Guild mortgage
OWN WHAT MATTERS

June 23, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Federal Home Loan Bank Membership – Request for Input

Dear Director Calabria:

Thank you for allowing Guild Mortgage Company the opportunity to provide FHFA with input regarding FHFA's reconsideration of FHLB member eligibility principles and requirements. Guild Mortgage Company, founded in 1960, is one of the oldest independent mortgage banks in the nation, having survived and flourished through numerous business cycles in the past sixty years. Our business model is to originate and retain servicing on 1-4-unit residential mortgages, with a specific emphasis on purchase transactions and first-time homebuyers. We originated approximately $22 billion in mortgages in 2019 and are presently servicing approximately $52 billion in mortgages backed by Fannie Mae, Ginnie Mae and Freddie Mac.

Guild is one of the largest purchase money lenders in the nation, both in terms of our absolute dollar volume of purchase loan originations and as a percentage of our entire book of business. We are also one of the largest originators of state and local Housing Finance Agency loan programs which typically focus on providing affordable lending products for first time homebuyers.

Below are Guild's responses to the seven questions posed by FHFA in your RFI dated February 2020. For the sake of brevity, the original questions in the RFI are listed by section number and letter below, with Guild's response.

1.a) FHFA should consider an applicant's business model and the extent of their focus on mortgage lending as a key consideration in their suitability for FHLB membership. Key principles should include:

- The entity should primarily or exclusively conduct their business to serve the residential mortgage market
- The entity should maintain this level of focus under all business cycles, specifically in time of economic downturns, when risks and costs increase
- The entity should primarily originate and/or service long term mortgages with terms of 15- to 30-years
- The entity should originate and/or service mortgages that are sound and economical, such as 30-year fixed rate loans with full documentation underwriting, that fully comply with all fair lending regulations
- The entity should be subject to routine and substantial regulatory and audit oversight, from Federal and state regulators, government agencies, the Enterprises, and private mortgage participants
- The purposes of access to FHLB member advances should be exclusively to support residential mortgage origination and servicing activities

The applicant entity or parent of the applicant entity should meet all eligibility, reporting, and ongoing approval requirements of the Enterprises (Fannie Mae and Freddie Mac) which are required for Seller and Servicer approval. Additional requirements, such as higher net worth or capital requirements may be imposed at the discretion of FHFA.

1.b) FHLB Membership approval for Independent Mortgage Banks (IMBs) would allow IMBs to receive access to dependable and low-cost liquidity throughout all business cycles. The stability of an IMB having access to FHLB liquidity would significantly improve the safety and soundness of IMBs and the entire housing finance system. In times of business cycle downturns, when typical IMB liquidity sources such as warehouse lines may be restricted or cancelled, a lack of access to liquidity could cause profitable firms to reduce operations or fail, impacting the safety of the housing industry, reducing competition in the market, and leading to higher costs for mortgage borrowers.

1.b)i. The safety and soundness risks to the FHLB system from IMB members would be managed by establishing appropriate minimum net worth, capital and business profitability requirements, only approving IMBs subject to numerous and continuous audits by Federal and state regulators and private business counterparty audits, requiring detailed monthly and quarterly financial reporting, performing high quality on-going counterparty surveillance in close cooperation with each Enterprise's counterparty risk teams, creating cross-default provisions in FHLB and Enterprise contractual agreements, and importantly establishing high quality standards and advance rates for the collateral pledged by IMBs against FHLB advances to ensure the

FHLBs do not suffer any losses in the event of a counterparty default. High thresholds should be established for the origination quality, risk profile, and loan performance of all originations by each IMB and monitored on a monthly basis, in conjunction with the Enterprise counterparty risk teams. Requiring all conventional mortgages above 80.0 percent LTV to have private mortgage insurance would reduce the severity of collateral loss exposure to the FHLBs and ensure additional loan quality and performance surveillance is conducted by private mortgage insurance companies.

1.b)ii. The FHLBs currently have approved member entities which are depositories where housing finance may not be the primary focus of their business model or activities, and many of these entities will shift their activities away from housing during times of market downturns. In contrast, IMB business models are 100% dedicated to the housing finance system and they cannot shift their focus to other more profitable non-mortgage activities during housing market cycle downturns. In times of housing market downturns when risks and costs increase, some depository entities will abruptly shift their business activities away from the housing market to earn higher returns in other product or market segments not involving residential housing.

