Statement of

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before the

U. S. House of Representatives Committee on Financial Services

Subcommittee on Housing and Insurance

TILA-RESPA Integrated Disclosure:
Examining the Costs and Benefits to the Real Estate Settlement Process

May 14, 2015

Mr. Chairman, Ranking Member Cleaver, and members of the committee, thank you very much for the opportunity to testify today. My name is Laurie Goodman, and I am the director of the Housing Finance Policy Center (HFPC) at the Urban Institute. The Urban Institute is a non-partisan, non-profit, social and economic policy research organization located in D.C. Founded in 1968, the Urban Institute brings decades of objective analysis and expertise to policy debates. HFPC is dedicated to providing timely, data-driven analysis of policy issues relating to housing finance and the housing market. Prior to joining the Urban Institute two years ago, I spent almost thirty years as a mortgage-backed securities research analyst and as head of securitized products research/strategy at several firms, including Amherst Securities Group LP and UBS. The views expressed in this testimony are my own and should not be attributed to the Urban Institute, its trustees or its funders.

Today, I will discuss the TILA-RESPA Integrated Disclosure and make the case for a hold-harmless period through the end of 2015. I will then explain my view that this is a minor operational issue in a housing finance system that is in limbo. While there has been significant progress made to reform the Government Sponsored Enterprises (GSEs) through administrative channels, there has been little progress through legislative channels. This presents an opportunity for Congress to make a real difference. But Congress must proceed carefully and thoughtfully, with a realization that the system remains fragile, and is failing to serve many credit-worthy borrowers.

TILA-RESPA Integrated Disclosure (TRID)

For years the real estate settlement process has been cumbersome and unnecessarily complex. At closing the borrower receives two sets of disclosure documents, generally understands neither, and faces closing costs that are much higher than expected. The disclosure documents are those required under the Truth in Lending Act (TILA) and those required under the Real Estate Settlement Procedures Act (RESPA); both rules are administered by the Consumer Financial Protection Bureau (CFPB). TILA was formerly administered by the Federal Reserve Board, and RESPA was formerly administered by the U.S. Department of Housing and Urban Development (HUD). The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in 2010, transferred authority for both sets of rules to the Consumer Financial Protection Bureau (CFPB) and required the CFPB to promulgate a rule combining the two sets of disclosures into one consumer-friendly form. Even though the disclosures were to be combined into a single integrated disclosure for mortgage loan transactions, it took the CFPB several years because the TILA and RESPA provisions governing timing, responsibility, and liability for the disclosures were not entirely consistent, and were not legislatively amended, leaving the CFPB with a very large reconciliation project. In addition, the CFPB did extensive consumer testing and offered numerous rounds of feedback. The CFPB completed their rulemaking in November, 2013, two substantive modifications were made in January, 2015, and the rule is scheduled to go into effect on August 1, 2015.

Under the new TRID rules, the two disjointed disclosures will be replaced with two new documents: the Loan Estimate, which replaces the initial Truth in Lending (TIL) and the Good Faith Estimate (GFE); and the Closing Disclosure, which replaces the closing TIL and the HUD-1. The Loan Estimate is required within three business days of the application's completion; this timing requirement is consistent with today's disclosures. However, the Closing Disclosure, detailing all costs, must be provided three days prior to closing, which represents a significant change for the industry; the documents have historically been provided on the closing date, although more general disclosures were required in advance.

The Loan Estimate details the costs of settlement services (appraisals, inspections, etc.), as well as good-faith estimates on prepaid interest, property insurance premiums, escrow accounts, charges paid to third party service providers selected by the consumer that are not on the lenders list of service providers, and charges for third-party servicers not required by the lender. The final CFPB rule restricts the circumstances under which consumers can be required to pay more for settlement services than is stated on the Loan Estimate form. Unless an exception applies, prices for the lender's or broker's own services, charges for servicers provided by an affiliate of the lender or mortgage broker, and charges for services for which the lender or mortgage broker does not permit the consumer to shop cannot exceed the amount stated in the Loan Estimate. Charges for other third-party services can exceed that stated in the Loan Estimate, but not by more than 10 percent. Exceptions include situations in which the consumer asks for a change, chooses a service provider not identified by the lender, or provides inaccurate information on the loan application, and situations when the loan application information becomes inaccurate or the loan estimate expires. To the consternation of many lenders, the rules seem to be silent on what happens when the closing date is significantly delayed. For example, the rule states that if the interest rate was not locked at the point of origination, when the rate is locked, a new Loan Estimate must be provided within three days. It is unclear if a borrower can be charged for a new rate lock if the borrower contributed to a delay.

