APPENDIX

MANDATORY ELEMENTS

For the Return of Private Capital to the Residential Marketplace

The following is intended to provide additional information and insight to the thought processes of the Subgroup toward the selection of the Mandatory Elements

Introduction

- The focus of the Private Capital Subgroup was to determine necessary steps to bringing private capital back into the marketplace
- Through its research, including a series of interviews with market experts and representatives of the sources of private capital, the Subgroup identified three primary marketplace components necessary to its return: Clarity, Confidence, Cash (profit)
- Recognizing the existence of numerous pending legislative and regulatory proposals, as well as the possibility that still others will emerge; and further recognizing the need to give NAR government affairs' efforts as much latitude and mobility as possible to work through political channels, the Subgroup recommends the adoption of a list of "Mandatory Elements" itemizing components necessary to achieve NAR endorsement.
- Strong consensus existed among Subgroup participants that some level of government regulation is the only way to achieve the standardization and mandatory elements necessary to provide the Clarity, Confidence and Cash required for the return of private investors to the mortgage marketplace. Investor input in designing these standards is critical
- While government standardization, regulation and enforcement will be necessary, the need for government to underwrite primary mortgage market risk should be slowly phased out and replaced by some form of secondary insurance to be triggered in the event of a catastrophic market collapse.
- Processes need to be simplified and NOT over regulated.

Guarantee

- Different classes of securitization should be priced and insured accordingly.
- The government guarantee is intended for catastrophic situations only
- The reference to insurance and enforcement similar to FDIC has also been stated by Millstein, NAHB, Isakson, Miller, Garrett, AMI and ICBA.
- The government backstop allows private labels to compete with government sponsored entities
- Regulatory oversight of the not-for-profit utility is needed.
- Duties of the "utility company" would include setting standards, holding stakeholders accountable to those standards and supplying initial and continuous ratings on the various pools.
- The Subgroup strongly feels there should not be market share limits as it is important to allow the market to set its own limits.
- Those wanting a guarantee/insurance against loss must be willing to pay a market price.
- Important that any guarantee/insurance cost passed on to the consumer is built into the rate versus an upfront fee.
- Important to establish the order of pay off when PMI is involved as pricing would be affected. PMI should be first followed by the guarantee.

Pooling Service Agreements

- Lack of standardization leads to divergent business practices and ambiguity in interpretations
- Existing today are ineffective mechanisms for enforcing remedies for the breach of reps and warranties
- The conflict of interests between stakeholders must be addressed. The body servicing the loan must maintain their fiduciary duties for the investor that owns the loan.
- Servicer Fee Schedules should be decided upon by the stakeholders – not regulation
- Federal Best Practices for private capital PSA's a must and best designed through a cooperative effort of "the utility company", Congress and the private sector.
- Deviations to the Best Practices must be disclosed.
- Default and the Buy Back process must be governed and enforced by the contract agreement.
- Statute of limitations for a Buy Back should be reduced to a maximum of 36 months for performing loans.

Loan Level Data

- Real time data means updated through the life of the loan.
- Lack of information on loan performance is unacceptable.
- Investors look at three kinds of risk: 1. Interest rate risk 2. Prepayment risk and 3. Credit risk (credit worthiness, data and market discovery). They can work with 1 and 2 but must be able to measure the credit risk in order to price accordingly
- If pools are rated throughout the loan's life - loses would be predicted in advance
- Transparency of loan level data is imperative but the individual borrower's privacy and identity must be protected.
- If data is wrong, the provider of the data needs to be held accountable.
- The current appraisal process is not working. Unreliable appraisals prepared by appraisers not proficient in the subject area add to the lack of confidence of the private sector.
- Loan level data presented in a standardized manner will facilitate the investor analysis prior to underwriting. The additional benefit of the guarantee/insurance product renders a "cooling off" period less relevant, and would only serve to complicate the process efficiency.

Underwriting Standards

- The Subgroup concurs with NAR that the determination of a borrower's ability to repay should be based on the following eight factors:
    - Current or expected income or assets (excluding the value of the home that secures the loan)
    - Current employment status
    - Monthly payment on the mortgage
    - Monthly payment on any simultaneous loans (secured by the same dwelling)
    - Monthly payment on any mortgage related obligations (taxes, insurance, association, condominium and cooperative fees, and assessments)
    - Current debt obligations

    - Monthly debt-to-income ratio, or residual income
    - Credit history
- The Subgroup concurs with NAR that the Safe Harbor definition of a QM should meet the following criteria:
    - No negative amortization, balloon, or interest-only payments, or a term of more than 30 years
    - Total point and fees cannot exceed 3% of the total loan amount
    - The borrower's income or assets relied upon in making the ability-to-repay determination are considered and verified
    - The underwriting of the mortgage (1) is based on the maximum interest rate in the first 5 years, (2) uses a fully amortizing payment schedule, and (3) takes into account any mortgage-related obligations
- The mandatory elements must be present for all loans. A second lien is a mortgage and does not need to be differentiated.
- The loan originators and their companies must accept the responsibility to meet the set standards
- Stricter enforcement and tracking performance of all Stakeholders is important

Infrastructure

- The infrastructure designed for private label securitization should have minimum eligibility requirements to use the platform.
- Smaller entities need equal access to the secondary market.
- Whatever plan is used – must have mandatory standards and guarantees
- Platform must be free from political pressures.
- A strong utility platform will be transparent, gain solid reputation, produce accurate ratings, offer guarantee and ultimately lead to a larger volume of buyers.
- Future expansion of securitization platform would include commercial liquidity goals

The Future of Fannie and Freddie

- Fannie Mae and Freddie Mac should be privatized over an extended period of time without disruption to capital flow.
- The Millstein plan offers a basis for consideration.