

Statement for the Record

On Behalf of the

American Bankers Association

Before the

House Financial Services Committee

May 23, 2023

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The American Bankers Association (ABA)¹ appreciates the opportunity to provide a Statement for the Record for this hearing, *FHFA Oversight: Protecting Homeowners and Taxpayers*. ABA is the voice of the nation's \$23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$19.2 trillion in deposits and extend \$12.2 trillion in loans.

We appreciate this committee's attention to the important issues facing our nation's mortgage markets and the vital role that the Federal Housing Finance Agency (FHFA) plays as the regulator of Fannie Mae, Freddie Mac (the Enterprises or GSEs) and the Federal Home Loan Banks and as conservator of Fannie Mae and Freddie Mac since 2008.

Our comments today focus on the following points: the need for Congress to end the conservatorships of the GSEs; FHFA's comprehensive review of the Federal Home Loan Banks; FHFA's efforts to address appraisal bias; and FHFA's role in assisting the industry in loss mitigation and loan servicing in light of the COVID 19 pandemic.

I. Principles for GSE Reform

FHFA, under multiple Administrations, has worked diligently and effectively to build a reliable capital framework and to erect guardrails to ensure that Fannie Mae and Freddie Mac operate in a safe and sound manor while fulfilling their statutory mission. We believe it is now time for Congress to end the conservatorships and adopt necessary reforms through legislation.

The ABA, through input and deliberation from banks of all sizes and from all parts of the country, has developed a set of principles to guide the reform of Fannie Mae and Freddie Mac. While these principles have previously been shared with Congress, they have been updated to reflect key changes that have taken place in the mortgage markets and adjustments to the conservatorships, including the end of the "sweep" of GSE profits to the Treasury.

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1. The GSEs must remain strictly confined to a secondary market role of providing stability and liquidity to the primary mortgage market, to ensure liquidity for qualified low-income and moderate-income borrowers, and must be strongly regulated, thoroughly examined and subject to immediate corrective action for any violation.

It is critical that the GSEs stay focused solely on ensuring qualified borrowers can access affordable mortgage credit by advancing stable, affordable, and readily available secondary market access to the primary market.

Shareholder returns or other investment goals cannot be allowed to drive their mission. While a certain level of competition is desirable to ensure innovation and responsiveness to the market, it should not be used as an avenue to expand GSE products or services into other businesses or investment areas. As we have seen in the past, the line between the primary and secondary market can be thin, and new secondary market activities or requirements can threaten or erode that line. Strong, targeted regulation will be necessary to keep the GSEs focused on their defined role. Any legislation must empower the FHFA with authority to promulgate and enforce regulations to keep the GSEs focused on their statutorily defined role and mission.

2. In return for the GSE status and the accompanying benefits, these entities must agree to support all segments of the primary market, as needed, in all economic environments and to provide equitable access to all primary market lenders.

We urge the Congress to make explicit the requirements to serve all markets in all economic conditions and to ensure equitable access to all eligible primary market lenders.

3. GSE guaranteed secondary market access must also include preservation of the “To Be Announced” (TBA) market and both servicing retained and sold options.

The TBA market, also known as the Cash Window, allows originators to sell loans on an individual basis to the GSEs. This option must be preserved to ensure access to the secondary market for lower volume lenders or those who choose for business purposes to sell individual loans. Similarly, so originators can continue to service loans consistent with their chosen business model, any reformed system must preserve flexibility to sell loans with servicing retained or servicing released.

4. Mortgage-Backed Securities issued by Fannie Mae, Freddie Mac should carry an explicit, fully priced, and fully transparent guarantee from the federal government.

The key benefit the GSEs provide to the primary market is access to long-term affordable liquidity for mortgage lending. The government guarantee is necessary to preserve that liquidity, but taxpayers should be fully compensated for the risks they bear in providing that guarantee. Fees necessary to support the guarantee must be fairly assessed and must be transparent so that they reflect the true cost of the guarantee. Fees should not be assessed to offset other government spending or unrelated priorities. It may be desirable to establish a segregated insurance fund to cover potential losses in the event that the guarantee is tapped in a crisis. Further, to ensure equitable access, the fees must be assessed equally on all lenders and not in proportion to their volume of business with the GSEs.

In recent years, the GSEs have begun charging upfront guarantee fees (referred to as either “loan level price adjustments” or “credit fees in price”) in addition to the ongoing guarantee fees. Changes to these upfront fees announced earlier this year, and put into effect on May 1, 2023, have caused considerable controversy. In reaction to that controversy, FHFA has issued a Request for Input to solicit feedback on the entire fee structure charged by the GSEs, including the potential elimination of the upfront fees. ABA will provide input to this solicitation. We look forward to working with all stakeholders to ensure that the fees charged by the GSEs are fair, appropriately compensate for the full cost of the guarantee being provided, and do not favor or disfavor any segment of the market, including borrowers.

5. Fannie Mae, Freddie Mac must be appropriately capitalized to the risks borne and regulated to ensure that they remain so in all market conditions.

