

July 21, 2010

Office of the Undersecretary for
Domestic Finance
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Office of the Assistant Secretary for Policy
Development and Research
Department of Health & Urban Development
451 7th Street SW
Washington, DC 20410

Re: Public Input on Reform of the Housing Finance System
EDocket Number: Treas-DO-2010-0001; HUD-2010-0092

To Whom It May Concern:

The American Bankers Association (ABA) is pleased to offer the following comments in response to the Obama Administration's questions seeking input on reform of the American housing finance system.

INTRODUCTION

Housing is one of the core policy priorities of any government. A federal role in support of the primary mortgage market for housing finance has long had ABA support. This support is unwavering, even as it is apparent that the nature of the housing finance system will change, and with it, the role of the federal government in supporting housing finance. Even with these changes, banks of all sizes will continue to meet the housing finance needs of their customers and will continue to provide assistance to communities for economic development and affordable housing.

The scope of the questions presented is broad. Housing finance policy encompasses a broad range of issues, including policies to promote stable and strong markets for mortgage finance and the wealth building that has come with homeownership. Our comments focus primarily on only a segment of this policy debate – the roles played by government sponsored enterprises (GSEs) and the private sector in developing and maintaining a secondary market, and the proper interaction of the secondary market with the primary mortgage market. Other policy areas, including those for development of affordable rental housing and to help develop homeownership skills, are all important components of a national housing policy. We are directing our comments primarily to the interaction of the secondary market GSEs and the private market because this is the area of our members' greatest concern. The ABA has devoted considerable time and effort in developing the following principles to guide the discussion of the future of housing finance as it relates to the interaction between the primary and secondary markets. In our discussion of the questions posed by the Administration, we will refer to these principles as they relate to each question, and also set them out in their entirety here.

- 1. The primary goal of any government-sponsored enterprise in the area of mortgage finance should be to provide stability and liquidity to facilitate the ability of the primary mortgage market to provide credit for borrowers who have the credit and skill sets required to maintain homeownership.*

2. *In return for the GSE status and any benefits conveyed by that status, these entities must agree to maintain their mission in all economic environments.*
3. *Strong regulation, examination and authority for prompt corrective action of any future GSE must be a key element of reform. Regulation also must include review and control for systemic risk.*
4. *Any GSE involved in the mortgage markets must be strictly confined to a well-defined and regulated secondary market role and should not be allowed to compete with the private, primary market.*
5. *Any reform of the secondary mortgage market must recognize the vital role played by the Federal Home Loan Banks and must in no way harm the traditional advance businesses of FHLBanks or access to advances by their members, particularly for community banks which play a vital role in providing mortgage finance and economic development.*
6. *GSEs must be allowed to pursue reasonable risks and rewards, but the risk/reward equation must be transparent and more rigorously defined and regulated.*
7. *GSEs must operate within a framework of market procedures and regulation governing the securitization of all mortgage assets.*
8. *Strong minimum regulatory standards are necessary to ensure sound underwriting for all mortgages. Insured depositories already comply with strong underwriting standards and are subject to vigorous examination. Comparable standards should be established for all loan originators with comparable levels of effective regulatory oversight.*
9. *True sales treatment and regulatory capital charges should appropriately reflect the reality of true risk-shifting activities, as well as balance sheet exposures. Accounting and regulatory changes should reflect and align the risks of mortgage securities and their underlying assets.*
10. *Affordable housing goals or efforts undertaken to broaden housing affordability are more suited to other programs and entities than the GSEs – whose principal focus should be on providing stability and liquidity to the primary market. Any affordable housing goals required of the GSEs should be in furtherance of their primary goals of promoting primary market stability and liquidity and should be delivered through and driven by the primary market, and should be structured in the form of affordable housing funds available to provide subsidies for affordable projects.*
11. *GSEs must provide for fair and equitable access to all primary market lenders selling into the secondary market through the GSEs.*

The above principles have been developed through extensive deliberations by the ABA's GSE Policy Committee and adopted by ABA's Government Relations Council, which is comprised of member banks from a wide range of financial institutions in both size and market share. These principles are broadly representative of the interests of the banking industry in the area of housing finance.

DISCUSSION

Before turning to the specific questions posed by the Administration, we would note two other factors which will play a key role in determining the future of housing finance. The first is the reshaping of the primary mortgage market through regulation and legislation. Since the beginning of the current economic crisis, significant new regulations, including changes under current authorities of the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Home Owners Equity Protection Act, have been proposed or implemented. Additionally, new requirements like the Home Valuation Code of Conduct have been implemented. Many more new regulatory changes will result from statutory changes in the Dodd-Frank Act.

