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Comments to "Building a New Infrastructure for the Secondary Mortgage Market"

Released by FHFA for industry comment October 4, 2012

The Absalon Project is a joint venture between Soros Fund Management and VP Securities, dedicated to best practices of the world's largest, non-government guaranteed, performing MBS market, from the tiny country of Denmark. VP Securities is the trustee, master servicer, CSD, clearing and settlement agent and reporting agent for the Danish financial system. It is mutually owned by the entire Danish financial system. The VP systems are the key to the administration and performance of the Danish mortgage market.

This document comments on the FHFA paper dated October 4, 2012. The first six sections are specific to the beneficial aspects of the Danish mortgage system and the value to FHFA. Section seven is on the pernicious effects of MI, the root of half the evil in the US mortgage system. Sections eight and nine are on the value of a common platform for the GSEs. Section ten is on the use and mis-use of Reps and warrants. Section eleven is on other technological changes which should be considered.

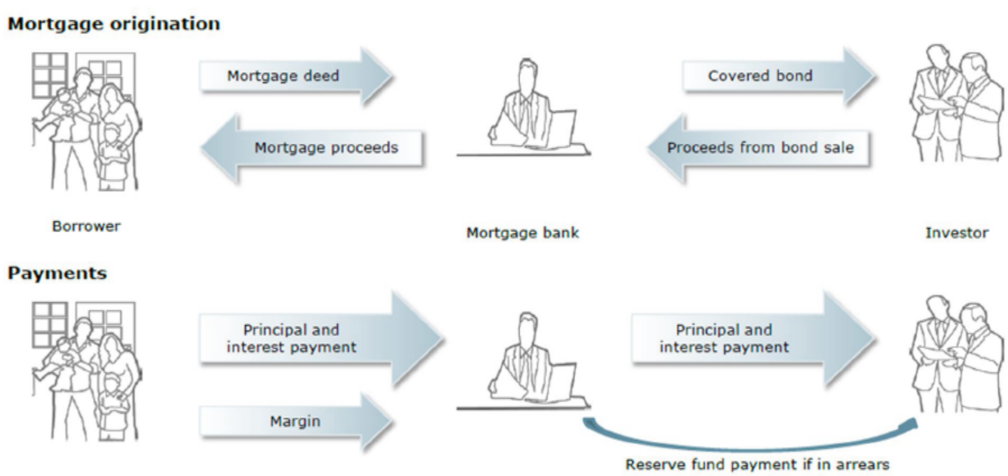
1. What are the attributes of the Danish mortgage bond administration system?

The Danish system has proved almost immune to financial crisis due to:

- **Asset-Liability Management Risks**
  - No maturity mismatch. Prepayment risk on bondholder
  - No interest rate mismatch
  - No currency mismatch
  - No hedging/CDO/insurance mismatch
  - Tight counterparty risk controls
- **Principle of Balance (PoB)**
  - Mortgages funded by simultaneous issue of bonds for like term, rate and amount
  - Tap issuance (large, liquid bond series open for 3 years)
  - Pass through interest and principal repayment (no warehouse risk)
- **Prepayment Options**
  - Callable and non-callable mortgage options
  - Prepayment options (partial and full)
  - Prepayment at par with cash
  - New lower rate loan financed by issuance of new bond
  - Alterative redemption feature
    - Prepayment at market price by buying the bonds in the market
    - New, smaller mortgage comes with higher coupon financed by issuance of new bonds
    - Highly counter-cyclical stabilizer for household and financial markets
    - Reduces risk to homeowner equity due to changes in interest rates
- **Responsible Lending (Full interest alignment)**
  - Originating Mortgage Credit Intermediary (MCI) services the loan
  - Originating MCI carries credit risk for the term of the loan