Since early 2021, Fannie Mae and Freddie Mac have been permitted to begin rebuilding capital from retained earnings. It is essential that the GSEs have adequate capital relative to their exposures to withstand market downturns. Required capital must also take into account the fact that they will be monoline businesses whose risks may be concentrated in certain circumstances. The ongoing risk to the taxpayer is one of the most important reasons Congressional action is needed.

While FHFA has established a robust capital structure for the GSEs and has sought stakeholder input, we believe that minimum capital requirements should be established by statute to ensure that they are not inappropriately loosened or otherwise weakened in the future.

6. Fannie Mae and Freddie Mac must continue to require sound and fair underwriting standards for the loans they purchase, which must be based upon and coordinated with underwriting standards applicable to the primary market.

Significant underwriting requirements imposed under the Dodd-Frank Act, most notably Ability to Repay (ATR) and Qualified Mortgage (QM) rules, have significantly strengthened mortgage underwriting in the primary market.

These rules, issued by the Consumer Financial Protection Bureau (CFPB) in consultation with FHFA, impose primary market underwriting requirements that serve as basic consumer safeguards and standards. These underwriting standards also support secondary market activity, regardless of whether residential mortgages are sold to the GSEs or to private label purchasers. As a general matter, mortgages sold into the secondary market with government guarantees must meet QM standards. Appropriately, private label securitizations only require the less stringent ATR standard as a baseline, although investors may establish additional standards at their discretion.

Fannie Mae and Freddie Mac should continue to be restricted to purchasing QM loans in order to “earn” the federal guarantee that limits risk to taxpayers and diverts non-QM mortgages to a private label, secondary market without taxpayer exposure.

7. Reforms should make Credit Risk Transfers a permanent feature of secondary market financing. Credit risk transfer must be a real transfer of risk and must be economically viable for the GSEs and the lenders they serve.

Credit risk transfers have been critically important innovations introduced to the GSE model in recent years. They have helped to revitalize private market participation and have reduced taxpayer exposure to GSE risks. They should become a permanent feature of secondary market financing. However, they must continue to be developed in ways that make economic sense for the GSEs, investors, primary market lenders, and for the borrowers they serve. Also, credit risk transfers must truly transfer credit risk in a permanent fashion to ensure taxpayer protection.

8. Any reform of the secondary mortgage market must consider the vital role played by the Federal Home Loan Banks and must not harm the traditional advance businesses of Federal Home Loan Banks or access to advances by their members.

The Federal Home Loan Banks (FHLBs) have provided mortgage financing in the form of collateralized advances to their member/owners for over 90 years. They have performed as intended, ensuring liquidity even in times of market crisis. Their effective performance, during the financial crisis of 2007-2008 and earlier this year when they ensured that banks of all sizes had access to liquidity, is due in part to incentives inherent to mutual ownership status: relatively high statutory capital requirements and fully collateralized lending. Changes to Fannie and Freddie may affect the FHLBs, even if unintended or indirect, and potential effects must be considered, accounted for, and avoided. Additionally, the FHLBs may have the potential to play an expanded role in a revised secondary market system, but any expanded role that exposes members' investment in the FHLB System to additional risk must be separately capitalized and regulated in such a manner that it does not put at risk the traditional advance business of the FHLBs. Our broader views on the FHLBs and FHFA's Comprehensive Review of the Federal Home Loan Bank System are addressed further below.

9. Affordable housing goals or efforts undertaken by the GSEs to expand the supply of affordable rental housing should be delivered through and driven by the primary market. These goals should be structured in the form of affordable housing funds available to provide subsidies for affordable projects.

The bright line between the primary and secondary market in the single-family housing finance area should also broadly apply to the affordable housing and multifamily market. Primary market lenders should be the originators of these loans supported by access to stable, long-term liquidity from the GSEs. Only in complex originations where the primary market lacks capacity should the GSEs be involved in direct financing, and strong regulation and oversight should be employed to ensure that there is no "cherry picking" of deals by the GSEs from the primary market.

We believe the FHLB Affordable Housing Program (AHP) provides a good model for other GSE affordable housing programs. The AHP is a competitive grant program created by Congress in the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The AHP is designed to address local housing needs and is administered regionally by each FHLB, working through its financial institution members and those members' community-based partners. These

community-based partners are working at the grass roots level and most closely understand the housing needs of their communities. To further ensure that AHP funded projects serve local housing needs, each FHLB is advised by an Advisory Council made up of community and nonprofit affordable housing and economic development organizations from within the FHLB's district. This model helps to ensure that affordable housing funds are directed by actual needs in a community as identified by community groups and private market lenders in that community. The participation and guidance of local partners is a powerful tool when combined with the resources that can be made available through any GSE-based affordable housing fund or program. To date, the FHLB AHP has awarded more than \$7.3 billion that has assisted in the purchase, construction or rehabilitation assisting over one million households across our nation.

