May 17, 2023

Federal Housing Finance Agency
Office of Fair Lending Oversight
400 7th Street, S.W., 9th Floor
Washington, D.C. 20219

Re: Enterprise Single-Family Social Bond Program: Request for Input

Dear Director Thompson:

The Federal Housing Finance Agency ("FHFA") request for comment on a social bond policy for Fannie Mae and Freddie Mac (the "Enterprises" or "GSEs") poses a series of questions that could inform future policy actions regarding Enterprise securitization activities, including the complexion of the social indices that both Enterprises deploy today. Although we do not respond to each of these questions, Housing Policy Council ("HPC")[1] members are directly affected by any such policy and therefore welcome the opportunity to share insight on the potential risks associated with the issuance of Enterprise single-family social bonds.

We recognize that the FHFA pursuit of information is primarily intended to understand the implications of Environmental, Social, Governance ("ESG") investing on borrowers. However, an important first consideration must be the Enterprise statutory obligation to provide stability and liquidity to the mortgage market. The high volume of loans delivered into Enterprise mortgage-backed securities enables the creation of large, diversified pools, a structure that moderates loan-level risk and generates a pricing benefit to American homebuyers and homeowners. Further, the GSE guarantee on the Mortgage-Backed Securities ("MBS") provides confidence to and therefore favorable pricing from GSE MBS bondholders. As a result, the GSE guarantee facilitates the flow of cash into the US housing finance system from global investors to the benefit of borrowers.

The value of this core statutory objective should not be overlooked or underestimated. Ironically, the *intent* of the social bond concept is to benefit borrowers, but the introduction of social bond specified pools is unlikely to enhance the pricing benefits beyond the current arrangement. In fact, the impact of social bonds may conflict with the statutory goals and associated benefits. The introduction of specialized social bonds could reduce the number of traditional, TBA-eligible pools in favor of specialized social pools, which would fundamentally

[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.

change the MBS markets in ways that will have negative consequences for borrowers and market stakeholders alike. In sum, the introduction of single-family social bonds by the Enterprises as conceived by the current social index or a program of the like may be more harmful than helpful.

Preserve TBA Pricing and UMBS Benefits

Our primary concern is that social bonds not degrade pricing in the TBA market or the strength and resilience of the UMBS market. Enterprise UMBS fosters nationwide liquidity, creating large pools of geographically diverse mortgages. As Director Thompson recently stated "FHFA is dedicated to preserving the strength and resilience of the UMBS market, given the significant improvement in liquidity and stability that UMBS has afforded the TBA market."[2] Yet, the introduction of specified pools of mortgages designed under an Enterprise social bond framework will inevitably diminish the size and diversity of TBA pools that generate significant market pricing benefits today. Shrinking the size of this market and removing loans that share certain characteristics that enhance the current pool diversity will result in lower prices for the remaining UMBS. Such a dilution would contradict FHFA's statutory mission to provide liquidity and stability to the market.

This movement to smaller specified pools of loans with certain characteristics, designed not by investors but by the Enterprises themselves, will not expand the Enterprises target population of loans or address any conspicuous gaps in their mission. As mentioned above, the new arrangement will likely shift targeted loans away from standardized, traditional TBA-eligible pools into specialized pools, resulting in worse pricing for overall GSE book of business. Indeed, it is not at all clear that this approach would even benefit the pricing of loans in the specified pools. As a broad generalization, while we believe the loans FHFA is targeting for social bonds typically have smaller principal amounts and thus are viewed as more valuable due to lower prepayment speeds, they may also have a greater propensity for default. It is not at all clear that concentrating such loans in specialized pools will enhance pricing of those loans or of loans left in standard securities.

Today, some portion of the GSE securitization is executed as specialized pools, but the determination regarding that specialized activity reflects an organic determination arising from investor demand, which keeps the overall market well-balanced. Investors are in the best position to design outcomes that meet their own investing objectives, whether ESG-based or not. The current level of variation amongst pools allows investors to express their interest based on expectations of MBS performance, rewards seller/servicers that create more desirable MBS, permits a variety of trading strategies, and helps foster liquid and vibrant trading.

