



**Statement of Michael D. Berman, CMB**

**Chairman-Elect,  
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**Before the**

**Committee on Financial Services**

**United States House of Representatives**

**Hearing on**

**“Housing Finance –  
What Should the New System Be Able to Do?:  
Part I – Government and Stakeholder Perspectives”**

**March 23, 2010**

Chairman Frank, Ranking Member Bachus, thank you for inviting the Mortgage Bankers Association<sup>1</sup> to testify on the very important issue of the present and future status of the secondary mortgage market. My name is Michael D. Berman, CMB, and I am the Chairman-Elect of MBA. I have been in the real estate finance industry for over 25 years, and I am a founder and principle of CW Financial Services and the President and Chief Executive Officer of CWCapital. Headquartered in Needham, Massachusetts, CW is a national lender to the multifamily and commercial real estate industry, with over 340 employees in 13 offices throughout the United States. My responsibilities include overseeing the strategic planning and operations for all of the company's loan programs, including multifamily programs with Fannie Mae, Freddie Mac and the Federal Housing Administration (FHA). Also, CW has been active in the commercial mortgage-backed securities arena as an investor, lender, issuer of securities, servicer and special servicer for over 22 percent of all commercial mortgage-backed securities (CMBS) in the United States.

In the midst of the turmoil in the housing finance system, MBA advocated a three-step approach to government relief efforts. The key elements of this approach were a) stabilize the markets, b) assist homeowners facing difficulties with their mortgages, and c) prevent a recurrence of the problems that created the current crisis. Congress and the Administration have made great strides in all of these areas. Federal Reserve actions, the Troubled Asset Relief Program (TARP) program and federal support for Fannie Mae and Freddie Mac have brought a level of stability to a system that was in dire need of it. Programs like the Home Affordable Modification Program (HAMP), while unable to help all borrowers in all situations, have assisted many who otherwise would have had to surrender their homes. And regulatory reform and other legislation being discussed by this Committee and others can, if properly structured, provide key safeguards to reduce the chances that the country will face another credit crisis like that of the past two years.

As a result of these and other efforts, signs of recovery are appearing.

But the current dynamic in the secondary mortgage market is unsustainable. We cannot press reverse, and we cannot stay stagnant. Our only choice is to move

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

forward. Congressional action on the GSEs is needed to attract private capital back to the market and to re-establish a self-sustaining mortgage finance system. MBA has specific recommendations for a framework to ensure housing finance liquidity.

I have the privilege of chairing MBA's "Council on Ensuring Mortgage Liquidity." This 23-member council is made up of industry practitioners from the single-family, multifamily and commercial sides of the industry. It includes depository institutions, mortgage banking firms, mortgage insurers and others.

During a House Financial Services Subcommittee hearing, chaired by Congressman Paul Kanjorski last June, I testified that MBA had been considering various approaches to ensuring the long-term viability of the secondary mortgage market. Specifically, the Council on Ensuring Mortgage Liquidity had been evaluating what a functioning market should look like for the long-term.

At that hearing I spoke of the guiding principles the Council had developed to serve as a tool for evaluating proposals that may arise for restructuring the secondary market. Shortly after that hearing, MBA and the Council released a set of concrete recommendations for the future government role in the secondary mortgage market.

Before describing the specific recommendations, I will highlight some of their most important characteristics.

First, the recommendations are based on a key set of principles. MBA's Council on Ensuring Mortgage Liquidity has been examining these issues for more than a year and a half. The group took a deliberate approach to developing its recommendations, building from a set of key considerations to principles to the recommendations themselves. I believe the thoughtful approach is in evidence in the recommendations.

Second, the recommendations are grounded in pragmatism. They were developed by a council of industry practitioners who understand the capital markets and have perspective on what will and will not work. At this juncture, we cannot afford to pursue unworkable plans that do not take account of market realities.

Third, MBA's proposal is distinct in its focus on ensuring an efficient secondary mortgage market, its reliance on private capital and its insistence on multiple layers of protections for taxpayers. Keeping all three of these goals in mind is imperative.

## **MBA'S GUIDING PRINCIPLES**

As I noted, before MBA developed its recommendations, it developed a set of principles by which a variety of proposals could be assessed. The full set of principles is attached to this testimony, but let me characterize a number of them in three general points.

