



October 11, 2016

Federal Housing Finance Agency
Office of Financial Analysis and Modeling
400 7th Street, SW
9th Floor
Washington, DC 20219

Dear Sir or Madame:

Enclosed please find our response to the FHFA, Division of Housing Mission and Goals, Single-Family Credit Risk Transfer Request for Proposals, dated June, 2016.

As noted therein, we believe:

1. In addition to the CRT's currently under discussion, down payment protection insurance ("DPP") represents an additional up-front risk transfer mechanism not currently in use.
2. DPP is the only up-front risk transfer mechanism designed to modify borrower behavior so as to avoid defaults
3. In contradistinction to other CRT mechanisms which only deal with defaults scenarios, DPP-related loans would be de-risked before actually getting on the GSE's balance sheets.
4. For the period just prior to, and during, the housing crisis (i.e., 1999 thru 2008), DPP covered transactions would have provided approximately \$2.2 Billion of coverage toward borrower down payments on loans that ultimately went into foreclosure, as well as an additional \$37.24 Billion to cover borrowers' home equity losses.
5. DPP-related loans backed by major reinsurers represent an efficient use of capital that positively impacts the cost structure of residential mortgage loans.

We look forward to discussing this matter with you in greater detail at your convenience.

Very truly yours,

A handwritten signature in black ink that reads "Joseph Melendez". The signature is written in a cursive, flowing style.

Joseph Melendez
Chief Executive Officer
PVI Agency LLC d/b/a Valueinsured



Introduction

Before specifically addressing **Questions A1** thru **Questions C2** (as set out below) of the **FHFA Single-Family Credit Risk Transfer Request for Input**, we offer the following initial observations as a background against which to evaluate our recommendation for using down payment protection insurance (DPP) as an additional up-front risk transfer mechanism.¹ In this regard, we note at the outset that our emphasis as described herein is on discussing the impact of a new up-front risk transfer mechanism (i.e., DPP), rather than discussing the effectiveness of current credit risk transfer programs (CRT's) presently being undertaken by Fannie Mae and Freddie Mac (GSE's).² Nevertheless, we are mindful of the GSE's need to balance the development and execution of new and old CRT's; and, therefore, argue for the inclusion of DPP together with other CRT's, not in lieu of any particular CRT currently in use. That said, in contradistinction to all other CRT's, the overarching goal of DPP utilization is to distribute mortgage credit risk *prior to* the loans being acquired by the GSE's, while offering significant, potential borrower benefits, and thereby create a new paradigm for residential mortgage transactions that is consistent with the FHFA's principles of CRT.³

As a threshold matter, our proposal for using DPP would provide an additional execution option for lenders which is not otherwise presently available, as well as benefits for borrowers by potentially reducing mortgage costs, as described herein. DPP would also serve to significantly enhance efficiencies and lower costs for the Enterprises without any adverse impact on their respective revenues or balance sheets. While we concur with the premise that multiple forms of credit enhancement should be eligible for inclusion among the various up-front transfer mechanisms employed by the GSE's, including: i) 'deep cover' private mortgage insurance, ii) lender recourse, and iii) structured finance; nevertheless, we strongly believe that DPP should also be included among the accepted mechanisms.⁴ However, in conjunction with each of these approaches, DPP could be an effective transmission mechanism that spreads efficiency throughout the mortgage lending process to the benefit of all of the other participants. Furthermore, DPP supported by major

¹ An illustration of DPP coverage is attached hereto as Exhibit A.

² The FHFA's progress report and Request for Input dated June 29, 2016, properly noted that back-end structures have comprised over eighty percent (80%) of the CRT transactions executed, implying the need for the types of complementary front-end solutions emphasized herein. In this regard, see Goodman, et al., *How to Improve Fannie and Freddie's Risk Sharing Effort*, Moody's Analytics and The Urban Institute (August, 2016).

³ DPP should be viewed as facilitating the GSE's ability to broaden the number of sustainable CRT options which are available, as well as enabling the GSE's to avoid warehousing more risk than desired.

