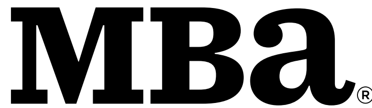

MORTGAGE BANKERS ASSOCIATION

August 14, 2023

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

RE: Enterprise Single-Family Pricing Framework Request for Input

Dear Director Thompson,

The Mortgage Bankers Association (MBA)[1] thanks the Federal Housing Finance Agency (FHFA) for the opportunity to provide feedback in response to the Request for Information (RFI) on the Fannie Mae and Freddie Mac (the Enterprises) Single-Family Pricing Framework.[2] The Enterprises' pricing structure is a critical component of the mortgage finance system, and MBA welcomed FHFA's decision to undertake a comprehensive review of the existing framework. The impact of the pricing framework must be properly evaluated so that the Enterprises and taxpayers are protected from potential future losses, lenders in the primary market are able to better serve eligible borrowers, and ample liquidity is provided to the secondary market. Any review should also ensure core principles – such as a level playing field for all sellers – are preserved.

The recent pricing changes resulting from this review ignited a spirited policy debate. Unfortunately, some of the conversation around these pricing changes was based on false narratives and misconceptions regarding risk-based pricing used by the Enterprises. This RFI is thus especially timely to allow stakeholders to express their views on the risk-based pricing and cross-subsidy that has always existed in the Enterprises' pricing grids. MBA appreciates FHFA's engagement with industry on these issues thus far and hopes this RFI provides stakeholders additional transparency and clarity regarding the Enterprises' pricing.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 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 2,200 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.

[2] Federal Housing Finance Agency, "Fannie Mae and Freddie Mac Single-Family Pricing Framework", May 15, 2023. Available at: https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Single-Family-Mortgage-Pricing-Framework-RFI.pdf

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We offer the following recommendations to FHFA and the Enterprises to improve elements of the pricing framework related to return on capital, implementation, and calibration to the Enterprise Regulatory Capital Framework (ERCF).

Determining the Target Return on Capital

MBA has long proposed that the Enterprises be regulated similarly to investor-owned utilities.[3] Utilities are encouraged to deploy capital in relatively low risk, regulated business models to achieve stable outcomes for investors and consumers while serving important societal functions. Companies with this mindset and culture in competitive markets compete through more efficient operations, product and process improvements, and customer service. The Enterprises should be low volatility companies that provide steady dividends, instead of companies that aggressively seek to expand market share or generate above market returns.

Typically, price regulation in these markets requires nondiscriminatory pricing across the customer base. Pricing also tends to be transparent, with rates and the rate calculation posted for public input. FHFA in its role as conservator has moved regulation of pricing in this direction already, with more level and transparent pricing than was the case pre-crisis. Through recent directives, FHFA has taken positive steps to ensure that single-family guarantee fee discounting or other favorable pricing or underwriting variances are not provided to market participants based on their volume, size, or business model. Pricing and underwriting across various programs and markets should be as transparent as possible to ensure that eligibility, qualification, and pricing information is clearly communicated to the market and balanced by sound risk-management practices.

The Enterprises should earn a “fair return” for shareholders while supporting broad liquidity and affordable mortgage rates in the single-family and multifamily housing finance market. The Enterprises should also maintain flexibility to set different rates of return for different products. Much like today, the Enterprises could have a lower rate of return on certain purchases including those serving low- and moderate-income borrowers and certain underserved markets. Calibrating pricing to better support “core mission borrowers” can be done in several ways, including, but not limited to, targeting certain housing types such as manufactured housing or condominiums, or compressing the pricing grids across loan-to-value ratio and credit score dimensions in a targeted fashion. Allowing for flexibility in pricing and rate of return will be essential to supporting mission-based lending.

