August 14, 2023

Comment Intake
Federal Housing Finance Agency
Constitution Center
400 7th Street, SW
Washington, D.C. 20219

Re: Single Family Pricing Framework: Request for Information

Dear Director Thompson:

The Housing Policy Council (HPC)[1] appreciates the opportunity to provide feedback on the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) on the Enterprises' Single-Family Pricing Framework. HPC's members have a direct interest in the RFI, given the role of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) as liquidity mediators. Further, as you well know, the single-family pricing framework and the policy priorities that FHFA establishes as conservator and regulator of the Enterprises affect the composition of the wider U.S. mortgage market. Pricing is a critical component of a lender's decision to deliver loans to the Enterprises or pursue an alternative execution.

Given the significance of the Enterprises' pricing as well as the Enterprises' financial health to the stability and resilience of the broader mortgage marketplace, we believe that it is important to provide some context to our responses to the RFI questions. Further, we think that the RFI presents an opportunity for FHFA to consider whether to publish the rate of return target that the agency sets and uses to assess the level of revenue generated by the Enterprises (as presented in the annual g-fee reports[2]). We do not address this question in this comment letter but note that additional transparency regarding this target would provide stakeholders a more meaningful perspective on risk, performance, and profits and losses across the Enterprise books of business.

Pricing and the ERCF

The FHFA commentary on the recent pricing changes focus in part on the need to generate sufficient returns to satisfy the capital standards set forth in the Enterprise Regulatory Capital Framework (ERCF). HPC is on record supporting the ERCF, recognizing that small adjustments may be necessary. The current framework reflects the substantial research and analysis performed by FHFA and the Enterprises as well as extensive commentary from stakeholders. The existing ERCF was promulgated following a full comment period, which provided the opportunity for meaningful input from all sectors of the mortgage industry. No standard will ever fully satisfy every housing stakeholder, but this ERCF represents a well-developed compromise. We recommend that FHFA retain the ERCF and require pricing

[1] HPC is a trade association comprised of the nation's leading mortgage lenders, servicers, mortgage insurers, and title and data companies. HPC advocates for the mortgage and housing finance interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promoting of lending practices that create sustainable home ownership opportunities leading to long-term wealth-building and community-building for families.

[2] https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Guarantee-Fees-History.aspx

levels that will allow the Enterprises to earn FHFA's targeted rate of return in accordance with the ERCF, over a reasonable period of time.

Enterprise Charter Privileges

An element of the pricing discussion that is absent from this RFI is the financial benefits and operating advantages that Fannie Mae and Freddie Mac derive from their government sponsored status. Any deliberation on pricing must acknowledge that as a result of their federal charters, the Enterprises are advantaged by a lower cost of debt financing and a lower cost of capital. In addition, they receive an exclusion from federal and state taxes. These financial benefits should not be ignored when considering Enterprise pricing levels and subsidies. The concept of a subsidy for borrowers stems in large part from these charter privileges, whereby the Enterprises, by virtue of their status, are in a position to pass on lower costs to consumers. The recent conversation regarding cross-subsidization obscured the reality that the Enterprises' ability to access credit at near-Treasury bond rates provides their unique pricing power. The Enterprises are competing against a private sector that does not have this bundle of benefits derived from the GSE charters. These benefits allow the Enterprises to achieve their mission objectives with minimal loan-level cross-subsidization.

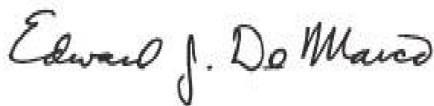
Basel III Proposal Conflicts with FHFA ERCF

While understandably not a part of the Agency's RFI on pricing, we also note that the recent Basel III implementation proposal published by the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency does not align with the ERCF. FDIC Commissioner McKernan's dissent to the proposal highlights this lack of coordination, "The proposal also does not acknowledge that we have rejected a recommendation made by the Financial Stability Oversight Council ("FSOC") that the U.S. bank regulators coordinate with FHFA to harmonize capital requirements across the banks and the GSEs to mitigate risks to financial stability driven by capital arbitrage."[3] The proposed Basel III implementation has a number of negative consequences for home financing, and contrary to the Administration's goals, will depress credit for first-time buyers and historically disadvantaged groups. We will address our concerns regarding the proposal in separate comments to the agencies. We note it here with the recommendation that FHFA will support its research and analysis that underpins the ERCF and communicate such to the bank regulators.

Conclusion

We appreciate the opportunity to comment. If you have any questions or would like to discuss our response, please contact Mike Gill at mike.gill@housingpolicycouncil.org.

Yours truly,



Edward J. DeMarco
President
Housing Policy Council

[3] Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework (July 27, 2023)

Appendix A

Return on Capital

1. *What is an appropriate long-term commercially reasonable return on capital threshold for the Enterprises to achieve?*

As mentioned above, the FHFA and Enterprises have not made public their target rate of return on capital nor actual performance against that target and we request that FHFA make this information available, perhaps in the annual guarantee fee report. As FHFA well knows, an appropriate long-term commercially reasonable return on capital will generate the revenue required to fully satisfy the ERCF. This means that Enterprise g-fee pricing must adequately cover the risk of loss, expected and unexpected, with earnings sufficient to hit the target rate of return on capital.

