Summary of Senate Banking Committee Leaders' Bipartisan Housing Finance Reform Draft

The housing market accounts for nearly 20 percent of the American economy, so it is critical that we have a strong and stable housing finance system that is built to last. The status quo in which Fannie Mae and Freddie Mac remain in conservatorship is not a sustainable option for our nation's housing finance system. In an effort to address these concerns and find bipartisan consensus, the Senate Banking Committee hosted an in-depth series of hearings and briefings in the fall of 2013 exploring essential elements necessary for reform. Building on Senator Corker and Warner's bill S.1217 and what was learned throughout the Committee process, Chairman Johnson and Ranking Member Crapo released a bipartisan draft that is designed to protect taxpayers from bearing the cost of a housing downturn; promote stable, liquid, and efficient mortgage markets for single-family and multifamily housing; ensure that affordable, 30-year, fixed-rate mortgages continue to be available, and that affordability remains a key consideration; provide equal access for lenders of all sizes to the secondary market; and facilitate broad availability of mortgage credit for all eligible borrowers in all areas and for single-family and multifamily housing types.

A New Housing Finance System

This bipartisan draft winds down and eliminates Fannie Mae and Freddie Mac and establishes the modernized, streamlined and accountable Federal Mortgage Insurance Corporation (FMIC), modeled in part after the FDIC. New entities will be regulated by FMIC in the same manner banks are regulated by the FDIC. It also creates a reinsurance fund, known as the Mortgage Insurance Fund, to protect taxpayers.

The new system establishes a type of mortgage-backed security with an explicit government backstop and 10% first loss private secondary market capital to absorb losses and protect taxpayers from future bailouts. This system is intended to help avert another catastrophic housing crisis. In general, these securities will be executed in the following manner:

- *Originators*: Originators underwrite mortgages for homebuyers and sell eligible mortgage loans into the secondary market.
- *Aggregators*: Aggregators pool the mortgages they purchase or originate, and after obtaining a guarantee from a guarantor or a credit enhancement through a capital markets execution, they deliver the pool to a Securitization Platform to be issued with a FMIC-backed government guarantee.
- *Guarantor execution*: Guarantors hold 10% capital and provide a guarantee on mortgage-backed securities (MBS). The government backstop only applies when the guarantor fails.
- *Capital markets execution*: Investors hold fully-funded first loss positions of at least 10% of the mortgage-backed security's value, putting private capital in front of the government guarantee. All types of capital markets mechanisms must be approved by FMIC.

Small lenders will have multiple access points to the secondary mortgage market, including the option to sell their individual loans through a new small lender mutual. The mutual will be jointly owned by small lenders, providing community banks, credit unions, and other small lenders direct access to the secondary market so that they will not be at the mercy of their larger competitors when Fannie Mae and Freddie Mac are dissolved.

The new system protects taxpayers and levels the playing field for all creditworthy borrowers, includes strong, market-based incentives for lenders to support the housing market in underserved communities, and provides certainty to investors and homeowners through standardization and improved market liquidity.

Federal Mortgage Insurance Corporation

The bipartisan draft establishes the Federal Mortgage Insurance Corporation (FMIC), which is charged with assuring the safety and soundness of entities in the new housing finance system as well as fair access and treatment to consumers in the mortgage market.

The FMIC is designed to:

- facilitate a liquid, transparent, and resilient single-family and multifamily mortgage loan credit market by supporting a robust secondary mortgage market;
- provide insurance on any mortgage-backed security that satisfies FMIC standards;
- monitor and supervise participants in the FMIC mortgage market; and
- facilitate the broad availability of mortgage loan credit and secondary market financing through fluctuations in the business cycle for eligible single-family and multifamily lending across all regions, localities, institutions, and property types – including housing that serves both renters and eligible borrowers.

Management

FMIC will be managed by an accountable, independent bipartisan board of directors. The board of five members will be appointed by the President and confirmed by the Senate.

The President will appoint one of the board members to be the Chairperson and one to be the Vice Chairperson and no more than three of the board members may be members of the same political party.

Advisory Committee

An advisory committee will be created to provide a mechanism for stakeholders to provide input to, and consult with, the board of directors and the Office of Consumer and Market Access on developments in the primary and secondary mortgage markets and their interaction with the ongoing mission of FMIC.