⁴ See also http://www.urban.org/research/publication/delivering-promise-risk-sharing/view/full_report which presents a comparative and comprehensive study of varying existing risk transfer mechanisms.



reinsurance carriers would represent a major, new and significant layer of capital (ahead of other investor capital) in residential real estate transactions⁵; and, thereby serve to further reduce taxpayers' risk exposure for GSE-related loans. In addition, securitizations containing DPP-related loans would constitute a new, enhanced class of RMBS, providing more capital in support of the mortgage market. Another way to express the same thought is to say that DPP-related loan pools would be de-risked *before* they get on the GSE's balance sheets, increasing competition for DPP-related credit risk in the securitization market.

More specifically (and as detailed herein), for all single family and condominium purchase loans originated by Fannie Mae and Freddie Mac during the period 1999 thru 2008⁶, DPP could have provided \$2.2 Billion of coverage for borrower down payments on loans that ultimately went into foreclosure or through short sales, as well as pay an additional \$37.24Billion to cover borrower's home equity losses where they were able to sell without actually going thru a short sale.⁷ The datasets supporting these conclusions are replicated and summarized in Exhibit B, hereto. The data strongly supports the thesis that for borrowers, DPP would help them retain their good credit, as well as help them get into their next home.⁸ For the mortgage industry, including both small and large lenders, DPP would mitigate a significant amount of risk ahead of any other risk product in the market today.

⁵ The new layer of capital would be available even after taking into account the stacking of limits of exposure by reinsurers who are already in privity with the Enterprises, insofar as DPP represents a separate and distinct risk classification.

⁶ The period 1999 thru 2008 was used in order to demonstrate full accident year results for a DPP product covering seven years, viz., thru 2015.

⁷ PVI loaded and analyzed all Fannie Mae and Freddie Mac Acquisition and Performance datasets for the years 1999 thru 2016 Q2. The datasets contain over 2.5 billion records, representing over 44 million loans. The datasets were utilized to develop an accurate understanding of the credit performance of Fannie Mae and Freddie Mac mortgage loans for the period in question. The population of the data reflected in this comment represents a subset of Fannie Mae's and Freddie Mac's 30 year, fully amortizing, full documentation, single family and condominium, conventional fixed-rate mortgages. The datasets analyzed did not include data on adjustable-rate mortgages loans, balloon mortgage loans, interest-only mortgage loans, mortgage loans with prepayment penalties, government-insured mortgage loans, Home Affordable Refinance Program ("HARP") mortgage loans, Refi Plus mortgage loans, and non-standard mortgage loans. In addition, certain types of mortgage loans (e.g., mortgage loans with LTVs greater than 97 percent, Alt-A, other mortgage loans with reduced documentation and/or streamlined processing, and programs or variances that are ineligible today) were excluded to make the datasets more reflective of current underwriting guidelines.

⁸ This is premised upon the ability of DPP protected loans to convert what would have been foreclosures into short sales.



That said, why isn't the residential housing segment more robust? We believe that despite historically low mortgage rates, home ownership rates are at depressed levels due to several major factors, including: (1) fear of loss of down payments by potential home buyers due to market volatility, (2) tightened mortgage standards requiring more money down; and, (3) a desire for flexibility and mobility by potential borrowers to address employment or life events.⁹ We feel, however, that each of these factors could be favorably impacted and/or mitigated thru the use of down payment protection insurance. We also believe that the housing market, in general, and the mortgage finance business, in particular, stand to significantly benefit in a number of important ways from innovations such as down payment protection insurance, which, in turn, will assist in creating a new and more viable paradigm for home financing. With these considerations in mind, we believe four key changes will occur in conjunction with the use of DPP:

1. For the first time, American home buyers' using DPP would be able to protect their biggest investment, i.e., their down payment.
2. DPP would assist in energizing the real estate market by providing greater confidence to renters and others who seek the benefits of home ownership, but have been reluctant to pursue home purchases that they may not otherwise be able to get out of in a down market.
3. DPP would inject an important (and substantial) new layer of capital into the housing market, thereby helping to propel the overall American economy due to the fact that DPP tied loans would perform better; and,
4. DPP-related loans would be safer, and, consequently, attract more buyers to the marketplace, causing steady and more reliable growth in the housing sector.

Responses

Our specific responses to the FHFA Single-Family Credit Risk Transfer Request for Input (the "RFI") are set out below.

