Mortgage Insurance Companies of America

Suzanne C. Hutchinson
Executive Vice President

August 31, 2009

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attention: Public Comments/RIN 2590-AA17

Ladies and Gentlemen:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the interim final rule (IFR) recently promulgated by the Federal Housing Finance Agency (FHFA) addressing new products and activities in which Fannie Mae and Freddie Mac seek to engage.[1] MICA is appreciative that FHFA has taken up the issue of new-product approval as a priority despite the fact that the Housing and Economic Recovery Act (HERA)[2] includes no deadline for action on any rule in this area. We concur that new products can be a source of significant risk from both a safety-and-soundness and mission perspective. However, it is precisely because we think the issue so important that we urge FHFA to withdraw the IFR, which is not to our knowledge required due to any emergency beyond the general conditions that have already led FHFA to place the government-sponsored enterprises (GSEs) into conservatorship. As such, Fannie Mae and Freddie Mac can take no substantive action without FHFA approval, which should ensure that no risky new ventures are commenced until an orderly process is put in place following a deliberative rule-making process. Further, the GSEs have undertaken an array of significant new ventures in recent months without application of the procedures in the IFR, making clear that housing market needs can and will be met during an orderly rulemaking.

Based on this, MICA will detail the following points in this comment letter:

- The IFR should be withdrawn and replaced with a notice of proposed rulemaking (NPR) subject to careful consideration by FHFA before final action. We recognize that FHFA believed that an emergency warranted waiving the usual requirements of the Administrative Procedure Act (APA)[3]

[1] Prior Approval for Enterprise Products, 74 Fed. Reg. 31,602 (July 2, 2009).
[2] Housing and Economic Recovery Act, Pub. L. No. 110-289, 122 Stat. 2654 (2008).
[3] Administrative Procedure Act, Pub. L. No. 79-404, 60 Stat. 238 (1946).

1425 K Street, NW
Suite 210
Washington, DC 20005
(202) 682-2683
Fax (202) 842-9252

with regard to this rule, but we do not believe any such emergency exists in light of the GSEs' conservatorship. In the absence of any demonstrable emergency related to products and activities, the law in fact requires a deliberative rulemaking process that should be followed in this case.

- Should any of the GSEs contemplate a venture which FHFA believes urgent on which the agency would like public comment, MICA knows of no statutory impediment to issuing a request for public comment. FHFA has allowed Fannie Mae and Freddie Mac to engage in numerous new products in recent months, making clear that the absence of a rule during the conservatorship does not stifle innovation or threaten the mortgage market.

- The IFR is not in compliance with Congressional directives that the rulemaking be as consistent as possible with those of the federal banking agencies. The banking agencies have a long history of seeking public comment on any product or activity that raises policy or statutory questions. In light of the far less defined statutory context for GSE ventures, FHFA should follow the banking agencies' practice with regard to any product for which there is no clear statutory authority, which would mean advance public notice and comment. FHFA should use its authority not only to improve the new product process, but also to make public any activity for which a GSE files a prior notice. This post hoc disclosure process is comparable to the one used by the Federal Reserve Board (FRB) and Office of the Comptroller of the Currency (OCC) for public notice of any variations in regulatory decisions specific to individual institutions that affect new ventures. Transparent markets ensure prudent operations without undue competitive favor to one or another GSE or the GSEs at the expense of private firms.

- The IFR's process is over-broad. This could lead FHFA to assume that high-risk ventures are, as represented by a GSE, only "activities" that do not warrant public notice and comment. FHFA should err on the side of issuing proposed ventures for public comment to ensure that its decision-making is fully informed with regard to the prudential, mission, macroeconomic and competitiveness issues Congress has directed it to consider.

- FHFA premises its broad rule on grounds that there is no way to define "new product" or differentiate it from "new activity." To meet Congress' goal of a sound prudential review, FHFA can in fact define "new product" on prudential grounds. For example, FHFA could require that any venture where an internal risk management review or FHFA determines that revised risk management steps and/or additional capital are appropriate, should be deemed a new product for purposes of public notice and comment. Risk determinations should ensure full consideration of credit, market, operational, interest rate, concentration, legal and reputational risk. This process will ensure that only prudent new products in compliance with the Enterprises' charter acts that take ample, advance notice of consumer protection are offered.

- Nothing in the new product process is unduly burdensome. The statutory comment deadlines are very short and the process very efficient.