All of these regulatory and legislative changes will have a dramatic impact on reshaping the primary mortgage market. The range of mortgage products has dramatically shrunk and likely will continue to do so. Borrower eligibility has decreased, and likely will continue to do so, as new documentation, debt to income and risk retention requirements take effect. The result will be less credit availability and higher costs for the credit that is available. These changes will impact the shape of the housing finance system, and the type of federal support needed for that system. They will likely lead to increased demand for affordable rental housing, and a growing need for federal support for its development.

The second factor which will determine the future of housing finance is the cost associated with the resolution of financial status of Fannie Mae and Freddie Mac. Currently, federal support for Fannie Mae and Freddie Mac is virtually unlimited. In the short term such support was necessary to help to stabilize the housing finance system and prevent further economic erosion, but such support is not sustainable over the long term.

We now turn to the specific questions posed by the Administration.

1. HOW SHOULD FEDERAL HOUSING FINANCE OBJECTIVES BE PRIORITIZED IN THE CONTEXT OF THE BROADER OBJECTIVES OF HOUSING POLICY?

As referenced earlier, housing is a basic human need, and the federal government should determine policies that promote developing safe, affordable and desirable housing. Beginning with that broad objective, we believe that it may be necessary to reorder the priorities of the federal government, and particularly those of the government sponsored enterprises. The GSEs' role in the recent past has been to foster stability, liquidity and affordability of housing finance with an overall goal of increasing homeownership. The fostering of affordability has become even more a focus of the GSEs since their conservatorship in an effort to promote and sustain recovery of the residential real estate market. We believe the current form of promoting affordability is not sustainable over the long term.

Therefore, it is our view that the broad priorities of the federal government – promoting stability and affordability while ensuring liquidity to the markets – should not change, but that the role of the GSEs in providing those goals must change. In particular, ABA believes that the primary role of the GSEs should be to promote stability and liquidity, but that affordability must be a secondary goal of the GSEs and should also be achieved through other governmental programs and policies. Affordability is in many ways an outgrowth of stability and liquidity. A stable,

liquid market makes it easier and more affordable to own a home. This view is reflected in our first principle:

The primary goal of any government-sponsored enterprise in the area of mortgage finance should be to provide stability and liquidity to the primary mortgage market in order to provide credit for borrowers who have the credit and skill sets required to maintain homeownership.

Increasing affordability in other ways, including borrower education and assistance, should not be a primary focus of the GSEs, but should be addressed through other means and entities. The GSEs' role is not one of subsidizing purchases, but of facilitating market function. Other federal entities, in particular the Federal Housing Administration, already have affordability as one of their goals. The FHA provides a vehicle for assisting first-time homebuyers with limited credit to buy a home. The GSEs' focus should be on ensuring stability and liquidity for borrowers whose credit is more firmly established. Additionally, there should be a more general focus on federal programs promoting the development and sustainability of rental housing as a means to encourage affordable housing. Both HUD and Rural Housing Service programs with this goal already exist and should be reviewed and possibly expanded.

As a secondary goal of the GSEs, affordability can be promoted through support for primary market generated and focused efforts. Our 10th principle states:

Affordable housing goals or efforts undertaken to broaden housing affordability are more suited to other programs and entities than the GSEs – whose principle focus should be on providing stability and liquidity to the primary market. Any affordable housing goals required of the GSEs should be in furtherance of their primary goals of promoting primary market stability and liquidity and should be delivered through and driven by the primary market, and should be structured in the form of affordable housing funds available to provide subsidies for affordable projects.

We note that the Federal Home Loan Bank System Affordable Housing Program has successfully operated for 20 years on such a model. Ensuring a role for the primary market in fostering and directing the development of affordable housing helps to maintain market discipline to ensure long-term viability of the projects supported.

Additionally, we believe that federal housing finance programs and activities should foster competitive primary, secondary and capital markets for the provision of capital to the housing sector. As such, programs and regulations should be aimed at better aligning the longer-term interests of market participants, including borrowers, lenders, servicers and investors. America's entire banking system should be encouraged to increase its share of the housing finance market for the following reasons:

- a. Banks and thrifts have higher capital levels than other market participants.
- b. Banks and thrifts have access to stable deposit funding and liquidity provided through Federal Home Loan Bank advances.
- c. Banks and thrifts know their lending markets and customers better than any other market participant and thus often are better able to underwrite loans.
- d. Banks and thrifts have the operational capacity to serve the primary and secondary mortgage markets.

