ENTERPRISE SINGLE-FAMILY SOCIAL BOND POLICY

Request for Input

February 2023

Division of Housing Mission and Goals

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Introduction

The Federal Housing Finance Agency (FHFA), as conservator and regulator of Fannie Mae and Freddie Mac (together, "the Enterprises") and regulator of the Federal Home Loan Banks plays a vital role in supporting equitable and sustainable access to mortgage credit nationwide, promoting the housing finance system's stability and liquidity, and protecting the safety and soundness of the housing finance system through its supervision of Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (together, "the regulated entities"). FHFA prioritizes improving affordable housing opportunities for homebuyers and renters – particularly those in underserved communities. FHFA is also focused on ensuring that fair lending, equity, and climate risk considerations are integrated into the mission and business activities of its regulated entities.

Through this Request for Input (RFI) on the Enterprises' single-family social bond policy and program design, FHFA is soliciting input on the opportunities and potential risks associated with single-family social bond issuances by the Enterprises, including with regard to borrower benefits and privacy. FHFA also seeks input to facilitate defining the criteria and appropriate impact measures for Enterprise-labeled single-family social bonds. This information will enhance FHFA's ability to ensure that the Enterprises fulfill their mission by operating in a safe and sound manner so that they serve as a reliable source of liquidity and funding for housing finance and community investment throughout the economic cycle. FHFA is also hosting a virtual listening session on March 28, 2023, to allow for additional public input.

Public Input Instructions

FHFA invites interested parties to provide written input, feedback, and information on all aspects of this RFI, including the questions below, no later than April 17, 2023. Public input may be submitted electronically using the response form at https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx (select "Social Bonds" in the pull-down) or via mail to the Federal Housing Finance Agency, Office of Fair Lending Oversight, 400 7th Street SW, 9th Floor, Washington, D.C. 20219.

FHFA encourages interested parties to provide responses to the RFI and to make their responses public whenever possible to inform broader public discourse on these issues. Generally, all input received will be made public and posted without change to FHFA's website, including any personally identifiable information that it may contain. However, FHFA encourages interested parties to contact FHFA if they seek to provide confidential or proprietary information as part of their responses and wish to request that the information not be made public.

Background

FHFA's Safety and Soundness and Housing Equity Mission

Congress established FHFA to regulate the Enterprises to ensure that the purposes of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act), the Enterprises' statutory charters, and any other applicable law are executed.[1] In doing so, Congress recognized that the Enterprises have important public purposes reflected in their statutory charters, and that they require safe and sound management in order to continue to accomplish their public missions.[2] FHFA and the Enterprises also have statutory and other commitments related to advancing equity for borrowers in the mortgage market.[3] FHFA is currently the conservator of each Enterprise.[4]

Mortgage-Backed Securities

Fannie Mae and Freddie Mac each issue and guarantee mortgage-backed securities (MBS) backed by pools of single-family and multifamily mortgage loans. The Enterprises began issuing single-family Uniform Mortgage-Backed Securities (UMBS) on June 3, 2019. Regardless of which Enterprise is the issuer for any particular UMBS, that UMBS is eligible to be traded in the To-Be-Announced market. As such, UMBS has effectively merged the formerly separate MBS

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[1] 12 U.S.C. 4511(b)(1) and (2).

[2] 12 U.S.C. 4501(1) (Enterprises and Federal Home Loan Banks have important public missions), (2) (their continued ability to accomplish their public missions is important, and effective regulation is needed to reduce risk of failure), and (7) (Enterprises have affirmative obligation to facilitate financing of affordable housing for low- and moderate-income families consistent with their public purposes, while maintaining a strong financial condition and a reasonable economic return).

[3] The Enterprises' Charter Acts, for example, provide that one of the Enterprises' purposes is to promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) (see, 12 U.S.C. 1716(4) (Fannie Mae charter); 1451(b)(4) (Freddie Mac charter)). The Charter Acts require the Enterprises, as part of their annual housing reports, to assess their underwriting standards, policies, and business practices that affect low- and moderate-income families or cause racial disparities, along with any revisions to these standards, policies, or practices that promote affordable housing or fair lending. The Safety and Soundness Act provides that, in meeting these requirements, the Enterprises are required to take affirmative steps to assist primary market lenders to make housing credit available in areas with concentrations of low-income and minority families. FHFA also established the Equitable Housing Finance Plan program to supplement existing FHFA and Enterprise requirements, programs, and plans, and to ensure a continued focus on housing equity that is aligned with other critical objectives including safety and soundness and other mission activities (see, https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Fair-Lending-Oversight-Program.aspx).