- Originating MCI makes sure that all payments are made to the bond holder
- **Transparency**
  - Transparent price and cost structure
  - Bond prices publicly available on NASDAQ/OMX website
  - All information posted to the entire market in real time
- **Liquid Bond Series**
  - Assured liquidity through large, tapable bond series
  - Joint bond series for smaller and new entrant MCI's (Totalkredit model – Multi-originator platform)
  - Voluntary Market Maker Agreement
- **Bond Series Features**
  - Fixed rates, Adjustable Rates and Floating Rates.
  - Cover pools can mix segments for funding efficiency.
  - Borrower gets near-wholesale interest rates
  - MCI retains service and credit risk on the borrower
  - Bond investor takes interest rate risk, currency risk (if any) and prepayment risk
  - Competition between MCIs is on service and rates – not credit laxity
  - Borrowers have better information and make better decisions
  - Even very small MCIs can finance mortgages at near wholesale rates through a multi-issuer platform
  - Capital is assessed dynamically to ensure continued responsiveness of MCIs to credit risk and loan quality

Balanced payment flows



- MCIs assume credit risk - *which they control* - and investors assume other risks - *which they price*
- Local banks, pensions and insurance investors are matched to local mortgage borrowers so less dependence on foreign sourced finance and lower exposure to global imbalances
- Deep, liquid bond markets attract investors – *even under stress conditions*
- Primary and secondary market prices are the same
- Prices are transparent to investors, borrowers, banks and supervisors
- Less cost, risk and complexity from synthetic or derivative products
- Sustained investor confidence and demand
- **Balanced mortgage bonds protect borrowers, banks and bondholders from instability, illiquidity and contagion risks**
- Market pricing, trading and liquidity ensure liquid borrower refinancing, sustained investor appeal and bank capital asset quality in all credit cycle conditions
- Dynamic capital assessment and cover pool management promote good behaviour bias and bondholder confidence
- Mortgage bonds proven counter-cyclical stabilising capital asset class and liquid investments
- No state bailouts, special liquidity facilities or guarantees to stress state fiscal and debt balances
- Better resolution outcomes as more domestic assets available to satisfy domestic creditors
- Restructuring debt through mortgage bonds rather than bank refinancing would reduce risks and instability

The model has worked for more than 200 years with no state bailouts, subsidies, liquidity facilities or guarantees.

Absalon information sheet and short description of the Danish Mortgage Model attached as appendix or download it here http://absalonproject.com/downloads for more information.

2. What are the goals of the Danish mortgage bond administration system?

This would ensure that the goals for the new model could be realized (Chapter 3):

- Promote Liquidity (we probably not need 2 layer trust structure so just standardization will make the bonds liquid),
- Attract Private capital (responsible Lending, Individual Capital Requirements per loan),
- Benefit borrowers: transparency and prepayment options
- Efficiency: straight thru processing, rules driven processes, relational database.

3. Does this model resemble anything already used in the USA?

The model we like is very much the Ginnie Mae II model

- Large, multi-issuer bond series

- Tap issuance, each loan enters the bond at that day's market price
- Specific requirements for issuers to maintain P&I payments to the bondholders

In addition, the Absalon systems will support
- Approval of final lending criteria to ensure AAA rating of bonds
- Pooling of funding in a 2 layer trust structure, which allows for issuer "skin in the game"
- Supervision of loans and the requirement of the originators to buy back (remove) loans that are defaulting from the pool.

4. What do others say about the Danish system?

- **Moody's: (2002)** *"Moody's believes that Danish mortgage bonds are very strong and very low-risk financial instruments"*

- **Mercer Oliver Wyman: (2003)** *"The Danish mortgage credit in a European context has high efficiency, low prices and large product offers"*

- **Bank for International Settlements (BIS): (2004)** *"However, in the Danish case the institutional structure, the regulatory approach and monetary policy together have resulted in a market which, relative to the US market, has shown little or no stress in periods with significant refinancing"*

- **International Monetary Fund (IMF): (2006)** *"Through the implementation of a strict balance principle, the system has proved very effective in providing borrowers with flexible, transparent and close-to-capital markets funding conditions. Simultaneously, as pass-through securities, mortgage bonds transfer market risk from the issuing mortgage bank to bond investors. Lastly, strict property appraisal rules and credit risk management by the mortgage banks have also historically shielded mortgage bonds from default risk."*

- **George Soros, The Financial Times (2008) "***I would recommend the system of mortgage credit used in Denmark. These mortgages are transformed into instantly tradable bonds… house values and bond prices tend to move in unison…this arrangement reduces the danger of householders' equity falling into negative territory… The standardization of mortgages in the Danish system promotes transparency and liquidity… I pioneered the introduction of the Danish system in Mexico…"*

