

August 14, 2023

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street, S.W.
Washington, D.C. 20219

Dear Director Thompson:

I am writing on behalf of the National Housing Conference (NHC) to comment on the Request for Input (RFI) on Fannie Mae and Freddie Mac's Single-Family Pricing Framework, published on May 15, 2023. We appreciate the commitment of the Federal Housing Finance Agency (FHFA) to address the concerns of affordable housing advocates and the mortgage and housing industry to develop a pricing framework that works for all Americans.

NHC is a diverse continuum of affordable housing stakeholders that convene and collaborate through dialogue, advocacy, research, and education, to develop equitable solutions that serve our common interest: an America where everyone is able to live in a quality, affordable home in a thriving community. Politically diverse and nonpartisan, NHC is a 501(c)3 nonprofit organization.

This response was informed by the input of a working group convened by NHC and conversations with our members. The working group consisted of subject matter experts and stakeholders representing various interests within the single-family housing industry. The group convened for a series of discussions that informed NHC's response to this RFI. While this letter is informed by their contributions, it represents the views solely of the National Housing Conference.

Guarantee fees (G-fees) are the foundation of risk-weighted return on capital for the Enterprises, ensuring they are responsive to their charter responsibilities while being profitable, safe and sound. If G-fees are allowed to go too low, or used to drive volume, they can fuel a "race to the bottom," as occurred during the 2008 financial crisis. If they are too high, they can move volume out of the Enterprise channel and onto the fully government guaranteed balance sheets of the Federal Housing Administration (FHA) and the Government National Mortgage Association (GNMA), placing additional burden of future losses directly on the U.S. taxpayer. This also results in lower-wealth homebuyers having fewer options. The Enterprise channel is unique as it incorporates the Enterprises and the Private Mortgage Insurance (PMI) industry into the risk tail, moving the taxpayer further away from the cost of a systemic failure. The Enterprise channel is also able to leverage a broader group of originators and servicers with a better execution for borrowers, especially when loans need timely modification to reperform. Thus, it is in the interest of borrowers, lenders, servicers, investors, and the taxpayer that the Enterprise channel is safe, sound, competitive, and widely available, especially to those underserved by the mortgage finance system.

Two fundamental factors impact G-fee pricing: capital requirements and return on capital (ROC). After 15 years of conservatorship, there is an opportunity to further reform the post financial crisis capital and G-fee framework. Ultimately, our goal is to maintain and enhance mortgage funding liquidity through a durable market structure that will support investments in mortgage financing through all business cycles, serving the entire market of qualified home buyers while protecting the taxpayers' investment. We are concerned that the current approach is overly complicated and places FHFA, the Enterprises' regulator for both mission as well as safety and soundness, in the position of

unnecessarily picking winners and losers among housing consumers. We are also concerned that the existing capital requirements are unnecessarily high, designed to facilitate an administrative release from conservatorship that would leave the Enterprises less competitive, serve lenders less effectively, and deny many qualified homebuyers access to mortgage finance in all market conditions.

Unreasonable capital requirements and G-fees would also harm minority communities, that have a long history of being ill-served by the mortgage finance system. A recent letter from the Housing Policy Center (HPC) to FHFA¹ regarding additional fees on higher debt-to-income ratios noted that “the Racial Equity Gap persists across income bands: 72% of Black and 76% of Hispanic purchase customers are non-LMI, and 55% of Black and 61% of Hispanic purchase customers have income that exceeds 100% AMI.” HPC went on to show that for mortgage customers with incomes below \$50,000, “for every 100 white homeowners, there are ~51 Black homeowners, ~70 Asian homeowners and ~59 Hispanic homeowners,” whereas for customers with incomes above \$150,000, “for every 100 white homeowners, there are ~88 Black homeowners, ~90 Asian homeowners and ~88 Hispanic homeowners.”

NHC joined HPC and the Mortgage Bankers Association, among others, in calling for a repeal of this fee, which FHFA has done. We appreciate your responsiveness to this issue. These statistics also underscore the importance of expanding homeownership to underserved homebuyers, including those who have not benefited from the privileges of multigenerational homeownership despite having middle-class incomes above 80% of the Area Median Income (AMI). We strongly believe that loan-to-value (LTV) is equally ineffective as a risk measurement when considered without a wide range of compensating factors. All risk measurements, whether debt to income (DTI) ratios, LTV ratios or credit score, to name a few, are somewhat predictive of individual loan performance. But none are meant to stand alone. Together they present a much better indication of loan performance, and this can be further mitigated by quality homebuyer counseling, competent risk management, and above all, responsible mortgage products.

