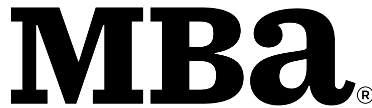

MORTGAGE BANKERS ASSOCIATION

May 12, 2023

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Enterprise Regulatory Capital Framework Amendments - Notice of Proposed Rule Making

Dear Director Thompson,

The Mortgage Bankers Association[1] (MBA) thanks the Federal Housing Finance Agency (FHFA) for the opportunity to respond to its notice of proposed rulemaking which would amend portions of the regulatory capital framework applicable to Fannie Mae and Freddie Mac (the Enterprises). The Enterprise Regulatory Capital Framework (ERCF) is critical to ensuring the Enterprises can operate in a safe and sound manner and as such it is important that it accurately captures the risks posed to the Enterprises. We appreciate that FHFA is taking steps to evaluate the ERCF regularly and incorporate lessons learned to better reflect the risks of the Enterprises' business models.

MBA is generally supportive of most of the amendments in the proposal as they appropriately recalibrate certain portions of the ERCF. Many of the changes, if finalized as proposed, should allow the Enterprises to operate as prudent managers and distributors of mortgage credit risk while promoting both safety and soundness. The changes related to representative credit score pose some concerns, and we encourage FHFA to delay implementation and further analyze the potential impacts of the proposed changes for all market participants, particularly if the capital framework changes will be implemented before the transition to a bi-merge credit report requirement as outlined in the proposal.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 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 to 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 more than 2,100 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

MBA also encourages FHFA to evaluate and reconsider two additional portions of the ERCF not included in the proposal that MBA believes are critically important. These include requirements related to third-party originated loans and the inclusion of a multifamily countercyclical adjustment. MBA would be remiss in not taking the opportunity to reiterate these positions while FHFA is considering amendments to the ERCF.

Guarantees on Commingled Securities

MBA continues to oppose strongly any risk weighting of commingled securities – certain Enterprise re-securitizations containing securities issued by the other Enterprise. MBA supports the changes in the proposal that would reduce the risk weight and credit conversion factor for commingled securities from 20 percent and 100 percent to 5 percent and 50 percent, respectively. The existing 20 percent risk weighting resulted in the implementation of a 50 basis point comingling fee last year. MBA expressed concern that the fee would generate significant frictions in the Uniform Mortgage Backed Securities (UMBS) market and impair the fungibility of Fannie Mae- and Freddie Mac-issued collateral that underpins the design of the UMBS. Ultimately, this could reduce market liquidity, which ultimately hurts borrowers.

MBA maintains that the ERCF should not include any provisions that could deter the Enterprises from engaging in the re-securitization of UMBS or from treating UMBS issued by another Enterprise as less than fully fungible with its own UMBS. As expressed in prior comments, any difference between the required capital for an Enterprise's own securities relative to those issued by another Enterprise could lead to different treatment and actions that weaken the aggregate UMBS market. We encourage FHFA to continue to monitor UMBS performance to ensure they remain fungible and make future adjustments to the ERCF as needed.

Representative Credit Scores for Single-family Mortgage Exposures

The proposed amendment would modify the current procedure for selecting representative credit scores to reflect FHFA's recent announcement that the Enterprises will move to a process that allows two rather than three credit reports (bi-merge credit report requirement). The first step in this process would now require the Enterprises to calculate the average score for each borrower rather than using the median of three scores or the lowest of two scores.

MBA acknowledges and appreciates FHFA's steps to prepare for this eventual transition; however, we caution against prematurely implementing this change without further analysis, and we encourage FHFA to share with the industry as much information as possible regarding the potential impact on predicted performance from this change. While the proposed changes are intended to account for an expected drop in scores, there are concerns that implementing this change ahead of the transition to the bi-merge requirement could artificially raise scores for some borrowers. As noted in the NPR, the changes in aggregate are negligible, but it may be valuable to examine subsets of the data to determine if there are any scenarios that create a larger than expected change for specific

segments of borrowers. MBA recommends FHFA delay implementation of this amendment, perform additional analysis, and report any findings as part of the new credit score implementation process.

