American Bankers Association
Building Success. Together.

James Ballentine

Executive Vice President
Congressional Relations
and Political Affairs
202-663-5359
jballent@aba.com

April 17, 2014

TO: Members of the Senate Banking Committee

FROM: James Ballentine, Executive Vice President, Congressional Relations and Public Policy

RE: Discussion Draft of Johnson/Crapo Housing Finance Reform and Taxpayer Protection Act of 2014

I am writing on behalf of the members of the American Bankers Association to share our views regarding the discussion draft of the Housing Finance Reform and Taxpayer Protection Act of 2014 proposed by Chairman Tim Johnson (D-SD) and Ranking Member Mike Crapo (R-ID) scheduled to be considered by the full Senate Banking Committee on April 29th.

The Johnson/Crapo draft represents a significant step forward in resolving the conservatorship of Fannie Mae and Freddie Mac and in charting a new and sustainable course for the American housing finance system. We commend the Chairman and Ranking Member for their efforts in crafting this bill and furthering this process.

ABA is supportive of the overall framework laid out in the discussion draft, and we note that it includes many elements that ABA has long advocated as necessary for a sustainable housing finance system. Key among these are an explicit federal guarantee on a limited class of mortgages targeted to low and moderate income borrowers; equitable access for lenders of all sizes in all geographic regions; and a substantial role for the private sector in the provision of mortgage finance going forward.

As with any draft legislation, however, there are areas which raise concerns and we believe we can offer guidance and suggestions for improvement. To that end, we have been working with the committee staff in what we believe has been a constructive dialog and we offer the following comments in the hope of providing assistance in the further development of this important legislation.

Regulatory Authority of the FMIC

The Federal Mortgage Insurance Corporation (FMIC) is tasked with the important role of protecting the guarantee fund and is granted significant regulatory authority. While the draft does take steps to reduce regulatory conflict and redundancy, we believe that more can be done to more tightly focus the FMIC's regulatory, standard setting, and examination authority. We have already shared with Committee staff proposed amendments to build upon the provisions in the discussion draft that encourage consultation with and use of the existing regulatory structure. Our goal is to more precisely focus the authority of the FMIC so that it can protect the insurance fund and the government guaranteed secondary market as intended, without otherwise duplicating, overriding or conflicting with other authorities newly established or reaffirmed by Congress in recent years to protect consumers and markets. Our recommendations are based upon the principles that FMIC regulatory authority should be targeted to the specific risks presented by each of the businesses covered – guarantor, aggregator and servicer. For example, the aggregator function presents significantly less risk to the insurance fund than the guarantor function. Additional regulatory overlap, redundancy, and conflict should be avoided whenever possible. The mortgage functions regulated under the discussion draft (except for the new guarantor function) are already extensively regulated by the state and federal prudential bank regulators (more than one of which is usually involved in regulating mortgage activities of a bank and its affiliates), the CFPB, the Justice Department and the various state AGs and state and local regulators. Where safety and soundness interests between the bank regulators and FMIC are aligned (such as those regarding capital levels), and the entity is regulated by a bank regulator, the bank regulator should be in control, keeping the FMIC informed and receiving FMIC's input. Where FMIC is regulating in some fashion, such as through an examination, a regulated entity that engages in activities beyond mortgage activities, FMIC's scope of regulation should be limited to the mortgage activities or activities that could impact the insurance fund. Our proposed amendments are intended to focus these regulatory activities more tightly and ensure that there are appropriate levels of regulation in all areas.

Guarantor versus Capital Markets Execution

The discussion draft allows both a guarantor channel and a direct capital markets execution channel as forms of credit protection for covered securities. Allowing these options is desirable in that it provides for the maximum flexibility for the new secondary mortgage market to develop. However, we do have concerns that one channel could become dominant and crowd out the other channel, increasing the potential for market instability, and denying consumers and market participants those advantages explicit and implicit to each channel. While the discussion draft does require that the FMIC seek "equivalency" between the guarantor and capital market structures, we suggest that this requirement be enhanced by providing the FMIC with a "traffic cop" role to encourage the flow through each structure, and to manage risks that might be unique to either structure. In doing so, the FMIC would be tasked with ensuring that both channels remain viable in all market conditions. A related enhancement would be to clarify that the smaller member mutual created under the bill is authorized to use either or both the guarantor channel or the direct capital markets channel.

Vertical Integration

The discussion draft currently allows private market participants to play any and all roles in the newly proposed system. They can serve as originators, aggregators, mortgage insurers and guarantors. While we believe that market practicalities may make it virtually impossible for any one player to achieve vertical integration where they served in all (or even most) of these capacities, we also believe that it is prudent to place limits to ensure that no one entity can operate both as a primary market originator and a secondary market guarantor. To that end, we urge the committee to amend the draft to prohibit guarantors from also serving as loan originators. We also urge that flexibility be provided to allow originators to make limited, noncontrolling investments in guarantors. We believe such an approach is prudent to ensure that sufficient capital is available for guarantors to develop.

Affordable Housing

We support the market based incentive approach taken in the discussion draft with regard to the funding of affordable housing initiatives, and also support the elimination of explicit affordable housing goals. We urge the committee to ensure that all affordable housing goals are eliminated, including those imposed on the Federal Home Loan Banks, not just those that were imposed on Fannie Mae and Freddie Mac.

