MORTGAGE BANKERS ASSOCIATION

October 11, 2016

Federal Housing Finance Agency
Office of Financial Analysis and Modeling
400 7th Street, SW
9th Floor
Washington, D.C. 20024

RE: Credit Risk Transfer Request for Input

To Whom it May Concern:

On June 29th, the Federal Housing Finance Agency (FHFA) issued a progress report and Request for Input (RFI) on credit risk transfer programs undertaken by Fannie Mae and Freddie Mac (the GSEs) since 2012. The RFI solicits comments from stakeholders on the programs generally, the framework used by FHFA to evaluate the programs' effectiveness, and specific questions included by FHFA on certain policy areas. The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to provide input on this important initiative.

Together with a Progress Report that was issued with it, the RFI provides background on the various CRT programs undertaken to date. The RFI also provides a framework of principles that FHFA seeks to balance in the development and execution of CRT transactions. This information is helpful and provides valuable insight into the considerations, costs and purpose of CRT as a whole and individual transaction structures.

MBA urges FHFA and the GSEs to continue building upon this early foundation to create a broadly diversified market for mortgage credit risk that accomodates participants of all sizes and business models on equivalent terms. CRT programs have significant value for the GSEs and taxpayers by providing protection against credit losses. However, these programs also have the potential to benefit the market as a whole. There are two primary types of CRT transactions: "back-end," such as STACR

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

and CAS; and "front-end," such as lender recourse, deep-cover mortgage insurance[2] and other capital markets executions that can permanently transfer credit risk prior to GSE acquisition. The former requires the credit risk to be transferred by the GSE after the loans are acquired and for the GSEs to carry this risk until it can be shed into the market; the latter, on the other hand, transfer the risk prior to or at the time the loan is delivered to the GSE. MBA has for decades advocated for a bright line between primary and secondary markets. One aspect of this bright line is that primary market lenders select front-end credit enhancements, while the GSEs structure back-end credit enhancements.

It is critically important for the GSEs to develop and implement additional CRT structures that are accessible to lenders of all sizes and business models in order to avoid reconcentration of the origination and servicing market. Deal terms should be made transparent and accessible to participants of all sizes on equivalent terms, including experimenting with lower collateral requirements or risk tranches. Additionally, pledged collateral should be subject to the same analysis and economic terms for all participants, regardless of size or business model. Providing viable CRT structures on equal terms for all approved Seller/Servicers will also ensure that the CRT programs preserve today's parity in credit pricing, i.e. guarantee fees and LLPAs.

As the Progress Report states, "back-end" structures have comprised over 80 percent of the CRT transactions executed, an overwhelming portion of the deals to date. While this has helped to indicate the interest from private investors in allocating private capital to mortgage credit risk, it provides only a partial picture of the market demand for and introduces structural hurdles that limit the diversity and liquidity that can ultimately be achieved under current rules and regulations. Moreover, back-end transactions require the GSEs to assume several months' worth of market risk in warehousing and structuring the transactions, exposing taxpayers if the GSEs are unable to sell all of the targeted credit risk.

Up-front risk-sharing structures with committed mortgage market participants such as lenders, mortgage Real Estate Investment Trusts (REITs) and mortgage insurers can distribute mortgage credit risk prior to the loan(s) being acquired by the GSEs, while offering potential borrower benefits. It is important to note that none of the transaction structures utilized in the CRT program to date have experienced a stress environment, meaning the GSEs could have significant market exposure if investor demand for STACR and CAS proves to be pro-cyclical. Well-conceived up-front risk sharing pilot programs, such as expanded lender recourse offerings, deeper mortgage insurance or other capital markets structures that are executed prior to GSE acquisition, can help the

[2] Deeper mortgage insurance could include expanding coverage to as low as 50% of the loan-to-value ratio, as well as facilitating competition to cover mortgages with loan-to-value ratios below 80% through reduced GSE credit pricing.

GSEs better determine which transaction structures are best able to expand the sources of private capital and withstand both the peaks and valleys in the credit cycle.