Process

Prior to the pricing review that FHFA initiated last year, the Enterprises’ pricing framework had not been evaluated for quite some time. Mortgage market conditions constantly evolve and can be impacted by a variety of factors including economic and political changes, new technology, or even public health crises. To ensure the Enterprises’ pricing is effective and

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[3] Mortgage Bankers Association, “GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market”, April 2017. Available at: https://apps.mba.org/pdf/MBA_GSE_Reform_White_Paper.pdf

appropriately set for current market conditions, MBA believes there should be periodic evaluations of their pricing framework. Regular reviews would prevent the pricing framework from becoming outdated and ineffective and allow industry participants to prepare for possible changes. We believe a 3- or 5-year review period would be appropriate. We also recognize that FHFA may also need to make changes to pricing outside of the regular review period in response to certain market conditions that affect profitability and performance. For all pricing changes, adequate stakeholder engagement and implementation time are key to avoiding market disruption and ensuring changes can be implemented properly.

MBA appreciates that FHFA has attempted to give ample implementation time for policy changes to avoid market disruption such as impacts to lenders' pipelines. Pricing adjustments require a multitude of process and technology changes that, for major changes, can take several months. For example, lenders have reported that for the most recent pricing changes announced on January 19, 2023, which had a delivery-based effective date of May 1, 2023, lenders would have had only 2 weeks to prepare for and begin implementation to meet the start date. Based on feedback we have heard from lenders, these timelines should be reevaluated and extended. This is particularly important for supporting mortgages on new construction.

Lastly, we would recommend that FHFA accept public comments on all proposed pricing changes. It is important to note that we are not recommending a formal notice and comment period, as that would make pricing changes too arduous. We understand that FHFA must remain nimble to adapt to changing market conditions and make pricing changes relatively quickly. Providing an avenue for industry to engage and provide comments on those changes, however, could help FHFA uncover potential operational or implementation issues that could arise – much like problems caused by the debt-to-income (DTI) based LLPA. One possible way to accomplish this would be for FHFA or the Enterprises to convene an advisory board to weigh in on potential pricing changes (with appropriate safeguards to prevent specific details from being disclosed prematurely) before they are announced, again with the goal of avoiding any unworkable constructs or problematic implementation issues.

ERCF

The Enterprises' pricing grids and the ERCF have always been linked. In January 2023 however, FHFA took additional steps to more closely align pricing to the ERCF. The ERCF is intended to ensure the Enterprises can operate in a safe and sound manner. It is therefore important that it accurately captures the risks undertaken by the Enterprises. While it is clear that the ERCF is central to the Enterprises' operations, it is important to highlight areas where the ERCF remains too complex and lacks transparency, and instances where the ERCF has caused unintended consequences when directly used to set pricing. We have seen this play out in past policy decisions including the implementation of the Uniform Mortgage-Backed Securities (UMBS) commingling fee, the proposed DTI-based LLPA, and the ongoing issue related to third-party-originated (TPO) loans. Each of these pricing moves arose from the ERCF, and each created problems that needed (or still need) to be addressed. Not all risk differentials in the ERCF should be discretely embedded in the pricing construct.

Naturally, the ERCF will entail a certain level of complexity in order to appropriately capture risk exposures and provide adequate loss-absorbing capacity in stressed markets. Much like the Enterprises' pricing, capital requirements should also be as transparent as possible so that market participants, regulators, counterparties, and other stakeholders can understand the objectives and constraints under which the institutions are operating. This transparency is particularly important for the ERCF, given the critical role that the Enterprises play in the infrastructure of financial markets, the availability of affordable housing throughout the country, and the performance of the broader economy. Further, the Enterprises themselves need to understand clearly how various aspects of their capital framework may bind over time, as they develop business strategies that most efficiently deploy their capital.

A simpler capital framework would allow for clearer analysis of how various components impact Enterprise business decisions. The ERCF is unnecessarily complex, with risk-based capital requirements implemented through various grids and multipliers or internal models, combined with multiple buffers, floors, and punitive minimums that ultimately make the ERCF more opaque and create more noise than signal. Taken together, these multiple, complex, overlapping constraints are likely to frustrate FHFA's goals of providing clearer signals to the Enterprises – and to the broader market – regarding how much capital is actually required for the Enterprises to manage risk and conduct their businesses safely and soundly.

