United States Senate

WASHINGTON, DC 20510

September 20, 2012

The Honorable Daniel K. Tarullo
Member
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Dear Governor Tarullo,

I am writing to you today in the wake of the Federal Reserve's announcement that it will purchase $40 billion in agency mortgage-backed securities each month until the economic recovery is on sounder footing. The Fed has made clear that mortgage credit availability at a lower interest rate is a paramount feature of economic growth, so much so that the Fed is willing to assume the risks of a much inflated balance sheet to achieve this goal. Initial market reaction is likely in-line with what you had hoped – secondary mortgage market interest rates have dropped by over 33 basis points since the day of the announcement.

I believe that the Fed is missing an important piece of the puzzle, however, if lower mortgage interest rates are the goal. As you know, the yield on a Fannie Mae or Freddie Mac mortgage-backed security is not the interest rate that a homeowner pays for a loan. It is instead the secondary market yield on a bond. The spread between this rate and the rate offered to homeowners is influenced by many factors, including the cost to service these mortgages, the cost of capital held against these mortgages, and the cost of regulatory compliance by the originator and servicer of these mortgages, to name a few. If these costs go up in proportion to the decline in the secondary market rate of the MBS, there is no benefit for the homeowner and therefore no impact on economic growth. And that is the focus of my letter today.

It seems clear that we not only face the much discussed "fiscal cliff" in 2013, we also face a "mortgage credit cliff" as a series of new regulations and capital rules will go into effect next year. Instead of ballooning the Fed's balance sheet to lower secondary market rates on the one hand while simultaneously raising the primary rate offered to borrowers on the other, perhaps a better approach would be to instead address the coming mortgage credit cliff through more sensible policies.

The list of federal government actions that will impact mortgage credit next year include the following:

1. The Qualified Mortgage ("QM") rule, which will set an outer bound for mortgage underwriting standards but may not provide a legal safe harbor for originators if they adhere to the checklist of rules established by the Consumer Financial Protection Bureau. Without this safe harbor, many community banks – who traditionally serve local customers such as homeowners – may not be able to afford the compliance costs of

potential litigation. This would put downward pressure on mortgage credit availability and upward pressure on mortgage interest rates.

2. The Qualified Residential Mortgage ("QRM") which, instead of simply establishing some sensible minimum underwriting rules in legislation, opted for an exceptionally complex matrix of rules that also require a 5% hold-back in cases where a loan does not adhere to the QRM box. This asset also requires capital, and therefore will drive up the cost of mortgage credit.

3. The New York Fed's premium capture cash reserve account, or "PCCRA" – a rule the New York Fed has drafted as part of QRM. As you know, this rule requires banks to hold back any amount sold above par when loans are securitized. The intention here is to make the overly complex QRM rule "work," and so I have a degree of sympathy with what the authors are attempting to accomplish. The problem, however, is that the holdback for securities sold above par will pose a cost that will ultimately be borne by the borrower in the form of a higher interest rate.

I understand that these regulatory challenges are problems that Congress has created. And I understand that you are doing what you can to implement rules in accordance with what Congress has given you. But it also seems to me that if you would take a role in helping some members of Congress understand that these rules will cause rates to go up materially, we might be able to accomplish the objectives you have set after with so-called QE3 without taking on the risks of an enormous balance sheet at the Fed.

Your insights here would be greatly appreciated. I stand ready to work with you and other policy-makers to address these issues in an appropriate manner as expeditiously as possible.

Sincerely,

Bob Corker

Bob Corker
United States Senator

cc:

The Honorable Ben Bernanke