

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1240

RIN 2590-AB17

**Enterprise Regulatory Capital Framework– Prescribed Leverage Buffer Amount
and Credit Risk Transfer**

AGENCY: Federal Housing Finance Agency.

ACTION: Final rule.

SUMMARY: The Federal Housing Finance Agency (FHFA or the Agency) is adopting a final rule (final rule) that amends the Enterprise Regulatory Capital Framework (ERCF) by refining the prescribed leverage buffer amount (PLBA or leverage buffer) and credit risk transfer (CRT) securitization framework for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac, and with Fannie Mae, each an Enterprise). The final rule also makes technical corrections to various provisions of the ERCF that was published on December 17, 2020.

DATES: This rule is effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER.]

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are not toll-free numbers. For TTY/TRS users with hearing and speech disabilities, dial 711 and ask to be connected to any of the contact numbers above.

SUPPLEMENTARY INFORMATION:

Table of Contents

- I. Introduction
- II. Overview of the Final Rule
 - A. Amendments to the ERCF
 - B. Effective Date
- III. General Comments on the Proposed Rule
 - A. 20 Percent Risk Weight Floor
 - B. Multifamily Countercyclical Adjustment
- IV. Leverage Buffer
- V. Credit Risk Transfer
- VI. ERCF Technical Corrections
- VII. Paperwork Reduction Act
- VIII. Regulatory Flexibility Act
- IX. Congressional Review Act

I. Introduction

On September 27, 2021, FHFA published in the Federal Register a notice of proposed rulemaking (proposed rule) seeking comments on amendments to the ERCF that would refine the leverage buffer and the risk-based capital treatment for retained CRT exposures.¹ FHFA proposed these amendments to ensure that the ERCF

¹ 86 FR 53230.

appropriately reflects the risks inherent to the Enterprises' business models and contains proper incentives for the Enterprises to distribute acquired credit risk to private investors rather than to buy and hold that risk. In meeting these objectives, the proposed amendments would help restore FHFA's intended paradigm of having the Enterprises' leverage capital requirements and buffer provide a credible backstop to their risk-based capital requirements and buffers, enhancing the safety and soundness of the Enterprises. FHFA is now adopting in this final rule the proposed amendments, substantially as proposed.

FHFA published the ERCF on December 17, 2020² with the purpose of implementing a going-concern regulatory capital standard to ensure that each Enterprise operates in a safe and sound manner and is positioned to fulfill its statutory mission to provide stability and ongoing assistance to the secondary mortgage market across the economic cycle.³ The ERCF, which became effective on February 16, 2021, aimed to address issues that arose during the notice and comment period such as the pro-cyclicality of the single-family risk-based capital requirements, the quality of Enterprise capital used

² 85 FR 82150.

³ In conservatorships, the Enterprises are supported by Senior Preferred Stock Purchase Agreements (PSPAs) between the U.S. Department of the Treasury (Treasury) and each Enterprise, through FHFA as its conservator (Fannie Mae's Amended and Restated Senior Preferred Stock Purchase Agreement with Treasury (September 26, 2008), https://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/FNM/SPSPA-amends/FNM-Amend-and-Restated-SPSPA_09-26-2008.pdf; Freddie Mac's Amended and Restated Senior Preferred Stock Purchase Agreement with Treasury (September 26, 2008), https://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/FRE/SPSPA-amends/FRE-Amended-and-Restated-SPSPA_09-26-2008.pdf). The PSPAs, as amended by letter agreements executed by the parties on January 14, 2021 (2021 Fannie Mae Letter Agreement, <https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf>; 2021 Freddie Mac Letter Agreement, <https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Freddie%20Mac.pdf>), include a covenant at section 5.15 which states: “[The Enterprise] shall comply with the Enterprise Regulatory Capital Framework [published in the Federal Register at 85 FR 82150 on December 17, 2020] disregarding any subsequent amendment or other modifications to that rule.” Modifying that covenant will require agreement between the Treasury and FHFA under section 6.3 of the PSPAs.

to meet the capital requirements, and the quantity of required capital at the Enterprises. Accordingly, the ERCF is significantly stronger than the statutory framework which governed the Enterprises' capital requirements prior to entering conservatorships.

However, after finalizing the ERCF, FHFA identified specific aspects of the framework that might incentivize risk taking in certain economic environments and create disincentives to the Enterprises' CRT programs. Together, these features of the ERCF could result in an excessive buildup of risk accruing to taxpayers and the housing finance market, particularly because the Enterprises presently are severely undercapitalized and lack the resources on their own to safely absorb the credit risk associated with their normal operations.

FHFA views the transfer of risk, particularly credit risk, to a broad set of investors as an important tool to reduce taxpayer exposure to the risks posed by the Enterprises and to mitigate systemic risk caused by the size and monoline nature of the Enterprises' businesses. Since their development began in 2013, the CRT programs have been the Enterprises' primary mechanism to successfully effectuate reliable risk transfer to the private sector. Through these programs, the Enterprises have shed a significant amount of credit risk to help protect against potential losses while the PSPAs have significantly limited the Enterprises' ability to hold capital and withstand losses through normal operations. During this current period where the Enterprises are building capital, CRT remains an important risk mitigation tool to protect taxpayers against the heightened risk of potential PSPA draws in the event of a significant stress to the housing sector. It is therefore crucial that the Enterprises' capital requirements are appropriately sized, where

the leverage capital framework is a credible backstop to the risk-based capital framework and where responsible and effective risk transfer is not unduly discouraged.

