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— Janet Yellen, Chairman, Federal Reserve Board of Governors
May 7, 2014

Introduction

The overall state of the US economy is significantly affected by the residential housing market, which is a key driver of GDP and job growth. As demonstrated in recent statements by Federal Reserve (Fed) Chairman, Janet Yellen, and the Financial Stability Oversight Council (FSOC) in its 2014 Annual Report, as well as several legislative proposals under consideration, the health of the housing market remains a key concern for policy makers. While there is general consensus that a greater role for private capital in the housing market is desirable, the appropriate balance and the path to get there remain elusive. The importance of housing to the nation’s economic health is reflected in the efforts to reform our national housing finance system; however, this process is far from complete.

This ViewPoint is the fifth in a series on housing finance policy. Much has changed since our last housing finance update in August 2013. There is a new Fed Chair, a new Federal Housing Finance Agency (FHFA) Director, and a new Department of Housing and Urban Development (HUD) Secretary (see Exhibit 1); the Fed is “tapering” its monthly purchases of mortgage-backed securities (MBS); and notwithstanding what had appeared to be a steady housing market recovery since the crisis, the housing market has shown mixed signals in the first half of this year. After boosting gross domestic product (GDP) for twelve straight quarters, residential investment was a detractor from growth in the first quarter of 2014. Further, while pending home sales data jumped 6.1% to an eight month high in May, new home sales dropped 8.1% in June, creating a mixed picture. Throughout this period, many of the key issues in our housing finance system remain unchanged – Fannie Mae and Freddie Mac, the two largest housing government-sponsored enterprises (GSEs) are still in conservatorship, approximately 99% of residential MBS issuance is

BLACKROCK PRINCIPLES FOR HOLISTIC HOUSING FINANCE REFORM

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The opinions expressed are as of August 2014 and may change as subsequent conditions vary.
government guaranteed,

the question of how to reduce the

US government dominance of the housing finance market

remains unanswered, and in the absence of comprehensive

legislative reform, regulatory agencies continue to forge

ahead with various activities altering the housing finance

landscape.

In this paper, we review the status of the housing market and

a number of the legislative, regulatory, and policy initiatives

underway. As we have indicated in previous papers,

BlackRock views this policy arena from the perspective of

investors and supports a comprehensive and holistic

approach to housing finance reform. Importantly, we

acknowledge the need for the presence of a government

guarantee in the mortgage market, while also

recognizing the need for a judicious reduction of the government’s current role

and a more normalized level of private capital assuming credit

risk. As we have said previously, the return of significant

private capital to the mortgage market requires a transparent

process that provides certainty and respect for the rights of

investors, both in the current framework and in the

subsequent transition to any future system.

Housing Market Overview

The US housing market has recovered significantly from the

historic lows of the financial crisis; however, the housing

market is showing mixed signals as of late. Continued

improvement in home prices coupled with a reduction in

delinquencies and foreclosure (Exhibits 2, 3 and 4) is

encouraging. These higher prices coupled with higher

mortgage rates (Exhibit 5) have reduced affordability

somewhat (Exhibit 6). Yet, affordability remains high by

historic standards. Coinciding with this reduction in

affordability, sales of single family homes decreased earlier in

the year (Exhibit 7). However, the most recent data has been

mixed, with May pending home sales increasing 6.1% to an

eight month high, while June new home sales dropped 8.1%.

A host of factors have contributed to these mixed signals in

the housing market, including not only interest rates, but also

impediments to credit, and deferred new household formation,

partially exacerbated by burgeoning student loan debt (see

sidebar on page 4).

The convergence of these factors, in

part, fueled by the uncertainty and the inconsistency in

housing finance policy and regulatory activity fosters a level of

concern and exerts a continued drag on the US

housing market recovery.

Exhibit 1: NEW FACES IN HOUSING FINANCE

As we explained in our August 2013 housing finance update, there

are many people and agencies involved in housing policy who

each have a significant influence over various aspects of housing

finance. Since our last update, four of the key seats have transitioned.

