



FANNIE MAE AND FREDDIE MAC SINGLE-FAMILY MORTGAGE PRICING FRAMEWORK

REQUEST FOR INPUT

May 2023

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Introduction

The Federal Housing Finance Agency (FHFA), as conservator and regulator of Fannie Mae and Freddie Mac (together, the “Enterprises”), is required by statute to ensure that each Enterprise operates in a safe and sound manner, fulfills its statutory missions, and fosters the liquidity, efficiency, competitiveness, and resiliency of the national housing finance markets. Consistent with these duties, FHFA has used its authority as conservator to promote safety and soundness and foster equitable and sustainable access to mortgage credit through oversight of the Enterprises’ single-family mortgage guarantee pricing.

The Enterprises charge guarantee fees to cover the costs of guaranteeing the securities they issue backed by the mortgages they acquire. An important component of the Enterprises’ current single-family mortgage guarantee pricing is risk-based pricing, where certain guarantee fees may vary with the risk characteristics of a loan. To evaluate the risks they guarantee, the Enterprises are now operating under the Enterprise Regulatory Capital Framework (ERCF)¹ – a set of capital requirements established by FHFA through notice and comment rulemaking. The ERCF has a significant impact on the risk-based pricing component of the Enterprises’ single-family mortgage guarantee fees. The Enterprises have been required to meet specified return on capital thresholds for several years. In light of the significant increase in regulatory capital requirements and an updated view of the risk of different loan characteristics in the ERCF, FHFA in the 2022 and 2023 Conservatorship Scorecards for Fannie Mae and Freddie Mac (Scorecards)² instructed the Enterprises to “Update the current pricing framework to increase support for core mission borrowers, while ensuring a level playing field for small and large sellers, fostering capital accumulation, and achieving viable returns on capital.”³

Through this Request for Input (RFI), FHFA is soliciting comment on the Enterprises’ single-family pricing framework and the goals and policy priorities that FHFA, as conservator and regulator of the Enterprises, should pursue in its oversight of the pricing framework. FHFA also seeks input on the process for setting the Enterprises’ single-family upfront guarantee fees,

¹ 12 CFR Part 1240.

² FHFA releases an annual Scorecard to communicate and provide public awareness of its priorities and expectations for the Enterprises and Common Securitization Solutions (CSS).

³ 2022 *Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions*, November 2021: <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2022-Scorecard.pdf>; 2023 *Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions*, December 2022; <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2023-Scorecard.pdf>

including whether it is appropriate to continue to link upfront guarantee fees to the ERCF, set risk-based upfront guarantee fees for both Enterprises, and set a minimum threshold for an Enterprise's return on capital. This information will enhance FHFA's ability to continue 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.

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 August 14, 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 "Enterprises' Single-Family Mortgage Pricing Framework" from the pull-down menu) or via mail to the Federal Housing Finance Agency, Office of Capital Policy, 400 7th Street SW, 9th Floor, Washington, DC 20219.

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. Interested parties may contact FHFA if they wish to provide confidential or proprietary information as part of their responses and wish to request that the information not be made public. However, FHFA encourages interested parties to make their responses public whenever possible to inform broader public discourse on these issues.

Background on Guarantee Fees and FHFA's Oversight

Regulatory and Conservatorship Oversight of Guarantee Fees

Pursuant to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992⁴ (Safety and Soundness Act), as amended by the Housing and Economic Recovery Act of 2008 (HERA),⁵ the FHFA Director's principal duties include ensuring that each Enterprise operates in a safe and sound manner, that the operations and activities of each Enterprise foster resilient national housing finance markets including activities relating to mortgages on housing for low-

⁴ 12 U.S.C. 4501 *et seq.*

⁵ Housing and Economic Recovery Act of 2008, Public Law 110-289 (July 30, 2008).

and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities, and that each Enterprise operates in a manner that is consistent with the public interest. FHFA is guided by those statutory duties in all its actions.

