Statement of

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Subcommittee on Securities, Insurance, and Investment

"Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions"

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Chairman Tester, Ranking Member Johanns and members of the Committee, my name is Sandra Thompson and I am the Deputy Director for Housing Mission and Goals for the Federal Housing Finance Agency (FHFA). Thank you for the opportunity to appear before you today to discuss the important role that community-based financial institutions play in the nation's housing finance system.

As you know, FHFA regulates Fannie Mae, Freddie Mac (the Enterprises) and the 12 Federal Home Loan Banks. Combined, these institutions support over $5.5 trillion in mortgage assets nationwide. FHFA has also served as the conservator for Fannie Mae and Freddie Mac for close to five years now. We take this responsibility very seriously and have focused on our statutory mandate to ensure the Enterprises operate in a safe and sound manner while preserving and conserving their assets.

Before joining FHFA in March, 2013, I spent 23 years with the Federal Deposit Insurance Corporation (FDIC), most recently as Director of the Division of Risk Management Supervision. In this capacity, I was responsible for all aspects of FDIC's risk management examination activities for approximately 4,500 FDIC-supervised institutions nationwide, overseeing a distributed workforce of employees deployed in six regional offices and 84 field offices across the country.

At the FDIC, I was involved in several outreach efforts designed to understand the vital role that community bankers play not only in their local communities, but also in the overall economy. Engaging in regional roundtable discussions and other forums, provided valuable insight from community bankers, their trade organizations and state banking commissioners about the challenges and opportunities they encounter in the banking industry.

In a similar manner, FHFA is committed to undertaking outreach efforts to better understand the activities of community-based financial institutions in the housing finance industry. As discussed later in my testimony, we are meeting with community bankers, credit unions, mortgage bankers and trade associations to help us better understand their access to and interaction with the secondary mortgage markets. Since joining FHFA I have participated in one meeting so far, and what is clear is -- without access to liquidity, many community-based lenders could not be active in the primary market.

In my testimony today, I would like to make the following points:

- Community-based financial institutions play an important role in the provision of housing credit;

- During conservatorship, FHFA has taken meaningful steps to ensure community-based lenders have equal access to the secondary market; and

- It is vital to ensure that community-based institutions have the ability to fully participate in the housing finance system of the future.

The Role of Community-Based Lenders

Community-based lenders play an important role in the provision of housing credit. In addition to broadly supporting the financial services needs of their customer base, this role is particularly important for certain areas of the country, for certain types of borrowers, and for certain types of mortgage products.

There is no generally accepted definition of "small lender" or "community bank" within the industry or between the Enterprises. Federal bank regulators generally define them as institutions with under $1 billion in assets, while employing various exceptions to this definition. The Enterprises generally define community-based lenders as lenders originating less than $1 billion of mortgages per year regardless of the institution's total asset size.

Despite the fact that community-based lenders account for a small percent of the residential mortgage lending market, they have a vital role in serving rural and underserved markets nationally. Most importantly, community-based lenders are committed to the people and the places where they lend money. They are a stabilizing force in their local markets and generally engage in responsible lending. Community-based lenders have a long history of making sound mortgage loans, choosing not to originate the kinds of abusive and predatory loans that contributed to the housing and financial crisis. This type of responsible lending helps local economies thrive.

Community-based lenders are particularly important in smaller and rural communities where lending can be challenging. Standard documentation that aggregators or large lenders require from mortgage originators before accepting loans for securitization may be more difficult to produce in smaller and rural communities. For example, appraisals for collateral located in rural areas and documentation for self-employed and seasonally-employed borrowers may not be acceptable to a larger lender and therefore may not be acceptable for secondary market participation, resulting in many small lenders retaining loans in their portfolios. Having lenders active and involved in smaller markets can be the difference in local borrowers having access to single family home financing.

For many community-based lenders, participation in the primary mortgage market is predicated on their ability to access the secondary market. This requires an established relationship with a secondary market participant. Historically, these lenders have maintained relationships with Fannie Mae and Freddie Mac, the Federal Home Loan Banks, Government National Mortgage Association (GNMA or "Ginnie Mae"), private label securitizers, and correspondent banks.

Since the financial crisis, private label securitizers have been almost entirely absent from the single family market, while a number of correspondent banks have either curtailed or abandoned that business. Today, a large number of community-based lenders continue to depend on relationships with Fannie Mae, Freddie Mac and/or the Federal Home Loan Banks for access to the secondary mortgage market. They also interact with Ginnie Mae when originating FHA and VA loans.