The Advisory Committee will be made up of nine members who have diverse experience with mortgage origination at community financial institutions, private mortgage insurance, consumer protection, multifamily housing, affordable rental housing, and asset management.

Underwriting Standards

FMIC underwriting standards will be robust and mirror the definition of "qualified mortgage", and set the down payment requirement at 3.5% for first time homebuyers and at 5.0% for other homebuyers (established over a short phase-in period).

Supervision Authority

FMIC is designed to be a strong regulator with supervision and examination powers. FMIC will be given the authority to:

- approve and supervise guarantors who back securities insured by FMIC;
- approve and supervise aggregators who deliver mortgages to the Securitization Platform for securitization as FMIC-insured securities ("Aggregators" are essentially the same as "Issuers" in S. 1217);

    - The Federal Home Loan Banks will be given the ability to form subsidiaries that may serve as approved aggregators.
- approve private mortgage insurers (PMIs) who want to participate in the new system; and
- approve standards for servicers of eligible mortgage loans that must not disadvantage small servicers.

FMIC will be given the authority to take enforcement actions against approved guarantors, aggregators, PMIs, and servicers found to be in violation of the law.

Smooth Transition to New System

Enabling a smooth transition to a new housing finance system is critical to ensuring stability in the housing market. The bipartisan draft maintains the 5-year transition period from S.1217 and adds flexibility by allowing for extensions if they are necessary to prevent market disruptions and spikes in borrowing costs. It creates a framework to simultaneously ramp up the new housing finance system while winding down Fannie Mae and Freddie Mac in an effort to accelerate the time it will take for a new system to be fully in place. Six months following enactment, FHFA's functions, powers, and duties are transferred to FMIC, and FHFA exists as an independent office within FMIC. FHFA will continue to be responsible for supervision and regulation of the GSEs and the Federal Home Loan Banks as well as the conservatorship of the GSEs. As of FMIC's certification date, Fannie Mae and Freddie Mac will no longer be able to conduct new business.

<u>FMIC Leadership</u>
The FHFA Director at the time of the transfer continues in that role and will serve as the Transition Chair of FMIC until a FMIC Chairperson is nominated by the President and confirmed by the Senate.

<u>Transition Committee</u>
The bipartisan draft establishes a Transition Committee to advise the FMIC Transition Chair or the FMIC Board of Directors. The Transition Committee is formed upon enactment and will be tasked with producing a transparent transition plan with measurable goals that will be communicated to Congress, investors, and the public.

<u>Transition Financing</u>
From enactment until the date on which the enterprises are prohibited from engaging in new business, assessments are collected from the enterprises in order to fund the operations of FMIC. These assessments will be used for administrative costs of FMIC, as well as to establish the Securitization Platform, the Small Lender Mutual, and multifamily subsidiaries of the enterprises. These assessments will also be used to capitalize the Mortgage Insurance Fund, which serves as an important buffer between taxpayers and credit losses.

Level Playing Field for Creditworthy Borrowers

A new housing finance system must ensure that the American dream of homeownership is attainable for all creditworthy borrowers in all areas. Approved guarantors and aggregators cannot discriminate in the new system consistent with current law. This bipartisan draft establishes market-based incentives for lenders to promote business in underserved areas.

Affordable Housing Allocations

The measure establishes an initial and incentive-based fee structure to support the Housing Trust Fund, the Capital Magnet Fund, and the newly-created Market Access Fund and authorizes FMIC to collect these fees. The incentive fee structure will be established by FMIC. The transparent and accountable housing-related funds will focus on ensuring there is sufficient, quality housing available. The funds are NOT paid for with tax dollars, but through a FMIC user fee (10 basis points) that is paid only by those institutions who choose to use the new system.

Supporting Rural and Tribal Housing Needs

The bipartisan draft makes changes to the Housing Trust Fund to require a set-aside for federally-recognized tribes, which will be administered by HUD through a competitive grant process aimed at meeting the housing challenges facing Indian Country. It also increases the minimum allocation a state will receive under the Housing Trust Fund. And, it issues a new requirement that the Capital Magnet Fund consider tribal housing needs.