- **Hancock and Passmore, Federal Reserve Board (2009)** *"We think implementing a Danish-Type system in the United States would have many benefits"*

- **Shin: (2010)** *"The Danish system of mortgage banks has attracted considerable attention as a resilient institutional framework .... Narrow banks would be akin to Danish mortgage banks whose liabilities match the duration of assets perfectly and whose equity provides a cushion for bond holders".*

- ***International Monetary Fund (IMF): (2011)*** *"Denmark has a sophisticated housing finance system with a unuique arrangement of asset liability management that has helped maintain financial stability over the last two centuries"*

5. **What are the systems and services provided by the Danish Mortgage Bond administration system?**

Absalon delivers a multi-issuer, ready-to-use solution that could be implemented at a local servicing company, referred to as a Mortgage Service Provider (MSP), to manage and operate the business procedures and IT systems that will deliver the mortgage services mentioned. This utility could be owned by the market participants.

Such a solution would utilize all services and products that Absalon offers in areas as:

- Business Consultancy
  - Project identification and description
  - Feasibility Study, including Business Model and Budget
- Business Model Implementation
  - Workflow implementation and training
  - Business Model Execution
- Systems Solutions
  - FundingXpert, Mortgage Functionality for integration with existing origination system
  - Absalon Turn Key Solution, ready-to-use solution delivered as Software as a Solution (SaaS) service
  - Systems Development and Customization
- Technical Integration and Operations
  - System integration and testing
  - Operation services

Standardization and Straight-Through-Processing (STP) is what we strive for in our solutions. We support standardized paperwork and processing and standardized information to the market. Absalon can deliver core functionality for Balanced Mortgage Bank products for integration with front- and backend systems from other vendors or we can work with partner(s) to deliver an Integrated Solution based on customer specifications and requirements.

6. **Building new infrastructure is a great idea. Why not start with the current reporting standard for the World's largest performing Private Label market?**

Everything about the Danish mortgage bond system is reported "real time" on the Nasdaq/OMX website.[1] All transactions, either exchange based or over the counter, are reported as they happen. Production of bonds is reported on a daily basis. Prepayments are reported on a weekly basis with a one day lag. All information is released at the same time. There is no inside information or prior knowledge. In the USA, large servicers and the GSEs know all of this information, but the bond

[1] See Nasdaq OMX website at www.nasdaxomxnordic.com/bonds/denmark for real-time, daily and weekly information about both open and closed bond series.

market does not. This puts the bond market participants at a distinct disadvantage. The lags in the USA can be as long as a month. Freddie Mac started reporting more information on pools originated post 2005, but they still do not report as much as they know. To compensate for lagged and restricted knowledge, the bond market must price agency MBS accordingly. This leads to lower bond prices and higher interest rates for all households in the USA.

Every year hundreds of trillions of dollars of volume are traded in real-time on the NYSE, NASDAQ, and through the Chicago Mercantile exchange. These are private yet heavily regulated organizations that support massive trading volume with no taxpayer support, and despite the enormous amount of money involved, there has never been a fraud involving their core trading operations. Granted, there are off-exchange "dark pools," where shares are traded privately, but ultimately these shares cannot be redeemed, nor can they change core trading prices without moving through an open, honest, regulated public exchange.

Similarly, everything about the Danish mortgage bond system is reported in "real time." Even OTC trades must be reported to a central website which, incidentally, is set-up and maintained by the NASDAQ/OMX.

Every aspect affecting the mortgage market is visible to the public and becomes available to everyone at the same time. No market participant is privy to inside information or prior knowledge. Open market information allows the US stock markets to largely self-regulate, in that no bank would trust another to both trade and hold the infrastructure. Similarly, an exchange related to housing related structured finance products will help restore free, fair, and functional markets.

In contrast to the Danish market, the US is far behind. Despite the clear mandate in HERA to disclose loan-level information, Freddie Mac engages in limited loan-level disclosures and Fannie Mae in virtually none at all until the beginning of this year. Publicly registered private MBS were required to file prospectuses, but these often excluded loan-level information or amended it after the securities were sold. Even when loan-level information is included, it is not standardized, making aggregation into a central database unnecessarily cumbersome. Many instruments, especially offshore SPV's and CDS transactions, have little or no publicly available information. This lack of information created an information disparity which helped foster a market imbalance and continues to destroy trust: it is a very real impediment to restoration of private capital.