In enacting HERA, which amended the Safety and Soundness Act, Congress recognized the safety and soundness implications of maintaining proper guarantee fee levels at the Enterprises. HERA required FHFA to “conduct an ongoing study of fees charged by enterprises for guaranteeing a mortgage” and to “annually submit a report to Congress on the results of the study.”⁶ Among other requirements, HERA states that FHFA’s report must “identify and analyze a breakdown of the revenue and costs associated with providing guarantees, based on product type and risk classifications.” Congress also recognized that declines in guarantee fees, without proper consideration of underlying risk, could cause a repeat of conditions where an economic downturn could increase credit losses that potentially result in a call upon the U.S. Department of the Treasury (Treasury Department) for capital support under the Senior Preferred Stock Purchase Agreements (PSPAs).

As conservator for Fannie Mae and Freddie Mac, FHFA has instructed certain guarantee fee activities.⁷ FHFA’s 2022 guarantee fee report⁸ presents a timeline of changes in guarantee fees through November 2021. FHFA’s objective for making these changes is to prevent potential safety and soundness concerns from the underpricing of mortgage credit risk. Additionally, FHFA has modified the pricing framework with the intent to, among other things, promote a level playing field across lenders of different sizes, attract private capital to the Enterprises, and facilitate the Enterprises’ mission activities by improving the efficiency of the Enterprises’ support for creditworthy low- and moderate-income and underserved borrowers.

What are Guarantee Fees?

Each Enterprise has historically charged fees for guaranteeing the timely payment of principal and interest on mortgage-backed securities it issues. Guarantee fees are an essential element of the Enterprises’ business model and the key revenue component in determining economic returns earned from their core credit guarantee business.

⁶ See Section 1601 of HERA, codified at 12 U.S.C. § 4514a. Each of the annual guarantee fee reports that FHFA has submitted since 2008 can be accessed on FHFA’s website at: [Guarantee Fees - All Reports](#).

⁷ With the Enterprises operating in conservatorships, FHFA has the authority of the boards, managements, and shareholders. See 12 U.S.C. § 4617(b)(2).

⁸ See <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GFee-Report-2021.pdf>.

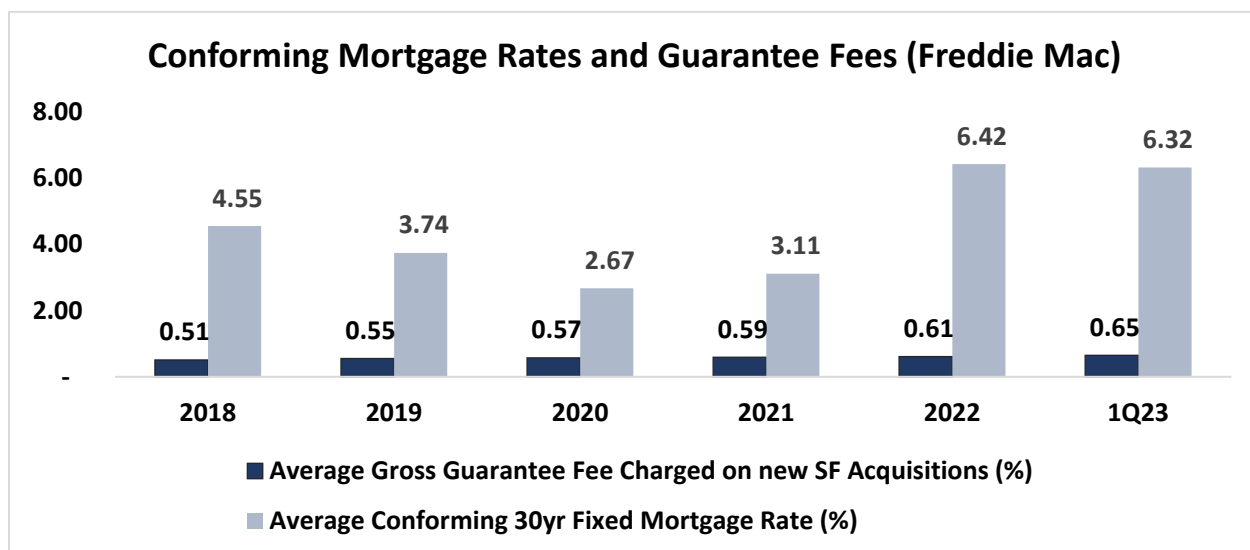
Fannie Mae and Freddie Mac Single-family Mortgage Pricing Framework: RFI

Single-family mortgage guarantee fees are generally composed of two basic components: ongoing guarantee fees and upfront guarantee fees. Ongoing guarantee fees, also known as base guarantee fees, are collected monthly over the life of a loan. Fannie Mae and Freddie Mac set ongoing guarantee fees independently of each other (subject to certain minimum requirements set by FHFA under its authority as conservator), with different ongoing guarantee fees for different product types, such as whether a mortgage is a 30-year fixed rate loan or a 15-year fixed rate loan.

