600 13TH STREET, N.W.
SUITE 400
WASHINGTON, D.C. 20005
Tel. 202.289.4322
Fax 202.589.2526

September 8, 2014

Federal Housing Finance Agency
Office of Policy Analysis and Research
400 7th Street, SW
Ninth Floor
Washington, DC 20024

RE: FHFA Request for Input on Fannie Mae and Freddie Mac Guarantee Fees

Dear Sir or Madam:

The Housing Policy Council (HPC)[1] of the Financial Services Roundtable appreciates the opportunity to provide input on the level and role of guarantee fees charged by Fannie Mae and Freddie Mac (the Enterprises). This submission is divided into two parts. In Part I, we make a general recommendation to the Federal Housing Finance Agency (FHFA) regarding future adjustments to guarantee fees. In Part II, we respond to some of the specific questions posed in the request for input.

I. FHFA Should Exercise Restraint in Making Adjustments to Guarantee Fees as long as the Enterprises Remain in Conservatorship

As long as the Enterprises remain in conservatorship, we do not recommend any significant changes in the guarantee fee structure. We believe that during the conservatorship any adjustments in guarantee fees should be made only when FHFA determines that a change is needed to promote market stability or protect taxpayers, and that the change will not harm consumers. Changes to guarantee fees that are intended to promote other policy goals could have unintended market consequences and impact the future of housing finance reform. Any adjustments to guarantee fees should be based upon the near-term purposes and constraints of the conservatorship and should not prejudge or prejudice Congressional action on housing finance reform legislation. The Housing Policy Council continues to support legislative action to reform and strengthen the housing finance system.

[1] The Housing Policy Council of The Financial Services Roundtable consists of thirty of the leading national mortgage finance companies. HPC members originate, service, and insure mortgages. We estimate that HPC member companies originate approximately 75% and service two-thirds of mortgages in the United States. HPC's mission is to promote the mortgage and housing marketplace interests of member companies in legislative, regulatory, and judicial forums.

II. Comments on the Questions

Question 1: Are there factors other than those described in section III – expected losses, unexpected losses, and general and administrative expenses – that FHFA and the Enterprises should consider in setting g-fees? What goals should FHFA further in setting g-fees?

As noted above, we believe that while the Enterprises are in conservatorship, they should be managed to preserve the stability of the mortgage market, protect taxpayers and maintain the affordability of housing finance. Guarantee fees should be set consistent with these goals.

Additionally, the risk mitigation provided by coverage from well-capitalized mortgage insurance (MI) companies should be fully reflected in guarantee fees. This permits a reduction in guarantee fees for low down payment borrowers. The lack of full recognition of the credit protection provided by MI results in an overall charge that is too high on mortgages with above 80 percent loan-to-value (LTV) ratios. With recently proposed new capital standards for the private mortgage insurers (the Private Mortgage Insurance Eligibility Requirements or "PMIERs") and new MI master policies meeting requirements set forth by the Enterprises under the direction of FHFA, guarantee fees should fully reflect the risk mitigation benefits of MI coverage on any loan when proved by a well-capitalized MI that meets the PMIERs requirements.

Question 2. Risk to the Enterprises increases if the proportion of higher-risk loans increases relative to the proportion of lower-risk loans. This change in mix can occur if lower-risk loans are retained on bank balance sheets instead of being sold to the Enterprises, if more higher-risk loans are sold to the Enterprises, or if the overall mix of originated loans changes. What alternatives, other than risk-based pricing, should be considered? What are the pros and cons of each alternative?

Risk-based pricing at greater levels of granularity may be an appropriate consideration in setting guarantee fees, though our members are not in complete agreement on this issue. They are, however, largely in agreement that some level of cross subsidization of risk is an appropriate consideration in setting guarantee fees. Cross subsidization of risk can help to stabilize markets and provide access to credit for certain groups of borrowers. Therefore, we urge FHFA to avoid a structure in which risk is disaggregated into too many risk buckets. Some greater aggregation of risk categories also would reduce complexity for lenders and simplify oversight by FHFA. To be clear, we are not calling for the elimination of all risk buckets, but fewer are better than more. As noted at the outset, we do not favor any significant changes in guarantee fees at this time. We are simply trying to avoid a structure in which risk categories are overly disaggregated and the benefits of cross subsidization are lost.

Question 3. Currently, target return on capital and the amount of capital largely determine required g-fees. What factors should FHFA and the Enterprises consider in setting target return on capital and amount of capital required? How should the Enterprises allocate capital across risk buckets?

As long as the Enterprises are in conservatorship and limited in their ability to rebuild capital, it is difficult to base guarantee fees on target capital returns and capital amounts. Nonetheless, to the extent that capital is a factor in setting guarantee fees, the most appropriate capital measure may be the amount of capital needed to ensure that taxpayers are not exposed to any additional cost.

Question 4. At what g-fee level would private-label securities (PLS) investors find it profitable to enter the market or would depository institutions be willing to use their own balance sheets to hold loans? Are these levels the same? Is it desirable to set g-fees at PLS or depository price levels to shrink the Enterprises' footprints, even if this causes g-fees to be set higher than required to compensate taxpayers for bearing mortgage credit risk and results in higher costs to borrowers?