II. Overview of the Final Rule

A. Amendments to the ERCF

After carefully considering the comments on the proposed rule, and as described in this preamble, FHFA is adopting, substantially as proposed, amendments to the leverage buffer and risk-based capital treatment of CRT exposures. FHFA continues to believe that the amendments in this final rule will lessen the potential deterrents to Enterprise risk transfer by properly aligning incentives in the ERCF and will position the Enterprises to operate in a safe and sound manner to fulfill their statutory mission throughout the economic cycle, both during and after conservatorships. Specifically, the final rule will:

- Replace the fixed leverage buffer equal to 1.5 percent of an Enterprise's adjusted total assets with a dynamic leverage buffer equal to 50 percent of the Enterprise's stability capital buffer as calculated in accordance with 12 CFR 1240.400;
- Replace the prudential floor of 10 percent on the risk weight assigned to any retained CRT exposure with a prudential floor of 5 percent on the risk weight assigned to any retained CRT exposure; and
- Remove the requirement that an Enterprise must apply an overall effectiveness adjustment to its retained CRT exposures in accordance with 12 CFR 1240.44(f) and (i).

In addition, the final rule will implement technical corrections to various provisions of the ERCF that was published on December 17, 2020, highlighted by a

significant typographical error in the definition of the long-term HPI trend that constitutes the basis for calculating the single-family countercyclical adjustment.

B. Effective Date

Under the rule published on December 17, 2020 establishing the ERCF, an Enterprise will not be subject to any requirement in the ERCF until the compliance date for the requirement as detailed in the ERCF. The effective date for the ERCF was February 16, 2021. The effective date for the ERCF amendments and technical corrections in this final rule will be 60 days after the day of publication of this final rule in the Federal Register.

III. General Comments on the Proposed Rule

FHFA received 89 public comment letters on the proposed rule from a variety of interested parties, including private individuals, trade associations, consumer advocacy groups, think-tanks and institutes, and financial institutions.⁴ In general, and as discussed in greater detail below in the relevant sections of this preamble, commenters were supportive of FHFA's proposed amendments to both the leverage buffer and the risk-based capital treatment of retained CRT exposures. Overall, most commenters supported FHFA's efforts to restore the intended paradigm between leverage capital and risk-based capital at the Enterprises and to properly incentivize risk transfer within the ERCF. However, as discussed in the relevant sections of this preamble, FHFA also received a number of comments indicating concern over various aspects of the proposed amendments.

⁴ See comments on Amendments to the Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer, available at <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-List.aspx?RuleID=708>. The comment period for the proposed rule closed on November 26, 2021.

Over half of the 89 comments FHFA received during this notice and comment period focused on issues not directly related to the proposed amendments or technical corrections. In these letters, commenters offered views on important topics such as loan-level pricing adjustments, incorporating guarantee fees into capital requirements, the ERCF grids and risk multipliers, the magnitude of single-family and multifamily risk weights, various other aspects of the CRT securitization framework, the costs of CRT transactions, and the overall complexity of the ERCF, among others. In addition, commenters offered views on housing finance reform and on matters relating to the Enterprises' conservatorships, including issues related to the Enterprises' consent to conservatorships in 2008, subsequent actions by FHFA or the U.S. Department of the Treasury (Treasury), the magnitude of funds remitted to Treasury by the Enterprises relative to cumulative draws, Treasury's financial interests in the Enterprises, and the PSPAs. FHFA acknowledges the importance of these topics and will thoroughly consider the public's feedback on these issues when relevant rulemakings and policy decisions are under consideration.

In addition to soliciting comments on the proposed amendments and technical corrections, FHFA also sought feedback on two additional topics related to the ERCF: the 20 percent risk weight floor on single-family and multifamily mortgage exposures and potential options for a countercyclical adjustment for multifamily mortgage exposures. FHFA received feedback on both topics.

A. 20 Percent Risk Weight Floor

FHFA asked the public whether, in light of the proposed changes to the leverage buffer and the risk-based capital requirements for retained CRT exposures, the prudential

risk weight floor of 20 percent on single-family and multifamily mortgage exposures was appropriately calibrated. FHFA did not propose a change to the risk weight floor on single-family and multifamily mortgage exposures. Nine commenters provided feedback on this question, and the opinions expressed by commenters were varied.

Some commenters recommended reducing or eliminating the 20 percent risk weight floor. Among these commenters, some suggested that lowering the floor is appropriate due to the Enterprises' improved balance sheets and mortgage lending standards relative to pre-crisis economics. Others suggested that the 20 percent risk weight floor in the ERCF is not appropriately calibrated. Another commenter suggested that the 20 percent floor distorts market signals about risk and incentivizes risk taking by the Enterprises.

Conversely, some commenters recommended maintaining the 20 percent risk weight floor. Among these commenters, some suggested that such a floor is prudent to ensuring the safety and soundness of the Enterprises. One commenter suggested that the risk weight floor is useful as an incentive for the Enterprises to transfer credit risk on lower-risk exposures. Another commenter suggested that the risk weight floor is important to mitigate the model risks inherent in the risk-sensitive methodology FHFA used to calibrate risk weights for mortgage exposures. One commenter suggested that reducing this risk weight floor could significantly increase the gap between the credit risk capital requirements of the Enterprises and other market participants.

One of the key objectives FHFA cited for proposing amendments to the ERCF was to ensure the leverage capital framework was a credible backstop to the risk-based capital framework. Despite changes to the 2020 ERCF proposed rule⁵ that increased

⁵ 85 FR 39274.

risk-based capital under the 2020 ERCF final rule, including raising the 15 percent risk weight floor on single-family and multifamily mortgage exposures to 20 percent and changing the dataset on which the single-family countercyclical adjustment is calculated, tier 1 leverage capital remains greater than tier 1 risk-based capital at each Enterprise in the absence of the leverage buffer and CRT amendments in the proposed rule. Should FHFA materially reduce the 20 percent floor on single-family and multifamily mortgage exposures without taking additional action, the likelihood that the leverage framework would once again be the binding capital constraint for the Enterprises would significantly increase. For this reason, and given the commenters' diverse feedback, FHFA has determined not to take action related to the 20 percent risk weight floor on single-family and multifamily mortgage exposures at this time.

