August 10, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, D.C. 20219

Hugh Frater
CEO
Fannie Mae
Midtown Center
1100 15th Street, NW
Washington, DC 20005

David Brickman
CEO
Freddie Mac
1551 Park Run Drive
Mclean, VA 22102

Dear Director Calabria, Executives Frater and Brickman:

We are writing to urge the Federal Housing Finance Agency (FHFA) to provide additional analysis regarding the impact of the re-proposed Enterprise capital rule on affected parties to the public in advance of the deadline for public comment on the notice of proposed rule-making (NPRM). This analysis should include the impact of the NPRM on the Enterprises' public mission and accompany any complete and unaltered analyses by Fannie Mae and Freddie Mac (the Enterprises).

As you know, the re-proposed rule is complex and requires a number of calculations and assumptions to translate the proposal into potential pricing and business-related decisions. The Enterprises would ultimately have to execute the proposed capital requirements, as well as new prescriptive liquidity requirements required by FHFA in June and starting September 1.[1] They are in the best position to illustrate what these calculations and assumptions might look like in the real world.[2] Clarity around the real-world impacts of the proposed capital rules and the updated liquidity requirements on issues like the level of guarantee fees and loan-level price adjustments (LLPAs), as well as the Enterprises' business operations that are critical in order to fully evaluate the re-proposed capital rule during the open public comment period.

Pricing Grids

The impact of the capital rules on pricing is one issue that warrants better clarity and transparency. FHFA's re-proposed rule provides base risk weights by loan-to-value and FICO scores, but does not make clear the ultimate impact its proposal will have on pricing. Risk-based capital requirements without an appropriate strategy for offsetting risk-based pricing to support the Enterprises' charter mission could put the mission in jeopardy. The Enterprises are in the best position to provide sample pricing grids based on the proposed capital charges, and to provide estimates of the impact on their ability to support the market. We also ask that the agency provide sample pricing grids under other facets of the proposal that could affect the Enterprises business and ability to support their public mission such as but not limited to: if pricing was based on historical loan loss performance and current implied capital requirements; if guarantee fee income were included as an offset to credit losses; if the framework provided more consideration of prepayment risk; and if the proposal provided more capital relief for credit risk transfers.

Cross Subsidization of Mortgage Rates

The cross-subsidization of mortgage rates through internally generated profits is a key strategy used by the Enterprises to reach underserved borrowers and communities, including to meet their affordable housing goals and duty to serve requirements. Research has demonstrated the critical role that these internally generated cross-subsidies play in supporting the Enterprises' mission[3] and the strides made in implementing utility-style pricing[4] that aids the Enterprises' cross-subsidization strategy. We recognize that both capital charges and investors' required rate-of-return impact decisions about guarantee fee levels. However, we are concerned that the proposed capital charges will reduce the profits available for cross-subsidies. It is critical to better understand how the Enterprises see capital in the range of $240 billion[5] impacting today's cross-subsidy, which is estimated by some economists to be about $3.8 billion annually.[6] We are also requesting that your analysis disaggregate the impact of the following proposed capital layers on the Enterprises ability to use cross-subsidization to support their charter mission: the 15% percent risk weight; not counting guarantee fees as an offset to credit losses; each of the three capital buffers (stress, stability and countercyclical); and other aggregate required capital to cover cushions and add-ons for market, operations and other risks.[7]

The Role of the Enterprises in Housing Finance

Because of affordable housing obligations pursuant to charter and statutory requirements, the Enterprises have led the conventional market in important ways in addition to their loan purchases, including by: offering a range of affordable housing products designed to reach underserved market segments; conducting key market research and outreach; and making investments and facilitating capacity-building with a variety of stakeholders, including those serving low- and moderate-income borrowers and underserved communities. The Enterprises do a significant amount of work associated with their mission and also set standards across the mortgage market.

We are seeking to better understand how the re-proposed capital rule might restructure the nation's housing finance system and alter the Enterprises' business and ability to support their charter mission and leadership in the conventional market. In the lead up to the financial crisis, for example, private label securitization assumed significant market share, had broad impacts on credit quality across the mortgage market and largely collapsed after the crisis.