While the Enterprises have traditionally added enormous value by setting standards, their role in building trading infrastructure may be counter-productive to the restoration of private capital because of their concurrent role as market participants. Investors are already skittish about US housing related investments. Exchanges run by the Enterprises, who many view as competitors, are not likely to alleviate their concerns. Indeed, this real or perceived disparity in data transparency results in higher pricing on the private market since investors must assume the worst, to the detriment of both the private market and US consumers.

Modeling new infrastructure around those used successfully in the equities and commodities market makes sense, and the FHFA's regulatory role is clearly needed as a housing finance parallel to the SEC. But, in much the same way that the stock and commodities exchanges have successfully functioned since the early 1800's, this infrastructure is best built and maintained by genuinely private organizations overseen by a strong government regulator.

Finally, there is a logistical concern: the FHFA informed Congress that one of the impediments to principal reduction was the inability of the GSE systems to account for it. Ignoring whether principal reduction is a good public policy, it was shot down for logistical reasons. FHFA should be aware that it is embarking on an exponentially more complex technology project that what was required to account for principal reductions.

7. What should the GSEs do about MI?

MI is the root of half the evil in the US mortgage system. MI has nothing to do with insurance. MI is a fee that you pay (either the borrower or lender) so that the GSEs will wrap a >80 LTV loan. Insurance shares these attributes:

- Premiums are fully reserved
- Income comes from investing reserves, net of expenses
- All risk is underwritten by the insurer
- Claims are paid, not litigated or denied (no such thing as "right of rescission")
- Claim-paying ability is backed by catastrophic reinsurance
- Reinsurers require high ratings from AM Best or some other respected NRSRO

MI has NONE of these attributes!!! MI is a simple regulatory arbitrage as they are allowed a 25:1 risk in force to capital ratio by state regulators. Basle III does not allow that capital ratio on whole loans with 80% LTV.

The AG Settlement goes after everything except GSE loans. The GSEs have repeatedly claimed that more progressive modification and principal reduction programs would somehow cost taxpayers money. The relationship between the GSEs and the MIs needs to be addressed. The GSEs are carrying at $139b accounts receivable on their balance sheets from the MIs. The MIs have almost no capital, market caps of only $9b and deminimus claims paying ability. The last thing the GSEs want is for the MIs to go bust, forcing them to DOUBLE their reported losses and take another $100b in Treasury Preferred with a 10% coupon.

To keep the accounting artifice going, the MIs encouraged the GSEs to do several things that would allow this charade to continue ad infinitum. First, the GSEs would continue to recognize the MIs as on-going businesses and direct borrowers to continue to pay new and existing MI insurance premiums. Second, the GSEs would pursue very slow loan loss mitigation strategies. Since MIs only pay after foreclosure when the final severity is known, there is a significant delay due to the GSEs not pursuing proven loss mitigation. Third, when a loss must be paid, the MIs would find any reason to exercise their right of rescission on loans, essentially saying that there was never any insurance coverage. The GSEs would then bring the foreclosed loan to the originator and ask for a full loan repurchase at par, since the originator had violated their Reps and Warrants clause by making a loan that did not qualify for MI.

This resulted in significant knock on effects to the originators, causing them to pull back from loan origination and exit entire mortgage business lines. This was all done to extend the accounting artifice that MI claims are a good asset on the GSE's balance sheet.

The proposed common system should have its first focus on giving the GSEs the ability to take over collecting premiums from the existing MI companies. That means a core accounting system, a call center management system and a default management system. Particular care should be taken in the core accounting system to be able to predict which borrowers will cure (improve their LTV and stop paying the premiums).

8. Should the GSEs share a common platform?

The current situation creates a huge advantage for the larger mortgage bankers. It is an enormous task to stay current on just one GSE seller interface. It requires a specialist staff to understand each change and/or overlay and another specialist staff to implement and beta test the changes. To the extent that DFA and the CFPB are increasing the number and complexity of rule changes, this task is stressing the entire industry. This hands a sustainable competitive advantage to the larger seller/servicers. Even though the GSEs have roughly the same economics in their MBS guarantee businesses, each uses their own idiosyncratic set of rules. This is exactly what oligopoly theory would predict. The result is increased barriers and reduced competition among the users of the GSEs guarantee function.

