regulations for mortgage credit risk. Consistent capital standards will enable all lenders to make rational decisions on whether to hold mortgages on their books, to sell and securitize them, or to layoff some or substantially all of the associated credit risk through various other credit risk transfer mechanisms.

Finally, the outline leaves open the appropriate down payment requirement for mortgage loans. Again, we believe that this is a standard that should be left to the FHFA in order to allow for appropriate variation by loan product, borrower profile, or other relevant risk characteristic. Leaving this policy standard to the regulator also would allow for future adjustments in response to changing market conditions or performance trends. Avoiding statutory limits also allows for future innovations that may make low down payments less risky, and more appropriate to help serve all borrowers, than we can envision today.

HPC Recommends Additional Specificity and Clarity in Regulatory Roles

There are two key areas of the Chairman's outline where we believe additional consideration is required: (1) FHFA's role in chartering, regulating, and supervising the guarantors; and (2) Ginnie Mae's responsibility for setting the terms of the securities agreements.

FHFA's regulatory responsibilities, as described in the outline, are focused primarily on setting the financial strength requirements for the guarantors, establishing standards for credit risk transfer structures, and the credit standards for the loans. We agree with these responsibilities but recommend that the framework add an explicit authority for FHFA oversight of the guarantors' operational risk. This is important, given the dissimilarities in the business models and activities of the distinct types of guarantors, with unique risks posed by those performing multiple functions in-house versus those who rely on legal agreements with independent vendors and counterparties.

For example, a regulator overseeing a "bundled" multifunction guarantor needs to ensure a separation of duties that will permit risk management to drive loan delivery and guarantee decisions. The GSE model broke down in the years immediately preceding the crisis when executives responsible for loan production and business volume overruled the warnings raised by the credit risk teams. Additionally, when regulating "stand-alone" guarantors, FHFA must set clear expectations for the guarantors to establish strong and well-balanced commercial counterparty standards and agreements that take into consideration the financial and operational capacity of issuer/master servicers as well as the division of accountability and liability between the guarantors and these counterparties.

This highlights the responsibility of FHFA in leveling the playing field and in having robust, transparent standards applied comparably for the same activity. Guarantors will not be equal in strength or diversity of their capital base and institutional form. A system that recognizes and accounts for those differences, while maintaining a level playing field, is to the benefit of the overall housing finance system.

All guarantors should compete on a level playing field and be held to the same transparent standards, ensuring the ongoing safety and soundness of the system and mitigating the risk of regulatory arbitrage based on inconsistently applied standards. For example, today FHFA holds private mortgage insurers to a transparent set of minimum operational and financial standards through the Private Mortgage Insurer Eligibility Requirements (PMIERs). While PMIERs may not be completely transferable to other forms of credit enhancement, the framework can serve as a starting point to ensure a common set of standards for all credit enhancement vehicles.

In sum, the FHFA regulatory standards and oversight regime for each distinct type of guarantor must be clear and consistent. This will ensure that prudential regulation results in fair and comparable regulatory treatment as well as the protection of the system's safety and soundness.

With respect to Ginnie Mae, HPC believes that housing finance reform legislation should explicitly list the core provisions and stipulations of the securities agreement that sets forth the rights and responsibilities of each party. More specifically, for Ginnie Mae's protection, housing finance legislation should authorize Ginnie Mae to set the terms of the securities, including, but not limited to:

- rules for submission and/or sharing of data and/or documents to validate loan attributes, pool composition, or the profile of a counterparty;
- rules for the custodial maintenance or recordation of any mandatory asset- or pool-level data or information;
- responsibility for protecting security performance from lenders that churn loans or otherwise produce abnormal prepayment speeds;
- standards regarding the format and content of investor disclosures;
- requirements and performance measures for bond administration functions, to ensure timely remittance of payments;
- standards for loan servicing, to include acceptable loss mitigation procedures that replicate the existing Fannie Mae and Freddie Mac servicing standards; and
- permissible remedial or enforcement actions that may be pursued, as warranted.

Such standards are typical in existing Ginnie Mae and GSE agreements, as well as private-label pooling and servicing agreements. The Committee should stipulate that Ginnie Mae is responsible for developing a new set of standardized terms and requirements that reflect the very best of these various contract documents.