- **Federal Reserve Board of Governors**
  - **Janet Yellen, Chair**
  - **Confirmed:** Jan. 6, 2014
  - **Succeeded:** Ben Bernanke
  - **Previous Position:** Vice Chair, Federal Reserve

- **FHFA**
  - **Mel Watt, Director**
  - **Confirmed:** Dec. 10, 2013
  - **Succeeded:** Ed DeMarco
  - **Previous Position:** US Congressman, North Carolina, 12th District

- **HUD**
  - **Julian Castro, Secretary**
  - **Confirmed:** Jul. 9, 2014
  - **Succeeded:** Shaun Donovan
  - **Previous Position:** Mayor, San Antonio, Texas

- **National Economic Council (NEC)**
  - **Jeffrey Zients, Director and Assistant to the President for Economic Policy**
  - **Assumed Role:** Mar. 5, 2014
  - **Succeeded:** Gene Sperling
  - **Previous Position:** Acting Director, Office of Management and Budget

Exhibit 2: US HOME PRICES

Source: National Association of Realtors as of June 2014 and S&P/Case-Shiller as of April 2014.
Exhibits 3 and 4: LEVELS OF DELINQUENCIES, FORECLOSURE and Real-Estate-Owned (REO)

Delinquency Levels Excluding Foreclosure and REO

Levels of Foreclosure and REO

Source: Loan Performance, BlackRock Solutions®.

Exhibit 5: 30-YEAR FIXED RATE MORTGAGE RATE

5%

4%

3%

Dec-12 Mar-13 Jun-13 Sep-13 Dec-13 Mar-14

Source: Mortgage Bankers Association of America. As of June 2014.

Exhibit 6: US AFFORDABILITY INDEX

Source: National Association of Realtors. As of May 2014.

Exhibit 7: US SINGLE FAMILY HOME SALES

Continued Government Dominance

The US housing market continues to rely on extraordinary levels of government support, ranging from accommodative monetary policy and purchases of MBS by the Fed, to the predominant role of the GSEs and the Federal Housing Administration (FHA) and Veteran’s Administration (VA) in the assumption of credit risk. Demand for mortgage product from the government ensured liquidity through the crisis and helped to keep rates low for US homebuyers. Over the past few months, the Fed’s accommodative monetary policy has shifted to tapering, resulting in a slight rise in the cost of mortgage credit. Moreover, while the market share of Fannie Mae, Freddie Mac, and the FHA/VA has recently declined slightly, the ongoing federal assumption of mortgage credit risk remains at historically high levels. As of the first quarter of 2014, the share of mortgage originations targeted for government guaranteed securities dropped to approximately 76%. About 22% of originations were targeted for bank portfolios and less than one percent of originations were targeted for private label securitizations.10

Mortgage credit remains tight for a variety of reasons including continued regulatory and enforcement concerns – for example, uncertainty regarding the interpretation of the Consumer Financial Protection Bureau’s (CFPB) Qualified Mortgage (QM) rules – and perceived tightened underwriting standards for the GSEs and FHA. In fact, the mean and median FICO scores on new originations have migrated up nearly forty points over the last decade.11 This constrained availability and the increase in the cost of mortgage credit, have functioned to impair the demand for housing.

Legislative Housing Policy Initiatives

Nearly six years since the financial crisis, the tenuous state of the housing recovery and the significant level of government support continue to attest to the need for comprehensive housing finance reform. Given the various policy pronouncements and legislative proposals currently under consideration in Congress, there is a growing consensus on the need for a greater role for private capital. However, there is considerable debate regarding the appropriate role, level, and delivery mechanisms of such private capital. For example, we have seen significant efforts that culminated in the favorable reporting of housing finance bills out of the respective authorizing committees in both the House and the Senate over the last year, yet, neither chamber has taken up the legislation on the floor. Furthermore, the bills proposed in the House and Senate reflect divergent views on how to address housing finance reform. Considered in conjunction with the upcoming midterm elections, the current status suggests that we are unlikely to see enactment of comprehensive housing finance reform legislation in 2014. Nonetheless, notwithstanding the outcome of the midterm elections, which could alter the shape of housing finance reform, the bills under consideration in this Congress could become templates for future reform efforts and will certainly influence the ultimate outcome. Accordingly, we have set forth a brief discussion of several recent housing finance reform bills.