Also, some community-based lenders that are members of a Federal Home Loan Bank are opting to sell their loans directly through the Federal Home Loan Bank System's Acquired Member Asset program. In some cases, the Federal Home Loan Bank buys loans outright for its portfolio, but increasingly the Federal Home Loan Bank acts as an aggregator for small lenders, buying loans from members and then selling them to Fannie Mae.

The Chicago Federal Home Loan Bank sponsors and administers the Mortgage "MPF Xtra" program, where whole loans are aggregated directly from members and sold to Fannie Mae for securitization. The "MPF Xtra" program is the largest seller using cash execution at Fannie Mae, delivering over $6.9billion in residential mortgage whole loans during 2012. Members of seven different Federal Home Loan Banks, including Chicago, utilize this cash execution in the secondary market.

Fannie Mae and Freddie Mac offer mortgage originators two options for delivering loans for securitization. Mortgage originators may either sell loans for cash through Freddie Mac's "cash window" or Fannie Mae's "whole loan conduit" or they may exchange loans for mortgage-backed securities in an MBS swap transaction. In this testimony we use the term cash window to refer to both Enterprises' mechanisms for delivering loans for cash. Through the cash window, the Enterprises purchase loans that meet their standards directly from lenders, packaging them into securities and selling the securities to the market. The cash window is a mechanism designed to enhance the liquidity of the lender.

Smaller lenders who do not have the scale to participate in the guarantor business generally use the cash window, although lenders of all sizes sell loans through this path. Fannie Mae and Freddie Mac each have an existing selling and/or servicing customer relationship with over 1,000 community-based lenders. Some institutions have relationships with both Enterprises.

Across all entities conducting business with the Enterprises -- including banks, credit unions and mortgage bankers, -- cash window volumes at Fannie Mae tripled from 2007 to 2012 and doubled at Freddie Mac over the same period. In 2012, over 2,200 customers sold $286 billion in loans for cash (one loan at a time or in bulk) representing 25 percent of Fannie Mae's purchase volumes and 19 percent of Freddie Mac's purchase volumes.

Over the past five years, the total volume of loans delivered to the Enterprises by community-based lenders has increased substantially. For example, in 2007, only 3.6

percent of loans delivered to Freddie Mac came from outside the top 100 lenders. In 2012, this increased to 15.1 percent of all loans at Freddie Mac, more than a fourfold increase. From 2007 to 2012, the number of community-based lenders at both Enterprises increased by 18 percent.

During conservatorship, FHFA has taken meaningful steps to level the playing field

FHFA has undertaken initiatives that maintain and help ensure community-based lenders have equal access to the secondary market. Last fall, FHFA mandated an increase in guarantee fees for mortgage-backed security (MBS) swap transactions relative to those charged for cash window transactions. Since large lenders tend to engage in swap transactions and small lenders tend to engage in cash transactions, the intended effect of these changes was to level the playing field between small and large lenders. This action followed price adjustments earlier in the conservatorships that had already significantly reduced the substantial pricing advantages large customers of the Enterprises historically used. Data provided to FHFA by both Enterprise indicates this objective has been achieved.

FHFA has also directed both Enterprises to align and streamline their servicing standards, and has encouraged consistent customer access and management through standard eligibility and counterparty requirements. In this regard, FHFA has discouraged the implementation of new minimum customer annual activity thresholds for selling, servicing and utilizing the Enterprises' automated underwriting systems. Freddie Mac's proposed "low activity" fee of $7,500 would have created a significant financial burden on smaller community-based lenders and discouraged their ability to obtain liquidity in the secondary mortgage market. With FHFA encouragement, the fee was changed and now there is only a minimal fee for community-based lenders who have not delivered a loan within the past three years. This fee allows small lenders to maintain their approved seller status, which is important because it keeps the option open to make future sales to the Enterprise.

It is vital to ensure that community-based lenders can participate in the future housing finance system

FHFA believes it is critical to include community-based lenders as we take steps to prepare the foundation for a new housing finance system. There should not be a significant difference in how large and small lenders are treated when securitizing residential mortgage loans. We are developing and executing alignment activities between the Enterprises, by establishing common data standards and uniform legal and contractual documents. Standardization of both data requirements and contractual language necessary for securitization will go a long way toward leveling the playing field between large and small securitizers.

In 2010, FHFA directed the Enterprises to initiate, develop and deploy a Uniform Mortgage Data Program (UMDP). This effort is designed to capture consistent and accurate mortgage data, improve loan quality, and enhance risk management capabilities.