However, there is an additional consideration. When contemplating an appropriate target for the Enterprises' return on capital, it is important to acknowledge that the Enterprises for years were required to pay Treasury a ten percent dividend on draws taken under the Preferred Stock Purchase Agreements. More recently, the net worth sweep owed to Treasury has been replaced with a dollar-for-dollar increase in Treasury's liquidation preference for each dollar of retained earnings. So, in HPC's view, any targeted rate of return must start with a floor of at least 10 percent.

2. *To what comparable industries and companies should these return on capital thresholds be calibrated?*

While not a precise match, the multi-faceted line of operations of the Enterprises is most akin to banks, particularly large commercial banks that specialize in mortgage and other consumer credit activities. While less perfect, large, publicly traded mortgage banks are also a useful point of reference. The services the Enterprises undertake cover a range of activities including whole loan aggregation, asset management, securities issuance, master servicing, property management and disposition, all of which require critical risk management and counterparty oversight.

3. *Should FHFA set only minimum return thresholds for the Enterprises, or a range of returns – including a maximum return target?*

The FHFA should set a minimum rate of return to explicitly obligate each company to target sufficient revenue to satisfy the ERCF. This minimum could be expressed as a range, understanding that in any specific period, earnings could exceed or fall short of the target based on market conditions. HPC sees no need at this time to set a maximum return target. We note that the very fact FHFA asked the question reflects the lack of market competition arising from the GSEs' unique federal charters and their federal backstop in conservatorship.

4. *For which loan characteristics and products should the Enterprises accept a lower return?*

We first must acknowledge the cross-subsidization model, with full flat-pricing, does not work and was one factor in the failure of Fannie Mae and Freddie Mac in 2008. It creates market distortions, encourages inappropriate risk-taking, and misleads consumers by removing beneficial pricing signals.

Further, subsidized pricing in an economic environment where homes are in short supply simply increases sales prices, exacerbating the already-acute affordability problem. The Urban Institute has estimated that approximately 23% of those receiving a cross-subsidy under the current system are not low or moderate-income households.[4] Instead of continuing to fine-tune cross-subsidization, this same amount of funding could be targeted directly to supporting borrowers defined in the Enterprise affordable housing goals and Duty To Serve requirements through subsidies that explicitly provide financial assistance to the borrower and thus reduce the risk of the transaction.

It is also important to note in October 2022, FHFA excluded the affordable housing loans from the upfront loan-level pricing adjustors. These loans are subject only to the base g-fee. This means that if FHFA removed the upfront fees for all borrowers, those borrowers with affordable housing loans likely would pay more than they do under today's pricing framework. This is because the g-fees would need to be increased across-the-board to accommodate for elimination of the loan-level pricing; overall g-fees would go up, an outcome that runs counter to the arguments for removal of the loan-level pricing.

5. *For which loan characteristics and products should the Enterprises target a higher return?*

Loans that are neither central to Fannie Mae and Freddie Mac's public mission and that are capable of obtaining private sector financing may be suitable for higher targeted returns. Such products may include: (1) second home mortgages, (2) investment property mortgages, (3) cash-out refinance loans, and (4) high-balance loans.

6. *How should return on capital be calculated for the Enterprises?*

FHFA manages this correctly today. The return on capital should be calculated to be sufficient to cover all of the Enterprise's business and operating costs and losses. In other words, the calculation must be set at a level that will generate the revenue required to fully satisfy the ERCF, which must cover the risk of loss, expected and unexpected, with earnings sufficient to hit the target rate of return on capital.

<u>Process</u>

7. *With what frequency should FHFA consider updating the upfront guarantee fee grids?*

FHFA should reconsider the upfront fees every one-to-three years, depending on changing economic conditions, any changes to ERCF, and the results in the annual G-Fee study. Pricing realignments should always reflect the level of risk to the Enterprises and the capital required to support that risk. Further, adequate notice should be provided to the industry to execute pricing changes, with substantial transition time during periods of high production volume or adverse market conditions.

[4] Urban Institute: *Access and Affordability in the New Housing Finance System* : Jim Parrott, Michael Stegman, Phillip Swagel, Mark Zandi (February 2018)

Components of Guarantee Fees

8. *In achieving commercially reasonable returns over time, should future guarantee fee changes be executed through ongoing guarantee fees or upfront guarantee fees?*

The FHFA should continue to permit adequate flexibility for the Enterprises to effectively use all their existing tools to meet the capital standards, including loan-level pricing, base g-fees, credit standards to manage product mix, and loss mitigation to reduce the severity of losses.

9. *Should upfront guarantee fees be eliminated?*

No. The upfront fees may be credibly considered one of the most significant post-crisis reforms put in place to help safeguard the safety and soundness of Fannie Mae and Freddie Mac in addition to the broader economy.

10. *Should risk-based pricing be calibrated to the ERCF?*

Yes. Capital standards are a traditional and proven safety and soundness tool for financial regulators. The ERCF is based on a comprehensive analysis of the risk characteristics of each Enterprise's book of business and the appropriate levels of capital that must be available to address credit, market, and operational risk exposure, in both normal economic conditions as well as periods of market stress. In turn, Enterprise pricing is designed to generate sufficient revenue to cover the modeled risk of loss, ensure the companies satisfy these capital requirements, and earn a target rate of return. Earning a commercially reasonable rate of return would enhance safety and soundness of the system as a whole, given the substantial role that the Enterprises play.