We do not believe that it is possible to identify a level at which guarantee fees would stimulate a private-label securities market because there are a variety of other factors that are affecting the restart of a significant private-label securities market. We also do not find it surprising that balance sheet lenders are returning to the market before PLS investors. The guarantee fee level that would incentivize investors in private-label securities (PLS) is not the same as the level that would incentivize balance sheet lenders. The mortgage crisis exposed significant risks to all parties in the securitization chain from PLS structures. In contrast, balance sheet lending aligns the interests of creditors/investors/servicers.

To date, the increases in guarantee fees have not succeeded in "crowding-in" private investors. The problem with this "crowding in" theory is the assumption that pricing is the only "advantage" preventing the injection of private capital back into the secondary market. In reality, there are a number of barriers to the return of private capital that raising guarantee fees will not resolve. Unless these barriers are removed, FHFA's strategy of continuing to increase g-fees would likely amount to an experiment conducted at the homeowner's expense with little, if any, impact on the government's dominant position in the mortgage market.

These barriers include significant questions around the impact of the qualified mortgage ("QM") and qualified residential mortgage ("QRM") designations on market originations and potential new legal liabilities. Questions also remain around assignee liability, rating agency

models and subordination levels and what data will ultimately be disclosed so investors can rebuild their models. From the institutional issuer side, there remains the issue of how long it will take to establish "shelves" that can issue at scale and be profitable, as opposed to issuing unprofitable one-off deals for publicity purposes.

This "shelf" issue is a critical one as it points to a key misunderstood aspect of today's markets. The lack of private capital does not reflect reluctant buyers so much as it reflects a "sellers strike" caused by regulatory and market uncertainties including those listed above as well as structural questions regarding the future of the Enterprises and the extent to which there will be a viable, sustainable non-agency market of sufficient scale. While there may be a limited number of "one-off trades" – and we have been seeing some recently (totaling less than 1% of the market) – issuers overall are unlikely to make the full investments in the necessary infrastructure until they believe that the market is stable and will continue uninterrupted so that they can recoup their initial investments.

Meanwhile, the ongoing deluge of market-shaping regulations – when combined with needed technology upgrade programs – is incenting issuers to delay making the large capital investments required to build a market. Uncertainty regarding QM, Risk Retention/QRM/Premium Capture, servicing standards and Reg. ABII makes originators, issuers and investors hesitant to put private capital into the market. At this point in time, industry and regulators alike have gone far enough down this path that all parties recognize there is no turning back. That does not mean it will not take some extended time to ameliorate the uncertainties – executional and market impact – engendered by the release of the Consumer Financial Protection Bureau's ('CFPB") mortgage rules.

Then there are the impending Basel III regulations, perceived by many in the industry to discourage both private label securitizations and portfolio lending in several ways. The impending regulations impose higher capital requirements for many mortgages that are held or securitized through PLS. They limit holdings of mortgage servicing rights ("MSRs") and reduce the value of MSRs that are sold to other entities. They require quarterly valuations of PLS cash flows for banks that hold them as investments. They continue the favorable capital treatment for loans securitized through the Enterprises or Ginnie Mae. Finally, they eliminate certain GAAP gains on sales that are considered important to originator profitability. Note that the uncertainty here does not lie in the regulations themselves. They are comparably clear to many industry observers. Rather, the uncertainty is which, if not all, of them is going to pass. If none or one or two (depending on which ones), then market participants will adjust and determine whether there is any profit to be had in securitizing through, and buying, PLS.

Finally, there is the uncertainty regarding the credibility of credit ratings and rating agencies, including the quality of their underlying models and the data on which they are based. Proposed levels of subordination in recent deals appear extremely high to most securitizers,

which only further discourages issuing PLS. Perhaps the disclosure of data from both Enterprises can help in this regard. The ratings agencies, as well as investors, could then analyze current credit risks in the market place with a little more assurance, improving their models. This, in turn, could perhaps lead to more normalized subordination levels.

Until the types of uncertainties discussed above are resolved to a degree that gives the industry a clear path forward, it is highly unlikely that further increases in g-fees will provide a sufficient incentive for the PLS market to re-emerge on any scale. Moreover, price increases would need to factor in all of the benefits that Enterprise securities currently provide in addition to the credit guarantee – including liquidity, favorable capital treatment and operational efficiencies. The price increases that would be required to eliminate these advantages would likely be substantial.

While a break point would be reached eventually, the experiment of making agencies increasingly hostile to overcome the aforementioned uncertainty costs associated with PLS, could be unnecessarily costly. What could happen is that pushing loans away from the Enterprises could cause originators to engage in one or more behaviors antithetical to extending greater credit in the mortgage markets. First, originators could pass most of this cost through to consumers, at the risk of doing so to the point they stop borrowing. Second, they could fill balance sheets to their limited capacity (an option currently being tested and with its own safety and soundness hazards). Or third, they could reduce lending, while still staying in business, and seek alternative profitable products.

