



September 5, 2014

Mr. Joseph Prendergast  
Manager of Policy Research  
Federal Housing Finance Agency  
Office of Policy Analysis and Research  
400 7<sup>th</sup> Street SW, Ninth Floor  
Washington, DC 20024

**Re: Fannie Mae and Freddie Mac Guarantee Fees: Request for Input**

Dear Mr Prendergast:

The following is the Mortgage Bankers Association's<sup>1</sup> (MBA) response to *Fannie Mae and Freddie Mac Guarantee Fees: Request for Input* (Request for Input). MBA lauds the Federal Housing Finance Agency's (FHFA) initiative to be more transparent in the setting of Fannie Mae and Freddie Mac's (the GSEs') guarantee fees (G-Fees) and loan-level price adjustments (LLPAs), and in allowing affected parties to share their views on credit pricing and the pricing proposal of December 9, 2013. Our general comments are below, followed by our answers to the specific questions provided in the Request for Input.

**Introduction**

G-Fees should be set to cover expected losses and general operating expenses, and should deliver an appropriate risk-adjusted return on capital. It is important that the GSEs recognize that the robust underwriting requirements under the Ability-to-Repay rule will ensure that sound underwriting remains the rule, not the exception. In this way, the GSEs should be mindful of the risks of a national downturn in housing but be aware that the loans they are purchasing or guaranteeing today and in the future will be significantly safer than those acquired prior to the financial crisis.

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

MBA strongly opposes any further, arbitrary increases in G-Fees or LLPAs, such as those envisioned in the December 9<sup>th</sup> proposal. Clearly, the GSEs were undercapitalized relative to their pre-crisis credit exposures. However, their guarantee businesses have not only been preserved and conserved through the conservatorship, but have increased in value as a result of the increase in cash flows. There is certainly no need to further increase pricing. It should also be clear that any further increases in credit prices will not “crowd in” private capital. Price is not the only obstacle preventing the return of an active private-label securities (PLS) market. Further increases in credit pricing would only act as a dead-weight loss to the market and consumers.

MBA also believes the adverse market delivery fee should be eliminated. Housing market conditions have improved, eliminating the justification for the imposition of these temporary add-on fees.

The GSEs should also reduce LLPAs in recognition of the reduced counterparty risk exposure faced by the GSEs. Although loans with higher loan-to-value ratios (LTVs) require loan-level mortgage insurance (MI), current GSE pricing does not fully account for this credit enhancement. The result is that current credit pricing is higher than it needs to be and presents an unnecessary obstacle to home purchases.<sup>2</sup> This is particularly problematic now that the GSEs are moving to implement strong eligibility criteria for private MI firms. Moreover, the strengthening of MI capital requirements provides new impetus for moving forward on MBA’s proposed up-front risk sharing proposal. Utilizing deeper up-front MI coverage on higher LTV loans and providing coverage on loans below 80% LTV from well-capitalized MIs would increase private capital participation in the market and could potentially reduce costs for borrowers if recognized with lower G-Fees or LLPAs from the GSEs. This approach would reduce the risk borne by the GSEs, and ultimately by the taxpayer, while bringing additional private capital into the market.

MBA believes credit pricing levels should be set in relation to the short-, medium-, and long-term goals of policymakers. In the short-term, as entities in conservatorship, the GSEs are effectively wards of the Federal Government, and as such are instruments of national housing policy. In light of the tepid purchase market recovery, the GSEs and FHFA should be mindful of the extent to which current credit pricing levels, particularly the LLPAs, have priced many first-time homebuyers and low-to moderate-income borrowers out of the conventional housing finance market.

Over the longer term, the credit pricing charged by secondary market credit guarantors should aim for a market rate of return on required capital, while covering expected losses and operational expenses. This rate of return will be determined in a competitive market with multiple competitors and the credible threat of additional entrants, and

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<sup>2</sup> In fact, in many cases the GSEs charge more in G-Fees for their second-loss position than private mortgage insurers charge for their first-loss position.

hence will not need to be determined through the regulatory process. In the medium term, we are challenged to balance credit pricing between these two objectives, given the ongoing conservatorships of the GSEs.

The outcome of housing finance reform should determine the direction of credit pricing and required capital levels over the longer term. These reforms will likely have a transition period, whereby new market entrants are allowed to build capital over time to ensure a stable, liquid market. In the meantime, there is no need for the GSEs to price to a capital requirement that is not currently in effect, and which would not be expected to be reached for a decade or more.