Senate Banking Committee Bipartisan Efforts: On March 11, 2014, Senate Banking Committee Chairman Tim Johnson (D-SD) and Ranking Member, Senator Mike Crapo (R-ID) announced a bill entitled the “Housing Finance Reform and Tax Payer Protection Act of 2014” (the “Johnson-Crapo Bill”). The Johnson-Crapo Bill was based on the legislation introduced by Senators Corker (R-TN) and Warner (D-VA) in June 2013. This bill proposes, amongst

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Student Loans & Impact on US Housing Market

One factor that has likely contributed to a reduction in new household formation and homeownership is the burgeoning student loan debt burden in the United States (Exhibit 8). As the growth rate in the cost of education has greatly exceeded inflation and as more and more Americans are attending college, many are saddled with significant student loan debt. The economic downturn in the last several years and the higher rates of unemployment and underemployment, particularly among younger Americans, has further contributed to high levels of student loan debt. Individuals with high levels of student loan debt are less likely to be able to afford to buy a home or may not be able to obtain a mortgage given tighter lending standards. Individuals in the age groups that are now saddled with the most student loan debt are largely concentrated in the age cohort that has traditionally represented new household formations and first time homebuyers. This contributes to the drag on the US housing market.

Exhibit 8: STUDENT LOAN DEBT OUTSTANDING

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Source: Federal Reserve Board of Governors. Available at http://www.federalreserve.gov/releases/g19/current/#table1
other things, to eliminate Fannie Mae and Freddie Mac. In their place, a new entity, the Federal Mortgage Insurance Corporation (FMIC) would be established to provide an explicit full-faith-and-credit guarantee on covered mortgage backed securities. This guarantee would be dependent on the mortgage aggregator obtaining 10% first-loss credit support in the form of private capital from either a guarantor or the capital markets. On May 15, 2014, the Johnson-Crapo bill was marked up and voted favorably out of the Senate Banking Committee with thirteen votes for the bill and nine votes against.

This bill has many components which merit strong consideration. For example, we are encouraged by the bipartisan acknowledgment and support for the importance of the government guarantee. Importantly, this bill demonstrates clear recognition of the importance of an adequate transition period to ensure that the existing market is not materially disrupted in the migration to a new housing finance framework. Additionally, we believe it is imperative that a new system ensure the fungibility of legacy securities so as not to “orphan” this substantial market. We also commend the establishment of standardized policies, practices, and documentation for government-backed securities utilizing a common securitization platform. We would further encourage the adoption of such uniform standards, best practices, and documentation for private label MBS as well, and we believe these standards should be augmented to explicitly impute a fiduciary standard for servicers and trustees.

Several components of the Johnson-Crapo Bill engender some concerns that merit further analysis. For example, the legislation’s reliance on the guarantor model to provide the required credit support raises some questions given the poor performance of monoline guarantors during the financial crisis. On the other hand, we are encouraged by the legislation’s embrace of capital markets approaches to providing credit support. The recent credit-linked note transactions executed by the GSEs\(^2\) are appealing to investors. These structures present the opportunity to develop a deep and liquid standardized agency mortgage credit market. We suggest that the final legislation accommodate and embrace comparable structures.

In addition to questions regarding the mechanism and models of credit support contemplated by the legislation, there are questions regarding the amount of private capital required in the bill. BlackRock Solutions\(^®\) analysis indicates that a 4% capitalization is more than adequate to cover losses in a crisis scenario. We question whether there is sufficient private capital available to assume the 10% first-loss credit risk position mandated in the legislation without raising the costs to consumers to prohibitive levels. Assuming sufficient private capital is available to support the 10% first-loss capital provision, it would pose an unnecessary cost to borrowers and impair access to mortgage credit. We strongly urge policymakers to consider the market implications of setting the appropriate level of private capital credit risk transfer requirements.