Finally, MICA would note that it is even more critical than ever that FHFA provide public notice and comment on all but the most minor variations in prior GSE activities. Fannie Mae and Freddie Mac have long had oligopoly power in the U.S. mortgage market – if they get into a business line, private competitors have generally been forced to exit it, as clearly evident by the complete absence of a private market for conventional, conforming mortgage securitization. With now the absence even of a private-label mortgage securitization market, Fannie Mae and Freddie Mac, together with the Federal Housing Administration, essentially control U S. residential finance. Should the GSEs engage in a new venture, private competitors will quickly come under so much pricing and similar pressure that GSE products will almost surely dominate the market and the potential exposure to the GSEs will quickly become material. If these products are not well considered from a prudential, borrower-protection and market-recovery point of view, irreversible harm could be quickly felt throughout a very fragile mortgage market.

Indeed, the conservatorship sharply heightens the risk that GSE products will dominate the mortgage market at risk both to borrowers and the GSEs. With the Treasury Department's $400 billion GSE backstop, U.S. taxpayers are at direct risk for any GSE venture that goes awry even as whatever market discipline that ever constrained the GSEs has evaporated. If these new products are risky or fail to serve the needs of mortgage borrowers – especially under current, highly-stressed conditions – mortgage-market liquidity or solvency could be

immediately threatened, giving FHFA little – if any – time to correct the problem.

The IFR Violates the Administrative Procedure Act

In the interim final rule, FHFA notes that:

> The notice and comment procedure required by the Administrative Procedure Act is inapplicable to this interim final regulation because it is in the public interest to implement section 1123 of HERA that amends section 1321 of the Safety and Soundness Act (12 U.S.C. 4541) immediately. *See* 5 U.S.C. 553(b)(B). The regulation facilitates the Enterprises' continued ability to meet their public mission in conservatorship, enabling them to contribute to combating the continuing deterioration and volatility of the residential mortgage market.[4]

MICA would respectfully disagree with this analysis. The urgent need within the conservatorship is not to bring new products to market, with the possible exception of those intended to prevent mortgage foreclosures which we shall discuss below. Rather, the critical decisions FHFA and the GSEs now confront are how to minimize their call upon the Treasury and restore their organizations to a viable condition that will permit consideration of emergence from conservatorship. The magnitude of the GSEs' problems makes any new venture likely to have, at best, minimal impact on this urgent question, obviating the applicability of the exceptions provided in the APA.

Indeed, MICA believes that the APA does not permit FHFA to bypass an orderly rulemaking. The law provides only three exceptions to an NPR: when doing so is "impracticable," "unnecessary" and, thus not in the "public interest."[5] Legislative history makes clear that "impracticable" means that an agency may not fulfill its mission without an emergency action and "unnecessary" means that the public has no interest in an action (e.g., a technical edit revising a minor aspect of a regulation).[6] The "public interest" exemption applies only if an agency finds that it is not in the public interest to issue a proposal because it is both impracticable and unnecessary to issue an NPR.[7] Court cases have historically taken a very narrow view of these

---

[4] *See* 74 Fed. Reg. 31,602, at 31,604.
[5] *See* 5 U.S.C. § 553(b)(3)(B) (1946).
[6] S. REP. NO. 79-752, at 199-201 (1945).
[7] *Id.*

exceptions and required regulators to issue rules other than under demonstrable emergencies or in compliance with express statutory requirements.[8] None of these exceptions applies to new products nor, as noted, does FHFA need to issue the IFR to deal with any ventures GSEs may propose during the interval until a final rule is adopted.

Indeed, to promote the public-interest goals FHFA espouses – preventing worsening and/or more volatile mortgage markets – it is vital that FHFA carefully consider any new GSE ventures. As noted, Fannie Mae and Freddie Mac almost single-handedly now determine who gets a residential mortgage at what interest rate and cost. Any products that do not take the full array of prudential, mission, charter and market concerns dictated by HERA into account could have immediate adverse consequences.

FHFA Can Address New Products without the Unnecessary Haste of the IFR

Further, MICA would note that there is no emergency need for the IFR because FHFA has numerous ways with which to address any new GSE product it believes must be quickly brought to market to address the current emergency. Indeed, FHFA has already allowed the GSEs to purchase refinanced loans with loan-to-value (LTV) ratios first of 105 percent and then up to 125 percent without any prior public notice or comment.[9] It did so to promote the Administration's Making Home Affordable Program. The GSEs immediately implemented these new LTV powers and have since purchased 1.9 million loans designed to prevent foreclosure, making clear that no public interest exists that warrants bypassing careful rulemaking deliberations as required by the APA to meet any immediate concerns in areas such as foreclosure prevention and loan modification.