A solid foundation of data standards is crucial to the future of housing finance and will allow lenders of all sizes to participate in the marketplace on equal footing. Developing an industry standard makes it far easier and cheaper for all lenders, including community-based ones, to acquire the necessary technology from a third-party vendor and apply it within their institution.

A component of UMDP that is currently underway is the Uniform Mortgage Servicing Data (UMSD) project. UMSD will expand and standardize the servicing dataset used for managing performing and nonperforming loans and for disclosure reporting. FHFA and the Enterprises are working with the industry to define the complete UMSD dataset requirements at this time; full build-out and industry adoption is expected to take several years. FHFA and the Enterprises are working with the Mortgage Industry Standards Maintenance Organization (MISMO) to ensure that UMSD data points are accurately defined and specified for industry adoption. We are also working with other Agencies and the Enterprises to standardize origination data collected through the new Consumer Financial Protection Bureau (CFPB) Closing Disclosure Form, which integrates parts of the HUD-1 and the final Truth in Lending forms. The Enterprises are also working to expand and reorganize the data collected on the Uniform Residential Loan Application (URLA).

FHFA has also made the Enterprises' development of the technical and functional capabilities of the Common Securitization Platform (CSP) a key component of the strategic goal to build a new infrastructure for the secondary mortgage market. The Common Securitization Platform is the technological means for packaging mortgages into a variety of security structures. It also provides the operational support to process and track the payments from borrowers to investors. Initially, the platform will be the infrastructure the Enterprises use for data validation, issuance, disclosure, master servicing and bond administration for their securities. This framework will connect capital markets investors to homeowners and is being developed with the potential to be used by other issuers in the future in a housing finance system with or without a government guarantee. It is also vitally important that all lenders, large and small, have access to the Common Securitization Platform.

Recently, FHFA in conjunction with the American Bankers Association (ABA), hosted a meeting with community bankers with operations in towns with populations as low as 11,000 from seven states. These bankers have relationships with their Federal Home Loan Bank, and with either Fannie Mae or Freddie Mac. The discussion centered on the role these banks play in serving primarily rural, small and potentially underserved communities. The asset size of these institutions ranged from $233 million to $508 million. In 2012, they originated between $35 million to $166 million in residential mortgage loans.

This was the first event in a larger outreach effort FHFA is undertaking to engage community-based lenders. We plan to meet with more groups of community-based financial institutions over the next month, leveraging the expertise of their respective industry trade groups, including the Independent Community Bankers Association

(ICBA), the National Association of Federal Credit Unions (NAFCU), Credit Union National Association (CUNA), the Mortgage Bankers Association (MBA), and multiple State Bankers Associations. The meeting with the ICBA member banks will be held in Chicago on August 12th. Similar to the initial meeting with the ABA members, we intend to raise and address the following:

- How to maintain and maximize community-based lender relationships with Fannie Mae, Freddie Mac and the Federal Home Loan Banks;
- How to ensure community-based lenders are on equal footing with larger competitors; and,
- The challenges and opportunities community-based lenders face, particularly in either rural or underserved areas.

After we have met with community-based lenders, we will review their feedback and consider changes to Enterprise processes and policies that would address issues of concern and provide benefit to smaller institutions.

The Federal Home Loan Banks may also have an opportunity to expand their role. This is especially important as the aggregation role for non-jumbo mortgage loans provided by the private label securitization model has largely evaporated. As Acting Director DeMarco recently commented at the 2013 Federal Home Loan Banks Directors Conference, there is opportunity for the Federal Home Loan Bank system to expand upon the limited loan aggregation role they are playing today with the Mortgage Partnership Finance (MPF) programs. With the existing cooperative structure, the Federal Home Loan Banks could offer liquidity with securities markets levels of execution, aggregating non-homogenous mortgage loans from members that would be funded with capital from global sources. As we consider a future secondary market with a reduced government guarantor role, providing members with aggregation services to access various types of secondary market execution might become an important opportunity for the Federal Home Loan Banks.

Conclusion

As we move closer to reforming our nation's housing finance system, it is important to ensure that community-based lenders are able to fully participate in the new system. In many respects, this means ensuring equal access to the secondary mortgage market, since for many community-based lenders the ability to be active in the primary market is based on an ability to access the secondary market. As conservator, FHFA has taken several steps to level the playing field for community-based lenders. We believe ensuring their participation in the future system is in the public interest and we stand ready to work with this Committee to see this goal reached. Thank you, and I am pleased to answer any questions you may have.