



April 14, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing & Urban Affairs
U.S. Senate
239 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
U.S. Senate
713 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown,

Thank you for your request for businesses, stakeholder groups and others to engage with the Senate Banking Committee on important issues to enhance economic growth and to increase consumers', market participants' and financial companies' participation in the economy.

While we understand that the Senate Banking Committee plans to take up comprehensive housing finance reform at a later date, which U.S. Mortgage Insurers (USMI) fully supports and encourages—there are several issues that can be acted upon in the leadup to comprehensive reform that will increase greater access to mortgage finance credit for borrowers, while at the same time, increasing private capital in mortgage finance and reducing taxpayer risk exposure. Two such issues are: (1) the calculation of points and fees to determine compliance with the Consumer Financial Protection Bureau's (CFPB) qualified mortgage (QM) rule for conventional mortgages; and (2) the use of front-end credit risk transfer (CRT) to further protect taxpayers from mortgage credit losses and to utilize transactions that seek to maximize transparency, access to credit, and benefits to borrowers.

In addition to the two specific proposals outlined in our submission to follow, USMI believes that the Committee should broadly focus on many of the following issues that facilitate economic growth and sustainable homeownership for Americans.

- Enable access to homeownership and affordable mortgage credit by:
 - Ensuring access to prudent low-down payment lending options that are backed by private capital, such as those available through private mortgage insurance;
 - Ensuring transparent pricing and use of the GSEs' guarantee fees, including loan-level price adjustments (LLPAs);
 - Promoting tax policy that encourages homeownership; and
 - Promoting increased housing inventory, especially the development of and access to starter homes and affordable homes.

- Protect taxpayers through increased private capital in the housing finance system by:
 - Promoting a preference for private capital ahead of taxpayer exposure in the housing finance system;
 - Establishing an appropriate balance between the conventional and government mortgage markets;
 - Establishing a coordinated housing policy across all federal agencies in the housing finance system to promote a balance between conventional and government mortgage markets; and
 - Enacting comprehensive GSE reform.

For more specific information on many of these issues, see USMI's [policy priorities](http://www.usmi.org/issues/) (<http://www.usmi.org/issues/>).

Again, thank you for your leadership and your work towards bipartisan solutions to foster economic growth, increase private sector participation, and enhance prudent access to credit for Americans. We look forward to working with you and the Committee over the coming months on housing finance reform and other issues, and appreciate the opportunity to present these tangible and broadly supported proposals for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'Lindsey Johnson', written in a cursive style.

Lindsey Johnson
President
U.S. Mortgage Insurers

Proposal #1: Qualified Mortgage (QM) Rule - Points and Fees

Issue: The 3 percent cap on points and fees as promulgated by CFPB excludes FHA’s mortgage insurance premiums (MIP) from the points and fees calculation. Private mortgage insurance (MI) does not have this same exemption, and therefore private mortgage insurance premiums (single premium or split premium policies) are included in closing calculations for conventional mortgages. The result of this arbitrary rule is that many creditworthy borrowers, who would otherwise be conventional borrowers, today may find their only option for mortgage credit is through FHA. Not only does this shift a greater number of borrowers to the 100 percent taxpayer backed government-insured agency, increasing taxpayer risk exposure, but it also unfairly pushes private market capital, such as MI, out of a market that it would normally serve. Importantly, the rule limits consumers’ choices and for many, their ability to attain a better mortgage product.

Proposal: Give equitable treatment to private mortgage insurance premiums as FHA premiums in the calculation of the points and fees threshold.

Impact of Change:

- Increased competition gives borrowers more choices. From our estimates, up to 192,492 borrowers per year could stand to benefit from this increased competition using single premium private mortgage insurance products with the potential to save up to \$90/month (\$1,080/year). Our analysis also estimates that up to 76,992 borrowers per year could benefit by using split premium private mortgage insurance products and could save up to \$35/month (\$420/year).
- Further, the borrowers that benefit are credit-worthy low-to-moderate income individuals that the conventional market, backed by private capital, can serve.
- The economic impact of this would eliminate an artificially created advantage that the 100-percent government-backed FHA insurance program has over the private sector. Private sector capital, such as in the form of private mortgage insurance, would be able to compete for credit-worthy borrowers. The industry’s estimates for the additional volume in increased conventional borrowers is \$50 billion of new insurance written by private mortgage insurance industry.¹

Background: The Dodd-Frank Wall Street Reform Act established the Qualified Mortgage (QM) rule as a primary means for mortgage lenders to satisfy its “ability to repay” requirements. Section 1431(a) of the Dodd Frank Act amends the Truth in Lending Act to require “for the purposes of computing the total points and fees under paragraph (4), the total points and fees shall exclude

- (i) “any premium provided by an agency of the Federal Government or an agency of a State;
- (ii) any amount that is not in excess of the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)A)), provided that the premium, charge, or fee is required to be refunded on a pro-rated basis and the refund is automatically issued upon the satisfaction of the underlying mortgage loan; and
- (iii) any premium paid by the consumer after closing.”