B. Multifamily Countercyclical Adjustment

FHFA also asked the public to recommend an approach for mitigating the procyclicality of the credit risk capital requirements for multifamily mortgage exposures that relies only on non-proprietary data or indices. Eight commenters provided feedback on this question, recommending three different types of approach. The first group of commenters suggested solutions following the same principles as FHFA's single-family countercyclical adjustment, where risk attributes such as the loan-to-value (LTV) ratio would be adjusted up or down depending on deviations from a long-term trend. For use in this approach, commenters recommended FHFA consider the property index published by the National Council of Real Estate Investment Fiduciaries (NCREIF), long-term vacancy rates, long-term property value and income growth rates, and adjusted cap rates. The second group of commenters recommended FHFA consider an approach where the

countercyclical adjustment is based on ratios of index peaks to current values. Commenters suggested FHFA could use the NCREIF property index for property values and Enterprise investor reporting for net operating income (NOI). This approach would assume that the multifamily risk weights already account for a 35 percent shock to property values and a 15 percent shock to NOI, so an adjustment would be made only to the extent that the property value and/or NOI index ratios suggest a further adjustment is necessary. Finally, one commenter suggested that FHFA should address pro-cyclicality for multifamily mortgage exposures by replacing mark-to-market LTV with original LTV and mark-to-market debt service coverage ratio (DSCR) with original DSCR.

FHFA appreciates the public's feedback on this topic and is committed to addressing the pro-cyclicality in the capital required for multifamily mortgage exposures. However, given the complexity of potential solutions and the diversity of suggestions provided by commenters, FHFA has determined that this topic requires further consideration, potentially in a future rulemaking. Therefore, FHFA has determined not to take action related to a multifamily countercyclical adjustment at this time.

IV. Leverage Buffer

The proposed rule would amend the ERCF by replacing the fixed tier 1 capital leverage buffer equal to 1.5 percent of an Enterprise's adjusted total assets with a dynamic tier 1 capital leverage buffer equal to 50 percent of the Enterprise's stability capital buffer.⁶ In the proposed rule, FHFA presented several benefits to this approach.

First, a properly calibrated leverage ratio requirement and leverage buffer are critical aspects of a sound regulatory capital framework. The purpose of leverage capital

⁶ 12 CFR 1240.400.

is to promote financial stability by establishing a robust capital floor that persists throughout the economic cycle and by limiting risk taking when risk-based capital may otherwise fall to unduly low levels. Recalibrating the 1.5 percent leverage buffer will promote safety and soundness and financial stability at the Enterprises by lessening the likelihood that leverage capital will drive Enterprise decision-making in the majority of economic environments and reduce the frequency in which an Enterprise has an incentive to take on more risk in a capital optimization strategy. Furthermore, restoring leverage capital to a position of a credible backstop will allow other aspects of the ERCF, namely the risk-based capital requirements, including the single-family countercyclical adjustment, to work as intended. Second, the proposed leverage buffer amendment will encourage the Enterprises to transfer risk rather than to buy and hold risk. Third, a leverage framework with a dynamic buffer that grows and shrinks as an Enterprise grows and shrinks, respectively, will function as a better backstop to a risk-based capital framework that includes a stability capital buffer linked to an Enterprise's size. And fourth, a dynamic leverage buffer that is tied to the stability capital buffer will further align the ERCF with Basel III standards. Internationally, under the latest Basel framework adopted by the Bank for International Settlements, global systemically important banks (G-SIBs) are required to hold a leverage buffer equal to 50 percent of their higher loss-absorbency risk-based requirements – a measure akin to the G-SIB surcharge in the U.S. banking framework – to tailor an institution's leverage ratio to its business activities and risk profile.

The vast majority of comments FHFA received supported decreasing the tier 1 capital leverage buffer from a fixed 1.5 percent of adjusted total assets. Many

commenters supported FHFA's proposed approach, while some supported decreasing the leverage buffer without tying it to the stability capital buffer and others favored eliminating the leverage buffer altogether.

Many commenters who recommended decreasing the leverage buffer suggested doing so because it is preferable for risk-based capital metrics to be the binding capital constraint more frequently than non-risk-based capital floors such as leverage. Commenters suggested that this paradigm helps eliminate incentives for the Enterprises to increase risk taking and risk retention while providing flexibility to the Enterprises as they manage risk and rebuild robust levels of capital. In addition, commenters agreed with FHFA that a smaller leverage buffer would encourage the transfer of mortgage credit risk from the Enterprises to private investors. Another commenter stated that the 1.5 percent leverage buffer is unnecessary relative to the Enterprises' recent stress test results, and that such a high buffer would likely be excessive to the point of impairing the Enterprises' ability to support the market and meet their mission.

Many commenters expressed their general support for FHFA's proposed approach of tying the leverage buffer to the stability capital buffer. Commenters contended that a dynamic leverage buffer that expands and contracts with an Enterprise as its size and strategy evolve would more accurately reflect the Enterprise's risk and thereby help facilitate the Enterprises' ability to carry out their missions through all economic cycles. Thus, commenters reasoned that the proposed approach would help leverage serve as a credible backstop to the risk-based capital framework and allow the Enterprises to withstand losses in excess of those experienced during the great financial crisis. Other commenters supported FHFA's effort to move toward a dynamic leverage buffer to better

reflect the spirit and intent of the leverage ratio, and also because dynamic buffers have proven to be an effective tool for managing capital at the global systemically important banks. Another commenter suggested that the proposed approach will help provide stability in the mortgage market and increase investor confidence in the Enterprises and overall economy throughout the economic cycle, helping stave off the need for emergency taxpayer intervention. Another commenter stated that basing the leverage buffer on a risk-based capital metric is preferable because it better reflects the varying levels of risk within an Enterprise's particular pool of total assets.