First, secondary mortgage market transactions should be funded with private capital.

Second, in order to promote uninterrupted market liquidity for the core of the mortgage market, the government should provide an explicit credit guarantee on a class of mortgage-backed securities. This guarantee should be paid for through risk-based fees.

Third, taxpayers and the system itself should be protected through limits on the mortgage products covered, limitations on the types of activities undertaken, strong risk-based capital requirements, and actuarially fair payments into a federal insurance fund.

A key conclusion of this is that the government's guarantee should be at the security-level, not the enterprise-level. The existing system extended an implied federal backing to all the activities of Fannie Mae and Freddie Mac, including not only their mortgage guarantees, but also their portfolio investments, derivative counterparties and corporate bondholders. Some of those activities were clearly undercapitalized, underpriced and under-supervised. As you will hear, in our proposal the degree of federal backing would be greatly reduced, making explicit what is guaranteed and what is not, and establishing mechanisms to properly capitalize, price and supervise those activities.

## **MBA'S RECOMMENDED MODEL**

Since I testified last June, the MBA and its Council have released a suggested framework for the government's involvement in the single-family and multifamily secondary mortgage markets. I will briefly describe some of the key elements in my testimony. I have attached the full recommendations for further reference. While clearly not the only potential framework for the future, the Council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market.

The centerpiece of MBA's recommendation for federal support for the secondary mortgage market is a new line of mortgage-backed securities. Each security would have two components: a) a security-level, federal government-guaranteed "wrap" (GG); which would in turn be backed by b) private, loan-level guarantees

from privately owned, government-chartered and regulated mortgage credit-guarantor entities (MCGEs). The government guarantee would be conceptually similar to that provided by Ginnie Mae by guaranteeing timely interest and principal payments to bondholders and explicitly carrying the full faith and credit of the U.S. government. These guarantees would be supported by a federal insurance fund, capitalized by risk-based fees charged on the supported securities. This government wrap will help provide affordable financing rates, as could risk-based fees. In supporting their own loan-level guarantees, the MCGEs would rely on their own capital base as well as risk-retention from originators, issuers and other secondary market entities such as mortgage insurers. Investors in the guaranteed mortgage-backed securities would face no credit risk, but would take on the interest-rate risk from the underlying mortgages.

It is important to note that while the mortgage-backed securities in this model would be guaranteed by the government, the MCGEs as institutions would not. The corporate debt and equity issued by the MCGEs would be purely private. As with other firms, investors in MCGE equity and debt would accept the potential risk of failure and loss. For this reason, the MBA proposal recommends regulators charter enough MCGEs to establish a truly competitive secondary market, and to overcome issues associated with “too big to fail.”

MBA’s proposal combines an acknowledgement that only a government guarantee can attract the depth and breadth of capital necessary for sustainable market liquidity through all economic cycles, with a reliance on private capital, insistence on multiple layers of protections for taxpayers and a focus on ensuring a competitive, efficient secondary mortgage market.

## **IMPORTANCE OF THE TRANSITION**

Another key feature of MBA’s position on the future of the GSEs is more operational than structural, but it is equally important. Any restructuring proposal must include consideration of, and measures to facilitate, the transition from the current to the future state. This is imperative because the market’s condition is still quite fragile and even the most carefully deliberated plan could destabilize the market further if implemented hastily.

MBA recognizes the need for GSE reform. Further, we recognize the need to keep the market functioning through any transition and to minimize the costs of the clean-up of the GSEs. We believe that there are measures that can be undertaken now to begin moving these companies in the right direction on a number of fronts. For example:

- During the boom, the GSEs, along with all other players in the industry, took on too much credit risk. As a result of the crisis, credit underwriting has become more conservative across the industry, including at the

GSEs. Regulators can look to these tighter standards to gain important lessons with regard to defining “core products” for the market going forward. Now is the time to focus the GSEs on a narrower range of mortgage products, fully documented loans, and underwritten using conservative ratios. This core of the market is what needs to be protected throughout the country at all times.