FHFA’s previous pricing grid penalized first-time homebuyers for lacking the multigenerational wealth that most Americans have been able to acquire through homeownership. The new pricing grid does the opposite, cross subsidizing the adjustments to make the earlier grid fairer by increasing fees on homebuyers who pose a lower risk of individual default, though not a lower risk of loss to the Enterprises. Neither model fully recognizes the risk mitigating benefits of PMI, which is somewhat ironic given FHFA’s leadership in strengthening the PMI industry to ensure that this vital source of credit enhancement and counterparty risk is well-regulated and well-capitalized at an appropriate level for the actual risk of the mortgage products available in this channel.

Appropriately priced G-fees on loans purchased by the Enterprises remain an effective mechanism for investors to pay for the guarantee on the timely payment of principal and interest on mortgage-backed securities, ensuring a liquid and efficient market. However, loan-level risk-based pricing through Loan Level Price Adjustments (LLPAs) on purchase money, owner-occupied mortgages have outlived their purpose. **NHC believes that the Enterprises should return to charging a flat G-fee on all purchase money mortgages for owner-occupied properties, as was the practice between 1938 and 2008, and as FHA loans do today. Further, FHFA should reexamine Enterprise capital requirements based on reasonable assumptions of real risk.**

¹ https://www.housingpolicycouncil.org/files/ugd/d315af_1da0e41cbb024549b166790bd578226b.pdf

General Commentary

It is apparent that when debating the merits of risk-based pricing, there are wide-ranging connotations associated with what exactly “risk-based” means. The media frenzy that accompanied FHFA’s announcement of the most recent single-family pricing framework grid made this abundantly clear. The RFI itself uses the term risk-based pricing in reference to loan level risk-based pricing, stating that risk-based pricing is “where certain guarantee fees may vary with the risk characteristics of a loan.”² We believe that the term should also be applied at the portfolio level. This necessitates two distinct definitions of risk-based pricing: loan level risk-based pricing and portfolio level risk-based pricing, referring to the entire Enterprise book of business.

When the Enterprises enact a portfolio-based G-fee with no loan-level adjustments, the pricing remains risk-based at the portfolio level, as the portfolio includes a variety of levels of PMI for mortgages with an LTV ratio above 80% and other credit factors. Further, the Enterprises adjust G-fees based in part on a lender’s performance underwriting mortgages. Lenders with better execution pay lower G-fees. Upfront G-fees, or LLPAs, on the other hand, are risk-based pricing at the loan level. This response will consider both types of risk-based pricing and differentiate as necessary.

There is a vital difference between product risk and borrower risk that must be acknowledged when considering responses to this RFI. No event better illustrates this than the 2008 financial crisis. There has been a persistent false narrative that the crisis was caused by people taking out mortgages that they could never afford in the first place – a narrative that is simply not true. The crisis came about from a number of simultaneous factors, including: phenomenal growth of the shadow banking system, evolution of financial regulation, profound changes in the mortgage industry, and most importantly, subprime mortgages that often accorded triple-A ratings by credit agencies with conflicted motives and coinciding predatory lending practices that led to toxic mortgages³ and serial equity stripping.⁴ This point is essential to counter the false narrative that borrower risk led to the financial crisis. This product risk was acknowledged and corrected through the Dodd-Frank Act of 2010.⁵ This fact should be the foundation of any decisions on GSE capital and pricing.

It should also be noted that the Temporary Payroll Tax Cut Continuation Act of 2011⁶ that imposed the 10 basis point (bp) increase on G-fees requires reporting only, not explicitly risk-based pricing on the broader business. It remains frustrating to many in the housing industry that this 10 bp increase is not in turn reinvested back into the housing market. Instead, it is used to fund infrastructure investments in road repairs necessary in part, because of heavy traffic resulting from longer commutes required of residents who cannot afford to live close to their work. Any criticism of cross-subsidization strategies in mortgage pricing pales in comparison to the egregious cross-subsidization of requiring 10 bp of additional fees on mortgages and using the money to pay for highways rather than fostering additional liquidity in the mortgage market, especially in times of economic stress. While the responsibility of this lies with Congress, it should be considered in the context of criticisms of cross-subsidization in mortgage pricing.

