August 14, 2023

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

Dear Director Thompson,

On behalf of U.S. Mortgage Insurers (USMI) and our member companies,[1] we appreciate the opportunity to provide feedback on the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) on the "Fannie Mae and Freddie Mac Single-Family Mortgage Pricing Framework" (GSE Pricing Framework).[2] USMI represents the nation's leading private mortgage insurance (MI) companies and our members are committed to a strong housing finance system backed by private capital that enables access to affordable and sustainable mortgage finance. The private MI industry is a critical component of the nation's housing finance system and sits at the intersection of access and affordability for homebuyers and promoting safety and soundness by providing risk protection to lenders, Fannie Mae and Freddie Mac (GSEs or Enterprises), and taxpayers. USMI is proud to represent an industry with a 66-year history of enabling first-time, minority, and low- to moderate-income (LMI) homebuyers to achieve the American Dream of homeownership.

As an industry that is dedicated to the U.S. housing finance system and serves homebuyers with limited access to funds for large down payments, private MIs are keenly interested in advancing policies that promote access to the conventional mortgage market and support sustainable homeownership. USMI strongly supports the FHFA's work to balance the safe and sound operations of the GSEs with facilitating borrower access to affordable mortgage finance. Since 1957, the private MI industry has helped more than 38 million households purchase or refinance a home, including more than 1 million in 2022 alone, with first-time homebuyers comprising 62% of purchasers last year.[3]

USMI appreciates the RFI as an opportunity to share data, observations, and recommendations about the GSE Pricing Framework. As long-term managers of single-family mortgage credit risk, USMI firmly believes that FHFA's oversight of GSE pricing policies warrants robust public comment and discussion given their significant impact on homebuyers, the GSEs, taxpayers, and housing market participants. The GSE Pricing Framework should be calibrated to best further the GSEs' statutory mandates to "provide stability in the secondary market for residential mortgages; respond appropriately to the private capital market; provide ongoing assistance to the secondary market for residential mortgages; [and] promote access to mortgage credit throughout the Nation."[4]

USMI believes that the approach used by the GSEs to estimate future returns on low down payment mortgages with private MI coverage systematically understates expected returns and incents the GSEs

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[1] USMI membership comprises the following private mortgage insurers: Enact Mortgage Insurance Corporation; Essent Guaranty, Inc.; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty, Inc.
[2] Federal Housing Finance Agency, "FHFA Requests Input on the Enterprises' Single-Family Pricing Framework" (May 15, 2023), available at https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Requests-Input-on-the-Enterprises-Single-Family-Pricing-Framework.aspx.
[3] GSE Aggregate Data and Private MI Company Data.
[4] 12 U.S.C. 1716; 12 U.S.C. 1451 note.

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to charge higher upfront fees than may be necessary to earn an adequate return on this mission-critical segment of the mortgage market. USMI's broader observations and recommendations regarding the GSE Pricing Framework are immediately below, followed by responses to specific questions posed by the RFI in the Appendix.

FHFA's oversight of the GSE Pricing Framework should be based on the following principles:

1) **Maximize responsible homeownership opportunities** – The GSE Pricing Framework must strive to balance the safe and sound operations of the GSEs and broader housing finance system with the ability to responsibly maximize homeownership opportunities for all home-ready borrowers, including those who lack large down payments.
2) **Fully account for the risk mitigating and capital benefits of private MI** – The GSE Pricing Framework should reflect the strong financial positions of private MIs as GSE counterparties that stand in the first loss position. GSE pricing should recognize the full value of post-2008 enhancements to the industry from updated Private Mortgage Insurer Eligibility Requirements (PMIERs), stronger Master Policy contractual language, expanded underwriting guardrails, and quality assurance refinements. FHFA should also consider an option for a fairly priced reduction in GSE upfront fees charged to lenders that obtain deeper than standard private MI coverage.
3) **More accurately reflect the real expected returns to the GSEs from low down payment mortgages with private MI coverage** – FHFA's oversight should ensure that the GSE Pricing Framework accurately prices mortgage credit risk and eliminates duplicative fees for first-time, LMI, and high loan-to-value (LTV) homebuyers. FHFA should assess the following potential adjustments as a means to redress shortcomings that result in the GSEs systematically understating expected returns on low down payment mortgage with private MI coverage. These changes would more accurately reflect the GSEs' expected returns on low down payment mortgages, thereby increasing GSE willingness to guarantee those mortgages and prudently allow for reduced upfront fees for these borrowers without additional subsidy:
    a. Take a "life of borrower" view to address the fundamental understatement of GSE returns on high LTV mortgages and better capture GSE returns on low down payment borrowers who will engage in subsequent mortgage transactions with the GSEs at attractive returns.
    b. Reform the Enterprise Regulatory Capital Framework's (ERCF)[5] counterparty haircuts for PMIERs-compliant private MIs.
    c. Reduce GSE capital requirements and expected losses in estimating returns to reflect significant post-2008 innovations that have proven effective at keeping borrowers in their homes and reducing the severity of losses to the GSEs in the event of default.
4) **Promote a coordinated approach to government housing finance policy** – FHFA should closely collaborate with the U.S. Department of Housing and Urban Development (HUD) when reviewing and implementing changes to the GSE Pricing Framework to promote a consistent and coordinated approach to the federal government's housing finance policy and prevent undue competition between government programs and the private sector in order to minimize risks to American taxpayers.
5) **Utilize a transparent approval and implementation process with extensive stakeholder engagement** – Future changes to the GSE Pricing Framework should be the result of robust engagement with policymakers and industry stakeholders to holistically assess risk management and affordability implications. To maximize stakeholder consultation when considering future changes to the GSE Pricing Framework, FHFA should engage in a transparent process that

