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Comment Letter - Enterprise Regulatory Capital Framework
12 CFR Part 1750 RIN 2590-AA95

The Community Home Lenders Association (CHLA) is pleased to submit this comment letter in response to FHFA's re-proposed capital rule for Fannie Mae and Freddie Mac (the "GSEs"). CHLA commends FHFA for moving forward on a capital rule - which, along with FHFA's recent action to retain advisors to help them develop plans to raise GSE capital, are essential elements in ending the GSEs' conservatorship.

CHLA has long been a strong proponent of the GSEs having substantial capital - including being an early and vocal opponent of ending the PSPA profit sweep that arbitrarily interfered with that objective.

Commentators have raised concerns about capital levels in the proposed rule, arguing that: (1) they exceed worst case loss scenarios developed by the Federal Reserve, (2) capital levels should reflect the fact that the GSEs are more like insurance companies than banks, and (3) higher capital levels could raise mortgage rates by 15 to 25 basis points. These are valid concerns and CHLA urges FHFA to take them into account in establishing the final rule, balancing the objectives of access to mortgage credit and taxpayer protection.

One specific recommendation CHLA would make for this proposed rule is to allow G Fee reserves to be counted toward regulatory capital, as is commonly permitted for other financial entities.

Finally, CHLA notes that the 2011 statutory provision charging 10 basis points to GSE borrowers to fund non-housing spending or reduce federal deficits is scheduled to expire next year. CHLA strongly opposes any extension of this provision. **ALL** G Fees should be used only for housing, which includes helping to build capital to meet the capital requirements that will be adopted pursuant to a final GSE capital rule.

However, *HOW* the GSEs emerge from conservatorship is just as important as their capital levels. There are many issues that hang in the balance that are critically important to small lenders and the consumers they serve. Following are CHLA priorities to protect smaller mortgage lenders:

1. **G Fee Parity – not just for Cash Window pricing but for all GSE pricing and policies, to protect smaller mortgage lenders and to maximize competition and access to mortgage credit for consumers.**

2. **A True Utility Model – that maintains the GSEs' focus on their primary role of creating an equitable securitization conduit for all lenders and limits excessive risk taking or charging of excessive fees.**

3. **No New Charters – to prevent vertical integration, to limit taxpayer risk, to avoid re-enforcing pro-cyclical forces, and to prevent cherry picking of loans by borrower, credit quality, or geography.**

4. **Balanced Risk-sharing Policies - to promote market discipline and reduce risk, with a prohibition against front-end risk sharing which could create a choke point on GSE mortgage loan origination.**

5. **An Explicit Government Guarantee – with the GSEs paying for the cost of that guarantee.**

6. **Full Transparency, Some Advocacy Restrictions – to promote public confidence that Fannie and Freddie are using their government guarantee to serve the public interest and to protect taxpayers.**

G Fee Parity: Preserving a Level Playing Field for Mortgage Lending

An important factor contributing to the financial losses and conservatorship of Fannie Mae and Freddie Mac in 2008 was their widespread practice of preferential pricing for the largest – and riskiest - mortgage loan originators, such as Countrywide and WAMU. This generally took the form of volume discounts on Guarantee Fees (G Fees) for these lenders – which hurt smaller lenders and the customers they served.

CHLA strongly commends FHFA for its current policy of parity with respect to G Fees - prohibiting Fannie or Freddie from pricing discrimination based on a lender's size or GSE loan volume.

However, this policy is not based in statute or regulation, and could change with the next FHFA Director. Thus, action is needed to make G Fee parity permanent – particularly after the GSEs leave conservatorship to become private entities that could be incentivized (or bullied) into returning to volume discounts.

The Administration's September 2019 *"Housing Reform Plan"* released by the Department of Treasury provides a roadmap on how to achieve this. That Plan recommends that the Preferred Stock Purchase Agreements (PSPAs) could be amended to accomplish certain policies after Fannie Mae and Freddie Mac are recapitalized and leave conservatorship – including a provision to *"require each GSE to maintain a nationwide cash window and provide equitable secondary market access to all lenders."*

CHLA has previously written FHFA to support this approach. This policy could also be achieved in other ways, such as FHFA requiring this by regulation or by inclusion in any consent decree that is established.

Such policy should include a prohibition against **ANY** pricing discrimination (including proxies for this) based on a lender's size or loan volume. This should apply not just to cash window G Fee pricing, but also to pricing under buy-up/buy-down grids in securitization transactions.

A uniform, non-discriminatory pricing policy should also apply to private mortgage insurance (PMI) in conjunction with Fannie Mae or Freddie Mac loans. Federal statute requires mortgage insurance on GSE loans over 80% loan-to-value (LTV). PMI pricing, whether lender-paid or borrower-paid, is an integral part of the underlying loan pricing that the consumer receives. Thus, the impact of MI volume discounts is the same as with GSE pricing. Without this protection, consumers that choose to obtain a GSE mortgage through a local community-based smaller lender could be discriminated against.