- Many of the GSEs’ unnecessary risks stemmed from their portfolio holdings. As originally proposed by former Treasury Secretary Henry Paulson, and as recently reiterated by Federal Housing Finance Agency (FHFA) Director Edward DeMarco, it is important to affirm plans to wind down the GSEs’ portfolios to a *de minimis* level. FHFA should direct that effort, being cognizant of market conditions, and the supporting role that the portfolios could play in the near term.
- Clearly defining the path to a new role for the GSEs will have several benefits. Most importantly, we recognize that the GSEs have built valuable infrastructures, relationships, and intellectual capital that the industry needs to retain. Ideally, we would envision the use of a good bank/bad bank strategy to retain the best people, processes, and infrastructure from the GSEs as we move to the new MCGE framework. Identifying and laying out a clear path forward will remove much of the current uncertainty, and ensure that the GSEs’ structural, operational and human resources remain of service in some form for the present and the future. MBA is closely studying issues related to the transition, and I would welcome the opportunity to come back and brief you on our work.

## **OTHER HOUSING FINANCE SYSTEM COMPONENTS**

Any model contemplating the roles currently played by Fannie Mae and Freddie Mac must also contemplate how those roles integrate with other public and private components of the housing finance system.

The MCGE framework is not intended to be the entire market. It is meant to focus on a narrowly defined set of core mortgage products that should be available in all market conditions.

Private investors, whether through whole loans, private label securitization, covered bonds or some other means, are vital to a robust, sustainable secondary market. The MBA proposal recognizes this and supports a re-emergence of the private model. It is anticipated the private market will expand and contract with investor risk appetites.

MBA’s recommended framework also complements existing government funding channels that provide direct support for affordable housing finance, such as FHA,

Ginnie Mae, the Veterans Administration (VA) and Rural Housing Service (RHS). Focusing government subsidies and other affordable housing programs through these channels minimizes market distortions and safety and soundness tensions that existed in the GSEs, while making government support more transparent, as befits such government expenditures. Additionally, as we note in our recommendations, the government guarantee entity could be an appropriate vehicle for an affordable housing fund.

## **OWNERSHIP OF THE GSEs' SUCCESSORS**

In early discussions of the future of the GSEs, former Treasury Secretary Paulson, Federal Reserve Chairman Ben Bernanke and others laid out a spectrum of options for future models – ranging from a fully private mode, to a fully public model. It is important to note that these discussions focused less on what the successors to the GSEs should do, and more on how and by whom they should be owned.

MBA's deliberations focused on what they should do. As such, we have not delved deeply into the specific ownership structures. But in our discussions a few points became clear.

First, the fully private model would be unable to attract the depth and breadth of capital needed to fund the U.S. housing finance system through all market environments. At the end of the day, the U.S. government would still be expected to provide some level of backstop, for which it would have had no advance control, oversight or funding. We concluded this to be unacceptable.

Second, it will be important that any system utilize the private market, and its ability to assess, price and manage risk and efficiently operate within a known set of constraints. While we believe it is essential for a portion of the market to have a government guarantee to retain liquidity, it is also essential that private capital be at risk to ensure that lending is efficient, effective and responsive to market conditions. Additional concerns about capacity, funding, responsiveness and political distraction make it clear that a fully-government-based system would not be optimal.

Our conclusion is that any ownership system going forward must be able to attract private capital to serve as a buffer and reserve against losses. To do that, it must provide a competitive return on equity and debt capital. It must also ensure that those private investors shoulder the vast majority of risks.

## **CONCLUSION**

I appreciate the opportunity to testify today and to present MBA's perspective. MBA's Council on Ensuring Mortgage Liquidity has been studying the issues

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before this Committee for the past year and a half, but most of the members of the Council and the MBA have been working on them for our entire careers. Our deliberations on these topics continue. As we work on the economics of the business model for the MCGEs and the GG insurance fund, as well as a transition roadmap. I would welcome the opportunity to update you on our work.

In closing, I want to thank the Committee for holding this hearing. The topics before you are sometimes contentious, often complex, and always important. As the Committee continues its work, I would ask that you emphasize three more important concepts. First, recognize the importance of fixing the system. Second, emphasize getting it right. And last, minimize disruptions during the transition.

Thank you.