² <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Single-Family-Mortgage-Pricing-Framework-RFI.pdf>

³ <https://nhc.org/understanding-the-cause-and-addressing-the-decrease-in-african-american-homeownership/>

⁴ <https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>, pg. 27-28

⁵ <https://www.congress.gov/bill/111th-congress/house-bill/4173/text>

⁶ <https://www.congress.gov/112/plaws/publ78/PLAW-112publ78.pdf>

Questions

1. *What is an appropriate long-term commercially reasonable return on capital threshold for the Enterprises to achieve?*

As the RFI makes clear, pricing is closely linked to capital requirements and the expected return on that capital. As noted in a recent report by the Urban Institute⁷, different end-states for the Enterprises require different rates of return on capital for investors. A fully private market rate of return would be in the mid double-digit range. A private utility rate of return would be closer to 9% and the rate of return for a government-controlled utility would be closer to 5-6%.

Ultimately, these returns are governed largely by the capital requirements. If the Enterprise Regulatory Capital Framework (ERCF) is unreasonably high, the rate of return required for the Enterprises to function outside of conservatorship will be inadequate to sustain investor interest. Thus, this question cannot be addressed without full consideration of whether or not the ERCF is accurate and appropriate. We believe it is not and must be reassessed. Some may be concerned that we are suggesting an outcome driven approach. We believe that an accurate assessment of Enterprise risk demonstrates that the existing capital requirements were outcome driven.

We agree with the authors of the Urban Institute report that the current capital framework is a “misguided approach to managing the risk the [Government Sponsored Enterprises (GSEs), referred to in the RFI and this letter as the Enterprises] pose.” The report continues:

Banks assume interest rate risk, credit risk, and funding risk on mortgages alone, not to mention the many other lines of business in which they operate. The GSEs, on the other hand, primarily assume only credit risk.⁸ And they assume that risk on millions of loans over several years, making returns relatively stable and predictable.

The capital framework’s strong mix of risk-invariant features is thus unnecessary for the GSEs. And it comes at a significant cost, forcing the GSEs to hold more capital than their risk warrants. How much more can be seen in table 2.

Other features of the capital requirements further distort the relationship between risk and capital, leading to still higher capital requirements than are needed.

The risk-based requirement sets a minimum risk weight of 20 percent on the lowest-risk loans, translating into 160 basis points of capital charge charged on nearly half the loans the GSEs guarantee (Golding, Goodman, and Zhu 2020). Intended to cover the model risk involved in

⁷ How to Think about Fannie Mae and Freddie Mac’s Pricing, by Edward Golding, Laurie Goodman, Jim Parrott, and Bob Ryan. Urban Institute, August 2023 <https://www.urban.org/sites/default/files/2023-08/How%20to%20Think%20about%20Fannie%20Mac%20and%20Freddie%20Mac%E2%80%99s%20Pricing.pdf>

⁸ Original endnote in Urban Institute report: Although the GSEs also assume other risks, such as interest rate risk and counterparty risk, the scale of these risks is modest, nowhere near the scale of the additional risks banks assume.

calibrating the credit risk used in the capital requirements, the capital charge is 5 to 10 times the level of risk implied by these loans, well above the model risk involved.⁹

TABLE 2A
Risk-Based Capital Requirements and Buffers

	Statutory	Supplemental		
	Total capital (statutory)	Common Equity Tier 1	Tier 1	Adjusted total capital
Capital requirement	8.00%	4.50%	6.00%	8.00%
Prescribed buffers				
Stress capital buffer		0.75%	0.75%	0.75%
Stability capital buffer		0.88%	0.88%	0.88%
Countercyclical buffer amount		0.00%	0.00%	0.00%
Requirement and buffers	8.00%	6.13%	7.63%	9.63%

TABLE 2B
Leverage Capital Requirements

	Statutory	Supplemental
	Core capital	Common Equity Tier 1
Capital	2.50%	2.50%
Leverage buffer ^a		0.44%
Requirement and buffer	2.50%	2.94%

Source: Federal Housing Finance Agency (FHFA), "Fact Sheet: Final Rule on Enterprise Capital" (Washington, DC: FHFA, n.d.).

