Office of the President

July 28, 2014

Mr. Melvin L. Watt, Director
Federal Housing Finance Agency
c/o The Office of Policy Analysis and Research
400 Seventh Street, SW, Ninth Floor
Washington, DC 20024

Re: Fannie Mae and Freddie Mac Guarantee Fees – Industry Input on Policy and Implementation

Dear Mr. Watt:

Navy Federal Credit Union ("Navy Federal") appreciates the opportunity to provide our comments to your request for industry input concerning the policy and implementation issues associated with the guarantee fees ("g-fees") charged by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (together, the "Enterprises").

By way of background, Navy Federal is the nation's largest natural person credit union with more than $60 billion in assets, over 5.1 million members, 248 branches, and a workforce of over 11,000 employees worldwide. We are committed to serving the needs and improving the financial condition of our members.

Navy Federal understands that, as the Enterprises' conservator, the legal authority of the Federal Housing Finance Agency ("FHFA") to direct certain guarantee fee increases is pursuant to the Housing and Economic Recovery Act of 2008 (HERA). Further, the FHFA has pursued previous increases for the following reasons: safety and soundness concerns related to the underpricing of mortgage credit risk observed prior to the financial crisis; equalizing g-fees among lenders of different sizes; and attracting private capital.

As you know, in December of 2013, the FHFA proposed an increase in the base g-fee; an adjustment in the upfront g-fees charged to borrowers in different risk categories; and the elimination of the twenty-five (25) basis-point Adverse Market Charge for all but four states. Earlier this year, under your leadership, the FHFA suspended the implementation of these changes pending a thorough review of their potential consequences. We applaud your deliberative and reflective approach to the question of whether to increase g-fees.

Navy Federal believes FHFA's primary goal should be to set g-fees at levels to ensure credit risk is adequately covered; that is, the fees should cover the risk related to the timely payment of principal and interest to investors in Mortgage-Backed Securities (MBS) if

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borrowers fail to make payments of the underlying mortgages. The fees should not provide a positive return on capital to the Enterprises, or to the FHFA. Additionally, excessive fees may have the effect of delaying further the housing recovery.

FHFA's Request for Industry Input: Questions Related to Guarantee Fee Policy and Implementation

The FHFA seeks input from industry participants on certain questions associated with the policy and implementation of g-fees. Based on our experience as a seller of mortgage loans to both Fannie Mae and Freddie Mac, Navy Federal's responses to these questions follow:

1. Are there factors other than those described in section III – expected losses, unexpected losses, and general and administrative expenses that FHFA and the Enterprises should consider in setting g-fees? What goals should FHFA further in setting g-fees?

RESPONSE: FHFA should also consider the future role of the Enterprises in supporting the mortgage market, particularly whether to maintain, expand, or contract their role. If the plan is to contract over the next five to ten years, then the need to generate higher target returns on capital is questionable.

2. Risk to the Enterprises increases if the proportion of higher-risk loans increases relative to the proportion of lower-risk loans. This change in mix can occur if lower-risk loans are retained on bank balance sheets instead of being sold to the Enterprises, if more higher-risk loans are sold to the Enterprises, or if the overall mix of originated loans changes. What alternatives, other than risk-based pricing, should be considered? What are the pros and cons of each alternative?

RESPONSE: No comment.

3. Currently, target return on capital and the amount of capital largely determine required g-fees. What factors should FHFA and the Enterprises consider in setting target return on capital and amount of capital required? How should the Enterprises allocate capital across risk buckets?

RESPONSE: The analysis in Figure 3 (FHFA Announcement, June 5, 2014, Page 7. "*Credit and LTV Breakdown, 1st Quarter 2014*") indicates 4 of the 9 risk buckets currently have a positive spread. Further, although the remaining buckets have a negative spread, FHFA notes that none are experiencing losses. Rather, the return on capital is positive, just less than the targeted return. This analysis indicates g-fees could be lowered. FHFA should not target returns greater than those necessary to cover the associated risk. Additionally, as noted in the response to Question #1, if the plan is to contract the Enterprises, the need for higher target returns is questionable.

4. At what g-fee level would private-label securities (PLS) investors find it profitable to enter the market or would depository institutions be willing to use their own balance sheets to hold loans? Are these levels the same? Is it desirable to set g-fees at PLS or depository price levels to shrink the Enterprises' footprints, even if this causes g-fees to be set higher than required to compensate taxpayers for bearing mortgage credit risk and results in higher costs to borrowers?

