May 17, 2023

Federal Housing Finance Agency
Office of the Director
Federal Housing Finance Agency
400 Seventh Street, SW., Washington, DC 20219

Re: Request for Information on Social Bonds

Dear FHFA:

We write in response to the Federal Housing Finance Agency (FHFA) Request for Information (RFI) on Social Bonds. We appreciate the opportunity to provide comments to this RFI, and look forward to continuing our engagement with FHFA and with Fannie Mae and Freddie Mac (the GSEs) on these important questions.

The SFA's viewpoints expressed in this letter reflect our full membership, which includes issuers, investors, data and analytic firms, law firms, and other market participants. In some cases, we reflect feedback from our investor and issuer members separately, and we note when that is the case. We hope that our feedback will be constructive for the FHFA in its role as regulator and conservator of the GSEs.

## I. Introduction

As SFA has worked to construct a best practices framework for ESG disclosures, we have centered our disclosure discussions around data that is relevant, available, objective, measurable, verifiable, comparable, and accurate. Doing so has helped us focus on those areas where our members believe reporting can be responsibly enhanced today, while identifying areas where more development is needed (i.e., obtaining better, more consistent data at origination) before reliably incorporating into disclosures.

At the outset, we note that the RFI is centered on ensuring the safety and soundness of the GSEs while serving as a reliable source of liquidity, while also exploring ways in which any Social Bond programs developed by the GSEs can benefit mortgage borrowers. We strongly agree with both of these objectives and urge FHFA to adopt the principle of "do no harm" to the safety and soundness of the GSEs, as well as to their important role as a provider of market liquidity. We too also believe that economic benefits accruing from a Social Bonds program should—to the degree possible—be directed back to borrowers, and we will discuss approaches for how these goals might be accomplished.

In doing so we will reiterate investors' need for transparency in Social disclosures that is sufficiently granular to allow them to make investment decisions on the basis of the information they receive, noting that opaque disclosures rolled up from various Social metrics do not meet the

needs of many investors, particularly investors seeking transparency on Social Impact investment opportunities. Finally, we will discuss the importance of liquidity and borrower privacy recognizing that while some challenges do exist, we believe that thoughtfully constructed Social Bond programs can achieve the needed investor transparency and benefits to borrowers while maintaining consumer privacy and a liquid agency RMBS market.

## II. Potential Approaches: Program-Specific Disclosure and Universal Disclosure

The RFI contains questions about both program-specific disclosures (i.e., disclosing certain data metrics for bonds that have been labeled as "Social Bonds" by the GSEs) as well as universal disclosures (i.e., disclosing certain Social data metrics across all GSE bonds regardless of whether a particular bond is labeled as a "Social Bond"). Below, we summarize market participants' views of the benefits and obstacles of both approaches and suggest how FHFA and the GSEs might navigate such concerns.

### A. Pay-Ups and Premiums

Before speaking to program-specific disclosures, we wanted to share some views on the nature of pay-ups and premiums. A shared understanding of how economic premiums are generated can help inform whether and how the GSEs could potentially direct such benefits back to borrowers.

There are two primary reasons why a pay-up or premium might emerge for Social Bonds, which in some ways operate like an Agency specified pool. The first is that a Social Bond could reasonably be expected to attract investors who currently do not invest in Agency MBS or could incentivize current investors to increase their purchase of Agency MBS. A broader and/or deeper investor base would be an ideal outcome of "increasing the size of the pie" as new sources of capital increase the depth and liquidity of the market, thus benefiting borrowers.

Our investor members have indicated that this additional investor demand is most likely to come from investors who are seeking additional investment opportunities for their Social Impact investment appetite. Some of the investors with likely current demand for such investment opportunities include—but are not limited to—certain family offices, high net worth individuals, sovereign wealth funds, and Social Impact investors operating under Article 8 of the European Union's Sustainable Finance Disclosure Regulation. Like the GSEs' Credit Risk Transfer (CRT) and multifamily Green Bond markets that GSEs initiated over the past decade, the establishment and growth of a nascent Social Bond market will take multiple years to build a deep investor base and associated liquidity. Nonetheless, we do believe that there is sufficient demand to form a foundational investor base upon which this market can be built.