^aThis was reduced by the 2022 amendment from 1.5 percent to 50 percent of the stability buffer.

The FHFA also uses the losses suffered during the 2008 financial crisis to determine how much capital is needed to cover unexpected losses. Though this is a commonly used metric, it is overly conservative, given the substantial policy changes that have taken place since.

The quality of lending the GSEs guarantee is considerably stronger than it was during the run-up to the financial crisis. The riskier products that led to the most severe losses have been banned by statute or regulation, and the GSEs now apply stricter income requirements. Previously, a borrower could submit two pay stubs over a relatively brief period to establish the income used on their application. Today, they must submit tax returns showing stable income over two years. As a result, for any given combination of credit score, loan-to-value (LTV) ratio, and debt-to-income level, the credit performance of loans today is much stronger than those originated before the financial crisis.

The loss mitigation waterfall the GSEs use has also improved meaningfully, reducing the rate at which loans move from serious delinquency into foreclosure and real estate ownership. Before the financial crisis, the relief offered to borrowers was uneven and ineffective, doing little to stem their losses. Short-term assistance was available to some struggling borrowers, but it was not well codified; servicers often added delinquent interest and fees to the mortgage balance,

⁹ Original endnote in Urban Institute report: Enterprise Regulatory Capital Framework, 85 Fed. Reg. 82150 (Dec. 17, 2020), 82220

dampening the relief. Permanent assistance through mortgage modifications were either unavailable or negotiated between the borrower and lender case by case.

The overwhelming number of delinquencies before the financial crisis forced policymakers and the industry to introduce a more aggressive, standardized approach to loss mitigation to reduce the stress to homeowners and losses in the mortgage market. The GSEs' loss mitigation efforts were strengthened further in their response to the COVID-19 pandemic, with an expansion of forbearance that has given struggling borrowers time to recover before the more costly steps of the loss mitigation waterfall kick in. All of this has dramatically reduced the cost to the GSEs of borrowers who default (Goodman et al. 2023).

These changes in the quality of lending and loss mitigation have reduced the risk of loss to the GSEs meaningfully since the financial crisis, yet they go unrecognized in the assumptions underlying the capital requirements.

Lower capital requirements, consistent with changes in the mortgage market required under existing statutory and regulatory requirements, allow for a much broader range of policy choices and more affordable pricing for borrowers.

2. To what comparable industries and companies should these return on capital thresholds be calibrated?

As noted above, banks assume interest rate risk, credit risk, and funding risk on mortgages, as well as risks from small business loans, real estate development loans, dependence on large deposits, and investments in a broad range of industries, to name a few. The Enterprises are unique in almost every material aspect from other mortgage market participants. The appropriate ROC threshold must be set with this in mind. As noted above, the end status of the Enterprises will dictate the appropriate target. For now, and through the foreseeable future, the Enterprises are government-controlled utilities and should meet capital requirements consistent with that status, likely in the 5-6% range. As the housing market has become increasingly unaffordable across the United States due to a lack of supply and rising interest rates, the cost of buying a home has risen dramatically. The Enterprises play a vital role in increasing first-time homeownership through their affordable housing goals and lending programs. Providing stable and affordable mortgage finance liquidity to this market segment is foundational to the Enterprises' mission.

NHC commends FHFA for removing any LLPA from their current mission-oriented mortgage products like Home Possible¹⁰ and HomeReady.¹¹ Despite these products and the growing popularity of Special Purpose Credit Programs, the market continues to struggle to close the racial homeownership gap and address housing disparities. Home Possible and HomeReady are also a very small component of their volume. A 2020 study showed that loan level risk-based pricing drives up interest rates for Black homeowners and contributes to \$250 per year more in interest charges for purchase loans. For GSE purchase loans, where risk-based pricing is prevalent, Black homeowners' average interest rate was greater than White homeowners by 20

¹⁰ <https://sf.freddiemac.com/working-with-us/origination-underwriting/mortgage-products/home-possible>

¹¹ <https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/homeready-mortgage>

bps.”¹² The same study found that Black homeowners pay on average 33 bps more on their mortgages when compared to White homeowners.¹³

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

While some have suggested that the Enterprises could remain in conservatorship indefinitely, we believe that providing reliable and durable countercyclical support for the housing market depends on the outcome of efforts to permanently address the structural problems in the secondary market that existed prior to the financial crisis, as the Dodd-Frank Act in 2010 did for the primary market.¹⁴ As comprehensive housing finance reform remains a highly debated topic with no indications of a release from conservatorship in the near future, it is appropriate to answer this RFI based on the status quo ante and not to set a ROC consistent with future investor expectations of a status that does not now exist.