10. Reform need not be radical or extreme but should be comprehensive in its effect.

Some have said the least disruptive path is to recapitalize and release the GSEs without Congressional action – relying upon continuing regulatory actions such as those that have been put in effect during the conservatorship and are unique to the powers of conservatorship. ABA rejects that approach, as it would return us to the untenable situation of public risk-taking to the benefit of private investors. Even with current reforms in place, it would encourage future abuses, instability, and undue risk to U.S. taxpayers. Further, legislation is necessary to establish the explicit and targeted government guarantee that virtually all have come to accept as necessary. Legislation should establish directed and limited activities, strong capital standards and a clear set of benchmarks for implementing and meeting those standards. Legislation should also establish a mandate to provide equitable access to all primary market participants, regardless of size or geographic location along with the ability to sell individual or groups of loans. A strong regulator must be part of reform, so too must be clear statutory guidance in this area.

It will also be necessary to ensure that a reformed system can meet these standards in practice and that reform is not overly complicated or uncertain in ways which could disrupt the housing finance system.

II. Comprehensive Review of the Federal Home Loan Banks

In 2022 the FHFA announced a Comprehensive Review of the Federal Home Loan Banks. This effort, coinciding with the 90th year of the FHLBs' existence, was presented as the first comprehensive review of the System in its history. While that may be technically accurate, we note that the FHLBs have not escaped regulatory or Congressional oversight and, in fact, have been changed through legislation a number of times. Nevertheless, ABA welcomed the review and participated, both at the ABA staff and leadership level and through coordination and support with our member banks, in several roundtables, listening sessions and comments filed with FHFA. We have included two comment letters, one from ABA² and a joint letter³ from

² <https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/ltrfhfa20221031.pdf>

³ <https://www.aba.com/advocacy/policy-analysis/joint-letter-to-fhfa-on-the-fhlbank-system>

ABA and 51 state bankers associations, to this statement, and below is a brief summary of our views.

The FHLBs are a vital source of reliable liquidity for banks. As cooperatively owned and capitalized institutions with joint and several liability, the FHLBs have a strong interest in meeting their members' liquidity and affordable housing needs in a safe, sound and responsible manner that has worked well for over 90 years.

The severe shortage of affordable housing is an urgent matter for the entire nation, and the FHLBs continue to play an important role in addressing this issue. However, it cannot fall to any one entity or sector of the economy alone. Coordinated efforts among the private sector, government agencies and non-profit entities will be required.

The FHLBs long and successful track record makes the System attractive to other entities that are not eligible for access. However, the cooperative ownership and joint and several liability structure of the System requires that its members share similar regulatory oversight and examination, and similar abilities to invest in and capitalize the System on an ongoing basis. Allowing access for entities without these attributes would put existing members' investment at risk and undermine the stability of the entire System. FHFA should be cautious in proposing to Congress any regulatory actions, recommendations, or changes to the System, as it continues to function as intended, and Congress should likewise be very cautious when considering any potential changes to the System.

III. Appraisals and Valuations – Data Access and Appraisal Bias.

FHFA has played an important role in addressing problems with appraisals in the U.S. housing market. ABA has requested that FHFA and the GSEs move forward in expanding availability of appraisal data to the banking industry. We appreciate FHFA's announcement in October 2022 that provides public access to millions of Uniform Appraisal Dataset statistics via two tools: the Uniform Appraisal Data (UAD), Aggregate Statistics Data File and UAD Aggregate Statistics Dashboards. ABA has requested that FHFA work with the Enterprises to achieve needed transparency more expeditiously via release of more granular valuation data. That data will benefit all stakeholders by expanding property condition information, improving the accuracy of tools for comparable properties, and providing information about real time sales and property condition.

ABA applauds FHFA and the GSEs for advancing the use of alternative valuation methods, and we appreciate the tools the agencies have provided to help lenders identify appraisal bias during appraisal reviews. The guidance updates for sellers have been useful tools to help lenders identify acceptable and unacceptable language within the report and other signs of potential bias in appraisals. ABA also appreciates Freddie Mac's May 1, 2023, announcement that Loan Collateral Advisor now includes message alerts to users when certain prohibited, subjective, or potentially biased words or phrases are included in appraisal reports submitted to Freddie Mac through the Uniform Collateral Data Portal.

IV. Loss Mitigation and Loan Servicing

ABA would like to thank FHFA and the GSEs for the programs that provided tools to help streamline the loss mitigation process during the COVID-19 pandemic. During the pandemic, the banking industry was able to collaborate with the agencies to provide new options that allowed servicers to respond quickly to assist millions of homeowners at risk of losing their homes. These enhanced and streamlined payment deferral policies were essential to efficiently and effectively helping borrowers avoid foreclosure. We also appreciate the agencies' ongoing efforts to enhance and streamline the GSEs' home retention options for borrowers experiencing other eligible hardships, outside of the COVID-19 pandemic.

Conclusion

The ABA appreciates the work of the Committee and the FHFA in the ongoing oversight of these important institutions. We urge the Committee to redouble the focus on reform of the GSEs and ensuring that the FHLBs continue to meet their important mission. We look forward to working with Congress and the FHFA as these efforts continue.