May 22, 2024

Federal Housing Finance Agency
400 Seventh Street, SW
Washington, DC 20219

RE: Proposed Enterprise New Product; Comment Request 'Freddie Mac Single-Family Closed-End Second Mortgages' (No. 2024-N-5)

To Whom It May Concern,

SIFMA[1] is pleased to submit comments to FHFA on this proposal by Freddie Mac to begin a second-lien purchase program.[2] New programs and changes to existing programs that have the potential to affect UMBS security performance will be most effectively designed if they can be reviewed and understood by market participants prior to their implementation. In that vein, SIFMA members appreciate the engagement on this new product through the RFI process.

A. Summary of Position

This proposal presents risks to the TBA, CRT, and consumer finance markets, is not necessary given existing private sector solutions, and is inconsistent with the Government Sponsored Enterprises' ("GSE") missions. Sufficient avenues to access home equity are available to mortgage borrowers today through well-functioning private markets and the GSEs' capital can be better deployed in more mission-focused activities. In short, SIFMA believes:

- There is no market failure that the GSEs are best positioned to rectify;

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development.
SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).
[2] The proposal is available here: https://www.federalregister.gov/documents/2024/04/22/2024-08479/freddie-mac-proposed-purchase-of-single-family-closed-end-second-mortgages-comment-request

- The focus of GSE activity should remain closer to their mission; just because they can do something doesn't mean they should; and
- The proposal lacks adequate detail and analysis to understand the potential size, scale, and impacts of the proposed program.

Finally, the letter addresses FHFA's specific questions.

B. There is no market failure that the GSEs are best positioned to rectify

Many mortgage borrowers have accumulated very significant amounts of equity. Today, these borrowers can access this equity though a variety of products in the private markets – including second mortgages, HELOCs, shared equity products, and reverse mortgages.

Pricing of these products is determined by efficient private market forces. Because of the competitive advantages of the GSEs, they will be able to provide aggressive pricing that may be more attractive than private market pricing and dominate the market. Undercutting a well-functioning private market is not a good use of the GSEs' market power. This contrasts with other areas of the mortgage market that would not exist without GSE participation, such as the TBA market or other affordability products. In those instances, the GSEs are essential.

C. The focus of GSE activity should remain closer to their mission; just because they can do something doesn't mean they should

The GSEs should retain a focus on products and services that are core to their mission, (i.e., first lien mortgages in the conforming loan market and additional products related to home buying for LMI borrowers, first-time homebuyers, and similar programs aimed at borrowers in underserved areas). Simply because the GSEs are permitted by their charters to purchase second mortgages does not mean this is the best use of their capital and focus.

D. The proposal lacks adequate detail and analysis to understand the potential size, scale, and impacts of the proposed program

It is difficult to fully comment on the proposal as it lacks detail and analysis. The likely impact of this program will be to slow refinancing and prepayment speeds particularly on discount coupon TBA-eligible securities as well as CRT products. This change will make TBA more negatively convex. All else equal, this will lower the valuation of these securities and cause some degree of spread widening in the first-lien securitization market. In this sense, borrowers of TBA-eligible mortgage loans will be subsidizing the origination of the second-lien mortgages. In the CRT market, the increase in the amount of second mortgages would make the first mortgages riskier, may create shifts in the callability of CRT bonds, and will not be positive for valuation in that market. However, because of the lack of detail in the Proposal, it is difficult to estimate the magnitude of these issues.

This is the extent of the MBS market analysis in the proposal, which is inadequate:

> *"Current mortgage-backed securities (MBS) investors may experience slower pre-payment speeds if borrowers decided against a cash-out refinance. The retention of the existing mortgage avoids a payoff transaction to the MBS. This could be beneficial to investors by enabling them to realize a more predictable and consistent rate of return."*

In addition to being inadequate, this conclusion is not correct. A slower rate of return of principal for discount Agency MBS is detrimental to the value of the security (and much of the coupon stack is valued at a discount today). Further, such unanticipated structural changes undermine investor confidence in UMBS broadly speaking.