We note that while the Senate Banking Committee passed the FHA Solvency Act of 2013 on July 31, 2013 by a vote of 21-1, the Johnson-Crapo Bill does not incorporate any of the reforms contained in the FHA reform bill. Comprehensive housing finance reform should include provisions to clearly define the role and strengthen the FHA program. In particular, the core role of FHA to facilitate access to credit should be clarified. As part of FHA reform, a provision that would preclude the refinancing of mortgages seized via eminent domain into FHA insured loans should be incorporated (see sidebar on page 8 for a discussion of eminent domain).

The Johnson-Crapo Bill has enjoyed some momentum this year and was voted out of the Senate Banking Committee with bi-partisan support. The tepid support by the Committee’s Democrats makes it unlikely that the leadership of the Senate will grant it floor time before the midterm elections. There are reports of continued efforts by the bill’s supporters in the Administration and in the Senate to garner additional Democratic support amongst the Senate Banking Committee members in an effort to convince the leadership to bring the bill to a vote on the Senate floor. To date, there has been little indication that these efforts have been successful. Accordingly, the probability of passage of a housing finance reform bill in 2014 is highly unlikely.

House Financial Services Committee Majority Leadership: The leadership of the House of Representatives Committee on Financial Services has espoused a significantly different approach than the Johnson-Crapo Bill. In July 2013, Chairman Hensarling introduced a bill entitled “Protecting American Taxpayer and Homeowners Act” (the “PATH Act” or the “Hensarling Bill”). While the PATH Act seeks to attract private capital to the sector to absorb mortgage credit risk, this bill calls for no future role of government support in the housing finance market beyond a reduced role for the FHA. The proposed PATH Act proposes to eliminate Fannie Mae and Freddie Mac over a five year period and to accelerate the reduction of their retained portfolio. This bill would not replace Fannie Mae and Freddie Mac with any form of government guarantee. The bill would redefine the mission of FHA by limiting its support to first-time and low-to-moderate income homeowners, and would reduce the FHA mortgage insurance coverage to 50% (down from almost 100%). The bill calls for the maintenance of a privately owned securitization platform, seeks several changes to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) mortgage and securitization requirements,
and aims to spur development of the covered bonds market. Finally, the proposed PATH Act would disallow any municipality that utilized eminent domain to seize mortgages from being eligible for GSE or FHA backing of any loan in that jurisdiction for ten years (see side bar on page 8 for a discussion of eminent domain).

While we commend the proposed PATH Act’s effort to address comprehensive housing finance reform, the bill raises several policy questions. Most significantly, the elimination of any form of government guarantee would likely materially impair the availability and increase the cost of mortgage credit to consumers, which would have a resultant impact on the nation’s housing markets. We note the efforts to spur the development of the domestic covered bond market; however, it is not an adequate substitute for the current agency guaranteed mortgage market, especially since covered bonds face resistance from banking regulators. We commend the bill’s efforts to prevent the misapplication of eminent domain by municipalities as eminent domain violates investors’ confidence in the housing finance markets and deters the return of private capital to the sector.

The proposed PATH Act passed out of the House Financial Services Committee on a straight party line vote of 30-27 on July 24, 2013. Most observers place a low probability on this bill moving forward to final passage since it has yet to be scheduled for a House floor vote. This bill remains important as it is expected that this bill will provide a guidepost for future negotiations.