Promote Lending Innovations to Address the Needs of Underserved Communities

A new Market Access Fund will be created to support innovation in responsible lending products, education, underwriting, and servicing that will help address the homeownership and rental housing needs of underserved communities. FMIC's Office of Consumer and Market Access will be responsible for maintaining and administering the Market Access Fund.

Maintain Conforming Loan Limits

Underserved communities are not the only areas with concerns about access to mortgage credit. Many high population-density areas have housing markets where the cost of homes far exceeds the national average. Homebuyers in these areas often need access to additional credit to be able to afford a modest home. The bipartisan draft will allow current conforming loan limits to be maintained so that mortgage credit continues to be available in high-cost areas.

Preserve the To-Be-Announced Market

The measure will allow consumers the certainty of locking-in interest rates prior to closing on a home and ensure the availability of the 30-year fixed-rate mortgage by maintaining broad liquidity in the To-Be-Announced (TBA) market. It also directs FMIC to take into account the impact of new products on the TBA market.

Elimination of the Affordable Housing Goals

The bipartisan draft will eliminate the affordable housing goals of Fannie Mae and Freddie Mac.

Office of Consumer and Market Access

The bipartisan draft establishes an Office of Consumer and Market Access (OCMA) within FMIC which will be responsible for:

- administering the Market Access Fund;
- monitoring national and regional markets for the needs of underserved markets, communities, populations and consumers;
- reporting on the FMIC securities market and available liquidity, and conducting studies on incentives to encourage the serving of underserved markets;

- providing technical assistance and best practice information to market participants and approved entities regarding communities identified as underserved in an effort to help address the housing needs of consumers in those underserved communities.

Small Lender Access

Small mortgage lenders play a key role in offering credit in our current national housing finance system. Often, small lenders are the only lenders offering credit to rural or low-to-moderate income creditworthy borrowers. Any reforms to the housing finance system must preserve small lender access to the secondary mortgage market.

Small Lender Mutual

The bipartisan draft creates a small lender mutual, a member-owned and-operated cooperative, to ensure the secondary market needs of its members. Members may include:

- depository institutions with $500 billion or less in assets;
- non-depository Institutions with a minimum of $2.5 million in net worth and annual mortgage production less than $100 billion;
- community Development Financial Institutions (CDFIs), mission-based non-profit lenders, and State Housing Finance Agencies (HFAs); and
- federal Home Loan Banks

The mutual will provide members with:

- a cash window in which to sell individual, eligible mortgages;
- pooling, aggregation and securitization services; and
- assistance in retaining servicing rights.

The small lender mutual will be governed by a board of directors selected from the mutual's membership. The mutual board has authority to set membership standards and fees. However, fees must be equitably assessed and cannot discriminate based on member size, loan volume, or entity type.

Securitization Platform

The Securitization Platform will improve standardization and liquidity in the secondary mortgage market. It will create a standardized security to be used for all FMIC guaranteed securities in order to promote broad mortgage availability for 30-year, fixed-rate mortgages, and will be available for the issuance of private label securities. The Platform will provide infrastructure for market participants of all sizes seeking to securitize mortgages, and will not assume or hold credit risk.

Ownership

The Securitization Platform will be an independent cooperative, or other corporate entity acting as a utility, owned and operated by its members and regulated by FMIC.

Management

An initial five-member board of directors comprised of Platform members will be established by FMIC. Following the expiration of the initial board terms, the subsequent board will be comprised of nine elected directors made up of representatives of the members in the Platform.

At least one director must represent the interest of small mortgage lenders, and one member will be an independent director.

<u>Enforcement and Fees</u>
The Platform will create and enforce rules for its members and establish fees that would be submitted to FMIC for review.

Fees would generally be uniform and based on member usage of the Platform.

The Platform directors will also have the discretion to:

- set tiered usage fees that will facilitate Platform access for small mortgage lenders, including CDFIs, and other organizations that promote the goals of affordable housing; and
- set different usage fees for the issuance of FMIC securities than the usage fees charged for the issuance of non-FMIC securities

<u>Membership</u>
The Platform directors are responsible for approving membership to the platform. Those eligible for membership include:

- mortgage aggregators;
- mortgage guarantors;
- mortgage originators;
- Federal Home Loan Banks;
- small lender mutuals; and
- any other market participants, provided that in the sole determination of the Platform directors having such market participant as a member of the Platform is necessary or helpful to fulfilling the purposes and obligations of the Platform.

