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Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street, S.W.
Washington, DC 20219

Re: Enterprise Duty to Serve Underserved Markets Draft Evaluation Guidance

Dear Mr. Pollard:

The Federal Home Loan Mortgage Corporation (Freddie Mac) is pleased to submit comments to the Federal Housing Finance Agency (FHFA) on FHFA's draft Duty to Serve Evaluation Guidance for the 2018-2020 Plan Cycle (the Draft Guidance). The Draft Guidance describes the procedures that Freddie Mac and Fannie Mae (the Enterprises) must follow in preparing their Duty to Serve Underserved Market Plans (Plans) required by 12 CFR 1282, as well as describing the proposed processes by which FHFA will evaluate the Plans annually.

Freddie Mac supports FHFA's efforts to develop a thoughtful framework to govern the drafting and evaluation of the Enterprises' Plans, and we appreciate the significant effort that went into preparing the Draft Guidance. In the sections that follow, we offer several recommended modifications to the Draft Guidance that we believe will enhance FHFA's ability to provide a complete and accurate evaluation of Enterprise support for the underserved markets.

Principles for Evaluation Guidance

In developing our comments, we were mindful of the following three basic principles that we believe should direct the development of guidance that, at its core, is meant to be a vehicle by which FHFA can evaluate the Enterprises' compliance with their statutory obligation to serve underserved markets.

1. Evaluation guidance should establish a framework that is transparent to all parties – FHFA, the Enterprises, and the public.
2. Evaluation guidance should lead to predictable results that are reflective of the actual support that the Enterprises provide to underserved markets.

3. Evaluation guidance should establish incentives that encourage the Enterprises to engage in activities that support the underserved markets in a manner that is consistent with the Enterprises' overall public purposes and that is within the bounds of safety and soundness.

Specific Comments

In the following specific comments, we focus on the Evaluation Process for Enterprise Performance that is proposed in Chapter 2. However, as noted, certain comments also address topics that are the subjects of the Questions for Public Input that FHFA included in Chapter 3 of the Draft Guidance.

Quantitative Evaluation of Performance

Partial Credit[1]

Step One of FHFA's proposed evaluation process is a quantitative calculation of the extent to which an Enterprise achieved each of the objectives specified in its Plan. The proposed quantitative evaluation methodology grants partial credit in instances when an Enterprise does not fully accomplish an objective, with four possible scores: 10 (accomplished objective), 6 (substantial accomplishment), 3 (moderate accomplishment), and 0 (failed to accomplish at least a moderate amount of objective). FHFA would then average the assigned scores that an Enterprise receives for each of its objectives in an underserved market to determine whether the Enterprise receives a passing score (7 or higher) for that market.

Freddie Mac strongly supports FHFA's decision to include a partial credit provision in the Draft Guidance. By permitting partial credit, FHFA is creating an incentive for the Enterprises to set stretch goals as they design their Plans, rather than setting lower goals that could be achieved with a higher level of confidence. Many possible Duty to Serve activities are highly innovative or are untested in underserved markets. Accordingly, it may be difficult for an Enterprise or FHFA to predict accurately what reasonable goals might be. By providing partial credit, FHFA reduces the risks associated with setting a goal that proves unrealistically high or with developing a novel product or approach. In addition, partial credit creates an incentive for the

[1] The comments in this section address certain issues raised in FHFA's Questions for Public Input; Chapter 2, Questions 1, 2. See Draft Guidance p.28.

Enterprises to develop a greater understanding about how they are best able to maximize underserved market support. Finally, providing partial credit will result in FHFA evaluations that more accurately reflect Enterprise actual support of underserved markets.

