Senator Johnny Isakson

The Mortgage Finance Act of 2011

Purpose

The Mortgage Finance Act transitions and creates a new regulatory framework for high quality mortgage securitization (for Qualified Residential Mortgages – "QRM") for both single family and multifamily mortgages, and accomplishes the following:

1. Resolves and eliminates Fannie Mae and Freddie Mac (through orderly receivership).
2. Fully pays back the American taxpayer for the cost of the Fannie Mae and Freddie Mac bail out.
3. Creates a new facility to guarantee securitizations of high quality QRM single family and multifamily mortgages.
4. Creates a catastrophic fund to protect against any future housing collapse.
5. Transitions the new facility to full privatization within 10 years from the date of enactment.

Central Dilemma In Any GSE Reform Proposal

No plan for GSE reform – to date – has appropriately confronted the central and critical issue of whether or not there is a government wrap or guarantee. Before Fannie Mae and Freddie Mac were placed in conservatorship, every MBS and debt issuance included the express disclosure that they were "not backed by the full faith and credit of the federal government." Despite that proclamation and disclosure, we now know that is not the case, that at times of national financial crisis the government may have no choice but to become involved, and the taxpayer will be on the hook. Regrettably, because of this precedent, going forward, it will be impossible to create a market mechanism or entity that the capital markets will ever believe is not backed by the federal government. The issue then is to recognize that dilemma, eliminate any implied guarantee, replace it with an explicit government guarantee, properly manage and pay for the guarantee, and build in protection for the American taxpayer.

The debate over the guarantee should not be the obstacle when other workable models exist. Consider the FDIC. The FDIC is a government agency that serves as an insurance company over deposits placed in federally regulated banks. Bank customers, through fees collected by the bank, pay for the protection of federal deposit insurance. The banking system hangs on the protection and backdrop of the FDIC but on a day-to-day basis flourishes with the market certainty of the protected deposits. Why not do the same with high quality mortgage securitization? The Isakson proposal will continue the progression of the high quality QRM, by creating a new mortgage facility or government agency that guarantees pools of QRM mortgages for a fee. The fees it charges will protect it from the risks of guaranteeing the performance of MBS, will build an industry funded catastrophic fund to eliminate the call on the federal government in the event of any future mortgage market collapse, and will provide for additional layers of private capital ahead of the federal government once the catastrophic fund is fully capitalized.

Senator Isakson Plan

Step One - Eliminate Fannie Mae and Freddie Mac and Pay for the Bailout

- Eliminate Fannie Mae and Freddie Mac, consolidating their operations and mortgage portfolios, putting them in run-off (receivership) by FHFA no later than 18 months from the date of enactment. Once placed into receivership, Fannie Mae and Freddie Mac will be prohibited from engaging in any new business. They will be required to immediately commence orderly liquidation.

- All remaining proceeds from the operations under receivership shall go to repaying the taxpayers for the obligations incurred in connection to the GSEs' failure in September 2008 – the amount of the bailout.

- The combined assets, including on-balance sheet portfolios, shall be managed by the Receiver to obtain resolutions that maximize the return for the taxpayer with all of the proceeds going to repay the government for the bailout.

- Any short fall from the bailout of Fannie and Freddie after the completion of the wind down in receivership shall be recouped: (1) by the sale -- in whole or in parts -- of the new Mortgage Finance Agency at the completion of the 10 year term, with any surplus going to fund the national debt; and (2) if still a deficiency, by such excess sums collected for the catastrophic fund not needed to carry out the function of the guarantee.

Step Two: Create the new Mortgage Finance Agency for Single Family and Multifamily QRM Mortgage Securitization

- A new Mortgage Finance Agency shall be created and chartered to guarantee pools of high quality single family and multifamily (QRM and QMM) mortgages securitized by approved lenders.

- The purpose of the MFA is to provide a dependable, transparent and liquid secondary (TBA) market to ensure access to high quality mortgages, with <u>equal</u> guarantee fee pricing for all lenders.

- The MFA will charge guarantee fees that will be actuarially based and priced to cover expected losses, capitalize the new catastrophic fund, finance purchases of supplemental insurance from the private sector and finance operations of the new entity. The revenue generated from the g-fees will score on budget and, after recoupment of start-up costs, shall not require government resources going forward.

- The MFA shall establish standards for a QRM that shall reflect the statutory language from Dodd-Frank, and not the narrow interpretation (20% down payment requirement) of the exclusion in the March 30, 2011 proposed rule. The language of the new bill – for the QRM definition – shall specifically permit 5% minimum down payment lending supported by private mortgage insurance.

- The MFA shall establish standards for multifamily mortgages that shall reflect industry standards for high quality multifamily mortgages, including LTV caps and minimum debt service ratios. The MFA shall also promulgate regulations for the financing of multifamily QMMs and shall facilitate the liquidity in the multifamily market by guaranteeing commercial mortgage backed securities backed by high quality multifamily mortgages.

- The MFA will be headed – on a day-to-day basis -- by a presidentially appointed Director, and governed and regulated by a board including the Director, a presidentially appointed Vice Chair, the Chair of the SEC, the Secretary of HUD and the Chairman of the Federal Reserve or their designees.

- There will also be a presidentially appointed advisory board comprised of members with housing and finance expertise that will review and opine on the planning of, and progress toward, privatization.

Step Three: Transition the Mortgage Finance Agency to fully private function

- No later than the third year from the date of enactment, the MFA shall, in consultation with its Board of Directors, develop a detailed plan for the orderly transition and sale (in whole or in parts) of the MFA no later than at the conclusion of the 10 year term. The MFA shall report to Congress on the transition plan in fifth year from the date of enactment, and shall update Congress on the status of the transition annually thereafter. The advisory board will also assist with, and report on, planning for privatization.

- All proceeds from the transition and sale of the MFA shall go to satisfy the unpaid balance of any obligations or residual costs of the receiverships of Fannie Mae and Freddie Mac, then the remaining obligations of the MFA, and finally the residual to pay down the national debt.