Upfront guarantee fees are one-time payments made by lenders upon loan delivery to an Enterprise that reflect risk characteristics of the loan. For example, upfront guarantee fees are different depending on the loan product type, loan-to-value (LTV) ratio, and credit score of the borrower, to name a few variables. Thus, upfront guarantee fees are a form of risk-based pricing where, generally, mortgage loans considered to be riskier in nature are charged higher fees. Beginning soon after FHFA placed the Enterprises into conservatorships, the Agency instructed the Enterprises to set upfront guarantee fees charged on loans with specific risk attributes to discourage the underpricing of risk by the Enterprises. Upfront guarantee fee schedules are publicly available on each Enterprise's website in their respective Guides. Fannie Mae refers to upfront guarantee fees as *loan level price adjustments* (LLPAs) and Freddie Mac refers to upfront guarantee fees as *credit fees in price*.

Both the ongoing guarantee fees and the upfront guarantee fees typically are factored into the interest rate and/or points paid by the borrower, and the guarantee fees are thereby effectively passed on to the borrower by the lender. Guarantee fees are only one component of the overall mortgage interest rate paid by the borrower. For example, a lender may price a single-family mortgage loan at a 6.0 percent interest rate based on a 3.5 percent 10-year Treasury benchmark rate, a 1.65 percent risk premium, a 0.6 percent total effective guarantee fee rate, and a 0.25 percent mortgage servicing fee. On average, ongoing guarantee fees comprise the majority of the total guarantee fee, with upfront guarantee fees representing a smaller subcomponent of the total.⁹

⁹ In its 2022 guarantee fee report, FHFA found the average total single-family effective guarantee fee rate was 56 basis points in 2021, with the average ongoing guarantee fee representing 43 basis points and the average upfront guarantee fee representing 13 basis points.



Source: Freddie Mac and FHFA analysis (Freddie Mac reports average guarantee fees on a net basis)

Guarantee fees are intended to cover the administrative costs, expected credit losses, and the cost of capital associated with guaranteeing single-family mortgage loans. Administrative costs include salaries, employee benefits, and other costs reflecting the Enterprises’ core business, taxes, and miscellaneous expenses such as the fee assessed for the Temporary Payroll Tax Cut Continuation Act of 2011 (TCCA).¹⁰ Expected credit losses are generally estimated based on loan-specific risks. The cost of capital is the most significant of these costs and is the product of the required return on capital and the amount of capital held. In order to maintain a sound pricing framework, FHFA expects each Enterprise to set guarantee fees consistent with the amount of capital they would need to support their guarantee businesses as if they were well capitalized, with regulatory capital requirements determined using the ERCF.

¹⁰ On December 23, 2011, the TCCA was signed into law to fund an extension of the payroll tax cut. To comply with the TCCA, in December 2011 FHFA directed the Enterprises to increase the ongoing fees for all loans by 10 basis points effective with April 2012 deliveries. In November 2021, the Infrastructure Investment and Jobs Act extended to 2032 the existing 10 basis point ongoing TCCA fee. This fee was previously due to expire in 2022. The Enterprises remit the proceeds from this fee to the Treasury Department.

Recent Developments

Transition to the ERCF

FHFA adopted the ERCF in a final rule published in December 2020 after notice and comment rulemaking. The ERCF is intended to ensure that the Enterprises operate in a safe and sound manner and are positioned to fulfill their statutory mission to provide stability and liquidity to the secondary mortgage market throughout the economic cycle. The ERCF became effective in February 2021, and after updating internal systems and procedures, the Enterprises began using the ERCF in 2022 for measuring the profitability of new mortgage acquisitions among other purposes.

