CUNA REGULATORY ADVOCACY

CUNA REGULATORY COMMENT CALL

November 21, 2012

CUNA Comment Call: Federal Housing Finance Agency White Paper on a "New Infrastructure for the Secondary Mortgage Market

EXECUTIVE SUMMARY

- The Federal Housing Finance Agency (FHFA) issued a white paper proposing a new framework for the secondary mortgage market to alter the three frameworks currently in use: Enterprise (Fannie Mae & Freddie Mac), Ginnie Mae, and Private Label. There are two parts to this framework: (a) a new securitization platform that would replace the three existing platforms, and (b) a model Pooling and Servicing Agreement (PSA) that would complement the current PSAs and which might become the industry standard.
- The major goal of the proposed framework is to minimize the role that government backed entities (especially Fannie Mae & Freddie Mac) play in assuming the credit risk in Mortgage Backed Securities (MBSs) by encouraging private investors to assume a greater share of the credit risk.
- The FHFA would also create standardized documents, including a new model PSA that would aggregate from current documents to create a selling and servicing guide.
- The proposal seeks to invite such private investment by standardizing certain securitization platform functions so that different MBSs can be easily compared. Further, such standardization, coupled with the application of the model PSA, could lead to greater transparency in pricing, risk, and disclosures—thus making credit risk assumption more attractive to private investors.
- The platform and PSA framework could help enforce Qualified Mortgage (QM)/Qualified Residential Mortgage (QRM) guidelines, screening for QM/QRM eligibility, and identifying corresponding risk retention requirements. To the extent that other proposed rules on mortgage origination or servicing become binding regulations, these could serve as tools to help monitor industry compliance.
- The platform's major functions would include:
    - Collateral management, specifically centralized note tracking;
    - Master servicing, asset and cash management, servicing metrics, data validation and reporting, and providing standardized interfaces to servicers, guarantors, and aggregators;
    - Issuance and related functions (eligibility rules, data quality standards, pool delivery, settlement, and disclosure);
    - Data validation for servicing and issuance, whereby the platform will store loan level, pool level, and bond level data (to improve data integrity, and market transparency and efficiency);
    - Bond administration and processing, including standardized investor and third party disclosures, principal and interest distributions, securities monitoring, portfolio reporting, and role of Trustee.

- Issuers and primary servicers would have access to the platform, which would allow them to make interest payments, provide disclosures, and provide loan modification information directly into the platform.
- The proposed platform would be able to support the current MBS market volume, TBA market, and securities across a range of fixed and adjustable rates.
- The FHFA is seeking industry input on the white paper, and has provided questions for consideration. These are included at the end of this document along with CUNA's questions on the proposed framework. Input on the white paper is due to FHFA by December 3, 2012; please submit your comments to CUNA by November 30, 2012. Input may be submitted directly to the FHFA via email at SecuritizationInfrastructure@fhfa.gov, or at the FHFA's website: http://www.fhfa.gov/default.aspx?Page=-995&Survey=2.
- For more information, please contact Senior Assistant General Counsel, Jared Ihrig, at jihrig@cuna.coop or Deputy General Counsel, Mary Dunn, at mdunn@cuna.coop.
- FHFA's complete white paper is located here.

BACKGROUND

The Federal Housing Finance Agency (FHFA) is proposing a framework for a new securitization platform and a model Pooling and Servicing Agreement (PSA) for the secondary mortgage market. The proposal is a result of the agency's *Strategic Plan for Enterprise Conservatorships* put forth in February 2012. The purpose of the Strategic Plan is to replace Enterprise infrastructures with an efficient standardized model, to invite private capital to assume greater credit risk, and to allow for flexibility in future policies in the field.

There are currently three frameworks in use: the Enterprise framework (which is actually two frameworks—for Fannie Mae and Freddie Mac), the Ginnie Mae framework, and the Private Label (no government credit risk) framework.

Current Securitization Platforms

While all three platforms are organized along the same MBS processes—from loan origination up to interest payments to MBS holders—their assignment of roles with regard to core functions vary considerably.