Finally, parity and non-discrimination based on lender size or volume should extend not just to loan pricing but also to other GSE policies - including the granting of DU/LP waivers, repurchase policies, and the use of pilot programs that are limited only a few lenders. The principal is the same: discrimination based on size or volume is bad for competition, bad for small lenders, and bad for consumers they serve.

A True Utility Model: Maintaining GSEs' Securitization Conduit Role

There is currently broad support for a so-called "Utility Model" for Fannie Mae and Freddie Mac, post-conservatorship. However, commentators use this phrase to mean widely different regulatory models.

CHLA believes a true Utility Model for Fannie and Freddie, should be structured to achieve the primary policy goals of providing a competitive, equitable secondary market securitization outlet for **all** mortgage lenders and balancing goals of access to mortgage credit and limiting excessive risk to protect taxpayers.

CHLA does not support giving FHFA detailed rate setting authority over GSE pricing in the same manner in which utilities have commonly been regulated by utility commissions. However, FHFA should continue to exercise authority it currently uses to ensure that G Fee levels are appropriate. This is explained in a Committee for Responsible Lending March 2020 paper entitled "Treat Fannie and Freddie as Utilities." That paper, which makes a strong argument for a Utility Model for Fannie and Freddie, notes that:

“Today, FHFA establishes a target bank for the GSEs’ overall implied ROE, in combination with FHFA’s capital standard, and routinely reviews GSE returns to determine whether guarantee fees charged to lenders are at an appropriate level.”

Additionally, in order to carry out a true Utility Model that balances mortgage access to credit and taxpayer protection objectives, FHFA should have the authority, both during a recapitalization period and post-conservatorship, to:

* Limit excessive risk taking with respect to credit risk on mortgage loans.
* Prohibit new products which do not serve the GSE’s essential charter objectives.
* Limit portfolio holdings to constrain interest rate risk to acceptable levels.
* Prevent excessive pricing that might otherwise be enabled as a result of their duopoly charter status.
* Enforce Housing Goals and Duty to Serve, to ensure the federal guarantee is used to serve low- and moderate, minority, and underserved borrowers, geographical areas, and markets.

Some of these authorities are clearly covered by the GSEs’ charter and some are not or are ambiguous. Ideally, Congress would adopt legislation to explicitly give FHFA these regulatory authorities and to clarify its policy goals and expectations. However, the last 12 years have demonstrated that we cannot wait for Congress to act to move forward on GSE recapitalization and exit from conservatorship. The 2008 HERA law and other statutory provisions give FHFA broad authority to take these actions.

Therefore, until Congress acts, the bullet point authorities identified above should be made explicit and more permanent by administrative action, through whatever vehicle is appropriate or available – including:

(1) FHFA incorporating them into regulations,
(2) adoption in the GSEs’ capital restoration plans,
(3) inclusion in any consent decreed that is established for the GSEs, and/or
(4) amending the Preferred Stock Purchase Agreements.

No New Charters: No Vertical Integration, Protecting Taxpayers

Neither Congress (nor FHFA through some backdoor action) should charter **any** new GSE guarantors.

More GSE charters is contradictory to a true Utility Model. The proliferation of more GSE-type guarantors would divert the GSE function from its primary role of providing a securitization conduit for lenders. CHLA agrees that competition is a worthy objective - but it should take place at the loan origination level with lenders competing on service and pricing, at the risk sharing level as back-end risk sharing, and at the PMI level for loans above 80% LTV.

More GSE charters is bad for smaller lenders. At a Senate Banking Committee GSE hearing in July 2017, all six organizations representing small lenders (including CHLA) testified AGAINST authorizing new GSE charters. The small lender panelists explained that more GSE charters would create opportunities for vertical integration by the large Wall Street banks, which could use their investment banking affiliate’s dominant position in the secondary market to gain an unfair advantage in the primary origination market (or use their GSE charter exclusively to serve only their own bank customers).

More GSE charters is bad for consumers. Since more GSE charters would hurt smaller lenders, by extension it would hurt the customers they serve. More broadly, the proliferation of charters would create strong economic incentives for these new guarantor entrants to cherry pick only the highest credit quality borrowers and loans, while ignoring underserved borrowers, underserved markets, and underserved areas. Arguably it is hard to envision entities seeking a new guarantor charter to compete against Fannie and Freddie without having this this goal in mind. Additionally, while housing goals and Duty to Serve are intended to prevent this from happening, they would be much harder to enforce with multiple guarantors.

More GSE charters is bad for taxpayers. A proliferation of new guarantors under the guise of "competition" could lead to a race to the bottom, with guarantors seeking out increasingly risky loans – or engaging in lending practices that are pro-cyclical, thus heightening overall market risk.

