October 5, 2020

Dr. Mark A. Calabria
Director
Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington, DC 20219

Dear Director Calabria:

U.S. Mortgage Insurers (USMI)[1] represents America's leading providers of private mortgage insurance (MI) and our members are dedicated to a strong housing finance system backed by private capital that enables access to prudent and sustainable mortgage finance. The MI industry has more than 60 years of expertise in underwriting and actively managing mortgage credit risk to balance access to affordable credit with protecting Fannie Mae and Freddie Mac (the GSEs) and the American taxpayer from mortgage credit-related losses. During that time, the MI industry helped more than 33 million households achieve sustainable homeownership, including more than 1.3 million in the past year alone.

On September 22, 2020 the Federal Housing Finance Agency (FHFA) released its "Strategic Plan: Fiscal Years 2021-2024" (Strategic Plan)[2] that establishes goals for FHFA to fulfill its statutory duties as both regulator and conservator of the GSEs. USMI appreciates the opportunity to submit input on the Strategic Plan and provide feedback on the framework and requirements for forthcoming FHFA actions. At a high level, USMI commends FHFA for formalizing the establishment of its new strategic goals to: (1) ensure safe and sound regulated entities through world-class supervision; (2) foster competitive, liquid, efficient, and resilient (CLEAR) national housing finance markets; and (3) position the FHFA as a model of operational excellence by strengthening its workforce and infrastructure. USMI supports these goals and they are consistent with the observations and recommendations outlined in our October 2018 administrative reform report.[3]

A primary goal of the Strategic Plan is to take actions that strengthen the operations and oversight of the GSEs to support their exit from conservatorship. This is consistent with the Administration's March 2019 "Memorandum on Federal Housing Finance Reform,"[4] which called on the U.S. Department of the Treasury (Treasury) to develop a plan to "End[] the conservatorships of the GSEs upon the completion of specified reforms" and Treasury's

[1] USMI's membership comprises the following private mortgage insurance companies: Essent Guaranty, Inc.; Genworth Mortgage Insurance Corporation; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty, Inc.
[2] Available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA_StrategicPlan_9222020.pdf.
[3] USMI, Areas of Alignment for Administrative Reform (October 23, 2018). Full report is available at http://www.usmi.org/areas-alignment-of-administrative-reform/ and a list of specific recommendations is available at http://72nut3mk2z64bywh6c1thwjy.wpengine.netdna-cdn.com/wp-content/uploads/2019/01/One-Pager.pdf.
[4] The White House, Memorandum on Federal Housing Finance Reform (March 27, 2019). Available at https://www.whitehouse.gov/presidential-actions/memorandum-federal-housing-finance-reform/.

subsequent "Housing Reform Plan"[5] which stated that "In parallel with recapitalizing the GSEs, FHFA should begin the process of ending the GSEs' conservatorships." While it will ultimately fall to Congress to complete the difficult work of making permanent and structural changes to the housing finance system, despite a number of legislative proposals over the past 12 years, Congress has yet to pass comprehensive reform. Though congressional action is still needed to provide for the necessary structural reforms, including a transparent and paid-for explicit guarantee of the GSEs' mortgage-backed securities, the FHFA and Administration can take certain actions to further reduce taxpayer risk exposure, level the playing field, and provide greater transparency regarding GSE pricing and practices—ultimately to put the GSEs and the housing finance system on more stable footing going forward.

Over the summer, the FHFA re-proposed a post-conservatorship capital framework[6] for the GSEs, which you have routinely characterized as the most important rulemaking that will occur during your time as Director. As indicated in our comment letter, USMI urges FHFA to adopt appropriate capital standards for the GSEs and believes that a well calibrated capital framework is a critical reform. However we also strongly believe that additional reforms are necessary, including reforms that reflect the lessons learned during and since the 2008 financial crisis, reduce the GSEs' duopolistic market dominance, and create long-term safety and soundness in the housing finance system. These reforms, if done correctly, will help to reduce taxpayer risk exposure and ensure that home-ready Americans continue to have sustainable access to prudent mortgage finance credit. Further, actions taken by the FHFA and Administration should help facilitate, not inhibit, Congress' ability to complete comprehensive housing finance.