**House Financial Services Committee – “Delaney-Carney-Himes Bill”**: On July 10, 2014, Congressman John Delaney (D-MD), Congressman John Carney (D-DE) and Congressman Jim Himes (D-CT) introduced another housing finance reform bill, the Partnership to Strengthen Homeownership Act. Like the proposed PATH Act, the bill proposes to eliminate Fannie Mae and Freddie Mac over a five year period. Unlike the PATH Act, this bill would replace Fannie Mae and Freddie Mac with a government guarantee provided by Ginnie Mae. Ginnie Mae would be required to seek reinsurance in the private market. Additionally, the aggregator would need to obtain 5% first-loss capital support. By looking to Ginnie Mae to provide the government guarantee, the bill would avoid the need to create a new entity to replace the GSEs as would be required under the Johnson-Crapo bill through the creation of FMIC.

We are encouraged by the bill’s continued support for a government guarantee to secure the nation’s housing finance system. In addition, the 5% first-loss capital support requirement is more reasonable and correlated to the actual historic loss experiences of the GSEs. The reliance on the existing Ginnie Mae infrastructure reduces some of the execution and operating risk implicit in the establishment of a new entity. However, it should be noted that the existing Ginnie Mae capacity and infrastructure would need to be significantly enhanced. The availability and pricing of reinsurance remains an open question. Regrettably, the bill does not address FHA reforms nor the misapplication of eminent domain.

The lack of movement to floor consideration of any of the housing finance reform bills suggests that advancement on the legislative front is highly unlikely in 2014. Moreover, even if the bills that were reported out of the House and Senate respective authorizing committees were passed on the floor of either chamber, the divergent provisions of each bill regarding the role and amount of private capital attest to the challenge of reconciling the bills to a product that would be tenable to the House, the Senate, and the Administration should they ever get to a conference committee. Given the limited number of legislative days before the 113th Congress adjourns and the backdrop of the upcoming midterm elections, the prospects for enactment of any bill this year seem minimal. The path to passage of comprehensive reform for the GSEs is further complicated by the existing litigation regarding the preferred and common stock of Fannie Mae and Freddie Mac.

**Regulatory Reforms**

Multiple US regulatory agencies continue to forge ahead, effectively altering the housing finance landscape. In particular, the actions of FHFA, as the regulator and conservator of Fannie Mae and Freddie Mac, are important and merit consideration. Indeed, new leadership at the FHFA has already signaled a change in direction and a new HUD Secretary just took the helm the last week of July 2014. In addition, a number of Dodd-Frank regulations have been proposed and/or finalized.

**FHFA**

On December 10, 2013, Mel Watt was confirmed as Director of FHFA (see Exhibit 1). Watt was most recently a Democratic Member of the House of Representatives, representing North Carolina’s twelfth district and a veteran of the House Financial Services Committee. On May 13, 2014, Director Watt gave his first public speech as FHFA Director at the Brookings Institution, which outlined his views on the future of the conservatorship of Fannie Mae and Freddie Mac. This speech outlined a shift in emphasis from his predecessor, Ed DeMarco, who served as Acting Director of the FHFA from 2009 to 2013. Specifically, Director Watt said that he does not view the role of the FHFA as that of policy making regarding the future of housing finance. Instead, he indicated that in light of his many years in Congress and his read of the authorizing statutes of FHFA, he views reform of the housing finance system exclusively in the domain of the Congress. Accordingly, he does not view shrinking the GSEs as part of FHFA’s statutory mission. Rather, he indicated that
under his direction, FHFA will, in effect, redefine and re-prioritize focus on the three main goals of, “maintain”, “reduce”, and “build”.14

The “maintain” goal requires the GSEs to carry out and strengthen aspects of their operations to preserve and improve liquidity in the housing finance market. Within this goal, the FHFA will not reduce current loan limits given the concerns regarding how such a reduction could adversely impact the health of the current housing market. FHFA will also ease some of the regulatory burden on lenders related to the representation and warranties “put back” requirements in an effort to encourage lenders to use the full spectrum of the allowable GSE credit parameters. This step is designed to ease some of the current constraints on mortgage credit availability. This would also appear to reconcile regulatory practice with monetary policy. The “maintain” goal is now given the greatest weighting in the GSEs 2014 Conservatorship Scorecard.15