RESPONSE: Currently, g-fees are at a level where we are willing to hold mortgages on our balance sheet. We believe this level is likely to differ by institution/investor. It is not desirable to set g-fees at levels which shrink the Enterprises' foot print, as borrowers will be harmed due to higher rates, which could jeopardize the housing market recovery. Rather, alternative means to incentivize private-label issuance should be pursued.

5. If the Enterprises continue to raise g-fees, will overall loan originations decrease? That is, will Enterprise loans decline without a commensurate increase in private capital?

RESPONSE: If g-fees continue to increase, originations will decrease. Every price increase, whether related to fees, or market factors, "prices out" potential borrowers. Looking at the proposed Loan-Level Pricing grids indicates that higher loan-to-value (LTV) borrowers will be the most affected. Since a significant percentage of first time homeowners fall in the high LTV range, these borrowers will feel the largest impact. Finally, the effects of excessive g-fees may further slow the housing recovery.

6. Is it desirable for the Enterprises to charge higher g-fees on low credit score/high LTV loans if it causes these loans to be insured/securitized through FHA/Ginnie Mae rather than through the Enterprises?

RESPONSE: Yes, the combination of higher LTVs and credit scores increase risk, and FHA/Ginnie Mae is a viable option for these borrowers; however, the proposed pricing grids raise these fees to excessive levels (see our Response to Questions 3 & 5 above).

7. Is it desirable for the Enterprises to (a) charge higher g-fees on high credit score/low LTV loans if it causes these loans to be insured / securitized through PLS or (b) held on depository balance sheets, rather than guaranteed by the Enterprises?

RESPONSE: No, the additional cost will price some borrowers out of the market. Additionally, many depository institutions don't have the balance sheet capacity to add long-term fixed rate loans. Finally, the Private Label Security market is likely to be dominated by big banks, which put small and mid-sized lenders at a disadvantage.

8. What approaches or alternatives should FHFA consider in balancing increased use of risk-based pricing with the HERA mission requirements of (1) liquid national housing markets and (2) acceptability of lower returns on loans made for low- and moderate-income housing?

RESPONSE: The Enterprises could support the housing market recovery through pricing incentives for particular targeted groups such as first-time homebuyers.

9. Are the ranges of credit score and LTV cells in the proposed credit score/LTV grids used to set upfront delivery-fees and loan level pricing adjustments appropriate? Should any of the ranges be broader or narrower and, if so, why?

RESPONSE: No comment.

10. Should risk-based pricing be uniform across the Enterprises or should each Enterprise manage its own pricing?

RESPONSE: Each agency should set risk-based pricing based on their organization's modeling assumptions, risk appetite, and desired returns. Such a strategy will preserve a competitive environment to better support the housing market recovery.

11. Taking into consideration that FHFA has previously received input on state-level pricing adjustments, do the g-fee changes proposed in December 2013 have any additional implications that should be considered in deciding whether to price for the length of state foreclosure timelines, unable to market periods or eviction timelines? Are there interactions with other pricing components under consideration that FHFA should consider in making decisions on the state-level adjustments?

RESPONSE: State-level pricing adjustments increase operational complexity. This is particularly true for national lenders. Setting fees to overall risk is preferred to state-level pricing, which could potentially harm the housing market recovery in the states impacted.

12. Are there interactions with the Consumer Financial Protection Bureau's Qualified Mortgage definition that FHFA should consider in determining g-fee changes?

RESPONSE: Typically, there are two ways to price g-fees into the loan.

a) An up-front fee, in this case, can be charged to borrowers, and count toward the 3% cap on points and fees. As a result, fewer loans will be considered qualified mortgages.
b) The fees can be priced into the interest rate. In this scenario, the higher rate results in additional loans being designated as high priced loans, which are not considered qualified mortgages.

In either case, higher fees may restrict the availability of credit, as some lenders may opt not to offer non-qualified mortgages.

In closing, Navy Federal appreciates the FHFA's efforts to address the concerns of credit unions and its members with loans that are eligible for purchase or securitization by the Enterprises. We look forward to continuing to work with the FHFA to craft reasoned approaches for a sustainable mortgage market in the years to come.

Should you or a member of your staff have additional questions about our responses, please contact Carmelo Bramante, Senior Analyst & Compliance Officer, at (703) 206-3263.

Sincerely,

Cutler Dawson
President/CEO

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