### **Background**

On December 9, 2013, the GSEs announced proposed increases to G-Fees and LLPAs. On January 8, 2014, FHFA's new Director, Melvin L. Watt, suspended implementation of these pricing increases pending further review and analysis. The Request for Input is part of that further review and diligence process.

Credit pricing includes on-going G-fees and LLPAs, which are paid at the time the loan is delivered to the GSE. LLPAs vary based upon loan terms including credit scores and LTVs. G-Fees and LLPAs are charged to lenders in return for providing a credit guarantee to ensure the timely payment of principal and interest to investors in mortgage-backed securities (MBS). The cost of credit pricing is ultimately borne by borrowers as part of their up-front closing costs and/or as part of the ongoing interest payments.

### **Credit Pricing Currently Restricts Access to Credit**

The central issue in establishing credit pricing in today's market is achieving a balance between an appropriate return on taxpayer capital at risk and fulfilling the GSEs' mission to promote a "liquid and efficient national housing market."<sup>3</sup> MBA is significantly concerned by the lack of financing in the conventional market for first-time homebuyers and other low- and moderate-income buyers, market segments most impacted by the increases in G-Fees and LLPAs in recent years. For instance, data show that while first-time homebuyers usually comprise roughly 40 percent of existing home sales, today this group makes up less than 30 percent of homebuyers.

Table 1 below shows the credit scores and original LTVs for Fannie Mae by vintage production year, while Table 2 shows the relative capital allocations for various borrowers across the credit spectrum.<sup>4</sup>

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<sup>3</sup> Housing and Economic Recovery Act, §1102(a).

<sup>4</sup> Fannie Mae, *Fannie Mae's Approach to Single-Family Credit Risk Management*, Updated April 2014, page 16.

**Table 1**

<u>Vintage</u> <u>Production</u>	<u>FICO</u>	<u>LTV</u>
<u>Year</u> 2009	761	68
2010	764	70
2011	763	72
2012	765	72
2013	762	71

**Table 2**

<u>Total</u>	<u>% of</u> <u>UPB</u>
0 to 60 LTV, 740+ credit score	12.20%
0 to 60 LTV, 700 - 739 credit score	3.20%
0 to 60 LTV, 620 - 699 credit score	3.30%
61 to 80 LTV, 740+ credit score	36.50%
61 to 80 LTV, 700 - 739 credit score	11.60%
61 to 80 LTV, 620 - 699 credit score	9.80%
81 to 97 LTV, 740+ credit score	14.60%
81 to 97 LTV, 700-739 credit score	5.50%
81 to 97 LTV, 620-699 credit score	3.30%
	<u>100.00%</u>

While this reflects an extremely high quality book of business during these years, it also demonstrates the lack of conventional mortgage credit available to prospective borrowers despite low interest rates. Borrowers who previously would have obtained conventional credit are opting for FHA or VA loans or are foregoing their home purchase altogether. For those who opt for FHA or VA loans, the taxpayer will bear the entire credit risk of the mortgage. Importantly, G-Fees impact not only the monthly cost a borrower will pay during the life of their loan, but also impact whether a borrower can qualify for a given loan in the first place.

A significant amount of this incremental cost comes from LLPAs. For instance, using general market interest pay-up multiples of 4-to-1, the LLPA for a borrower with a FICO of 695 who makes a down payment of ten percent will incur roughly a 31.25 bps increase in the interest rate charged for a loan – costs incurred in addition to the on-going base G-Fee and payments for a private mortgage insurance policy that stands in front of the GSEs. It should be noted that credit pricing, when incorporated into the borrowers interest rate, counts against the interest rate spread used to distinguish safe

harbor Qualified Mortgages (QMs) from rebuttable presumption QMs. Further, any LLPA or adverse market delivery fee paid up-front by the borrower will count against the points and fees cap established in the QM standard.

For these reasons, MBA strongly opposes any further, arbitrary increases in G-Fees or LLPAs, such as those envisioned in the December 9<sup>th</sup> proposal. MBA also strongly recommends that the adverse market delivery fee be eliminated. The conditions in the housing market have improved since the imposition of the 25 basis point fee, and the GSEs' current book of business consists of extremely strong credit quality loans. There is no reason to continue imposing this fee on borrowers.

