June 8, 2023

Ms. Sandra Thompson, Director
Federal Housing Finance Agency 400 7th Street SW
Washington, DC 20219

RE: Request for Information on the Enterprises' Single-Family Pricing Framework

Dear Director Thompson:

On behalf of the American Credit Union Mortgage Association ("ACUMA"),[1] I would like to provide input with regards to the request for information ("RFI") issued on the Enterprises' Single-Family Pricing Framework.[2] Given the increased level of attention that the topic of the Enterprises' pricing has received in recent months, we hope that this RFI will yield constructive input that will aid in decision making. As the only trade association that is solely focused on credit union mortgage lending, we feel that we can provide an important perspective.

It is well known that credit unions are an incredibly important source of banking services to communities across America and that our members exist to serve their members. Credit unions provide reasonably priced access to credit for their members, originating loans with a standard of care that demonstrates a commitment to sustainable homeownership. As we speak on behalf of credit unions, we're also mindful that we are speaking on behalf of every member they represent that dreams of an affordable path to homeownership.

Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System ("FHLBs") are important sources of liquidity for credit unions. In the case of many institutions, upfront and ongoing guaranty fees ("g-fees") inform not only their pricing of loans to be sold but also the loans that they will hold in portfolio, despite the significant differences in capital regimes between the Enterprises and credit unions. Therefore, it is important to remember that g-fees have implications that extend beyond the segment of the market that the Federal Housing Finance Agency ("FHFA") typically concerns itself with.

In considering the RFI in its entirety, we have the following concerns which we will expand upon as part of this letter:

- The FHFA is moving too quickly on this topic.
- Additional transparency around the elements of the g-fee and return calculation is needed.
- The Enterprise Regulatory Capital Framework ("ERCF") and its application are creating issues that need to be addressed before pricing decisions are made.

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[1] ACUMA is a non-profit trade association committed to promoting credit union mortgage lending. Our membership consists of credit unions, credit union service organizations ("CUSOs"), and affiliate members who serve the credit union community.

[2] https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Requests-Input-on-the-Enterprises-Single-Family-Pricing-Framework.aspx

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<u>The FHFA is moving too quickly on this topic</u>

In its report on Enterprise Single-Family Guaranty Fees in 2021, there were references made to the ERCF, but the analysis contained within was still representative of the Conservatorship Capital Framework ("CCF").[3] This reporting was mandated by Title VI, Sec. 1601 of the Housing and Economic Recovery Act of 2008.[4] It is clear from the statute that there is a public interest in understanding the factors considered in determining the amount of g-fees being charged, and yet the industry is asked to provide input on a pricing framework that results from a capital regime that is not understood. Absent an analysis of the existing g-fee structure that is informed by the ERCF, we are left guessing as to what is appropriate or even possible given the goal of the Enterprises of achieving appropriate returns on capital.

As you are no doubt aware, the public at large does not understand recent pricing changes that were made in alignment with the ERCF – and this extends to the mortgage industry as well. Simply put, what was understood as a capital framework that appeared to be more risk-based has resulted in pricing that often appears less risk-based, and yet we see no reason to challenge the FHFA's assertion that the pricing changes were done as a result of the ERCF.

Ultimately, the root of the problem can be traced back to a rush to finalize the ERCF and a failure to specifically disclose how the ERCF could potentially impact G-Fees. This information, along with some of the analysis that would typically appear in the report to Congress could have been included in the RFI. Instead, we are informed that there will be future increases, but that they will be implemented over time. To the extent that you are aware of future increases and are seeking comment on the pricing framework, would it not make sense to provide this additional level of transparency?

Stakeholders need a better understanding of how the ERCF functions and how it impacts pricing to opine in an informed manner.

As we survey the rest of the mortgage landscape, the FHFA must consider how its actions impact the rest of the mortgage market. Ideally, the FHFA would produce a whitepaper that lays out their assumptions and forecasted outcomes that result from the implementation of the ERCF.

We believe that the FHFA should enable stakeholders to benefit from additional information and analysis before closing the RFI and/or moving forward with additional pricing changes. In addition, we would advise the FHFA to suspend the recent upfront g-fee changes until the socialization of the ERCF that should have taken place in 2020 is complete. Given the current state of the housing finance ecosystem, pricing changes should be undertaken with extreme caution given the substantial impact higher rates have already had on affordability.