Notwithstanding these views, if FHFA and Freddie Mac determine to proceed with this program, we present a number of questions and suggestions below.

- Why is only Freddie Mac proposing this program? Will Fannie Mae follow? If so, when? Will their programs be the same? This is a UMBS environment, and actions by one GSE affect the entire TBA market. This program may cause shifts in the TBA deliverable, which could harm the entire market; at the extreme it could make one GSE consistently worst-to-deliver and undo the benefit of the combined market of UMBS. We also note that the commingling fee has not been eliminated, and it presents a barrier to getting wraps from the other GSE. Given that this program could become very large, careful consideration needs to be paid to the impact on UMBS.
    - Prior to the implementation of UMBS, if one GSE took an action that worsened convexity, the Fannie/Freddie swap would have widened and signaled to the GSE that the program was viewed negatively. In today's UMBS environment, that isn't possible. This could become an example of the "race to the bottom" concern that was expressed in the lead-up to UMBS.[3]
- Should the GSEs be promoting the re-leveraging of mortgage borrowers? The amount of equity held by borrowers today is protective not only of the GSEs, but also the financial system. We note that Freddie Mac proposes an 80% cap on CLTV which is helpful, but question whether it is appropriate for the GSEs to use their market power to promote the re-leveraging of borrowers. We recognize that this is a housing policy choice, but the proposal does not reflect the careful analysis these questions deserve.

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[3] See, e.g., SIFMA letter to FHFA on UMBS Proposed Rule (November 16, 2018), at 7. "In a single security regime, any action a GSE takes that accelerates prepayment behavior or incentivizes churning will also harm the value of their competitor's MBS. Accordingly, the check on a GSE's actions previously provided by the need to protect their own MBS market is removed, and an action that a GSE may not have taken in an attempt to gain market share in the past (because of concern for a relative cheapening of their MBS) may now be more palatable (because MBS should be harmed equally given a common delivery)."

- No information has been provided as to loan size requirements and how purchasing and guaranteeing closed-end seconds will satisfy the conforming loan limits. Is the requirement that the first and second combined balance be below the loan limit in place when the first lien is originated?
- What will disclosure look like? It is unclear from this proposal how this activity would be disclosed to MBS investors and analysts. How will the first and second mortgage be linked? We suggest it needs to be attached to both the first and second lien in disclosure.

E. Answers to FHFA questions

1. *To what degree might the proposed new product advance any of the purposes set forth in Freddie Mac's charter act (see section I.B above)?*

   As discussed above, while this activity appears to be permitted under the charter, we do not believe it would promote the core mission of the GSEs which is to provide liquidity to the market in a manner that private markets cannot do. The TBA market is an excellent example of this. In fact, this program has potential to harm TBA and CRT valuations. We do not believe this program corrects a market failure or provides a solution that private markets cannot do on their own.

2. *To what degree might the proposed new product advance Freddie Mac's Duty to Serve Underserved Markets activities and support Freddie Mac in meeting its housing goals?*

   We do not consider markets for home equity products to be underserved, as a general matter.

3. *To what degree might the proposed new product already be supplied by other market participants?*

   There are numerous providers of second mortgage and home equity products, and they are easily accessible to borrowers (e.g., https://www.bankrate.com/home-equity/home-equity-loan-lenders/?zipCode=10025#lenders, see also https://www.nationalmortgagenews.com/list/20-bank-lenders-with-the-largest-second-lien-volume-in-q1)

4. *To what degree might the proposed new product promote or lessen competition in the marketplace?*

   We expect this product would, at least in the near term, disintermediate private markets and focus most activity on GSE execution. New home equity product development would likely be reduced or changed to fit into whatever box Freddie Mac draws, lessening innovation and competition. It is important to note that with

this program, the GSEs would not just compete with second lien mortgage lenders; they would also compete with the entire consumer finance market as borrowers would likely concentrate existing auto, home, personal, and other debt onto the GSEs' balance sheets. The proposal does not reflect adequate consideration of these issues. If this program is large enough, it is easy to envision safety and soundness risks to the GSEs.