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.

⁹ See *More on Why First-time Home Buyers Are Staying on the Sidelines* at <http://www.valueinsured.com/trendsource/2016/1/6/further-reasons-why-first-time-home-buyers-are-staying-on-the-sidelines>



The following additional consideration should be taken into account in Sections II and III of the RFI:

A1. Section II Considerations

The FHFA should consider down payment protection insurance ("DPP") as an additional program that would serve as a viable front-end credit risk transfer mechanism that could easily complement the existing programs described in the RFI (as hereinafter substantiated).

A1. Section III Considerations

While the credit risk transfer principles listed in Section III are seemingly comprehensive, we believe they do not address certain additional, potential mechanisms that could change borrower behavior, i.e., those that could actually serve to mitigate or lessen the likelihood that the borrower would default in the first instance. Stated differently, we believe that borrower impact should be an additional consideration in re-imagining the framework for the functions of CRT's. Consequently, the FHFA should consider mechanisms that would directly affect and/or modify borrower behavior by providing financial incentives not to default. We argue that the use of DPP, in particular, will positively impact consumer behavior insofar as there would be a disincentive to default in many circumstances where previously the borrower had no incentive not to default. Borrowers knowing that coverage would now be available to assist in short sales or cover equity declines in down markets would have a different mindset about defaults and potential responses to negative equity situations. With the adoption of DPP as an up-front risk transfer mechanism by the FHFA, the coverage could be rapidly 'socialized' by the GSE's following principles set out in a recent Harvard Business Review article entitled *Change Consumer Behavior with These Five Levers*.¹⁰ Specifically, the article argues for: i) making the product understandable, ii) making the product convenient and accessible, iii) making the product desirable, iv) making the product economically worthwhile, and v) making the use of the product commonplace. Following these guidelines would assure that borrowers feel the requisite confidence in paying for a relatively new product because they would now understand that, for a small premium, their down payment is protected. At the same time, the GSE's would garner all of the benefits summarized in the Introduction to these Responses.

Research into borrower motivations has also been conducted for the past year highlighting several key data points that indicate that down payment protection would improve borrower behavior.¹¹ Highlights include the fact that 81% of existing homeowners who want to upgrade would do so sooner if they didn't have to worry about losing their down

¹⁰ See <https://hbr.org/2012/11/change-consumer-behavior-with>

¹¹ All research referenced herein was conducted by Neilsen/Harris Poll or Equation, commissioned by the respondent between October, 2015 and June, 2016. Reports and accompanying assumptions are available upon request.



payment, and 83% of millennial renters believe down payment protection would give people more confidence in buying a home.¹²

In general, an analysis of *borrowers' behaviors*, and their corresponding expectations, reveals a gap in the current home buying risk profile that needs to be addressed in order to motivate both existing homeowners and new buyers, as well as aid in stabilizing defaults over the longer run.

The data supporting our conclusions about borrower behavior is set out in the table below¹³:

All Single Family / Condo Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, No Foreclosure Behavior Changes)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,974,683,803	\$ 10,524,233,783	\$ 3,848,031,477	\$ -	\$ 18,346,949,063	\$ 32,196,299,505	\$ 3,442,326,497	10.7%	\$ -	-	196,978
Grand Total	\$ 5,240,543,909	\$ 15,744,804,621	\$ 5,364,332,082	\$ 50,516,457,934	\$ 76,866,138,546	\$ 1,918,713,830,672	\$ 294,859,023,048	15.4%	\$ 38,520,503,440	1,924,215	9,393,161

All Single Family / Condo Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,974,683,803	\$ 10,524,233,783	\$ 3,848,031,477	\$ -	\$ 18,346,949,063	\$ 32,196,299,505	\$ 3,442,326,497	10.7%	\$ 1,445,083,055	178,065	196,978
Grand Total	\$ 5,240,543,909	\$ 15,744,804,621	\$ 5,364,332,082	\$ 50,516,457,934	\$ 76,866,138,546	\$ 1,918,713,830,672	\$ 294,859,023,048	15.4%	\$ 39,965,586,495	2,102,280	9,393,161