Notwithstanding our enthusiasm about the concept of awarding partial credit, Freddie Mac has concerns that the methodology specified in the Draft Guidance could result in a seemingly anomalous result because the values assigned for partial credit for an objective do not align with the threshold for an average passing score for a particular market. For example, an Enterprise could accomplish a substantial amount of all its objectives for one of the underserved markets (resulting in an average score of 6), but still fail the quantitative evaluation component because it did not receive the required passing grade of 7. FHFA could avoid this outcome by aligning the value assigned to substantial accomplishment of an objective with the passing score for an underserved market. We believe that substantial compliance (representing accomplishment of at least three-quarters of a target[2]), whatever numeric score is assigned, should result in an Enterprise passing the quantitative evaluation for an underserved market.[3]

Alignment of the score assigned to substantial accomplishment of an objective with the passing score for an underserved market would make it possible for an Enterprise to pass the quantitative evaluation even if unanticipated circumstances have contributed broadly to the inability of the Enterprises to fully and feasibly accomplish multiple objectives in an underserved market. During a period of widespread and significant market disruption, it may not be possible for an Enterprise to achieve many or all of its objectives, even if the targets were reasonable when created and the Enterprise worked diligently to accomplish the objectives. Under circumstances where widespread and unforeseen conditions make full accomplishment of many objectives impossible or impractical, substantial compliance should not result in the Enterprise failing Step One.[4]

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[2] Draft Guidance p.17.

[3] Notably, a bank's substantial achievement of its Community Reinvestment Act (CRA) plan goals when operating under a CRA strategic plan will result in a "satisfactory" rating. See, *e.g.,* 12 CFR Part 25, App. A (e)3.i (OCC standards for assessment and ratings of bank strategic plans under the CRA).

[4] The Draft Guidance provides for excluding an objective from evaluation if the objective is determined to be infeasible. See Draft Guidance p.19. However, if most or all of the objectives for a particular underserved market are deemed infeasible and excluded, evaluation would be difficult or impossible.

Recommendation: Freddie Mac recommends that FHFA modify the quantitative evaluation methodology in the Draft Guidance to align the value associated with substantial accomplishment of an objective with the passing score for an underserved market.

Qualitative Evaluation of Performance

Limit on Final Scores

Step Two of the Draft Guidance is a qualitative evaluation of an Enterprise's performance under its Plan. The proposed scoring methodology permits final scores of up to 50 when an Enterprise significantly outperforms the level targeted by the objective with a high concept score (over 30), while objectives with lower concept scores are not eligible to receive a final score higher than the concept score.

Freddie Mac's view is that placing a cap on potential final scores in situations where the concept score is 20 or below discourages the Enterprises from engaging in activities that could assist an underserved market beyond the stated target. This approach may create an unintentional disincentive for the Enterprises to innovate and explore new ideas to address challenges in markets that historically have not thrived using conventional solutions.

Our experience is that certain of our historic programs (*e.g.,* our Multifamily Green Advantage) have far exceeded market expectations at the time that these programs were designed and implemented. Because the initial assessment of an objective's potential (reflected in the assignment of a concept score) can be incorrect, we recommend against limiting possible final scores. Even though concept scores are not finalized until the end of an evaluation year, Enterprises will have made strategic decisions during the course of that year based on preliminary concept scores, which may include strategic decisions to focus on activities that have greater potential to earn higher final scores. Instead, and consistent with our stated principles, we believe that the final score for an objective should be based on its actual support of an underserved market.

In addition to encouraging individual high-impact objectives, we suggest that the proposed scoring methodology also should encourage the Enterprises to engage in a series of lower impact objectives that collectively have a significant positive effect on an underserved market. By limiting the highest final scores exclusively to objectives that have higher concept scores, the methodology specified in the Draft Guidance may constrain Enterprise efforts related to objectives that individually have a low impact, but that are designed to work together to support a market. For example, a series of objectives that involve a review of two existing products may have low individual concept scores, but may result in the development of an innovative product or approach that has a significant impact on an underserved market. In this type of situation, the final score of an objective should not be bound by the concept score when the objective operates in tandem with other objectives to produce a significant aggregate impact on an underserved market. Again, our view is that final scores should be tied to actual impact on underserved markets.

> Recommendation: Freddie Mac recommends that FHFA permit final scores of up to 50 for all objectives, irrespective of concept scores. This approach also would allow FHFA to give appropriate credit for multiple lower score objectives that could combine to have a significant impact on a market.