### **The GSEs Are Currently Benefitting From a Government Backstop and Should Not Target Private Sector Returns**

A key driver of the G-Fee analysis provided by FHFA in Section II of the Request for Input is the assumed after-tax return on capital required by the GSEs. MBA has concerns with the return on capital assumptions FHFA uses, and these concerns are elaborated below. However, the Request for Input does not address a key, overarching issue that is critical to this discussion – the status of the GSEs.

The GSEs have been in conservatorship since the summer of 2008. As conservator, FHFA is required to “preserve and conserve the assets” of the GSEs in order to bring them to a “sound and solvent condition.”<sup>5</sup> The sharp increases in credit pricing over the past 5 years, from effective G-Fee levels of roughly 20 bps to today’s level above 50 bps, mean that the GSE guarantee businesses are generating substantially more revenue, on a higher credit quality book, than was true pre-conservatorship.

Clearly, the GSEs were undercapitalized relative to their pre-crisis credit exposures. However, the guarantee businesses have not only been preserved and conserved through the conservatorship, they have increased in value given the increase in cash flows. There is certainly no need to further increase pricing. Rather, a better approach would be to implement MBA’s up-front risk sharing proposal to allow private capital to take a larger interest in the loan-level credit risk prior to the loan being acquired by a GSE. This approach would reduce the risk borne by the GSEs, and ultimately by the taxpayer, while bringing additional private capital into the market.

While conservatorship was intended to be a temporary “time out,” its eventual termination remains unclear as does the mechanism by which it could occur. Complicating matters further, the GSEs are subject to the Preferred Stock Purchase Agreements entered into with the Treasury Department. These Agreements, as amended, provided that the GSEs will actually reduce overall capital by \$600 million per year until 2018, at which point neither will have any retained capital. The result will be

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<sup>5</sup> Federal Housing Enterprises Financial Safety and Soundness Act, §1367 (as amended).

that both GSEs would be entirely dependent upon the remaining commitment from the US Treasury, with taxpayers taking the first dollar of unexpected loss.

Beyond the next few years, however, legislative housing finance reform will likely lead to a new framework for credit pricing that would necessarily be implemented with an extended transition period. There is no reason for the GSEs to act today as if that new framework were already in place, or even to act as though they are at the beginning of a transition period. Rather, per the terms of the conservatorship, the GSEs should continue to fulfill their mission to provide housing finance liquidity for lending to low-, moderate-, and middle-income homebuyers.

In terms of the assumptions presently in Figure 2 of the Request for Input (Figure 2), the required after-tax returns listed are too high for government entities, particularly in today's housing environment. For the scenario assuming a lower rate of return, the profit margin after expected credit losses and general and administrative expenses (but before the impact of the Temporary Payroll Tax Cut Continuation Act of 2011 (TCCA)) ranges from 72 percent to 86 percent. For the higher target return scenario, the profit margin ranges from 81 percent to 91 percent. Such margins are high given the present status and uncertain future of the GSEs described immediately above.

Figure 2 also assumes that 100 percent of the income of the GSEs will come from direct credit pricing, and assumes that the GSEs earn nothing on float, i.e., net interest income on the considerable cash flows from the business. It further assumes that there is no income from other services such as buy-up/buy-down fees.

While the GSEs are in conservatorship and benefiting from explicit Treasury support and the mortgage industry at large faces substantial headwinds, the near-term profit potential should be weighed against the GSEs' role as liquidity providers, particularly with respect to lending that could benefit first-time homebuyers and low- to- moderate-income borrowers.

In addition to the return on capital, the second key driver of credit pricing is the required level of capital. Based on recent experience, MBA believes that a 4 to 5 percent capital requirement would be sufficient for a privately capitalized credit guarantor to survive a stress path similar to the one experienced during the financial crisis. However, the GSEs are not privately capitalized and are currently prohibited from building capital on a go-forward basis – in fact, they are required to continue reducing capital over the next few years until retained capital reaches zero. As mentioned above, the GSEs are operating with a combined line of credit from the Treasury of more than \$200B. This is a clear distinction between the GSEs and private companies. Because of their unique operating status, it is questionable whether the GSEs should be targeting private sector returns, or pricing to capital levels that a purely private company would aspire to.