[5] 85 Federal Register 82150 (December 17, 2020).

includes a public comment period, targeted outreach meetings, and public forums with market participants and consumer advocate organizations.

USMI appreciates the opportunity to share its views on FHFA's RFI regarding the GSE Pricing Framework. As an industry dedicated to serving low down payment borrowers while simultaneously ensuring safety and soundness in the housing finance system, we view ourselves as natural partners with the FHFA to promote policies, including through the pricing of mortgage credit risk, that support affordable and sustainable homeownership opportunities. We welcome any questions you may have concerning our observations and recommendations, and please do not hesitate to contact me at sappleton@usmi.org or 202-280-1820 for additional information related to this submission.

Very truly yours,

Seth D. Appleton
President
U.S. Mortgage Insurers

Appendix

Return on Capital – *Should FHFA set only minimum return thresholds for the Enterprises, or a range of returns – including a maximum return target?*

FHFA should establish a range of returns on capital that facilitates compliance with the ERCF, ensures that the GSEs are well positioned to respond to the full market cycle, and supports their public mission. A range of target returns would allow FHFA and the GSEs to be responsive to market conditions and not force the GSEs to unnecessarily tighten the credit box if or when other mortgage markets and executions contract. While FHFA has not publicly stated the target rate(s) of return for the GSEs, USMI urges FHFA to include this information in future guarantee fee (G Fee) annual reports. The new information should identify the target rate of return for each GSE, performance against the target, any product- and borrower-specific targets, and the level of cross-subsidy.

It is important to note that simplistic return on capital frameworks that estimate guaranty business return on capital using the G Fee (including the annualized value of upfront fees) and initial ERCF capital allocation systematically understates the returns the GSEs will earn on low down payment mortgages and their value to the GSEs, as well as the broader housing finance system. First, the initial ERCF capital allocation for low down payment mortgages is overstated considering home price appreciation (HPA) reduces the capital allocation as mark-to-market LTVs decline on average over time. In contrast, high down payment mortgages backed by the GSEs generally do not experience significant reductions in ERCF capital requirements from HPA because the risk is already quite low at inception of the GSE guarantee. FHFA should require the GSEs to adopt more rigorous approaches for estimating GSE returns on low down payment mortgages. This could take the form of replacing the initial ERCF capital allocation with a five-year average capital level based on modest HPA or using more sophisticated modeling methods that analyze stochastic scenarios. Such an adjustment would increase, and more accurately reflect, the GSEs' expected returns on capital for low down payment mortgages.

In addition, the return on capital framework should holistically consider a "life of borrower" economic value for first-time homebuyers rather than focusing on them as single, standalone transactions. The GSEs should recognize that once low down payment borrowers start on the ladder of homeownership, they build equity, refinance into lower risk mortgages, refinance into profitable cash-out loan products, and/or use their equity for a new down payment on a larger home purchase. A holistic return on capital viewpoint makes it clear that low down payment lending to mission-centric first-time and LMI borrowers is the catalyst for future high return on capital transactions that benefit the GSEs and the housing finance system.