The Enterprises have unique business models and should be treated as such. A utility-like model similar to their current business model would hold them accountable to regulations including a regulated rate of return, open and transparent underwriting, and publicly disclosed pricing. We recommend setting a range of returns, as specific targets are difficult when market conditions fluctuate. This range should include a ceiling and floor that could be benchmarked on a quarterly basis to account for the volatility of the market without constraining excess returns.

4. *For which loan characteristics and products should the Enterprises accept a lower return?*

NHC supports a strategy of accepting lower returns in a manner that manages overall risk. Given that product risk has been substantially reduced and traditionally held characteristics of borrower risk are not necessarily tied with ability to repay, the pricing framework should accept lower returns for first-time homebuyers, first generation homebuyers, and socially disadvantaged groups that are less likely to find credit availability in the traditional mortgage market.

There is a long history of underprivileged groups, particularly people of color, being purposefully excluded from receiving mortgages. As FHFA has a principal duty to ensure that “the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to mortgages on housing for low- and moderate-income families, and neighborhoods of color involving a reasonable economic return that may be less than the return earned on other activities),”¹⁵ it is imperative to recognize the disproportionate impact of LLPAs on communities of color.

5. *For which loan characteristics and products should the Enterprises target a higher return?*

Should FHFA determine the need to target higher returns, we recommend higher G-fees be applied only to second homes, cash-out refinance mortgages, investment properties, and single-family rental properties.

¹² <https://mitsloan.mit.edu/sites/default/files/inline-files/Mortgage-Cost-for-Black-Homeowners-10.1.pdf>

¹³ <https://mitsloan.mit.edu/sites/default/files/inline-files/Mortgage-Cost-for-Black-Homeowners-10.1.pdf>

¹⁴ <https://nhc.org/wp-content/uploads/2019/09/NHC-Housing-Finance-Reform-White-Paper-FINAL-9-3-19.pdf>

¹⁵ 12 U.S.C. § 4513 (a)(1)(B). See also Fannie Mae Charter, 12 U.S.C. § 1716; Freddie Mac Charter, 12 U.S.C. § 1451 note (Statement of Purpose).

6. *How should return on capital be calculated for the Enterprises?*

One of the most glaring failures of the current capital structure is its failure to give proper credit for the role of PMI. After the financial crisis, the mortgage finance system underwent a significant and vital evolution that necessitated the new distribution of risk. To ensure that the PMI industry is well positioned to serve as a permanent, dedicated source of first loss credit risk protection, the Private Mortgage Insurer Eligibility Requirements (“PMIERS”) were updated to bolster PMI industry capital, appropriately manage the PMIs as Enterprise counterparties, and provide credible federal regulation that had previously not existed. The PMIERS standards, which were enhanced in response to the 2008 housing crisis, are more rigorous than the standards of state regulators, and are a key component of today’s PMI industry. In response to the crisis, LLPA’s were thought to be needed to ensure adequate credit enhancement and bolster Enterprise revenues at a time when deep losses and taxpayer bailouts continued. As of the end of Q2 2023, nearly \$1.4 trillion of GSE-backed mortgages currently benefit from PMI coverage and the industry holds more than \$10.6 billion of eligible assets in excess of GSEs’ PMIERS.¹⁶

7. *With what frequency should FHFA consider updating the upfront guarantee fee grids?*

The guarantee fee grids should have a determined appropriate process of visitation to ensure that its regulation does not become a volatile political tool. While politicizing regulation is not always avoidable, it should be mitigated wherever possible, including setting changes on odd number years to offset them from election cycles. NHC recommends giving the industry ample notice of pricing changes, with at least three quarters of time to update systems to reflect pricing changes. Industry participants should anticipate changes similarly to changes in conforming loan limits. NHC also recognizes that FHFA may need to make pricing changes outside of this predetermined window. Any off-cycle changes are even more important to have ample notice for the industry to make pricing updates, including opportunities to make comments on proposed changes and voice any implementation concerns.