<u>Platform Agreements</u>
All FMIC securities using the Platform will be required to use a Uniform Securitization Agreement for FMIC guaranteed securities.

Non-FMIC securities issued using the Platform will be required to use agreements that include a common set of basic contractual terms.

The Platform directors may establish an Optional Uniform Agreement for non-FMIC Securities that will have requirements that could differ from those specified by the Uniform Agreement for FMIC Securities.
Non-FMIC securities issued through the Platform will have the option, but not the requirement, to use the Uniform Agreement for FMIC Securities, or the Optional Uniform Agreement for non-FMIC Securities.

Nothing will prohibit off-Platform, non-FMIC securities from adopting either the Uniform Agreement for FMIC Securities, the Optional Uniform Agreement for non-FMIC securities, or the common set of basic contractual agreement terms required for all non-FMIC securities issued through the Platform.

Multifamily

Multifamily housing is an important – and growing – segment of the nation's housing market. Across the country, 35 million renters call multifamily housing home, with demographic trends such as the growing numbers of empty nesters indicating increasing demand in the future. The bipartisan draft builds upon proven secondary market products while establishing important new provisions aimed at maintaining a vibrant multifamily market in the new housing finance system.

The multifamily housing programs of the GSEs successfully maintained credit quality throughout the financial crisis, experiencing default rates of less than 1%. During the transition period, the GSEs will be permitted to continue offering these products to support the multifamily market while laying the groundwork for the future system through the establishment of distinct multifamily subsidiaries within each enterprise to support the transition to the new finance system.

<u>Future System</u>

FMIC will approve multifamily guarantors to both guarantee the first loss position on multifamily securities and issue securities for which they provide guarantees. The bipartisan draft provides that the successful mechanisms currently offered by the enterprises, the DUS and Series K products, can be used by approved multifamily guarantors in the new system. Approved multifamily guarantors will have 10% capital requirements standing before the public guarantee.

<u>Continuing to Serve Working Families</u>

Each enterprise and approved multifamily guarantor must ensure that 60% of the rental housing units financed are affordable to low-income families (families with incomes at or below 80% of Area Median Income) at origination. FMIC may suspend or adjust this requirement in the event of economic distress or adverse market conditions.

<u>Improving Access for Smaller Properties</u>

Smaller properties – those with less than 50 units – serve families in urban, suburban, and particularly rural areas. As important a source of housing as these properties are, they often face barriers accessing the secondary market. The bipartisan draft establishes a pilot program in FMIC's Office of Multifamily Housing to test and assess methods or products designed to increase secondary mortgage market access for small multifamily properties.

<u>Office of Multifamily Housing</u>

Recognizing the unique nature of the multifamily housing market, the bipartisan draft creates an Office of Multifamily Housing within FMIC to provide special focus on multifamily housing.

Taxpayer Protections

<u>Winds Down and Eliminates Fannie Mae and Freddie Mac</u>

The legislation will wind down and ultimately eliminate Fannie Mae and Freddie Mac, through a responsible, stable transition to a new system by providing specific benchmarks and timelines.

<u>High Capital Requirements for Future Market Participants</u>

All future mortgage-backed security guarantors would be completely private and be required to hold a minimum of 10% private capital. The bill further prohibits bailing out any of these institutions in the event that they fail.

Private Capital in a First Loss Position

To be eligible for Federal Mortgage Insurance Corporation (FMIC) reinsurance, any market structured mortgage-backed security must first secure private capital in a first loss position of at least 10%.

Strong Underwriting

Borrowers would need to have at least 5% equity in the home to ensure against a downturn in the market. First-time homebuyers would be allowed to purchase with at least a 3.5% minimum equity. Borrowers would need to meet further underwriting requirements establishing an "ability-to-repay."

Mortgage Insurance Fund to Further Protect Taxpayers

The FMIC would be required to maintain a re-insurance fund, known as the Mortgage Insurance Fund, and modeled after the Deposit Insurance Fund that is maintained by the FDIC. The Mortgage Insurance Fund will be funded by private companies that choose to participate in the new housing finance system, not by taxpayers.