The return on capital framework should also fully reflect the risk and capital mitigating benefits of private MI coverage on low down payment loans. Private MI companies are well-capitalized, exceed the robust PMIERs capital requirements, disperse substantial credit risk through traditional and capital markets-based reinsurance transactions, and have substantial future premium income as additional resources with which to pay claims. Yet, the ERCF haircuts[6] the GSEs' capital benefit for private MI coverage and reduces their expected returns on low down payment mortgages with private MI coverage. We urge FHFA to reevaluate and reform the ERCF's application of counterparty haircuts to the capital relief the GSEs receive from PMIERs-compliant private MIs.

[6] 12 CFR 1240.33(e)(3).

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Finally, the return on capital framework should consider the significant advancements that have made since the 2008 financial crisis in providing borrowers with expanded forbearance and other loss mitigation options that have proven to be effective at keeping borrowers in their homes and reducing the severity of loss in the event of default. The GSEs implemented these impactful changes under an aligned framework developed by FHFA that has served borrowers well, and has had a beneficial impact on the drivers of credit losses – both incidence of default and severity given default. Yet, the ERCF and the return on capital estimation remain, to the best of our knowledge, fundamentally rooted in historical data that fails to reflect these risk-reducing innovations. Importantly, the innovations in forbearance and loss mitigation are particularly impactful for low down payment loans, especially first-time and LMI borrowers. These borrowers are both more likely to encounter hardships as they lack the income and wealth of higher downpayment borrowers, and to result in potentially higher gross losses (before recovery from private MI) because of their reduced equity positions. The application of even a modest beneficial impact from forbearance and loss mitigation improvements to the capital requirements of low down payment mortgages in the ERCF could enhance GSE returns or be utilized to further reduce upfront G Fees to increase affordability for this mission-centric segment of the GSEs' business.

In sum, the methodological changes recommended above would each result in better alignment to the real risk and value of the GSEs' guarantees. By taking reasonable steps to redress the systematic understatement of expected returns on low down payment mortgages, the GSEs would be more willing to guarantee mortgages to this mission-critical section of the market and mitigate the need for any further upfront fee increases to this segment. We urge FHFA to direct the GSEs to carefully examine these potential changes and consider prudent revisions to the return on capital estimation framework to more accurately reflect the true returns of credit guarantees on mission-critical low down payment loans.

Return on Capital – *For which loan characteristics and products should the Enterprises accept a higher or lower return?*

The GSEs are explicitly permitted to accept different rates of return for different categories of borrowers and loan products, and their congressional charters require them to "provide ongoing assistance to the secondary market for residential mortgages (*including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities*."[7] Inherent in the principle that the GSEs can – and should – accept different rates of return for different classes of borrowers and loan products is the cross-subsidy embedded in the GSEs' current pricing. The GSE Pricing Framework should clearly and directly identify the cross-subsidy and the extent to which certain borrowers and products are funding affordable financing for mission borrowers, most notably first-time and LMI homebuyers. USMI supports the prudent application of cross-subsidy in the form of reduced or waived upfront fees to support affordable homeownership for first-time and LMI homebuyers, including for borrowers who lack large down payments.

USMI believes that loans to borrowers lacking the funds for large down payments are inherently mission-focused loans that merit consideration to be priced at lower rates of return by the GSEs. These borrowers generally have a much more difficult time obtaining financing from bank portfolio lending or

[7] 12 U.S.C. 1716(3); 12 U.S.C. 1451 note.

private label securitization and, absent GSE support, could be relegated to the Federal Housing Administration (FHA) as their only viable financing option. Within the low down payment mortgage market, first-time and LMI borrowers are particularly mission-focused, and the ability to access the GSE market to refinance into a conventional low down payment loan can also provide borrowers with significant savings through a lower mortgage rate. Conversely, mortgages that are not mission-focused are appropriate for higher targeted rates of returns. These loan products include: (1) second home mortgages; (2) investment property mortgages; (3) high-balance mortgages; and (4) cash-out refinance transactions. However, we understand that there is a limit to which fees on these non-mission loan products can be increased without forcing them to migrate from the GSE-backed market to other executions. Careful consideration of market dynamics would be warranted to ensure that sufficient non-mission volume remains in the GSE-backed market.

Process – *With what frequency should FHFA consider updating the upfront guarantee fee grids?*

While USMI supports ongoing monitoring and reviews of the GSE Pricing Framework, we do not think it is appropriate for there to be a statutory or regulatory requirement regarding the frequency of updates to upfront G Fees. Pricing changes should be guided by economic factors, prudent risk management, and serving mission borrowers rather than an arbitrary timeline.