Time-based Calls for CRT Exposures

The proposed rule includes amendments to the existing framework that are intended to encourage continued use of Credit Risk Transfer (CRT) mechanisms by the Enterprises. The Enterprises can calculate risk weights using the “credit risk transfer approach” only if the CRT meets the ERCF’s “operational criteria for CRT,” which includes restrictions for “clean-up calls.” Time-based calls are routinely used by the GSEs to manage CRT economics, and they are not currently included in the definition of “clean-up calls.” The proposed amendments would clarify the eligibility of CRT transactions with time-based calls and facilitate the accurate calculation of risk and the continued use of CRT by the Enterprises.

CRT transactions allow the Enterprises to disperse mortgage credit risk across willing sources of private capital rather than concentrating this risk in their portfolios. By doing so, the Enterprises can operate as through-the-cycle managers and distributors of mortgage credit risk, which improves their safety and soundness, protects taxpayers, and enhances price discovery. MBA is supportive of this amendment to the ERCF as it supports this business model and will better position the Enterprises to use CRT transactions to manage risk.

Pricing for Third Party Originated Loans

MBA remains concerned about variations in GSE pricing for loans with substantially similar credit characteristics based on origination channel – specifically pricing penalties with respect to third-party-originated (TPO) loans. At least one of the GSEs is providing worse execution/pricing on TPO loans relative to retail loans solely due to this difference in origination channel, and the disparity in pricing stems from the higher risk multiplier for those loans in the ERCF.

The reported disparities in pricing for TPO loans are a dramatic departure from the core level playing field principle FHFA has established and that MBA strongly supports. Lenders of varying sizes, charters, or business models – including those that specialize in different origination channels – must have the ability to compete on a level playing field. All pricing differences should be based on loan-level factors that influence risk. FHFA has not presented compelling evidence that an equivalent loan with identical characteristics is riskier based upon origination channel.

These pricing variations negatively impact borrowers, particularly those that are critical to the core missions of FHFA and the GSEs. Minority and low- to moderate-income borrowers make up a higher percentage of TPO loans than of retail loans, and the weaker pricing currently offered by at least one GSE flows through to these borrowers, resulting in higher costs for those who obtain TPO loans. FHFA has consistently reiterated its focus on efforts to address our nation’s long-standing challenges related to housing equity – particularly with

respect to the racial homeownership gap. The current TPO pricing disparities run contrary to this objective and do not further efforts to increase liquidity to support historically underserved borrowers.

Finally, we reiterate that FHFA has not produced compelling data to support the need for a higher risk multiplier for TPO loans. We believe this aspect should be reevaluated to determine the appropriate risk level. It is possible that at a point in time TPO loan performance differed from its retail counterparts in a causal manner. There has been no recent evidence, however, to support these claims, and given the structural and regulatory changes in the mortgage market since the Great Financial Crisis, it is less likely that origination channel alone would be a primary or causal factor in loan performance. MBA encourages FHFA to update, reexamine, and share data related to TPO loan performance.

We urge FHFA to take immediate steps to address these variations in TPO pricing, as this inappropriate risk multiplier is resulting in pricing penalties, creates an unlevel playing field among lenders, and is simultaneously harming underserved borrowers. Further, we recommend that the Enterprises be granted flexibility to use methods other than pricing to manage certain risks to avoid violating the level playing field principle.

Multifamily Countercyclical Adjustment

MBA continues to see the need to include a multifamily countercyclical adjustment in the ERCF, and we recognize that the approach used in the single-family portion of the ERCF does not directly translate to multifamily. As stated in prior comments, MBA recommends that FHFA consider an approach that limits the capital impact of market declines in values and incomes until they breach the levels associated with the stress scenarios (-35 percent for values and -15 percent for income). Such an approach would operationalize the intent of the capital framework – building capital during market growth and relying on that capital during market declines.[2]

We understand such an approach will require additional time and effort to fully develop, and we also note the importance of a functioning countercyclical mechanism for the multifamily businesses, particularly given the critical role the Enterprises play in refinancing maturing loans during downturns.

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MBA appreciates the opportunity to provide observations and recommendations on the proposed amendments to the ERCF as well as additional portions of the ERCF. A robust and well-balanced capital framework is critical to ensuring the Enterprises can operate in a safe and sound manner and further strengthens the housing finance system to prepare for their eventual exits from conservatorship.

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[2] MBA comments on Enterprise Regulatory Capital Framework, p. 13 (Aug. 31, 2020).

Thank you again for the opportunity to comment. We look forward to our continued partnership and will work closely with you in the coming months on this and other critical housing finance issues.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association