Moreover, the GSEs appear to be pricing credit risk as though they were required to immediately attain the hypothetical proposed capital levels. As noted above, such an

assumption is unwarranted. Nearly every proposed solution for recapitalizing or replacing the GSEs has contemplated a transition period whereby the required capital levels would be built up gradually over at least a decade to ensure that the market would not be disrupted.<sup>6</sup>

### **FHFA Cannot “Crowd In” Private Capital in the Near Term**

For several years, FHFA has publicly stated that the justification for raising G-Fees was to “crowd in” private capital, in the process reducing the government’s footprint in housing finance. The assumption was that the only obstacle to private capital was the relative yields of GSE securities compared with private-label offerings. MBA believes that private capital is ready and willing to engage in investing in mortgage credit. In addition to banks holding loans on balance sheet and private-label securities offerings, capital has entered the market through mortgage insurance firms, reinsurance transactions, and unsecured credit notes, and MBA knows of several alternative structures currently under development. Clearly, private capital is coming into the market in new ways and in increasing amounts, albeit slowly.

Despite this, the GSEs remain the dominant aggregator of loan-level mortgage credit risk and are likely to remain so for the foreseeable future due to their decades of dominance and expertise in this market. Further increases in credit pricing are unlikely to alter what has become a structural barrier to entry and instead only act as a dead-weight loss to the market and consumers (currently inuring to the benefit of Treasury).

#### *G-Fee Increases Do Not Address Structural Barriers to PLS Issuance*

As noted above, the private-label MBS market is being held back by structural obstacles that are unrelated to price. For instance, market observers note that there still remains little participation from traditional “deal anchor” AAA credit investors due to yields and trust issues. The trust issues relate particularly to rating agencies and originators, with representation and warrant issues at the heart of the latter. This has driven investors to demand 100 percent loan-level due diligence, with an estimated cost of \$900 per loan according to MBA’s members. This lack of trust and low demand from AAA investors make present deal structures not yet scalable to large volumes and a variety of loans outside prime jumbo product. In addition, sellers are reluctant to securitize in today’s market for a variety of reasons, including an unwillingness to take on the potential litigation risk with investors and the reputation risk with CFPB and other regulators arising from servicing delays caused, in part, by investor conflicts.

Besides market factors, there are numerous regulatory and other factors that impact, from the originator/aggregator’s standpoint, the desirability of sponsoring a private-label securitization such as:

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<sup>6</sup> For example, both the Johnson-Crapo and Carney-Delaney-Himes bills allowed the Mortgage Insurance Fund to be capitalized to 2.5% of total covered unpaid principal balance over a 10-year period.

- Loans which do not meet the criteria of a Qualified Mortgage (QM) impose on originators significant legal risk.
- Under the Dodd-Frank's risk-retention requirements, issuers of private-label MBS will be required to retain 5 percent of the risk of the security. An exemption is made for MBS backed entirely by Qualified Residential Mortgages, which under Dodd-Frank cannot be broader than the definition of a QM mortgage. The six regulators responsible for creating the QRM rule are in the fourth year of debate over the definition.
- The final Basel III rule requires significantly more capital to be held by banks to support securitized interests that do not carry an express or implied government guarantee. Banks in the past have been large holders of private-label MBS.
- Basel III also is extremely harsh in its treatment of mortgage servicing rights (MSRs) which result from securitizations and for certain servicing-related advances.
- As noted above, lender and sponsor representations and warrants have been at the heart of many conflicts between mortgage bankers and investors. Uncertainty surrounding the transference of risk and the duties and liabilities assumed by each party to the transaction are currently the subject of massive industry workgroup efforts, as well as the Treasury Department's recently announced stakeholder initiative.
- The SEC's proposed revisions to Reg AB, introduced over 4 years ago, were just finalized in late August. The proposed changes require significant disclosures at registration of a publicly traded MBS as well as significant ongoing disclosures, subjecting the executives of depositors and issuers to substantial liability.
- FAS 167 requires that one of the parties to a securitization will generally be required to consolidate the assets and liabilities of the securitization trust in their consolidated financial statements. Banks in the past have been actively engaged in securitization. However, an amendment to Basel I after the release of FAS 167 requires banks that must consolidate a securitization's assets to hold risk-based capital for those assets. This will discourage many banks from participating as a party to a private-label securitization.
- General disagreements among key market participants. For example, each of the credit rating agencies have released new rating models with significantly higher probability of default and loss severity assumptions increasing the required level of subordination or credit enhancement for private-label MBS. While investors continue to distrust the credit agency ratings, many

originators/aggregators believe that the ratings assume a “hundred year flood level.”