With that said, back-end CRT transactions should continue to be part of the GSEs' menu of options. Transactions like STACR, CAS, and pool reinsurance could provide valuable pricing signals to the market if the GSEs increase their transparency. It is this potential that has caused nearly every GSE reform proposal to date to build from the foundation described in the Progress Report. However, more needs to be done to create a deep and diversified risk transfer program that is open to participants of all sizes and business models on equivalent terms.

MBA's General Comments below urge that more be done to provide market participants with transparency into the individual transactions and structures in order to benefit the market as a whole. Next, we identify principles and considerations that FHFA and the GSEs should add to their framework. Finally, we respond to FHFA's specific questions in the Appendix.

General Comments

MBA applauds FHFA for spurring the development of the CRT programs over the past three years. The various transactions have protected the taxpayer and begun the long process of building a deep, liquid and privately-capitalized market for residential mortgage credit risk. However, as the strategy matures, FHFA must do more to ensure that the market can build on these programs to accelerate the transfer of risk from taxpayers to private investors while remaining open to participants of all sizes and business models.

First, it is important to increase the transparency of these programs, including providing real-time, detailed information about each transaction. Only with broad transparency can the economic relief provided by individual deals and deal-types be compared to offer a cohesive picture of the market for residential mortgage credit risk. This is critical to ensuring that market participants can execute transactions efficiently and will help to support a level playing field. As a case in point, very few details of the recent Freddie Mac credit insurance transaction have been widely dissemenated, making it difficult to assess the structure in the context of FHFA's principles framework.[3]

MBA sees three valuable focus areas where transparency would have broad benefits to the market as a whole:

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[3] Freddie Mac should release details such as the framework for the auction process, cover bid and syndication structure to help market participants better understand the deal and its impact. Despite press release reports, to those not hand-selected to participate this deal has been far from "transparent."

- **Transparency into the GSE economics and capital implications of each deal.** This will provide insight into the capital framework, rate of return targets, and other economic considerations that are driving CRT execution, as well as the resulting price signalling provided by each deal. Transparency of this sort would allow for an "apples to apples" comparison across deals and deal structures. This should include reinsurance and recourse transactions that have heretofore not been subject to broad disclosure, as well as a fair comparison between collateral- and capital-based CRT structures.

- **Increased loan-level performance data disclosures, including the ability to tie loan performance back to specific MBS.** This will provide a greater window into prepayment and loss experiences, allowing market participants to price risk more accurately – including loss severity. If done in a uniform and size-neutral way, loan-level performance data per seller could also provide lenders with a valuable tool to measure the quality of their collateral. To date, the GSEs have provided just enough data disclosure to support the next deal structure. Instead, the GSEs should proactively release their entire historical datasets.

- **Publication of a counterparty risk-assessment framework that stakeholders can utilize.** Much is made in the RFI and Progress Report about counterparty risk and concentration risk among particular counterparties, particularly mortgage insurers. Notably, FHFA and the GSEs recently finalized and implemented the PMIERs capital regime and updated operational and rescission standards within the master policy agreements,[4] yet the RFI and Progress Report provide little insight into how the GSEs are assessing counterparty risk outside this regime. Committing to eliminate or virtually eliminate counterparty risk is not a viable solution for the CRT program because doing so would eliminate many potential sources of private capital, limiting the overall benefits of the program. Developing a vibrant, liquid market for mortgage credit risk consistent with FHFA's principles framework requires that multiple approaches be developed and tested, and it is incumbent on the GSEs to ensure that any counterparty standards are reasonably set for the risk assumed and well publicized to the market. Standardizing and publishing this framework would also help small- and mid-sized lenders better assess their options for participating in a CRT transaction.