As Director of the FHFA, you have previously indicated that the agency "will continue to engage with Treasury to develop a responsible plan to end the conservatorships—with a clear road map and mile markers—and to adjust the Treasury share agreements accordingly."[7] We are pleased that there are specifc "mile markers" and reforms that will have to be met prior to ending the conservatorships of the GSEs. These reforms and mile markers should be met *before* the GSEs exit conservatorship and are mostly possible if done by the Director of FHFA in his role as conservator. You have stated on a number of occassions your desire and intent to improve competition in the marketplace with the GSEs, noting that "[c]ompetition lowers prices, improves quality, and drives innovation…and ensure[s] no institution is 'too big to fail.'"[8] However, even if Congress were to provide FHFA the authority to grant charters to new guarantors, for competition to ever exist in the marketplace, the GSEs' significant market advantages would have to be addressed. Over the decades—and particularly during their more than 12 years in conservatorship—the GSEs have made significant investments in proprietary systems and technologies that have made the mortgage finance system even more reliant on the

[5] U.S. Department of the Treasury, Housing Reform Plan (September 5, 2019). Available at https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf.
[6] Notice of Proposed Rulemaking on Enterprise Regulatory Capital Framework. 85 Fed. Reg. 39274 (June 30, 2020). USMI's comments are available at http://www.usmi.org/usmi-comment-letter-on-fhfas-proposed-rule-on-the-enterprise-regulatory-capital-framework/.
[7] Remarks by FHFA Director Mark Calabria, 2019 Ginnie Mae Summit (June 13, 2019). Available at https://www.fhfa.gov/Media/PublicAffairs/Pages/Prepared-Remarks-of-Dr-Mark-A-Calabria-Director-of-FHFA-at-2019-Ginnie-Mae-Summit.aspx.
[8] *Id*.

GSEs. Addressing these vast advantages and implementing these reforms is necessary ahead of allowing the GSEs to build capital and exit conservatorship, where they would otherwise be able to leverage their existing capital and operational advantages to maintain their market dominance.

During conservatorship, stakeholders across the ideological spectrum have put forth a multitude of proposals and recommendations on housing finance reform. While they differ on various details, the proposals and recommendations have a critical similarity among them—they generally recognize that the GSEs should not be recapitalized and released before certain necessary meaningful reforms are completed and made permanent. Further, these proposals also include many common features for what should be considered "mile markers" to be met in advance of ending the net-worth sweep and ahead of the GSEs retaining capital. To varying degrees, many of the leading legislative and Administrative proposals for GSE reform have leaned on a utility-like secondary mortgage market function for the GSEs to reduce their current duopoly and market power in the mortgage finance system. Nearly all such proposals call for capping the GSEs' rates of return, limiting their scope of activities to secondary market functions, and providing open and transparent access to the GSEs' data, pricing, and technologies for private market participants, policymakers, and consumers. As to Congress, recent legislative proposals[9] envision a role for the GSEs in a future housing system with an explicit government guarantee at the security level, call for the GSEs to ensure access for smaller lenders, and include transparent affordable housing requirements. These proposals signify that Congress feels there are critical functions currently imbedded in the GSEs and deems these functions/features necessary in a future housing finance system—either within the GSEs or placed in a separate utility or public exchange.

Ultimately, we believe that any actions taken by the Administration should seek to further four key policy objectives: (1) maintain what works in the current system; (2) further reduce taxpayer risk; (3) level the playing field between the GSEs and private market participants; and (4) provide greater transparency regarding the GSEs' pricing and business practices. At a minimum, prior to the GSEs' release from conservatorship, USMI urges FHFA to take the following administrative actions to achieve the above stated policy objectives:

1. **Limit the GSEs' activities to only those necessary for the GSEs to fulfill their intended role of facilitating a liquid secondary market for mortgages, preserving a bright line separation between primary and secondary market activities.**

   Objective 2.1 of the Strategic Plan calls on the FHFA to "ensure the activities of the regulated entities stay within the boundaries of their charters and appropriately respond to market events and downturns." USMI strongly supports policies and supervision that preserve the "bright line" separation between the primary and secondary mortgage markets. It is imperative that the GSEs' activities be limited to the secondary mortgage market, as stipulated by their congressional charters which explicitly state that their purposes are to "provide stability in the secondary market for residential mortgages; to

[9] "Bipartisan Housing Finance Reform Act of 2018" discussion draft (Hensarling-Delaney-Himes) and Chairman Crapo's Housing Reform Outline (February 2019).

respond appropriately to the private capital market; to provide ongoing assistance to the secondary market for residential mortgages…; and to promote access to mortgage credit throughout the Nation."[10] Before the GSEs are released from conservatorship, FHFA should use its authority to implement regulatory guardrails to ensure the GSEs do not encroach on primary market activities and do not disintermediate private market participants. Infringements of the longstanding bright line serve only to increase the GSEs' market dominance and diminish the role that private capital plays in the housing finance system. For instance, the selection of loan-level credit enhancement has been a function of the primary mortgage market for more than 60 years and it is critical that it remains as such going forward to ensure that a vibrant, competitive private MI market is maintained to benefit taxpayers and consumers, and to prevent greater entrenchment of the GSEs.