It is our recommendation that there be a formalized process for any future pricing grid changes that includes sufficient opportunity for stakeholder feedback. The media response to this recent pricing grid update undoubtedly contributed to the overall politicization of housing policy, a dangerous outcome that can too easily devolve into heated debate by many who do not understand the intricacies of the mortgage market.¹⁷ Such a process would allow for an announcement, solicitation of input, and a final rule. A transparent, anticipated process on a timeline offset from presidential terms will help to depoliticize the conversation around mortgage pricing and shield major housing policy decisions from decision making influenced more by political divides than evidence-based policy.

8. *In achieving commercially reasonable returns over time, should future guarantee fee changes be executed through ongoing guarantee fees or upfront guarantee fees?*

Changes should be executed only through ongoing G-fees.

¹⁶ 2Q2022 GSE and PMI 10-Q filings, and <https://www.usmi.org/wp-content/uploads/2023/06/USMI-Report-MI-in-your-State-2023.pdf>

¹⁷ <https://nhc.org/its-time-for-a-coherent-policy-on-mortgage-pricing/>

9. *Should upfront guarantee fees be eliminated?*

Yes. As noted above, it is well documented that the upfront costs of home purchases remain the most significant barrier for first-time homebuyers, many of whom are people of color. Finding ways to reduce and eliminate these upfront costs is vital to helping close the racial homeownership and wealth gap and further the work of the Enterprises in service to their mission.

The RFI states that “upfront guarantee fees are a form of risk-based pricing where, generally, mortgage loans considered to be riskier in nature are charged higher fees.”¹⁸ Completing a mortgage and charging a borrower a higher rate who has already been determined as riskier to making timely payments is counterintuitive. If a person is considered higher risk and is punished with higher interest, their ability to accumulate savings into a reserve account is derailed by higher payment obligations that further harm their economic health and creates vulnerability to economic shocks. A borrower should either be considered qualified for the mortgage or not yet qualified.

Appropriately priced G-fees on loans purchased by the Enterprises remain an effective mechanism for investors to pay for the guarantee on the timely payment of principal and interest on mortgage-backed securities, ensuring a liquid and efficient market. However, loan-level risk-based pricing through LLPAs on purchase money, owner-occupied mortgages have outlived their purpose. NHC believes that the Enterprises should return to charging a flat G-fee on all purchase money mortgages for owner-occupied properties, as was the practice between 1938 and 2008, and as FHA loans do today.¹⁹

10. *Should risk-based pricing be calibrated to the ERCF?*

Risk-based pricing should only be calibrated into the ERCF through portfolio-level assessments that consider the overall risk to the Enterprises using FHFA’s stress test for the severely adverse scenario. As FHFA’s most recent report shows, the worst-case scenario assumes a total comprehensive loss of income of \$8.4 billion. Yet the ERCF, “based on their financial condition as of September 30, 2021, the Enterprises together would be required to hold approximately \$319 billion in adjusted total capital.”²⁰ Even if the losses from a future crisis with five times the impact of the 2008 financial crisis were to occur, costing the Enterprises a total of \$42.25 billion, under the ERCF they would be required to hold \$276.75 billion in unnecessary capital.

¹⁸ <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Single-Family-Mortgage-Pricing-Framework-RFI.pdf>

¹⁹ Federal Housing Finance Agency Fact Sheet: Final Rule to Amend The Enterprise Regulatory Capital Framework, February 25, 2022. https://www.fhfa.gov/Media/PublicAffairs/Documents/Fact-Sheet-Final-Rule-CRT_2252022.pdf

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Dodd-Frank Act Stress Tests – Severely Adverse Scenario Results