In this environment, the cost of incurring credit risk is but one variable in a complex equation concerning the re-start of the private-label MBS market. Structural issues such as regulatory burdens and basic trust are at the heart of the continued inactivity in the private-label MBS market, and these issues will not be solved through credit risk pricing alone. MBA therefore recommends that FHFA abandon the strategy of attempting to crowd-in private capital through increasing G-Fees.

Since the start of 2013, one of FHFA’s strategic objectives has been to reduce the GSEs’ credit risk exposure by facilitating risk-sharing transactions between the GSEs and private market participants. Investors have two primary ways to invest in mortgage credit risk ahead of the GSEs – 1) assuming the risk on a loan-level, “up front” basis; or 2) investing in a structured, “back end” security.

MBA has proposed that the GSEs implement up-front risk sharing through private MI and other forms of up-front risk sharing. MBA advocates for simply an expansion of market practices that have been common for decades - namely lenders and MI firms taking substantial first loss risk, while the GSEs maintain a deep, catastrophic loss position

### **The TCCA Add-on to G-Fees is Poor Policy**

The Congress passed and President Obama signed the TCCA which requires Fannie Mae and Freddie Mac to raise guarantee fees by not less than 10 bps as a means to pay for the lost tax revenue from the temporary payroll tax decrease used to attempt to stimulate the economy in 2011 and 2012.

MBA understands that FHFA is merely executing an Act of Congress, and that is why we call upon Congress to terminate this unwise homeownership tax. Notably, borrowers for new loans through October 1, 2021 will be penalized by this additional G-Fee charge that is totally unrelated to the GSEs’ business or to housing in general. The fact that this TCCA fee is two and a half times the expected losses that Fannie Mae and Freddie Mac project for new loans clearly indicates the errors of Congress using G-Fees to “pay for” unrelated legislation.<sup>7</sup>

### **Conclusion**

The GSEs have historically played a critical role in providing liquidity to the housing finance market, and FHFA should ensure this continues. In the short-term, FHFA should be especially cautious regarding LLPAs, which have priced many potential first-time homebuyers out of the conventional mortgage market. In particular, MBA strongly

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<sup>7</sup> See Request for Input, at 4.

opposes the overall G-Fee and LLPA increases from the December 2013 proposal. Over the medium term, FHFA should work with the GSEs to ensure that credit pricing provides an adequate return to taxpayers while recognizing the peculiar status of the GSEs in conservatorship and the benefit they receive from the backstop provided by the Federal Government. Over the longer term, credit pricing will likely reflect the results of housing finance reform, which will hold credit guarantors to an appropriate capital standard and likely include a transition period adequate to build capital over time.

Any questions on MBA's response should be addressed to Dan McPheeters at (202) 557-2780 or at [dmcpheters@mba.org](mailto:dmcpheters@mba.org); or to Jim Gross at 202-557-2860 or [jgross@MBA.org](mailto:jgross@MBA.org).

Sincerely,

A handwritten signature in black ink, appearing to read "D.H. Stevens". The signature is fluid and cursive, with a large initial "D" and "H" followed by a period and the name "Stevens".

David H. Stevens  
President and Chief Executive Officer

**MBA's Responses to FHFA's Specific Questions**

1. Are there factors other than those described in Section III – expected losses, unexpected losses, and general and administrative expenses that FHFA and the Enterprises should consider in setting G-Fees? What goals should FHFA further in setting G-Fees?

**MBA's Response:** G-Fees should be set to cover expected losses and general operating expenses, and should deliver an appropriate risk-adjusted return on implied capital. It is important that the GSEs recognize that the robust underwriting requirements under the Ability-to-Repay rule will ensure that sound underwriting remains the rule, not the exception. In this way, the GSEs should be mindful of the risks of a national downturn in housing but aware that the loans they are purchasing or insuring today and in the future will be significantly safer than those acquired prior to the financial crisis.