Specifying a Range of Concept Scores for Loan Purchase Objectives

Under the methodology in the Draft Guidance, FHFA would assign a concept score for each objective in an Enterprise's Plan, with such score measuring "the expected level of impact that achievement of the objective would represent, assuming at least effective implementation."[5] Concept scores can be 0, 10, 20, 30, 40 or 50. The concept scores ultimately inform FHFA's scoring of an objective, with FHFA considering the Enterprise's actual achievements and implementation of the objective through various standards.

In the case of loan purchase objectives, Freddie Mac believes that it would be possible and desirable for FHFA to provide a range of concept scores based on an Enterprise's achievements relative to a targeted range. Freddie Mac took this approach in our Plan, presenting in many instances a concept score (*e.g.,* 30, 40 or 50) that would be associated with specified levels of purchases in each Plan year. This concept score range approach would significantly increase the transparency and predictability of the evaluation process, eliminating uncertainties to the Enterprises and other stakeholders about how purchase performance will be evaluated. We also believe that development of a range of concept scores would be relatively straightforward. FHFA presumably would have to consider higher and lower purchase volumes as it makes its

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[5] Draft Guidance p.21.

determination of the single concept score that reflects "at least effective implementation." These higher and lower volumes could be used to establish a reasonable range that defines high impact/implementation performance, as well lesser performance.

Recommendation: Freddie Mac recommends that, whenever possible, FHFA establish a range of concept scores for an Enterprise's loan purchase objectives.

Measuring Efficiency

The qualitative evaluation methodology specified in the Draft Guidance indicates that an Enterprise's performance with respect to each of its objectives will be evaluated for impact and implementation. For the implementation component, the Draft Guidance continues by indicating that FHFA will "include a focus on how efficiently and effectively the Enterprise allocated resources to execute the objective."[6] The implementation criteria in Appendix B indicates that efficient allocation of resources is among the criteria associated with higher implementation scores (30 and above).[7]

The Draft Guidance does not specify what standards FHFA would use to measure efficiency, and we are concerned that, absent clarity about such standards, the Enterprises will not have an informed understanding about the level of resources that would be appropriate to allocate on Duty to Serve objectives. In many instances, there may be a direct correlation between the amount of resources dedicated to achieving an objective and the impact of that objective. While achievement of objectives ultimately is bound by safety and soundness considerations, the Enterprises should have additional guidance to understand the point at which efforts will count against results that are achieved.

Even if standards for evaluating efficiency existed, we are concerned that a significant emphasis on efficiency in the evaluation process may operate as a disincentive to attempt innovative objectives where there is a degree of uncertainty about both effectiveness and costs. A heavy emphasis on efficiency places the Enterprises in a position where they could be penalized for unsuccessful pilots or other actions that may require a significant upfront investment of resources.

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[6] *Id.*
[7] *Id.* p.32.

Recommendation: Freddie Mac recommends that FHFA remove efficiency as a qualitative evaluation criterion or articulate the specific metrics that FHFA intends to use to evaluate efficiency.

Other Comments

Complexity

As a general observation, Freddie Mac notes that the scoring methodology in the Draft Guidance is complex, with multiple components and a high degree of subjective evaluation necessary to determine an Enterprise's performance. We appreciate the challenges of designing a process that accurately measures an Enterprise's support of underserved markets, and we applaud FHFA's effort to address the many considerations that should be included in an evaluation methodology. However, we believe that the complexity of the proposed framework tends to reduce the transparency and predictability of the guidance and, in some cases, may not fully measure actual support of a market.

Because the Enterprises already have prepared their Plans in consideration of the proposed requirements in the Draft Guidance, Freddie Mac does not recommend significant structural changes in approach prior to finalization of the current guidance. However, we believe that it would be desirable for FHFA to take steps to reduce some of the complexity of its evaluation framework when it develops evaluation guidance for future cycles. FHFA indicates in its Overview of the Evaluation Process that it will "engage in ongoing analysis and consideration of the evaluation process during the Plan cycle," noting that this will enable FHFA "to incorporate lessons learned over the first Plan cycle regarding the effect of the initial standards and thresholds in the evaluation process and to make modifications to the Guidance as appropriate."[8] As it conducts this process, we encourage FHFA to consider modifications that would simplify its current evaluation methodology.