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[3] https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GFee-Report-2021.pdf

[4] https://www.govinfo.gov/content/pkg/PLAW-110publ289/pdf/PLAW-110publ289.pdf

Additional transparency around the elements of the g-fee and return calculation is needed.

There is much talk in the RFI of return targets, and yet there is no disclosure as to what those return targets are. What we know is that there are three different segments considered, each with a different return target. Given that the Enterprises remain in conservatorship, and the FHFA exerts its authority over pricing, it would be wholly appropriate to share what these targets are.

One important element when it comes to return targets is that of profitability, and expenses can play a significant role when it comes to profitability. The ongoing conservatorship situation, in conjunction with the profit sweeps implemented by the U.S. Department of the Treasury's ("Treasury") Senior Preferred Stock Purchase Agreements[5] has created a situation in which the Enterprises have little incentive to be more vigilant with regards to expenses than required by the FHFA. In the current environment, lenders are being forced to engage in significant cost-cutting measures, including layoffs, as the industry scales to the current level of demand. Meanwhile, the Enterprises do not appear to face the same market reality. What's more, with the mandate to maintain comparable prepayment speeds to facilitate the UMBS, there is no reason or ability to pursue efficiency that can be passed along to the market in the form of material savings. In the aggregate, this has the effect of distorting returns and profitability.

Another element that is missing from the discussion is the 10 basis point fee that is the result of the Temporary Payroll Tax Cut Continuation Act of 2011 and its extension. Currently, this fee is passed along to borrowers. As the Enterprises remain in conservatorship and have been subject to a profit sweep of equal magnitude to their required capital levels, it is inappropriate for this fee to be counted in the return calculations and passed along to the public. This fee should exist outside the return calculations to the extent that there is sufficient GSE profitability to fund the fee. Stated another way, it should be viewed as an incremental profit sweep, not a tax on homeownership.

We know that the Enterprises are actively engaging in Credit Risk Transfer ("CRT"), and yet the RFI misses the opportunity to discuss how CRT impacts the calculations. At certain times in the past, CRT-implied g-fees have been lower than what was charged by the Enterprises, and at other times the situation was reversed. Do the Enterprises' CRT programs improve returns? The FHFA has previously published a paper indicating that CRT hurts the profitability of the Enterprises.[6] In light of the conclusions in this paper, it is important for the FHFA to clarify how CRT impacts the return calculations to aid the industry in providing feedback on the pricing framework, as well as on the ongoing CRT programs.

The final consideration on this topic is how financial guarantors and insurers look at return on capital. This is appropriate as the business model of the Enterprises' is closer to a financial guarantor than it is a bank. In the case of financial guarantors and insurers, investment yield can play an important part in their return calculation, with the ability to potentially charge lower premiums thanks to investment yield subsidization. Unfortunately, we remain in the dark as to whether this component is included in the g-fee return calculations.

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[5] https://www.fhfa.gov/Conservatorship/Pages/Senior-Preferred-Stock-Purchase-Agreements.aspx

[6] https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Overview-05172021.pdf

The Enterprise Regulatory Capital Framework ("ERCF") and its application are creating issues that need to be addressed before pricing decisions are made.

Although the ERCF is the result of the rulemaking process, the impacts of the rule were not disclosed in a transparent manner. We are left with a situation in which a capital rule was implemented without knowledge of the impact it could have on housing finance, or the impact was known but not disclosed. Neither alternative is appealing, and the ongoing controversies surrounding pricing changes resulting from the ERCF are evidence that there is a communications gap. Even now, the industry has yet to grasp the complex interaction of risk-based factors, risk floors, various adjustments, and buffers. While the FHFA considered industry feedback, it was also in a position to be able to ascertain that most commenters did not properly understand the ERCF.

As we now are starting to realize, the ERCF was marketed as being a risk-based capital regime and yet appears to be implemented as something different. If the desire is to have a risk-based capital standard, then the FHFA should either reopen the rule to remove some of the buffers or allocate these buffers in a risk-based manner with respect to pricing calculations. The FHFA's decision to view the various buffers as something that should be distributed equally amongst loans creates significant distortions, obscuring what true risk-based capital would look like and depriving stakeholders of an understanding as to where subsidization is occurring. These buffers exist to absorb losses, and losses generally tend to result from risk.