Seamless Transition – Practical Steps for the Conservator

A commonly cited rationale for retaining the status quo housing finance system, however flawed, is that housing finance reform legislation may disrupt an otherwise functioning housing market. Yet, there are simple actions that the Conservator can, and should pursue, that would set the stage for an expedient and smooth transition from the current system. In other words, the Conservator can initiate actions that would pave the path to legislative reform. The primary goal of such actions is to build the foundation for new entrants to compete with the GSEs.

The transition from the current housing finance system requires the development of a level playing field that allows private companies the opportunity to compete with Fannie Mae and Freddie Mac. There are at least two areas where the GSEs enjoy an overwhelming competitive advantage that should be addressed: (1) current mortgage-related regulations, some of which are not within the sole purview of the FHFA; and (2) the GSE's infrastructure in the form of data, models, and tools.

Over the last few decades, GSE control and influence has grown substantially, in part due to the special privileges and exemptions afforded to the GSEs, including lower capital costs, appraisal exceptions under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), and the Qualified Mortgage (QM) patch, contained in the Ability to Repay / QM regulation. These and other privileges have provided the resources and insulation from competition that has allowed the GSEs to expand their operations and adopt innovative approaches that other private companies cannot pursue under the current regulatory regime.

The return of the private label securitization market has been stymied, in part, by this imbalance. Investors are prepared to support private market activity, but the differential regulatory treatment of GSE mortgages creates a vast disparity in operational efficiency, costs, and legal liability. Addressing some of these disparities will require the cooperation of various federal regulators.

Separately, the Conservator can take actions to disseminate some components of the GSE infrastructure in a manner that leaves the infrastructure intact for the existing GSEs yet shares elements with new entrant competitors. For example, the GSEs have amassed millions of residential property appraisals, records that capture information on both the subject property and several comparable properties. Similarly, the GSEs, representing approximately one-half of the 10 trillion-dollar mortgage market, have millions of loan records, composed of indispensable transaction and performance data. Some portion of this data was released to support investor participation in the Credit Risk Transfer (CRT) initiative, but a significant segment of this critical information has not been published. This data should be shared with other market participants.

Possession of this expansive set of data provides the GSEs with a significant competitive market advantage. It permits the two companies to monitor, evaluate, analyze, and model risk in ways that are potentially more accurate, reliable, and predictive. Other private companies have the capabilities to develop competing technology and risk management tools. However, the GSE data monopoly ensures that the GSEs are always better informed of patterns and trends than any potential competitors.

To foster a truly competitive and transparent marketplace that will afford private companies the opportunity to evaluate becoming guarantors, HPC recommends that the Conservator publicly release, or "democratize," the GSE data. In addition to new guarantors, other stakeholders and market participants could benefit from the publication of this data. Broad market access to this data would permit wide-ranging evaluation and understanding of risk from industry, government, academia, advocacy organizations, and think tanks.

The Conservator could also consider other components of the extensive GSE infrastructure, including technology tools that were built to manage, parse, and derive conclusions from the GSEs' massive data sets, as well as the risk models that are embedded in these tools and the various business systems of the GSEs. Most of these tools have been built while the companies have been in conservatorship, meaning they have been built using taxpayer funds. For example, HPC has requested release of the models used in the GSE capital framework. We continue to believe public release of this information would be beneficial for private market risk analysis. The distribution of this type of foundational information would facilitate enhancements in the risk management capabilities of the entire marketplace, a benefit to the overall health and soundness of the system.

Affordable Housing – New Approaches to Achieve Better Results

The various housing finance reform proposals put forward over the last several years have all included a mechanism to generate funds to stimulate the production and preservation of affordable rental housing and to bolster targeted homeownership assistance programs. HPC supports this approach. Our members recognize that appropriations for housing programs are not keeping pace with housing need in this country. Therefore, given the benefits derived from the government guarantee envisioned in housing finance reform, it is reasonable for legislation to establish an obligatory contribution of dollars through transaction fees to expand the supply of desperately-needed affordable housing.

HPC also supports funding for specialized homeownership programs. However, it is the preference of HPC members to direct new funds for homeownership assistance to programs that contribute directly to the households in need, reducing the barriers to entry and financial challenges that these individuals and families face. HPC would prefer that new funds not be used to simply subsidize higher-risk loans or to compensate the industry to make loans that may not perform using more lenient underwriting criteria.