Some commenters expressed more reserved support for setting the leverage buffer equal to 50 percent of the stability capital buffer. Several commenters expressed concern that tying the leverage buffer to the stability capital buffer could have pro-cyclical implications in the sense that an Enterprise's market share tends to grow during a stress when other market participants are growing slowly or shrinking. Thus, requiring an Enterprise to increase its leverage buffer during the period when the Enterprise is fulfilling its countercyclical role could limit the Enterprise's ability to supply market liquidity when it is most needed. In contrast to these commenters' concern, FHFA anticipates that setting the leverage buffer equal to 50 percent of the stability capital buffer will actually reduce the pro-cyclicality of the leverage framework because increases to an Enterprise's adjusted total assets are reflected in the fixed 1.5 percent leverage buffer immediately whereas increases to an Enterprise's share of the overall mortgage market are reflected in the stability capital buffer with up to a two-year delay.⁷ FHFA believes this delayed need to raise capital relative to the current ERCF will

⁷ *Id.*

facilitate the Enterprises' abilities to provide liquidity to the mortgage market during a stress, even if an Enterprise grows its portfolio as a result of fulfilling its countercyclical mission.

A few other commenters supported FHFA's proposed amendments but recommended that FHFA: i. continue to study the relationship between leverage, risk-based capital, and the stability capital buffer to determine definitively that the leverage buffer should be linked to the stability capital buffer; and ii. provide historical data affirming the proposed approach and demonstrating that under the proposed amendments leverage will rarely exceed risk-based capital.

Another commenter recommended that FHFA must ensure that its regulatory capital framework avoids discriminatory outcomes and promotes equitable treatment of borrowers and communities of color. One commenter supported FHFA's proposed amendments but expressed a desire for FHFA to be more anticipatory and expansive in the list of provisions it chooses to reconsider.

Some commenters recommended decreasing the leverage buffer but not tying it to the stability capital buffer. One commenter expressed concern that the stability capital buffer was itself arbitrarily determined, so by association a leverage buffer equal to 50 percent of the stability capital buffer is also arbitrarily determined. This commenter recommended that FHFA consider alternative methods of the setting the leverage buffer that are more closely tied to an Enterprise's risk. One commenter recommended that FHFA decrease an Enterprise's leverage buffer by some estimate of future guarantee fees. Similarly, another commenter recommended that FHFA decrease an Enterprise's leverage buffer to reflect risk transferred through CRT in the same way that the risk-

based capital framework provides capital relief for CRT. Several commenters recommended FHFA simply reduce the leverage buffer from 1.5 percent of adjusted total assets to a lower percentage of adjusted total assets, such as 0.5 percent, because market share is not a reasonable representation of Enterprise risk.

Some commenters recommended FHFA eliminate the leverage buffer completely. These commenters generally viewed the leverage buffer as not necessary for the leverage framework to be a credible backstop to the risk-based capital framework. Two commenters suggested the 2.5 percent leverage capital requirement is itself sufficient as a credible backstop to risk-based capital in the ERCF. Another commenter suggested the leverage buffer is unnecessary because: i. stress losses on a new month of originations are lower than the capital required by the ERCF; and ii. future guarantee fees provide a significant source of claims-paying resources, which are not considered as a source of capital in the framework. One commenter suggested FHFA eliminate the leverage buffer rather than decrease it because a future FHFA director can just as easily increase it again.

Finally, some commenters recommended that FHFA maintain the fixed 1.5 percent leverage buffer. One commenter claimed that FHFA does not provide evidence that the existing ERCF leverage-based requirements would be binding throughout the economic cycle, and that it is difficult to envision any realistic scenario in which the proposed amendments to the leverage buffer would result in a leverage-based requirement that could exceed the risk-based requirement, violating the concept of being a credible backstop. FHFA disagrees with the premise of this argument because the argument compares tier 1 leverage capital to adjusted total risk-based capital, which includes tier 2 capital. When looking only at tier 1 capital, one can readily construct

realistic scenarios where tier 1 risk-based capital at an Enterprise decreases due to a period of sustained house price appreciation such that tier 1 leverage capital exceeds tier 1 risk-based capital and therefore leverage becomes the binding capital constraint.

The commenter also suggests that FHFA fails to explain how the calibration of the 1.5 percent leverage buffer is flawed and how the proposed leverage buffer is analogous to the risk-weighted-asset-based Basel leverage buffer for international G-SIBs. In the proposed rule, FHFA discussed how the leverage framework unduly disincentivizes risk transfer predominately due to the outsized leverage buffer, and how a fixed leverage buffer may not concurrently be appropriate for both a large and a small Enterprise. FHFA views these characteristics as flaws in the calibration of the leverage buffer because the design could result in taxpayers bearing excessive undue risk for as long as the Enterprises are in conservatorships and excessive risk to the housing finance market both during and after conservatorships. In addition, FHFA discussed how the proposed leverage buffer is similar to the Basel leverage buffer in that both are derived from measures that attempt to quantify the amount of systemic risk posed by the Enterprises and G-SIBs, respectively – the stability capital buffer in the ERCF and the G-SIB surcharge in the Basel framework. There are, of course, structural differences between the two buffers in both derivation and application, as is appropriate given that the Enterprises and the other financial institutions have different business models.