Possible legislative text:

Option 1: [Strike \(C\) “Mortgage Insurance” section](#); or

Option 2: Amend section 1431(a) of the Dodd Frank Act to provide that
“(C) Mortgage Insurance—For the purposes of computing the total points and fees under paragraph (4), the total points and fees shall exclude

- (i) “any premium provided by an agency of the Federal Government or an agency of a State;
- (ii) any premium provided by an eligible insurer as determined by the Federal Housing Finance Agency, the Government Sponsored Enterprises, as approved by state insurance commissioners, or by other federal financial regulators;

Proposal #2: Front-End Credit Risk Transfer - Taxpayer Protection and Market Access for Mortgage Finance

Issue & Background: Since 2013, Fannie Mae and Freddie Mac (the “GSEs”) have been required by their regulator and conservator, the Federal Housing Finance Agency (FHFA), to engage in credit risk transfer (CRT) transactions with the private sector to reduce the GSEs’, and therefore taxpayers’, exposure to mortgage credit risk. While the GSEs have included more than \$1.4 trillion in mortgage loans in expanded risk sharing since 2013, only approximately \$49 billion of risk has actually been transferred via CRT transactions. This represents a mere 1.23 percent of risk transferred on the approximately \$4 trillion in mortgages collectively purchased by the GSEs since 2013. Furthermore, approximately 98 percent of CRT to date has been done on the back-end, with the GSEs warehousing credit risk, sometimes as long as 15 months, before transferring to the private sector.

This proposal seeks to strike a more appropriate balance between front-end and back-end CRT by promoting transactions that transfer credit risk at the time of mortgage origination, *before* the risk gets to the GSEs, thereby placing more private capital ahead of taxpayer exposure. Private mortgage insurance represents a time-tested, reliable source of private capital that can expand front-end CRT and truly transfer first-loss credit risk to the private sector. It is also important to promote CRT transactions that keep primary market functions, such as the selection of credit enhancement, in the primary market and not upend 60 years of precedent by shifting that function to the GSEs.

Proposal: Direct the FHFA Director to establish guidelines requiring the GSEs to engage in significant and increasing front-end CRT that: 1) provides greater taxpayer protection; 2) promotes stability through durable risk-bearing capacity in all economic cycles; 3) offers transparency in pricing, organization and operation; and 4) facilitates the goal of achieving comprehensive housing finance reform. Under the proposal, the GSEs would be required to set and publish guarantee fees, including loan level price adjustments (LLPAs), to reflect the reduced credit risk resulting from new CRT transactions.

Impact of Change: While the GSEs’ CRT business has grown significantly over the years, there is little pricing transparency—particularly related to if there is any borrower benefit to risk being transferred. There is also a relatively limited universe of types of counterparties the Enterprises share this credit risk with today. Further, smaller institutions without significant scale or capital, have not been able to participate in the back-end transactions to date. This proposal seeks to identify CRT transactions that promote greater transparency and are accessible to the vast majority of lenders of all types and sizes.

➤ **Economic Impact –**

- **U.S. Budget Impact:** The GSEs are currently in conservatorship, and under the Preferred Stock Purchase Agreements (PSPAs), are required to reduce their capital to zero by January 1, 2018. With diminishing capital (and CBO’s estimate that allowing the GSEs to hold capital could increase the federal deficitⁱⁱ), it is imperative for the GSEs to transfer credit risk before it reaches the GSEs’ balance sheets, which will lower their need to hold additional capital against this risk, and therefore would lower the government’s risk exposure.