The Enterprise platform is the broadest in its view of the Enterprises' core functions. Thus the Enterprises perform widespread functions including issuing MBSs, guaranteeing MBSs, pricing and underwriting MBSs, and servicing MBSs. In doing so, the Enterprises assume the credit risk for the mortgage loans for MBSs issued through the platform. Additionally, the Enterprises are responsible for, and guarantee, interest and other payments to the holder of MBSs that originated in the platform. There are currently two Enterprise platforms in use—for Fannie and Freddie. In proposing a single MBS platform, the proposal seeks to eliminate the problems and costs associated with managing two platforms.

The Ginnie Mae platform is much more limited in scope than is the Enterprise platform. This is because Ginnie is not an issuer or an investor in the MBS market. Rather, Ginnie is a high-level overseer of the market. Thus, the Ginnie Mae platform is limited to the administration of MBSs, and is primarily involved in policy-making, contract management, risk management and primary servicing of MBSs. All other functions within the Ginnie Mae framework are outsourced to third parties.

Private Label platforms are contractually based and have no set roles or responsibilities for parties in the platform. Parties are free to contract out the major roles including issuance, servicing, risk management, and trusteeship. In practice, the platform is customized to each MBS transaction. The proposed framework seeks to provide Private Label MBS transactions a level of standardization to reduce the costs associated with individually contracting the various elements of the platform. The proposal hopes that these measures will increase Private Label MBS activity.

Summary of the current platforms:

	Enterprise	**Ginnie Mae**	**Private Label**
Overview	Widespread functions from aggregating mortgages to funding the securitization process.	Limited to administering the MBS program for federally insured mortgages.	Private parties perform all functions
Major Current Functions Directly Responsible for	Issuance, guaranteeing, underwriting (enhancing credit), pricing, and master servicing MBSs.	Policy-making, contract management, risk management, servicing.	Each party's function is determined contractually.
Risk	The Enterprises assume loans' credit risk, and distribute payments to security holders.	Because Ginnie is not an issuer or investor, it does not assume loans' credit risk (federal agencies do), and is not involved in the distribution of payments to security holders (issuers are responsible).	Each party's risk is determined contractually.
Issues	Market participants are forced to manage two separate Enterprise infrastructures (Fannie & Freddie). Maintaining two infrastructures increases costs to participants and the taxpayer.	A complex system whereby Ginnie outsources several functions to third parties, while creating guidelines for and overseeing such functions.	No requirement for platform standardization.

Current Contractual Framework & PSAs

The contractual framework and PSAs in all three models are comprised of documents of a similar nature. The major documents are a selling guide, a servicing guide, a master agreement or pool purchase contract, a master trust agreement, and additional documents depending on the structure of the security. While the Enterprise and Ginnie Mae models have very similar contractual provisions in these documents, the Private Label does not have such standardized contractual provisions. Private Label contracts and PSAs are often customized for every MBS transaction. This leads to three major issues. First, parties are often unclear about their responsibilities and cannot rely on previous contractual terms for guidance. Second, parties are often unclear about their contractual rights and remedies. Finally, the divergence in Private Label MBS contracts leads to inconsistent outcomes among largely similar transactions. The proposed contractual and PSA framework seeks to remedy some of these issues and inconsistencies.

DESCRIPTION OF THE PROPOSAL

Proposed Platform

The following chart summarizes the proposed platform:

Pooling & Servicing Agreement	***Overview***: Agreement that would establish basic contractual requirements for pooling and selling and for the MBS/PC Trust. This would be a relatively short document that leverages Selling & Servicing Guides and other relevant agreements. Lender-specific requirements or variances could be captures in an addendum to the agreement.
	Replaces: Master Trust Agreement, Mortgage Selling and Servicing Contract, Master Agreement, MBS/PC Pool Purchase Contract. ***Incorporates by Reference***: Selling Guide, Servicing Guide, Master Custodial Agreement.
Selling Guide and Servicing Guides	***Overview***: The Selling and Servicing Guides would generally remain in place, but would be re-created as a single aligned version of the existing Fannie Mae and Freddie Mac guides/agreements incorporating input from industry participants and best practices from the private market.
	Replaces: Existing Enterprise guides/agreements.

