H.R. 2413, The Secondary Market Facility for Residential Mortgages Act of 2011

By Representatives Gary G. Miller and Carolyn McCarthy

Representative Gary G. Miller (CA-42) and Carolyn McCarthy (NY-04) have introduced legislation to establish a Secondary Market Facility for Residential Mortgages (Facility).

Purpose of the Facility

- Provide stability in the secondary market for residential mortgages.
- Respond appropriately to the private capital market.
- Maintain the secondary market for residential mortgages, including the ''TBA'' (to-be-announced) market, and improve the distribution of investment capital available for residential mortgage financing.
- Promote access to mortgage credit throughout the United States (including central cities, rural areas, high cost areas, and underserved areas) to qualified borrowers.
- Manage and liquidate the mortgage portfolios of Fannie Mae and Freddie Mac in an orderly manner, in a way that contributes to the stability of the housing market and with minimum loss and maximum profit to the Federal Government.

Activities of the Facility

Borrowing, giving security, paying interest and other return, and issuing notes, debentures, bonds, and other obligations and securities to fund the purchase of residential mortgages, and to achieve initial capitalization levels.

Purchasing residential mortgages on single-family or multifamily housing that are originated by lenders approved to sell mortgages to the Facility.

Maintaining the ''to-be-announced'' market for securities based on or backed by residential mortgages on single-family or multifamily housing.

Issuing and guaranteeing timely payment of principal and interest on, securities and other obligations based on or backed by a pool of residential mortgages purchased by the Facility, whose qualities and characteristics are interchangeable with securities issued by the enterprises, including applicable rules related to the calculation of net capital requirements.

Collecting guarantee fees from approved sellers and reinsurance fees from investors.

Managing interest rate risk associated with operations of the Facility.

Facility Operations and Governance

The Secondary Market Facility for Residential Mortgages will be a corporate body without capital stock. It will operate as an instrumentality of the Federal Government, providing a mechanism to facilitate the flow of private mortgage capital.

Facility operations will be fully self-supporting from income derived from its operations. It will be required to establish appropriate capital reserves and collect fees for a reinsurance fund.

The Facility will be governed by a Board. The Board will be comprised of 5 members. Three Board members will possess extensive experience and expertise in financial management or oversight, capital markets (including debt markets), the secondary mortgage market, and mortgage-backed securities. Two Board members will possess extensive experience and expertise in mortgage finance (including with single family and multifamily housing mortgage finance, and with credit unions and small institutions). Each member of the Board shall be appointed for a term of 5 years, and may be removed by the President only for cause. Not more than three members of the Board may be members of the same political party. A member of the Board appointed to fill a vacancy occurring before the expiration of the term for which the member's predecessor was appointed shall be appointed only for the remainder of that term. A member of the Board may serve after the expiration of the member's term until a successor has been appointed.

Ending Federal Conservatorship of Fannie Mae and Freddie Mac and the Transition to a Sustainable Secondary Market Facility for Residential Mortgages

No later than 6 months after enactment of this Act, the Secretary of the Treasury, in conjunction with the Director of FHFA, shall submit a plan to congress that provides for the orderly and timely wind-down and termination of Fannie Mae and Freddie Mac, in no case no later than 3 years after the enactment of this Act.

The plan shall provide for, among other things, the transfer of all assets, obligations and liabilities of the Enterprises to the Facility, to purchase the preferred stock in the Enterprises held by Treasury, provide for the fulfillment of all obligations of the Enterprises under any outstanding debt or MBS and the repeal of the respective charters of the Enterprises.

The assets of Fannie Mae and Freddie Mac will be incorporated into the Secondary Market Facility for Residential Mortgages.

Existing assets will be handled by the Facility in a manner to ensure maximum profit to the federal government.

The Facility would pay dividends until all preferred stock of GSEs held by Treasury is repurchased by the Facility.

Facility's Regulator

The Facility will be regulated by the Federal Housing Finance Agency (FHFA). The FHFA will operated by a Board. The Board shall be comprised of 5 members: Secretary of the Treasury or a designee; Secretary of Housing and Urban Development or a designee; three members who shall be appointed by the President, by and with the advice and consent of the Senate. One of these members shall possess extensive experience and expertise in financial management or oversight, capital markets (including debt markets), the secondary mortgage market, and mortgage-backed securities. Two of these members shall possess extensive experience and expertise in mortgage finance (including single family and multifamily housing mortgage finance, and experience with credit unions and small institutions), development of affordable housing, and economic development and revitalization. Not more than 3 members of the Board shall be members of the same political party.