The “reduce” goal is aimed at reducing taxpayer risk by increasing the role of private capital in the mortgage market. The goal no longer includes specific steps to contract the GSEs’ market share, as had been the case under Director DeMarco. Instead, the FHFA will focus on reducing Fannie Mae’s and Freddie Mac’s overall risk exposure. This includes increasing the annual credit risk transfers for the single-family credit guarantee businesses. This will require Fannie Mae and Freddie Mac, each to triple the amount of risk transfers in 2014 from $30 billion (unpaid principal balance) of risk transfers last year to approximately $90 billion in 2014 through the issuance of additional credit linked notes (STACR and CAS) transactions and obtaining other forms of reinsurance. Furthermore, on June 5, 2014, FHFA announced a request for comment on the level of guarantee fees (“g-fees”) charged by Fannie Mae and Freddie Mac. This follows the actions of December 2013, when Director Watt issued a directive to the GSEs to delay the g-fee increase that had been set to occur.

Finally the “build” goal focuses on refining the ongoing efforts to create the Common Securitization Platform (“CSP”) – which is essentially the infrastructure supporting the mortgage securitization and securities issuance process – to narrow its focus to the existing needs of Fannie Mae and Freddie Mac. This narrowed approach means that the FHFA will not seek to build the CSP as a market utility to accommodate all products (agency and non-agency) and market participants and instead will focus only on GSE securitizations.

Dodd-Frank Reforms
Under Dodd-Frank, several regulatory agencies were tasked with rule writing related to various aspects of securitization. Given the complexity and the interplay between these rules, it is critical to take a holistic look at the set of rules rather than just examine each rule independently. The following are some of the highlights of the rules that have been completed or are close to being finalized.

**National Mortgage Servicing Standards**
The CFPB issued final “National Mortgage Servicing Standards” rules on January 17, 2013. The rules became effective on January 10, 2014. Specifically, the regulations: (i) standardize the minimum information and communications that must be provided to borrowers about their mortgages; (ii) establish standards for communication and intervention with delinquent borrowers; and (iii) require servicers to follow loss mitigation procedures and restricts dual-tracking. We have consistently stated that we support clear and consistent national mortgage servicing standards and encourage their uniform implementation. We support and commend the creation of national servicing standards that set forth the standards for servicers vis-à-vis borrowers. We strongly urge regulators to similarly develop uniform servicing standards to clearly delineate the roles and responsibilities of servicers vis-à-vis investors. In many cases, investors are directly or indirectly “consumers” through direct purchases of MBS and holdings of mutual funds invested in MBS. In this capacity, investors deserve consistent protections.

**Risk Retention Rules and Definitions of QRM**
On August 28, 2013, the Office of the Comptroller of the Currency (OCC), the Fed, the Federal Deposit Insurance Corporation (FDIC), the FHFA, and HUD jointly announced the re-proposal of the Credit Risk Retention rules that they are directed to implement under Section 941 of Dodd-Frank which would generally require sponsors to retain at least 5% of the credit risk of a securitization. As investors, we are pleased to see that the re-proposed rule is responsive to many of the comments that were raised with respect to the initial proposal.

In particular, the re-proposed rule brings the definition of Qualified Residential Mortgage (QRM), which would establish credit standards that exempt issuers from credit risk retention requirements, in line with the Qualified Mortgage (QM)16 definition that was issued by the Consumer Financial Protection Bureau (CFPB), something that BlackRock has supported. As we indicated in our comment letter in response to the re-proposed rules, consistency between the definitions of QRM and QM is necessary to ensure that regulations do not create conflicts between origination and subsequent securitization of residential mortgages. Consistency between these two definitions is integral to the goal of attracting more private capital back to the sector, including the return of a robust private label MBS market.17

While we are generally supportive of many aspects of the re-proposed risk retention rules, we have several concerns related to specific asset classes that are covered by this rule.
In particular, rules for commercial-mortgage backed securities (CMBS), tender option bonds (TOBs), asset-backed commercial paper (ABCP), and collateralized loan obligations (CLOs) need further work. Regulators continue to work on these rules but there is no clear indication of when they will be finalized. Media reports have indicated that after initial opposition to a QRM definition that is consistent with the CFPB’s QM definition, regulators are moving toward an agreement on this point. However, there has been no public indication of whether the concerns raised regarding CMBS, TOBs, ABCP or CLO have been addressed.