	Automated Underwriting Tools: Would intersect with Selling Guide contracts to reflect terms and conditions for selling and delivery of loans. ***Selling and Delivery Standards***: Would continuously improve through alignment efforts thereby creating updates to the Selling Guide. ***Custodial Provisions*** and related documentary requirements would be references in the Selling Guide. ***The Government Sponsored Enterprise (GSE) Servicing Alignment***: Initiative exemplifies current aligned standards for loss mitigation activity that addressed industry issues by providing timely changes to loan servicing policies. These new servicing standards were issued as updates to the Servicing Guide.	
Disclosure Documents including Prospectus and Prospectus Supplements	***Overview***: Would remain in place and, to the extent appropriate, align the structure of Fannie Mae and Freddie Disclosures.	
	Replaces: Existing Enterprise Disclosures. ***Incorporates by Reference or Describes Terms of***: PSA, Guides, Enterprise SEC Filings.	

The proposed platform is being designed to be automated and capable of processing large volumes of transactions. It is also meant to be flexible to accommodate several types of securities, market participants, and market conditions. Finally, it is meant to be transparent and welcoming of private investors to take on credit risk currently taken on by the Enterprises in conservatorship.

The proposed platform has three major operational features. First, it seeks to distribute credit risk to private investors in order to reduce the conservators' role in guaranteeing against such risk. Second, it seeks to define certain utility roles that might be applicable to all MBS market participants in an effort to promote the proposed platform as the universal platform for MBS transactions. Third, the platform seeks to provide a streamlined approach to MBS transactions, including providing for primary issuers to enter loan modifications directly into the platform.

The platform would distribute credit risk by maintaining market liquidity and through various credit risk sharing arrangements. In maintaining market liquidity, the platform will be able to account for various securitized bundles, and for fixed and adjustable rates—all while maintaining the current MBS transaction volume of over $100 billion per month. In accommodating risk sharing arrangements, the platform would support both securities guaranteed by either government or private sector entities. It would also be able to allocate risk such that private sector credit enhancers would absorb more of the risk of individual loan defaults than government credit enhancers. The platform could also account for various private sector guarantors and their contractual arrangements with respect to credit risk.

The platform will perform five major at-issuance and ongoing services:

(a) <u>Data validation</u>: The platform would verify that the submitted issuance requests conform to agreed-upon standards and data formats. The platform will notify requestors of acceptance or rejection. In case of a rejection, the platform will provide details of the rule violations so that corrected requests can be resubmitted.

(b) Issuance: The platform would register securities with appropriate agents, and would transfer securities back to the original owners on the settlement dates. The platform would also validate the settlement and provide confirmation to issuers, loan information to Master Servicers, and data to disclosure services.
(c) Disclosures: The platform would perform preliminary, final, and on-going disclosures. Such disclosures would be published on the internet and possibly in other forms.
(d) Master servicing: The platform would collect and process primary servicer loan activity and verify that principal and interest payments are correct for each reporting cycle. The platform would also perform security balance roll ups from loan balances for each reporting cycle, and would provide this and other information to the various servicers. Primary servicers would have the option to enter information and cash directly into the platform. The platform would monitor and document custody, servicer performance and other compliance information such as delinquency reporting on non-performing loans. Finally, it would responsible for processing modification requests—to remove loans from securities, modify loans, and transfer primary servicing or ownership stakes.
(e) Bond administration: The platform would support first level securitizations and second level re-securitizations, and several types of multiclass securities as well as single class securities. It would calculate investor payment factors and make data available for investor disclosures, and would supervise timely payments to investors. Finally, the platform would support tax reporting for all the securities within its purview.

