MEMORANDUM

TO: Drafting Committee Members, Advisors and Observers,
Proposed Home Foreclosure Procedures Act

FROM: Bill Breetz, Chair of the Drafting Committee

DATE: January 24, 2014

RE: ISSUES MEMORANDUM; MISCELLANEOUS MATTERS

I hope you find the enclosed memorandum useful; it highlights what I believe to be the principal issues confronting us for discussion at the meeting next week.

I have tried to incorporate in this memorandum all the observations, arguments and suggestions many of the Committee members and observers have provided to the Reporters, Barry Nekritz and me since the last meeting. At the same time, I freely acknowledge that the Memorandum contains my own musings on some of these issues and my efforts to synthesize various points that have been raised.

Several other points are relevant:

1. You should have received these other materials from Lucy Grelle:

   A. A letter and enclosures from Mark Greeenlee and Thomas Fitzpatrick of the Cleveland Federal Reserve Bank concerning Abandoned Property;

   B. A summary prepared by Larry Platt of K&L Gates of the new Consumer Financial Protection Bureau rules regarding mortgage servicing standards; those rules became effective on January 10, 2014.

   C. A memorandum dated January 22, 2014 from Alfred Pollard with comments and suggestions regarding the November draft of the Act.

While the memorandum contains excerpts from all of these materials, I have not included their entire text in the memorandum. I encourage you to bring copies of those materials with you in whatever format you find most accessible.

2. In my November cover memorandum, I noted the possibility that the Executive Committee might defer final reading of this Act until the 2015 annual meeting. Subsequently, the Executive Committee officially took that action and the act will not be up for final reading until 2015.

3. While most of you will know this, the United States Senate voted in December to confirm Congressman Melvin Watt of North Carolina as the new Director of the Federal Housing Finance Agency and he was sworn in on January 6, 2014. Alfred Pollard continues to

serve as General Counsel at FHFA and will join us for part of our meeting in San Diego. I attach a news story, reprinted from Mortgage Servicing News, commenting on what that source believes to be some of the implications of Congressman Watt's appointment.

4. The agenda for the meeting will be sent to you shortly. In the meantime, I look forward to seeing you all next week.

Reprinted from Mortgage Servicing News, dated 1-6-2014

Mel Watt at FHFA Seen as Enigma in Fannie-Freddie Market

Mel Watt's first act overseeing Fannie Mae and Freddie Mac came before he officially started.

At about 9 p.m. on the Friday before Christmas, as Washington and Wall Street were shutting down, the incoming head of the Federal Housing Finance Agency sent reporters an email from his personal account telling them he would indefinitely put on hold planned increases in the fees the two companies charge for insuring mortgage securities.

With the three-sentence message, Watt signaled a break from his FHFA predecessor Edward DeMarco and hinted at how he'll shape the direction of the two firms that account for about 60% of new U.S. mortgages. Set to be sworn in today by President Obama, Watt already is seen by consumer advocates as a potential champion for helping homeowners and by bond managers as a possible threat to the value of their investments. Watt, a 68-year-old Democratic Congressman from North Carolina, remains circumspect as to his intentions.

"Everyone wants to know what Mel Watt is going to do," said Mortgage Bankers Association President David Stevens, who from 2009 to 2011 ran the Federal Housing Administration that insures loans with low downpayments. "He's really a bit of an enigma: You don't know exactly where he's going to head."

Under DeMarco, a career civil servant who took over the FHFA's top role in 2009 and later won accolades from Republicans for his approach, the agency initially focused on limiting Fannie Mae and Freddie Mac's losses from the housing slump. The FHFA said in December it planned to raise guarantee fees to reduce their footprint in the market five years after the government had to rescue them.

Watt's decision, after complaints by mortgage bankers and others in the housing industry that the higher charges set to take effect in March and April were too steep and sudden, may slow those efforts. Peter Wallison, a senior fellow at the American Enterprise Institute, said it's the type of decision he expected.

"He's a thoughtful man, he's a smart man and he's a good man, but that is something that is certainly along the lines of what I expect Mel to do," said Wallison, a frequent critic of the two companies, who as a member of the Financial Crisis Inquiry Commission blamed government policy for causing the housing meltdown. "To follow the guidance he's getting from people on the left and government-housing complex about what FHFA should be doing."

Watt is inheriting a lengthy list of pending decisions from DeMarco, including whether to reduce the maximum size of mortgages that Fannie Mae and Freddie Mac can finance, which currently ranges from $417,000 to as much $629,500 in high-cost areas. A reduction would potentially hurt homeowners and builders by making larger loans more expensive, while it may help banks and issuers of private mortgage bonds expand their share of the market. In December, DeMarco sought public comment on cutting the limits to $400,000 to $600,000.