2. Risk to the Enterprises increases if the proportion of higher-risk loans increases relative to the proportion of lower-risk loans. This change in mix can occur if lower-risk loans are retained on bank balance sheets instead of being sold to the Enterprises, if more higher-risk loans are sold to the Enterprises, or if the overall mix of originated loans changes. What alternatives, other than risk-based pricing, should be considered? What are the pros and cons of each alternative?

**MBA's Response:** The GSEs should utilize a combination of underwriting parameters and risk-based pricing in a transparent manner to manage their risk exposure and target a reasonable return. In the near-term, public policy dictates that LLPAs should be mitigated where they negatively impact access to credit.

The net risk exposure to the GSEs can be controlled by utilizing more up-front private credit enhancement that places private capital ahead of taxpayer risk, such as MI from well-capitalized MI companies or lender recourse. For example, the FHFA could define a level of protection sufficient to leave the GSEs in only a very remote risk of loss position (a "catastrophic risk" position) and require the GSEs to charge G-Fees commensurate with this exposure. The resulting G-Fees would thus be lower than current levels, with competition among private, well-capitalized entities driving the pricing of the first-loss position, benefitting borrowers through lower costs. This policy would create strong incentives to expand the role of private capital significantly and reduce the amount of risk the GSEs take in a manner that is compatible with our current housing finance system, including the to-be-announced (TBA) market.

3. Currently, target return on capital and the amount of capital largely determine required G-Fees. What factors should FHFA and the Enterprises consider in

setting target return on capital and amount of capital required? How should the Enterprises allocate capital across risk buckets?

**MBA's Response:** Per MBA's comments in the body of the letter above, the answer to this question differs based upon the timeframe in question. Currently, the GSEs are pricing many first-time homebuyers out of the market. In their role to provide liquidity to the market, and in recognition of the increased counterparty strength of private mortgage insurers resulting from the recently announced draft mortgage insurer capital framework, the GSEs should lower LLPAs. Over the medium term, the GSEs should adjust their return targets given their conservatorship status, as they should not be aiming for private sector returns while they are backed by the government. Finally, capital allocation and pricing over the longer term will necessarily be impacted by the direction of legislative housing reform. There is no need in the short-term to assume a direction of this reform given its current uncertainty and given the long transition window contemplated with any legislation.

4. At what G-Fee level would private-label securities (PLS) investors find it profitable to enter the market or would depository institutions be willing to use their own balance sheets to hold loans? Are these levels the same? Is it desirable to set G-Fees at PLS or depository price levels to shrink the Enterprises' footprints, even if this causes G-Fees to be set higher than required to compensate taxpayers for bearing mortgage credit risk and results in higher costs to borrowers?

**MBA's Response:** Rates on jumbo mortgages are currently below those on conforming loans. This primarily reflects origination for bank balance sheets, but PLS issuers are also providing similar rates. At least for strong credits, GSE pricing exceeds that from private capital sources.

The PLS market is facing a number of structural, economic, and regulatory obstacles beyond pricing at this point, however, which has hampered its recovery. Recent successful issuances have included higher average FICO and lower average LTVs than what is seen in the market as a whole. Non-prime issuances, on the other hand, have been rare as investors demand loan-level due diligence that is cost prohibitive to scale. With no private competition in this space, the GSEs are the sole avenue for funding the majority of home loans, especially for first-time homebuyers, low- to moderate-income borrowers, and underserved markets. In the near term, the GSEs should act as a countercyclical force in the market and ensure that borrowers not currently served by private capital can obtain financing.

5. If the Enterprises continue to raise G-Fees, will overall loan originations decrease? That is, will Enterprise loans decline without a commensurate increase in private capital?

**MBA's Response:** Yes. Raising G-Fees or LLPAs will make borrowers worse off. They may find another loan opportunity through FHA or private sources, but with even higher costs. Borrowers don't generally know the execution path of their loan through their lender. They don't opt for a GSE loan, they make rate and cost decisions. If increases in G-Fees make loans costlier, it may dissuade borrowers from making the decision to enter into a loan (or home purchase) or restrict the size of loan a borrower qualifies for.

6. Is it desirable for the Enterprises to charge higher G-Fees on low credit score/high LTV loans if it causes these loans to be insured/secured through FHA/Ginnie Mae rather than through the Enterprises?