USMI strongly believes that any future changes to the GSE Pricing Framework and policies concerning the interplay between pricing, ERCF requirements, and rates of return should be the result of robust engagement with policymakers, market participants, and consumer advocate organizations. A structured stakeholder engagement process would promote a more comprehensive understanding of the impact of proposed pricing changes on borrowers, the GSEs, and market participants. It is critical that FHFA engage in extensive outreach and consultation to holistically assess risk management, affordability, and operational implications. To maximize stakeholder consultation when considering future changes to the GSE Pricing Framework, FHFA should engage in a transparent process that includes an RFI public comment period, targeted outreach meetings, and public forums with market participants and consumer advocate organizations.

While the GSEs remain in federal conservatorship with a direct backstop from the U.S. Treasury, FHFA has a very robust oversight toolbox in its role as regulator *and* conservator of the GSEs. In a post-conservatorship housing finance system, USMI encourages FHFA to exercise regulatory authority over the GSEs to ensure a uniform process for pricing changes and any corresponding changes to counterparty requirements and standards. It is important for FHFA to oversee a uniform process for any post-conservatorship changes to the GSE Pricing Framework to ensure smooth implementation, promote efficient market operations, and prevent market bifurcation or a pricing-based race to the bottom.

Components of Guarantee Fees – *Should upfront guarantee fees be eliminated?*

Balancing Capital and Mission

The GSE Pricing Framework must carefully balance the safe and sound operations of the GSEs and broader housing finance system with the ability to responsibly maximize homeownership opportunities. USMI fully supports Director Thompson's consistent message that affordability and sustainability for borrowers and safety and soundness for the GSEs are not mutually exclusive. It is critical for the GSE Pricing Framework to be appropriately calibrated to fully account for the risk mitigating benefits of

private MI, reflect the strong financial positions of private MIs as GSE counterparties, and consider an option for additional credit enhancement in the form of deeper than standard MI coverage that could result in lower G Fees being charged to borrowers. Considering that high LTV mortgages have credit risk protection from private MI, FHFA must ensure that the GSEs price credit risk in a manner that is transparent and eliminates redundant fees. FHFA must also be judicious in allowing the GSEs to use less than standard private MI coverage as a way to provide subsidies to certain targeted borrower segments. The use of less than standard MI coverage increases credit risk to the GSEs and does not promote safety and soundness.

Removing Duplicative Fees

In March 2008, the GSEs introduced upfront G Fees (Fannie Mae's "loan-level price adjustments" and Freddie Mac's "credit fees") based on LTV ratios, credit scores, and other risk factors to protect against the heightened credit risk posed by deteriorating housing market conditions and lax pre-crisis underwriting standards. The upfront fees, however, are disproportionately paid by mission-centric borrowers as data demonstrates that first-time, LMI, and minority borrowers tend to utilize low down payment mortgages and have lower credit scores.[8] The GSE Pricing Framework should be based on transparent actuarial analysis of the mortgage credit risk being guaranteed by the GSEs and should fully reflect the risk-reducing benefits of private MI on low down payment mortgages, which significantly reduces the GSEs' and taxpayer risk exposure. Insufficient credit for private MI essentially charges borrowers twice for the same risk protection and the GSEs often charge more for their second loss risk exposure than private MIs charge for the first loss position.[9] USMI commended[10] FHFA for the October 2022 and January 2023 announcements regarding targeted waivers of upfront fees and the recalibrated single-family pricing framework, respectively. These cost reductions for many first-time and LMI borrowers are directionally positive and we encourage FHFA to further examine and reduce upfront fees for these mission-centric borrowers in order to remove duplicative fees.

In the event that FHFA eliminates upfront G Fees, it would be important to ensure that the policy change does not create undue exposure to mortgage credit risk and that the GSE Pricing Framework allows for deeper levels of private MI coverage to reduce risk exposure for the GSEs and American taxpayers.

Private MIs Provide Critical Risk Protection and Capital Relief

Private MIs stand in the first loss position ahead of GSE and taxpayer exposure to single-family mortgage credit risk. Nearly $1.4 trillion[11] of GSE-backed mortgages currently benefit from private MI coverage

[8] Urban Institute, "Before the Pandemic, Homeowners of Color Faced Structural Barriers to the Benefits of Homeownership" (August 28, 2020). Page 11, "…with homeowners of color having lower credit scores and higher LTV ratios and debt-to-income ratios than white homeowners." Further, June 2021 research from New American Funding shows that 41.1% of Black and Hispanic borrowers pay over 100 bps in upfront fees while only 28.7% of other borrowers pay that level of upfront fees.