Credit Rating Agency Reform

The reform of the credit rating agencies pursuant to Dodd-Frank being considered by the Securities and Exchange Commission (SEC) will also have a material impact on the re-emergence and functioning of the private-label RMBS (PLS) market. We have addressed detailed views regarding credit rating agency reform in the ViewPoint - Credit Rating Agencies: Reform, Don’t Eliminate, July 2013. We encourage regulators to develop a clear understanding of how investors use credit ratings, and how asset managers use credit ratings, and to establish agreement on the objectives of credit rating agency reform. In particular, we support measures that increase transparency of data underlying credit ratings decisions for investors and we encourage the SEC to continue to rigorously monitor credit rating agencies to ensure adherence to stated ratings methodologies. We have also recommended some approaches to minimizing the so called practice of “ratings shopping” by moving up the formal engagement of rating agencies in the rating process. In brief, we support reforms that address conflicts of interest in the business model while we discourage measures that attack the fundamental business of credit rating agencies.

Mortgage Settlements & Enforcement Actions

Over the past few years, several legal and regulatory settlements with mortgage servicers for alleged misdeeds during the financial crisis have occurred. BlackRock supports the efforts of state and federal authorities to investigate and seek damages for improper practices. Unfortunately, these settlements have re-used a template from the $25 billion State Attorneys’ General servicing settlement in 2012, which allowed sanctions on servicers to unwittingly be “paid” by investors who were neither at fault nor represented in the negotiations of the settlements. These investors may even have been harmed by the servicer actions. The monitor’s report for the State Attorneys General settlement indicated that the banks utilized investors’ assets to meet nearly a quarter ($5 billion) of their settlement obligations.

The Office of the Comptroller of the Currency (OCC) and the Federal Reserve adopted the very same construct in their servicing regulatory settlement actions.

It appears that this template has been used by the Department of Justice in the $13 billion J.P. Morgan Chase & Co. settlement agreement in 2013 and the $7 billion Citigroup settlement announced in July 2014. Press accounts suggest that this template could be applied again in a large settlement with Bank of America. These settlements are related to activities that explicitly harmed investors, which makes this approach even more troubling than the earlier servicer settlements which focused on harm to homeowners. In effect, these newer settlements, which are related to misdeeds that caused harm to investors, are likely to cause additional harm to investors.

These types of actions deter private capital from being put at risk in the housing finance sector and are at cross-purposes with the bi-partisan goal of attracting substantial amounts of

Eminent Domain

As we reported in our August 2013 update, several municipalities in the US have contemplated a distorted use of the power of “eminent domain” to seize mortgages which are held in MBS trusts, and force restructurings of performing loans. While several municipalities have considered this tactic, Richmond, CA is the only municipality to take steps to move forward with such a plan. At present, the Richmond, CA effort is at a stalemate due to the lack of a super majority in the Richmond City Council, which is required to continue to move ahead. Various public officials have spoken out against this approach including the New York State Attorney General Eric Schneiderman, and Chicago Mayor, Rahm Emanuel as investors, we remain concerned about the implications of eminent domain on the rights of securities holders.

Additionally, the Transportation/HUD Appropriations Bill was voted out of the House Appropriations Committee on May 21, 2014 and included language that would preclude the use of eminent domain to seize mortgages and refinance them into FHA loans. It remains unclear whether this language would be accepted by the Senate and whether individual appropriations provisions will be passed or Congress will pursue a Continuing Resolution (CR) approach to extend government funding past the September 30 fiscal year end.
private capital to the housing finance sector. We strongly urge the monitors of these settlements to focus on the ownership of loans being modified to ensure banks are not disproportionately modifying investor-owned loans or in any way targeting investor-owned loans. In addition, we believe any future settlements should recognize the rights of investors and give investors a seat at the table in negotiating the terms of any settlements.

