



Director Mark Calabria
Federal Housing Finance Agency
Constitution Center
400 C St. SW, Washington D.C.

April 9, 2019

Dear Director Calabria,

I would like to take the opportunity to congratulate you on your appointment as Director of the Federal Housing Finance Agency (FHFA). The Structured Finance Industry Group¹, for which I act as the Head of Mortgage Policy, looks forward to working with you in your new role. We are also engaged with other regulators and legislators on issues under your purview, including our February 1st, 2019 letter to Senate Banking Committee Chairman Crapo thanking him for his recent draft outline on GSE reform², and our subsequent testimony before the Senate Banking Committee³. We had also communicated with previous Acting Director Otting on these matters⁴. In these efforts, we stand ready to provide market-based data and industry expertise from the entire breadth of the secondary market which I hope will aid you as you carry out your important statutory responsibilities and establish policies that will impact the lives of Americans everywhere.

To that end, and in furtherance of your role as Director of the FHFA and Conservator of Fannie Mae and Freddie Mac (the Government Sponsored Enterprises, “GSEs”, or Enterprises”), I would like to highlight a few specific items that we believe are necessary to ensure the healthy functioning of the secondary market. SFIG represents institutions involved in every aspect of the securitization value chain, which includes the GSEs, private lenders and an investors, and federal agencies like FHA. At all times, securitization is a fundamental component of making home loans available and affordable to borrowers of all geographies and income levels across the country.

As you no doubt know, the American mortgage market is enormously complex. Even selling loans to a GSE involves credit reporting bureaus, credit rating agencies, data and analytics, and today, the American taxpayer. Private label securitization, or “PLS”, is similar in complexity, although the taxpayer is not as directly involved. Both GSEs and PLS securitization play a major role in our housing market, along with traditional bank lending. All these arenas need constant attention, and regulators in Washington play a crucial role in helping to ensure they are used safely and properly.

Today I want to highlight a few areas where we believe that there are specific steps the FHFA can take—both unilaterally and in coordination with other regulators, agencies, and departments—that

¹ SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, to drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market, including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

² http://www.sfindustry.org/images/uploads/pdfs/SFIG_Letter_to_Senator_Crapo_on_GSE_Outline_2.1.2019.pdf

³ <https://www.banking.senate.gov/imo/media/doc/Bright%20Testimony%203-27-19.pdf>

⁴ http://www.sfindustry.org/images/uploads/pdfs/SFIG_letter_to_FHFA_Acting_Director_Oting_%28Final_with_Signature%29.pdf

can help add depth and liquidity and, potentially, countercyclicality via a safe private label securities (PLS) market that complements government lending. An appropriately-regulated and structurally sound PLS market is not only a necessary component of a deep and liquid secondary market that attracts private capital, but if done in a properly regulated way, can help ensure that American consumers can access the global capital markets to finance home ownership in a sustainable way.

A robust and prudently regulated non-GSE market for securitization that allows some risks to be moved away from the Enterprises can be an enormously additive component of any efforts to evolve our mortgage market. With that in mind, SFIG would like to offer the following ideas that we hope might serve as a useful roadmap to help achieve a healthy and functioning PLS market that can complement pure government or quasi-government lending. These steps fall into four broad categories: Equitable Capital Treatment, Standardization, Private Markets and Transparency.

Equitable Capital Treatment Between Enterprises and Banks

In November 2018, SFIG submitted our response to the FHFA's Proposed Rule on Enterprise Capital⁵. We welcomed the opportunity to provide our thoughts on this important framework, especially as it represented the first opportunity for the public to weigh in on the capital requirements of the GSEs while they operate in Conservatorship with the explicit backing of the U.S. taxpayers. In that response, SFIG commented on the need to "Develop and maintain a level playing field for capital to facilitate capital flows to multiple types of entities to bear mortgage credit risk."⁶ What this means in practice is that the Enterprises' capital requirements cannot be viewed in isolation. Rather, we must also take into account the requirements applicable to other entities subject to regulatory capital rules, as well as other aspects of the Enterprises' own operations (e.g., guaranty fees).