The transition to the ERCF's requirements has important implications for the Enterprises' capital accumulation process and their pricing and profitability. The ERCF is a granular, mortgage risk-sensitive framework, the adoption of which resulted in updated capital requirements across credit characteristics, as well as an increase in overall capital requirements. Importantly, the ERCF includes reductions to risk-based capital requirements for loans with LTV ratios above 80 percent with private mortgage insurance where the private mortgage insurance provider meets the Enterprise mortgage insurer eligibility requirements. Several features of the ERCF that are not impacted by the risk characteristics of the loan, for example buffer requirements and risk-weight floors, result in the ERCF having a relatively flat risk gradient across credit characteristics, resulting in loans with stronger credit characteristics receiving more significant capital increases than loans with weaker credit characteristics, relative to prior proposed capital requirements.¹¹

In general, the ERCF capital requirements are substantially higher than the requirements under which the Enterprises previously operated. Specifically, the aggregate increases in the Enterprises' capital requirements reflect the following components of the ERCF: (1) a risk-weight floor minimum requirement for mortgage exposures, (2) a countercyclical adjustment to single-family credit risk capital requirements that increases single-family requirements when real house prices are significantly above their long-run trend (and vice versa), and (3) risk-insensitive capital buffers for stability, stress, and leverage.

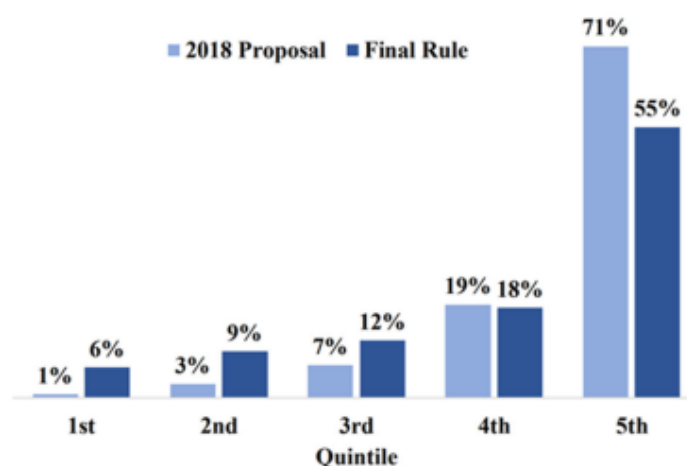
¹¹ FHFA provided a discussion on the impacts of transitioning to the ERCF in the latest annual guarantee fee report: *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2021*, November 2022: <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GFee-Report-2021.pdf>

Fannie Mae and Freddie Mac Single-family Mortgage Pricing Framework: RFI

The transition to the ERCF also changed capital requirements across credit risk characteristics using base grids (where base risk weights are generally determined using LTV ratios and credit scores) and risk multipliers (which increase or decrease base risk weights for additional risk characteristics). Under the ERCF, the credit risk-weight floor of 20 percent on single-family mortgage exposures increased required capital more significantly for loans with stronger credit characteristics (e.g., higher credit scores, higher down payments, lower debt-to-income (DTI) ratios, and 15/20-year fixed rate products) than for loans with weaker credit characteristics. For example, a loan with a 780 credit score and a 30 percent LTV ratio has an identical risk weight of 20 percent as a loan with a 660 credit score and a 60 percent LTV ratio, all else equal. In addition, the ERCF's risk-insensitive capital buffers, which an Enterprise holds in addition to its minimum capital requirements, have an outsized impact on loans with stronger credit risk characteristics because the buffers, which are applied equally across all loans, represent a larger portion of the total capital held for loans with lower risk-based capital requirements than for loans with higher risk-based capital requirements.

As evidenced in the following figure,¹² these ERCF features led to credit risk capital being more evenly distributed across the credit risk spectrum and increased required capital for loans with stronger credit risk characteristics under the ERCF relative to FHFA's 2018 regulatory capital proposal:

Share of Single-Family Total Net Credit Capital by Risk Weight Quintile



¹² For purposes of this chart, single-family mortgages are ranked by the adjusted risk weight assigned to the exposure and grouped by quintile. See Fact Sheet: Final Rule on [Enterprise Capital](#) (December 2020).