Furthermore, two commenters noted that the Financial Stability Oversight Council's (FSOC) review of the 2020 ERCF proposed rule found that capital requirements "that are materially less than those contemplated by [the proposed rule] would likely not adequately mitigate the potential stability risk posed by the Enterprises,"

and that the proposed rule would result in a material two-thirds reduction to the leverage buffer, increasing risks to taxpayers and financial stability. FHFA generally agrees with the findings presented in FSOC's activities-based review of the secondary mortgage market.⁸ However, similar to approaches followed by other financial regulators, FHFA intends to periodically review the ERCF and adjust various elements as necessary to ensure the safety and soundness of the Enterprises so they can carry out their mission throughout the economic cycle. In addition, FHFA notes that Federal Reserve officials have publicly identified binding leverage capital requirements under the Supplementary Leverage Ratio (SLR) framework as an important issue that must be addressed so that banks' incentives are not skewed to increase risk-taking. FHFA continues to agree with this guiding principle for the Enterprises under the ERCF.

The final rule adopts the dynamic tier 1 capital leverage buffer equal to 50 percent of the stability capital buffer as proposed. In consideration of the public comments on the proposed rule, FHFA continues to believe that such a leverage buffer determined in this manner will best position the Enterprises to fulfil their mission in a safe and sound manner throughout the economic cycle by ensuring that the leverage framework acts as a credible backstop to the risk-based capital framework and by encouraging the Enterprises to transfer credit risk rather than to buy and hold risk.

FHFA notes that the final rule will not change the tier 1 leverage capital requirement, which will remain at 2.5 percent of adjusted total assets. This requirement, plus other features of the ERCF such as the single-family countercyclical adjustment and the risk weight floor on single-family and multifamily mortgage exposures, will continue

⁸ <https://home.treasury.gov/news/press-releases/sm1136>.

to mitigate the potential stability risk posed by the Enterprises and will ensure an Enterprise maintains robust capital even during the best economic conditions when risk-based capital requirements might fall due to significant house price appreciation.

In addition, FHFA continues to believe that the leverage buffer plays an important role in the ERCF, despite the recommendations of several commenters to eliminate the buffer. The leverage buffer represents a cushion above an Enterprise's 2.5 percent leverage ratio requirement that can be drawn down in a stress scenario without violating prompt corrective action, providing an Enterprise with flexibility to continue its normal operations without risk of breaching a requirement.

V. Credit Risk Transfer

The proposed rule would replace the prudential floor of 10 percent on the risk weight assigned to any retained CRT exposure with a prudential floor of 5 percent on the risk weight assigned to any retained CRT exposure and would remove the requirement that an Enterprise must apply an overall effectiveness adjustment to its retained CRT exposures.⁹

Many commenters expressed the view that CRT is an effective means by which to transfer risk to private markets, protect taxpayers, and stabilize the Enterprises and housing finance more generally. Consequently, the vast majority of comments FHFA received on the proposed amendments to the risk-based capital requirements for retained CRT exposures were generally supportive of the amendments. However, a minority of comments questioned the efficacy of CRT and noted that the amendments would weaken the Enterprises' financial resilience. Several other commenters offered broad critiques of

⁹ 12 CFR 1240.44(f) and (i)

and suggestions for the risk-based capital approach to CRT and the Enterprises' CRT programs more generally. While FHFA appreciates and considers all comments, the following discussion focuses on comments directly pertaining to the amendments put forward in the proposed rule.

CRT Risk Weight Floor

In the proposed rule, FHFA contended that amending the CRT risk weight floor was necessary for two reasons. First, the 10 percent floor on the risk weight assigned to a retained CRT exposure unduly decreases the capital relief provided by CRT and reduces an Enterprise's incentives to engage in risk transfer. This occurs in part because the aggregate credit risk capital required for a retained CRT exposure is often greater than the aggregate credit risk capital required for the underlying exposures, especially when the credit risk capital requirements on the underlying whole loans and guarantees are low or the CRT is seasoned. Second, the 10 percent risk weight floor discourages CRT through its duplicative nature. The operational criteria for CRT, which state that FHFA must approve each transaction as being effective in transferring the credit risk, as well as the Enterprises' own ability to mitigate unknown risks through their underwriting standards and servicing and loss mitigation programs, lessen the need for a tranche-level risk weight floor as high as 10 percent.

Commenters were generally very supportive of the proposed amendment to the CRT risk weight floor. Commenters suggested that reducing the risk weight floor on retained CRT exposures from 10 percent to 5 percent raises the regulatory value of risk transfer closer to its economic value. Commenters stated that the change would restore the incentive for the Enterprises to engage in CRT to disperse credit risk among private

investors and thereby lessen the systemic risk posed by the Enterprises. Commenters also suggested that transferring credit risk away from the Enterprises strengthens their safety and soundness and supports the overall mortgage market, including by promoting greater private market participation without an adverse impact on affordability. Several commenters supported the 5 percent floor because it represents a more market-sensitive treatment of CRT and better aligns capital to risk. In this regard, one commenter suggested that unduly high capital requirements will hamper an Enterprise's ability to fulfill its statutory mission of facilitating loans to low-income and very low-income borrowers and communities. In addition, commenters suggested that the 5 percent floor would provide reasonable protection from model risk while maintaining a conservative discount to equity capital, which has flexibility and fungibility advantages.

Furthermore, several commenters recommended lowering the CRT risk weight floor below 5 percent or eliminating it altogether. Commenters suggested that the floor is not analytically supported and provides excessive protection against CRT-related risks. One commenter's analysis suggested that CRT requirements are too stringent even if the floor is removed and recommended that FHFA calibrate the risk-based capital requirements for retained CRT exposures to be consistent with the economics of CRT transactions.