**MBA's Response:** The GSEs have the ability to cross-subsidize today because there is little competition in the conforming segment of the market. Because they have pricing power and because they are required by HERA to accept a lower rate of return on business to support the housing market, they should continue to provide this support in the form of reduced LLPAs for those portions of the market most utilized by first-time homebuyers. This short-term reduction in LLPAs should be re-evaluated after a period of time to determine its effectiveness. An added benefit of this approach would be to reduce the government's exposure to losses by allowing MI to assume some of the loan- and pool-level credit risk.

7. Is it desirable for the Enterprises to (a) charge higher G-Fees on high credit score/low LTV loans if it causes these loans to be insured/secured through PLS or (b) held on depository balance sheets, rather than guaranteed by the Enterprises?

**MBA's Response:** This is already occurring given the rapid increase in base G-Fees over the past few years. The best execution currently is to retain high credit quality loans on depository balance sheets. There is no reason to raise fees further.

8. What approaches or alternatives should FHFA consider in balancing increased use of risk-based pricing with the HERA mission requirements of (1) liquid national housing markets and (2) acceptability of lower returns on loans made for low- and moderate-income housing?

**MBA's Response:** First, the GSEs should recognize the benefits of private MI and lender recourse as mechanisms that can reduce the GSEs' risk at the loan level. Currently, there are situations where the combination of G-Fees and LLPAs exceed MI premiums, even though MI stands in a first-loss position. Reducing G-Fees and LLPAs would make loans more affordable and facilitate greater lending among the populations that are currently underserved.

Second, FHFA and the GSEs should rapidly move to adopt MBA's up-front risk sharing proposal to allow the private market to assume loan-level credit risk before the loan is purchased by the GSEs and to provide an elimination of LLPAs and/or a G-Fee reduction in exchange. This effort will increase competition for credit risk, but only if the GSEs are willing to provide a bona fide discount in the cost of credit protection.

9. Are the ranges of credit score and LTV cells in the proposed credit score/LTV grids used to set up-front delivery-fees and loan-level pricing adjustments appropriate? Should any of the ranges be broader or narrower and, if so, why?

**MBA's Response:** Adjusting the grid of credit score and LTV combinations presents several benefits and drawbacks. Generally, utilizing a less granular grid would introduce more cross-subsidization among borrower segments, while also smoothing prices across borrowers more generally. This would be consistent with HERA's requirement that the GSEs provide liquidity to the national housing market at large, and to do so while accepting lower returns on certain underserved populations.

On the other hand, greater segmentation allows for more granular credit protection and would limit adverse selection.

10. Should risk-based pricing be uniform across the Enterprises or should each Enterprise manage its own pricing?

**MBA's Response:** Given their status in conservatorship, there is little reason for their pricing to differ. However, it is important to note that due to the relative lack of liquidity of the Freddie Mac PC, there are differences in execution. For that reason, it is imperative that FHFA move expeditiously to implement the single security proposal. Doing so will increase liquidity and provide greater price transparency, to the ultimate benefit of consumers.

11. Taking into consideration that FHFA has previously received input on state-level pricing adjustments, do the G-Fee changes proposed in December 2013 have any additional implications that should be considered in deciding whether to price for the length of state foreclosure timelines, unable to market periods or eviction timelines? Are there interactions with other pricing components under consideration that FHFA should consider in making decisions on the state-level adjustments?

**MBA's Response:** The GSEs have the ability to cross-subsidize different markets today because there is little competition in the conforming segment of the market. However, certain states have unreasonably long foreclosure timelines that are effectively subsidized by states with less onerous

requirements. MBA previously recommended awarding a G-Fee or LLPA credit for states with good foreclosure policies, i.e. those where foreclosure costs are 1.5 or more standard deviations below the current median cost. This would serve as an incentive for states to enact cost-effective foreclosure policies while preventing borrowers in those states from subsidizing the foreclosure policies of less favorable states. In sum, MBA believes this issue demonstrates the need for greater uniformity in state foreclosure laws to eliminate the moral hazard and unfair G-Fee pricing that can occur.

12. Are there interactions with the Consumer Financial Protection Bureau's Qualified Mortgage definition that FHFA should consider in determining G-Fee changes?

**MBA's Response:** Yes. To the extent that LLPAs remain high, there is a risk that LLPAs could trigger the 3 percent points and fees cap if the fees are paid by the borrower, or the 150 bp over APOR cap if the LLPAs are paid by the lender and incorporated into the rate.