March 6, 2019

Acting Director Joseph Otting
Federal Housing Finance Agency
Constitution Center
400 C St. SW, Washington D.C.

Dear Acting Director Otting,

I would like to take the opportunity to congratulate you on your work as Acting Director of the Federal Housing Finance Agency (FHFA). The Structured Finance Industry Group[1], for which I act as the Head of Mortgage Policy, looks forward to working with you in what remains of your time as Acting FHFA Director, as well as your role as Comptroller of the Currency. We are also engaged with other regulators and legislators on issues under your purview, as noted in our February 1st, 2019 letter to Senate Banking Committee Chairman Crapo thanking him for his recent draft outline on GSE reform. 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 materially impact the lives of Americans everywhere.

To that end, and in furtherance of your role as Acting 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 through all market cycles. At SFIG, we represent institutions involved in every aspect of the securitization value chain. Sometimes securitization involves selling pools of loans to the GSEs, sometimes securitization involves simply a lender and an investor, and sometimes it involves federal agencies. 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, a complex set of plumbing, and, today, the balance sheet of the American taxpayer. Private label securitization, or PLS, is similar in complexity, although the taxpayer is not as directly involved. Both GSE and PLS securitization play a major role in our housing market, along with traditional bank lending, of course. All these arenas need constant attention, and regulators in Washington play a very important role in helping to ensure they are used safely and properly.

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[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.

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 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 help finance home ownership in a sustainable way.

A robust and prudently regulated non-GSE market for securitization that allows some risks to be disseminated 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, and we hope they might serve as a useful roadmap to help achieve a healthy and functioning PLS market that can play a complementary role to pure government or quasi-government lending. These steps fall into three broad categories: Transparency, Equitable Capital Treatment, and Governance, each of which I describe below:

Additional Transparency Would be Helpful

In November 2018, SFIG submitted our response to the FHFA's Proposed Rule on Enterprise Capital[2]. We welcomed the opportunity to provide our thoughts on this important framework, especially as it represented the first substantive 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.

Unfortunately, the current Conservatorship Capital Framework (CCF) under which the GSEs presently operate has not been published, nor has the proposed rule been finalized. To the degree there are differences between the Proposed Rule and the CCF, such differences and their effects are unknown to the public. We would encourage you first to make the current CCF public and transparent, and to continue the work to date on the Proposed Rule, viewing such actions as the first two steps in an ongoing dialogue about the appropriate levels of capital and the capital framework under which the GSEs operate now and in the future.

Additionally, while in Conservatorship, the GSEs have undertaken a number of 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 of these pilot programs. While continued innovation and business evolution is an important part of any market, concerns raised by many other market participants regarding the potential negative impacts of "mission creep" merit scrutiny. While pilot programs have been implemented throughout the conservatorship, the GAO notes that since 2016, FHFA's annual Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions specifically calls on

[2] http://www.sfindustry.org/images/uploads/pdfs/SFIG_Signed_Final_Response_to_FHFA_on_Proposed_Capital_Rule.pdf

Fannie Mae and Freddie Mac to test and implement them[3]. The FHFA's Office of Inspector General (OIG) has undertaken a number of examinations or audits on some of the pilot programs[4], but the cumulative extent of all such programs—including any purported costs and benefits—remains largely unknown. Exhibit I lists GSE Pilot Programs that have been disclosed since 2016. Due to the GSE's massive market footprint, even modest pilot programs can have an outsized impact, moving or even creating altogether new markets. In order to achieve stated outcomes, market participants would benefit from having time to respond to such pilot programs in a way that enables these programs to reach their full potential without creating unintended consequences or undue burdens across the economy.

Increased transparency into such programs—including a clearer framework for how such programs are proposed, evaluated, approved, and overseen—would benefit the GSEs, the intended beneficiaries of such programs, and the secondary housing market at large.

EXHIBIT I: List of Disclosed Pilot Programs

Pilot Program	Source
REO Pilot Program	2016 FHFA OIG Semiannual Report to Congress
HomeReady Housing Counseling	2017 FHFA Scorecard Progress Report
IMAGIN Mortgage Insurance	Freddie Mac IMAGIN Pilot FHFA-OIG report
Single Family Rental Financing	Determination on Enterprise Activity in SFR Market
Fannie Mae Chattel Lending	Duty to Serve Chattel Pilot Input Request
Fannie Mae ACCESS Multifamily MBS	2017 FHFA Scorecard Progress Report
Remote notarization and eNotarization	2017 FHFA Scorecard Progress Report
Collateral Rep & Warrants for Appraisal	2016 FHFA Scorecard Progress Report
Front-end MI CRT transactions	2016 & 2017 FHFA Scorecard Progress Reports
Multifamily Cap Exclusions (LIHTC, Section 8, Green Initiatives)	2016 & 2017 FHFA Scorecard Progress Reports
Minority Borrowers First-time & low downpayment offerings	2017 FHFA Scorecard Progress Report
Supplemental Income (AirBnB) Down Payment Program	2018 GAO Report
Chattel Lending Pilot Program	2017 Duty To Serve FHFA Report
Self-employed borrower pilot	2018 GAO Report

Note: These programs may alternately be referred to as "programs", "initiatives", "undertakings", or "directives". The absence of a uniform definition of what constitutes a pilot program distinct from other programs may hamper or obscure their effectiveness. Moreover, as the 2018 GAO report notes that the FHFA Scorecards have referred to pilot programs as the GSEs since 2016, this list includes only programs since 2016. This list is not exhaustive, as there have been GSE pilots before 2016, and there may be other pilots of which we are unaware. Finally, there is no clear rationale for when a pilot iniative transitions to simply being an ongoing program at the GSEs.

Equitable Capital Treatment Between Enterprises and Banks

In response to the above-mentioned FHFA Proposed Capital Rule for the Enterprises, 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."[5] 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).

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[3] https://www.gao.gov/assets/700/695479.pdf

[4] See, for instance: https://www.oversight.gov/sites/default/files/oig-reports/WPR-2018-005.pdf; https://www.fhfaoig.gov/Content/Files/AUD-2018-003%20FHFA%27s%20Oversight%20of%20Fannie%20Mae%27s%2097%20LTV%20Programs%20%28Public%29.pdf; https://www.fhfaoig.gov/Content/Files/WPR-2012-003.pdf

[5] SFIG Response to FHFA Proposed Capital Rule for Enterprises https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15278

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 entities like the 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 official 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 the OCC and 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 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 II 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 II: GSE CRT Capital Relief Comparison

CRT Capital Relief Comparison

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

	Kept on Balance sheet	Credit Risk Transfer Transaction - Retention of 1st loss and senior/AAA interests		
Financial Metrics	*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 apporach 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, 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 offer[6]. 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

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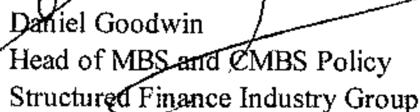
[6] "HAMP Limitations Frustrate Homeowners Trying to Avoid Foreclosure" According to the article, which cites a Treasury OIG Report, less than a third of the money allocated for HAMP had been spent on incentives for servicers, investors, and borrowers, demonstrating how the program had fallen short of 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

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.

Conclusion

I once again want to congratulate you on your appointment as Acting 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,



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