Testimony of
The Honorable Robert M. Couch
Before the Committee on Banking, Housing and Urban Affairs
United States Senate

Housing Finance Reform: Powers and Structure of a Strong Regulator

Thursday, November 21, 2013

Chairman Johnson, Ranking Member Crapo, and members of the Committee, thank you for the opportunity to be here today to discuss housing finance reform.

Before I get into the substance of my remarks, I want to commend the Committee for the deliberate, bipartisan approach it has taken in examining this very complicated subject, one of immense importance to the American people and our nation's economy. The series of hearings that the Committee has convened have done an excellent job in illuminating the key decision points in designing a new, more sustainable housing finance system. These hearings, in turn, have performed a vital service by helping educate the public.

This past March, the Committee heard from my good friend and colleague Senator Mel Martinez, who outlined the housing finance reform recommendations of the Bipartisan Policy Center Housing Commission.

Founded in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole, and George Mitchell, the Bipartisan Policy Center is a Washington-based think tank that actively seeks bipartisan solutions to some of the most complex policy issues facing our country. The Housing Commission was launched in October 2011 with the financial support of the John D. and Catherine T. MacArthur Foundation. The commission has 21 members from both political parties who bring to the table a wide variety of professional experiences. Former Senators George Mitchell, Kit Bond and Mel Martinez, and former HUD Secretary Henry Cisneros, serve as commission co-chairs.

Suffice it to say that the commission strongly supports the objectives of S. 1217, the Housing Finance Reform and Taxpayer Protection Act, and I am pleased that many of the bill's provisions reflect our own recommendations. Like S. 1217, the commission proposes the wind down of Fannie Mae and Freddie Mac over a multiyear transition period; a greater role for private capital in assuming mortgage credit risk; and a continued government presence through a limited "catastrophic" guarantee of mortgage-backed securities that is funded through the collection of actuarially sound fees charged to borrowers. The commission believes that a limited government guarantee in the secondary market is essential to ensure widespread access to long-term and fixed-rate mortgage financing, in particular the 30-year fixed-rate amortizing single-family mortgage.

The Powers of the New Regulator

The new housing finance system envisioned by the commission and outlined in S. 1217 will only work with a strong regulator at the system's center. This regulator will function as "Mission Control" for the new system and will be charged with fulfilling two responsibilities that are admittedly in tension: promoting a widely accessible mortgage market, while protecting the wallets of the American taxpayers.

The commission calls its proposed regulator the Public Guarantor, while S. 1217 establishes the Federal Mortgage Insurance Corporation ("FMIC") to assume the regulatory and guarantee functions currently performed by the Federal Housing Finance Agency ("FHFA"), Fannie Mae, and Freddie Mac.

Under the system envisioned by the commission and outlined in S. 1217, the new regulator would have significant powers and responsibilities, including (a) guaranteeing investors the timely payment of principal and interest on covered mortgage-backed securities ("MBS"); (b) collecting fees in exchange for providing this insurance as well as to cover operational costs; (c) establishing and maintaining a catastrophic risk fund; (d) developing credit risk-sharing mechanisms for private entities to assume the first-loss position; (e) qualifying private institutions to serve as issuers of securities, servicers, private mortgage insurers, bond guarantors, and other types of credit enhancers; and (f) overseeing and supervising the common securitization platform developed by the FHFA.

S. 1217 also commendably seeks to promote transparency and standardization in the market by directing the FMIC to maintain a database of uniform loan level information on eligible mortgages, establish an electronic registry for eligible mortgages that collateralize covered securities, and develop standardized securitization agreements. Greater transparency and standardization should encourage more risk-bearing private capital to enter the mortgage system.

As the former president of a savings bank in Alabama, I particularly appreciate the provisions of S. 1217 that require the FMIC to facilitate access to the secondary market by small, mid-size, and community banks, many of whom may lack securitization capabilities. Ensuring access to the government-guaranteed secondary market on full and equal terms to lenders of all sizes and types was a major objective of the commission.

Looking at S. 1217, let me highlight five areas where the Committee can strengthen the FMIC's role in the new housing finance system while promoting mortgage liquidity:

1. The Ginnie Mae Model. The commission examined a variety of models around which to design a new housing finance system. We concluded that the Ginnie Mae model offers a number of distinct advantages that can be successfully reproduced in the segment of the mortgage market now dominated by Fannie Mae and Freddie Mac. This model has a proven track record of promoting broad access to affordable mortgage credit while posing minimal risk to the taxpayers.