Second, the GSEs should leverage their role to better facilitate a broad menu of deep, sustainable CRT options. While the GSEs should favor long-term durability over short-term gains, they must nevertheless retain the ability to exploit advantageous market conditions that could lead to better taxpayer protection or otherwise further FHFA's

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[4] *See* Private Mortgage Insurer Eligibility Requirements (PMIERs) http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Overhaul-of-Fannie-Mae-and-Freddie-Mac-Mortgage-Insurance-Master-Policy-Requirements.aspx.

policy directives. One of the more important benefits that GSE CRT programs can provide to the market is in connecting the front-end, “retail” perspective of credit risk to the back-end, “wholesale” perspective in a systematically durable and transparent manner. Allowing stakeholders to more readily compare the execution and relief offered by individual deals and across structures will help deepen this market and avoid technical barriers that reduce liquidity.

Finally, MBA urges the GSEs to explore more up-front credit risk transfer techniques as well as increased frequency and predictability of back-end transactions in order to reduce the amount of credit risk warehoused by the GSEs. Currently, back-end transactions are aggregated by the GSEs over a period of months.[5] Some up-front transactions have also utilized long warehouse periods; however, the loans in these deals are held by privately-capitalized lenders rather than the GSEs, eliminating the taxpayer’s exposure to this risk. More deals with shorter pooling periods would balance several principles: it would prompt the GSEs to find the most operationally repeatable and stable execution; reduce or eliminate market risk held by the taxpayer; and connect more easily to the GSEs’ core business by closely tying credit pricing to loan delivery, enabling broader participation by small- and mid-sized lenders and other potential CRT investors.

CRT Principles

FHFA identifies in the RFI ten specific principles[6] that it weighs in evaluating CRT transactions. While these principles provide a good foundation, MBA recommends adding a principle to the framework. Additionally, MBA recommends adding to existing principles some considerations that do not appear to be reflected in the RFI or Progress Report.

Borrower Impact: FHFA should add Borrower Impact as a principle in its framework for considering CRT transactions. Ultimately, the role of the GSEs is to ensure liquidity in the mortgage markets, with borrowers as the ultimate beneficiaries. The 2016 Conservatorship Scorecard requires the GSEs to transfer credit risk on at least 90 percent of the unpaid principal balance (UPB) of targeted new acquisitions. In light of the significant role CRT is intended to play in furthering the GSEs’ operations, consideration of the impact on the borrower should be a key principal for consideration. The GSEs should ensure that CRT programs do not negatively impact borrowers through unnecessary volatility or constraints on credit availability.

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[5] For example, loans in a recent reinsurance deals appear to have been warehoused for more than a year before the risk transfer was complete.

[6] These principles are: Reduce taxpayer risk; Economically sensible; Continuity of core business; Repeatable; Scalable; Counterparty strength; Broad investor base; Stability through eocnommic and housing cycles; Transparency; Level playing field.

The GSEs price for risk through their guarantee fees (g-fees), which include an on-going payment and an up-front loan-level price adjustment (LLPA). G-fees have been raised substantially in recent years, in part through an effort to “crowd in private capital.” LLPAs, which can range as high as 325 basis points of the loan’s UPB, have also been critized as a significant hurdle to credit availability for borrowers who lack large downpayments.[7]

CRT transactions can have borrower impacts that are worthy of consideration. CRT transactions, both individually and taken together, can offer competing price signals to that of the GSEs, which under conservatorship must rely on “virtual” assumptions in setting prices. More robust competition can deliver benefits to borrowers in terms of potentially lower pricing or more inclusive credit evaluations. However, this impact is wholly dependent on the level of transparency, something that should be increased markedly.

Additionally, certain CRT programs are less susceptible to capital market volatility than others. For example, the CAS and STACR transactions have exhibited large price movements in the secondary market despite an otherwise benign housing market, with the execution across transactions reflecting primarily the global capital market conditions at the time of issuance. It is unclear whether these price swings have been seen in the pool reinsurance transactions ACIS and CIRT; greater transparency and disclosure are needed to fully compare. However, insurance-type transactions, including deeper MI, are based on a long-term capital framework and generally exhibit less price volatility from transaction to transaction. Lender recourse could provide similar benefits in that they rely on parties that are committed to a ongoing presence in the mortgage market over the long-term. Reducing the volatility of transaction pricing could result in more stable execution, providing borrowers with more consistent pricing and product offerings during the ebbs and flows of an economic cycle.