A few commenters recommended rejecting the proposed amendment in favor of the 10 percent risk weight floor. Several commenters claimed that the proposed amendment weakens the financial resilience of the Enterprises. These commenters suggested that the amendments will increase leverage at the Enterprises which will

increase insolvency risk, and that FHFA should not balance incentivizing CRT with safety and soundness when considering capital standards.

Some commenters generally supported FHFA's proposal to lower the CRT risk weight floor but offered alternatives to the 5 percent floor in the proposed rule. A few commenters recommended that FHFA apply the CRT risk weight floor on a sliding scale such that the risk weight floor decreases as credit risk becomes more remote. A few commenters suggested that the floor should reflect an exposure-level analysis and perhaps be functionally related to economic variables such as seasoning or house price appreciation. One commenter recommended removing the floor and using an econometric approach that requires capital above the risk-based capital amount and provides a marginal benefit to risk reduction activities beyond stress loss.

The final rule adopts the prudential floor of 5 percent on the risk weight assigned to any retained CRT exposure as proposed. In consideration of the public comments on the proposed rule, FHFA continues to believe that a prudential risk weight of 5 percent sufficiently ensures the viability of CRTs while mitigating their safety and soundness, mission, and housing stability risks. The final rule does not eliminate the CRT risk weight floor, as recommended by some commenters, because the prudential floor for a retained CRT exposure avoids treating that exposure as posing no credit risk, which continues to be an important policy objective for FHFA. In addition, FHFA has determined to finalize the 5 percent risk weight floor as proposed rather than adopting one of the alternatives suggested by commenters in order to maintain consistency with other aspects of the CRT securitization framework that were designed with a static risk weight floor in mind.

Overall Effectiveness Adjustment

In the proposed rule, FHFA presented rationale for eliminating the overall effectiveness adjustment due to the duplicative nature of the adjustment within the risk-based capital requirements for retained CRT exposures. Unlike the counterparty and loss-timing effectiveness adjustments in the CRT securitization framework, the overall effectiveness adjustment does not target specific risks. Rather, similar to the risk weight floor on retained CRT exposures and the CRT operational criteria, the overall effectiveness adjustment was designed to address risks that are difficult to measure, such as model risk and the loss-absorbing benefits of equity capital relative to CRT. FHFA reasoned that, considering the additional elements of the CRT securitization framework that also target these difficult-to-measure risks, the overall effectiveness adjustment is duplicative and creates an unnecessary disincentive for the Enterprises to engage in CRT.

The vast majority of comments supported FHFA's proposed amendment to eliminate the overall effectiveness adjustment from the CRT securitization framework. Several commenters contended that the overall effectiveness adjustment was redundant and was not analytically supported. Commenters also reasoned that the proposed amendment produces a CRT treatment that better recognizes the risk reduction in CRT through improved CRT economics, provides appropriate incentives for the transfer of credit risk, and that even after removing the overall effectiveness adjustment, the capital relief provided by the framework is conservative. One commenter maintained that the overall effectiveness adjustment can be removed without sacrificing the Enterprises' safety and soundness. Multiple commenters suggested that the elimination of the overall effectiveness adjustment would encourage the Enterprises to disperse credit risk among

investors rather than retaining that risk where taxpayers are ultimately liable, and that the proposed amendment would facilitate the Enterprises to carry out their mission throughout the economic cycle.

Several commenters supported keeping the overall effectiveness adjustment. These commenters contended that the proposal to eliminate the overall effectiveness adjustment further weakens the financial resilience of the Enterprises to withstand future credit losses that may occur during an economic stress and that FHFA should keep the adjustment because it accounts for differences in loss-absorbing capacity between CRT and equity capital. Several other commenters recommended FHFA keep the overall effectiveness adjustment in the CRT securitization framework, but their support for this aspect of the framework was conditional on either eliminating the CRT risk weight floor or making substantive reductions to the proposed risk weight floor.

The final rule adopts the removal of the overall effectiveness adjustment as proposed. In consideration of the public comments on the proposed rule, FHFA continues to believe that the overall effectiveness adjustment should be eliminated from the risk-based capital requirements for retained CRT exposures. FHFA believes that the risk weight floor, loss timing effectiveness adjustment, counterparty effectiveness adjustments, and CRT operational criteria, including FHFA's authority to review and approve CRT transactions as effective in transferring credit risk, sufficiently protect the Enterprises from the potential safety and soundness risks posed by CRT.

VI. ERCF Technical Corrections

The proposed rule would make technical corrections to the ERCF related to definitions, variable names, the single-family countercyclical adjustment, and CRT

formulas that were not accurately reflected in the final rule published on December 17, 2020. These technical corrections would revise the ERCF for the following items:

- In § 1240.2, the definition of “Multifamily mortgage exposure” would be moved from its current location to a location that follows alphabetical order relative to the other definitions within the section. The definition of a multifamily mortgage exposure would not change.
- In § 1240.33, the definition of “Long-term HPI trend” would be updated to correct a typographical error that resulted in only the coefficient of the trendline formula, 0.66112295, being published. The corrected trendline formula would be $0.66112295e^{(0.002619948*t)}$. The Enterprises use the long-term HPI trend as the basis for calculating the single-family countercyclical adjustment. As published in the ERCF, the trendline would be a time-invariant horizontal line rather than a time-varying exponential function.
- In § 1240.33, the definition of OLTV for single-family mortgage exposures would be amended to include the parenthetical (*original loan-to-value*) after the acronym to provide additional clarity as to the meaning of OLTV. Single-family OLTV would continue to be based on the lesser of the appraised value and the sale price of the property securing the single-family mortgage.
- In § 1240.37, the second paragraph (d)(3)(iii) would be redesignated as (d)(3)(iv) to correct a typographical error.