[2] Statement from FHFA Director Sandra Thompson January 19, 2023.

Operational Concerns

The Request for Input ("RFI") notes that "An Enterprise-labeled social bond should positively impact borrower sustainability, affordability, and / or equity." As lenders, our members are the conduit through which these goals may be attained. However, lenders cannot pass through pricing benefits without certainty on the premium derived. TBA-eligible loans have that certainty; social bonds would not. Any borrower savings based upon a rate lock requires price certainty and confidence in the ability to match a loan with a future supported social bond. Doing so requires a sufficient volume of production and investor interest.

The concept of a "borrower opt-out," identified in the RFI questions, also raises operational concerns. We believe it would be operationally difficult -- if not impossible – for lenders to administer an opt-out provision. Tracking loans for this unique feature would be technologically challenging, disrupt standard loan pricing practices, and likely deter participation in the program by most lenders.

Finally, we are concerned about borrower privacy, should the GSE disclosures be expanded to enable social bonds. Investors understandably will desire more data to confirm the profile of the underlying loans in a social bond. Indeed, investors may have audit responsibilities for their ESG funds that require expanded disclosure. However, investors' need for collateral data may infringe on borrower privacy; multiple data points could be used to triangulate and identify a particular borrower. HPC discussions with market participants indicate that borrower re-identification is occurring in the market and a social bond program with enhanced disclosures could further expand borrower re-identification algorithms. Further, the division of the deliverable UMBS universe into more and smaller specialty pools, in lieu of large, diversified pools, will make such re-identification easier.

Annual Reporting

The RFI references the importance of communicating to investors the expected and/or achieved impacts of the investments. Should the FHFA and GSEs proceed to offer social bonds, we believe it is equally important that both the Enterprises and FHFA report on pricing and market impacts of any future social bond program. We recommend that the Enterprises report whether social bonds are trading at a premium or a discount to UMBS and how the introduction of social bonds affects actual mortgage rates on loans that are placed in social bonds relative to those in regular securitizations (as compared to the relative prices observed before introducing social bonds). Furthermore, the Enterprises should provide data on loan and dollar volume, product type, risk class, loan purpose, LTV, credit score, and seller volume group (e.g. MBS Swap cash window). This data will enable FHFA, the Enterprises, and market participants to fully evaluate the impact of the program.

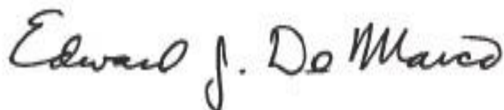
Again, it is our recommendation that FHFA not proceed with this concept, but if the agency does so, we recommend that FHFA issue annual reports on several aspects of market stability and liquidity, per the above questions, including:

- Borrower Benefit – how have investment benefits flowed through to individual, traditionally underserved borrowers;
- Overall credit quality – what is the differential between social bonds versus standard TBA pools;
- Disparate pricing / pricing anomalies / pricing volatility – does the increase in specified pools for social bond issuance produce unexpected pricing or market impacts;
- Impact on counterparties – are there challenges associated with small and medium issuers' capacity to produce, receive, or pass through any premium pay-up, should it exist;
- Cost-benefit analysis – is there a trader pricing/benefit vs. degradation in liquidity for global investors?

Conclusion

Thank you for consideration of our concerns and recommendations. Our membership does believe that there is a place for impact investing in the GSE MBS market. Any program should be thoughtful, allow for innovation and shared support between originator, Enterprises, and investors. It should preserve TBA, generating participation from new investors as well as new loan creation. Should FHFA proceed, we request that the agency and GSEs work closely with the industry and other stakeholders to model the potential impact of on UMBS stability and liquidity, consider the effect on lender operations, and develop transparent reporting of these products.

Yours truly,



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