Recommendation: Freddie Mac recommends that FHFA use the 2018-2020 Plan Cycle as an opportunity to simplify the Duty to Serve evaluation criteria for future plan cycles based on its experience with the current methodology.

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[8] *Id.* p.16.

Officer Certification

The Draft Guidance specifies that the final version of an Enterprise's Plan must include "a certification from a senior executive officer responsible for submitting the Plan to FHFA stating that, to the best of his/her knowledge and belief, the historical information provided in the Plan is true, correct, and complete."[9] However, the Draft Guidance does not specify what constitutes "historical information," and this term potentially could be construed to include a broad range of materials in an Enterprise's Plan. Our interpretation is that this term means an Enterprise's data and information used to formulate its baselines and targets and does not include information that the Enterprise may have received from third parties, such as information included in reports from non-profit organizations.

> Recommendation: Freddie Mac recommends that FHFA clarify the declaration requirement to specify that an Enterprise's Plan must include "a certification from a senior executive officer responsible for submitting the Plan to FHFA stating that, to the best of his/her knowledge and belief, the historic Enterprise information used to set baselines and targets in the Plan is true, correct, and complete."

Modification Process

The Draft Guidance indicates that Enterprises may modify their three-year plans annually, but requires that modifications be submitted to FHFA at least 90 days before the end of the Plan evaluation year for the modification to take effect in the subsequent year.[10] This timing would require an Enterprise to submit a proposed modification with only six months of reported results on an objective (*i.e.,* results as of June 30 of that Plan year), which may not be sufficient for the Enterprise to determine whether a modification is needed. We believe that a 45-day advance submission requirement would be appropriate for major Plan modifications, even those that may require public input. For minor modifications, such as a request to change a specific numeric target of an objective by a modest amount, we believe that notice to FHFA with opportunity to object to the change would be sufficient.

> Recommendation: Freddie Mac recommends that FHFA permit major proposed modifications to be submitted within 45 days of the end of an evaluation year and

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[9] *Id.* p.3.
[10] *Id. p.10.*

permit the Enterprises to make minor Plan modifications with notice to FHFA as few as 15 days prior the end of an evaluation year.

Providing Preliminary Concept Scores

The Draft Guidance describes FHFA's approach of determining a concept score for each objective included in an Enterprise's Plan. The concept score informs FHFA's evaluation of the achievements and implementation of the objective, with a higher concept score assigned to more meaningful objectives."[11] FHFA indicates that it intends to advise an Enterprise of its preliminary concept score for each objective at the time that it makes a non-objection decision,[12] but also asks a question concerning the timing of sharing preliminary concept scores.[13]

Freddie Mac believes that early notice of the concept scores from FHFA will help the Enterprises significantly as they work to develop their final Plans. In a situation where a preliminary score is lower than anticipated, early notice would provide an Enterprise with the opportunity to consider revisions to its Plan (*e.g.,* increases in targets or modification of objectives) and will allow it to increase the chances of success both for the Enterprise and for the communities it is trying to serve. The activities and objectives that an Enterprise selects to include to support a particular underserved market can be intended to work together to maximize impact to the market, and adjustment of one objective late in the process may jeopardize the success of achieving other objectives. Because of this interrelationship between objectives, we believe that the Enterprises need as much time as possible to understand how components of the Plan are likely to be evaluated and to work with FHFA on appropriate adjustments if a preliminary score is lower than expected.

Recommendation: We recommend that FHFA share its preliminary concept scores with the Enterprises at the same time it provides comments to them on their draft Plans.

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[11] *Id p.21.*
[12] *Id.*
[13] *Id. p.29 (Chapter 3, Question 5).*

Freddie Mac appreciates the opportunity to provide its feedback on the Draft Guidance. Please do not hesitate to contact me if you have any questions or would like to discuss our comments further.

Sincerely,

Wendell J. Chambliss

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