The FHFA is working with Fannie Mae and Freddie Mac to complete rules on the amount of capital that private mortgage insurers such as MGIC Investment Corp. and Radian Group Inc. must hold to do business with the companies. The agency also needs to respond to criticism from developers, lenders and affordable-housing advocates about its plans to shrink apartment-building financing, after a 10 percent cut last year.

The FHFA has said it will expand a program started last year to reduce the initial risk of losses to Fannie Mae and Freddie Mac on certain loans by selling bonds or purchasing additional insurance. This approach reflects a strategy that many lawmakers see as the most likely path of reforming the $9 trillion mortgage finance system.

The stakes are high because “there are numerous players in the housing finance system that have structured their businesses and household decisions around the current system, contributing to nearly 20% of the economy,” Tim Johnson, a South Dakota Democrat who heads the Senate banking committee said last month at a hearing. “As we draft changes to the system, we must keep that in mind.”

Residential investment including construction and remodeling and housing services, such as home use, rents and utilities, accounted for more than 15% of U.S. gross domestic product last year, according to U.S. Bureau of Economic Analysis data. In a nation in which consumer spending accounts for about 70% of economic activity, roughly 25% of American household wealth stems from home equity, according to the latest Census Bureau data.

Watt, a lawyer who was one of only two blacks elected to Congress from his state during the 20th century, declined to be interviewed.

“I do not expect to elaborate further on this statement until after I have been sworn in as director of the FHFA in January,” he wrote in the surprise Dec. 20 email.

The Yale Law School graduate won Senate approval last month to become the FHFA’s director after Democrats changed the procedural rules governing presidential nominees, giving Obama his first opportunity to fill the post since being elected six years ago.

Republicans, who approved of DeMarco’s policies, initially blocked Watt’s confirmation in October, before the rule change.

Obama’s previous pick, former North Carolina Banking Commissioner Joseph A. Smith Jr., withdrew from consideration in 2011 after facing similar resistance from Republicans.

Consumer advocacy groups and unions including the Center for American Progress, New Bottom Line, Communications Workers of America and National Low Income Housing

Coalition applauded Watt's confirmation on the expectation that he will add more of a focus on aiding homeowners and making housing affordable.

Watt hasn't made any promises and his statements have been guarded. He said in an interview in May that it would be "putting the cart before the horse" for him to give specifics on what he'd do and that his often pro-consumer congressional positions wouldn't necessarily impact his job as a regulator.

While the FHFA's leadership post is filled by the president, the agency acts independently from the White House and the term lasts for five years. With a Democrat leading the FHFA, the agency's policies may more closely dovetail with efforts by the Democrat-controlled Senate and the Obama administration to overhaul the system.

The White House is working with Republicans and Democrats in the Senate on legislation to replace Fannie Mae and Freddie Mac with a government-owned reinsurer of mortgage bonds backed by private capital. Johnson and the Senate banking panel's leading Republican, Mike Crapo of Idaho, have said they plan to introduce a bill in early 2014.

Getting legislation approved by Congress and fully implementing it may take as long as a decade. Leading the FHFA in the meantime gives Watt unusual latitude to unilaterally establish policies in one of the economy's key sectors, "in a political era defined essentially by gridlock," according to Bank of America Corp. analyst Chris Flanagan.

One example of the importance of the actions the FHFA can take without legislation came in 2011, when DeMarco pushed for an expansion of the two companies' Home Affordable Refinance Program, helping to unlock access to cheap money being made available by the Federal Reserve, Flanagan wrote in a report last month.

Mortgage-bond managers are girding for Watt to further expand the HARP program that allows homeowners with little or no home equity to refinance, potentially damaging the value of their investments. Bank of America analysts, for example, have said he may extend the cut-off date to include loans made after mid-2009.

Michael Cudzil, an executive vice president who specializes in mortgages at Newport Beach, Calif.-based Pacific Investment Management Co., said many investors are being too complacent about the extent of possible changes.

"This is not yesterday's FHFA," he said. "This is not Ed DeMarco's FHFA; this is Mel Watt's FHFA. We all can go back and forth on what that means but we're not going to know until he starts making decisions."

Consumer advocates also want Watt to revisit the idea of allowing Fannie Mae and Freddie Mac to reduce the loan balances of troubled homeowners. DeMarco had studied and rejected the approach on concern that it would fuel new defaults and add to the two mortgage companies' costs.

Some of Watt's steps may be limited by forces outside of his control. Rising interest rates are cutting down on how many borrowers could save money from refinancing even with expanded qualification rules, and climbing home prices that are reducing the urgency of reducing borrowers' principal.