Shellpoint Partners

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August 1, 2014

Mr. Joseph Prendergast
Manager of Policy Research
Federal Housing Finance Agency
Office of Policy Analysis and Research
400 7th Street SW, Ninth Floor
Washington, DC 20024

Re: Fannie Mae and Freddie Mac Guarantee Fees: Request for Input / Shellpoint Partners LLC Response

Introduction

Shellpoint Partners LLC ("Shellpoint") is a specialty finance company that focuses on the U.S. residential mortgage market. It has assembled a group of companies to serve the complete spectrum of today's mortgage finance market. New Penn Financial, LLC ("New Penn"), Shellpoint's lending arm, offers a full menu of mortgage products including FHA, conventional and non-agency products. Shellpoint is strongly committed to a balanced mortgage finance system that includes FHA, Fannie Mae and Freddie Mac and the restoration of a healthy private-label securities market. Shellpoint commends FHFA's willingness to seek broad public input on the issues involving Fannie Mae and Freddie Mac guarantee fees. Shellpoint is pleased to share our perspective and knowledge on several questions with respect to which FHFA has asked for public input.

Set forth below are Shellpoint's responses to certain questions posed by FHFA in its Request for Input. We have provided responses to **Question numbers 2, 4, 5, 9, 10 and 12.**

FHFA Questions / Shellpoint Responses

QUESTION #2. Risk to the Enterprises increases if the proportion of higher-risk loans increases relative to the proportion of lower-risk loans. This change in mix can occur if lower-risk loans are retained on bank balance sheets instead of being sold to the Enterprises, if more higher-risk loans are sold to the Enterprises, or if the overall mix of originated loans changes. What alternatives, other than risk-based pricing, should be considered? What are the pros and cons of each alternative?

Shellpoint's Response to Question #2

Securitization is an important tool in a healthy mortgage finance market. As an example, the GSE MBS is an important method of risk diversification, particularly for small and regional financial institutions. It is also important to re-establish an effective private-label securities market that can inject necessary capital into the secondary housing market when the portfolio capacity of financial institutions diminishes.

The recently released Harvard Joint Center 2014 State of the Nation's Housing identified the fact that portfolio lending has significantly increased. Portfolio lending accounted for fully 19% of originations in 2013, an 8-percentage point increase post-mortgage meltdown lows. While this level is still below the 30% portfolio level of a decade earlier, it presents a stark contrast to private-label securitization levels, which account for less than 1% of recent originations. It is apparent that portfolio lending is likely to continue for originators with portfolio capabilities. The increase in portfolio lending requires both Fannie Mae and Freddie Mac to have appropriate tools in place to assure that no lender is adversely selecting the loans that are being delivered to the agencies (and "cherry picking" – that is, retaining – higher quality loans on its own balance sheet). This is an area where regulatory transparency between the banking agencies and FHFA would be appropriate and potentially very valuable.

Shellpoint therefore believes that lenders should be required to report to the respective GSEs, on a periodic basis (no more frequently than quarterly but no less frequently than annually), the makeup of loans that such lender has retained in portfolio and sold to the GSEs (and also to third-party aggregators ultimately for tracking purposes). This report should be confidential and treated in a manner similar to the Fannie Mae "MORA" review, which would protect lenders' proprietary business information but provide the GSEs with data critical to identify, address, discourage and prevent adverse selection and cherry picking by lenders.

QUESTION #4. At what g-fee level would private-label securities (PLS) investors find it profitable to enter the market or would depository institutions be willing to use their own balance sheets to hold loans? Are these levels the same? Is it desirable to set g-fees at PLS or depository price levels to shrink the Enterprises' footprints, even if this causes g-fees to be set higher than required to compensate taxpayers for bearing mortgage credit risk and results in higher costs to borrowers?

Shellpoint's Response to Question #4

We believe that products requiring deep subsidization are appropriate for FHA lending. Subsidies are not appropriate for borrowers who do not need the subsidy – i.e., borrowers who are stronger credits or who are better able to secure mortgages at market rates, especially as lenders strive to expand the credit box responsibly. As a matter of policy, we believe that a healthy housing market and a properly functioning economy require a much greater private capital presence, and that subsidizing a GSE footprint as large as the one currently in place places too much risk and burden on taxpayers.

QUESTION #5. If the Enterprises continue to raise g-fees, will overall loan originations decrease? That is, will Enterprise loans decline without a commensurate increase in private capital?

Shellpoint's Response to Question #5

If the Enterprises raise g-fees, we believe there will be an initial decline in originations because private capital may not be ready to step in and provide the same lending capacity to cover the population of loans that would no longer be GSE eligible. Private capital is sensitive to return relative to risk, however, and can scale up quickly. We therefore believe that private capital would be able to make up this gap in a timely manner, and that a more robust private label securitization market would ultimately engender more competitive pricing to borrowers.

QUESTION #9. Are the ranges of credit score and LTV cells in the proposed credit score/LTV grids used to set upfront delivery-fees and loan level pricing adjustments appropriate? Should any of the ranges be broader or narrower and, if so, why?

Shellpoint's Response to Question #9

The grids provide a reasonable amount of granularity. Excessive segmentation, however – particularly at the higher end of the credit score spectrum – could result in squeezing out any benefit of pooling or cross subsidization. This further limits the GSE's ability to serve all segments of the market. We therefore believe FHFA should look closely at the following buckets, which represent clear historical and performance-based breakpoints:

FICO: 620 – 679, 680 – 739, 740+
LTV: 0 – 65%, 65.01 – 80%, > 80%

QUESTION #10. Are the ranges of credit score and LTV cells in the proposed credit score/LTV grids used to set upfront delivery-fees and loan level pricing adjustments appropriate? Should any of the ranges be broader or narrower and, if so, why?

Shellpoint's Response to Question #10

It is our recommendation that FHFA permit each Enterprise to continue to manage its own pricing during the period of conservatorship. Furthermore, greater transparency into how each Enterprise sets its pricing would be extremely constructive. Such transparency would provide lenders with increased understanding of lending parameters and reduce or potentially eliminate pricing differentials based on factors other than the quality of lenders' GSE books. If the GSEs did not want to publish actual lender pricing, we recommend that they publish objective pricing tests that apply to different tiers of loan quality and performance. This would accomplish a similar objective without disclosing actual g-fee differentials by lender. We believe that this approach reflects the GSEs and FHFA's stated intention of creating more pricing parity based on loan quality, rather than lender size and volume.

QUESTION #12. Are there interactions with the Consumer Financial Protection Bureau's Qualified Mortgage definition that FHFA should consider in determining g-fee changes?

Shellpoint's Response to Question #12

The qualified mortgage definition as promulgated by the Consumer Financial Protection Bureau (the "CFPB") lays out underwriting boundaries that are designed to limit risk and volatility. Fannie Mae and Freddie Mac have been given a 7-year exemption from following these standards, and instead have been permitted to establish their own definitions of qualified mortgage based on their respective eligibility parameters. We believe that if a GSE mortgage loan meets the CFPB's qualified mortgage criteria as published, the g-fee for such mortgage loan should be reduced to reflect the lower risk of such loan. This approach could provide meaningful benefit to the consumer, promote a more equitable lending environment generally and help Fannie Mae and Freddie Mac serve a broader market segment.

Sincerely,

Saul Sanders
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Jerry Schiano
Chief Executive Officer & President, New Penn Financial, LLC