Finally, there is a risk that private investors may focus their capital on safer loans, providing coverage for pristine borrowers rather than expanding credit availability. FHFA should be vigilant to ensure that CRT structures facilitate credit availability across the entirety of the GSEs’ credit box. The GSEs could further this by publishing a transparent “bid/ask” for credit risk, offering part of the g-fee in exchange for mortgage credit risk that meets minimum characteristics that ensure broad access throughout the credit box. These bids could be published as part of the LLPA grid, since they would essentially operate as LLPA credits, or periodically like today’s buy-up/buy-down grids.

Additional Considerations: FHFA’s principles of credit risk transfer establish a valuable framework for considering and balancing various factors implicated by the CRT programs. In addition to adding a Borrower Impact principle as described above, MBA

[7] Stakeholder Letter to Director Watt re: LLPAs and G-fees; June 22, 2016.

recommends the following considerations be taken into account when evaluating existing framework principles:

Level playing field: MBA has consistently argued that GSE program offerings should be offered on equal terms to Seller/Servicers, and not depend on the volume sold by a particular lender. This is a critical principle for the industry to ensure a level playing field that fosters robust competition of products and services. FHFA captures this as a principle, yet appears to hedge by recommending that smaller lenders utilize aggregators rather than participating directly.

This focus on scale is misguided and risks reconcentrating the market for single-family mortgage credit risk. Lender participation in a CRT program should be conditioned solely on their willingness to invest in or work with an approved, well-capitalized partner to manage the credit risk, not the volume that is delivered. FHFA has successfully narrowed the g-fee difference between large and small lenders in recent years; there is no reason why the same cannot be achieved in CRT offerings.

Many smaller- and mid-size lenders are interested in investing directly in mortgage credit they produce and have approached the GSEs to do so, with mixed success. To the extent there are economies of scale or fixed costs that need to be overcome, the GSEs can provide leadership by developing standardized structures, publishing standard deal documents and simplifying processes to bridge the gap. One such approach would be to execute CRT transactions more frequently with lower pool sizes, lowering the barriers to entry and diversifying the GSEs' credit investor base, considerations that are part of FHFA's principles framework. More frequent deal executions would also sharply reduce the warehouse period, reducing reducing or eliminating the GSEs' exposure to this risk while facilitating a deeper, more fully developed market that encompasses "day one" credit risk. The GSEs should also publish alongside their LLPA grids a prevailing bid for g-fee offered to the market in exchange for assuming certain levels of credit risk to ensure that all participants receive the same economic terms.[8] Tiering the level of risk assumed, perhaps in 100bps increments (starting at the first 100 bps of exposure, for instance) would help alleviate some of the capital burden while still distributing first-loss credit risk at the time of loan delivery.

Additionally, FHFA should apply the level-playing field principle to its evaluation of transaction types. Currently, collateral and capital-based transactions are reviewed under different analytical frameworks and there is little, if any, transparency into how the GSEs compare their respective benefits and drawbacks under FHFA's principles

[8] *See* Borrower Impact above.

framework.[9] As noted above, it is important for transparency and market understanding to facilitate an "apples to apples" comparison of deal structures and executions. Part and parcel to this is the need for the GSEs to facilitate competition between both collateral- and capital-based transaction types, with a clear standard for interpreting the relief offered by each. Anything less risks tilting the default toward the current collateral approach without fully evaluating the merits or long-term performance of capital-based or partial collateral models.

Overall, we urge FHFA to work more closely with small- and mid-size lenders and the GSEs to facilitate the creation of new front-end CRT structures that will enable multiple, economically equivalent execution options that can be utilized by lenders of all sizes. The GSEs should use their leadership role to disclose and standardize deal documents and key terms to reduce costs from transaction to transaction.