- In § 1240.43(b)(1), the term “KG” would be replaced with “ K_G ” to correct a typographical error.
- In § 1240.44,
 - In paragraph (b)(9)(i)(C), the term “ $(LTFUPB\%)$ ” would be replaced with the term “ $(LTFUPB\%)$ ” to correct a typographical error;
 - In paragraph (b)(9)(i)(D), the term “ $LTF\%$ ” would be replaced with the term “ $LTF\%$ ” to correct a typographical error;
 - In paragraph (b)(9)(ii), the term “ $LTF\%$ ” would be replaced with the term “ $LTF\%$ ” to correct a typographical error;
 - In paragraph (b)(9)(ii)(B), the term “ $(CRTF15\%)$ ” would be replaced with the term “ $(CRTF15\%)$ ” to correct a typographical error;
 - In paragraph (b)(9)(ii)(C), the term “ $(CRT80NotF15\%)$ ” would be replaced with the term “ $(CRT80NotF15\%)$ ” to correct a typographical error.
 - In paragraph (b)(9)(ii)(E)(2)(i), the equation would be revised to correct a typographical error. The revised equation would be:

$$LTF\% = (CRTLT15 * CRTF15\%) + (CRTLT80Not15 * CRT80NotF15\%) + (CRTLTGT80Not15 * (1 - CRT80NotF15\% - CRTF15\%));$$

- In paragraph (b)(9)(ii)(E)(2)(iii), the term “ $LTF\%$ ” would be replaced with the term “ $LTF\%$,” to correct a typographical error;
- In paragraph (c) introductory text, the term “ $RW\%$ ” would be replaced with the term “ $RW\%$ ” to correct a typographical error;

- In paragraph (c)(1), the term “*AggEL%*” would be replaced with the term “*AggEL%*” to correct a typographical error;
- In paragraph (g), the first three equations would be combined into one equation to correct a typographical error that erroneously split the equation into three distinct parts. The revised equation would be:

$$\begin{aligned}
 & \text{if } (SLS_{\%,Tranche} - ELS_{\%,Tranche}) > 0 \text{ then} \\
 LTEA_{\%,Tranche,CM} &= \frac{100\% * \max\left(0, \min\left(1, \frac{LTK_{A,CM} + AggEL\% - A}{D - A}\right)\right) - ELS_{\%,Tranche}}{(SLS_{\%,Tranche} - ELS_{\%,Tranche})} \\
 LTEA_{\%,Tranche,LS} &= \frac{100\% * \max\left(0, \min\left(1, \frac{LTK_{A,LS} + AggEL\% - A}{D - A}\right)\right) - ELS_{\%,Tranche}}{(SLS_{\%,Tranche} - ELS_{\%,Tranche})}
 \end{aligned}$$

The final rule adopts the ERCF technical corrections as proposed.

VII. Paperwork Reduction Act

The Paperwork Reduction Act (PRA) (44 U.S.C. 3501 *et seq.*) requires that regulations involving the collection of information receive clearance from the Office of Management and Budget (OMB). The final rule contains no such collection of information requiring OMB approval under the PRA. Therefore, no information has been submitted to OMB for review.

VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation’s impact on small entities. FHFA need not undertake such an analysis if the agency has certified that the regulation will not have a significant

economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of the final rule under the Regulatory Flexibility Act. The General Counsel of FHFA certifies that the final rule will not have a significant economic impact on a substantial number of small entities because the final rule is applicable only to the Enterprises, which are not small entities for purposes of the Regulatory Flexibility Act.

IX. Congressional Review Act

In accordance with the Congressional Review Act (5 U.S.C. 801 *et seq.*), FHFA has determined that this final rule is a major rule and has verified this determination with the Office of Information and Regulatory Affairs of OMB.

List of Subjects for 12 CFR Part 1240

Capital, Credit, Enterprise, Investments, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons stated in the Preamble, under the authority of 12 U.S.C. 4511, 4513, 4513b, 4514, 4515-17, 4526, 4611-4612, 4631-36, FHFA amends part 1240 of Title 12 of the Code of Federal Regulation as follows:

CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY

SUBCHAPTER C—ENTERPRISES

Part 1240—CAPITAL ADEQUACY OF ENTERPRISES

1. The authority citation for part 1240 is revised to read as follows:

Authority: 12 U.S.C. 4511, 4513, 4513b, 4514, 4515, 4517, 4526, 4611-4612, 4631-36.

2. Amend § 1240.2 by removing the definition of “Multifamily mortgage exposure” and adding the definition of “Multifamily mortgage exposure” in alphabetical order to read as follows:

§ 1240.2 Definitions.

* * * * *

Multifamily mortgage exposure means an exposure that is secured by a first or subsequent lien on a property with five or more residential units.

* * * * *

§ 1240.11 Capital conservation buffer and leverage buffer.

3. Revise § 1240.11(a)(6) as follows:

(a) * * *

(6) *Prescribed leverage buffer amount.* An Enterprise’s prescribed leverage buffer amount is 50 percent of the Enterprise’s stability capital buffer calculated in accordance with subpart G of this part.

4. Amend § 1240.33(a) by:

a. In the definition of “Long-term HPI trend”, removing “0.66112295” and adding “ $0.66112295e^{(0.002619948*t)}$ ” in its place; and

b. Revising the definition of “OLTV”.

The revision reads as follows:

§ 1240.33 Single-family mortgage exposures.