An important advantage of a Ginnie Mae-like approach is that it allows for a greater number of financial institutions to be issuers of MBS. As applied to the FMIC, the Ginnie Mae model would carefully align the interests of all the parties in the mortgage chain and allocate risk among them: 1) the borrowers (who have down payment and home equity risk and, in some states, face the risk of a deficiency judgment); 2) the MBS issuers (who maintain the risk associated with "representations and warranties") and the mortgage servicers (who have risk for the timely payment of principal and interest); and 3) a credit-enhancement facility that assumes "first-loss" credit risk. Like Ginnie Mae, the Public Guarantor would stand in the fourth-loss position (behind borrowers, MBS issuers and mortgage servicers, and private credit enhancers) with a significant buffer of protection for the taxpayers.[1]

As you revisit S. 1217, we urge you to consider legislative language that would allow the FMIC to replicate the Ginnie Mae model as a part of its ongoing operations.

*2. Common Securitization Shelf***.** The commission felt strongly that the portion of any new housing finance system guaranteed by the Public Guarantor must have a single security or "common shelf" for single-family mortgages in order to ensure the system's liquidity, interact effectively with the To-Be-Announced (TBA) market, and establish an equal playing field for lenders of all sizes. A common shelf also allows mortgages with different terms, interest rates, and other attributes to be pooled into a single security.

In our proposal, the Public Guarantor is specifically directed to provide a common shelf. Based on our reading, it is unclear whether S. 1217 contemplates the FMIC guaranteeing a single, common security or multiple securities. We recommend that the FMIC be explicitly directed to provide a common shelf for the segment of the market it backstops and to focus its efforts on promoting the liquidity of the new mortgage-backed securities.

*3. Resolution Authority***.** Under the commission's proposal, the Public Guarantor would have the authority to temporarily take over the business of issuers, servicers, and/or private credit enhancers that happen to fail and to transfer that business to other private participants in the mortgage system. S. 1217 does not appear to give the FMIC the same type of resolution authority. With resolution authority, the FMIC can

[1] Ginnie Mae in its current form might not have sufficient capacity to become the Public Guarantor, but might be a suitable vehicle if given greater authorities and flexibilities.

help preserve liquidity and ensure a fully functioning market, particularly during periods of economic stress.

4. Emergency Authority. The commission also proposed that the Public Guarantor be given the authority to price and absorb first-loss credit risk for limited periods during times of severe economic stress in order to ensure the continued flow of mortgage credit. Under these circumstances, the Public Guarantor would be required to notify the Treasury Department, the Federal Reserve, and the chairs of the appropriate congressional committees before taking any such action.

S. 1217 provides the FMIC with similar emergency authority, but this authority is subject to a number of more stringent conditions. First, the authority may only be exercised upon the *written* agreement of the Chairman of the Federal Reserve Board and the Treasury Secretary, in consultation with the HUD Secretary. Second, it may only be exercised for a period of six months. Third, the authority may not be exercised more than once in any given three-year period.[2] While these safeguards are understandable, the Committee may wish to consider empowering the FMIC with the flexibility to respond more quickly to emergency conditions in the mortgage market.

5. Wind down of Fannie Mae and Freddie Mac. The hard and fast five-year deadline that S. 1217 proposes for transitioning from the current government-dominated housing finance system to one in which private capital plays a larger role in bearing credit risk may not allow for sufficient flexibility and adjustments during this critical period. The commission adopts a more flexible approach by suggesting that a transition period of five to ten years be built into the legislation.

Structure and Governance of the New Regulator

The FMIC and the Public Guarantor are similar in that both would be self-supporting institutions that do not rely on federal appropriations but rather finance their catastrophic risk funds and operational expenses through the collection of guarantee fees. The primary purpose here is to protect the taxpayers from unnecessary risk, but operating largely outside the appropriations process also gives the institutions some insulation from political interference.

S. 1217 describes the FMIC as an "independent agency of the Federal Government,"[3] whereas the commission proposes that the Public Guarantor be established as an independent, "wholly-owned" government corporation under the Government Corporation Control Act of 1945.[4] The commission concluded that establishing the

[2] Section 205.
[3] Section 101(c).
[4] Examples of wholly-owned government corporations include Ginnie Mae, the Export-Import Bank of the United States, the Overseas Private Investment Corporation, and the Pension Benefit Guaranty Corporation.

Public Guarantor as a wholly-owned government corporation would provide it with an additional layer of protection from political influence while subjecting it to well-established budgetary and fiscal controls.[5] We encourage you to examine whether this type of organizational structure is appropriate for the FMIC.

S. 1217 appropriately specifies that the multifamily businesses of Fannie Mae and Freddie Mac must be transferred to the FMIC, and it appears that the Mortgage Insurance Fund would cover both single-family and multifamily mortgage-backed securities.[6] The commission, on the other hand, concluded it was best to establish separate single-family and multifamily catastrophic risk funds since single-family and multifamily lending are fundamentally different businesses with different underwriting approaches. I encourage the Committee to take a second look at this issue.