<u>Stability through economic and housing cycles</u> – FHFA notes in its principles framework the importance of ensuring that the CRT programs can be sustained through a housing or economic downturn.[10] We agree, and as a result urge the GSEs to reduce reliance on "spot market"-type pricing structures that are inherently subject to investor sentiment at the time of issuance. Rather, CRT programs delivered at the point of sale to consumers, i.e. front-end risk sharing, should reflect a "through the cycle" mentality, with long-term residential mortgage credit investors ready and willing to price credit risk through all parts of the cycle and an emphasis on structures that facilitate this approach.

While CAS and STACR have attracted more than 100 unique investors, these entities are largely asset and money managers, with mortgage REITs comprising a relatively small percentage of activity.[11] Unlike lenders, mortgage insurers and mortgage REITs, many of these investors are able to select from a wide array of assets globally in which to invest their capital and are able to quickly reallocate their portfolios to other, non-mortgage investments. For this reason, the current investor profile is not conducive to sustainability throughout an economic cycle, presenting an opportunity cost by diverting liquidity from other, possibly more durable structures. Capital markets executions are a valuable tool in the toolbox but may not be sufficient to disburse mortgage credit risk away from the GSEs.

The GSEs should also factor regulatory or structural hurdles in evaluating their potential investor base and develop structures that avoid these hurdles. For example, certain structures run afoul of REIT income or asset requirements , limiting the participation of a

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[9] For example, comparing the perceived counterparty risk in a deeper MI approach with the observed market risk in STACR/CAS under the principles of scalability and stability through economic cycles.
[10] "Transaction structures should be designed to ensure that at least some investors will remain in the market through stressful phases of the housing price cycle, including during economic downturns." RFI, page 4.
[11] Progress Report, Page 16.

potentially significant source of private capital that is committed to the residential mortgage market.[12] Some structures may also implicate bank capital or derivatives rules, leading to unnecessary expense. The GSEs should ensure that CRT structures, particularly those that are expected to issued on a consistent basis, avoid these obstacles to ensure the deepest, most durable execution at the lowest fixed cost. To help further this, FHFA should work with other relevant regulators to ensure that hurdles are minimized to the extent possible.

These structural considerations could reduce the chances of the GSEs being left warehousing more risk than anticipated, while still allowing the GSEs to be opportunistic in laying off risk during favorable market conditions. A focus on more cyclically-durable structures would also provide some of the borrower impacts noted above, particularly stability in price and product offerings.

Conclusion

The CRT programs undertaken to date are an important start to the process of de-risking the taxpayer and spurring private capital investment in single-family mortgage credit risk. However, more should be done to ensure the foundation laid to date can provide maximum benefit to the taxpayers, borrowers, and market as a whole. Ensuring a level playing field, consideration of borrower impact, enhancing transparency, and favoring long-term stability over short-term advantages will help deepen the market and reduce the need for the GSEs to play an outsized role in its continued development.

In addition to our comments above, MBA provides specific reponses to FHFA's questions in the accompanying appendix. For more information on this topic, please contact Dan McPheeters at dmcpheeters@mba.org.

Sincerely,

David H. Stevens, CMB
President and Chief Executive Officer

Appendix

Responses to FHFA Questions

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[12] For example, further mortgage REIT participation the in STACR and CAS programs is limited by a lack of guidance from Securities and Exchange Commission staff on the "qualifying asset" treatment of the bonds under the Investment Company Act of 1940, as amended, for 3(c)(5)(C) purposes. We have been informed by several mortgage REITs that favorable SEC Staff guidance on the regulatory treatment of these assets would increase mortgage REIT participation, furthering FHFA's goal of encouraging long-term, private capital sources to invest in mortgage credit risk.

Question A1: Are there credit risk transfer principles that FHFA should consider in evaluating front-end credit risk transfer transactions that are not listed in Section II? Similarly, are there significant risks that FHFA and the Enterprises should consider in evaluating credit risk transfers structures that are not included in Section III? Please also provide any comments or views about the principles and risks described in Section II and III.