1.b)iii. In times of housing market downturns, two negative events occur. First, many depository institutions shift away from mortgage investments or originations. Second, many IMBs are impacted by reduced access to warehouse financing lines. The resulting lack of liquidity for the entire mortgage market impacts the overall health of the system and can cause otherwise profitable institutions to be harmed or to fail. Specific examples include lenders' inability to make margin calls on their open MBS hedge positions, which are financial instruments intended to reduce overall systemic risk in the secondary mortgage markets, lenders' inability to have access to warehouse funding to fund originations, and servicers not having sufficient liquidity to make short term P&I or T&I advances even though they are operating profitable origination and servicing operations.

Depositories face stringent risk-based capital requirements to hold mortgages or MSRs on their balance sheets, which are more stringent than other asset classes. In times of economic downturns when balance sheets are strained, this creates an additional incentive for depositories to shift their assets to those with more favorable capital requirements, further impacting liquidity in mortgage market.

2.a) FHFA should hold all FHLB applicants to at least the minimum standards required by each Enterprise (Fannie Mae and Freddie Mac) for both seller and servicer eligibility. In addition, FHFA should consider requiring higher net worth, length of business profitability and other measures to ensure all FHLB members have proven business models which primarily or exclusively serve the residential mortgage market. Additional factors that should be considered are the applicant's proven ability and commitment to serve the mortgage market during all business cycles, and the financial performance of the applicant's business model under different market stress scenarios.

Given that a primary activity of an FHLB member business relationship is access to collateralized borrowing liquidity, the quality of the underlying collateral should be paramount to a member's approval. The member should demonstrate a long history of high origination quality, a sound risk profile and strong mortgage performance over many business cycles.   FHLB members could be required to utilize the Enterprise MBQRF reporting system to avoid duplicate reporting requirements and to reduce the regulatory burden of the FHLBanks to provide oversight of their members.

2.b) Members should be subject to stringent ongoing financial reporting requirements, similar or identical to those required by the Enterprises, including the regular reporting of monthly and quarterly business and financial data. In addition, routine quality control reviews of the members collateral supporting FHLB advances should be performed, including manufacturing quality, risk profile, expected default rates, expected loss severities, actual default rates, and actual loss severities.

3.a) FHFA should look at any applicant, and any applicant–parent relationship to determine if the entity and/or parent entity would utilize a FHLB membership to support and enhance the origination and/or servicing of high quality residential loans, and whose business activities are consistent with the principles outlined in section 1.a) above.

3.b) FHFA should not focus so much on entity type, but rather focus on the historical performance of the applicant entity, and its proven level of commitment to the residential mortgage market, along with its detailed business plan on how FHLB membership would further support the principles of the FHLB mission. Entities which cannot make a compelling argument that their membership is consistent with the FHLB mission should not be approved for membership regardless of their entity type.

3.c) FHFA should consider establishing an ongoing membership eligibility requirement that requires all approved entities to continue to utilize their membership to support the principles of the FHLB mission, and any entity that is not operating in this fashion could be subject to membership suspension or termination.

3.d) Any limits to the amount of advances that any specific FHLB could make to any single member entity should be based upon fair and sound principles of risk diversification and counterparty oversight. The failure of one counterparty member should never risk the safety and soundness of any FHLB bank. Fair and reasonable limits should be established based upon the quality of the applicant entity, and the quality of their collateral utilized to support advances, as well as the expected loss exposure any individual FHLB would face.

4.a) FHFA should mandate that any conduit and/or parent entity are jointly and severally liable for all obligations and responsibilities of FHLB membership, and one or both entities are subject to rigorous audit review by Federal, state, Enterprise, HUD, other government agency regulators, as well as audits by private market participants such as MBS trading dealers, warehouse bank lenders, mortgage insurance companies, correspondent lenders, and state Housing Finance Agencies

In addition, one or both entities should be required to provide ongoing, monthly and electronic business and financial reporting, substantially similar at minimum to the MBRF requirements of both Enterprises for both seller and servicer approved entities. Each entity should also provide detailed monthly reporting regarding the collateral utilized to support FHLB advances, including QC by independent firms, including FHLB auditors or designated third party firms.
4.b) FHFA should not provide advances to an entity unless the entity or a contractually obligated parent is subject to effective oversight from sufficient government and private regulators and audits.

4.c) Each FHLB should have the authority to adjust the level of collateral discounts, capital requirements, or utilize other risk management practices commensurate with the risk exposure each FHLB may face with the unique risks of any specific member.