[4] https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-FHFA-Director-James-B--Lockhart-at-News-Conference-Annnouncing-Conservatorship-of-Fannie-Mae-and-Freddie-Mac.aspx; 12 U.S.C. 4617(b) (powers and duties of the conservator).

markets of the two Enterprises. UMBS has broadened and enhanced liquidity in the secondary market for residential mortgages and reduced costs to taxpayers.

A prepayment on a mortgage loan is the amount of principal paid in advance of the loan's payment schedule. Full prepayment occurs when a borrower pays off the loan ahead of the scheduled maturity. MBS that are likely to prepay more slowly provide investors with interest payments for a longer period of time and typically receive specified pay-ups. The Enterprises issue specified pools (or, spec pools) that are comprised of loans that share a similar characteristic (e.g., unpaid principal balance below a given threshold) which is typically correlated to lower prepayment speeds. Investors generally are willing to pay a premium for these specified pools, which is referred to as the specified pool pay-up.

ESG Investing and Social Impact Investing

ESG investment criteria refers to Environmental, Social, and Governance factors that an investor may consider when making an investment decision.[5] ESG investors have diverse priorities and may invest based on one or more ESG factors. For example, ESG investors may prioritize climate, social, or faith-based investing. ESG considerations can strengthen business risk identification and may ultimately improve investment returns.[6] In 2022, there were $8.4 trillion in assets classified as ESG investments, representing 13 percent of total U.S. assets under professional management.[7]

In addition to integrating ESG into investment analysis, new financial products that focus on facilitating positive social and environmental outcomes have been developed. These "impact investments" provide explicit opportunities to fund activities intended to benefit a specific class of persons or the environment.[8] For example, social funds and social bonds have supported the

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[5] "The Division of Examinations' Review of ESG Investing," *Risk Alert, Division of Examinations,* U.S. Securities and Exchange Commission, April, 9, 2021, https://www.sec.gov/files/esg-risk-alert.pdf

[6] See, e.g., Elizabeth Pollman, "The Making and Meaning of ESG," U of Penn, Inst for Law & Econ Research Paper No. 22-23, European Corporate Governance Institute - Law Working Paper No. 659/2022, October 31, 2022, https://ssrn.com/abstract=4219857 (noting "Although not unqualified, a large body of research has found correlations between corporate financial and ESG performance, and some evidence of financial materiality of ESG factors to portfolio risk-adjusted returns.").

[7] "2022 Report on US Sustainable Investing Trends," US SIF Foundation, December 13, 2022, https://www.ussif.org//Files/Trends/2022/Trends%202022%20Executive%20Summary.pdf

[8] The Global Impact Investing Network, a nonprofit organization supported by the Rockefeller Foundation and J.P. Morgan, defined impact investments in 2009 as "investments made into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return." See also, e.g.,

construction of affordable housing and schools, and impact investments have facilitated access to lower costs of capital for companies engaged in activities with a positive social benefit. Social impact investing can be defined as a subset of ESG investing and is distinguished in that social impact investing seeks to create social value, rather than minimize adverse impacts.[9] Additionally, sustainable bonds combine green and social aspects to provide positive impacts for both the environment and society.

Investors in social bonds may have a mandate to seek positive social impacts, may invest because of expected returns, or may pursue a combination of both factors.

Social Bond Program Impacts

An Enterprise-labeled social bond should positively impact borrower sustainability, affordability, and/or equity. A cornerstone of any social bond program is the set of specific outcomes that the program is attempting to achieve. Outcomes may include homeownership rates, sustainability and home retention outcomes, or improved liquidity. A social bond program may seek to positively influence these outcomes by isolating loans originated with desirable social attributes and features, and may require that eligible collateral provide down payment assistance, buydown programs, cost subsidies, liquidity funds, increased borrower education and counseling, or other borrower benefits.