All Single / Condo Family Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes, Severity is 2x avg dp pct or <= 30%, Confidence=85%)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,496,211,256	\$ 8,048,373,772	\$ 3,203,593,170	\$ -	\$ 14,748,178,197	\$ 26,925,412,482	\$ 2,793,739,384	10.4%	\$ 905,852,880	156,546	174,740
Grand Total	\$ 4,762,071,362	\$ 13,268,944,610	\$ 4,719,893,775	\$ 50,516,457,934	\$ 73,267,367,680	\$ 1,913,442,943,649	\$ 294,210,435,935	15.4%	\$ 39,426,356,319	2,080,761	9,370,923

This data demonstrates with an eight-five per cent confidence level, that the infusion of \$900 Million Dollars of available DPP claim payments would have changed the behavior of

¹² Ibid.

¹³ These tables are intended to represent three distinct scenarios: i) Total population of Single Family and Condominium Purchase Loans, showing Projected DPP Claims (labeled as "Loss Payment") and Projected DPP Frequency (labeled as "Loss Freq"), ii) Total population of Single Family and Condominium Purchase Loans, now inclusive of all potential Foreclosure Behavior Changes, which show Projected DPP Claims and Projected DPP Frequency, iii) Selected population of Single Family and Condominium Purchase Loans, now inclusive of potential Foreclosure Behavior Changes, based on severity not exceeding two times the average down payment percentage, or 30%, and a recovery of 85% based upon the distribution of recoveries for loans that ultimately concluded in being prepaid based upon severity for the same time period. Expressed slightly differently, for the period under consideration, viz. 1999 thru 2008, the data demonstrates that 85% of all homeowners in down markets (30% down) prepaid their loans even without DPP. We believe, that at a minimum, homeowners with DPP would mirror the same or better results.



almost one hundred sixty thousand home owners whereby they would have pursued a previously unavailable short sale option versus a going through an undesirable foreclosure proceeding as a way to terminate their loan. In other words, the data clearly reveals that borrowers who would have obtained DPP coverage would be far less likely to default on their loans than borrowers who did not have DPP coverage.

Consequently, we are proposing the adoption, and ultimately, widespread use of down payment protection insurance that is supported by the major reinsurers and other capital markets participants to mitigate the frequency and severity of mortgage defaults across all types of possible market conditions as a major behavior modification incentive. In this context, DPP could play an important role within the overall framework of CRT programs being considered and evaluated by the FHFA.

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?

Section II Considerations:

Section II highlights various individual considerations, which we summarize individually, as follows:

- *Reducing Taxpayer Risk:*

When one views the "risk stack" associated with the GSE's lending activities, it currently looks like the following:

- Mortgage Originator Risk Retention
- Mortgage Insurance Companies
- GSE's
- STACR
- CAS
- CAT Bonds
- Taxpayer

One of the objectives of DPP is to provide an additional layer of capital that sits on top of (i.e., is ahead of) Mortgage Originator Risk Retention. Consequently, the new "risk stack" would look like the following:

- **Down Payment Protection Insurance**
- Mortgage Originator Risk Retention
- Mortgage Insurance Companies
- GSE's
- STACR
- CAS
- CAT Bonds
- Taxpayer

The diagram set out below represents the benefits to both the debtor and creditor sides of a hypothetical default chasm.

	Front-end Risk Transfer	Back-end Risk Transfer
Beneficiary	Mortgage Debtor	Mortgage Creditor
Risk Type	<i>Default Avoidance</i>	<i>Default Risk Transfer</i>
Issuer/Counterparties	US Domestic multi-line P&C Insurer Global multi-line P&C reinsurers	Mortgage Originator Risk Retention, Mortgage Insurers, GSEs
Programs	Down Payment Insurance	MO Collateralized Retention, MI, Deep MI, STACR /CAS, Credit Linked Notes, CIRT/ACIS
Purpose	Avoid defaults from occurring, Enables short-sales, Empowers Negative Equity Sales,	Facilitation of partial reimbursements in event of default by priority subject to counterparty financial strength
Effect	Levels playing field for homeowners Salvages future homeowner credit	Counterparty strength, Increased capacity for new investors
Net Impact	Reduced Defaults	Reduced Claims

More specifically, DPP would represent a significant, new source of 'up-front' capital, not previously available in residential real estate transactions.