The transition to the ERCF also has important implications for returns and profitability. Higher capital requirements and flatter risk gradients in the ERCF result in a lower and flatter return profile across the credit risk spectrum. That is, the reduction in profitability stemming from the ERCF's capital requirements and buffers is more pronounced for loans with stronger credit risk characteristics than for loans with weaker credit risk characteristics.

Changes to the Pricing Framework

Guarantee Fees

Consistent with FHFA's statutory duties and purposes, and as articulated in the 2022 and 2023 Scorecards, FHFA has taken a series of steps to update the Enterprises' single-family guarantee fee pricing framework to increase support for creditworthy borrowers limited by income or by wealth, while ensuring a level playing field for small and large sellers, fostering capital accumulation, and achieving viable returns on ERCF capital. FHFA intends for these updates to promote safety and soundness while complementing the Enterprises' ongoing programs, products, and tools designed to facilitate housing affordability and stability, including by meeting annual housing goals and fulfilling statutory Duty to Serve mandates.

To frame FHFA's actions, it is useful to consider how the Agency approached the process of setting upfront guarantee fees for the Enterprises' single-family mortgage acquisitions. FHFA categorizes the Enterprises' acquisitions into three broad segments for assessing profitability and returns on ERCF capital. First, the Enterprises' standard purchase and rate-term refinance mortgage acquisitions should, over time, provide commercially reasonable returns to the Enterprises. Second, the Enterprises target higher returns for mortgage products that are supported by other reliable sources of mortgage financing beyond the Enterprises yet serve as an important source of cross-subsidization when acquired by the Enterprises. These products include cash-out refinance loans, second home loans, investor property loans, and high balance loans. Third, the Enterprises accept lower but still reasonable returns for mortgage loans made to low- and moderate-income borrowers, the vast majority of whom are first-time homebuyers. Per the table below characterizing the 2022 acquisitions of purchase loans made through the Enterprises' affordable housing programs, this segment generally consists of creditworthy borrowers limited by income, borrowers limited by resources for down payments, and underserved communities including borrowers in rural areas.

Fannie Mae and Freddie Mac Single-family Mortgage Pricing Framework: RFI

	Fannie Mae	Freddie Mac	Fannie Mae	Freddie Mac
	Home Ready	Home Possible	HFA Loans	HFA Loans
UPB (Billion)	\$16.10	\$15.30	\$5.35	\$1.34
Loan Count	76,486	71,305	23,629	6,044
First Time Homebuyer %	77%	80%	94%	88%
Wtd Avg LTV	90%	91%	94%	92%
Wtd Avg FICO	743	742	735	739
Wtd Avg DTI	42%	42%	41%	40%

Source: FHFA¹³

In January 2022, FHFA announced targeted increases to the Enterprises' upfront guarantee fees for certain high balance loans and second home loans. To ensure that the Enterprises continue to provide strong support for affordable housing, FHFA instructed the Enterprises to exempt loans to first-time homebuyers in high cost areas with incomes at or below 100 percent of area median income (AMI) and loans supported by the existing affordable housing programs from the new fees.

In October 2022, to build on the earlier pricing increases, FHFA announced targeted increases to the upfront guarantee fees for most cash-out refinance loans. Simultaneously, FHFA announced the elimination of upfront guarantee fees for mortgage loans made to many first-time homebuyers, low-income borrowers, and underserved communities. While many loans made through HomeReady and Home Possible (Fannie Mae's and Freddie Mac's respective flagship affordable mortgage programs) already had zero upfront guarantee fees, upfront fees were fully eliminated for the following borrowers and programs: first-time homebuyers at or below 100 percent of AMI in most of the United States and below 120 percent of AMI in high cost areas, HomeReady and Home Possible loans, HFA Preferred and HFA Advantage loans (Fannie Mae

¹³ FHFA 2022 Housing Mission Report

and Freddie Mac's respective Housing Finance Agency loan programs), and single-family loans supporting the Duty to Serve program (which addresses rural housing, affordable housing preservation, and manufactured housing).

