NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

September 8, 2014

Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, D.C. 20024

Re: Proposed State-Level Guarantee Fee Pricing

Dear Director Watt:

The New York State Department of Financial Services (the "Department") opposes the Federal Housing Finance Agency's revised December 9, 2013 proposal to increase the guarantee fees ("g-fees") charged by Fannie Mae and Freddie Mac (the "Government Sponsored Enterprises" or "GSEs") on New York's and three other states' borrowers by 25 basis points. Although intended to address the GSEs' higher costs of guaranteeing loans in certain states, the proposal targets these four states by considering only half the equation: gross cost rather than net cost to the GSEs. As set forth in this letter, the Department's position is that it is not only inappropriate for FHFA to target any states for higher g-fees, but that it is particularly irresponsible and harmful to borrowers and the housing market recovery to use incomplete data to do so. Indeed, the Department believes that the approach that FHFA's prior leadership advanced in this matter is fundamentally flawed and should be abandoned.

Specifically, the Department opposes this proposal because it:

A. Unfairly targets borrowers in four states based on an analysis that arbitrarily excludes critical data – specifically the net cost of guaranteeing a loan, the very thing that the payment of a guarantee fee purchases;

B. Disincentivizes foreclosure policies that are beneficial not only to consumers, but also to the GSEs; and

C. Potentially harms the housing market recovery in New York by increasing the cost of home ownership.

I. Background

On September 25, 2012, FHFA issued a proposed rulemaking to increase g-fees on single family mortgages in New York State, as well as in four other states that FHFA labeled "outliers" for having higher than average foreclosure costs. On November 26, 2012, in response to a request for public input, the Department submitted a letter explaining why the proposal and its underlying rationale was unsound with respect to New York State.

On December 9, 2013, FHFA released a new proposal that simplified the criteria it used to determine which states qualified as outliers. Under the new approach, the increased g-fees would apply to those states in which foreclosure carrying costs are more than two standard deviations greater than the national average.[1] Foreclosure carrying costs are calculated by taking into account two variables: (1) foreclosure timeline and (2) cost per day to the investor to hold the mortgage during the foreclosure process. A third variable, the default and foreclosure rate, is actually a constant because FHFA used the single national (rather than individual state) foreclosure rate. Under this new calculation, New York, Connecticut, Florida, and New Jersey would remain subject to the increased g-fees.

Although the qualifying criteria have changed, FHFA's justification for treating states differently remains the same. In a published analysis of the proposal ("White Paper"), FHFA reiterated that borrowers in the majority of states should not be required to subsidize borrowers in those few states where foreclosure costs are significantly higher than average.[2]

On January 8, 2014, new FHFA Director Melvin L. Watt suspended implementation of the proposal and invited both general and specific comments. In response, the Department respectfully submits that the underlying problems present in the September 25, 2012 g-fee proposal have not been satisfactorily addressed. The new proposal, like the old one, fails to accomplish its stated purpose of extracting extra fees from only those states that cost GSEs (and therefore taxpayers) more money. At bottom, it remains fundamentally unfair and is likely to seriously undermine housing recovery efforts in New York State.

II. Analysis

A. The Proposal Relies on Arbitrary and Unfair Assumptions

1. FHFA Should Use State-Specific Foreclosure Rates

The White Paper makes clear that FHFA's analysis comparing the various states looks only at the debit side of the GSEs' ledgers: the costs of foreclosure. For policy reasons, FHFA decided to exclude each state's foreclosure rate, i.e. the percentage of loans originated in a given state that go into foreclosure. But by ignoring the state-specific foreclosure rate, FHFA fails to take into account how many GSE-guaranteed loans are originated in the state, how much money the GSEs are taking

[1] FHFA, "State-Level Guarantee Fee Analysis," at 3, *available at* http://www.fhfa.gov/AboutUs/Reports/Report Documents /20131209_StateLevelGfeeAnalysis_508.pdf.

[2] *Id.*

in via g-fees on those loans, and how many of those loans do not go into foreclosure. These figures represent the credit side of the GSEs' ledgers, and without knowing about both the credit and debit sides of the ledger, FHFA cannot assess the net cost (or profit) of guaranteeing loans in a given state. Thus, FHFA cannot meet its stated goal of determining the extent to which borrowers in lower-cost states subsidize borrowers in higher cost-states.