A second way that pay-ups or premiums might emerge from Social Bonds would be that investors can more accurately price the risk of bonds based on certain enhanced disclosures. In this case, the pay-ups and premiums would derive from more favorable prepayment characteristics as exist in specified pools. One example of this is how low balance mortgages which—due to their prepayment characteristics—can command a higher premium in specified pools today. In other words, enhanced social disclosure would allow investors to "cut up the existing pie into different-sized slices".

As we will discuss below, the GSEs could structure the economic benefits of such pay-ups and premiums in a way that can be passed back directly to the borrowers whose loans drive the

premiums. While it will take some additional work to interpret economic data yielded from these pay-ups and translate them into programs that can benefit borrowers we believe the GSEs and the FHFA are perfectly positioned to assess which social characteristics could most likely result in such economic pay-ups especially as their analysis is paired with the input from their ongoing, active investor outreach initiatives.

### B. Program-Specific Disclosures

Program-specific disclosures refers to the idea of creating a GSE-labeled Social Bond that is comprised of loans which focus on transparent Social metrics. A good example would be the HomeReady program from Fannie Mae[1] and the Home Possible program from Freddie Mac[2]. While bonds backed by mortgages meeting these programs are not currently labeled "Social", we believe that these programs provide a useful framework for how labeled Social Bonds could be issued by the GSEs, how they could meet investor needs, and how they directly benefit borrowers.

*Features and Benefits for Secondary Market Investors*

In a Social Bond program focused on specific loan characteristics, there should be well-defined and disclosed eligibility criteria.

For example, the Home Possible and Home Ready programs require that borrowers have an income at or below 80% of their area median income ("AMI"). This allows investors in bonds backed by loans in the program to make investment decisions based on a specific Social criteria that defines a pool. If there are pay-ups or premiums associated with such bonds, the use of proceeds could more easily be re-directed programmatically to lenders, who could then then pass that benefit to the very borrowers whose loans drive the premiums or pay-ups.

In determining which criteria may drive additional social impact pay-ups, SFA is working with our members to identify and prioritize the most important characteristics for Agency RMBS and look forward to providing follow-up feedback to the FHFA. In the meantime, existing ESG frameworks provide insights into key social attributes that are generally important to domestic and international investors. Some of the specific existing frameworks that our members have pointed to include ICMA, SASB, and UNPRI.

*Features and Benefits for Primary Market Borrowers*

As mentioned above, such a program could allow the GSEs to require lenders to pass along pay-up driven benefits back to borrowers. Because borrowers would receive the direct benefit at or near the time of origination, borrower outcomes could therefore more easily be tracked, monitored, and improved over time. Provided that the criteria remain well-defined and disclosed (i.e., there is sufficiently granular transparency into the composition of the Social Bond), the program-specific approach to enhanced Social disclosures would allow some flexibility and innovation within the program to provide different forms of assistance, and note which ones provide the most benefits to

[1] See: https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/homeready-mortgage
https://sf.freddiemac.com/working-with-us/origination-underwriting/mortgage-products/home-possible

[2] See: https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/homeready-mortgage
https://sf.freddiemac.com/working-with-us/origination-underwriting/mortgage-products/home-possible

the most borrowers. While the Home Ready and Home Possible programs focus on low- and moderate-income borrowers, it is possible that similar programs could be fashioned across other Social criteria.