In establishing GSE capital requirements, the FHFA should not ignore the tested and rigorous approaches adopted by other prudential financial regulators. Financial regulators must create a level playing field so that GSEs do not enjoy capital benefits that add to the tilting of the market in favor of quasi-government execution and put taxpayers at significant risk. Notwithstanding the GSEs' lack of designation by the Financial Stability Oversight Council (FSOC) as Systemically Important Financial Institutions, they must still be recognized as the large systemically important financial institutions that they in fact are, with GSE capital standards aligning with banks and other similar institutions – including those institutions' minimum leverage requirements – as much as possible.

At the same time, one area where other prudential regulators could look to the framework established by the FHFA is in the FHFA's treatment of capital relief for Credit Risk Transfer (CRT) transactions. Currently the GSEs have successfully operated their CRT programs as a means of offloading credit risk to private investors, and SFIG believes that the GSEs and/or their successors should continue operating these programs going forward and beyond conservatorship. **The success of these programs at the GSEs, however, highlights the fact that private sector institutions in the U.S. that are subject to regulatory capital requirements are not currently able to achieve similar levels of capital relief for engaging in substantially similar transactions.** SFIG believes that this

⁵ http://www.sfindustry.org/images/uploads/pdfs/SFIG_Signed_Final_Response_to_FHFA_on_Proposed_Capital_Rule.pdf

⁶ SFIG Response to FHFA Proposed Capital Rule for Enterprises <https://www.fhfa.gov/SupervisionRegulationRules/Pages/Comment-Detail.aspx?CommentId:15278>

significantly inhibits the creation of a vibrant market for mortgage credit risk beyond those for the GSEs, missing an opportunity to expand an enormously successful program for the benefit of the entire U.S. housing market.

Moreover, the European Banking Authority (EBA), in carrying out their directives under the international Basel III standards have likewise provided capital relief to private European financial institutions engaging in Significant Risk Transfer (SRT) transactions, which are substantively similar to GSE CRT transactions. This patchwork regulatory framework—which does not allow U.S.-based financial institutions to achieve capital relief by engaging in CRT-like transactions—places American institutions at a competitive disadvantage relative to both their European-based counterparts, as well as the GSEs. Exhibit I puts in stark relief the effects of this asymmetry, demonstrating the favorable treatment received by the GSEs relative to private sector financial intuitions. In particular, the capital used and risk-weighted assets required to be set aside by the GSEs are a fraction of what would be required by their U.S. bank counter-parts for an identical transaction. This results in making the same business far more profitable for the GSEs simply due to capital treatment. **These asymmetries may lead to capital inefficiencies, concentration of risk at the GSEs, and instances of capital arbitrage.**

Exhibit I: GSE CRT Capital Relief Comparison

CRT Capital Relief Comparison

Reflects \$350MM Whole Loan originated and securitized in cash transaction

<u>Financial Metrics</u>	Kept on Balance sheet	Credit Risk Transfer Transaction - Retention of 1st loss and senior/AAA interests		
	NonConf WL	Current US Bank Treatment	Treatment under current rules, if OCC approves Capital Relief	Proposed Treatment for GSE Capital Relief under CCF
Net loan yield ⁽¹⁾	0.74%	0.70%	0.70%	0.70%
Return on Assets (ROA) Before Tax	0.74%	0.70%	0.70%	0.70%
Est. Basel 3 Capital Usage % ⁽²⁾	4.75%	4.75%	2.60%	0.59%
Est. Basel 3 Capital Usage \$MM ⁽²⁾	16.6	16.6	9.1	2.1
Est. Basel 3 Capital Usage % ⁽³⁾	1.21%	1.21%	1.75%	0.59%
Est. Basel 3 Capital Usage \$MM ⁽³⁾	4.2	4.2	6.1	2.1
Return on Equity (ROE) Post Tax				
Basel 3 Standardized Approach	12%	11%	20%	90%
Basel 3 Advanced Approach	46%	44%	30%	90%
Effective Risk Weighted Assets				
Basel 3 Standardized Approach (%)	50%	50%	28%	6%
Basel 3 Standardized Approach (\$MM)	175.0	175.0	97.8	21.0
Basel 3 Advanced Approach (%)	13%	13%	17%	6%
Basel 3 Advanced Approach (\$MM)	44.4	44.4	60.7	21.0

1 - Estimate of yield on mortgage portfolio, net of after expenses and servicing costs

2 - Assumed Common Equity Tier 1 capital (CET1) requirement of 9.5% and using the Standardized approach for calculating capital required

3 - Assumed Common Equity Tier 1 capital (CET1) requirement of 9.5% and using the Advanced approach for calculating capital required

Notes

CET1: OCC requires a floor of 4.5% CET1 of 4.5% of risk weighted assets (RWA) + 2.5% of RWA as a "capital conservation buffer". Additionally regulators may impose a "discretionary counter-cyclical buffer" of up to 2.5% of RWA.