- *Economically Sensible:*

DPP is economically sensible for several reasons:

- i) There is no cost to the GSE's
- ii) DPP premiums are reasonable
- iii) DPP premiums are paid by the borrower, or can be paid by loan originators and/or mortgage insurers.
- iv) DPP premiums are modest in comparison to mortgage insurance premiums, G-fees and LLPA's
- v) DPP results in fewer, and less severe, claims on participants further down in the 'risk stack'

- *Continuity of Core Business:*

The use of DPP not only preserves the continuity of the GSE's core business, it facilitates and enhances it by: (i) stimulating additional borrower activity on the part of individuals previously reluctant to enter the market for fear of losing their equity; and, (ii) reducing the



cost of back-end risk transfer to the GSE through the improved quality of DPP-related loans.

- *Repeatable:*

In virtually all circumstances where, as a threshold matter, DPP coverage would be suitable for a particular borrower's circumstances, DPP would be repeatable: i) in all market conditions; and, ii) across the entire spectrum of mortgage originators. The latter result would be achieved as a consequence of the GSE's incentivizing virtually all types of lenders thru the reallocation of risk transfer costs.

- *Scalable:*

During the period 2008 thru 2011 one of the most turbulent in the history of the housing market, DPP would have been available to cover approximately 2.5 million residential real estate purchase transactions. By comparison, mortgage insurance would have covered only twenty-five percent of those transaction, viz., roughly six hundred thousand purchases. The table below, provides the relevant numbers for each of the relevant years.

Year	SF Homes + Condos	SF Homes + Condos with MI
2008	732,027	260,880
2009	637,452	132,461
2010	579,928	102,047
2011	520,044	126,626
Grand Total	2,469,451	622,014

- *Counterparty Strength:*

One of the keys to the success of this particular up-front risk transfer mechanism will be the participation of a cross-section of different, well capitalized reinsurance carriers and other sophisticated capital market participants who quickly recognize and understand the viability and benefits of this new 'book of business.' Reinsurance companies, in particular, represent some of the largest, most secure capital sources available. Their participation dramatically alters the 'landscape' of residential real estate transactions.

- *Broad Investor Base:*

Following origination of a loan, it is anticipated that DPP-related loans will be put into pools and securitized. Preliminary discussions with major investment banks suggest that these pools will command premium pricing, all other considerations being equal, i.e., DPP loans



securitized by the GSE's will receive a premium over non-DPP related loans, inasmuch as the default characteristics of DPP related loans will be less severe and less frequent than non-DPP related loans.¹⁴ This assertion is validated by the data in the following table which demonstrates that with the use of DPP in connection with one hundred sixty thousand loans made during the relevant period which would have gone to foreclosure could now have been eligible for short sales and thereby benefited all parties to the mortgage.¹⁵

All Single Family / Condo Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, No Foreclosure Behavior Changes)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,974,683,803	\$ 10,524,233,783	\$ 3,848,031,477	\$ -	\$ 18,346,949,063	\$ 32,196,299,505	\$ 3,442,326,497	10.7%	\$ -	-	196,978
Grand Total	\$ 5,240,543,909	\$ 15,744,804,621	\$ 5,364,332,082	\$ 50,516,457,934	\$ 76,866,138,546	\$ 1,918,713,830,672	\$ 294,859,023,048	15.4%	\$ 38,520,503,440	1,924,215	9,393,161

All Single Family / Condo Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,974,683,803	\$ 10,524,233,783	\$ 3,848,031,477	\$ -	\$ 18,346,949,063	\$ 32,196,299,505	\$ 3,442,326,497	10.7%	\$ 1,445,083,055	178,065	196,978
Grand Total	\$ 5,240,543,909	\$ 15,744,804,621	\$ 5,364,332,082	\$ 50,516,457,934	\$ 76,866,138,546	\$ 1,918,713,830,672	\$ 294,859,023,048	15.4%	\$ 39,965,586,495	2,102,280	9,393,161