- e. Banks and thrifts are subject to more stringent regulation and examination than other market participants.
2. WHAT ROLE SHOULD THE FEDERAL GOVERNMENT PLAY IN SUPPORTING A STABLE, WELL-FUNCTIONING HOUSING FINANCE SYSTEM AND WHAT RISKS, IF ANY, SHOULD THE FEDERAL GOVERNMENT BEAR IN MEETING ITS HOUSING FINANCE OBJECTIVES?

We have already opined above that the federal government should play a role in the promotion of stability and liquidity, but that affordability, and particularly affordable housing, should be the focus primarily of programs beyond the GSEs. The risks borne by the federal government should be allocated selectively among these programs and the GSEs. With regard to the promotion of affordability, it is likely that the federal government may consider taking on more direct risk than in the promotion of stability and liquidity. In fulfilling the primary goals of stability and liquidity through the GSEs, the federal risk should be limited and should be offset by fees associated with the benefits provided by federal sponsorship. Our view is that the most likely federal support for stability and liquidity will come in the form of a government guarantee which will be provided to the primary market for a fee – although other approaches may also be worth considering. Regardless of how the federal support is delivered or paid for, we believe the following guiding principles 2, 3 and 6 must be met:

In return for the GSE status and any benefits conveyed by that status, these entities must agree to maintain their mission in all economic environments.

Any GSE involved in the mortgage markets must be strictly confined to a well defined and regulated secondary market role and should not be allowed to compete with the private, primary market.

GSEs must be allowed to pursue reasonable risks, but the risk/reward equation must be transparent and more rigorously defined and regulated.

Governmental support must be consistently available regardless of economic conditions, and should assist and facilitate but not infringe upon the primary market. Government should foster reasonable risks to promote growth and competition, but constrain undue risk-taking through regulation and enforcement. Rewards achieved through risk taking should be directed to encourage further investment in the stability, liquidity, and affordability of housing finance. Much in the way that the Federal Home Loan Banks operate, reasonable risks may be undertaken with the returns directed toward promoting the missions of the member/owners of that system, including dividends which support community lending and affordable housing funds which foster member sponsored undertakings.

3. SHOULD THE GOVERNMENT APPROACH DIFFER ACROSS DIFFERENT SEGMENTS OF THE MARKET, AND IF SO, HOW?

We have largely addressed this question in our previous comments, but would reiterate here that the different goals of the government will apply differently to each segment of the market. Assisting affordability will be far more important to the lower end of the market, while

supporting stability and liquidity is important for all segments. This is in large part why we believe the different goals should be carried out by different government programs and entities. Agencies devoted to first time homebuyer assistance and to increasing rental availability and affordability should be separate from the GSEs whose focus should be on market stability and liquidity.

4. HOW SHOULD THE CURRENT ORGANIZATION OF THE HOUSING FINANCE SYSTEM BE IMPROVED?

Beyond the division of the goals as described above, ABA believes that improvements can be made to the organization of the housing finance system, but we do not have specific recommendations for a new structure at this time. Nevertheless, the existing resources of Fannie Mae and Freddie Mac should be preserved and utilized to the extent possible. Whether policymakers settle on a more narrow restructuring of the existing GSEs or a broader scale change, both Fannie Mae and Freddie Mac have valuable assets in terms of systems, processes, staff and other resources which should be maintained and utilized to maximize efficiency and utility. The costs of resolving the GSE conservatorships may be high, and any existing assets should be preserved to prevent losses from becoming even higher, and to avoid unnecessary and unwarranted market disruptions.

Going forward it will also be necessary to strengthen and improve regulation and oversight of the GSEs or their successors. The regulatory framework put in place under the Housing and Economic Recovery Act (HERA) is a sound one which paved the way for the necessary conservatorship of Fannie Mae and Freddie Mac shortly after its enactment. This framework should be the starting point for future regulation and enforcement, but ultimately the structure of the housing finance system and of the GSEs themselves will dictate what additional changes and enhancements must be made.

The ABA has set forth principle 7 on regulatory framework:

GSEs must operate within a framework of market procedures and regulations governing the securitization of all mortgage assets.

We envision the role of the secondary market GSEs to be that of providing some form of government guarantee for securities at a reasonable price. All securitizations, whether they receive a government guarantee or not, should be subject to similar regulatory and market requirements. The assets going into the securities may be originated under varying rules (i.e. more stringent requirements for higher cost loans), but the rules for securitizations should maintain transparency necessary to stable market processes and informed decision-making by investors. Regulatory policy should anticipate and encourage the re-emergence of portions of the mortgage market not dependent on government guarantees.