2. Increase transparency around the GSEs' operations, credit decisioning, technologies, and role in the housing finance system.

Implementing elements of a utility-like secondary market function for the GSEs, including transparency around their data, technology, and pricing, are appropriate guardrails that can help ensure the GSEs' activities are within the bounds of their charters. Further, initiatives and technologies at the GSEs, such as those that seek to reduce the use of appraisals for purposes of assessing collateral during the underwriting process, can dramatically increase risk in the mortgage finance system if not done with transparency and in collaboration with other market stakeholders. Innovation, without proper guardrails and transparency, can further hardwire the GSEs' automated underwriting systems (AUSs) into the broader housing finance system and complicate the prospects and logistics of enacting permanent structural reforms.

3. Require a "notice and comment period" process and prior approval of new products and activities.

During their 12 years in conservatorship, the GSEs have developed and introduced programs, products, and pilots with little to no transparency, often representing expansions into areas of the mortgage finance system considered to be functions of the primary mortgage market. This includes pilots for guaranteeing loans for single-family rentals, financing a select group of large non-banks to support mortgage servicing operations, executing lender risk sharing credit risk transfer (CRT) transactions, and utilizing less regulated and capitalized forms of credit enhancement – Fannie Mae's "Enterprise-Paid Mortgage Insurance" (EPMI) and Freddie Mac's "Integrated Mortgage Insurance" (IMAGIN). These pilots were introduced into the market without transparency for stakeholders and without a comment period to receive industry input on both the need for the pilots and recommendations to improve their operations. In some

[10] Fannie Mae Charter (12 U.S.C. 1716); Freddie Mac Charter (12 U.S.C. 1541 note).

cases, they were only made available to a select group of industry participants—generally at the sole discretion of the GSEs, thereby picking winners and losers among industry participants. More recently, FHFA has directed the GSEs to end some of these pilots,[11] and has indicated it plans to release a Request for Input (RFI) or Notice of Proposed Rulemaking (NPR) regarding the prior approval of new products and programs at the GSEs. USMI strongly supports a regulatory mechanism to exercise greater scrutiny of new GSE activities to ensure they support the GSEs' explicit public policy objectives and comply with their charters. New products, activities, and pilots should only be allowed when there is clear and compelling evidence that the GSEs are needed to fill a market void that the private market cannot meet. A robust approval process that complies with the Administrative Procedure Act (APA) and provides for input from market participants and stakeholders will help ensure that private capital plays a significant role in the mortgage market and prevent the GSEs from being further entrenched in the housing finance system.[12]

4. Require that counterparty standards be set by the FHFA.

Objective 2.1 of the Strategic Plan also calls on the FHFA to "establish standards for sellers, servicers, and counterparties to the regulated entities that strengthen the overall function and resiliency of the mortgage markets." Private MIs are one of the only counterparties that have rigorous capital and operational standards, the Private Mortgage Insurer Eligibility Requirements (PMIERs),[13] set by the GSEs and approved by FHFA, which were finalized through a public comment process. MIs must comply with the PMIERs standards in order to insure loans guaranteed by the GSEs. PMIERs ensure MI counterparty creditworthiness, as well as providing minimum standards for capital, operations, procedures, conflicts of interest, and other controls. USMI supports the FHFA promulgating strong risk-based capital and operational standards for all credit enhancement providers to ensure the availability of first-loss, loan-level credit enhancement across market cycles.

The Administration has an opportunity to promote greater transparency and oversight of the GSEs and their counterparties and to correct what has proven to be at times a conflicting role that the GSEs play by both setting standards for market participants and then competing against these same private market participants. Lenders and other market participants should feel confident that they can access the secondary market on a level

[11] FHFA, Determination on Enterprise Activity in the Single-Family Rental Market (August 21, 2018); FHFA, End of Mortgage Servicing Rights Financing Pilot Program (September 18, 2019); FHFA, Credit Risk Transfer Progress Report: 4Q 2019, commentary on lender risk sharing, page 14 (April 3, 2020).