All Single / Condo Family Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes, Severity is 2x avg dp pct or <= -30%, Confidence=85%)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,496,211,256	\$ 8,048,373,772	\$ 3,203,593,170	\$ -	\$ 14,748,178,197	\$ 26,925,412,482	\$ 2,793,739,384	10.4%	\$ 905,852,880	156,546	174,740
Grand Total	\$ 4,762,071,362	\$ 13,268,944,610	\$ 4,719,893,775	\$ 50,516,457,934	\$ 73,267,367,680	\$ 1,913,442,943,649	\$ 294,210,435,935	15.4%	\$ 39,426,356,319	2,080,761	9,370,923

- *Stability Through Economic and Housing Cycles:*

As noted above, an obvious benefit of DPP is its ability to serve as a more cyclically durable program that's part of the overall constellation of CRT programs deployed by FHFA.

Stability is achieved thru various aspects of DPP utilization, including: i) serving as a backstop to falling housing prices by changing borrower behavior, ii) protecting borrowers' home equity during market downturns, and iii) mitigating GSE losses during times of economic stress.

- *Transparency:*

At the highest level, there is, in general, a need to increase the transparency of various aspects of varying CRT's so the benefits of each can be compared, and a cohesive picture developed which informs overall policy decisions at the FHFA and GSE levels. The comparison needs to include the use of DPP. These considerations, in turn, need to be

¹⁴ Based upon ongoing discussions with Credit Suisse. Specific references available upon request.

¹⁵ See footnote 11 for caption descriptions.



viewed in concert with the GSEs economics, including the capital implications of each CRT program.

At the consumer level, consumer facing transparency is achieved in several ways: (i) a "Plain English" disclosure that is provided to each DPP coverage applicant concurrent with the application; (ii) TRID/Reg. Z compliant disclosures provided on both the forms Loan Estimate ("LE") and Closing Disclosure ("CD"); and, (iii) supplemental information available on the respondent's website.

- *Level Playing Field:*

DPP will be offered on a non-discriminatory basis on the same terms and conditions to all borrowers on all GSE eligible loans (viz., for all new home loans; not for refinances); however, it is thought that the logical place to initiate coverage would be with 15 and 30 year fixed rate loans, insofar as there is more than ample data available to demonstrate the benefits of DPP coverage attached to these loans. Because such loans would be offered by both large and small originators, DPP would benefit lenders of virtually all sizes.

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?

Risk would be managed by diversification, insofar as the growth in the use of DPP is accompanied by a parallel growth in the number and corresponding size of reinsurers who back the program. The bedrock principle underlying the use of DPP would be that reinsurers would do on the front-end what mortgage insurers do on the back end. Realistically, reinsurers are the most attractive new, up-front market participants with the depth and breadth of capital to impact the losses confronted by GSE's during turbulent markets. They would be supported on the back-end by strong capital market participants who seek to acquire interests in DPP-related Insurance Linked Securities ("ILS") instruments.

In evaluating these credit risk transfer transactions, consideration should also be given to certain trade-off's of the sort highlighted in a recent Asset Securitization Report where it observed: "One of the subtler lessons of the financial crisis is that offloading one kind of risk can mean taking on another. At Freddie Mac, Kevin Palmer is taking this to heart."¹⁶ Mr. Palmer's point being that: "One concept that is commonly misunderstood is the use of the terms 'front end' and 'back end.' This terminology is only in reference to when the risk transfer transaction was arranged. Transferring the risk as soon as possible is important." That is exactly what happens with DPP insured loans; the risk is essentially transferred before it gets on the GSE's balance sheets.

¹⁶ See http://www.asreport.com/news/residential_mbs/reimbursement-not-timing-is-key-to-gse-risk-sharing-259811-1.html

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?

As a threshold matter, we readily acknowledge that pilot programs are valuable mechanisms for testing and feedback, and, therefore, support the FHFA's directive to the GSE's to pilot different front-end structures.

Our specific recommendation is to initiate the program in support of the origination of 30 year fixed rate loans, due to the availability of historical data that was used to demonstrate the validity of the program. Commensurate with this criteria, Pilot distribution channels should be put in place with selected GSE strategic partners that ensure sufficient market penetration throughout the entire country to establish efficacy.