If the FHFA prefers something that is not risk-based, then reopening the rule to remove complexity is in order. The current situation results in a combination of risk-based and not risk-based that is simply too opaque and prone to surprise outcomes.

The FHFA clearly recognizes the shortcomings of the ERCF, as it provides examples of loans that have identical capital requirements thanks to the loan level risk weight floor – which changed from 15% to 20% between the Notice of Proposed Rulemaking and Final Rule.

Further along these lines, we have yet to see disclosure by the FHFA with regards to how the countercyclical adjustment will impact pricing. The Urban Institute produced a paper detailing the issues with this component,[7] and yet we don't have an understanding of how it is supposed to fit into the pricing framework.

As pricing is going to be driven by capital, it is critical to get capital correct before changing pricing. It's not clear that the ERCF is truly the capital regime that was intended or anticipated.

Conclusion

In addition to the above comments, ACUMA would also like to provide answers to the questions posed by the RFI. These can be found after the end of this letter.

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[7] https://www.urban.org/sites/default/files/publication/105186/our-perspective-on-the-enterprise-regulatory-capital-framework.pdf

Although we have significant concerns regarding the timing of this RFI and ongoing pricing changes, the amount of transparency, and the ERCF as the basis for pricing, we applaud your willingness to engage with industry. We must arrive at a place where g-fee pricing not only supports the safety and soundness of the Enterprises but where it also exists in harmony with the entire mortgage ecosystem.

As a conduit to the credit union mortgage community, we would like to serve as a resource to help provide you with a platform to work directly with credit unions that are impacted by these policy decisions, as well as future policy initiatives.

Sincerely,

Peter Benjamin, CMB
President
ACUMA

APPENDIX – Responses to questions posed in the FHFA's Request for Input

Return on Capital

1. What is an appropriate long-term commercially reasonable return on capital threshold for the Enterprises to achieve?
2. To what comparable industries and companies should these return on capital thresholds be calibrated?

This depends on the future state of the Enterprises.

If they continue to serve as instrumentalities of the Federal Government, the returns should be bookended by FHA / Ginnie Mae returns and the yield on Treasury securities.

If they are to be purely private market entities that are not utilized to implement public policy and seeking to maximize profits, then returns should be bookended by CRT yields or the rates of return used by financial guarantors or mortgage insurers.

In the middle, if they are to be public utilities, then rates of return appropriate for utilities would apply.

3. Should FHFA set only minimum return thresholds for the Enterprises or a range of returns – including a maximum return target?

To set a maximum return target, there would need to be a mechanism to return excess profits to those who paid into the system, or thresholds set that trigger changes before any ceilings are hit – otherwise, the result is volatile pricing.

4. For which loan characteristics and products should the Enterprises accept a lower return?
5. For which loan characteristics and products should the Enterprises target a higher return?

We need more transparency as to the range of returns and pricing implications to be in a position to make an informed comment.

6. How should return on capital be calculated for the Enterprises?

The FHFA should consider how insurers think about capital and returns – both for return on capital, but also for the very concept of capital itself.

Process

7. With what frequency should FHFA consider updating the upfront guarantee fee grids?
Changes should be as infrequent as possible, with significant lead time and consideration given to avoiding periods of high volume for sudden increases, as well as consideration for overall market conditions.

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Components of Guarantee Fees

8. In achieving commercially reasonable returns over time, should future guarantee fee changes be executed through ongoing guarantee fees or upfront guarantee fees?
9. Should upfront guarantee fees be eliminated?

Ongoing fees present a strong alignment between revenue and the period the Enterprises are holding risk. Upfront fees generate excess profits during periods of high refinance activity and represent a barrier to borrower savings and improved performance that result from lower rates.

10. Should risk-based pricing be calibrated to the ERCF?

The issue here is that the ERCF is not truly risk-based. Therefore, it would be unwise to attempt to impose a risk-based pricing structure that is informed by a capital rule that is not risk-based.

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