The new infrastructure platform targets issuance, disclosure, bond administrations and master servicing. These functions are typically performed by multiple different Trustees in the private label market and are performed individually by the GSEs for their bond programs. The only effective mortgage market that is functioning on any real scale big enough for the US housing market is the government guaranteed GSE markets. The TBA market, essentially a cash settled futures market, is the back bone of liquidity for the US housing market. This market will always need the explicit guarantee of the US government to cover catastrophic risk, but it does not require the government to be in a first loss position. The structure of the TBA market requires both the guarantor of the loans and the issuer of the government protected bonds to be the same GSE entity. While the USA needs more private capital to take credit risk on the loans, we don't need more government guaranteed bond issuers. More issuers only fracture the market and reduce liquidity in the market.

There is a lack of competition in the system between the current GSEs and no infrastructure in place to enable private risk capital to enter. Today, the lack of liquidity in PCs issued by Freddie Mac renders them uncompetitive and gives Fannie Mae an unfair competitive advantage. This monopolistic power is not conducive of a liquid market or best rates for borrowers.

We need a single security to eliminate this problem, but how do we get there? The first step is to create a universal infrastructure platform for physical issuance, disclosure, bond administrations and master servicing. There are many enhancements that can be made to data disclosure, such as sharing all the loan level data given to the GSEs for risk analysis with investors, removing performance reporting time lags, and including servicing data the reflects all of the activities of and with the borrowers. Creating standardization in reporting and data will help create consistency for market participants and ultimately a more transparent and liquid.

The private label market also creates a mechanism to attract private risk capital through structured transactions that can efficiently distribute credit risk across investors with different risk appetites and tolerances. This can also enable lower lending rates. A challenge to the liquidity of private label markets is the lack of standardization, which was by intended design. However, standardizing the infrastructure platform would be positive to liquidity, without limiting the private label markets ability to distribute risk. Currently there are multiple different trustees, issuers and servicers that report differently with different data sets and formats creating a challenging environment for an investor to evaluate. Having a centralized infrastructure for these functions would help facilitate more liquidity and transparency. The centralized infrastructure would have to comply with any SEC requirements, such Reg AB or other regulatory reporting requirements. There should be a joint effort across regulatory agencies to avoid conflicts in governance and policy.

The GSE government guaranteed market should have only one shelf. The trade-off that comes with the liquidity of explicitly government guaranteed futures market is the standardization. Underwriting guidelines should be uniform. A regulator responsible for the government guarantee, FHFA, would have the ultimate determination of the outer envelope of risk included in the underwriting guidelines.

9. Should the GSEs be merged or kept as separate entities? If they are kept as separate entities, should they be competing to offer the same Federal reinsurance wrap or should they each have a more narrow focus?

The GSEs do not compete with each other in any meaningful way. Each does provide some unique platforms, which could the basis for a plan to either merge their functions or have them each perform separate and completely unique functions. It is clear that the portfolio function provided no value to the US financial system, in fact the portfolios acted as pro-cyclical accelerators in both directions. Consensus has developed to eliminate the portfolio function in the future. The most valuable function that FHLMC ever provided was running the old Cash Series auction process (16 and 17 series), and that was turned off to allow the portfolio to take advantage of information asymmetries.

On the issue of risk sharing, the Federal reinsurance model (option #3) is the one to choose. The merged GSEs should be turned into the FMGC (Federal Mortgage Guarantee Corporation), which should be modeled upon the FDIC. The FMGC should offer a full faith and credit wrap on future, TBA eligible MBS. For conforming loans, that wrap may come with some first loss sharing by the originator. The inception point for the FMGC should start at a very high level, say 95% of the loan value, and fall by 1-2% per year until the private sector first loss is at 10-20%. The private sector should hold ring fenced capital against the first loss. The most tax and capital efficient way is via an offshore reinsurance contract. A Bermudan protected cell company would be the logical choice. This is not MI in the traditional sense, but true loss bearing insurance with proper regulation and capital reserves.