Regulation of the mortgage markets is not confined only to the primary and secondary market regulators. Accounting standards also play a significant role in the housing finance system. ABA has developed this principle with regard to accounting treatment of housing finance activities: *True sales treatment and regulatory capital charges should appropriately reflect the reality of true risk-shifting activities, as well as balance sheet exposures. Accounting and regulatory*

changes should reflect and align the underlying risks of mortgage securities and their underlying assets.

Finally, we strongly believe that the Federal Home Loan Banks, which are performing as designed and meeting their mission goals, should not be harmed by any restructuring of the housing finance system. This is reflected in principle 5, which states:

Any reform of the secondary mortgage market must consider the vital role played by the Federal Home Loan Banks and must in no way harm the traditional advance businesses of FHLBanks or access to advances by their members, particularly for community banks which play a vital role in providing mortgage finance and economic development.

There may well be an expanded role for the FHLBanks to play in the housing finance system, but if an expanded role is considered, it must not come at the expense of the traditional, functional and necessary advance business of the FHLBanks. The Federal Home Loan Banks are a vital source of liquidity for banks of all sizes, as was clearly demonstrated during the financial crises of 2008 and 2009.

As we reconsider our nation's housing finance needs and providers, we must never lose sight of the fact that community banks have long provided high quality credit and financial services which must remain at the core of the finance system. The Federal Home Loan Banks' role in providing liquidity to community banks must not be harmed or diminished.

5. HOW SHOULD THE HOUSING FINANCE SYSTEM SUPPORT SOUND MARKET PRACTICES?

ABAs believe that sound market practices are necessarily established through sound underwriting by originators as reflected in principle 8:

Strong minimum regulatory standards are necessary to ensure sound underwriting for all mortgages. Insured depositories already comply with strong underwriting standards and are subject to vigorous examination. Comparable standards should be established for all loan originators with comparable levels of effective regulatory oversight.

Significant regulatory changes already have been imposed on originators, resulting in dramatic changes to the products and amount of credit available. Further changes on the horizon, including risk retention requirements for securitizers (and potentially originators), will further alter the landscape for market practices. ABA firmly believes that the first line of defense – strong underwriting by the primary market – remains the best defense. The housing finance system should recognize this fact and require such practices of all mortgage originators, not just banks and thrifts. Restrictions should be considered on the ability of mortgage brokers to originate and sell to the secondary market with little direct supervision. Conversely, traditional banks, which are backed by significant capital and which are supervised to adhere to stringent underwriting rules being imposed by their primary regulators, should not face additional regulatory burdens from the secondary market. Both regulation and supervision must be appropriate and uniform, while taking into account the type of loan being sold and the type of originator making the loan.

6. WHAT IS THE BEST WAY FOR THE HOUSING FINANCE SYSTEM TO HELP ENSURE CONSUMERS ARE PROTECTED FROM UNFAIR, ABUSIVE OR DECEPTIVE PRACTICES?

ABA's view here is similar to that stated in answer to question 5. Consumer protections are best achieved through strong regulation and enforcement in the primary market. Currently, the prudential regulators – and likely the new Consumer Financial Protection Bureau in the future – require primary lenders to adhere to consumer protections. These protections can be enhanced by ensuring that all originators face the same regulation and enforcement that banks currently face. Past abuses have largely come from less well-regulated and less enforced segments of the market. Ensuring quality enforcement of regulations for all originators is the key to preventing abuses.

7. DO HOUSING FINANCE SYSTEMS IN OTHER COUNTRIES OFFER INSIGHTS THAT CAN HELP INFORM U.S. REFORM CHOICES?

The United States' housing finance system is unique in many ways. Few if any other nation's residents can access 30-year fixed rate loans, and fewer still benefit from a homebuyer's tax credit. While other systems may offer insights for reform, a threshold question which policymakers must answer first is how much of the established, traditional American housing finance process they are willing to forgo or alter. Shorter term, adjustable rate loans, as are standard in the Canadian system, offer affordability for borrowers there, but with less stability than provided by the 30-year fixed product. The lack of a housing tax credit in many countries is offset by other services provided (in return for higher taxes). These are certainly options which policymakers may want to consider, but it is ultimately up to them and the American voter to determine which features are realistic and desirable.

CONCLUSION

Again, we appreciate this opportunity to provide our views on this important segment of the overall discussion of the future of American housing finance. The tasks ahead are large but achievable and we look forward to working with you to preserve what works in our system and making the necessary improvements.

Sincerely,