In particular, giving GSE charters to large Too-Big-To-Fail (TBTF) institutions, particularly entities affiliated with FDIC-insured banks, would grow the risk of a taxpayer bailout similar to what we experienced with TARP. By necessity, it would also expand the scope, cost, and burden of regulators in monitoring both financial safety and mortgage market conduct of numerous new guarantors.

The issue of whether to charter multiple guarantors is covered extensively in a February 2019 publication by the National Association of Realtors entitled "Working Paper: NAR's Vision for Housing Finance Reform." The paper raises concerns about different proposals for multiple guarantors, noting that:

- ***". . . history shows that competition among guarantors is the problem—not the solution."***
- ***"One major concern regarding a multi-guarantor system is that the plurality of entities would damage the very foundation of the TBA system."***
- ***"The multi-guarantor structure may also undermine the CRT market."***

Balanced Risk Sharing Policies: With No Front-End Risk Sharing

Risk Sharing is a practice that has been implemented by FHFA using its conservatorship authority. Risk sharing reduces risk to the GSEs (and taxpayers) and it imposes market discipline, since an inability at any time to offload GSE loan risk might indicate undue risk in the loans GSEs are purchasing.

CHLA believes that FHFA policies requiring risk sharing should be balanced. The levels should not be excessive, as that could unnecessarily add to the cost and rates of GSE loans. There should also be a countercyclical aspect to requirements; during an economic crisis, risk sharing should be suspended and during flush times when risk sharing pricing is strong, risk sharing should be used more extensively.

To date, Fannie and Freddie have carried out the great majority of their risk sharing on a back-end basis, i.e. after GSE purchase of the qualified loan. This practice maximizes the pricing obtaining for risk sharing and creates a broad, efficient, and transparent aftermarket for the risk sharing.

The GSEs and FHFA have experimented with up-front risk sharing, where risk sharing is obtained before sale of loans to Fannie and Freddie. However, it is critically important post-conservatorship that Fannie and Freddie do **NOT** use this approach.

Up-front risk sharing could threaten small lender equitable access to Fannie and Freddie, by creating a choke point for sale of loans, compared to ease in which smaller lenders can now sell loans to the cash window or alternatively securitize their loans. If risk sharing becomes an additional condition of selling loans to the GSEs (or if preferential G Fee pricing is provided in such transactions), this would open the door to vertical integration – Wall Street Banks leveraging their risk sharing function to engage in anti-competitive practices, such as exclusively dealing with their bank lending affiliate or engaging in the practice of volume discounts. Indeed, one of the risk sharing deals of this type was with J P Morgan Chase, where the federal guarantee was used on these loans for the exclusive benefit of their bank customers.

Additionally, up-front risk sharing is much more likely to result in the re-aggregation of risk that could result from a small group of institutions or investors doing risk sharing on the front end.

For all these reasons, he simplest and most effective way to achieve the beneficial impacts of risk sharing is to do it as back-end risk sharing, only after loans have been sold to the GSEs.

Explicit Government Guarantee: MBS Guarantee/Line of Credit

There is an almost universal consensus that Congress should enact a federal guarantee on the Mortgage Backed Securities (MBS) of Fannie Mae and Freddie Mac. CHLA concurs with this consensus.

However, the GSEs' exit from conservatorship should **not** be delayed by any Congressional failure to enact such a guarantee. We note that the existing Line of Credit arrangement has worked well in engendering market confidence. CHLA is also confident that once the GSEs are on the road to exiting conservatorship, Congress will feel compelled to adopt legislation to provide an MBS guarantee.

Even if Congress adopts a federal guarantee of GSE MBS, we believe there is also value in maintaining a Treasury Line of Credit. In the event of a crisis in the future, our objective should not just be to ensure that MBS security holders are made whole, but also to ensure that Fannie Mae and Freddie Mac can continue to provide their essential role in facilitating affordable 30-year fixed rate mortgage loans. This is particularly true in a crisis, where their capital may be depleted.

Therefore, instead of dealing with this problem in the middle of a crisis, CHLA believes it is better to have a Line of Credit already established, so Fannie and Freddie have the necessary resources to continue to provide mortgage access to credit in a crisis.

Transparency and Advocacy: To Promote Public Confidence

GSE policies (pricing, new product development, others) should be as transparent as possible – consistent with a Utility Model and a mission of providing a lender securitization outlet.

CHLA appreciates that excessive lobbying efforts played a role in lax financial regulation of Fannie and Freddie leading up to the 2008 housing crisis. Thus, CHLA would support a prohibition against Fannie Mae or Freddie Mac making political contributions or having a PAC. The current ban on lobbying should be revisited, to explore whether some sort of restraints on advocacy can be retained while protecting 1st amendment rights and encouraging the appropriate sharing of information and analysis with Congress.

Sincerely,

COMMUNITY HOME LENDERS ASSOCIATION