Public private label securities issuers are regulated by the SEC and can only issue securities using an SEC approved shelf. There needs to be flexibility left in the private label process to enable lending and risk transference outside a vanilla box that might be created in the government program.

In terms of a model PSA that could be used for both government and private label issuance, there some inherent flaws in both the public and private securities documents that could be improved:

- Rep & Warranties - Rep and Warranties are too vague and need a causal materiality standard. They need to clearly define which party is taking which risk to ensure risk transference has actually happened. (see section 5)
- The Trustee or an objective 3rd party should have some teeth and be responsible for monitoring and enforcing the Rep & Warranties. This should be the case in both GSE and PLS securities.

There is too much uncertainty about risk transference and uncertainty about the practical reality of a put back situation. The lack of competition in the GSE space, gives the GSEs too much leverage over a Lenders future business and can force a lender to take on additional risk and loss regardless of materiality or reasonableness. In the private label market, investors have had very little ability to protect their rights as the Trustees are typically only passive participants and Master Servicers are typically conflicted. An objective arbitration process needs to be put in place.

10. Reps and Warranties are a serious and unresolved issue.

Reforming the use of Reps and warranties put backs will play a large role in developing deep and liquid capital markets. In order for changes in the repurchase program to have a significant impact on the availability of housing credit, lenders must have certainty in the sale process; they must know whether they have actually transferred credit risk. The recently announced changes provide modest assistance compared with what is needed to substantially increase housing lending.

There is a need for a materiality standard. Without greater certainty in reps and warrants, credit will remain tight in the mortgage market. One pressing need is establishment of a materiality standard for all reps and warrants, along with a definition that made clear the purported underwriting defect was causally related to the default. Absent a detailed and clearly defined policy on materiality, lenders remain uncertain whether the enforcement policies will remain constant and will not be subject to changing interpretations over time of what might be an actionable breach.

During the last few years, the GSEs have been requiring lenders to repurchase loans for violations of rep and warrants policies based on interpretation of guidelines different from interpretations used previously. This extraordinary change in behavior is a major reason that mortgage credit is so tight. Lenders plans and policies were adversely affected in ways that could not have been predicted or accounted for in advance by even the best managers. A clear definition of causal materiality and a policy that required the existence of such materiality could have provided the guidance needed to prevent that disruption. A monetary payment based upon actual damages the GSEs suffer as a result of the failure of the loan to meet the guidelines is a better remedy, and could be measured by an increased g-fee that would reflect the risk of the loan had the defect not existed. Substituting a damages remedy for repurchase would correct many of the deficiencies of the current repurchase program, particularly if the change were combined with requirements that (i) the GSEs identify material breaches when seeking damages and (ii) the establishment of an adequate appeal process that includes arbitration or another third party resolution process.

This new program is not designed to deal with servicing issues that may develop after delivery. FHFA, however, should issue guidance clarifying that repurchase is not a remedy for servicing violations. Servicing fees are not priced with an assumption that repurchase risk for servicing violations is transferred with the servicing rights. The Reps and warrants putback process is designed to allow the buyer and seller to agree on the characteristics of a loan that is purchased and provide a remedy should a loan materially deviate from those terms. Servicing issues, by their nature, go to a different part of the bargain, and must be decoupled from a repurchase remedy.

Doing so will increase the value of servicing and will enhance the tools to manage servicer performance.

The current credit market is largely frozen due to unprecedented changes in GSE behavior. The most extraordinary of those changes have been (a) the lack of proof of materiality or causation in many of the repurchase demands, as described above, and (b) the tidal wave of repurchases for putative underwriting defects long after underwriting could reasonably be said to have impacted the default on the loan. While many of the defaults seen early in the crisis (especially early payment defaults) were caused by improper underwriting, the majority of the defaults in the past two to three years have been caused by the impacts of the prolonged recession on a highly leveraged population. The shifting of this credit risk is not what reps and warrants are supposed to accomplish, but it is the unfortunate truth of today's market.

- Reduce the sunset period to 24 months. The 36 month period is far too long, and the fact of default at 35 months virtually never has anything to do with the underwriting of the loan. A more appropriate period for determining if the loan was underwritten properly would be regular payments over 24 months.