### C. Universal Disclosures

Another approach, which is complementary to program-specific disclosures, would be to enhance Social disclosures across all GSE bonds. This would be similar to the approach that Ginnie Mae took in February 2023 for securities backed by FHA and VA loans. For instance, Ginnie Mae's release states:

> Investors can now identify the number of underlying loans made to Low-to-Moderate (LMI) borrowers, the percentage of LMI loan count out of total loan count, the unpaid principal balance (UPB) of LMI loans in the MBS, and the percentage of LMI UPB out of total MBS UPB.[3]

Our investors have shared with us that Ginnie Mae's approach demonstrates that disclosures can be enhanced across the board, and that such disclosures would better enable them to make improved investments decisions. Enhancing Social disclosures encourages market innovation and incentivizes investors to undertake the analysis necessary to gain insights that can yield pay-ups and premiums. In turn, to the degree that such improvements are primarily driven by economic factors (i.e., disclosures that provide information on bond performance and prepayments), such information could signal to the FHFA where new, specific GSE programs could be introduced to take those premiums or pay-ups and re-direct them back to targeted borrowers on a transparent, programmatic basis.

In contrast to the enhanced program-level disclosures, the widespread nature of universal enhanced disclosures could make the benefits more difficult to trace directly to an individual borrower. Additionally, it may be the case that certain targeted borrowers or borrower populations identified by the GSEs' respective Equitable Housing Finance plans do not give rise to economic premiums or pay-ups in bonds backed by those loans. However, as noted above, with the available data that the FHFA and the GSEs have, they are in the best position to evaluate whether there are potential economic pay-ups based on the prepayment or other performance characteristics of targeted borrowers.

## III. Data Transparency and Safeguards

Having discussed the outlines of program-specific and universal Social disclosures, we will next share some thoughts on safeguards for the TBA market. Knowing what does and does not work for investors will help guide decisions about what kinds of disclosures will be beneficial.

### *A. Potential limits and Obstacles*

The population served by the GSEs is much broader than the population served by FHA and VA. Additionally, GSE mortgage pools are typically much smaller than Ginnie Mae pools, which may make it easier to identify GSE borrowers' personally identifiable information (PII) Lastly, unlike Ginnie Mae, the GSEs must also consider how any programmatic changes reflected in their guides would impact prepayments within the UMBS.

[3] See https://www.ginniemae.gov/newsroom/HAPS/Pages/Post.aspx?PostID=75

Even as we strongly encourage enhanced Social disclosures, a few issuer and originator members have expressed concerns that providing enhanced Social disclosures that incentivize the formation of specified pools with certain attributes—particularly related to prepayment characteristics of certain loans—could adversely impact the pricing of non-Social and/or standard TBA pools. However, other members—including all of our investor members—believe that there would likely be no adverse effect on the TBA market, or any impact would likely be minimal and outweighed by the benefits of enhanced Social disclosures.

In recognition of these concerns, while we advocate for enhanced Social disclosures, it may be appropriate to release such disclosures with some safeguards. These safeguards may include minimum pool size, carefully considered stratifications that relate to particular Social disclosures (i.e., % of loans in a pool where borrowers fall within a given percentage of AMI), or pool-level disclosures (instead of loan- or other cohort-level data). We encourage FHFA to continue their ongoing oversight of the TBA market, particularly on how enhanced disclosures (either as part of program-specific Social Bond disclosure or universal enhanced disclosures) might impact the TBA market and pricing of non-Social and non-specified pool TBAs. We welcome the opportunity to continue ongoing dialogues on this important topic.

*B. Publication of Social Index Score*

The RFI specifically asks about the GSE Social Index, and whether scores from the index should continue to be disclosed to market participants. On this point, there are differing views among our investor members. Our letter from December 2022 lays out those varying views in more detail, but investor feedback on the Social Index has uniformly and unanimously been that the scores provided by the Index cannot serve as the basis for ESG impact investment decisions[4]. Moreover, updating the Social Index or modifying it in some way does not fix the fundamental problems inherent in an issuer-created, aggregated, rolled-up Social Index score. Simply put, a Social Index score—no matter how created—cannot replace the essential role of transparent, granular disclosures necessary for investors' analysis, due diligence and compliance obligations, especially for Social Impact investing.

Based on this, some of our investor members believe that the Social Index scores should not be published, and that the cessation of the Social Density Scores (SDS) and Social Criteria Scores (SCS) will encourage the GSEs to publish the transparent, granular data in a form that is more usable for investors. However, other investors have noted that some pricing differences for UMBS with higher SDS and SCS scores has developed as a potential correlation between the Social Index score and prepayment speeds is present. Given this, they believe the GSEs should continue to publish the Social Index Score until more granular data can be provided in a way that protects borrower privacy without impeding overall TBA liquidity.