The President shall designate one of the appointed members to be Chairperson of the Board. The Chairperson shall designate another member to serve as Acting Chairperson during the absence or disability of the Chairperson. Each member of the Board shall be appointed for a term of 5 years, and may be removed by the President only for cause. A member of the Board appointed to fill a vacancy occurring before the expiration of the term for which the member's predecessor was appointed shall be appointed only for the remainder of that term. A member of the Board may serve after the expiration of the member's term until a successor has been appointed.

The Board shall meet upon notice by the Chairperson, but in no event shall the Board meet less frequently than once every 2 months. Any member of the Board may, upon giving written notice to the Chairperson, require a special meeting of the Board, which shall be convened by the Chairperson within 30 days after such notice.

On an annual basis, the Board shall testify before Congress regarding the safety and soundness of the Secondary Market Facility for Residential Mortgages; any material deficiencies in the conduct of the operations of the Facility; the overall operational status of the Facility; operations, resources, and performance of the FHFA's Board; and such other matters relating to the Board and the Facility.

FHFA would also have an Advisory Committee of industry, consumer groups, etc.

Taxpayer Protections and Benefits

Guarantee fees (g-fees) will be charged by the Facility, which will be used for the capital reserve fund and all expenses of Facility operations. Facility operations must be fully self-supporting.

The Regulator will determine the appropriate capital base for the Facility, based on GSE default rate history and risk of products the Facility will purchase.

Investors will pay a re-insurance fee. Premiums from re-insurance fees will go into a reinsurance fund to insure against failure of the Facility. In addition to requirements for the Facility to only purchase safe and sound mortgages from approved lenders, representations and warranties by such lenders, and title insurance for each mortgage, Facility capital reserves would have to be depleted before the reinsurance fund is accessed to meet the guarantee provided to the MBS investors.

The Facility Board will set the fees. It will determine the guarantee fee in an amount that it determines appropriate and reasonable, based on likelihood of loss for the particular type of product and to provide for operation of the Facility. It will establish the reinsurance fee in such amount as may be necessary to cover obligations of the Facility to the extent the capital funds of the Facility cannot cover such obligations and shall be based on the outstanding mortgage exposure of the Facility. In order to prevent political influence in the fee-setting process, the FHFA may establish minimum amounts for the guarantee fee and the reinsurance fee.

Once capitalization and reinsurance fund levels are achieved, all excess earnings from the operations of the Facility shall annually be transferred to the general surplus account of the Department of Treasury.

The prices to be paid by the Facility for mortgages purchased in its secondary market operations should be established within the range of market prices for the particular class of mortgages involved, as determined by the Regulator.

Requirements for Mortgages

The Facility will only purchase mortgages that meet the guidelines set by its Regulator.

Mortgages must be safe and sound mortgages, as defined by the Regulator. Such definition will include: 30 year fixed-rate mortgages and single-family and multi-family loan purchases; whole loan programs, certificate programs, other non-FHA, non-Ginnie Mae-backed facilities for the purpose of providing adequate liquidity in the marketplace.

The outstanding principal balance of the mortgage at the time of purchase <u>may not</u> exceed 80 per centum of the value of the property securing the mortgage, unless one of the following conditions is met:

- The seller retains a participation of not less than 10 per centum in the mortgage.

- For such period and under such circumstances as the Facility may require, the seller agrees to repurchase or replace the mortgage upon demand of the Facility in the event that the mortgage is in default.

- That portion of the unpaid principal balance of the mortgage which is in excess of such 80 per centum is guaranteed or insured by a qualified insurer as determined by the Facility.

- Mortgages that are financed in part (no more than half of the required 20 percent down payment) through a shared equity arrangement under which independent, private sector investors invest, together with the mortgagors, equity funds for such residences and thereby share in the ownership of such residences.

Notwithstanding the provisions above, the Facility will not be permitted to purchase mortgages where the down payment is less than 5 percent.