- Delinquency should not be defined as one payment overdue, particularly if meeting that definition only once over a substantial period of regular payments disqualifies the loan from release of repurchase. We believe that consumers, whether for vacation purposes or simply through a busy life intervening are apt to miss a single payment occasionally. All borrowers do not use automatic payment services. We believe that 60 days delinquent is a more appropriate cutoff date for defining delinquency for purposes of repurchase rules.

- A 60 day delinquency can be treated as a reason to refuse a sunset. There is a balance that can be found between the number of payments required and the number of delinquencies of different kinds during that period, and I would be pleased to meet with you and discuss how to reach that appropriate balance.

- The GSEs should expedite their QC process. Swift and certain punishment is a much better "stick" than the current process of lengthy delays and uncertain outcomes. The GSEs should expedite their review, making the process transparent and well understood. The loans that were subject to review should not be further audited or subject to repurchase for findings which were discoverable during the initial review.

- The exceptions for fraud in the proposal are too broad. Unintentional misstatements should not serve as the basis for repurchase.

- Immaterial data delivery inaccuracies provided to the GSEs should not be the basis to exclude the loan from the sunset. Any such inaccuracies must be material.

Certainty would be advanced if the GSEs would determine and clarify to lenders what data is fundamental data about the loan, the inaccuracy of which would trigger the exclusion. The standard should be that the loan would not have been deliverable to the GSEs had the erroneous data been correctly represented.

- The determination of the LTV must be made using a contemporaneous appraisal—not an after-the-fact reevaluation of property value

- GSEs' guidance do not provide for any process of dispute resolution with respect to the GSEs' rep and warranties claims. The new framework will only be effective if lenders can rely on a dispute resolution process that is reviewed by a neutral third-party to ensure that the new framework is applied consistently and fairly.

11. Infrastructure changes.

The mortgage industry should adopt a series of rules -- and corresponding tech tools -- to model the purchase and sale agreement (PSA) including the waterfall, triggers, and O/C. The current proposal has a built-in assumption that a future private MBS market will work in a similar fashion to the current GSE market, but history shows that this is unlikely. Any model must show great flexibility. Private money will want to compete, and will become increasingly creative in how deals are structured. In order for this to work, the GSEs will need to include tools to support these alternative structures. This will include a flexible and robust waterfall modeler, rather than a standardized PSA, at the beginning.

Once this standardized waterfall model has been created, anyone can generate the complete PSA's; there will be no need for the supplements. If they're all basically the same, computers will quickly see that, or even if there are subtle differences, the computers will show that too. Then, when the private market returns, the computers can read those structures and quickly show investors the difference. This type of tool could even include a PSA verbiage generator based on the model so there's no more ambiguity in the PSA's. This enables investors to load the structure rules, add their own assumptions, and make quick and accurate decisions. That seems like it would speed along private MBS: there will be no more need to carefully parse the PSA's or rely solely on ratings agencies. By building the PSA's from standardized components, investors can meaningfully assess the merits of each deal.

Despite standardized tools, the PSA's do not need to all be the same, issuers can use those standard components to build whatever they want, similar to how a homebuilder can use standardized building materials to construct widely different structures. Standardization of the business rules and technology will enable faster and clearer communication between issuers, investors, guarantee agencies and any other stakeholder. Once the initial MBS modeler is in place, it is even possible to add and model CMO's and CDO's on the same modular blocks so that investors could quickly find the level of risk they're comfortable buying and then track performance almost in real-time.

There are other rule changes that would make technology more effective. FHFA should ask Congress to modify HERA to tone down or even eliminate the privacy requirements for loan-level data because

- it's nearly impossible to meaningfully report loan level data and remittances in a manner that makes it impossible to tie the reports to a specific house, and
- since the mortgages and NOD's/LP's are already public there's no reasonable borrower expectation of privacy, and
- it would provide better visibility for investors and even defaulters; no more questions about what the collateral is likely worth to the investor or "who owns my loan" delays from borrowers, and
- Treasury said a lack of visibility, to both Treasury and industry, helped cause the mess because everybody assumed the worst when things started to fall apart; that became self-fulfilling since it seized up the whole system rather than just some of the more dysfunctional parts.