The closing document, which states the actual terms of the transaction and the actual costs associated with the settlement of that transaction, must be provided by either the lender or the settlement agent. However, as with the Loan Estimate, the creditor has the ultimate responsibility and liability for ensuring the disclosure is done properly. If a change occurs after the Closing Disclosure is initially provided, but before closing, the creditor is generally permitted to provide a revised Closing Disclosure at or before closing. The only changes that require a new three-day waiting period are a change in the Annual Percentage Rate (APR) of more than oneeighth of 1 percent above or below the disclosed APR, a change in the loan product, or the addition of a prepayment penalty.

If implemented properly, this new regime should significantly improve the consumer experience. The CFBP conducted extensive consumer tests with these documents after the release of the rules, gathering feedback and revising accordingly. The components on the forms are transaction-specific and only include information related to the borrower's transaction. There are very detailed requirements relative to the organization and presentation of the content, including the number of tables, the order of the fees, and specific information about bolding, rounding, and aggregating of information, all of which are meant to enhance the borrower's experience.

Need for a hold-harmless period. While I believe the CFPB has done a good job, and the result would definitely improve the closing experience for the borrower, I am concerned that the August 1 implementation date is too tight for many lenders, and I would encourage the CFPB to provide a reasonable hold-harmless period through the end of the year, following the August 1 effective date of the TRID regulation. According to an April study by Capsilon Corp., reported in National Mortgage News, 41 percent of mortgage lenders say they are not ready for the August 2015 TRID implementation. The study, polling more than 100 executives from leading lenders during the Mortgage Bankers Association technology conference in early April, found only 12 percent of respondents felt "very prepared" for the August requirements.

Why should lenders need a postponement for rules largely finalized in November, 2013? New data fields were required to comply with the rules, as the customization of the forms required new data elements. The data standards to support the new Loan Estimate and Closing Disclosure were not available until MISMO 3.3 (Version 3.3 of the Mortgage Industry Standard Maintenance Organization Reference Model) which was first released in February, 2015. Why was MISMO 3.3 so late? It could not be released until Fannie Mae and Freddie Mac issued the final version of their Uniform Closing Dataset (which has 899 elements).

Systems to support the new TILA-RESPA Integration must be developed to interact with the new version of MISMO, so systems development could not move very quickly until the data elements were in place. Some lenders use vendor systems, some lenders use their own systems exclusively, other lenders use vendor modules for items like this (which must then be integrated into the lender's own loan origination systems). In addition, some institutions that use vendor systems, use different vendor systems for quality control, which requires not only integration with the lender's own systems, but also with other vendor systems. Vendor systems that address the new TILA-RESPA requirements are currently being delivered, often in a beta or preliminary state and integration is, for many lenders, still in process. Finally, staff training, an essential part of making the systems work as designed, cannot really start until the systems are up and running.

While the lender has the ultimate responsibility for implementing these changes, as well as for making sure that each and every loan fulfills the TILA-RESPA requirements, the lender deals with many different vendors including mortgage brokers, title insurance agents, attorneys, closing (settlement) agents, and pest inspectors. Each of these parties must be integrated into the process as well. The lenders must set up systems to track approved vendors and their fees, and have a mechanism that allows approved vendors to communicate changes in those fees. This includes vendors in the 0 percent tolerance categories, as well as those in the 10 percent tolerance category (pest inspectors, title insurance agents, settlement agents). Compliance systems must be developed to monitor all of these vendors.