Basel 3 Standardized Approach: Under this approach banks use pre-determined formulae for calculating RWA for different types of credit exposure

Basel 3 Advanced Approach: Under this approach banks are allowed to develop their own empirical modes to quantify RWA for different types of credit exposures. This approach is subject to approval by local regulators and, because of operational and technological complexity, its use is generally limited

In beginning this work, FSOC members can take under advisement the steps already taken by the FHFA in allowing capital relief via CRT, as well as the approach of the EBA under Basel III in providing capital relief for SRT transactions. Moreover, as you—in your capacity as Comptroller of the Currency, FHFA Acting Director, and FSOC Member—undertake the work of harmonizing the overall capital and regulatory framework, SFIG stands ready to provide insight and market expertise that will help avoid the concentration of risk at federally-insured depository financial institutions, thereby benefitting taxpayers, American home owners, and secondary market participants.

Additionally, in establishing equitable capital treatment, it is imperative to consider the entirety of secondary market funding channels, including, FHA, VA and USDA programs. Simply reducing the GSE's footprint without addressing the impact of other government programs will most likely simply shift the means of taxpayer-backed support from the GSEs to other government programs, and it will do little to place private capital in front of potential taxpayer losses. Programs such as the GSE's "QM Patch"—which grants QM status to any GSE-eligible loan, regardless of DTI limits—face looming statutory deadlines requiring regulatory foresight and coordination in order to avoid market disruption. Such coordination efforts include:

- Harmonizing loan limits at the GSEs with the loan limits at FHA, VA and USDA
- Coordinating with the CFPB on the ATR/QM rules, so that any changes in the GSE's footprint can be accomplished in an orderly way, and
- Establishing a plan to phase out or modify the GSE Patch in a way that signals to the market the timing of such a modification while providing a roadmap of the steps necessary to ensure that private capital can continue to provide access to credit in the housing market as it has historically done.

Efforts to allow private capital to take on a greater role in our housing market depends in part on a coordinated effort between industry participants and a range of Federal programs and agencies, all of whom should be encouraged to work together towards the common goal of a robust, safe, and secure housing finance system.

Standardization and Competition Helps Foster Liquid Markets

While the GSEs are in Conservatorship, the FHFA effectively serves as the board of directors and management for both Fannie Mae and Freddie Mac. In this capacity, the FHFA governs the GSEs as well as entities owned by the GSEs, including Common Securitization Solutions (CSS), which manages the Common Securitization Platform (CSP). As the CSP was originally developed (and CSS was initially formed) while the GSEs operated under Conservatorship, SFIG believes that there are important questions for the governance of CSS and the CSP after conservatorship. Currently, the policy priorities related to the CSP have been focused on the development and release of the Uniform Mortgage Backed Security (UMBS) later this year. The CSP, a tremendous repository of data and technology which was effectively paid for by taxpayers, should not merely serve as the securitization platform for the GSEs or their successors providing liquidity to the "conventional" mortgage market. Such market data could be leveraged to benefit the entire secondary market and potentially expand access to credit to worthy borrowers otherwise underscored or ignored by less robust models. The data that resides within the GSEs and the CSP can help to unlock the lending market's true potential, helping to make credit available for a wider swath of American homeowners.