Mortgages must contain a representation and warranty certifying that a policy of title insurance is in place. This will transfer title-related risks to state licensed title insurance companies.

Mortgages must include a property valuation that complies with appraisal independence requirements in the Federal Reserve's interim final rule amending Regulation Z (Truth in Lending).

Underwriting

The Facility will promote uniform standards for mortgage underwriting that promote transparency, uniformity, and consumer protections.

Facility underwriting standards will establish a borrowers' ability to repay the mortgage obligation including standards for determining and documenting borrowers' income, assets, liabilities, and credit history, and credit risk.

Lender Approval

Lenders selling products to the Facility must be approved, pursuant to standards established by the FHFA Board.

The Facility will set guidelines for the lenders, including their:

- Contractual obligations.
- Representations and warranties that must be made on each mortgage.
- Indemnification for losses.
- Delivery of documents.
- How mortgage files and records are owned, established, maintained, retained, examined, and stored.
- Fidelity bond and errors and omissions coverage.
- Capitalization, net worth, and liquidity.
- Lending practices.

Market Share

The Facility will not compete with the private sector. To achieve this goal, the FHFA Board would, by regulation, seek to ensure that the market share of the Facility does not exceed approximately 50 percent of mortgage originations in the United States.

If the Facility's market share exceeds 50 percent, the Facility would be required to implement a plan, approved by its Regulator, to reduce its market share. Such a plan should seek to impact all lenders as equally as possible, taking into account historic share of activity in the facility.

Such a plan should impact all geographic regions of country equally.

Such a plan would reduce market share by:

- Restricting refinances.
- Increasing the price of g fees and/or RI fees.

Such a plan should seek to avoid excessive disruption to the stability of the mortgage market.

Safety valve -- The Facility would be authorized to increase its market share during times when the private sector withdraws from the market, as is currently the situation.

Portfolio Size

The Regulator will be authorized to set portfolio caps for the Facility, not to exceed $250 Billion (number will be adjusted annually with an appropriate inflation index).

Portfolio retention will be allowed for the Facility to utilize in support of multi-family housing, mortgages that are not securitizable (i.e. mortgages on odd lots), and to help alleviate any mortgage financing gaps that may occur during another economic downturn.

The Regulator will monitor the portfolio to ensure it is used for the specified purposes.

Safety Valve -- Larger portfolios will be allowed in times of economic crisis where mortgage capital is not otherwise available.

Guarantee Fees

The Facility will price guarantee fees based on the risk of the product. Pricing will not be based on the volume of mortgages sold to the facility, but on quality of the mortgages. Fees may not be based on or incorporate any consideration of reducing the costs of homeownership.

The Facility will allow higher pricing only to reduce market share (see above) or for other purposes approved by the Regulator for programmatic purposes.

Federal Insurance Backstop

The Facility shall collect and transfer into a Reinsurance Fund, which will be established in the Treasury, a reinsurance fee that is paid by the purchaser of Mortgage Backed Securities. The fee will be in such amount as is necessary to cover the obligations of the Facility under the guarantees to the extent the capital funds of the Facility cannot cover such obligations and shall be based on outstanding mortgage exposure of the Facility.

The Reinsurance Fund will be credited with all reinsurance fees collected by the Facility, any amounts earned on investments in the Fund, and any other amounts as may be required to be credited by the Secretary of the Treasury.

Amounts in the Reinsurance Fund shall be available at the direction of the FHFA Board, and only for payments of obligations of the Facility under guarantees issued by the Facility of timely payment of principal and interest on MBS and only to the extent that the FHFA Board determines that the capital of the Facility is insufficient to cover such obligations.

Deficit Reduction

Any receipts and earnings of the Facility in excess of amounts required for operations, for capital reserves of the Facility, for Reinsurance Fund deposits, and for the repurchase of senior preferred stock for the GSEs shall be transferred to the Treasury and used to reduce the budget deficit of the Federal Government.

Equal Access to Products

The Facility should have a goal of providing equal access to all eligible/qualified and approved lenders, all markets, all times for products consistent with standards set by the Regulator.

The Regulator will ensure that mortgage capital is available to qualified home buyers throughout the nation.

Evaluation

Review of system after 5 years to check performance.

Metric should express difference in performance pre-2009 and post-2009.