More recently, one market expert has observed that between 2007 and 2020, the share of single-family mortgages guaranteed or owned by the Enterprises while in conservatorship rose by just under 20 percent, while the share of their business with credit scores under 700 fell from 37 percent to 14 percent.[8] Over that same period, bank portfolio holdings grew by 70 percent and the volume of Ginnie Mae securities backed by FHA and VA increased by 360 percent. These shifts highlight that the Enterprises face competitive pressures that will impact the Enterprises' business decisions in light of the proposed rule's effect on pricing, which merits analysis. Will FHFA's proposal diminish the Enterprises' role in serving underserved consumers and markets, and which other market participants will serve these markets in their absence?

Intersection with the CFPB's Qualified Mortgage Proposed Rule

We also urge you to publish analyses on the intersection of FHFA's capital proposal with the CFPB's proposed changes to the "GSE Patch" and the general Qualified Mortgage (QM) loan definition, and in particular, the proposal to replace the current debt-to-income-based standard with a price-based approach. As you know, lenders that originate loans to QM standards benefit from a legal safe harbor. Because the proposed capital charges will impact mortgage pricing, it is key to have better clarity and transparency around how the proposed capital charges would impact on safe harbor provisions associated with the CFPB's QM rules. In particular, the CFPB's proposed QM rule could both affect the Enterprises ability to serve underserved consumers and markets and to maintain safety and soundness.

Conclusion

In essence, we believe both FHFA and the Enterprises should provide additional analysis to illuminate how the agency's re-proposed capital rule and updated liquidity requirements will impact mortgage pricing, the Enterprises cross-subsidization strategy, and their mission business and how it might intersect with the CFPB's QM rules' safe harbor provisions. Without greater transparency from the Enterprises and the agency around these real-world impacts, it will be extraordinarily difficult for the public to meaningfully comment on the proposed rule.

Sincerely,

National Community Reinvestment Coalition
National Association of Realtors
Better Markets
Center for Responsible Lending
Consumer Federation of America
Grounded Solutions Network
Leadership Conference on Civil and Human Rights
NAACP
National Association of Real Estate Brokers, (NAREB)
National Community Stabilization Trust
National Consumer Law Center (on behalf of its low-income clients)
National Council of State Housing Agencies
National Fair Housing Alliance
National NeighborWorks Association
National Urban League
New Jersey Citizen Action
Pittsburgh Community Reinvestment Group
Prosperity Now
UnidosUS

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[1] Fannie Mae and Freddie Mac disclosed in their second quarter 10-Q results that new liquidity guidance from FHFA requires them to hold more liquid assets than is required under the current framework and that they expect this change to negatively impact net interest income. The updated liquidity guidance is also more stringent than the liquidity requirements of banks and other depositories and may result in higher funding costs.

[2] While third-party researchers are providing some analysis of the impact of the re-proposed rule on mortgage rates and other issues, it is critical to have a greater understanding of how both the Enterprises and the agency are viewing these questions.

[3] Cooperstein, Richard and Stegman, Michael. *A Missing Piece of the Administrative Reform Puzzle: How the GSEs Generate Cross-Subsidies,* Joint Center for Housing Studies of Harvard University (October 2019).

[4] Layton, Don. *Why is the Administration Not Talking About Utility-style Regulation of G-fees?* Joint Center for Housing Studies of Harvard University (July 2019).

[5] FHFA's re-proposed capital rule estimates $243 billion as of September 30, 2019 (p. 39278). One expert commenter opines: "The proposal has very specific, complex, and lengthy calculations for a risk-based capital requirement calculation. It then applies no less than three different defined capital requirements...to come up with a "highest of" number… There is also an accounting-driven leverage requirement. It is currently higher than the risk-based calculation, and thus would be "binding,"…it puts the total required capital up to $243 billion." Layton, Don. *The New Proposed Capital Rule for Freddie Mac & Fannie Mae: Ten Quick Reactions,* Joint Center for Housing Studies of Harvard University (May 2020).

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

[7] "Included in the additional conservatism of the May 2020 proposal is a 15 percent risk weight (or 1.2 percent minimum capital requirement) on all loans guaranteed by Fannie and Freddie irrespective of risk, which if not rescinded would further penalize affordable housing borrowers by drastically reducing the amount of "excess" fees on low-risk loans available to be used as cross-subsidies for higher-risk loans." Howard, Tim. *Comment on FHFA Capital Re-proposal,* Howard on Mortgage Finance (July 2020).

[8] Ibid.