4.d) The risks to the FHLBanks of increased costs due to the failure of an approved member are best mitigated by focusing on the quality of the underlying collateral supporting the advances, and the advance rate against the collateral. This will allow the FHLBanks to continue to suffer few losses from defaults of member entities.

5.a) No. The original intent of the 1932 Act was to provide liquidity to all entities that were serving the U.S. mortgage market in accordance with the underlying mission of the FHLBanks to foster safe, sound, low cost and long-term mortgages to strengthen the U.S. housing system. The inclusion of insurance companies within the member eligibility criteria established under the 1932 Act was an acknowledgment of the role played by insurance companies who were a major source of mortgage lending, by originating and holding these assets in their portfolios. Some estimates indicate that insurance companies originated approximately 30% of mortgages in 1932.

The independent mortgage banker (IMB) business model that we know today did not exist in 1932 and did not effectively come into existence until after the creation of the Ginnie Mae and later the Enterprise MBS markets, which allowed lenders to originate and service mortgages with a steady supply of capital provided by the Secondary Mortgage or MBS markets. Today IMBs represent approximately 60% of all annual mortgage originations. In many cases, IMBs have a greater focus on purchase mortgage lending, a greater focus on serving first time homebuyers. Depository lenders tend to have a relatively greater focus to originate adjustable rate mortgages, shorter term 15-year mortgages, or high balance and jumbo mortgages, particularly for loans to be held in their portfolios, whereas IMBs typically are relatively more focused on originating 30-year fixed rate conforming balance mortgages sold into MBS through the secondary mortgage market.

IMBs are more relevant to the U.S. residential mortgage market today as insurance companies were in 1932. The conforming balance, 30-year fixed rate mortgages, which are the overwhelming predominant product originated by IMBs, are clearly in full alignment with all founding principles and the mission of the FHLBanks.

Not allowing IMBs to be members of the FHLB system, when IMBs play such a large role in our housing market, and thus depriving the majority of the housing finance market from having access to dependable, safe sources of liquidity only harms the overall health of the housing finance industry, increases risks, and raises costs. The resulting lack of liquidity reduces competition and results in higher costs to consumers.

5. b) Yes. FHFA should require all FHLB member entities to continuously demonstrate a deep commitment to housing finance in order to retain their membership status. The FHLB was only created to provide liquidity to support housing finance.

5. c) FHFA should look at conduits and their parents collectively and only allow membership for conduit/parent entities that are primarily if not exclusively dedicated to the U.S. housing finance industry.

5. d) Yes. Creating increased demand for MBS and broadening the types of MBS that can be issued, will reduce costs in the system, improve MBS liquidity and diversify investor bases. This will lead to lower costs for consumers and a stronger overall housing finance system.

6. FHLB eligibility membership standards should be clear and transparent. Each applicant's business model should clearly and substantially comply with all the underlying principles of the FHLB's mission. Each FHLB should be allowed to exercise some degree of reasonable judgment to determine if any applicant or current member's business strategy or model is consistent with these objectives. If an applicant does not have a business strategy or model that substantially complies with these principles, then they should not be approved as a member, and any existing member whose business strategy or model has changed, should no longer be allowed to continue their membership. FHLB membership and access to liquidity should be specifically allocated to entities that are deploying the capital in support of the housing finance system.

7. Other issues and concerns. The majority of IMBs rely upon warehouse lending lines as their primary source of liquidity to fund their daily operations. When the housing market and economy are growing, warehouse lines are plentiful, and the terms are reasonable. In times of market downturn warehouse lines can be reduced or withdrawn on short notice. As this source of liquidity is removed from the system, it raises costs, creates operational inefficiencies, systemic risk is increased, competition is diminished, and consumers pay higher costs.

Adding a dependable, consistent source of liquidity to the housing finance system, such as FHLB member advances, reduces risks, reduces costs, and strengthens the entire U.S. housing finance system. The FHLB model where originators retain the servicing and retain a financial interest in the loans they originate creates an important "skin-in-the-game" concept that aligns the interests of mortgage originators and credit risk investors, creating a fundamentally stronger housing finance system, and puts into practice one of the key lessons learned from the Great Recession in 2008.

We appreciate the opportunity to provide input to the FHFA as you seek to reevaluate the membership regulation of the FHLBanks system.   We welcome any opportunity to engage in further dialogue with respect any of these or other issues that may help FHFA gain a broader understanding of the complex issues and potential benefits to the U.S. housing finance system.

Please do not hesitate to contact me at 858) 492-5830 if you would like to discuss any of these matters further.

Sincerely,

Terry Schmidt
President
Guild Mortgage Company