With specific regard to the creation of a Mortgage Access Fee (MAF), we observe that the mechanics of the MAF, as currently drafted, are overly complex, opaque and will result in inefficiency and excess cost for borrowers. Significantly, the current structure also cannot be soundly effectuated by lenders of all sizes, creating significant operational and litigation risks, among other serious challenges.

We believe that the MAF should be an upfront, one-time user fee that endows a Fund to enable Office of Consumer and Market Access (OCMA) – based on the information gathered by FMIC through its regular course of business – to incentivize affordable housing originations through explicit and transparent subsidies and incentives. The fee should be collected one time, at the creation of a covered security (MBS), and should be appropriately sized to avoid any recurring assessment relating to such security. A recurring fee is unrealistic in light of the industry's customary and frequent mortgage and serving sales and transfers. Assessing and collecting recurring fees over the life of a mortgage or MBS, rather than at inception, would be economically distortive, impair current mortgage market economics, and would be particularly unfair to smaller mortgage originators (such as community banks) that may not retain servicing rights or receive post-origination mortgage-related cash flow tied to a particular mortgage or covered security pool to pay a recurring fee assessed for the life of the mortgage or MBS.

Above all, banks must be able to manage pricing to cover all costs of doing business, including any Mortgage Access fee. Product and servicing pricing and availability are determined by consideration of all costs, coupled with the ability to achieve a fair return on equity. It is impractical and impossible to effectuate a prohibition on a business' ability to seek recovery of its costs. Otherwise, it is unclear how revenue to support the MAF will be generated.

Finally, we urge that any additional data collection by the FMIC related to the MAF be deleted**.** Incenting affordable originations is a commercial activity, not a regulatory activity. There is no need for FMIC to collect additional information from lenders and aggregators because FMIC, as regulator of the Guarantors, will have collected all necessary mortgage origination data through its regular course of business to analyze past originations "mix," and to calibrate future needs for subsidies and incentives to meet affordable lending targets defined through its own gap analysis.

Federal Home Loan Bank Regulation

The discussion draft would transfer the regulation of the Federal Home Loan Banks (FHLB) to an Office of Federal Home Loan Bank Supervision within the Federal Mortgage Insurance Corporation. While we appreciate the efforts made to ensure regulation that recognizes the distinct nature and role of the Federal Home Loan Banks, we remain concerned that housing FHLB regulation within the FMIC will lead to a conflict of interest that may be detrimental to the FHLBs and their members. While it is certainly reasonable for the FMIC to regulate the Federal Home Loan Banks activities (and affiliated or subsidiary entities) involved in the new secondary market structure being created (e.g. serving as aggregators or members of the mutual), it is troubling to also have the FMIC regulate, even in a separate office, the traditional advance business of the FHLBs. The advance business is an alternative to secondary market sales and is an important source of liquidity for FHLB member institutions, and we expect it to remain so going forward. To place the regulation of this system under the same authority which provides and protects the guarantee for the new system being developed could lead to detrimental treatment for the advance business. We strongly urge the committee to consider leaving the regulation of the Federal Home Loan Banks with an independent agency or, at the very least, strengthen the separation between the regulatory functions of the Office of Federal Home Loan Bank Supervision and the rest of the FMIC and providing for an annual report to Congress on the regulation of the FHLBs by the FMIC Office of FHLB Supervision.

Fiduciary Duty

In recent days, there has been discussion of adding to the draft a new requirement to impose a fiduciary duty on corporate trustees as a part of their relationship with servicers and investors. This is an ill-advised effort that would fundamentally restructure the role of such trustees in securitization transactions. ABA strongly opposes any effort to impose a fiduciary duty on corporate trustees.

Under current law and regulations, corporate trustees perform only ministerial duties that are expressly set forth in the documents governing the transaction until there is a defined event of default. The very limited scope of such duties is commensurate with the minimal fees paid to corporate trustees. After such an event of default, the corporate trustee is subject to a “prudent person” standard of care.

Importantly, trustees are expected to act in the interest of *all* investors. However, for example, the interests of the AAA tranche investors may diverge significantly from the interests of the equity tranche investors, depending on their rights in the waterfall. Because of this, investors holding a requisite amount of assets in a transaction may direct the trustee to take action so long as the trustee is reasonably indemnified (the indemnification requirement being in direct relationship to the potential risks and costs associated with the action being contemplated and to compensate the trustee for extraordinary actions beyond their contractual duties).

Investors seeking the imposition of a fiduciary duty on corporate trustees are responding to the ambiguity in the governing documents of transactions at issue in the financial crisis, particularly with respect to breach of representations and warranties concerning the underwriting of residential mortgage loans and other servicing considerations and the alleged failure of trustees to respond to investor concerns. There is no question that those documents were woefully inadequate to address the needs of both investors and trustees. However, the SEC has proposed rules that would remedy many of those deficiencies including an asset-level disclosure and an independent party to review breaches of representations and warranties. The SEC should be allowed to finalize those rules before Congress takes action on this issue. If corporate trustees were subject to a fiduciary duty and the attendant level of liability, they would have to demand a significant increase in their fees which would ultimately be borne by investors and homeowners.

Conclusion

The Johnson/Crapo discussion draft is a substantial achievement and a solid vehicle for legislative reform of the government guaranteed secondary market system. It is our hope that our proposed changes are helpful in advancing this important legislation and we stand ready to assist further in addressing these and any other concerns that may arise.