We believe that funds used to address the areas of risk that drive the increased pricing, rather than subsidizing that pricing, would better serve the households in need. Examples of these types of programs are down payment assistance grants that enable households to enter homeownership with some amount of equity in the property; savings programs that offer matching funds to increase the down payment amount or, equally importantly, that create "rainy-day" reserves to address future needs; and dedicated accounts that could be tapped by homeowners in financial distress, to avoid missed payments and / or foreclosure. The application of dollars to these types of programs, as well as critical homeownership counseling and education services, would help families prepare for and sustain homeownership, improve access, address the real barriers, and create a true financial benefit and performance boost for low- and moderate-income (LMI) households.

Along these same lines, HPC recognizes that there may be interest by some in preserving the GSE Affordable Housing Goals and Duty-to-Serve activities. The intent of these programs is to ensure the secondary mortgage market makes credit available for more low- and moderate-income households, and targeted market segments (affordable housing preservation, rural markets, and manufactured housing) than the private sector may serve on its own without government support. However, HPC believes that it is worthwhile to assess and revisit the impact and outcomes of these programs and consider alternatives that better achieve the intended objectives. Rather than repeat the use of methods that have had, at best, mixed results, we should seek new types of measurable targets and financing goals to ensure that traditionally underserved segments are targeted for guarantor support. For example, there may be high-impact ways to use additional funding, modeled on the Federal Home Loan Bank System's Affordable Housing Program, which has effectively served communities nationwide for decades now.

Comprehensive Housing Finance Reform Should Include FHA and PLS Segments of Market

The recommendations from HPC in this testimony have been focused almost exclusively on the conventional conforming segment of the marketplace (backed by Fannie Mae and Freddie Mac today and by guarantors/Ginnie Mae in the Chairman's outline). However, HPC members believe that true and comprehensive reform should also take into consideration the government-backed (e.g., FHA and VA) and private label securities (PLS) components of the market. We believe that legislative reform and the marketplace will benefit from a secondary market framework that supports the full continuum of mortgage products and the full range of consumer needs and circumstances.

Therefore, we advocate for comprehensive reform that includes the Federal Housing Administration (FHA), as the primary government lending vehicle, *as well as* PLS-related provisions, to establish market standards, infrastructure, and/or practices to buttress the wholly private PLS segment of the market. We believe that it is critical to include these other important components of the mortgage market in developing a complete legislative proposal.

Historically, FHA has operated the flagship program for serving first-time, low-and moderate-income (LMI), and minority homebuyers in this country. The FHA offerings need to be appropriately calibrated and aligned with conventional products to provide well-priced, safe, and sustainable financing options to those borrowers who cannot access conventional financing. Consumers who rely on these products must do so with appreciation for lower-cost alternatives offered in the conventional market and a full understanding of the steps they might take to move from FHA to conventional products. In other words, FHA must complement and supplement the conventional market, yet always be available to fulfill the countercyclical role the government plays as a reliable backstop if and when the private market contracts, as it did during the recent recession.

Because FHA augments and complements the conventional market to ensure a broader, deeper mortgage market than the private market may achieve on its own, it is critically important for housing finance reform legislation to better align FHA's core underwriting, eligibility, and servicing standards, as well as the capital requirements that drive pricing, with those of the conventional market. Further, it is no secret that resource constraints at FHA have hampered the agency's capacity to fulfill its mission and perform its risk management role as the largest mortgage insurance company in America. HPC advocates for legislative reform that expands and enhances FHA's capabilities to manage its important duties and serve homebuyers.

HPC believes that the PLS segment of the marketplace should be addressed in the housing finance reform dialogue as well. This portion of the market could benefit from uniform standards and practices, an approach that has facilitated the growth of the conventional conforming segment of the market. Examples of the types of standards and practices that could be addressed in legislation include: loan-level data standards for borrower, property, and product characteristics; disclosure rules, for both the content and format of securities disclosures; due diligence practices; servicing and loss mitigation requirements; representation and warranty / counterparty liability agreements; and more. There has been some discussion regarding migrating or sharing of some of the infrastructure that is used in the conventional conforming market with the PLS market to achieve such standardization and we would encourage the Committee to facilitate this conversation to consider how housing finance reform can and should bolster the PLS market.

Conclusion

Thank you for the opportunity to testify today on this critically important topic. HPC appreciates that the Chairman and the full Committee intend to pursue legislative housing finance reform and we are prepared to work with you. We think that the Chairman's outline reflects a workable set of ideas, many of which have been circulated in previous proposals, and we applaud you, Chairman Crapo for reinvigorating this critical policy discussion.