

**Congress of the United States**  
**Washington, DC 20515**

December 2, 2015

The Honorable Melvin L. Watt  
Director  
Federal Housing Finance Agency  
Constitution Center  
400 7th Street, SW  
Washington, D.C. 20024

Dear Director Watt:

We read with great interest the recent Federal Housing Finance Agency (FHFA) report Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions (CRT Report).<sup>1</sup> We are pleased by the ongoing use of credit-risk sharing transactions to encourage greater participation by private capital in our housing finance system.

We support FHFA's goal-setting for Fannie Mae and Freddie Mac (the GSEs) via the Scorecard<sup>2</sup> and for your consistent interaction with the GSEs to steadily increase the amount of private capital bearing credit risk. However, we remain concerned about the lack of balance between "front-end" and "back-end" risk sharing. With FHFA having affirmed the importance of using private capital whenever practicable and equitable in credit-risk sharing transactions, we wanted to urge additional exploration and refinement of credit-risk sharing techniques that are consistent with other federal housing goals.

The CRT Report explains how credit-risk sharing can be done in a number of ways that involve a variety of entities, structures, and investors. Credit risk can be shared before or after the GSEs purchase or guarantee a mortgage or pool of mortgages, and the credit risk can be assumed via structured finance transactions, reinsurance, or other methods. The CRT Report notes that nearly all transaction activity subject to Scorecard measurement can be characterized as "back-end" risk sharing, *i.e.*, occurring after the GSEs purchase/guarantee a loan or pool of loans and assume the related credit risk. Historically, "front-end" risk sharing has occurred through the use of the lender/seller retaining a portion of the credit risk or, more commonly, obtaining private mortgage insurance (MI) from an approved insurer to provide default loss

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<sup>1</sup> FED. HOUS. FIN. AGENCY, OVERVIEW OF FANNIE MAE AND FREDDIE MAC CREDIT RISK TRANSFER TRANSACTIONS (2015), <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Overview-8-21-2015.pdf>.

<sup>2</sup> FED. HOUS. FIN. AGENCY, 2015 SCORECARD FOR FANNIE MAE, FREDDIE MAC AND COMMON SECURITIZATION SOLUTIONS (2015), <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2015-Scorecard.pdf>.

protection in addition to borrower equity before the loan or pool of loans is purchased or guaranteed by the GSEs.

Although the CRT Report provided a helpful update, we write to inquire regarding your plans further incorporate “front-end” risk sharing, particularly involving those with broad market application such as MI, during this period of experimentation for several important reasons:

- **Front/back-end balance.** The CRT Report illustrates that 90 percent of GSE single-family business is subject to back-end arrangements, with very little front-end. We would like to better understand FHFA’s expectations regarding how credit-risk sharing will be apportioned and the criteria used for apportionment.
- **Borrower and lender benefit and participation.** The CRT Report does not describe how all borrowers or lenders may benefit or participate in credit-risk sharing activities, and whether FHFA considers this an important factor in determining the relative desirability of credit-risk sharing mechanisms.
- **Durability of credit risk sharing capacity.** The CRT rightly emphasizes the importance of market stability through the housing price cycle. It will be difficult to assess the relative durability of front and back-end credit risk sharing capacity without ensuring substantial volumes within each approach before there is any material change to the housing price cycle, and then observing how that capacity responds to changing conditions. Given the substantial head start enjoyed by the back-end approach, we would like to inquire whether FHFA envisions requiring some proportionality between front and back-end credit risk sharing approaches to obtain an appropriate point of comparison regarding available risk sharing capacity over time.
- **Larger housing finance reform considerations.** Comprehensive housing finance reform continues to be debated as FHFA begins its eighth year as conservator for the GSEs. An important housing reform issue that continues to be debated is the ability and willingness of other market participants to undertake the multiple roles performed currently by the GSEs. Front-end credit-risk sharing seems to offer the advantage of managing credit risk before the mortgage loans reach the GSEs and receive a taxpayer guarantee. We urge that FHFA consider the preservation or creation of housing finance reform alternatives as an important goal in FHFA’s work with the GSEs on credit-risk sharing efforts particularly if, as we believe, front-end credit risk sharing offers the prospect of being more affordable for borrowers, providing more protection to taxpayers, and remaining consistent with the other goals of the conservatorship and federal housing policy generally.


We look forward to your response and engaging with you further on this important housing policy topic.

Sincerely,



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Gwen S. Moore  
Member of Congress



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Steve Stivers  
Member of Congress