Subsequently, a program would provide impact metrics to enable stakeholders to understand the impact of investments. Impact metrics may include, for example, information on mortgage rate and terms (e.g., basis points above/below the Average Prime Offer Rate (APOR)), access to credit, and improved borrowing costs. Per the International Capital Market Association (ICMA) Social Bond Principles, which outline voluntary process guidelines, a social bond program should provide regular, transparent reporting to communicate to investors the expected and/or achieved impacts of the investment.

Clarkin, John E. and L. Cangioni, Carole. “Impact Investing: A Primer and Review of the Literature” Entrepreneurship Research Journal 6, no. 2 (2016): 135-173. https://doi.org/10.1515/erj-2014-0011 (describing impact investing as “investments that are primarily made to create tangible social impact, but also have the potential for financial return on the investment … by bringing profit-seeking investments to bear on efforts to generate social and environmental value”).

[9] Many factors related to social and other ESG bonds are not defined in federal securities law, may be subjective, and may be defined in different ways by different funds or sponsors. There is no Securities and Exchange Commission (SEC) “rating,” “score,” or qualification that can be applied to determine whether a product is “social.” “Social-washing” may be perceived to occur if the extent to which products or services take into account social factors is overstated or exaggerated.

Investor Disclosures and Borrower Reidentification

The Enterprises have aligned single-family disclosure data to provide investors with information on individual loans and on pools of loans.[10] FHFA prioritizes promoting transparency and market stability by monitoring, analyzing, and providing mortgage data to the public. As a component of developing the loan-level disclosures for UMBS issuance, the Enterprises and FHFA worked to foster market liquidity while also considering potential implications for borrower privacy due to the risk of borrower reidentification. Balancing those objectives includes choices about how best to disclose geographic information about each property while withholding other loan-level data attributes that in combination would increase the likelihood a borrower's identity could be compromised. Protecting the privacy of borrowers may involve, for example, rounding loan amounts or omitting the day of the month on which the borrower is obligated to make their first mortgage payment.

Likewise, other federal agencies have made careful decisions about how to promote transparency and access to data that furthers the public interest, while also protecting consumer privacy. For example, under the Home Mortgage Disclosure Act (HMDA), the Consumer Financial Protection Bureau (CFPB) applied a balancing test to modify or remove data fields for public release when the risks to privacy are not justified by public disclosure purposes.[11] The Securities and Exchange Commission (SEC) applied a similar approach under its 2014 Regulation AB rule in determining mortgage asset disclosures.[12] The Enterprises and FHFA periodically revisit whether the current disclosure regime is appropriately calibrated, particularly given the pace of technological changes such as big data, machine learning, and other technologies, and whether new frameworks or approaches to certain data elements are necessary to ensure that FHFA is appropriately balancing these interests, or to align with its peer regulators.

Current Enterprise ESG Bond Issuances

Fannie Mae and Freddie Mac do not currently issue labeled single-family social bonds. Both Enterprises issue labeled multifamily social bonds. Freddie Mac issued its first labeled multifamily social bond in 2020 under its Social Bonds Framework, and Fannie Mae issued its

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[10] In general, loan-level data includes at-issuance data about the borrower, property, and mortgage loan and monthly data about the performance of each loan. Pool-level data includes summary or aggregated information about the mortgage loans in a security.

[11] https://files.consumerfinance.gov/f/documents/HMDA_Disclosure_FPG_--_Final_12.21.2018_for_website_with_date.pdf

[12] https://www.sec.gov/rules/final/2014/33-9638.pdf

first labeled multifamily social bond in 2021 under its Sustainable Bond Framework. The Enterprises have published regular reports on the projected impact of these issuances.

Although the Enterprises do not designate any single-family UMBS issuances as "social," they issue single-family affordable bonds and also provide disclosures intended to increase transparency into socially oriented lending. In 2021, both Enterprises began to issue single-family affordable bonds that are comprised of loans originated under each Enterprise's affordable loan products. These bonds, however, are not designated as social bonds. The Enterprises recently adopted the Social Index, a methodology for measuring the degree of socially oriented lending activity within a pool, and started publishing new single-family MBS disclosures based on this methodology. The new disclosures were designed in response to investor demand and aim to provide insights into the socially oriented lending activities supported by the Enterprises while helping to preserve the confidentiality of borrowers' personal information. The Social Index disclosures have facilitated the issuance of "High Social Index" pools.