G-fees, of course, are charged at origination on all GSE-guaranteed loans, not just on those loans that end up in foreclosure. The very nature of a GSE guarantee is that the g-fees charged on performing loans subsidize the costs to the GSEs associated with non-performing loans. Therefore, when examining the adequacy of g-fees in a given state (if indeed a state-specific analysis is necessary), it is critical to look at a state's originated loans and the extent to which g-fees charged at loan origination are sufficient to pay for the GSEs' foreclosures in the state.

To address the omission of this critical data in FHFA's analysis, the Department took FHFA's data as set forth in Table 2 of the White Paper and factored in each state's foreclosure rate, to reflect the extent to which performing loans subsidize non-performing loans in each state. Under this analysis, which is reflected in Appendix I to this letter, New York's net cost to the GSEs is less than one standard deviation from the national average – far below the two-standard-deviation threshold selected by FHFA.

2. Penalizing New York For Its Effective Foreclosure Policies Is Contrary To The White Paper's Stated Aims

The White Paper does not offer any statistical reason for excluding the critical data described above. Rather, it states that FHFA declined to use state foreclosure rates for policy reasons. Specifically, FHFA wants its methodology to reflect factors that states can control, rather than economic factors like state housing market effects. For the reasons explained below, however, FHFA's exclusion of relevant data on these grounds works counter to the White Paper's stated concern with saving the GSEs money. But even if it did not, because of new nationwide regulations, New York is no longer even in a position to change its policies.

(a) New York's Mandatory 90-Day Pre-Foreclosure Period and Mandatory Settlement Conferences Reduce Costs to the GSEs

Like the original proposal, the new proposal assumes that a consumer-protective (and therefore longer) foreclosure process affects the GSEs only negatively. It does not take into account any of the cost savings associated with a state's consumer protections.

In response to the foreclosure crisis, New York State enacted legislation that provides distressed borrowers with foreclosure prevention opportunities before a foreclosure action is even commenced. This legislation requires lenders, assignees, or mortgage loan servicers to send borrowers a pre-foreclosure notice at least 90 days before commencing a foreclosure action, during which time borrowers have the opportunity to cure deficiencies or work out other resolutions short of foreclosure. Each pre-foreclosure notice encourages borrowers to seek the assistance of a housing counselor, and these notices provide referrals to local housing counselors.

Because the White Paper's methodology treats New York's 90-day pre-foreclosure period as part of the foreclosure timeline,[3] New York is penalized for this policy even though this type of proactive intervention by the State has reduced foreclosure-related costs for GSEs by obviating the need for foreclosures in many instances. Indeed, New York's foreclosure rate is significantly lower than the national average.[4] As of July 2014, New York's foreclosure rate was 1 in every 1,802 homes as compared to the national rate of 1 in every 1,203 homes.[5]

Moreover, New York's mandatory settlement conferences are similarly effective at helping borrowers keep their homes and helping mortgage investors and the GSEs save money. Mandatory settlement conferences provide borrowers with access to a court-supervised opportunity early in the foreclosure process to negotiate loss mitigation options and avoid unnecessary foreclosures.

The White Paper considers and rejects the argument that a consumer-protective foreclosure process might in some instances reduce foreclosure-related costs. Among other arguments, the White Paper states that "because the public input cited only anecdotal evidence, FHFA ha[d] little basis to conclude that any cost savings associated with these laws are substantial."[6]

In response, the Department offers its own data that reflect the effectiveness of New York's foreclosure policies. Pursuant to New York State law, lenders or servicers must notify the Department of a pre-foreclosure notice at the time such notice is made to the borrower, i.e. at least 90 days prior to the filing of a foreclosure action, and then must notify the Department again when filing a foreclosure action. These filings with the Department demonstrate that the number of borrowers at risk of foreclosure is dramatically lower than the number of foreclosures actually filed with the courts. During the second half of 2012, for example, more than 130,000 New York borrowers received pre-foreclosure notices informing them of their default; however, only about 8% of those defaulted loans resulted in a foreclosure filing within one year of the pre-foreclosure filing, indicating that for the remaining 92%, the parties were pursuing a workout or the lender or servicer deemed the default to be insufficiently significant to pursue foreclosure in a timely fashion.