In short, even though lenders have had a long time to implement this rule, time which, arguably, they could have made better use of, the operational issues are overwhelming, and many institutions are not yet completely set up, or have not adequately tested their capacity to handle these issues. There will be many institutions using manual work-arounds until all their systems work together seamlessly. A hold-harmless period will allow both the CFPB and lenders to work through all these issues, from vendor management to the clarification of the rules applicable to a delayed closing.

A hold-harmless period will force implementation on August 1, but will give industry participants an important learning period. Without this period, the severe consequences for errors under TILA may cause lenders to reduce originations, ultimately harming the borrowers this was designed to help.

Ultimately, TRID, if implemented properly, should result in a vast improvement in the consumer experience. Let’s give the lenders the breathing room they need to do this right.

The Path Forward

It is important to realize that the TILA-RESPA Integrated Disclosure is a minor operational issue, overwhelmed in importance by the much broader question of what the future state of the housing finance market will look like. Thus far there has been no legislative housing reform, nor does such reform appear likely in the near term. The Federal Housing Finance Agency (FHFA) has made great strides to place the GSEs on the path many of us, including myself, hoped legislative reform would take us. In particular, I believe, as does a strong bipartisan contingent, that the goals of legislative reform should be to preserve the 30-year fixed-rate mortgage, assure broad access to credit, and move the bulk of the risk to the private market.

Among this group, there has been a growing recognition that the government and hence the taxpayer must bear the catastrophic risk, but this should be insulated behind the private capital so that the risk that it is ever tapped is remote. The argument for the government to bear the catastrophic risk: it is necessary if the 30-year fixed-rate mortgage is to remain affordable; without a government guarantee, mortgage loans are not fungible, liquidity is compromised, and the cost of all mortgages goes up. Moreover, without a liquid market, lenders would not be able to sell mortgage loans forward, hence making it significantly more costly for borrowers to lock their rate before closing. Essentially, the so-called TBA (to be announced) market, in which pools of mortgages can be bought and sold on a forward basis without knowing exactly which loans are included, is critically dependent on the government guarantee.

While there is a developing bipartisan consensus on the goals of GSE reform, there has been little legislative consensus on how to accomplish GSE reform. And it seems unlikely that the necessary consensus can be developed before the next presidential election. While the ultimate resolution of the GSEs will require Congress, the FHFA has taken actions to reduce taxpayer risk, improve the system's functions, and expand access to credit. We will first review the actions taken by the FHFA, then discuss the limitations to administrative reform.

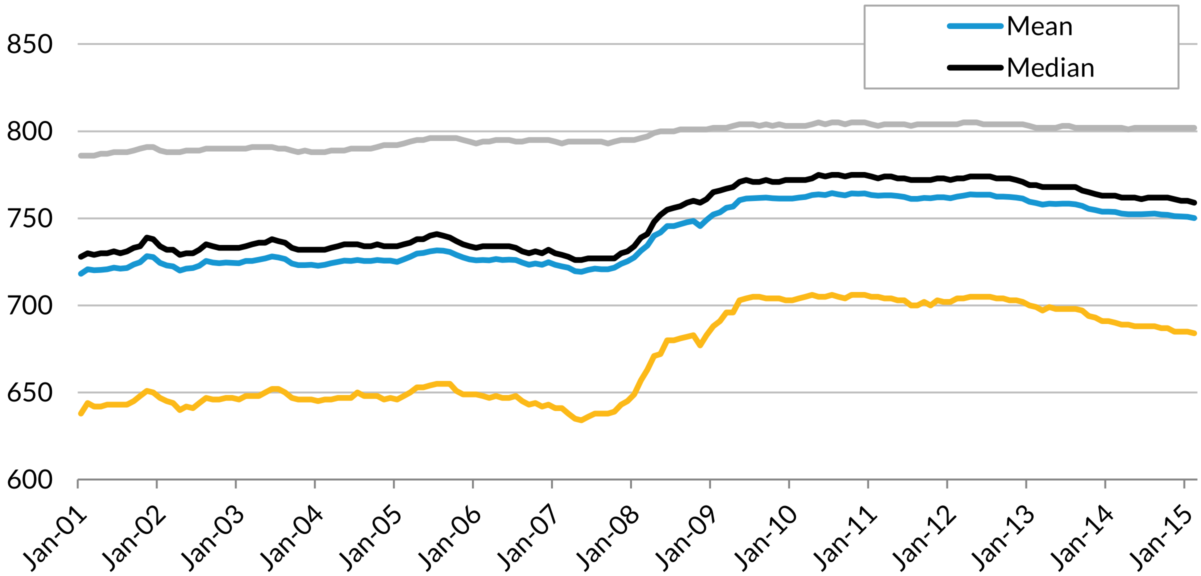
In 2012, under former Acting Director Ed DeMarco, the FHFA outlined the strategic goals under which it would move forward. This basic vision, albeit with some changes in emphasis, has continued under the leadership of Director Mel Watt. In its 2014 Strategic Plan, FHFA outlined its reformulated strategic goals:

- maintain, in a safe and sound manner, foreclosure prevention activities and credit availability for new and refinanced mortgages to foster a liquid, efficient, competitive, and resilient national housing finance market;
- reduce taxpayer risk through increasing the role of private capital in the mortgage market; and
- build a new single-family securitization infrastructure for use by the GSEs and adaptable for use by other participants in the secondary market in the future.[i]

Credit Availability

The first goal is to enhance credit availability. Following the collapse of the housing market in 2008, the GSEs tightened their credit standards. However, on top of these already prudently tight credit standards, some originators have imposed additional conditions such as higher minimum credit score requirements. Figure 1 shows FICO scores over time for GSE borrowers purchasing a home. Note that the mean score has gone from 722–725 in the 2001 to 2007 period, rose sharply to 762 by 2011, and has tapered to 752 in 2014. The 10th percentile of scores has moved up even more dramatically, from 644 in 2001 to 688 in 2014.

Figure 1: FICO Score at Origination for GSE Purchase Mortgages



Source: Urban Institute calculations from CoreLogic Servicing data.

These credit overlays resulted from a number of factors. First, lenders fear that if they make a loan and it later goes on to default, the GSEs will find some small defect in the loan, and will put the loan back to the lender, as is permitted under the GSE Representation and Warranty framework. Second, the costs of servicing delinquent loans are high and very variable. Finally, lenders fear litigation risk. While the final element is beyond the control of the FHFA, the first two are within their scope and they have taken extensive actions to respond to lender concerns while maintaining the sound operation of the GSEs.

Rep and warrant clarity. Recognizing that the lack of clarity about the representation and warranty requirements has contributed to the overlays, the GSEs have made a number of attempts to clarify these requirements, and to inform lenders that they will be held responsible only for defects in the loan manufacturing process, not the advent of a serious delinquency. These actions include the introduction of sunsets, clarifications of life of loan exclusions and earlier due diligence.

In September, 2012, the FHFA, Fannie Mae and Freddie Mac each announced a new rep and warrant framework, effective on January 1, 2013, in which rep and warrant relief was provided for loans with 36 months of consecutive, on-time payments. For Home Affordable Refinance Program loans, rep and warrant relief was provided after 12 months of on-time payments. In May, 2014, the sunset eligibility requirements were relaxed to allow loans with no more than two 30-day delinquencies and no 60-day delinquencies during the applicable 36- or 12-month period to qualify.

In November 2014, the Watt FHFA put out detailed clarifications of the rep and warrant claims that run for the life of the loan and do not sunset. These life-of-loan exclusions include (1) misrepresentations, misstatements and omissions; (2) data inaccuracies; (3) charter compliance issues; (4) first-lien enforceability or clear title matters; (5) legal compliance violations; and (6) unacceptable mortgage products. The first two items received the most attention, as they were the focus of originator fears. A misstatement, for example, must involve at least three loans delivered to the GSE by the same lender, be "significant," and be made pursuant to a common activity involving the same individual or entity.

