American Bankers Association
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Mr. Joseph Prendergast
Manager of Policy Research
Office of Policy Analysis and Research
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Re: Request for Input on Guarantee Fees

Dear Mr. Prendergast

The American Bankers Association[1] appreciates the opportunity to provide the Federal Housing Finance Authority (FHFA) input on the guarantee fees (G fees) charged by Fannie Mae and Freddie Mac, and on whether those fees should be increased at this time.

The following lays out ABA's policy position on G fees and details how that position should be tempered by current conditions. In short, ABA has argued for higher G fees both to better compensate taxpayers for the risk being taken by the federal government while Fannie and Freddie are in conservatorship, and to reduce barriers to private entities reentry into the secondary market. The call for higher G fees is tempered, however, by a number of factors detailed below. These include the still fragile state of the U.S. housing market and overall economy, and the lack of legislative reform of the GSEs which inhibits the return of private capital to the secondary market even with higher G fees.

Background – ABA Position

ABA has long maintained that the G fees should be increased both to more fully compensate the federal government for the risk being borne by taxpayers while Fannie Mae and Freddie Mac are receiving the support and backing of the federal government, and as a means of encouraging the private sector to re-enter the secondary mortgage market. This position was stated in brief in our letter of February 9, 2011 to the then Treasury and HUD Secretaries. In relevant part that letter read:

ABA recommends that the primary mechanism for reducing government involvement (and for compensating the government for its ongoing support) is through adjustments to the guarantee fees (G fees) paid to the GSEs (or their successors). The current G fees are too low – the

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans. Learn more at www.aba.com.

compensation being paid for what amounts to full government backing is simply not priced correctly. Raising the G fee can do much to encourage development of the private market and to begin to repay the government for its current support. By "dialing up" the G fees in an orderly and well-detailed manner, eventually the private market will find itself in a position where it is better able to compete with the GSEs for business. With a high enough G fee, the private market will be able to price for risk in a fashion that allows for safe and sound investment and lending at a rate that is comparable (and eventually better) than the rate charged by the GSEs. In the meantime, the increased rates for G fees will help to offset losses and assist in the repayment of the government's investment in Fannie Mae and Freddie Mac. This approach also allows for flexibility in the setting of guarantee fees, thereby ensuring a safety valve for housing finance in the event of private market disruptions.

Background – Current State of GSE Conservatorship

While both the House Financial Services Committee and the Senate Banking Committee have considered legislation to eliminate the GSEs and restructure the government's role in the secondary market, neither bill has gained broad enough bi-partisan support to advance further in either chamber.
Thus, the GSEs remain in conservatorship, with the federal government providing full backing for them. While the GSEs have, in recent quarters, improved their cash flow, the reality is that they continue to operate without any real capital, and any downturn could cause them to again require infusion of funds from the U.S. Treasury. Further, under the existing conservatorship agreement, any "profits" made by the GSEs are swept to the Treasury, not used to rebuild capital, or even to retire the existing debt owed to the Treasury. All funds going to Treasury are essentially a dividend with the government's "investment" remaining in place.

Background – U.S. Economy and the Housing Market

While the U.S. economy has improved in recent years, growth remains slow and home sales weak in many areas of the nation. Growth fell 2.9 percent in the first quarter. We have only seen GDP fall during an expansion three times in the past 50 years, and two of the three have been in recent years. Housing continues its improvement based on price recovery, but existing and new home sales have fallen below their year ago levels. New rules required under the Dodd/Frank Act have made it more difficult for borrowers to qualify for loans, further inhibiting lending.

Recommendation

Given the above factors, ABA has modified our recommendation on increased G fees as follows:

While ABA still maintains that increased Guarantee fees are in important mechanism for reducing barriers to private capital reentry into the secondary market, and are desirable as a means for better compensating the federal government for risks being borne by the taxpayer, we also recognize that G fees are only a part of the puzzle and must be adjusted in conjunction with other policy changes. Absent those other policy changes, increasing G fees may do little to spur the return of private capital and may, in fact, make further reforms to the secondary market more difficult to attain.

As long as all "profits" from the GSEs are being swept to the U.S. Treasury without building a capital base for the GSEs (or their successor(s)) or retiring the existing debt owed to the Treasury, increasing the G fees can in fact make reform more difficult, because these "profits" are a stream of income to the federal government which will be lost under reform efforts.

While increased G fees do provide more income to the Treasury and in the broadest sense do provide compensation for the risk being borne by the taxpayers, that compensation is unfocused so long as it goes into general Treasury funds. Ideally, increased G fees would be directed to a new guarantee fund or to the capital base for the GSEs or successor guarantors, or at least more directly focused on the government's role in the secondary market.

Additionally, given the precarious state of the U.S. economy generally, and the housing market in particular, increasing the G fees at this time may further inhibit affordability and harm the market.

ABA therefore does not recommend to the FHFA that G fees should be raised at this time but that increases should be undertaken as part of a holistic approach that has as its goal the return of private capital to the secondary market, the shrinkage of the government's role in that market, and more adequate compensation paid to the government for the risks it assumes. All of this must be considered in the context of the current and expected economic conditions, and must take into consideration any expected legislative actions (or inactions) in the foreseeable future.

Again, we appreciate this opportunity to provide input and stand ready to assist further as needed. If you have questions or would like to discuss any of these issues further, please do not hesitate to contact the undersigned at JPigg@aba.com or via telephone at 202-663-5480.

Sincerely,

Joseph Pigg