Governance

With respect to the governance of the new regulator, the commission ultimately recommended vesting authority in a single individual appointed by the President of the United States and subject to Senate confirmation. In reaching this judgment, we recognized that the regulator of the new system would have an enormous set of responsibilities, particularly in the early stages of the new system's build out. Our view was that putting a single person in charge would promote accountability and ease of decision-making.

Ginnie Mae does not operate under a Board of Directors with management oversight responsibilities.[7] In my view, and speaking as a former President of the organization, Ginnie Mae has consistently been one of the best-run organizations within the federal government. But I certainly understand that its governance model is somewhat unique among federal agencies and there are logical reasons for establishing a Board of Directors for the FMIC.

---

[5] While there is no general incorporation statute at the federal level, the Government Corporation Control Act of 1945, as amended ("GCCA"), does provide for standardized budget, auditing, debt management, and depository practices for most government corporations. Under the GCCA, "wholly-owned" government corporations are required to submit annual "business type" budgets to the President. See Kevin R. Kosar, *Federal Government Corporations: An Overview,* Congressional Research Service (June 8, 2011). Among a number of items, these budgets must a) contain estimates of the financial condition and operations of the corporation for the current and following fiscal year, b) contain estimates of operations by major activities, administrative expenses, borrowings, and any appropriations that may be needed to restore capital impairments, and c) provide for emergencies and contingencies. Budgets submitted to the President by the government corporation become part of the budgets submitted by the President to Congress.

[6] See Section 203.

[7] The President of Ginnie Mae is responsible to the Secretary of HUD and, ultimately, to the President of the United States.

The most compelling reason is that re-booting our nation's housing finance system and running the FMIC is a huge undertaking requiring a deep bench of experience. An engaged, experienced Board of Directors can be an enormously valuable asset to the Director of the FMIC. While the Director should have demonstrated experience in financial management and a broad understanding of the capital markets, he or she must also be someone who can draw upon and utilize the skills of others, including the members of the FMIC Board, and inspire the members of the FMIC staff to work at a high level of proficiency. Having these personal qualities is essential for the FMIC Director to be effective.

If, as contemplated by S. 1217, the FMIC is to be managed by a Board of Directors, I encourage the Committee to amend the legislation to ensure that members of both political parties are represented on the Board. Bipartisan representation on the FMIC Board will provide some assurance to the public and Congress that the Board is making decisions for sound operational and risk-management reasons, and not because of political considerations. Building public confidence in the new housing finance system will be particularly critical in the early stages of its development.

There is plenty of precedent for this bipartisan approach: Critical financial regulatory agencies like the Securities Exchange Commission and the Commodities Futures Trading Commission are required to have political balance. Likewise, no more than three members of the five-member Board of Directors of the Federal Deposit Insurance Corporation may have the same political affiliation. While there have been occasions when these and other similarly-governed Boards and commissions have descended into partisan bickering, the totality of the evidence over the years suggests they have worked reasonably well.

I strongly support S. 1217's requirement that members of the FMIC Board have significant experience in at least one of the following fields: asset management, mortgage insurance, community banking, and multifamily housing.[8] This requirement will help ensure that relevant experience is represented on the Board. There is also precedent for this approach. For example, one of the members of the FDIC Board is required by statute to possess a background in state bank supervision.

During my career in the mortgage banking industry, I have seen first-hand how duplicative and overlapping examination and reporting requirements can increase expenses and raise mortgage costs. To improve coordination among our nation's financial regulators, as well as to facilitate information sharing about market developments and potential risks to the stability of the financial system, I support S. 1217's decision to make the Chairperson of the FMIC a member of the Financial Stability Oversight Board ("FSOC").[9] As we build a new housing finance system, FSOC should

[8] Section 103(a)(1)(B)(i) through (iv).
[9] Section 102(c).

promote regulatory streamlining and harmonization and, when appropriate, encourage regulators to rely on the work and conclusions of their counterparts to avoid unnecessary duplication.

Finally, I support the establishment of an Office of Inspector General ("IG") within the FMIC to promote the efficient operations of its programs and detect and deter fraud and other forms of corruption.[10] I also support the additional requirement established in S. 1217 that the FMIC IG conduct periodic audits of the adequacy of the private capital assuming the first-loss position in the new housing finance system and make recommendations for addressing any deficiencies.[11] By requiring the IG, as well as an independent actuary, to issue annual reports to Congress on the adequacy of the guarantee fees charged by the FMIC and the Mortgage Insurance Fund itself, S. 1217 provides an important mechanism to assist Congress in performing its oversight responsibilities.[12]

Thank you for your attention. I look forward to your questions.

---

[10] Section 104.
[11] Section 104(a)(2)(A)(i).
[12] Section 104 (a)(3)(A) and (B). S. 1217 also requires the Comptroller General of the United States to conduct an annual audit of the financial transactions of the FMIC. These audits, too, should assist Congress in performing its oversight responsibilities. Section 106(c).