The most important shift is that the GSEs are identifying loans with manufacturing defects much earlier in the process, giving lenders feedback and greater certainty. Think of it this way: if students are walking into a final exam and they have turned in homework all semester, taken the midterm and received their grades on both the homework and midterm, they will be far more comfortable than they would be if the course only had a final exam, and they had received no feedback. The ultimate goal is that the detection systems improve to the point that detection can be done at the point of origination. For example, if the appraisal is within a certain tolerance of the value computed by the GSEs automated system, the GSE should be able to assure the lender they have no further liability on the appraisal.

Servicing delinquent loans. The high costs and uncertainty associated with servicing are a contributing factor to lender overlays. The GSEs have always required servicers to pay compensatory fees if the servicer's timeline to foreclose exceeds the "allowable delays", timelines published by the GSEs due to factors within their control. Before November 2014, these state-by-state limitations were so tight that two out of three loans that went through foreclosure were flagged as over the allowable limit. While a servicer is not responsible for "uncontrollable delays" once a loan is flagged, the servicer must establish the extent of such delays on a loan-by-loan basis, a cumbersome process with an uncertain outcome. In November 2014, the timelines were recalibrated and extended, so only 40 percent of the loans would exceed the target. In addition, Lenders whose compensatory fees are under $25,000 for the month are exempt from these compensatory fees; this effectively exempts many smaller lenders.

Increasing the Role of Private Capital

The FHFA's Strategic Plan calls for Fannie Mae and Freddie Mac to reduce taxpayer risk by increasing the role of private capital in the mortgage market. This is to be done through four channels: deepening the credit risk transfers for the GSEs' single family credit guarantee businesses, ensuring the stability of the mortgage insurance companies that the GSEs depend upon for taking the first loss risk on mortgages over 80 LTV (the Private Mortgage Insurance

Eligibility Requirements [PMIERs]), continuing with multifamily transactions that share credit risk with market participants, and the ongoing reduction of the GSEs' retained portfolio.

Single Family Credit Risk Sharing Arrangements and PMIERs

Credit risk sharing arrangements can be broken down into two types: risk sharing of loans already in portfolio (back-end risk sharing) and risk sharing of loans at the point of origination (front-end risk sharing). Thus far, the GSEs have focused primarily on the back-end risk sharing arrangements.

Freddie Mac did the first credit risk transfer deal in mid-2013 through its Structured Agency Credit Risk (STACR) shelf, and has since completed a total of 11 transactions, laying off part of the risk on $281.1 billion of its $1.6 trillion total portfolio, or 18.1 percent of its book of business. Fannie Mae, through its Connecticut Avenue Securities (CAS) Shelf, has completed 7 transactions, laying off part of the risk on $299.2 billion of its $2.5 trillion total portfolio, or 11.4 percent of its book of business. Table 1 provides a comprehensive list of the STACR and CAS transactions to date.

Table 1: CAS and STACR Deals

Fannie Mae – Connecticut Avenue Securities (CAS)		
Date	*Transaction*	*Reference Pool Size ($ millions)*
October-13	CAS 2013 – C01	$26,756.40
January-14	CAS 2014 – C01	$29,308.70
May-14	CAS 2014 – C02	$60,818.48
July-14	CAS 2014 – C03	$78,233.73
November-14	CAS 2014 – C04	$58,872.70
February 2015	CAS 2015 - C01	$50,192.00
Fannie Mae Total Reference Collateral		**$299,182.00**
Percent of Fannie Mae's Total Book of Business		**11.40%**
Freddie Mac – Structured Agency Credit Risk (STACR)		
Date	*Transaction*	*Reference Pool Size ($ millions)*
July-13	STACR Series 2013 - DN1	$22,584.40
November-13	STACR Series 2013 - DN2	$35,327.30
February-14	STACR Series 2014 - DN1	$32,076.80
April-14	STACR Series 2014 - DN2	$28,146.98
August-14	STACR Series 2014 - DN3	$19,746.23
August-14	STACR Series 2014 – HQ1	$9,974.68
September-14	STACR Series 2014 – HQ2	$33,434.43
October-14	STACR Series 2014 – DN4	$15,740.71
October-14	STACR Series 2014 – HQ3	$8,000.61
January-15	STACR Series 2015 – DN1	$27,600.00
March-15	STACR Series 2015 - HQ1	$16,551.60
April-15	STACR Series 2015 - DNA1	$31,875.70
Freddie Mac Total Reference Collateral		**$281,059.44**
Percent of Freddie Mac's Total Book of Business		**18.11%**

Sources: Fannie Mae, Freddie Mac, and Urban Institute.