(a) * * * * *

OLTV (original loan-to-value) means, with respect to a single-family mortgage exposure, the amount equal to:

- (i) The unpaid principal balance of the single-family mortgage exposure at origination; divided by
- (ii) The lesser of:
 - (A) The appraised value of the property securing the single-family mortgage exposure; and
 - (B) The sale price of the property securing the single-family mortgage exposure.

* * * * *

§ 1240.37 [Amended]

- 5. Amend § 1240.37 by redesignating the second paragraph (d)(3)(iii) as (d)(3)(iv).

§ 1240.43 [Amended]

- 6. Amend § 1240.43(b)(1) by removing the term “KG” and adding the term “*K_G*” in its place.
- 7. Amend § 1240.44 by:
 - a. In paragraph (b)(9)(i)(C), removing the term “(*LTFUPB%*)” and adding the term “(*LTFUPB%*)” in its place;
 - b. In paragraph (b)(9)(i)(D), removing the term “LTF%” and adding the term “*LTF%*” in its place;
 - c. In paragraph (b)(9)(ii) introductory text removing the term “LTF%” and adding the term “*LTF%*” in its place;
 - d. In paragraph (b)(9)(ii)(B), removing the term “(*CRTF15%*)” and adding the term “(*CRTF15%*)” in its place;

- e. In paragraph (b)(9)(ii)(C), removing the term “*CRT80NotF15%*” and adding the term “*CRT80NotF15%*” in its place;
- f. Revising the equation in paragraph (b)(9)(ii)(E)(2)(i);
- g. In paragraph (b)(9)(ii)(E)(2)(iii), removing the term “*LTF%*” and adding the term “*LTF%*,” in its place;
- h. In paragraph (c) introductory text:
- i. Removing the term “*RW%*” and adding the term “*RW%*” in its place; and removing “10 percent”; and
 - ii. Adding the term “5 percent” in its place;
 - i. In paragraph (c)(1), removing the term “*AggEL%*” and adding the term “*AggEL%*” in its place;
 - j. In paragraphs (c)(2) and (c)(3)(ii), removing the term “10 percent” and adding the term “5 percent” in its place;
 - k. Revising the first equation in paragraph (d);
 - l. In paragraph (e), removing the term “10 percent” and adding the term “5 percent” in its place;
 - m. Revising paragraph (f)(2)(i);
 - n. In paragraph (g), revising the first three equations;
 - o. Revising the first equation in paragraph (h); and
 - p. Removing and reserving paragraph (i).

The revisions read as follows:

§ 1240.44 Credit risk transfer approach (CRTA).

* * * * *

(b) * * *

(9) * * *

(ii) * * *

(E) * * *

(2) * * *

(i) * * *

$$LTF_{\%} = (CRTLT15 * CRTF15_{\%}) + (CRTLT80Not15 * CRT80NotF15_{\%}) \\ + (CRTLTGT80Not15 * (1 - CRT80NotF15_{\%} - CRTF15_{\%}))$$

* * * * *

(d) * * *

*RW*_{% , Tranche}

$$= \begin{cases} 1,250\% \text{ if } K_A + AggEL_{\%} \geq D \\ 5\% \text{ if } K_A + AggEL_{\%} \leq A \\ 1250\% * \left(\frac{K_A + AggEL_{\%} - A}{D - A} \right) + 5\% * \left(\frac{D - (K_A + AggEL_{\%})}{D - A} \right) \text{ if } A < K_A + AggEL_{\%} < D \end{cases}$$

$$AggEL_{\%} = 100\% * \frac{EL_{\$}}{AggUPB_{\$}}$$

* * * * *

(f) * * *

(2) *Inputs*—(i) *Enterprise adjusted exposure*. The adjusted exposure (EAE) of

an Enterprise with respect to a retained CRT exposure is as follows:

$$EAE_{\% , Tranche} = 100\% - (CM_{\% , Tranche} * LTEA_{\% , Tranche, CM}) \\ - (LS_{\% , Tranche} * LSEA_{\% , Tranche} * LTEA_{\% , Tranche, LS}),$$

Where the loss timing effectiveness adjustments (LTEA) for a retained CRT exposure are determined under paragraph (g) of this section, and the loss sharing effectiveness

adjustment (LSEA) for a retained CRT exposure is determined under paragraph (h) of this section.

* * * * *

(g) * * *

if $(SLS_{\%,Tranche} - ELS_{\%,Tranche}) > 0$ *then*

$LTEA_{\%,Tranche,CM}$

$$= \frac{100\% * \max\left(0, \min\left(1, \frac{LTK_{A,CM} + AggEL_{\%} - A}{D - A}\right)\right) - ELS_{\%,Tranche}}{(SLS_{\%,Tranche} - ELS_{\%,Tranche})}$$

$LTEA_{\%,Tranche,LS}$

$$= \frac{100\% * \max\left(0, \min\left(1, \frac{LTK_{A,LS} + AggEL_{\%} - A}{D - A}\right)\right) - ELS_{\%,Tranche}}{(SLS_{\%,Tranche} - ELS_{\%,Tranche})}$$

* * * * *

(h) * * *

if $(RW_{\%,Tranche} - ELS_{\%,Tranche} * 1250\%) > 0$ *then*

$$LSEA_{\%,Tranche} = \max\left(\left(1 - HC * \frac{(UnCollatUL_{\%,Tranche} * 1250\% + SRIF_{\%,Tranche} * 5\%)}{(RW_{\%,Tranche} - ELS_{\%,Tranche} * 1250\%)}\right), 0\%\right)$$

* * * * *

[Approved]
Sandra L. Thompson,
Acting Director, Federal Housing Finance Agency.

2/23/2022
Date