FHLBank System at 100

Freedom Mortgage Corporation Written Comments to FHFA

October 31, 2022

On behalf of Freedom Mortgage, we applaud the FHFA and Director Thompson for leading this conversation and seeking input from all stakeholders on how the Federal Home Loan Bank system should evolve to best serve the needs of today's US housing finance system. Please accept the below perspectives from Freedom as our submission to the FHFA request for comments.

The Mission of the Federal Home Loan Banks

Since its inception 90 years ago, the FHLB system has served as a critical source of liquidity to support housing. When Herbert Hoover signed the foundational Federal Home Loan Bank Act in 1932 he said, "Its purpose is to establish a series of discount banks for home mortgages, performing a function for homeowners somewhat similar to that performed in the commercial field by the Federal Reserve banks through their discount facilities." We would like to emphasize the words "for homeowners". At inception, it was recognized that the true mission of the system was for the benefit of homeowners - not institutions of a particular type. Hoover's statement went on to say that "Building and loan associations, savings banks, insurance companies, etc. are to be eligible for membership in the system."

In the 90 years since the Act was signed, the US housing finance system has evolved – highlighted by the dramatic changes over the last 15 years. The roles of building and loan associations and savings banks have been assumed by others – with non-bank mortgage companies as the source of most - over 60% - newly originated mortgage loans, and other organizations like MBS REITs serving as a primary source of longer term capital.

The FHLBanks exist to provide reliable liquidity to its member institutions to meet the credit needs of the communities they serve across the country, during all economic cycles, notably supporting low- to moderate-income, minority and rural areas. We believe that original mission and purpose of the FHLB system is still highly relevant today, but the institutions which best serve as the most effective delivery mechanism for that mission have expanded and evolved.

Meeting the Needs of Affordable, Equitable and Sustainable Lending in Today's Market

For conventional and government insured and guaranteed loan programs, the role of non-bank mortgage companies is dominant. According to GNMA's September 2022 Global Market Analysis Report, the percentage of agency-purchased and government-insured or guaranteed mortgage loans originated by non-bank mortgage companies is approaching 75%. When looking at just the government-insured and -guaranteed mortgage programs of the FHA, VA and USDA, the essential role of the non-bank mortgage company is even more pronounced. Almost 90% of the loans in originated in the last 3 years under these programs, which are heavily focused on affordable home financing for first time home buyers, veterans, low-to-moderate-income and underserved communities and minority borrowers, were provided by non-bank mortgage companies.

According to 2021 HMDA data, these loans serve minority homebuyers and communities and low to moderate income homeowners at a significantly greater level than conventional loans. 35% of purchase-money loans under these programs were provided to African American and Hispanic homebuyers and 24.7% were for properties in majority-minority census tracks (versus 16.5% and 18.7% for conventional loan programs).

In addition to originating approximately 90% of the loans in these government loans programs, non-bank mortgage companies hold a comparable share of the servicing rights for these loan types and comprise 8 of the top 10 GNMA mortgage servicers.

FHLB Membership Eligibility to Meet the System's Mission

Through a few key programs such as the Affordable Housing Program (AHP) and the Community Investment Program (CIP), the Federal Home Loan Banks have done an admirable job in channeling profits and funds for the support of affordable, sustainable, equitable and resilient housing and community investment. Non-bank mortgage companies could greatly expand the reach of these programs, borrowers and communities which are at the core of the FHLB's service mission.

In the wake of the Great Recession, non-bank mortgage lenders have filled a critical gap left behind by the exit of commercial banks in the government-insured origination space. Permitting independent non-bank mortgage companies to access the Federal Home Loan Bank system is fully justified based on the critical role that non-bank lenders continue to contribute to the US housing finance system and will help the FHLB System to fulfill its continuing mission more effectively.

Membership of an institution to a FHLBank is defined by the FHLB Act in categories – US-based insured depository institutions such as savings and loan associations, cooperative banks and savings banks, as well as community development financial institutions (CDFIs) and insurance companies are named in the statute.

While there is a statutory constraint of categories of membership, the regulatory interpretation of the definitions of institutions under those categories could be reconsidered, which would allow expanded eligibility. In a 2017 Final Rule, FHFA narrowed its definition of what it considers an "insurance company" to exclude captive insurance companies, overturning existing membership eligibility and removing a possible point of entry for independent mortgage companies

Returning to the pre-2017 interpretation of this restricted interpretation would be a pathway to again allow indirect eligibility of the institutions which are the leading providers of home mortgage loans using existing statutory authority. There are numerous ways to refine this rule to provide any additional constraints to ensure alignment with the FHLB mission. Absent this, the only other apparent method of expanding FHLBank member eligibility would be to rewrite the statute, which would certainly be a very lengthy and complex process.

"Inspection and Regulation" of Member Institutions

Structured as regional cooperatives since inception, with member institutions required to purchase capital stock in their regional Bank, members have "skin in the game" and a strong incentive to maintain a successful risk-and-control environment. The regional banks, through this structure, maintain extremely high levels of capital relative to comparable institutions. Nonbank mortgage companies with captive insurance subsidiaries would have the same obligation to purchase capital further supporting the financial strength of the system. In considering any expansion of membership for the FHLB System, a legitimate question is – "What risks do any new entrants present to the system, and how can those risks be mitigated?"

