October 13, 2016

Director Melvin L. Watt
Federal Housing Finance Agency
Office of Financial Analysis and Modeling
400 7th Street, S.W., 9th floor
Washington, D.C. 20219

Dear Mr. Watt:

Re: Request for Input on Single-Family Credit Risk Transfer

Alaska USA Federal Credit Union (Alaska USA) appreciates the opportunity to provide the Federal Housing Finance Agency (FHFA) feedback on its Single-Family Credit Risk Transfer Request for Input (RFI). Alaska USA is a federally chartered credit union with $6.8 billion in assets, serving over 589,000 members. Alaska USA originates conforming and government-backed mortgage loans and sells these loans into the secondary market through Fannie Mae and Freddie Mac cash windows and creation and sales of Mortgage-Backed Securities (MBS). In 2015, Alaska USA sold over $500 million to Fannie Mae and Freddie Mac.

Alaska USA supports FHFA's efforts to strengthen Fannie Mae and Freddie Mac and increase consumer access to mortgage credit by reducing overall risk to the Enterprises. However, Alaska USA is concerned by the potential consequences to borrowers and small lenders of the proposed Front-End Credit Risk Transfer. Several of these consequences, as explained below, will decrease liquidity for small lenders in the housing finance market, limit the ability of small lenders to sell directly to the Government Sponsored Enterprises (GSE), increase costs of home ownership, and reduce borrower options to access mortgage loans. In addition, the RFI does not provide specific details on pool sizes and aggregation options. These two factors could have a dramatic long-term impact on small lenders that could lead them to being priced out of the market entirely, thereby eliminating local competition and choices in markets across the United States.

A. *Front-End Credit Risk Transfer Proposals*

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.

In general, Alaska USA agrees with the principles and risks outlined in Section II and III. However; the shift in front-end credit risk transfer to lenders will have negative and disproportional impact on small, local lenders, like Alaska USA, by increasing the cost to cover allowance for loan losses, collateral accounts, liquidity needs and additional capital requirements. This additional cost will be either absorbed by the small lender or passed along to the borrower. In either case, the increased cost to small lenders will widen the pricing gap offered by small and large lenders. This pricing advantage afforded large lenders due to their economies of scale could potentially drive small lenders out of the mortgage business leaving borrowers with fewer choices and potentially higher cost due to the lack of competition. In addition, small lenders will most likely limit loans made to

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borrowers of less than perfect credit due to the increased cost associated with the new front-end credit risk transfer. This will have a negative impact on home ownership especially in remote, rural areas like Alaska where small lenders fill a niche not currently served by large lenders. In either scenario the front-end credit risk transfer will cause a more dramatic impact to small lenders and their local borrowers over the long term.

The proposed front-end credit risk transfer will require lenders to allocate capital to cover potential losses on loans sold to the Enterprise. As the FHFA is aware, credit unions, as not-for-profit cooperatives, build capital through retained earnings. Unlike banks and mortgage bankers that raise capital through investors, credit unions do not have alternative capital options. This will place additional constraints on credit unions to comply with this new Enterprise concept of shifting the loan risk back to lenders. FHFA should take into consideration the limitations of raising capital for some lenders and its impact, as part of their testing.

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?

As noted in A1 above, small lenders will have limited availability of capital to regularly sell loans into front-end credit risk transfer structures as the additional collateral requirements will lower the amount of funds available to use for future lending. (For example, Alaska USA has originated and sold $500 million in mortgage loans to the GSEs during the past year. We estimate that at 5% risk retention, $25 million would be retained in the collateral account.) Larger lenders would be impacted less by additional collateral and capital requirements due to their diversified lending, economies of scale and ability to raise capital.

Additionally, small lenders will have the added cost of holding mortgages to meet the FHFA security pool size requirements and retain a substantially higher amount of interest and credit risk prior to securitization. The other option for small lenders is to sell their loans to an aggregator. The aggregator acts as a middle man to the securitization process at an additional cost to the small lender. In addition, using an aggregator eliminates the lender's option to service the loan. The smaller lender would no longer maintain the borrower's relationship for payments and escrow services. The loss of loan servicing could lead to losing the primary account relationship over time to the aggregator who may provide similar account services.

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?

FHFA and the Enterprises should use private mortgage insurance (PMI) as the only source of credit risk transfer. PMI would be in lieu of establishing collateral accounts. In addition, FHFA and the Enterprises should require PMI companies to maintain adequate capital standards to ensure their sustainability through adverse mortgage market conditions. The PMI approach provides an equal playing field for managing and funding counterparty risk by both large and small lenders.