It is important to note that investors who prefer that the SDS and SCS continue to be published are not making investment decisions for ESG funds with specified Social Impact criteria, and these investors would concede that the Social Index does not provide ESG investors with the data necessary to make ESG investment decisions. Furthermore, such purchases are made within these investors' existing Agency MBS investment strategy, meaning that such investments decisions reflect a targeted reallocation of capital that is already in the market, rather than introducing a new

[4] https://structuredfinance.org/wp-content/uploads/2023/01/SFA-Letter-to-GSEs-on-Social-Index-website.pdf

source of additional ESG-focused capital. Moreover, because the reallocation of capital is based on an opaque and broad set of diffuse criteria, it would be impossible to know which specific characteristic(s) is/are driving the price differences, and therefore would be impossible to redirect any sort of benefit to the borrowers whose loans are driving the price differences. In short, these investors believe that while the continued publication of SCS and SDS scores is preferable for now, it should be seen only as an interim step until more transparent and granular data can be published in a way that ensures borrower privacy and does not adversely impact the overall TBA market.

As we stated in our letter, the Social Index was crucial in furthering conversations around Social disclosures; indeed, this RFI itself is likely an outgrowth of the efforts that went into creating, implementing, and communicating around the Social Index. We noted that while the construct of a rolled-up Social Index score is unworkable for ESG investors, we expressed optimism that further dialogue on this topic would help the GSEs (as well as the overall market) take further steps to advance Social disclosures, and that appears to be taking place.

## IV. Conclusion

In summary, we strongly recommend an approach that balances providing additional investor transparency and the resulting borrower benefit with ensuring the safety and soundness of the GSEs and does not harm their ability to provide market liquidity. In any actions that the FHFA and/or the GSEs undertake, we understand and agree that care must be taken to avoid sharing borrower PII or to use the enhanced Social disclosures in a way that would re-identify an anonymized borrower. As noted above, the inclusion of limitations or safeguards may be appropriate to protect borrower privacy and/or ensure the continued liquidity of the TBA market. While we have no evidence at this stage to suggest that enhanced Social programs from the GSEs will lead to material differences in prepay speeds between the Fannie Mae and Freddie Mac, it will be imperative that any new GSE Social lending programs, policies, and practices be closely aligned to ensure that no material difference is created within UMBS. Moreover, it will be imperative that FHFA continue to monitor the UMBS to ensure its ongoing functioning within the market, and—if issues arise—to take appropriate remediation.

But even as we highlight these limits and safeguards, we reiterate that our view that additional Social data can and should be disclosed by the GSEs in a more transparent and granular manner than what is currently provided. We believe that steps can be taken to do so in a way that meets the legal, regulatory and public policy requirements of protecting borrowers and ensuring safety and soundness of the GSEs, while still providing investors with the kind of enhanced Social disclosures that will allow them to make investment decisions that can ultimately benefit borrowers. Moreover, the benefits of doing can—over time—broaden and deepen the Agency MBS investor base. Additionally, enhanced Social disclosures can leverage competitive market dynamics among a broader and deeper investor base to provide signals and direction for the GSEs to construct seller/servicer loan origination programs that can better meet the needs of underserved borrowers.

We again appreciate the opportunity to comment on this topic, as well as applaud the work that has been done at FHFA and within the GSEs to provide enhanced Social disclosures. While there is important work that remains to be done to provide investors with needed Social data on GSE loans to increase the investor base and fine-tune identified risks in the Agency market, we believe that such work can serve to draw upon new and deeper sources of capital that will help support the GSEs, market participants, and importantly the borrowers who rely upon the GSEs to obtain vital

mortgage funding. SFA looks forward to continuing this dialogue with both GSEs, as well as with the FHFA. If you have any questions, please do not hesitate to contact me.

Sincerely,

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Kristi Leo
President, Structured Finance Association