[12] The rulemaking and subsequent approval process should guidance on differentiating between "new products" at and "new activities." Section 1123 of HERA outlines a specific approval process for "new products" that includes a public notice period and review based on: charter permissibility; public interest; and the safety and soundness of the overall mortgage finance system. "New activities," however, are not subject this process/requirements.

[13] Fannie Mae PMIERs available at https://singlefamily.fanniemae.com/mortgage-insurers (September 27, 2018); Freddie Mac PMIERs available at https://sf.freddiemac.com/general/private-mortgage-insurer-eligibility-requirements-pmiers (September 27, 2018).

playing field with their competitors, based on clear and transparent standards. While diminished under a more utility-like system, there will still be a conflict for the GSEs to set counterparty standards, as there will continue to be opportunities to arbitrage the rules to compete with the private market and/or to pick winners and losers in the marketplace. A further post-conservatorship complication is that the GSEs may not continue to collaborate on PMIERs updates and the existence of two competing eligibility standards could cause market arbitrage opportunities and market distortions. Therefore, FHFA, under its authority and responsibility as regulator, should remain intently engaged in the development and approval of PMIERs. It is also important that the FHFA create transparent and consistent/comparable standards that promote a level playing field across counterparties.

Further, consistent with nearly all other federal financial regulatory regimes, the FHFA as a prudential regulator of the GSEs should supervise the GSEs' risk management processes and financial health. FHFA should use its regulatory authority whenever possible (as opposed to its authority as conservator) to minimize regulatory arbitrage by having a coordinated and consistent oversight approach.

5. Promote a clear, consistent, and coordinated housing finance system.

Finally, actions taken by FHFA should increase transparency and consistency, and should reduce, not merely shift, mortgage credit risk in the housing finance system. To accomplish this, the FHFA should work closely with other federal regulators to implement a transparent and coordinated housing policy that facilitates access to credit, promotes prudent mortgage underwriting, and creates a level playing field. Robust coordination between the FHFA, U.S. Department of Housing and Urban Development (HUD), and Consumer Financial Protection Bureau (CFPB) will ensure that borrowers are best served by housing market participants and that the federal government, and therefore American taxpayers, are adequately protected from losses related to mortgage credit risk. Federal policy should clarify which borrowers should be served by the GSE-backed market and which are better served by the Federal Housing Administration (FHA). This is consistent with Treasury's "Housing Reform Plan, which stated that "FHFA and HUD should develop and implement a specific understanding consistent with these defined roles for the GSEs and the FHA so as to avoid duplication of Government support."[14] Importantly, the GSEs have demonstrated that first-time homebuyers and borrowers with low down payments can effectively be supported by the conventional market. The GSEs and MIs have a long history of facilitating access to affordable and prudently unwritten low down payment mortgages, and conventional loans with private MI have been the preferred option for low down payment borrowers for every year since

[14] U.S. Department of the Treasury, Housing Reform Plan (September 5, 2019). Available at https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf.

2016.[15] These home-ready borrowers should have mortgage options and not be categorically restricted to government-insured programs such as the FHA.

A primary aspect of promoting a coordinated housing finance system is that the Administration, and FHFA specifically, should advance policies that promote borrowers being served by the conventional market, by private capital, where possible. As stated in our comment letter on the re-proposed Enterprise Regulatory Capital Framework, USMI strongly encourages FHFA to promote private capital standing in front of the GSEs, including through loan-level first-loss protection through entities that can actively manage mortgage credit risk, such as private MIs. Further, the Administration could encourage or require these private entities to disperse credit risk, similar to how private MIs currently operate and use the reinsurance and capital markets to further distribute mortgage credit risk to diverse global sources of capital.

A well-functioning housing finance system should provide consistent, affordable credit to borrowers across the nation and through all parts of the credit cycle without putting taxpayers at undue risk. Fixing our nation's housing finance system and putting it on a sustainable path is the last piece of unfinished business following the 2008 financial crisis. We urge the FHFA and Administration to pursue the reforms enumerated above to ensure greater taxpayer protection and a more level playing field that enables a more transparent housing finance system and promotes sustainable access and affordability. Questions or requests for additional information may be directed to Lindsey Johnson, President of USMI, at ljohnson@usmi.org or 202-280-1820.

Sincerely,

Lindsey D. Johnson
President
U.S. Mortgage Insurers

[15] Inside Mortgage Finance, Primary Mortgage Insurance Activity.