These deals are evolving over time: the typical deal structure prior to 2015 was that Freddie or Fannie kept a small first loss piece, then sold then next 2.7–4.2 percent of the risk, and retained the remaining risk. In STACR 2015 DN1 and subsequent deals, Freddie sold the first loss piece. The most recent Freddie deal, STACR 2015- DNA1, completed in April, 2015 was the first deal in which Freddie Mac calculated losses based on actual severity rather than based on a pre-set severity schedule. In addition to these capital market executions, both Freddie and Fannie have completed several reinsurance arrangements, laying off risk already on their books.

By contrast, front end risk sharing is very much in its infancy. Fannie Mae has completed three transactions in which it allowed the originator to share risk at the point of origination in exchange for a meaningful reduction in g-fees: one with JPMorgan Chase, one with Redwood Trust and most recently, one with PennyMac. This type of transaction must, by its nature, be restricted to larger originators. The MBA has proposed a slightly different type of risk sharing: deep mortgage insurance, which insures the value of the mortgage down to a level where the GSEs are unlikely to take a loss. Currently standard mortgage insurance will take a 95 percent LTV loan to 67 percent. Deep mortgage insurance would bring it down to, say 50 percent LTV. This could be done on a loan-by-loan basis, making it more attractive for smaller entities.

One prerequisite for front-end risk sharing is that the private mortgage insurance counterparties be in a strong enough financial position that Fannie and Freddie are willing to take on additional counterparty risk with these entities. That is, the PMIs are vital to the system; the GSEs are required by charter to have first loss credit enhancement to support mortgages with loan-to-value ratios in excess of 80 percent. Private mortgage insurers have provided the major mechanism by which the GSE's are able to meet this requirement. However, the financial crisis exposed weaknesses both from a financial and operational perspective; leaving the GSEs to in some cases take losses as a result of weak PMI counterparties. The PMIERs rules that were announced in April, 2015, addressed the operational issues and increased the capital requirements for these institutions. The capital requirements are now set such that the PMIs can meet their obligations, even under very adverse market conditions. This should pave the way for front end risk sharing using deep MI.

The direction for bringing capital back is well in place. The FHFA strongly believes that the GSEs should aggressively ramp up their credit risk transfer operations and should have a wide variety of credit risk transfer tools available. The 2015 Strategic Scorecard requires that Fannie Mae transact credit risk transfers on reference pools of single family mortgages with an unpaid principal balance (UPB) of at least $150 billion; Freddie Mac's requirement is $120 billion. By contrast the 2013 requirement was $30 billion apiece and the 2014 requirement was $90 billion apiece. The 2015 scorecard requires that each GSE use at least two types of credit risk transfer structures. It is likely that private capital will continue to return to the housing market through these credit risk transfer transactions.

Multifamily Credit Risk Transfers

On the multifamily side, credit risk transfers have long been an integral part of the business model. Fannie Mae uses loss-sharing through its delegated underwriting system, while Freddie Mac uses a capital markets execution. These models have been highly successful, as confirmed by the performance of the GSEs' multifamily portfolio through the crisis. The FHFA is not requiring any changes to the multifamily credit risk transfer process at the present time. However, the 2014 Strategic Plan makes it clear that the "FHFA will explore whether transfers of additional risk can be achieved within the Enterprises' multifamily business models by evaluating whether private capital is willing to share additional credit risk for multifamily and at what cost….The FHFA will review the results of this analysis and will consult stakeholders to determine whether FHFA should consider making changes in Fannie Mae's and Freddie Mac's multifamily credit risk transfer models."[ii]

Shrinking the GSE portfolios

Prior to the crisis the GSEs had both accumulated large portfolios of mortgage-backed securities and mortgages, which were funded by unsecured debt. These portfolios were not necessary for the smooth functioning of the mortgage-backed securities market, but were rather used for income generation. In fact, these portfolios generated well over two thirds of the GSEs' profits in the 2004–2006 period, and highlighted how the GSEs' implicit government backing conferred unfair advantages such as a lower cost of funds. Since the profits were privatized and the losses were socialized, the GSEs were incented to build up large investment portfolios, which could be funded at wider margins than their competitors.