MBA Response: FHFA should add Borrower Impact as a principle in its framework. Additionally, MBA recommends that FHFA enhance its Level Playing Field and Stability principles to better account for market dynamics and avoid potential systemic or cyclical risks, such as investor concentration or significant pro-cyclicality. Finally, FHFA should monitor CRT developments with an eye toward GSE reform and potential future end states – the foundation laid today should continue to serve and facilitate a deep, liquid market for mortgage credit risk regardless of the ultimate outcome of reform.

Question A2: How would proposed front-end credit risk transfer structures meet and balance the principles outlined in Section II and address the risks outlined in Section III?

MBA Response: The development of a broad array of competitive, front-end transfer structures, such as deeper MI, would likely provide a favorable balance between many of the principles outlined in FHFA's framework. For instance, front-end participants such as lenders, REITs and mortgage insurers are long-term participants in the market and would add valuable diversity to the private capital sources supporting the CRT programs. It would also align with prevailing, bipartisan views of GSE reform by putting the GSEs in a catastrophic risk position at the time of acquisition. Thus, while individual deals may price differently, there would likely be less volatility from deal to deal because the investor base would be more likely to remain stable and committed to the mortgage market in both good and bad times.

Additionally, front-end structures would better facilitate the Level Playing Field principle because front-end proposals generally rely on well-understood mechanisms that are already being utilized. This would reduce operational complexity while improving scalability, repeatability and the ability of smaller lenders to participate.

One criticism of the current CRT paradigm, which MBA shares, is that comparisons of investors and counterparties from deal to deal and across front- and back-end executions is very difficult in light of the different standards and structure types. As noted in our General Comments above, enhanced transparency of individual deal executions and counterparty standards would help improve this analysis and allow more of an "apples to apples" comparison of the economic reflief obtained from individual deal and deal types. The GSEs should publicize a detailed framework for how they consider such risks and allow market participants to manage to it. The depth and breadth of the

CRT market would benefit from a set of transparent, manageable standards that allow a true comparison of the various CRT options available. For instance, Freddie Mac should publish details of the auction process, cover bid and syndication structure for its recent credit insurance pilot program.

Question A3: In considering proposed front-end credit risk transfer transaction structures, how should FHFA and the Enterprises manage the counterparty risk involved in these transactions?

MBA Response: MBA reiterates its call for the GSEs to publish a transparent framework for how it considers and evaluates counterparty risk. For example, PMIERs and the revised Master Policies would seem to serve this function for the GSEs mortgage insurer counterparties.

This transparency could facilitate a periodic lender or mortgage insurer “scorecard” that would inform market participants of how each CRT participant is peforming, thus helping to inform best execution decisions for future transactions. The same framework could be used for evaluating “back-end” reinsurance counterparties and facilitating a true comparison between different executions and collateral. Finally, the GSEs could consider a margin-like approach in their CRT structures to reduce the collateral requirements without moving wholly to a counterparty capital regime. All of this would help facilitate more programmatic CRT offerings, deepening the market for this risk and allowing prospective participants to raise capital more easily on the basis of this liquidity.

FHFA could also consider utilizing the Federal Home Loan Banks (FHLBs). The FHLBs can issue letters of credit that could serve as a valuable instrument in supporting collateral-backed structures. Additionally, the FHLBs can help reduce the capital intensity of certain transactions through their match-funding capabilities. Both efforts would help develop liquidity as individual CRT programs are launched and monitored.

Question A4: In developing their credit risk transfer programs, the Enterprises have used pilot transactions to evaluate new credit risk transfer transaction structures. As FHFA considers proposed front-end credit risk transfer structures, one option is for the Enterprises to engage in pilot transactions. If approved by FHFA, what issues or characteristics should be tested in pilot transactions?