The platform would standardize certain utility roles which are applicable to all MBS market participants and transactions. Specifically, the platform's scope would include security issuance, master servicing of loans, distribution of payments to MBS holders, and data and disclosure tracking. The standardization of these utility functions will ensure that the MBS market has several common elements such that private risk investors would be able to easily and directly compare and monitor transactions, regardless of the role played by government and private sector guarantors.

Platform Interoperability

The platform would have a common business and data architecture to drive interoperability and easy access, and would be adaptable to new and emerging technologies. These changes would help ensure greater transparency and level the playing field for all industry participants. The platform would have a standard interface and would provide proper support to minimize disruptions on the switch. Further, it will support a series of standard inputs (requests for issuance, reports, modifications, etc.) and outputs (issuing prospectuses, disclosure reporting, activity reports, etc.).

Four major interoperability interactions that the platform will support are:
(a) Standard requests for securitization: The basic securitization data framework will follow the ULDD structure that uses the industry-recognized MISMI Version 3.0 standard, with the option of expanding this model where needed. This would allow for greater investor disclosures, and would facilitate the primary market to more easily delivery bundles of mortgages into an array of securities.
(b) Loan reports from primary servicers: The platform would process and track payments from borrowers through to investors by leveraging the Uniform Mortgage Servicing Dataset Initiative to standardize definitions and other criteria. This would help reduce risk, improve services, and provide flexibility to market participants.

(c) Disclosures to investors: Investors would have access to more and better data, along with customized viewing criteria. The process for disclosure and data availability will be streamlined.
(d) Loan and security reporting to issuers/guarantors: Issuers and guarantors will be provided with updated loan and security positions and other data in a secure, standard data format. This will be aided by the standardization of terms and definitions.

The platform would provide a streamlined approach to MBS transactions that would make it easy to monitor a transaction from loan origination to interest payments to investors. This would allow issuers and primary servicers to input and receive payments and information directly from the platform. For instance, the platform would allow for payments, loan modification and disclosure information, and loan and security reports to be made and extracted directly from the system.

Proposed Pooling & Servicing Agreement Framework

The proposed PSA framework is built on the Enterprises' current PSA documents. It is hoped that the proposed framework serves as a model PSA for future Private Label MBS transactions. The framework will maintain the current servicing and selling guides, PSA agreement, and disclosure documents. However, it will clarify the duties and responsibilities of parties in the securitization platform, will propose a compilation or best practices to operate in the platform, and will promote greater standardization in Private Label PSAs.

The model PSA will incorporate current Enterprise PSA initiatives including (i) alignment and enhancement of existing policies, practices, and legal documents of the Enterprises, and (ii) standardized servicing, disclosure and other practices of the Enterprises.

QUESTIONS TO CONSIDER REGARDING THE PROPOSED SECURITIZATION PLATFORM & PSA FRAMEWORK

1. The proposed securitization platform has four core functions (issuance, disclosure, bond administration and master servicing). Will these core functions provide an efficient and effective foundation for the housing finance system going forward?

2. Are there additional functionalities that should be considered as core functions of the platform? For example, should the platform independently verify or determine the following or rely on an issuer or guarantor:
   a. Underwriting and loan eligibility rules?
   b. Pooling rules?

3. Will the framework for a model PSA described in this paper provide the foundation for a standardized contractual framework for the housing finance system going forward?

4. Are there additional elements/attributes that should be included in a model PSA? For example,
   a. Should the model PSA define when a non-performing loan is required to be purchased out of the trust?
   b. Should the model PSA define when a non-performing loan is required to be transferred to a specialty servicer?

5. If the framework for a model PSA is a good contractual foundation, how should compliance with the PSA be monitored in the future?

6. What enhancements to the role of trustee should be considered in order to better attract private capital to the housing finance system?

7. How should document custodial and assignment responsibilities be handled in the housing finance system going forward?

8. Do you see small lenders receiving equal access to the securitization platform to request securitization?

9. Do you think it would beneficial to allow issuers and primary servicers direct access to the platform? Do you foresee any problems with such access?