The first Senior Preferred Stock Purchase Agreement, in September, 2008, required the GSEs to wind down their portfolios at 10 percent per annum. The Senior Preferred Stock Purchase Agreement, as amended in 2012, required the GSEs to reduce their retained portfolios at an annual rate of 15 percent, until each portfolio reached a target level of $250 billion, which could occur no later than December 31, 2018. As of March 2015, Fannie's portfolio stood at $411.7 billion, while Freddie's portfolio stood at $405.6 billion. This combined total of $812.3 trillion is less than half of the 2008 peak of $1.65 trillion, and most of the way to the combined target of $500 billion. The FHFA is also directing the GSEs to reduce taxpayer risk by selling less liquid assets in an economically sensible manner.

The Common Securitization Platform and the Single Security

FHFA has been working with the GSEs to develop a Common Securitization Platform (CSP) infrastructure and improve the liquidity of the GSEs' securities through the development of a single common security. The CSP would focus first on supporting the existing GSE single family securitization activities; after almost seven years in conservatorship, both GSEs have systems that have been patched numerous times and need an overhaul. To create a single security, which will improve liquidity, the two GSEs must use the same systems. The CSP is a huge piece of software, requiring work on five distinct modules: data validation, issuance support, disclosure, master servicing operations, and bond administration.

The single common security is designed to reduce the disparity in value between Fannie and Freddie securities. Currently Fannie securities trade more successfully than Freddie's due to higher liquidity. As a result, Freddie Mac "makes up" part of this differential, essentially providing a rebate of guarantee fees to its lenders, in order to attract business, to the detriment of taxpayers. The FHFA has proposed a structure in which the securities are standardized with the same delay (that currently used by Fannie Mae) and the same disclosures (that currently used by Freddie Mac), essentially incorporating the best features of each security.[iii] Fannie Mae would continue to issue Fannie securities, Freddie Mac would continue to issue Freddie securities, both using the standardized structure. Under the proposal, Fannie securities would be deliverable into Freddie's Giant Pools and Freddie's securities would be deliverable into Fannie's Mega Pools. This should eliminate the value disparity, because if Freddie securities sell "too cheap", market participants will opt to deliver Freddie Mac securities into Fannie's Megas.[iv]

What else should be done administratively?

There are two additional steps that FHFA can and should take to improve upon the system we have today and offer more flexibility to reform the housing finance system in the future. First, they should direct the GSEs to gather more information on how the market would price risk. This includes both first-loss risk as well as the risk associated with different (credit score, loan-to-value ratio) buckets.

In a new or reconstituted system, the government would drop into the role of a re-insurer, insulated behind a great deal more private capital taking first loss risk. Yet, to date, we have precious little sense of how the market will handle that first loss risk. Freddie has completed a few structures this year in which the first loss risk is shared. Front-end risk sharing is by its nature a sharing of first loss risk, but there have been relatively few front-end risk sharing transactions. As a result, we simply don't know which structures will most benefit consumers, which will most benefit the market and which will show greatest returns to the GSEs.

In addition, we have no information on how the market would price (lower credit score, higher LTV loans). This is critical information: if private capital was to be placed in a first loss position, the design of the system might well depend, in part, on whether and how much cross subsidization was required. In the STACR and CAS deals, there is segmentation by loan-to-value ranges, but these loans are not further segmented by credit score. It would be helpful for the FHFA to explicitly direct the GSEs to experiment with structures that provide for this price discovery, so that when Congress re-engages again on long term reform, no one need guess about these critical questions.

Second, the FHFA should make clear that the end objective of the development of the securitization platform is not an agency-only platform, which would only further entrench the duopoly. It is important to take care of the present system first, but it should be clear that the end objective should be a platform which is designed to be open to other market participants. This will reduce rather than heighten barriers to entry for an expanded set of participants.