**Treasury Request For Comment On Private Label MBS Markets**

On June 26, 2014, the US Department of the Treasury announced an effort to help determine what steps can be taken to encourage the return of a well-functioning PLS market. Accordingly, it has issued a request for public comment to solicit feedback from market participants and stakeholders on ways to encourage more private capital to enter the sector. We commend this effort and look forward to participating in the discussion in order to reflect the perspective of investors.

**Conclusion**

The US residential housing market is an integral component of the nation’s economy. Accordingly, it remains a key concern to policymakers and stakeholders, alike. While a consistent, albeit attenuated recovery in the housing market has occurred, it has sent some mixed signals over the course of the first half of this year. The recovery has been slowed by impaired access to credit and macroeconomic factors such as rate movements and delayed new household formation. It has also been influenced by the current unprecedented level of government support for the housing finance market and the ongoing policy, regulatory, and legal inconsistency and uncertainty regarding the future state of the US housing finance system. In the past year, we have seen movement on the policy formulation front. There is consensus that there is a need for additional private capital to support the housing finance system. However, there is little agreement on the appropriate amount of private capital and the proper delivery system to channel it to the market. Accordingly, the prospect for the enactment of legislation this year is very low.

Notwithstanding the low probability of the enactment of comprehensive housing finance reform legislation, the landscape continues to be shaped by regulatory actions by FHFA, the continued implementation of the Dodd-Frank provisions and the legal, regulatory, and enforcement actions by the financial regulators and the Department of Justice, which are often inconsistent with the policy objective of attracting more private capital to this sector.

BlackRock once again calls for the development and implementation of housing finance policy on a holistic basis which recognizes and respects the rights of investors and the orderly functioning of the markets. Specifically, we continue to support housing finance reform measures which maintain a government guarantee to support a deep and liquid market and preserves the TBA market. We support prudent levels of private capital assuming credit risk in the market. The transition to any future housing finance system should allow for the fungibility of outstanding existing GSE securities to the new framework and provide for a seamless transition, so as not to disrupt the markets. We also advocate development of best practices, policies, and documentation, including a fiduciary standard for servicers and trustees in both the government guaranteed and the PLS markets.

We continue to call for the promulgation of national servicing standards not only to define a servicer’s responsibilities vis-à-vis consumers, but to investors as well. Finally, we urge the cessation of policies and regulatory actions which disregard the rights of investors, like the misapplication of eminent domain authority by municipalities and the legal and regulatory settlements that use assets owned by investors to settle the obligations of others. The implementation of housing finance reform and regulatory policies which recognize and respect the rights of investors is the means to achieve the objective of attracting significant amounts of capital to the sector to support the housing market.
Endnotes

8 Ibid.
11 Ibid.
12 Freddie Mac recently launched the Structured Agency Credit Risk (STACR) issuance transactions. Fannie Mae recently launched the Connecticut Avenue Securities (CAS) transactions.
16 A “Qualified Mortgage” (QM) was defined by the CFPB as a loan with no excess up-front points and fees. A QM cannot have certain “risky” features, such as terms greater than 30 years, interest-only payments, or negative amortization payments. A QM is generally considered to be a loan where the borrower generally has a debt-to-income (“DTI”) ratio less than or equal to 43%. A QM is assumed to have met the “Ability to repay” rule. The “Ability-to-Repay” rules and the QM definition were released by the Consumer Financial Protection Bureau (CFPB) on January 10, 2013. The regulation is intended to protect consumers from irresponsible mortgage lending by requiring lenders to ensure prospective buyers have the “ability-to-repay” any mortgage that is given to them. It also effectively provides a safe harbor for originators.