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Assessing Proposals to Reform America's Housing Finance System

Nearly a decade after the financial crisis, the housing finance system remains largely structurally unreformed. While there have been several legislative pushes for comprehensive reform after American taxpayers provided $187 billion in bailout assistance to Fannie Mae and Freddie Mac (the "GSEs") and since both GSEs were placed into conservatorship in 2008, all comprehensive reform efforts to date have failed to be enacted.

USMI firmly believes that meaningful reform is necessary to put our housing finance system on a more sustainable path. This is vital so that creditworthy borrowers will have access to prudent and affordable mortgage credit in the future and so that taxpayers are better shielded from housing related credit risks. The 115th Congress and the Trump Administration have a unique opportunity to address this last unfinished reform to truly put America's housing finance system on a sustainable path. Recently, there have been a number of reform proposals from think tanks, trade associations, and others—each articulating a specific set of principles or visions for the structure of the new housing finance system, and elements of the transition to a future state.

Private mortgage insurance (MI) already plays a critical role in providing access to mortgage credit and protecting taxpayers. It is an essential part of a smooth transition and any future housing finance system. To accomplish meaningful reform and put the housing finance system on stable footing long term, USMI believes that the transition to any future housing finance system should be consistent with USMI's four housing finance reform principles:

- **Protecting taxpayers** by allowing private capital to absorb all credit losses in front of any government guaranty;
- **Promoting stability** across housing market cycles through a stable secondary market and uniform guardrails across lending and insuring channels;
- **Ensuring accessibility** to mortgage finance for creditworthy borrowers and participation by lenders of all sizes and types; and
- **Fostering transparency** through a consistent and coordinated approach to the federal government's housing policy among all government agencies and entities.

This paper analyzes the various reform proposals through the lens of USMI's housing finance reform principles, with particular attention to the role of private capital to protect against taxpayer risk exposure in the proposed new systems. Several legislative proposals for housing finance reform exist, but this matrix is restricted to analysis of white papers and reform proposals put forward by think tanks and trade associations. Simply returning to the pre-conservatorship status quo does nothing to strengthen the housing finance system and USMI looks forward to working with industry and consumer groups, Congress, and the Administration to identify the best reforms to put America's housing finance system on a sustainable path.

Milken Institute (Bright & DeMarco)

Summary

GSEs would exit conservatorship and be reconstituted as mutual-owned by the seller-servicers and would have two primary business functions: (1) provide credit enhancement by syndicating mortgage credit risk through a variety of credit risk transfer (CRT) structures; and (2) maintain a cash window for small and mid-sized lenders.

Proposal would open Ginnie Mae's Charter to allow for private sector credit enhancement from entities licensed and regulated by the Federal Housing Finance Agency (FHFA), including private mortgage insurers, Federal Home Loan Banks, lender recourse, and the reconstituted Fannie Mae and Freddie Mac mutuals. Lenders would also have the opportunity to create a new "small lender only" mutual.

Approximately 8% of private capital would stand in front of the Ginnie Mae backstop/government guaranty:

- Investors' private capital would cover first 4% of losses;
- Mutual owners would cover the next 2% of losses; and
- The MIF, funded by a 5-10 bps fee collected from all approved secondary market credit enhancers, would cover the next 1-2% of losses.

Analysis

Alignment with USMI Reform Principles:

Protect Taxpayers:

- Requires more private capital to stand in front of government/taxpayers.

Promote Stability:

- Utilizes Ginnie Mae's existing infrastructure and systems, which leverages an existing infrastructure and increases competition.

Recommendations:

Protect Taxpayers:

- Should include an explicit requirement for high LTV conventional mortgages to have loan-level credit protection, such as private MI, to reduce taxpayers' amount of risk exposure.
- To avoid fleeting capital that will leave the system during times of stress or low yield, it is critical to have sources of private capital that can participate in both good and bad housing cycles.

Promote Stability:

- GSEs' dominance and issues associated with retaining control of data and systems can be resolved by transitioning their proprietary data and underwriting systems to be used by all market participants.
- First loss coverage should be provided to loans with the government guaranty by loan-level entity based credit enhancement.
- Reform should provide for sufficient time and flexibility to ensure a stable transition to the new housing finance system.
- One way to work around issues associated with the mutual operating cash windows is to open Federal Home Loan Bank membership to independent mortgage banks (non-depositories).
- To ensure that the GSEs in their new form (credit risk management companies structured as utilities) don't disadvantage private capital, there should be a greater distinction between issuers and guarantors.

Ensure Accessibility:

- Pricing should not permit discounts based on volume, market share, or type of originator.
- GSEs' market advantages (proprietary data, systems technology, etc.) should be made available (through a utility or other platform) to all market participants.

Foster Transparency:

- Credit risk should be transparently priced to reflect losses and fully account for the risk-reducing benefits of credit enhancement.

MBA GSE Reform Principles & Guardrails

Summary

The GSEs would be reformed and repurposed as utility guarantors which, along with new entrants authorized by the FHFA, would issue mortgage-backed securities (MBS) that carry an explicit government guaranty. The federal guaranty would be funded by insurance premiums paid by chartered guarantors that would go into a dedicated, actuarially sound Mortgage Insurance Fund (MIF).