For these reasons and the uncertainties discussed above caused by current policymaking (and sometimes the lack thereof), HPC believes the FHFA should generally refrain from raising g-fees unless it were to become clear that credit risk is being underpriced in the market again. Given the credit book put on by the Enterprises in the past several years, as evidenced by their growing profitability, such underpricing is not likely the case in the current market environment. As such, continuing to increase g-fees in the near term across all Enterprise guaranteed loans seems to create unnecessary risks in the mortgage markets that would potentially work to the detriment of American homeowners.

We conclude, therefore, that guarantee fee levels should not be set to achieve any goals other than to promote market stability, protect taxpayers and maintain the affordability of mortgage credit. They should not artificially seek to restrict the role of the Enterprises in providing mortgage credit before an alternative robust source of mortgage credit is established post-crisis. Not only would this be bad policy, but we believe it would be beyond the scope of FHFA's duties as conservator.

Question 5. If the Enterprises continue to raise g-fees, will overall loan originations decrease? That is, will Enterprise loans decline without a commensurate increase in private capital?

Recently, other governmental policies notably monetary policy and the HARP and HAMP programs, have had a greater impact on originations than guarantee fees. Even though increases in guarantee fees have increased the cost of mortgage credit, these other policies have contributed to growth in originations. It is, nonetheless, possible that higher guarantee fees, which are reflected in higher rates to consumers, would reduce originations, including refinances, without a commensurate increase in private capital. Additionally, such a change could increase FHA originations relative to Enterprise originations.

Question 6. Is it desirable for the Enterprises to charge higher g-fees on low credit score/high LTV loans if it causes these loans to be insured/securitized through FHA/Ginnie Mae rather than through the Enterprises?

While FHFA is not responsible for FHA policies, we would urge policymakers in the Administration and Congress to evaluate how the Enterprises' guarantee fees and FHA premiums are affecting the overall housing market.

Question 7. Is it desirable for the Enterprises to (a) charge higher g-fees on high credit score/low LTV loans if it causes these loans to be insured/securitized through PLS or (b) held on depository balance sheets, rather than guaranteed by the Enterprises?

As noted above, risk based pricing is an appropriate consideration in setting guarantee fees. However, we do not advocate for FHFA to artificially raise guarantee fees at this time on any market segment.

Question 8. What approaches or alternatives should FHFA consider in balancing increased use of risk-based pricing with the HERA mission requirements of (1) liquid national housing markets, and (2) acceptability of lower returns on loans made for low- and moderate-income housing?

The Enterprises are currently unmatched in providing market liquidity for mortgage credit through their MBS sales. Moderate cross-subsidization of higher credit-risk borrowers by lower credit-risk borrowers can help stabilize broad markets during times of stress, benefiting both lower and higher risk borrowers. A policy of lower relative returns within acceptable credit guidelines may be fulfilled while still protecting the taxpayer from risk on the aggregate exposure of the Enterprises. During this interim period of conservatorship, we do not recommend significant changes to the guarantee fee structure.

Question 9. Are the ranges of credit score and LTV cells in the proposed credit score/LTV grids used to set upfront delivery-fees and loan level pricing adjustments appropriate? Should any of the ranges be broader or narrower and, if so, why?

As noted in response to question 2, we believe that the current pricing structure may be too granular. A more simplified pricing structure would be easier for industry to implement and for FHFA to oversee.

Question 10. Should risk-based pricing be uniform across the Enterprises or should each Enterprise manage its own pricing?

So long as underwriting guidelines are different between the two Enterprises, each Enterprise's data should determine its own risk-based pricing.

Question 11. Taking into consideration that FHFA has previously received input on state-level pricing adjustments, do the g-fee changes proposed in December 2013 have any additional implications that should be considered in deciding whether to price for the length of state foreclosure timelines, unable to market periods or eviction timelines? Are there interactions with other pricing components under consideration that FHFA should consider in making decisions on the state-level adjustments?

Where state-by-state LGD differentials are observed, the Enterprises should price their exposure to reflect that risk to taxpayers.

Question 12. Are there interactions with the Consumer Financial Protection Bureau's Qualified Mortgage definition that FHFA should consider in determining g-fee changes?

Enterprise share of the market is de facto responsible for broadly granting QM status to the majority of new originations. Guarantee fee increases that reduce Enterprise share of the market will result in fewer loans receiving QM status as some percentage of borrowers will not pass the CFPB's 43% DTI QM test.

Additionally, some lenders are unwilling to originate non-QM loans at this time. If borrowers are priced out of the market as a result of higher guarantee fees, there may not be alternative sources of mortgage credit available at any price to serve certain market segments as a result of lender unwillingness to make non-QM loans.

In conclusion, we believe that FHFA and the GSEs should base decisions pertaining to the appropriate level of G-Fees on what is needed to preserve the stability of the market, protect taxpayers and maintain access to mortgage credit. Actions should not be taken that prejudge or prejudice long-term housing finance reform which requires legislation by Congress. The Housing Policy Council appreciates the opportunity to provide these comments and looks forward to working with FHFA and the GSEs on other steps to stabilize and strengthen the housing market.

Sincerely,

John H. Dalton
President
Housing Policy Council
The Financial Services Roundtable