

March 17, 2016

**BY ELECTRONIC SUBMISSION**

Alfred M. Pollard, General Counsel  
Federal Housing Finance Agency  
Attention: Comments/RIN 2590-AA27  
400 7th Street, SW, Eighth Floor  
Washington, D.C. 20219

**Re: Notice of Proposed Rulemaking—  
Enterprise Duty to Serve Underserved Markets**

Dear Mr. Pollard:

U.S. Mortgage Insurers (“USMI”) welcomes the opportunity to respond to the request for comments by the Federal Housing Finance Agency (“FHFA”) on FHFA’s Notice of Proposed Rulemaking<sup>1</sup> (“NPR”) to implement the Duty to Serve requirements contained in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (“Safety and Soundness Act”), as amended by the Housing and Economic Recovery Act of 2008 (“HERA”). USMI is a trade association composed of the following private mortgage insurance (“MI”) companies: Arch Mortgage Insurance Company, Essent Guaranty, Inc., Genworth Financial, Mortgage Guaranty Insurance Corporation, National Mortgage Insurance Corporation, and Radian Guaranty Inc.

USMI strongly supports *both* components of the general principle established in the Safety and Soundness Act — that Fannie Mae and Freddie Mac (the “Enterprises”) “[1] have an affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes, while [2] maintaining a strong financial condition and a reasonable economic return.”<sup>2</sup> Importantly, too, the NPR, citing a HERA provision, specifically notes that, as with all affordable housing financing activities, “[t]he Enterprises should expect mortgage purchases and activities pursuant to the Duty to Serve to earn a reasonable economic return, which may be less than the return earned on activities that do not serve these underserved markets.”<sup>3</sup> FHFA should implement the Duty to Serve by giving clear and direct effect to these statutory provisions and otherwise ensure that the Duty to Serve is applied consistently with the terms and obligations of the Enterprises’ Charter Acts.

We recognize that the FHFA neither intends nor has the authority to require the Enterprises to engage in activities that are inconsistent with applicable law. In the proposed rules, however, the Underserved Markets Plans (“Plan”) are not required to include a detailed explanation of how the relative risks are measured, how economic capital will be allocated against those risks, the

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<sup>1</sup> 80 Fed. Reg. 79181 (Dec. 18, 2015).

<sup>2</sup> 12 U.S.C. § 4501(7).

<sup>3</sup> 80 Fed. Reg. at 79183, *citing* 12 U.S.C. 4513(a)(1)(B)(ii). The language referring to a “reasonable return” was previously contained in the Enterprises’ Charter Acts. *See* 12 U.S.C. §§ 1451 note, 1716 note.

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administrative expenses that will be allocated to the Duty to Serve activities, or the pricing—*i.e.*, the guarantee fee and other charges related to Duty to Serve activities. If the Plans lack transparency, USMI members and other stakeholders will be missing key information that would allow them to critically evaluate and offer substantive input on the best use of Enterprise resources to support their statutory obligation. We do not suggest that the Enterprises should seek to achieve the same return on their Duty to Serve activities as in other businesses, but believe that a Plan cannot be properly evaluated by market stakeholders unless the costs and risks are clearly understood.

It will be more difficult for FHFA to implement and measure progress as well. The NPR provides detailed requirements for each Enterprise to demonstrate how its Plan will meet the affordable housing needs of the specified markets. Unfortunately, however, the NPR provides no criteria for determining what is a “reasonable economic return” or the degree to which that return may vary from the returns earned on non-affordable housing activities. Without such criteria, it is unclear how FHFA can determine a baseline with which to compare the Enterprises’ performance against current private and public participation in the identified underserved markets. Without a baseline, it will be unclear whether the Enterprises are providing additional liquidity and resources or simply displacing existing efforts, and what the basis for the activity is. The Enterprises’ Plans could result in adverse selection of existing public programs and discourage private capital from participating in these underserved markets, but the NPR is not organized to anticipate or measure these possible outcomes.

Of course, the systemic outcomes could be more favorable than expected as well, but without additional transparency regarding how the Enterprises approach these obligations in terms of fundamental economic, financial, and operational assumptions, policymakers will not be well placed to use these outcomes in a coordinated manner. In some cases, targeted subsidies (*e.g.*, such as those that are used or proposed for broadband access) could be more efficient and less market-distorting than Plans based on opaque capital management and return assumptions — and the NPR provides no way to test those assumptions. Within the context of the unfinished business of housing finance reform and the ongoing conservatorship, failing to insist on further transparency in the Plans represents an important opportunity missed.

Nor does the NPR require the Enterprises to demonstrate that their proposed activities clearly fall within the boundaries of their Charters. The FHFA notes in the preamble to the NPR:

All activities an Enterprise undertakes in furtherance of its Duty to Serve must be consistent with its Charter Act. Nothing in this rulemaking would permit or require an Enterprise to engage in any activity that would be otherwise inconsistent with its Charter Act or the Safety and Soundness Act.<sup>4</sup>

For example, the Enterprises should be required to show that, under their Plans, the Charter provisions requiring credit enhancement on low-down payment mortgages are consistently applied across product alternatives and lenders. The Plans should also provide a means for

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<sup>4</sup> 80 Fed. Reg. at 79184.

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FHFA to verify the Enterprises' compliance with its representations about both the economics of the Plan and Charter compliance.

Although the NPR addresses only the three markets identified in HERA as underserved, the Enterprises' true "duty to serve" LMI borrowers encompasses the entire mortgage marketplace. The MI industry's interest in the NPR arises from our concern that a lack of transparency in the economics of Duty to Serve Plans will result in Plans that leave unanswered whether policy aims have been met in the most efficient way available.