- **Access/Market Participant Impact –**
 - **Small Lenders** – Back-end CRT transactions to date have only been accessible to the biggest banks, hedge funds, asset managers and re-insurers. Front-end transactions, such as through mortgage insurance, have the advantage of being available on an equitable basis to lenders of all sizes and types.
 - **Entity-Based Credit Enhancement**—While it appropriate for the GSEs to test other forms of capital markets executions, there has been a relatively small number types of transaction partners to date. The GSEs should not rely disproportionately on forms of CRT that are untested in times of market volatility and are unfamiliar to housing market stakeholders. Entity based capital is a time-tested form of credit enhancement that is available in good and bad economic cycles.
- **Borrower Impact –**
 - The GSEs were established to facilitate the ability of borrowers to obtain economical mortgage financing and build wealth through homeownership. Front-end CRT has the additional advantage of establishing transparent value and pricing in advance so that lenders can determine whether to make use of such CRT on a prospective basis, fostering competition among CRT providers to the benefit of borrowers who may be funding all or part of the CRT.
- **Facilitation of Housing Finance Reform—**
 - Many policymakers have embraced the goal of future housing finance reform, which could very well include changes to the role of the GSEs. The GSEs' CRT activities should be assessed in this context. A CRT approach that emphasizes GSE aggregation of credit risk and distribution of that credit risk through long-term contracts requiring substantial monitoring may not be consistent with housing finance reform alternatives that change the role of the GSEs. Therefore, FHFA and the GSEs should implement CRT programs that facilitate, or at least do not obstruct, measures such as termination of the GSEs' conservatorships and the transition to a different role for the GSEs.

Prior Congressional Actions: Front-end CRT, including the expanded use of private mortgage insurance, has enjoyed bipartisan and bicameral support.

Legislation

- House: Reps. Royce (R-CA) and Moore (D-WI) introduced H.R. 6487 in the 114th Congress and would require the GSEs to engage in additional forms of CRT, including more front-end CRT.
- Senate: Sen. Shelby (R-AL) introduced S. 1484 in the 114th Congress and would require the GSEs to engage in more front-end CRT (Section 706).

Letters in support of front-end CRT

- November 18, 2014 letter from Sens. Warner (D-VA) and Warren (D-MA)
- June 10, 2015 letter from Sens. Corker (R-TN), Crapo (R-ID), Heller (R-NV), Warner (D-VA), Tester (D-MT), and Heitkamp (D-ND)
- December 2, 2015 letter from Reps. Moore (D-WI) and Stivers (R-OH)
- December 2, 2015 letter from Reps. Luetkemeyer (R-MO) and McHenry (R-NC)
- July 7, 2016 letter from Sens. Corker (R-TN), Crapo (R-ID), Heller (R-NV), Warner (D-VA), Tester (D-MT), and Heitkamp (D-ND)

[DISCUSSION DRAFT]

115TH CONGRESS
2D SESSION

S. _____

To require Fannie Mae and Freddie Mac to engage in credit risk transfer transactions, and for other purposes.

IN THE UNITED STATES SENATE

Mr. _____ introduced the following bill; which was referred to the Committee on _____

To require Fannie Mae and Freddie Mac to engage in credit risk transfer transactions, and for other purposes.

1 *Be it enacted by the Senate and House of Representatives of the*
2 *United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “_____ Act
5 OF 2016”.

6 **SEC. 2.**

7 Subpart A of part 2 of subtitle 1 of the Federal
8 Housing Enterprises Financial Safety and Soundness Act

9

1 of 1992 (12 U.S.C. 4541 et seq.) is amended by adding
2 at the end the following new section:

3 **“SEC. 1328. ENTERPRISE CREDIT RISK TRANSFER TRANS-**
4 **ACTIONS.**

5 “(a) REQUIREMENT TO ENGAGE IN RISK TRANSFER
6 TRANSACTIONS.—Not later than 12 months after the date
7 of enactment of this Act, the Director shall, after taking
8 into consideration market conditions, the public interest,
9 and the safety and soundness of the enterprises, establish
10 guidelines requiring that each enterprise engage in significant,
11 increasing, and varied risk transfer transactions, in
12 order to further reduce enterprise credit risk and to test
13 differing methods of risk transfer, with particular emphasis on methods
14 that (1) promote benefits and access to
15 all types and sizes of mortgage originators, (2) provide
16 durable risk-bearing capacity in all economic cycles, (3)
17 offer transparency in pricing, organization, and operation,
18 (4) reduce risks to taxpayers, and (5) facilitate the goal
19 of achieving comprehensive housing finance reform.

20 “(b) STANDARDS.—The guidelines established pursuant to
21 subsection (a) shall require the enterprises to—

22 “(1) to achieve balance in their distribution of
23 front-end and back-end risk transfer transactions;
24 and

1 “(2) use substantial and ongoing volumes of entity-based
2 risk transfer involving the assumption of credit risk by a third
3 party to accomplish both front-end and back-end risk transfers;
4 which requirements shall be measured from the date
5 of enactment of this section and shall not include
6 risk transfer activity required to comply with sub-
7 paragraph (B) or (C) of section 302(b)(2) of the
8 Federal National Mortgage Association Charter Act
9 (12 U.S.C. 1717(b)(2)) or subparagraph (B) or (C)
10 of section 305(a)(2) of the Federal Home Loan
11 Mortgage Corporation Act (12 U.S.C. 1454(a)(2)),
12 as implemented by the enterprises in a predominant
13 number of their loan programs.