FHFA, as successor to the Federal Home Loan Bank Board, provides federal regulation of the FHLBanks, which in turn rely in part on prudential regulation of member institutions by other financial regulators such as the FDIC for safety and soundness assurance. Interestingly, the Federal Home Loan Bank Act seems to stipulate an equivalency between Federal and state supervisory oversight, noting that a member must be "…subject to inspection and regulation under the banking laws, or under similar laws, of the State or of the United States…"[1]

Independent mortgage banks are not banks at all – we do not take consumer deposits and therefore should not be subject to comparisons of prudential oversight by the Federal Deposit Insurance Corporation (FDIC). To be sure, independent mortgage banks come in all different colors, shapes and sizes and may require different views of risk to the system. Regardless of these broadly varied business models, independent mortgage companies are certainly subject to robust "inspection and regulation" from both regulatory and programmatic agencies that govern our business. Freedom Mortgage is chartered and licensed in each of the 50 states within which we conduct mortgage lending and governed as such by those 50 state regulators. We are also subject to numerous federal and state laws governing mortgage origination and servicing, complying with rules and regulations from consumer protection to financial securities issuance and administration enforced by government agencies such as the Consumer Financial Protection Bureau (CFPB) and state financial industry regulators.

At the core of our business, we originate and service residential mortgages that are underwritten according to guidelines published by federal agencies (FHA, VA and USDA) and government-sponsored enterprises (Fannie Mae and Freddie Mac) and are subject to initial and ongoing financial and operational requirements monitored by those agencies in order to continue as a participating seller and/or servicer of mortgages. Both the state regulatory requirements and the federal agency programmatic participation requirements including FHA, VA, USDA, the GSEs and GNMA feature strong capital and liquidity standards for nonbank mortgage companies in order to ensure financial soundness in all markets. Another notable aspect of oversight to which nonbank mortgage companies are subject is by their warehouse lenders, which monitor for counterparty risk and impose market discipline on maintaining financial soundness.

There is current precedent to FHLB membership without federal regulatory oversight. Insurance companies, which are eligible by statute for FHLB membership, are chartered and regulated by each state in which they do business – much in the same way as independent mortgage companies are regulated. Additionally, as amended in 2015[2], the FHLB Act allows for membership upon acceptance by a FHLB of non-federally insured credit unions, which are state-regulated and feature private share coverage or other non-federal insurance.

In any event, in the words of the MBA: "This regulatory scrutiny and market discipline address not only compliance with consumer protection laws, but also financial assessments of capital and liquidity by

[1] 12 U.S. Code § 1424 - Eligibility for membership

[2] In 2015, Congress passed and President Obama signed the Fixing America's Surface Transportation Act, which contained section 82001 amending the Federal Home Loan Bank Act to expand FHLBank eligibility to certain credit unions without federal share insurance. In June 2017, FHFA issued a Final Rule implementing that amendment.

counterparties with strong incentives to protect their own interests."[3] Today, independent mortgage banks clearly meet the statutory requirement of being "Subject to inspection and regulation."

Collateral and Today's Mortgage Market

Providing liquidity for the key segments of the current housing finance system requires a broader view of the assets which the FHLB's finance along with a broader interpretation of membership - both of which we believe are already permitted under the Act. Non-bank mortgage lenders who drive the housing system of today are less dependent on sources of permanent financing – a role well served by the GSEs and GNMA. But as delivery mechanism for these programs, various forms of interim and short-term financing are required. Funding advances of amounts due from government insurance and guarantee programs, financing loans originated pending sale to the GSEs and GNMA, and participation interests in the cash flows including mortgage servicing rights from these mortgage loans are roles the FHLB can serve in the modern mortgage financing system.

We recommend that the FHFA review the role and importance of mortgage servicing rights (MSRs) and the assets' direct relationship to the mission of supporting affordable housing finance in the United States. We believe MSRs should be included as mortgage related assets and eligible to be pledged as collateral to secure FHLB advances. Many IMBs have an origination platform and retain the servicing rights of the assets they ultimately securitize with GNMA and the GSEs and the portfolio of retained servicing rights are typically the most significant asset on an IMBs balance sheet. The responsibilities of the servicer is a critical role in serving the homeowner, providing escrow account services for taxes and insurance, providing customer care for the life of the borrower's mortgage loan, ensuring the protection of the lien on the homeowner's property, providing loss mitigation solutions for troubled borrowers including forbearance plans, loan modifications as well as offering borrowers refinancing opportunities that provide a net tangible benefit are just a few examples of the importance of independent non-bank residential mortgage servicers and the integral relationship to supporting affordable housing solutions and financing to US consumers.

Providing liquidity for these assets would support a robust market and ultimately lower costs to the consumer by providing competitive financing terms to independent, non-bank residential mortgage servicers.

Summary

The mortgage market has evolved far beyond the relatively simple construct of depositories, insurance companies and balance sheet lending since the FHLB Act was implemented in 1934. Warehouse funding, MSRs and other market innovations have fundamentally and permanently changed the landscape of residential housing finance, and consequently has changed the market itself. In order to stay relevant, FHLBanks must adapt to that evolution. At the same time, FHFA must re-align its rules and regulations that meet today's housing finance market realities.

Lastly, we believe that while President Hoover and Congress may not have conceived how the US housing finance system has evolved from 1932 to today in the 21st century, they did have the wisdom to

[3] MBA Paper – "The Rising Role of the Independent Mortgage Bank – Benefits and Policy Implications" © Mortgage Bankers Association, February 2019

conceive a durable mission vision that is still relevant today, and to understand that some degree of flexibility would be needed for the system to fulfill that mission for homeowners.

Again, Freedom Mortgage thanks Director Thompson and the FHFA for opening up this conversation, and we look forward to participating in the robust upcoming discussions to help enhance the achievement of the critical mission of the Federal Home Loan Banks.