While these activities may be interpreted and treated by some investors as social issuances, they were not developed by the Enterprises as Enterprise-labeled, designated social bonds. Through this RFI, FHFA seeks to inform future actions by the Enterprises to develop and issue social bonds.

Public Input Questions

A. Outcomes, Borrower Benefit, and Reporting

Question A-1	What program outcomes and borrower impacts should an Enterprise Single-Family Social Bond program seek to achieve? Which borrower benefit impact measures should be reported?
Question A-2	Should pay-ups from social bonds that accrue to the Enterprises or lenders be deployed to maximize borrower benefit? For example, should funds be allocated for specific programs,[13] to provide financial or other benefits to the individual borrowers that comprise a given pool, or some combination of options? Would improved liquidity resulting from the issuance of MBS social bond pools generate a sufficient benefit to borrowers, or should borrowers

[13] For example, Special Purpose Credit Programs, the Housing Trust Funds, or potential new programs.

	whose loans are included in a social pool receive specific benefit(s)? What could those specific benefits be?
Question A-3	Should the Enterprises monitor ongoing borrower impacts and benefits? If so, how? How often should reporting on impacts be provided?
Question A-4	Should the Enterprises isolate, measure, and report on increased market liquidity for Enterprise social bonds and any resulting benefit for eligible borrowers? If so, how?

B. Eligible Loans

Question B-1	What attributes should be used to determine whether a loan is eligible for a social bond pool (e.g., income, , geography, down payment assistance, reduction in mortgage interest rate, buydown programs)? What are the advantages and disadvantages to identifying eligibility based on mortgage product versus some other methodology (e.g., minimum Social Index scores)?
Question B-2	Are the Social Index loan criteria aligned with investors' social and/or impact mandates? If not, what adjustments are needed to the criteria or to reporting of the scores?
Question B-3	What are the advantages and disadvantages of identifying loans for inclusion in social bonds prior to origination, compared to after funding? What notice, if any, should borrowers be given regarding potential inclusion of their loan into an Enterprise social bond? Should borrowers be able to opt out of a social bond program?

C. General Questions on a Social Bond Program

Question C-1	What considerations should be made to ensure the issuance of social bonds appropriately aligns with and supports the safety and soundness of the Enterprises? Are there social bond features or program designs that would conflict or be in tension with the Enterprises' safety and soundness requirements?
Question C-2	If the Enterprises begin issuing social bonds, should they continue issuing single-family affordable bonds, or other "non-social" specified pools?
Question C-3	If the Enterprises begin issuing social bonds, should they continue disclosing Social Index scores for all UMBS issuances?

Question C-4	What market risks, including potential impacts to the UMBS, should be considered when developing a social bond program? For example, could certain program outcomes be harmful to UMBS liquidity, and, if so, under what circumstances, if any, would such a result be prudent?
Question C-5	What activities or monitoring should the Enterprises and/or FHFA consider to ensure compliance with fair lending laws?

D. Disclosures and Borrower Reidentification

Question D-1	For investors with a social investment mandate, what attributes, impact measures, and guidelines/standards[14] would be necessary to meet that requirement? Do current Enterprise products or programs already meet these investment guidelines, or would investors prefer or need Enterprise-labeled social bonds? Are there any guidelines that would prevent investment in social issuances?
Question D-2	What incremental insights or additional disclosures do ESG investors need to appropriately evaluate social bonds? For each proposed insight or disclosure (e.g., borrower income band), should it be provided at the loan-level, pool-level, cohort-level, or some other level, or should some type of masking be employed? How would that additional disclosure aid investment decisions? To what extent would a specific disclosure increase the risk of borrower reidentification or provide sensitive, personal insight into the borrower?
Question D-3	What are the advantages and disadvantages of providing additional loan-level and/or pool-level data about the borrower?
Question D-4	Are there techniques to anonymize borrower data that the Enterprises should consider to mitigate the risk of borrower reidentification from disclosures supporting Enterprise issuances? For example, should the Enterprises remove some data elements from existing disclosures, revert to pool-level or cohort-level disclosures, or round the values of certain data elements?

[14] Standards include but are not limited to: ICMA global principles, UN Sustainable Development Goals, and the Sustainable Finance Disclosure Regulation (SFDR).