14 “(c) PREVENTING EXCLUSION OF FRONT-END RISK
15 TRANSFER. —

16 “(1) LIMITATION.—Neither the Director in establishing
17 the guidelines required under subsection
18 (a), nor the enterprises in complying with such
19 guidelines, may exclude any type of front-end risk
20 transfer, including types in which the first loss is transferred
21 to a third party, where the risk to the
22 enterprises is transferred prior to or simultaneous
23 with the origination of a loan or security by an enterprise.

24 “(2) GUARANTEE FEES.—To prevent the exclusion of
25 any type of front-end risk transfer, the enter-
26 prises shall set and publish guarantee fees commensurate with

1 the enterprises' reduced credit risk, and such adjusted fees
2 shall be uniformly available to all lenders
3 approved by an enterprise regardless of size or volume.

4 “(d) APA COMPLIANCE.—The guidelines required
5 under subsection (a) shall be issued and made available
6 to the public pursuant to section 553 of title 5, United
7 States Code.

8 “(e) DEFINITIONS.— For purposes of this section, the
9 following definitions shall apply:

10 “(1) BACK-END RISK TRANSFER.—The term
11 ‘back-end risk transfer’ means, with respect to a residential
12 mortgage loan or any security backed by a
13 residential mortgage loan, a risk transfer on such
14 mortgage loan or security that occurs after the loan
15 or security is acquired by an enterprise.

16 “(2) CREDIT RISK.—The term ‘credit risk’
17 means, with respect to a residential mortgage loan

18

1 held or guaranteed, or intended to be held or guaranteed, by
2 an enterprise or any security held or
3 guaranteed by the enterprise, the risk of loss to the
4 enterprise that could result from a mortgagor's failure to
5 repay the loan in accordance with its terms.

6 “(3) ENTITY-BASED RISK TRANSFER.—The
7 term ‘entity-based risk transfer’ means a risk transfer program
8 under which the holder is a person that
9 is subject to minimum regulatory capital requirements
10 established or recognized by a Federal or
11 State prudential regulator and that meets minimum
12 requirements established or recognized by the Director,
13 pursuant to a public notice and comment process, with respect
14 to capital, leverage, and reserve requirements.

15 “(4) FIRST LOSS.—The term ‘first-loss’ means
16 the risk of loss for an enterprises on a mortgage
17 loan or security beginning with the first dollar of
18 loss.

19 “(5) FRONT-END RISK TRANSFER.—The term
20 ‘front-end risk transfer’ means, with respect to a
21 residential mortgage loan or any security backed by
22 a residential mortgage loan, a risk transfer that occurs before
23 or at time of origination of
24 the loan.

[Discussion Draft]

1 “(6) GUARANTEE FEE.— The term ‘guarantee
2 fee’” has the meaning given such term in section
3 1327(a) (12 U.S.C. 4547(a)).

4 “(7) RISK TRANSFER.—The term ‘risk transfer’
5 means the sale or disposition of credit risk by one
6 holder to another, who assumes the credit risk in accordance
7 with agreed upon terms that may be set
8 before, simultaneous with origination of the loan, or after an
9 enterprise acquires the loan or security and such holder meets
10 minimum requirements set by the Director, which
11 such requirements shall be determined and applied
12 on a functionally equivalent basis to all holders seeking to
13 participate in such transfer.

14 “(8) THIRD PARTY.—The term ‘third party’
15 means any person that is a holder of credit risk who
16 is not a lender, approved seller, or enterprise.”

ⁱ The payment comparison key assumptions are 30-yr fixed and \$205,000 purchase price... which puts the loan amount right around FHA's average. Credit Score Distribution: February 2017 FHA Single Family Origination Trends Credit Risk Report https://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgroom/sforgtr; For the number of Purchase Loans Endorsed: February 2017 FHA Single Family Production report https://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgroom/fhapodprt. For the average Purchase Loan Amount: FHA Annual Report to Congress, Fiscal Year 2016 <https://portal.hud.gov/hudportal/documents/huddoc?id=2016fhaannualreport1.pdf>

ⁱⁱ The Consolidated Appropriations Act of 2016 (P.L. 114-113), specifically the “GSE Jumpstart” provision, restricts Treasury’s ability to sell, transfer, liquidate, or divest its holdings of preferred stock acquired under the PSPAs before January 1, 2018. As estimated by the Congressional Budget Office (CBO), a policy decision to allow each GSE to retain up to \$5 billion annually over 10 years would increase the federal deficit by \$85 billion over 10 years. <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/52089-gse-report.pdf>