MBA Response: Pilots are valuable mechanisms for testing different features and allowing for broad feedback. MBA strongly recommends that FHFA direct the GSEs to pilot different front-end structures, including additional lender recourse and capital markets options, and deeper MI. These pilots should test issues such as pricing dynamics (for example, avoiding large price swings such as those experienced in STACR and CAS); alternative approaches for mitigating counterparty risk; alternative risk capitalization models, such as a partial collateral and margin approach; and different size executions (for example, in 100, 200, or 300 bps of exposure).

Additionally, multiple pilots and monitoring of performance would help inform how each deal structure could be scaled throughout the market and facilitate market feedback to determine where additional transparency and disclosure could be useful.

It should be noted that CAS and STACR have implicitly benefited from years of research and development by the GSEs, including significant opportunities for feedback from the investors and underwriters who have participated to date. The same level of research and development care should be invested in up-front pilots as well to optimize each structure.

Question B1: What credit risk transfer strategies work best for small lenders? Why?

MBA Response: Operational simplicity and ensuring a level playing field are at the heart of small lender concerns. Ensuring that small lenders can participate in front-end CRT transactions in practice as well as theory will require full transparency on deal terms, structure types and economic features, particularly the mechanism by which the g-fee is reduced or shared with the lender. FHFA and the GSEs should also take care to ensure that the deal executions reflect consistent, unit pricing; additional transparency across specific deals will help in this regard. Mortgage insurance provides many of these benefits and is currently in widespread use by market participants large and small. Another approach would be to reduce the capital intensity of recourse structures, such as through a margin-type collateral approach or reducing the minimum exposure a lender must assume.

Question B2: Do other types of front-end credit risk transfer work better for small lenders than collateralized recourse transactions? How so?

MBA Response: A fully collateralized recourse approach is not the only recourse model that could be implemented, and FHFA should direct the GSEs to experiment with many different structures before settling on a preferred option. For instance, the GSEs could relax the collateral requirements and implement a margining regime to lessen the liquidity burden on smaller lenders while still protecting itself with cash. An alternative structure that is operationally simple and could work well for smaller lenders would be deeper MI because it utilizes business relationships and processes that are already in place and widely understood. As noted above, other approached include margin-type recourse collateral models or reducing the minimum risk a lender must assume. To make any such model work, however, the per-loan g-fee implications of the transaction will need to be clearly disclosed prior to execution.

Question C1: How should FHFA and the Enterprises incorporate information learned through the pricing of credit risk transfer transactions into the practice of setting both the level of and frequency of changes in the Enterprises' guarantee fees?

MBA Response: It is important to note that the GSEs will not be the only beneficiaries of a well-crafted and transparent disclosure regime for CRT deals; the market as a whole will benefit mightily in terms of understanding risk and having transparent, available reference points by which to compare risk and economic exposure across time and deal structures. This should spur a virtuous cycle; more private capital will be deployed to invest in these deals as the market comes to better understand each structure type.

While market conditions and price signals should be used to evaluate the right g-fee levels overall, it is important that the GSEs employ a cautious, systematic process for updating the g-fees and loan-level price adjustments. Too frequent price changes could negatively impact the borrower through volatile price movements. On the other hand, too infrequent updates could risk allowing inefficiencies to build up in the pricing structure, disfavoring up-front executions to the benefit of back-end executions (and possibly the GSEs).

Question C2: Should FHFA and the Enterprises maintain the policy of taking a longer-term view of setting guarantee fees in an effort to provide greater liquidity and stability in the housing finance market? Would a change in this practice impact market liquidity and borrower access to credit? If so, how?

MBA Response: Yes. FHFA and the GSEs are right to focus on longer-term, through the cycle considerations. However, the current level of transparency and disclosure of specific deals and across deal structrues does not facilitate liquidity or stability; there is simply too many differences between capital and collateral-based deals and too much unknown in the economics and specific structures of each deal. This information should be disclosed more broadly to allow the market to better understand, compare and provide feedback to help FHFA and the GSEs employ a long-term focus in their credit pricing policies.