Last year, FHFA implemented a 50 basis-point (bps) UMBS commingling fee as a result of the existing 20 percent risk weighting in the ERCF for commingled securities - certain Enterprise re-securitizations containing securities issued by the other Enterprise. MBA has and continues to strongly oppose any differential risk weighting of commingled securities, and we expressed concern that the fee would generate significant frictions in the UMBS market and impair the fungibility of Fannie Mae- and Freddie Mac-issued collateral that underpins the design of the UMBS. This could reduce market liquidity, which ultimately harms borrowers.

Months later, following thorough analysis and stakeholder engagement, the fee was reduced to 9.375 bps, and FHFA followed that with a recently proposed amendment to the ERCF that reduces the risk weight and credit conversion factor for commingled securities from 20 percent and 100 percent to 5 percent and 50 percent, respectively. We appreciate the stakeholder engagement that led to the adjustment of this fee and the corresponding risk weight in the ERCF, but it should have occurred before the onerous fee was considered. This was a clear example of a misrepresentation of risk in the ERCF that resulted in an ineffective and harmful pricing decision. MBA continues to recommend the elimination of the commingling fee and maintains that the ERCF should not include any provisions that undermine the fungibility of the UMBS.

The ERCF also contains a 20 percent surcharge on loans with a DTI ratio of 40 percent or greater, which drove FHFA's recent decision to implement a DTI-based LLPA that was later rescinded. The implementation of a DTI-based LLPA would have led to several serious

operational problems, including multiple changes to a borrower's pricing throughout the loan application process, compliance implications related to TILA-RESPA Integrated Disclosures (TRID), compromised borrower trust, and post-closing quality control (QC) issues. We are pleased that FHFA ultimately engaged with industry stakeholders and the Congress, recognized the negative impacts of the fee, and rescinded its implementation. This is an example of a risk reflected in the ERCF that is better managed by means other than pricing.

MBA also remains concerned about variations in Enterprise pricing for loans with substantially similar credit characteristics based on origination channel – specifically pricing penalties with respect to TPO loans. At least one of the Enterprises 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 disparities in pricing for TPO loans are a dramatic departure from the core and vital 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 as long as they deliver investment quality loans to the enterprises. 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 to support the need for a higher risk multiplier for TPO loans.

This is yet another case of the ERCF influencing pricing, resulting in pricing variations on TPO loans that negatively impact borrowers, particularly those critical to the core missions of FHFA and the Enterprises. 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 Enterprise 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.

MBA understands that a robust and well-balanced capital framework is critical to ensuring the Enterprises can operate in a safe and sound manner, and that the ERCF, on some level, will influence pricing decisions. However, it is clear that the Enterprises' pricing grids cannot always be a literal translation of the ERCF. We recommend that the Enterprises be granted flexibility to use methods other than pricing to manage certain risks to avoid unintended consequences and disruptions to the mortgage market.

In the longer term, MBA recommends FHFA consider further revisions to the ERCF to improve effectiveness and transparency, pending the finalization of the proposed Basel III rule in the US. That rule is expected to impose a 15 to 20 percent increase in capital requirements for larger institutions, and MBA strongly opposes the proposal. Such a substantial hike will have both macroeconomic and sector impacts that could stunt economic growth and fundamentally shift what business lines mid-sized and regional banks

focus on. The level of compatibility between the ERCF and Basel III is not clear. Revising the ERCF post-Basel III finalization will give FHFA the opportunity to address compatibility, provide transparency, and lower complexity, which will allow the Enterprises to more accurately and effectively determine capital requirements based on actual risk. This is especially important given the link between the ERCF and decisions regarding single-family pricing for the Enterprises.

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MBA appreciates the opportunity to comment on the Enterprise Single-Family Pricing Framework RFI, and we urge FHFA to continue engagement with the mortgage industry to improve clarity and transparency regarding the Enterprises' pricing framework. 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