To be fair, the White Paper "recognizes the theoretical merit of including the savings associated with state laws as well as their costs in its methodology," but it finds doing so to be operationally unworkable.[7] To this concept, the Department responds that if there is no practical way to calculate the effect that different state foreclosure policies have on costs to GSEs, then the fair solution is to treat all states the same with respect to g-fees.

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[3] FHFA defines "foreclosure timeline" as "the number of days from the last paid installment on the mortgage to the point at which the investor has obtained a marketable title to the foreclosed property." *Supra* note 3, at 6.

[4] *See* http://www.realtytrac.com/statsandtrends/foreclosuretrends.

[5] *Id.*

[6] *Supra* note 3, at 11.

[7] *Supra* note 3, at 12.

(b) The Pre-Foreclosure Period Is No Longer Solely In New York's Control

The White Paper's stated methodology is to hold certain states accountable for those factors that the states can control. As of January 2014, however, New York's 90-day pre-foreclosure period no longer falls into that category.

This pre-foreclosure work-out period has proven so effective at preventing foreclosures that the Consumer Financial Protection Bureau implemented similar protections nationwide. As of January 2014, CFPB regulations require servicers to contact borrowers before they are 36 days late on their mortgage payments, and the regulations prevent servicers from initiating foreclosures until borrowers are more than 120 days delinquent.[8] Thus, New York's pre-foreclosure period has been subsumed by the similar rule that applies nationally. The consumer-protective pre-foreclosure period that FHFA apparently wants to discourage is no longer solely in New York's control, and the state could not abandon this policy even if it wished to do so.

In addition, given these new nationwide requirements and the fact that New York's pre-foreclosure period now applies to all states, it is unlikely that the White Paper's data (from 2011) accurately reflect relative foreclosure timelines in 2014.

B. The Proposal Will Constrain State-Level Foreclosure Policy to the Detriment of Consumers

Many of New York's mortgage-related consumer protections were put in place as a direct result of the rampant fraud, failures, and abuses of certain lenders and the servicers they employed, which contributed so significantly to the financial crisis. Indeed, the Department's ongoing investigations of certain mortgage servicers reveal that many servicers likely do not have sufficient capacity to service and manage their significant portfolios of distressed loans and lack an adequate system of internal controls and oversight with respect to their servicing practices. These failures have resulted in such abusive and inefficient practices as dual tracking modifications and foreclosures, hiring unethical foreclosure counsel, fraud, loss of documentation, and many other significant problems that have caused delays in the courts and necessitated additional judicial intervention. FHFA's proposal would improperly shift the cost of these failures onto New York State borrowers.

The White Paper acknowledges that "there have been widespread cases of servicer misconduct," but it states that FHFA was unable to determine to what extent that misconduct caused delay or whether servicer misconduct was worse in states with long foreclosure timelines.[9] But it is exactly because the precise effect of servicer misconduct has not been determined that higher g-fees should not be imposed on those states with stronger consumer protections. The GSEs employ the very servicers who engage in what the White Paper characterizes as widespread misconduct. It is therefore unfair to impose extra costs on certain states for the benefit of GSEs before determining to what extent the cause of the problem lies with the servicers and, as such, is partially within the

[8] 12 C.F.R. § 1024.41(f); *accord* Consumer Financial Protection Bureau Fact Sheet, "Mortgage Rules," *available at* http://files.consumerfinance .gov/f/201312_cfpb_mortgagerules.pdf.

[9] *Id.* at 13.

GSEs' control. If there is no fair way to make this determination, then the Department respectfully submits that disparate penalties should not be imposed.

C. The Proposal Could Harm the Housing Market Recovery in New York by Increasing the Cost of Home Ownership

Finally, the proposal could harm the housing recovery in New York and hamper financial recovery in the State. There are a significant number of loans in New York that are in foreclosure or default. Although its foreclosure rate is lower than the national average, New York is still in a state of recovery.

Given the state of the housing recovery, the Department cannot support this proposal. To impose such an additional cost to New York borrowers, especially to those who are creditworthy and seeking to enter or re-enter the housing market at this time, would not be equitable or prudent. Such additional costs could damage the housing market in New York and hamper the housing recovery by increasing the cost of home ownership and making credit less available for otherwise creditworthy borrowers.

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In closing, we urge FHFA to withdraw its proposal to maintain the 25 basis point Adverse Market Delivery Charge for New York, while removing it in 46 other states. We remain open to working with FHFA to examine options that would meet the goals of FHFA while protecting homeowners in New York State.