Bright line between primary and secondary mortgage markets established, thereby restricting guarantors' allowable activities to the secondary market to facilitate competition and guard against system risk concentration.

Envisions a statutory framework with guardrails to protect taxpayers, preserve elements of the current system that work well, and align incentives across the primary and secondary markets.

The Common Securitization Platform (CSP) would be made an independent, government-owned corporation and be made available to new guarantors once chartered. CSP would own all GSE historical single-family data that would be available to market participants for analysis for an administrative fee.

Analysis

Alignment with USMI Reform Principles:

Protect Taxpayers:

- Recognizes the benefit of private mortgage insurance and the value of loan-level credit enhancement.

Promote Stability

- Explicit guaranty applies only to the MBS and not the entities issuing or guarantying the securities.
- Proposal calls for a bright line between the primary and secondary mortgage markets.

Recommendations:

Protect Taxpayers:

- Loan-level credit enhancement should be the primary method for private capital to minimize first loss taxpayer risk. High LTV conventional mortgages should have loan-level credit protection, such as private MI, to reduce taxpayers' amount of risk exposure.
- Important to have several tiers of well capitalized sources of private capital in the housing finance system that are available during all housing market cycles.
- The government's guaranty on MBS should be remote and behind several sources of private capital.
- The proposal should identify qualifiers for the deeper level of government support that is proposed in the event of a systemic crisis.

Promote Stability:

- More specificity needed to better define primary and secondary mortgage markets. Providing loan-level credit enhancement should be an exclusively primary market function.

A More Promising Road to GSE Reform (Parrott, Ranieri, Sperling, Zandi & Zigas)

Summary

GSEs' operational assets would be transferred to a new structure, the "National Mortgage Reinsurance Corporation" (NMRC), that would issue MBS which would have an explicit government guaranty for catastrophic risk. NMRC would collect a guarantee fee, 10 bps of which would fund the Mortgage Insurance Fund (MIF).

Private capital would compete to take all non-catastrophic credit risk, protecting taxpayers up to 8.5% of losses. Proposal includes five layers of private capital:

1. Homeowners' equity;
2. Loan-level credit enhancement for borrowers with less than 20%;
3. Risk transfers using a broad mix of entity- and transaction-based capital, front- and back-end execution, and at the loan and pool level;
4. Capital from fixed-rate dividend securities; and
5. MIF.

To be eligible for inclusion in MBS, mortgages would need to meet the Qualified Mortgage (QM) standard and borrowers with less than 20% down would be required to have a form of loan-level credit enhancement.

Analysis

Alignment with USMI Reform Principles:

Protect Taxpayers:

- Recognizes the benefit of loan-level credit enhancement.

Promote Stability:

- Proposes a merger of efficiencies by consolidating the two GSEs into one entity and creates the opportunity for further streamlining.

Recommendations:

Protect Taxpayers:

- First loss coverage should be provided to loans with the government guaranty by loan-level entity-based credit enhancement.
- There should be comparable and equivalent standards for credit enhancers, including increasing the areas of regulatory oversight, capital, reserves, and leverage and liquidity requirements.

Promote Stability:

- Sources of private capital should be well capitalized and available throughout all housing market cycles. This can reduce the likelihood of mortgage rates becoming pro-cyclical due to investors entering and exiting the market based on yield and risk appetite.

Summary

The GSEs would be wound down and replaced with an independent, wholly-owned government corporation, the "Public Guarantor." The Public Guarantor would provide an explicit catastrophic guaranty on qualified MBS. Like Ginnie Mae, the Public Guarantor would not buy or sell mortgages or issue MBS but rather simply guaranty the timely payment of principal and interest to MBS investors.

The government would be in the fourth-loss position and the limited catastrophic guaranty would only be triggered after the following private capital had been exhausted: (1) borrower equity; (2) private credit enhancers; and (3) the corporate resources of the issuers and servicers.

The Public Guarantor would establish the guarantee fees to cover potential catastrophic losses, ensure the actuarial soundness of two separate risk funds for the single-family and rental markets, set standards for mortgages backing government-guaranteed securities, and qualify institutions to serve as issuers, servicers, and private credit enhancers.

Analysis

Alignment with USMI Reform Principles:

Promote Stability:

- Utilizes Ginnie Mae's existing infrastructure and systems.
- Explicit guaranty applies only to the MBS and not the entities issuing or guaranteeing the securities.

Ensure Accessibility:

- Standard, transparent, and consistent pricing to lenders of all types and sizes.

Foster Transparency:

- Advocates clarifying the FHA and conventional markets and returning FHA to its traditional role/footprint using lower FHA loan limits and higher insurance premiums.

Recommendations:

Protect Taxpayers:

- Credit enhancers should be subject to comparable and equivalent standards, including in the areas of regulatory oversight, regulatory capital, reserves, and leverage and liquidity requirements.
- The government guaranty should stand behind sources of private capital that are well capitalized and available through all housing market cycles. While the government guaranty should be remote, it is beneficial for attracting investors and sources of private capital to the housing finance system.

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