At any point FHFA deems that a new product is essential to improving the mortgage market or alleviating borrower foreclosure risk, it has full authority under current law to authorize the product. HERA does not address the manner in which new products may be offered by the GSEs until the requisite rulemaking is in place and the

---

[8] *See* NRDC v. Evans, 316 F.3d 904, 911 (9th Cir. 2003) (holding APA notice and comment procedures should be waived only when delay would cause real harm), Riverbend Farms v. Madigan, 958 F.2d 1479, 1484 (9th Cir. 1992) (holding good cause exceptions only apply when compliance would interfere with an agency's ability to carry out its mission), U.S. Steel v. EPA, 595 F.2d 207, 214 (5th Cir. 1979) (holding APA exceptions should be narrowly construed and not used to circumvent notice and comment requirements based on agency convenience).

[9] Press Release, Federal Housing Finance Agency, FHFA Authorizes Fannie Mae and Freddie Mac to Expand Home Affordable Refinance Program to 125 Percent Loan-to-Value (July 1, 2009).

lack of a deadline for it indicates that Congress clearly understood that there would be a delay – possibly a long one – between enactment and a final rule. While HERA of course addresses the prospect of a conservatorship, it was premised on ongoing GSEs in their longstanding public-private structure – a structure that made it more than likely that one or both GSEs would continue to bring new products to market until a final rule was effective. Nothing in HERA directly or indirectly blocks new GSE products at any time before FHFA promulgates a final rule, thus eliminating any urgent need for this IFR.

The IFR Contradicts Congressional Intent on Process

As FHFA has often said, the goal of HERA was to establish a "world-class regulator" for the housing GSEs. To that end, Congress determined that the prior process used by the Department of Housing and Urban Development (HUD)[10] was insufficient, transferring new product authority to FHFA to ensure appropriate consideration of prudential, charter and market-impact considerations. As it did so, Congress urged FHFA to model its new product review process on that used by the federal banking agencies. See, for example, the report on the legislation by the House Financial Services Committee, which states:

> The Committee intends that the Agency will look to similar processes developed by the federal bank regulatory agencies in establishing procedures to minimize unnecessary burden on the enterprises and originating institutions while fulfilling the objectives of the provision.[11]

To ensure that FHFA processes in fact are modeled after those of the federal banking agencies with both burden-reduction and safety-and-soundness protections, MICA recommends review of the new-product procedures long employed by the FRB and the OCC. Those of the Federal Deposit Insurance Corporation (FDIC) are not as instructive because the FDIC directly supervises only state-chartered, non-member banks, where activity approval is generally the responsibility of state, not federal, regulators (although federal law of course imposes limits on activities states may approve).

The processes of the FRB and OCC differ, but each is considerably more transparent than the process included in the IFR. Both agencies publish for advance public comment any product that is

---

[10] Federal Housing Enterprises Financial Safety and Soundness Act, Pub. L. No. 102-550, 106 Stat. 3672 (1992).
[11] H.R. REP. NO. 110-142, at 91-92 (2007).

substantively different than previously approved activities, doing so despite the clear delineation in federal law for the activities authorized for bank holding companies[12] and national banks.[13] Both of the agencies then carefully consider public comments, with the FRB from time to time even holding public meetings to discuss the merits of new ventures for bank holding companies. Both agencies also publish announcements of any minor variations on previously approved products in interpretive letters made public on a monthly basis, ensuring a transparent process in which all interested parties know of even small differences in bank products that could raise policy, competitiveness or consumer protection concerns.

To be sure, the FHFA cannot simply follow the procedures used by the FRB and OCC in establishing a new product approval process because of the express directions given to it in HERA.[14] However, the transparent, complete nature of bank regulatory consideration of new ventures creates the precedent Congress intended FHFA to track in its procedure, with clear delineation of how new products are defined and full prior public notice and comment for any and all ventures that raise prudential, consumer protection, mission or market integrity considerations. Indeed, if Congress had not intended so careful a process, it would not have listed these and all the other criteria FHFA is required to consider for new products in the new law. There is simply no way for FHFA to give adequate consideration to all the factors without a transparent, deliberative process, which the IFR does not provide.

The IFR Also Violates Congressional Intent on Content

In the IFR, FHFA has determined that there is simply no way to define a new product, thus setting up a process in which it will review GSE activities and decide on a case-by-case basis which activities may trigger public notice and comment under the new-product procedures stipulated in HERA. Specifically, FHFA notes that:

> FHFA concludes that the determination whether a new activity is a new product in specific instances is committed to agency discretion by law. The agency does not believe that it is practical to require an Enterprise to identify a new product – as distinct from a new activity that is not a product – in advance for

[12] 12 U.S.C. § 1843 (2009).
[13] 12 U.S.C. §§ 81-92 (2009).
[14] *See* Pub. L. No. 110-289, at §1123.