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

Many small and mid-sized lenders are prejudiced by the inability to achieve the economies of scale that are requisite to participating efficiently in various CRT programs. DPP, by comparison, is accessible to all size market participants on the same basis, and provides an economically equivalent execution option that can be used by lenders of all sizes.

In this regard, we are mindful of the FHFA's overarching goal of creating a deep, diversified market for mortgage credit risk that accommodates participants of all sizes and business models, including small lenders. One reason DPP would benefit small lenders is that it would allow them to attract a great deal of additional new business, viz. 'early adopters' offering something their competitors do not. Many other products are designed for large originators, but DPP (especially if paid by the lender), could be a potent marketing tool in lieu of other, less productive forms of marketing. Lender paid DPP would further serve to underscore the fact that the small lender has the borrowers' best interest at heart. It is a coverage that directly benefits the borrower in contradistinction to mortgage insurance or lender's title insurance that only benefit the lender.

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

An important distinction needs to be made in response to this particular question.

Specifically, lender recourse (like all the other risk transfer mechanisms cited in the

Request for Input) deal with how to address a problem once the borrower has defaulted.

DPP, on the other hand, deals with preventing defaults in the first instance. By modifying borrower behavior (as explained above), fewer defaults would occur; and, therefore, none of the other risk transfer mechanisms would be triggered. Even in circumstances where a short sale needs to be accommodated, proceeds arising under DPP coverage would be available for use at closing to help 'close the gap,' and facilitate the consummation of the sale.

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?

The tables and graphs set out below detail the impact of DPP during different market cycles. From this data it is possible to extrapolate "the level and frequency of changes in the Enterprises' guarantee fees." Our summary conclusions are drawn from the following tables:

All Single Family / Condo Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, No Foreclosure Behavior Changes)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,974,683,803	\$ 10,524,233,783	\$ 3,848,031,477	\$ -	\$ 18,346,949,063	\$ 32,196,299,505	\$ 3,442,326,497	10.7%	\$ -	-	196,978
Grand Total	\$ 5,240,543,909	\$ 15,744,804,621	\$ 5,364,332,082	\$ 50,516,457,934	\$ 76,866,138,546	\$ 1,918,713,830,672	\$ 294,859,023,048	15.4%	\$ 38,520,503,440	1,924,215	9,393,161

All Single Family / Condo Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,974,683,803	\$ 10,524,233,783	\$ 3,848,031,477	\$ -	\$ 18,346,949,063	\$ 32,196,299,505	\$ 3,442,326,497	10.7%	\$ 1,445,083,055	178,065	196,978
Grand Total	\$ 5,240,543,909	\$ 15,744,804,621	\$ 5,364,332,082	\$ 50,516,457,934	\$ 76,866,138,546	\$ 1,918,713,830,672	\$ 294,859,023,048	15.4%	\$ 39,965,586,495	2,102,280	9,393,161

All Single / Condo Family Purchase Loans - (Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes, Severity is 2x avg dp pct or <=30%, Confidence=85%)											
Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$ -	\$ -	\$ 121,434,554,488	\$ 17,589,287,417	14.5%	\$ -	-	712,150
Prepaid				\$ 50,516,457,934	\$ 50,516,457,934	\$ 1,739,584,879,370	\$ 270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$ 1,265,860,106	\$ 5,220,570,838	\$ 1,516,300,605	\$ -	\$ 8,002,731,549	\$ 18,802,920,895	\$ 2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$ -	\$ -	\$ 6,695,176,413	\$ 804,909,463	12.0%	\$ -	-	33,106
Foreclosure	\$ 3,496,211,256	\$ 8,048,373,772	\$ 3,203,593,170	\$ -	\$ 14,748,178,197	\$ 26,925,412,482	\$ 2,793,739,384	10.4%	\$ 905,852,880	156,546	174,740
Grand Total	\$ 4,762,071,362	\$ 13,268,944,610	\$ 4,719,893,775	\$ 50,516,457,934	\$ 73,267,367,680	\$ 1,913,442,943,649	\$ 294,210,435,935	15.4%	\$ 39,426,356,319	2,080,761	9,370,923

The summary conclusion drawn from the above analysis is that based on the existing portfolio of Fannie Mae and Freddie Mac Single Family and Condominium Purchase loans from 1999 through 2008, which equaled 9.4 million residential real estate transactions. The introduction of DPP would have positively affected approximately 2.0 million loans equating to \$38.5 Billion in projected claims associated with DPP coverage (without regard to any further benefits attributable to an additional one hundred sixty thousand potential foreclosures which also could have been converted to short sales, saving an additional \$900 Million)

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?