Which reforms require legislative action?

While dramatic steps have been taken on the administrative side to move toward a more permanent housing finance system, administrative reforms, even if they continue, cannot take the final steps. In particular, the GSEs cannot be taken out of conservatorship and recapitalized without legislation. They cannot be replaced without legislation. There cannot be new competitors without a new housing finance system, which requires legislation.

Some have asserted that the administration could simply change the PSPAs to stop requiring dividends and let the institutions rebuild capital, after which the institutions could be sold to private investors.[v] Others have argued this is not so easy in practice.[vi]

Even if the GSEs were able to rebuild capital it would take them many years to build a level of capital acceptable to support their book of business.[vii] Moreover, it is not clear how viable the GSEs would be if they exit conservatorship without a government guarantee. Without a government guarantee, existing GSE paper would have a full faith and credit guarantee,[viii]while new paper would not. It is not clear how well the housing finance market would function or how much mortgage interest rates would rise if securities backing loans sold to the GSEs lacked a catastrophic government guarantee.

If the GSEs were to exit with a government backstop, under the PSPAs, the taxpayer is owed a fee equal to the value of the backstop. A fee equal to the fair value of the Treasury's $258 billion line of credit would be prohibitively high, particularly in combination with trying to build capital. Thus, as a practical matter, the GSEs cannot exit conservatorship with or without a guarantee absent legislation. Moreover, they cannot be replaced without legislation, and new entrants cannot enter without legislation.

Conclusion

It is important that the CFPB create a hold-harmless period after the implementation of the TILA-RESPA Integrated Disclosures. The idea behind the rules was to enhance the consumer experience. Implementation without a grace period on liability until the industry is ready will do exactly the opposite.

But TRID is a minor operational issue in a world where the future of the housing finance system remains unresolved. And this is an issue that ultimately cannot move without Congressional action. The FHFA has been leading the GSEs down the path of administrative reform, accomplishing many of the goals that housing finance reform was meant to accomplish: preserve the 30-year fixed-rate mortgage, assure broad access to credit, and transfer the bulk of the risk to the private market. However, there are a number of items that administrative reform cannot accomplish. Administrative reform cannot take the GSEs out of conservatorship and recapitalize them or replace them or allow for more competitors. For that, we need Congressional action.

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[i] The 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac, Federal Housing Finance Agency (FHFA), May 13, 2014.

[ii] Ibid, page 14.

[iii] See the Request for Input, Proposed Single Security Structure, Federal Housing Finance Agency (FHFA), August 12, 2014.

[iv] See Laurie Goodman and Lewis Ranieri, "Charting the Course to a Single Security," Housing Finance Policy Center Commentary, Urban Institute, September 3, 2014.

[v] See Jim Millstein "Its Time for Administrative Reform to End the Conservatorships", *MetroTrends* (blog), Urban Institute, May 29, 2014.

[vi] See Jim Parrott, "Why the GSEs Need Congress to Exit Conservatorship", *MetroTrends* (blog), Urban Institute, May 29, 2014.

[vii] Lets look at the math. If the GSES needed to accumulate a 4 percent capital requirement on $4.2 trillion of assets, the GSEs would need $168 billion of capital. Assuming steady state earnings of 30 bps on new single family production (after all expenses, losses, and the payroll tax surcharge), that is $12.6 billion of net income. Assuming $2.5 billion on their multifamily business, and $7.5 billion on the portfolio (150 bps on a combined $500 billion of portfolio holdings), that produces a net profit of $22.6 billion between the two GSEs. Even if the Treasury dividend were zero, it would still take almost 7.5 years to accumulate the capital. At a more reasonable dividend, and actually paying back the outstanding obligation, it would take much longer.

[viii] Section 6.3 of the PSPAs prohibits any change that would compromise the interest of the agency MBS investor, so a full faith and credit guarantee, as essentially promised is essential. If the GSEs were to be recapitalized without a backstop, it would compromise liquidity. Does this compromise the interest of agency MBS investors? It is likely this would result in litigation, leaving the decision to the courts.