In January 2023, after the Enterprises had fully transitioned to the new capital regime, FHFA announced further changes to the Enterprises' single-family pricing framework by introducing redesigned and recalibrated upfront fee matrices to align the fee structure more closely with the risk factors utilized in the ERCF. These changes broadly impacted purchase and rate-term refinance loans and further built upon the upfront fee changes announced by FHFA in January and October 2022. The new fee matrices consist of three base grids by loan purpose for purchase, rate-term refinance, and cash-out refinance loans – recalibrated to the credit score and LTV ratio categories used in the ERCF – along with associated loan attributes for each.

To align with risk and the ERCF more closely, the updated grids announced in January 2023 included a specific new upfront fee for certain borrowers with DTI ratios above 40 percent. FHFA received feedback from mortgage lenders and other industry stakeholders about the operational and other challenges of implementing a DTI-based fee and subsequently removed the fee in May 2023.

FHFA believes that the changes made to the single-family mortgage guarantee pricing framework under FHFA's oversight will enhance safety and soundness by better aligning mortgage guarantee pricing to required capital and improving the Enterprises' capital positions, support the Enterprises' goal of reaching viable returns over time, and result in a more efficient delivery of the Enterprises' mission support through pricing. Specifically, FHFA expects that recalibrating the fee grids to improve alignment with the ERCF, targeting higher returns for certain borrowers and products, and eliminating upfront guarantee fees for certain creditworthy borrowers limited by income or by wealth will positively impact the Enterprises, traditionally underserved borrowers, and the overall housing finance system.

Return on Capital

In addition to the pricing changes outlined above, the Enterprises have been required to meet specified return on capital thresholds since 2018. FHFA has found the setting of minimum return thresholds to be a particularly effective tool to discourage underpricing of risk. By requiring the Enterprises to achieve minimum aggregate returns on new acquisitions, FHFA seeks to mitigate the risk that the Enterprises might pursue increased market share through price reductions that have historically undermined safety and soundness, thereby promoting a more stable housing finance system and protecting United States taxpayers from potential losses. Beginning in 2022, these minimum profitability thresholds on new single-family mortgage

acquisitions have been determined by levels of required capital under the ERCF. FHFA's objective is for the Enterprises to achieve commercially reasonable returns over time.

Given the substantial amount of capital required to be held by the Enterprises on new mortgage acquisitions as a result of the ERCF, the Enterprises are not currently earning commercially reasonable aggregate returns on new single-family mortgage acquisitions. FHFA estimates that the Enterprises are generally earning mid-single digit returns on equity on aggregate new single-family mortgage acquisitions.

The Enterprises are in the process of phasing in the effects of the ERCF by gradually increasing returns over time to help ensure that they achieve commercially reasonable returns in a responsible and systematic manner that prioritizes safety and soundness and minimizes disruptions to the housing finance market. Earning a commercially reasonable rate of return would enhance safety and soundness and help prepare the Enterprises to succeed without impacting United States taxpayers or impacting liquidity for borrowers.

Request for Input

The transition to the ERCF has necessitated an ongoing evaluation of the Enterprises' single-family mortgage guarantee fee pricing framework, which FHFA initiated through the 2022 Scorecard, to enable the Enterprises to reach viable returns on capital over time. FHFA is soliciting input from the public through this RFI on the process, framework, and policy considerations that should be considered in setting single-family mortgage guarantee fees by the Enterprises going forward.

Specifically, FHFA requests public input on the following topics:

Return on Capital

- What is an appropriate long-term commercially reasonable return on capital threshold for the Enterprises to achieve?
- To what comparable industries and companies should these return on capital thresholds be calibrated?
- Should FHFA set only minimum return thresholds for the Enterprises, or a range of returns – including a maximum return target?
- For which loan characteristics and products should the Enterprises accept a lower return?
- For which loan characteristics and products should the Enterprises target a higher return?
- How should return on capital be calculated for the Enterprises?

Process

- With what frequency should FHFA consider updating the upfront guarantee fee grids?

Components of Guarantee Fees

- In achieving commercially reasonable returns over time, should future guarantee fee changes be executed through ongoing guarantee fees or upfront guarantee fees?
- Should upfront guarantee fees be eliminated?
- Should risk-based pricing be calibrated to the ERCF?