Sincerely,

Benjamin M. Lawsky
Superintendent
New York State Department of Financial Services

Appendix I

Total Basis Points and State Foreclosure Rates with Standard Deviations from the National Mean

State	Total Basis Points[1]	Foreclosure Rate (fraction)[2]	July 2014 Foreclosure Rate (decimal)	Result (Total Basis Points * Foreclosure Rate)	Standard Deviation from National Mean[3]
AK	485	1/1179	0.00084818	0.411	-0.244919899
AL	388	1/2055	0.00048662	0.189	-0.653909698
AR	489	1/3955	0.00025284	0.124	-0.773665417
AZ	477	1/1359	0.00073584	0.351	-0.35586461
CA	577	1/1032	0.00096899	0.559	0.026584271
CO	544	1/1843	0.00054259	0.295	-0.458448385
CT	1417	1/1043	0.00095877	1.359	1.495758233
DC	454	1/7807	0.00012809	0.058	-0.894011391
DE	708	1/948	0.00105485	0.747	0.371566119
FL	1410	1/469	0.00213220	3.006	4.52391463
GA	488	1/1048	0.00095420	0.466	-0.145164625
HI	814	1/4030	0.00024814	0.202	-0.629694001
IA	907	1/2691	0.00037161	0.337	-0.381489124
ID	706	1/2020	0.00049505	0.350	-0.358599862
IL	1280	1/747	0.00133869	1.714	2.148023597
IN	911	1/911	0.00109769	1.000	0.836801359
KS	842	1/2432	0.00041118	0.346	-0.364641866
KY	779	1/2273	0.00043995	0.343	-0.371070494
LA	743	1/1270	0.00078740	0.585	0.074236841
MA	918	1/3012	0.00033201	0.305	-0.440788362
MD	1032	1/553	0.00180832	1.866	2.4285705
ME	956	1/1496	0.00066845	0.639	0.173467959
MI	943	1/1330	0.00075188	0.709	0.302078164
MN	772	1/2078	0.00048123	0.372	-0.318159677
MO	462	1/3683	0.00027152	0.125	-0.770357125
MS	524	1/4634	0.00021580	0.113	-0.793078119
MT	568	1/25337	0.00003947	0.022	-0.959681099
NC	528	1/1313	0.00076161	0.402	-0.26188727
ND	957	1/159734	0.00000626	0.006	-0.989867916
NE	685	1/6535	0.00015302	0.105	-0.80825194
NH	589	1/2162	0.00046253	0.272	-0.500233506
NJ	1499	1/1186	0.00084317	1.264	1.321787521
NM	829	1/2119	0.00047192	0.391	-0.281936803
NV	580	1/639	0.00156495	0.908	0.667125189
NY	**1696**	**1/1802**	**0.00055494**	**0.941**	**0.728702582**
OH	1012	1/839	0.00119190	1.206	1.215726866
OK	806	1/1630	0.00061350	0.494	-0.092184935
OR	623	1/1515	0.00066007	0.411	-0.245185337
PA	1222	1/1322	0.00075643	0.924	0.697793855
RI	855	1/1821	0.00054915	0.470	-0.138046585
SC	725	1/893	0.00111982	0.812	0.491078956
SD	1056	1/10700	0.00009346	0.099	-0.819514359
TN	467	1/4610	0.00021692	0.101	-0.814718145
TX	639	1/1824	0.00054825	0.350	-0.35708562
UT	482	1/1010	0.00099010	0.477	-0.12388638
VA	412	1/2468	0.00040519	0.167	-0.694101571
VT	1067	1/10070	0.00009930	0.106	-0.80616049
WA	521	1/1436	0.00069638	0.363	-0.334143255
WI	1010	1/1432	0.00069832	0.705	0.295250645
WV	491	1/12974	0.00007708	0.038	-0.931331015
WY	581	1/3395	0.00029455	0.171	-0.686388409

[1] This data was taken from Table 2 of the White Paper. It represents Total Time multiplied by Cost Per Day as calculated by FHFA using 2011 data.

[2] July 2014 foreclosure rates are available at http://www.realtytrac.com/statsandtrends/foreclosuretrends.

[3] Standard deviations shown in this column are calculated using the "Result" column immediately to the left. The mean for this dataset is 0.545, with a standard deviation of 0.544.