With the integration of more sophisticated technological systems and analytic tools, it is possible to envision the advent of dynamic pricing models which monitor and more accurately reflect appropriate price levels for DPP, in the same fashion as LLPA's and other loan origination related fees. In the same manner that interest rates vary with differing market conditions, we now have the ability to forecast or predict the rates that should prevail for various DPP coverages.



Exhibit A

The table set out below is for illustration purposes only. Actual coverage would be subject to the terms and conditions of a DPP policy

Prepaid/Short Sale Scenario (with DPP reimbursements to both homeowner and lender/servicer)

	without DPP	with DPP	Loss Reduction with DPP*
Purchase Price	\$300,000	\$300,000	\$-
Down Payment	\$30,000	\$30,000	\$-
Mortgage UPB	\$270,000	\$270,000	\$-
Sale Price	\$260,000	\$260,000	\$-
UPB Deficiency	\$10,000	\$-	(\$10,000)
Loss to Homebuyer	\$30,000	\$10,000	(\$20,000)

DPP Coverage Details

Insured Interest /down payment (i)	\$30,000	Amount equal to down payment covered with DPP
FHFA HPI Movement	-15%	Assume FHFA's House Price Index drop larger than down payment
FHFA HPI Loss (ii)	\$45,000	
Actual Loss (iii)	\$40,000	Purchase price - sales price
Insurance Recoverable	\$30,000	Lesser of down payment (i), HPI loss (ii) and sales loss (iii)

DPP Distribution

Lender/Servicer UPB	\$10,000	DPP reimburses \$10,000 for UPB loss
Borrower	\$20,000	DPP reimburses remaining \$20,000 to homebuyer

Coverage Term

Coverage Term	7 Years	
Elimination Period	12 Months	No claims first 12 months



Exhibit B

The following table presents a summary of all single family and condominium purchase loans originated by Fannie Mae and Freddie Mac during the period 1999 thru 2008. This analysis demonstrates that DPP could have provided \$2.2 Billion of coverage for borrower down payments on loans that ultimately went into foreclosure or through short sales, as well as pay an additional \$37.24Billion to cover borrower's home equity losses where they were able to sell without actually going thru a short sale.

All Single / Condo Family Purchase Loans -(Origination Years 1999 thru 2008, 3% to 20% Deposit, Including Foreclosure Behavior Changes, Severity is 2x average down payment percent or <=-30%, Confidence=85%)

Zero Balance Code	MI Loss	GSE Loss	Delinquent Interest	Borrower Loss	Total Loss	Home Value	Down Payment Coverage Amount	Avg DP CV PCT	Loss Payment (Purchases)	Loss Freq (Purchases)	Loan Count (Purchases)
Outstanding				\$0	\$0	\$ 121,434,554,488	\$17,589,287,417	14.5%		0	712,150
Prepaid				\$50,516,457,934	\$50,516,457,934	\$ 1,739,584,879,370	\$270,715,644,579	15.6%	\$ 37,240,498,335	1,844,720	8,366,318
Short Sale	\$1,265,860,106	\$5,220,570,838	\$1,516,300,605	\$0	\$8,002,731,549	\$ 18,802,920,895	\$2,306,855,093	12.3%	\$ 1,280,005,105	79,495	84,609
Repurchased				\$0	\$0	\$ 6,695,176,413	\$804,909,463	12.0%		0	33,106
Foreclosure	\$3,496,211,256	\$8,048,373,772	\$3,203,593,170	\$0	\$14,748,178,197	\$ 26,925,412,482	\$2,793,739,384	10.4%	\$ 905,852,880	156,546	174,740
Grand Total	\$4,762,071,362	\$13,268,944,610	\$4,719,893,775	\$50,516,457,934	\$73,267,367,680	\$ 1,913,442,943,649	\$294,210,435,935	15.4%	\$ 39,426,356,319	2,080,761	9,370,923