We look forward to working with our customers, FHFA, the Enterprises, and other market stakeholders to help the Enterprises meet their "Duty to Serve" obligations.

### **Responses to Specific Questions**

#### **1. How much discretion should the Enterprises have in selecting activities—Core Activities and Additional Activities—to serve the underserved markets?**

As noted above, regardless of how FHFA decides to award credit for servicing the underserved markets, one important principle of the Duty to Serve rule should be transparency. This is especially true when the Enterprises engage in activities that may have a lower economic return. It is important to the entire market that the risk/reward profile of these activities be transparent—not only to allow third parties to assess whether the returns that the Enterprises receive on their investments in underserved markets reflect a realistic assessment of the risk of the activity, but also to assist the market by allowing it to benefit from the Enterprises' risk information and risk judgments.

Although the Enterprises' rate of return on Duty to Serve activities may be lower than the return on other activities, it still must reflect a reasonable economic return on their investments. If a proposed Plan does not clearly disclose the true risks of an activity and how the plan would address them, FHFA and commenters will not be able to determine whether the activity truly serves the market or simply transfers risk from the Enterprise to the taxpayers.

#### **2. Should FHFA establish specific Regulatory Activities for the underserved markets, or should the Enterprises have broad discretion to decide how to serve these markets?**

See response to Question No. 1.

#### **3. Are the proposed Regulatory Activities, as identified in the proposed rule for each of the underserved markets and described further below, appropriate for accomplishing the Duty to Serve objectives?**

See response to Question No. 1.

#### **4. Are the requirements for Objectives discussed above appropriate, and should there be any additional requirements?**

See response to Question No. 1.

**9. Should public input be sought on the Enterprises' proposed Underserved Markets Plans and, if so, is there a more effective approach than the proposed approach?**

USMI strongly supports the proposal to require public input on the Enterprises' proposed Plans. Input from other stakeholders is essential for FHFA to be able to make an informed decision about the benefits and risks of an Enterprise's proposed activities. We recommend that the rule require Plans to include assumptions about economic returns for the underserved markets, including the basis for those assumptions, and compare actual performance to the assumptions. FHFA also should consider comparing performance to similar public programs and benchmarking, to the extent permitted and possible, to performance by private market participants.

**13. Should the Enterprises receive credit for purchasing chattel loans, on an ongoing or pilot basis? If so what improvements should be made in the process for originating and servicing that would make chattel loans safer for purchase by the Enterprises and safer for borrowers?**

As FHFA is aware, private MI companies are not permitted to underwrite insurance on chattel loans. We note, however, that the Enterprises have other forms of credit enhancement available, such as lender recourse and loan participations, so FHFA and the Enterprises should not be deterred by the regulatory limitation on MIs' ability to insure.

**30. Are there other ways the Enterprises can support the statutorily-enumerated programs in addition to those discussed above?**

We note as a general matter that FHFA should be sensitive to the housing policy context in which the Enterprises are allowed, encouraged, or required to operate on a risk-based capital management and pricing basis that is much less evident in traditional public programs. The difference in approach raises the adverse selection risk to less risk-sensitive public programs, so FHFA's overall assessment should consider that public programs are not subject to the same constraints as the Enterprises. Additionally, regarding Charter compliance, FHFA should ensure that an "affordable housing" exception is not created for recourse or other arrangements in which the security required by the Enterprises is lower based only on the public purposes being pursued, without regard to the economic impact of the exception.

**64. Are there additional ways [aside from ground leases, shared equity, etc.] that the Enterprises could support long-term affordable homeownership preservation?**

USMI believes that ground leases, shared appreciation, and other approaches to ensuring that affordability is maintained when property changes hands deserve consideration, but the principles of transparency and maintaining a reasonable rate of return discussed above apply. For example, a Plan that includes shared-equity features such as deed-restricted covenants, ground leases, "piggyback" subordinate loans, or shared appreciation, or other approaches to

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affordable homeownership preservation, should fully address and quantify the increased risk that may be created. USMI members have considerable experience in this area and we would be happy to work with FHFA in addressing these issues.

**65. Should affordable homeownership be preserved for longer than 30 years to qualify for Duty to Serve credit and, if so, for how long?**

See response to Question No. 64.

**66. Should Enterprise support for affordable homeownership preservation be a Regulatory Activity?**

See response to Question No. 64.

**67. How can the Enterprises provide further support for affordable homeownership preservation beyond those specified above or in the proposed rule?**

See response to Question No. 64.

**70. Would one of the four [alternative] definitions [of the term “rural area”] discussed above better serve Duty to Serve objectives, and if so, why?**

We recommend adoption of a single, standard “rural” definition across all Enterprise and counterpart public programs, clarifying assumptions regarding expected returns in this underserved market, and monitoring performance to determine whether (and by how much) the Enterprises are providing additional liquidity and the degree of adverse selection being experienced by public programs serving the same underserved market. We note that underwriting issues are well established for rural lending regarding borrower, collateral, and location-related risks.

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Private MI can be a significant partner in helping the Enterprises achieve their mission of making affordable housing available to LMI borrowers “while maintaining a strong financial condition and a reasonable economic return.” Our entire industry is devoted to helping borrowers of modest means achieve the dream of homeownership in a safe, sustainable, and well-regulated manner. We look forward to working with FHFA and the Enterprises to achieve those goals.

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USMI appreciates the opportunity to comment on FHFA's NPR. Questions or requests for further information may be directed to Lindsey Johnson, President and Executive Director of U.S. Mortgage Insurers, at [ljohnson@usmi.org](mailto:ljohnson@usmi.org) or 202-280-1820.

Sincerely,

/s/

Lindsey Johnson