Private Markets Can Be More Responsive to Distressed Borrowers

SFIG also believes that an appropriately-regulated private market often can be more responsive than the GSEs in some critical ways. We have seen crisis-era modification efforts adopted by the GSEs that—due to their size and “one-size-fits-all” approach—sometimes lacked the flexibility and customization that an appropriately-regulated private market can offer⁷. In contrast, focused, customized efforts by servicers and investors of PLS securities resulted in millions of troubled borrowers receiving modifications with more flexible payment reduction and other changes in loan terms than what was available for borrowers with GSE loans. As result of lessons learned from the crisis, PLS pooling and servicing agreements today frequently give the servicer delegated authority to make loss mitigation decisions, thereby allowing them the flexibility to tailor solutions that generally avoid pushing borrowers into default. While most servicers do mirror GSE rules on loan modifications, exceptions and changes to terms can be made to PLS securities in the interest of minimizing the risk of default that does not exist under GSE one-size fits all rules. An appropriately-regulated PLS market—with issuers, servicers, and investors acting within both the letter and the spirit of the law—provides the market with targeted, focused, and flexible solutions that are frequently unavailable to the GSEs.

Additional Transparency Would be Helpful

As noted above SFIG responded to the FHFA’s Proposed Rule on Enterprise Capital. While we commend the FHFA for this undertaking, there are specific areas where additional transparency would be welcomed by the industry. For instance, while the proposed applicability of the enterprise capital rule would be unlimited, the data set the enterprises have released so far contains only a subset of 30-year and less, fully amortizing full documentation, single family, conventional, fixed-rate mortgages, which largely comprise the relatively safe loans they have made post-crisis. This data excludes historical products that continue to make up a portion of the GSEs legacy guaranty portfolio. Releasing a much more complete data set comprising loan-level data on all loans acquired by the enterprises historically would serve to better justify the parameters of the new capital rule and would also help the market avoid some of the most dangerous product features going forward. We received a letter from Acting Director Otting informing us that FHFA staff was working on the enterprise capital rule, and that he expected a final rule later this summer.

Finally, while in Conservatorship, the GSEs have undertaken several pilot programs across a wide range of their business lines. Due to the lack of transparency over the course of Conservatorship, it can be difficult to analyze the success, failures, justification, or even existence of the entirety of all these pilot programs. While continued innovation and business evolution is an important part of any market, the FHFA must employ rigorous parameters for analyzing, authorizing, monitoring, and reviewing such pilot programs to ensure the costs of such programs are justified by any benefits. We

⁷ “HAMP Limitations Frustrate Homeowners Trying to Avoid Foreclosure” According to the article, which cites a Treasury OIG Report, less than a third of the money allocated for HAMP had been spent on incentives for servicers, investors, and borrowers, demonstrating how the program had fallen short of expectations. A housing advocate working with troubled borrowers stated “Almost any other loan modification program I know of is easier to get approved than HAMP.” <https://triblive.com/business/headlines/6659825-74/hamp-program-mortgage>

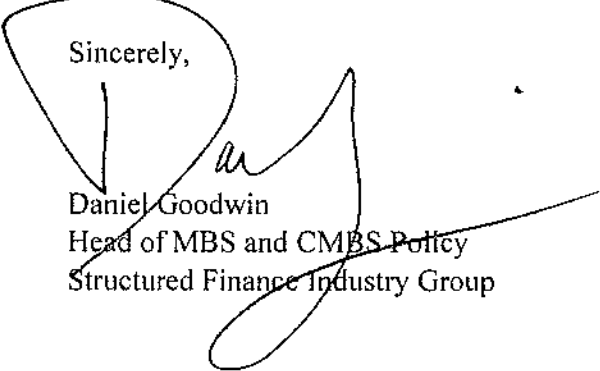
look forward to continued engagement on this topic and would be happy to provide any assistance that you or your staff may require.

Increased transparency into FHFA initiatives such as the proposed capital rule and various pilot programs—including a clearer view into the framework of such programs and the data underlying the parameters of these initiatives—would benefit the GSEs, the intended beneficiaries of such programs, and the secondary housing market at large.

Conclusion

I once again want to congratulate you on your appointment as Director of the FHFA and express my willingness to assist as you undertake this important role. As you contemplate potential actions under your authority as conservator and regulator of the GSEs, please know that SFIG stands ready to help quantify the potential impact and downstream effects of any potential changes you are considering, and our member companies are eager to help you achieve your goals successfully and to help ensure that American homeowners end up better served once changes any are done. Please reach out at any time.

Sincerely,



Daniel Goodwin
Head of MBS and CMBS Policy
Structured Finance Industry Group