Question A4: If approved by FHFA, what issues or characteristics should be tested in pilot transactions?

Pilot transactions should test the risk appetite of private mortgage insurance companies to ensure for front-end credit risk at a competitive price with an offset in reduced guarantee fees. In addition, we recommend the proposed front-end credit risk transfer should be tested on small, medium and large lenders (e.g. large banks, community banks and credit unions) to ensure the changes do not adversely impact these entities as it relates to the FHFA's goal of providing an equal playing field for all lenders. In addition, the test should include various security pool sizes and aggregator options.

B. *Equal Playing Field for All Lenders*

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

As noted in Section A, small lenders typically have lower overall capital and limited ability to handle balance sheet recourse obligations. Strategies that would work best for small lenders would include third-party private insurance such as mortgage insurance. Alternatively, FHFA should consider funding collateral accounts with a rebate generated from the guarantee fee as an additional option to help lenders manage the cost of front-end credit risk transfer. This would allow small lenders to continue to originate loans commensurate with the size of their balance sheet and provide them with an added incentive to originate quality loans that will minimize the cost/losses and reduce the impact of the front-end credit risk transfer.

The Equal Playing Field for All Lenders does not address the potential cost to small lenders of aggregators and the security pool size options. Additional details on both these items should be outlined in advance and tested in the pilot.

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

Small lenders will be disadvantaged by front-end credit risk transfer. Currently smaller lenders have the ability to hedge and securitize MBS on the To Be Announced (TBA) market and obtain pricing that is competitive to larger lenders. However, as noted in the RFI, it is likely that small lenders will need to use aggregators or increase their loan warehouse to sell the volumes required by the Enterprises. This will result in small lenders being less competitive in the market due to inferior pricing and/or larger hedging costs. Small lenders need to have the ability to competitively sell loans directly to the Enterprises or to sell smaller security blocks (like Ginnie Mae II) that aggregate into a larger marketable security. We would recommend the Enterprises consider establishing a similar program as Ginnie Mae II for small lenders. This would be a more cost-effective and efficient way for small lenders to pool securities for sale.

C. *Guarantee Fee Impacts and Tradeoffs*

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?

As noted in section C of the RFI, the guarantee fee components are made up of credit quality and other market factors. For credit risk transfer transactions, the FHFA should analyze the guarantee fee information it collects to establish a minimum fee target range that will compensate FHFA for the unexpected and catastrophic losses along with minimal administrative costs. No additional guarantee fee should be levied on lenders, since lenders will be required to retain the front-end credit risk transfer.

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?

Similar to Ginnie Mae, which transfers virtually all credit risk to government insurers and has a constant, known guarantee fee, the FHFA should take a long-term view of setting guarantee fees. Currently, changes to the guarantee fee and factors such as the Enterprises Loan Level Price Adjustors result in higher costs to borrowers as lenders incorporate the changes into pricing and hedging practices. Similarly, frequent changes to guarantee fees will cause increased volatility to markets and negatively affect borrowers' access to credit as lenders build in increased margins to cover for the uncertainty of the guarantee fee. In addition, FHFA could consider rewarding lower

than anticipated losses with a rebate of the guarantee fee. The rebate could be added to the lender's collateral account as an alternative way of rewarding lenders for achieving better than anticipated loss results.

In closing, Alaska USA is concerned by the potential consequences of the front-end credit risk transfer on small lenders. Front-end credit risk transfer will decrease liquidity in the housing market, limit the ability of small lenders to sell loans to the GSEs, increase cost-of-home ownership, and reduce the ability of borrowers to access credit. The best way to meet the goals outlined in section II, Principles of Credit Risk Transfer, is to test PMI and determine if there is an appetite by these insurers to underwrite this additional risk that will be shifted to lenders. Using PMI gives lenders of all sizes and structures the best possibility of attaining an equal playing field for all lenders, reducing taxpayer risk, increasing counterparty strength, and meeting the other goals outlined in the RFI. Lenders should be given sufficient lead time to implement the final front-end credit risk transfer requirements after it has been thoroughly tested.

Thank you again for this opportunity to comment. Please contact me at (907) 375-3948 if you have any questions.

Sincerely,

Steven Larson
Senior Vice President,
Mortgage Finance and Servicing