[9] For a borrower with 5% down payment and 740 FICO credit score, the GSE upfront fee would be 62.5 bps while standard cover private MI would be 53 bps. Based on upfront fee schedule that took effect on May 17, 2023 and current published private MI rate cards.

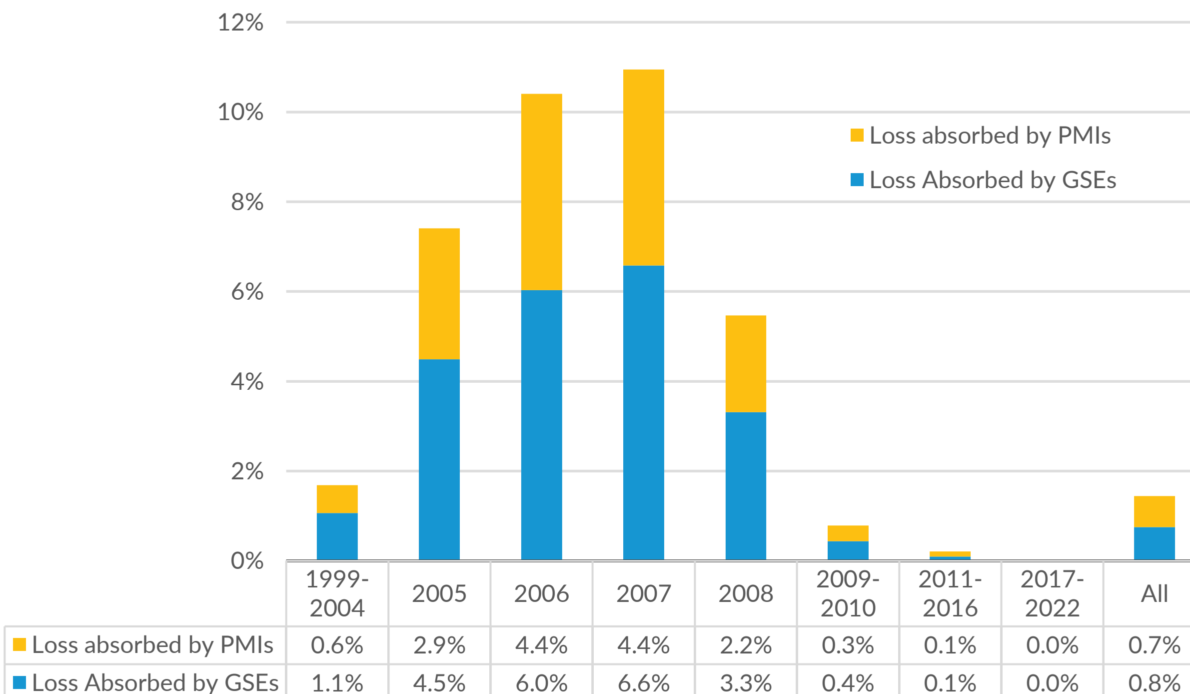
[10] USMI Statement, "FHFA's Announcements Regarding GSE Pricing, Credit Scores, and Appraisal Data" (October 25, 2022), available at https://www.usmi.org/statement-fhfas-announcements-regarding-gse-pricing-credit-scores-and-appraisal-data/; USMI Statement, "FHFA's Announcement of Additional Updates to Upfront GSE Pricing" (January 19, 2023), available at https://www.usmi.org/press-release-statement-on-fhfas-announcement-of-additional-updates-to-upfront-gse-pricing/.

[11] As of June 30, 2023 based on 2Q2023 GSE 10-Q filings.

and the industry has covered nearly $60 billion in claims since the GSEs entered conservatorship in 2008.[12] Private MI standard coverage insures up to 35% of the value of a loan (plus allowable interest and expenses) and increases based on the borrower's LTV ratio to ensure that the GSEs' – and therefore taxpayers' – risk exposure is remote. This coverage reduces the effective LTV of a loan with private MI to well below 80%.