Table 1: DFAST Severely Adverse Scenario Results – Combined

Cumulative Projected Financial Metrics (Q1 2023 - Q1 2025)					
	Results without establishing valuation allowance on deferred tax assets		Impact of establishing valuation allowance on deferred tax assets	Results with establishing valuation allowance on deferred tax assets	
	Billions of dollars	Percent of average assets ⁷		Billions of dollars	Percent of average assets ⁷
Pre-provision net revenue ¹	\$62.0	0.82%		\$62.0	0.82%
(Provision) benefit for credit losses	(\$38.0)	0.50%		(\$38.0)	0.50%
Mark-to-market gains (losses) ²	(\$5.4)	0.07%		(\$5.4)	0.07%
Global market shock impact on trading securities and counterparty	(5.5)	0.07%		(5.5)	0.07%
Net income before taxes	13.0	0.17%		13.0	0.17%
(Provision) benefit for taxes	(2.5)	0.03%	(18.4)	(20.9)	0.28%
Other comprehensive income (loss) ³	(0.6)	0.01%		(0.6)	0.01%
Total comprehensive income (loss)	9.9	0.13%	(18.4)	(8.4)	0.11%
Net Worth	\$107.2			\$88.9	
CET1 Capital ⁴	(\$140.5)			(\$137.9)	
Credit losses ⁵	(\$34.9)			(\$34.9)	
Credit losses (% of average portfolio balance) ⁶	0.46%			0.46%	

¹ Includes net interest income, operational risk losses, foreclosed property income (expense), and other non-interest income/expenses.

² Includes fair value gains (losses) on derivative and trading securities, and other gains (losses) on investment securities.

³ Includes global market shock impact on available-for-sale securities.

⁴ Represents the Enterprises' hypothetical common equity tier 1 capital deficit as of March 31, 2025.

⁵ Credit losses are defined as charge-offs, net plus foreclosed property expenses.

⁶ Average portfolio balance over the nine-quarter planning horizon.

⁷ Average total assets over the nine-quarter planning horizon.

Additional Notes

· Numbers may not foot due to rounding.

Notwithstanding the unrealistic capital requirements under the ERCF, it is reasonable to incorporate portfolio level risk-based pricing. However, incurring an upfront fee through LLPAs should not be calibrated to the ERCF. The inclusion of LLPAs opens up the structure of a mortgage market that creates “winners” and “losers” in pricing that is neither appropriate nor necessary. Further, risks are well accounted for through GSE cross-subsidization, the addressed product risk through the Dodd-Frank Act, and additional risk mitigation through PMIERS that reflects the strength of today’s PMI industry.

An analysis by the Urban Institute shows that for 30-year fixed rate, full documentation, fully amortizing mortgages, originated between 1992 and 2022, the loss severity of Enterprise loans with PMI is 40 percent lower than that without, even with the higher LTV of mortgages with the

insurance.²¹ Another analysis found that the loss severity of GSE loans without mortgage insurance was 37.6% higher, which was significantly higher than the 26.4% severity for loans with PMI.²² This underscores the critical role of mortgage insurance as a strong layer of protection against credit risk in the GSE-backed conventional mortgage market, as the GSEs can now better rely on mortgage insurance as first-loss credit risk.

Conclusion

Enterprise G-fees play a pivotal role in ensuring an appropriate risk-weighted return on capital in the conventional conforming market, ensuring Fannie Mae and Freddie Mac operate both profitably and securely. If G-fees are too low, they can contribute to a wide range of consequences, as we saw during the 2008 financial crisis. However, if G-fees are too high, consumers will be directed to the fully government-backed GNMA market, adding risk to the taxpayer and limiting options for the consumer. Depending on banks to lead this market is likely to lead to a heavily pro-cyclical mortgage market that limits options for less wealthy homebuyers and exposes bank portfolios to added convexity risk.

Unrealistic capital requirements and inflated G-fees also disproportionately impact minority communities, which have traditionally been underserved by the mortgage finance system. Historically, homeownership has been a key wealth generator for many American families. FHFA's previous pricing model penalized first-time homebuyers who didn't have access to generational wealth through homeownership. The newer model tries to address these imbalances but does so at the expense of low-risk homebuyers. There is a notable absence of recognition for the risk-diminishing advantages of PMI, despite FHFA's efforts to bolster the PMI industry. And the entire pricing structure is driven by capital requirements that are empirically proven to be highly inflated.

NHC believes that the Enterprises should return to charging a flat G-fee on all purchase money mortgages for owner-occupied properties, as was the practice between 1938 and 2008, and as FHA loans do today, and that FHFA should reexamine the ERCF based on reasonable assumptions of real risk.

Sincerely,



David M. Dworkin
President and CEO

²¹ https://www.urban.org/sites/default/files/publication/92676/2017_08_18_sixty_years_of_pmi_finalizedv3_0.pdf

²² <https://www.usmi.org/wp-content/uploads/2023/06/USMI-Report-MI-in-your-State-2023.pdf>