In a further reduction of competition, the requirement that Freddie Mac hold the first lien risk (and presumably, the same requirement for Fannie Mae when they implement the program) would effectively lock in lenders to that GSE and create a captive set of sellers and borrowers, at least for a period of time. Our members have expressed concern that this could distort the GSEs' pricing incentives.

5. *To what degree might the proposed new product overcome natural market barriers or inefficiencies?*

As discussed above, we do not see a market failure or barrier the GSEs are uniquely positioned to overcome.

6. *To what degree might the proposed new product raise or mitigate risks to the mortgage finance or financial system?*

The new product is expected to lessen the cost to homeowners of extracting equity, and therefore promote the extraction of this equity. As such, borrower CLTVs would broadly increase more quickly than they otherwise would under private market forces. Higher leverage will increase borrower default risk and increase the risk of a shortfall on the loan if housing values decline. In other words, the housing sector would likely be less resilient in the face of broad-based home price declines, if they were to happen. The proposal also negatively impacts the market for first-lien mortgages and CRT as discussed above.

The new product could also negatively impact bank and non-bank consumer lending markets, as the GSEs will have a funding and pricing advantage given their status. This consolidation activity has a potential to move sizeable amounts of consumer debt balances currently held at banks onto the government balance sheet, and bank and non-bank consumer lending businesses would face further challenges competing with longer term quasi-government guaranteed second mortgages that may be tax deductible. Depending on the eligibility criteria, it seems possible that the GSEs could siphon off the best customers from banks and other lenders (further making the point that the GSEs effort here is duplicative of private sector resources, and is not targeted where there is the most need).

The proposal does not discuss or project the impact of any of this on GSE capital requirements. As FHFA knows, capital requirements drive where institutions focus

their activities, and capital is finite. If this program were initially or in the future to have a significant impact on GSE capital requirements, it could reduce the availability of capital to allocate toward the GSEs' first-lien securitization or other affordability-focused activities.

The proposal also does not address the fact that the program will increase GSE exposure to non-bank servicers, which FSOC recently identified as a significant risk to the financial system.[4]

Finally, the proposal does not address macroeconomic impacts of the proposal. For example, if the program were as large as it potentially could be, could it have an inflationary impact? Would it further reduce borrower incentives to sell their homes, exacerbating housing supply issues and placing further upward pressure on home prices? Additionally, this program could also significantly increase the amount of outstanding U.S. government debt (or quasi-government debt), which has not been analyzed in the proposal. We are not taking a position on these points, but rather asking if this analysis has been done, as they seem like legitimate risks.

7. *To what degree might the proposed new product further fair housing and fair lending?*

We do not have a comment on this question.

8. *To what degree might borrowers benefit from or be adversely affected by the proposed new product?*

On one hand, the proposal may make equity extraction cheaper for homeowners, but on the other hand it may negatively impact the market for first-lien mortgages and MBS. Higher CLTVs (and monthly payments) will mean borrowers are less resilient in the face of home price declines, job losses, or other negative life events, and as we have seen historically, this can have very significant economic ramifications.[5]

9. *Are there any other factors that the Director should take into consideration concerning the proposed new product?*

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[4] FSOC noted that "because NMCs focus almost exclusively on mortgage-related products and services, shocks to the mortgage market can lead to significant deterioration in NMC income, balance sheets, and access to credit simultaneously. NMCs rely heavily on financing that can be repriced or canceled by the lender at times when the NMC is under financial stress." See FSOC report at 1, available here: https://home.treasury.gov/system/files/261/FSOC-2024-Nonbank-Mortgage-Servicing-Report.pdf

[5] We note that there is nothing in the proposal indicating that CTLV limits, currently proposed to be 80%, will remain at that level in perpetuity. Indeed, intra-GSE competition could incentivize a loosening of the program so as to gain market share.

Nothing further at this time; we will write further if we would like to raise additional considerations.

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We appreciate your consideration of our comments. If you would like to discuss our views in more detail, I can be reached at ckillian@sifma.org or 212-313-1126.

Sincerely,

Christopher B. Killian
Managing Director
Securitization and Credit