OLTV	Portion of Losses Covered by PMI (standard cover)	Private MI Net Impact on LTV	Effective LTV
90%	25.0%	-22.5%	67.5%
95%	30.0%	-28.5%	66.5%
97%	35.0%	-34.0%	63.1%

Further, the risk mitigating benefits of private MI are present throughout the economic cycle as the presence of private MI significantly reduces GSE losses on loans with LTV ratios above 80% to the same levels as the losses on loans with LTV ratios up to 80%. GSE data from 1999 through 2022 in the graph below demonstrates that private MI is highly effective in reducing mortgage credit losses to the GSEs.[13]



	1999-2004	2005	2006	2007	2008	2009-2010	2011-2016	2017-2022	All
Loss absorbed by PMIs	0.6%	2.9%	4.4%	4.4%	2.2%	0.3%	0.1%	0.0%	0.7%
Loss Absorbed by GSEs	1.1%	4.5%	6.0%	6.6%	3.3%	0.4%	0.1%	0.0%	0.8%

[12] GSE and Private MI Company SEC and Statutory Filings.
[13] Urban Institute analysis of Fannie Mae data (loans originated 1Q1999-4Q2022, performance data through 4Q2022) and Freddie Mac data (loans originated 1Q1999 through 3Q2022, performance data through 4Q2022).

A direct benefit the GSEs derive from private MI is the ERCF's credit enhancement multiplier[14] that reduces capital required on single-family mortgage exposures that are subject to loan-level credit enhancement. While the ERCF acknowledges the benefit of private MI in the form of reduced capital allocation for high LTV mortgages, USMI has consistently called for refinements to the excessive counterparty haircuts[15] currently applied to PMIERs-compliant private MIs. The haircuts, which are driven by a subjective "counterparty rating" system, fail to recognize the full value of private MI, thereby impacting the GSEs' own pricing and capital planning.

Private MIs are Strong Counterparties to the GSEs

Since upfront fees were implemented in 2008, improvements throughout the housing finance system have dramatically increased mortgage credit quality and reduced GSE risk exposure. Importantly, the private MI industry, along with other mortgage market participants, has implemented significant reforms and enhancements over the last 15 years to improve capital positions, underwriting standards and processes, contractual obligations to insureds, and risk management. Today, private MIs are sophisticated managers of mortgage credit risk that comply with robust capital and operational standards set by the GSEs and FHFA and are subject to prudential regulation by state insurance departments.

These critical enhancements since 2008 within the private MI industry include:

- Capital: robust capital and operational requirements for MIs to be "approved insurers" were established and periodically updated by the GSEs. The industry is well capitalized and currently holds more than $10.6 billion in excess of PMIERs minimum required capital, representing a 168% sufficiency ratio.[16]
- Underwriting: significant increase in non-delegated underwriting (currently 30-40%) compared to the historical rate of 10-15% prior to the Great Financial Crisis and expanded post-close review processes that reduce rescissions.
- Contractual Obligations: a new Master Policy implemented on March 1, 2020 that builds upon the much improved 2014 Master Policy to further strengthen coverage and streamline the payment of claims to ensure, in the event of borrower default, that MI results in reliable and predictable payments. The 2020 Master Policy also aligns MIs' Rescission Relief Principles with the GSEs' Representations and Warranties framework.
- Risk Management:
    - Pricing: use of more granular, risk-based and dynamic pricing to more accurately assess and price for mortgage credit risk.
    - MI Credit Risk Transfer (CRT): similar to the GSEs' CRT programs, MI-CRT has helped transform the MI business model from "buy-and-hold" to "aggregate-manage-distribute" by transferring mortgage credit risk to both traditional reinsurers and capital markets-based reinsurance investors. Since 2015, the MI industry issued 52 mortgage insurance-linked notes (MILNs) through the capital markets to transfer more than $21.1 billion of risk exposure on more than $2.2 trillion of notional mortgages.[17] During that

[14] 12 CFR 1240.33(e)(2).
[15] 12 CFR 1240.33(e)(3).
[16] As of June 30, 2023 based on private MI company 2Q2023 10-Q filings. Aggregate available assets of $26,204,761,000 and required minimum assets of $15,557,702,000.
[17] Private MI Company Data.

same period, MIs also executed 42 quota share (QSR) and excess of loss (XOL) reinsurance transactions to transfer an additional $47 billion of risk to the traditional reinsurance market.[18]

Yet, despite these important enhancements in the private MI industry, along with a multitude of system-wide improvements related to underwriting requirements, capitalization/liquidity, and industry standards, upfront fees continue to downplay the benefit of private MI's risk protection. USMI urges FHFA to further calibrate the GSE Pricing Framework to reflect the totality of private MI enhancements since 2008.

[18] *Id.*