> purposes of determining which type of submission to make to the agency.[15]

As detailed below, MICA respectfully disagrees. We believe that it is indeed feasible to define by rule which activities are new products and that it is essential to do so to meet Congressional intent with regard to the overall purpose of this provision. We urge FHFA to adopt such a clear, up-front definition to guide the new product process. Without one, the GSEs will have no guidance as to what activities may trigger new product review, significantly complicating their strategic planning and subjecting them to a potentially idiosyncratic process based on which FHFA officials may review what activity filing when. This process is most uncertain, as the law permits FHFA at any time subsequent to new activity review to alter its judgment and withdraw authority for any such venture. It also creates significant potential for variations on similar requests from each of the GSEs, resulting in unnecessary competitive problems for Fannie Mae and Freddie Mac. The bank regulators have the open, transparent process detailed above in part to ensure that no bank is secretly allowed a venture about which others in the industry do not know. In light of the GSEs' huge market clout, it is especially vital that FHFA establish a transparent, certain process based on a clear definition of covered new products.

MICA recommends that FHFA adopt the following definition for any activity that will be deemed a new product:

> A new product is any activity, offering, service or venture that could increase the risk incurred by an Enterprise, or that requires revisions to an Enterprise risk management procedure as determined either by the Enterprise or by the Agency upon review of the notice provided by an Enterprise. In determining whether an activity, offering, service or venture is a new product the Enterprise shall take into account credit, interest rate, operational, market, concentration, compliance, strategic, legal and reputational risk. Any activity that requires a revision to an Enterprise's regulatory capital, by applicable FHFA rule, by order from the Agency and/or as reflected in internal Enterprise economic capital allocation models, shall also be deemed a new product. In considering these risks, the Enterprises shall take particular care to review legal risk, and any activity that requires a legal opinion (whether by inside or outside counsel) to assess the authorization for the product under the Enterprise's charter or other

[15] *See* 74 Fed. Reg. 31,602, at 31,603.

governing law shall be deemed a new product. The Enterprises shall also carefully consider reputational risk and housing market risk, and the Agency shall deem any activity that may, as required by law or as determined by the Enterprise and/or the FHFA, require enhanced consumer disclosures, revised documentation or other borrower protections to be a new product.

This definition ensures full consideration of prudential, charter and consumer protection considerations. It does not in any way bar any product, but ensures that any and all that are identified by an Enterprise or the Agency as raising risk management, charter or public interest questions are fully vetted and evaluated through the public notice and comment process stipulated in HERA.

Nothing in an Orderly, Delineated Process Impedes Innovation

The new product definition would, MICA believes, create a clear template focused on critical issues to ensure full consideration of any potentially problematic new venture. Nothing in it would result in undue delay for any GSE product offering. As FHFA detailed in the IFR, HERA includes a very rapid process for consideration of any and all new products. Public notice must be filed almost immediately upon receipt by a GSE of a request for entry into a new product and the comment period may be no more than thirty days. Should FHFA fail to act promptly after the completion of the comment period, a GSE may bring a new product to market without further delay. The law also establishes a process for temporary approval of any new product FHFA determines is required to meet "exigent" market circumstances.

Conclusion

For all of the reasons detailed above, MICA urges FHFA to withdraw the IFR and replace it with an NPR that includes a clear definition of new products as provided above. We believe a new-product definition will provide both the GSEs and the mortgage market with greater certainty about which ventures will trigger FHFA and public review, reducing long-term legal and reputational risk for the GSEs and prudential or borrower-protection risks for the broader market. There is no emergency warranting circumvention of an orderly NPR process that leads to a final rule providing both the GSEs and market participants with certainty about how FHFA will consider new products, as FHFA has full authority – used earlier this year – to allow the GSEs to engage in even the most dramatic departures from prior activities without public notice and comment in the absence of a final rule. Indeed, due to this existing FHFA authority and its actions

pursuant to it, the IFR violates the Administrative Procedure Act because no emergency creates a public interest that warrants bypassing the orderly rulemaking process dictated by law.

MICA would be pleased to provide more detail or otherwise assist the FHFA as it considers this issue and moves forward with a new NPR.

Sincerely,

Suzanne C. Hutchinson