FACT SHEET: PROPOSED RULE ON ENTERPRISE CAPITAL

FHFA Proposed Rule on Enterprise Capital

PURPOSE

The Federal Housing Finance Agency (FHFA) suspended regulatory capital requirements after placing Fannie Mae and Freddie Mac (the Enterprises) into conservatorships in September 2008. FHFA subsequently identified the need to develop an aligned risk measurement framework to better evaluate each Enterprise's business decisions while they are in conservatorship and to ensure that the Enterprises make prudent business decisions when pricing transactions and managing their books of business.

The framework developed is the Conservatorship Capital Framework, initially implemented in 2017. It provides the foundation for FHFA's proposed capital regulation.

While any final rule for Enterprise regulatory capital requirements would remain suspended during conservatorship, issuing this proposed rule will achieve several objectives:

- It will transparently communicate FHFA's views as a financial regulator about capital adequacy as Congress and the Administration work to determine the future of housing finance reform;
- It will update the existing capital rule by drawing on regulatory developments implemented in response to the recent financial crisis;
- It will allow market participants to comment on the proposed capital requirements for the Enterprises and other entities playing the same or similar roles after housing finance reform; and
- It will help inform FHFA's views as conservator about refinements that may be appropriate to the Conservatorship Capital Framework, which FHFA will continue to apply as long as the Enterprises remain in conservatorship.

By proposing this rule, FHFA is not attempting to take a position on housing finance reform and the proposed rule is not connected to efforts or ideas about recapitalizing the Enterprises or administratively releasing them from conservatorship. FHFA continues to believe that it is the role of Congress to determine the future of housing finance reform and what role, if any, the Enterprises should play in that reform.

BACKGROUND

-The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) prescribed both a minimum leverage capital requirement and a highly prescriptive risk-based capital requirement for the Enterprises.

-The Housing and Economic Recovery Act of 2008 (HERA), which amended the Safety and Soundness Act, gave FHFA greater authority to determine the capital standards for the Enterprises.

-FHFA suspended Enterprise capital requirements in 2008 after placing the Enterprises in conservatorships.

-Currently, capital support for the Enterprises is provided by the U.S. Department of the Treasury through Senior Preferred Stock Purchase Agreements.

SUMMARY OF THE PROPOSED RULE

FHFA is proposing a regulatory capital framework for the Enterprises that includes two components:

- A new framework for risk-based capital requirements; and
- Two alternative approaches to setting minimum capital requirements for the Enterprises.

Proposed Risk-Based Capital Requirements

- The proposed rule includes a risk-based capital framework that provides a granular assessment of credit risk specific to different mortgage loan categories, as well as components for market risk, operational risk, and a going-concern buffer.
- The proposed risk-based capital requirement is designed to require the minimum capital necessary for the Enterprises to cover losses and continue operating after a stress event comparable to the recent financial crisis.
- The proposed credit risk capital requirements use a series of approaches – including base grids, risk multipliers, assessments of counterparty risk, and capital relief due to credit risk transfer transactions – to produce tailored capital requirements for different categories of mortgage loans and guarantees.
- The proposed market risk capital requirement focuses on capturing the spread risk associated with holding different assets in the retained portfolio.
- The proposed operational risk capital requirement of 8 basis points (bps) for all assets and guarantees reflects the risk of ongoing business operations.
- The proposed risk-invariant going-concern buffer of 75 bps for all assets would enable the Enterprises to continue operating without external capital support for one-to-two years after a stress event comparable to the recent financial crisis. Enterprise guarantee fees and other earned revenues would also support continued operations, but are not factored into the risk-based capital requirements themselves.
- The asset-specific capital requirements would be applied to each Enterprise's book of business to produce total risk-based capital requirements.

Proposed Minimum Leverage Capital Requirements

The proposed rule includes two alternative leverage ratio proposals. In proposing these two alternatives, FHFA is seeking to obtain feedback on how to establish a minimum leverage requirement that would serve as a backstop to the proposed risk-based capital requirements, while avoiding or mitigating potential impact on the Enterprises' marginal economic decision-making.

Alternative 1: The Enterprises would be required to hold capital equal to 2.5 percent of total assets and off-balance sheet guarantees. This approach, consistent with Basel leverage capital requirements for banks, would require the Enterprises to hold a minimum amount of capital for assets and guarantees that does not differentiate between the risk characteristics of assets and guarantees

Alternative 2: The Enterprises would be required to hold capital equal to 1.5 percent of trust assets and 4 percent of non-trust assets. This approach, consistent with the Enterprises' Safety and Soundness Act, differentiates between the greater funding risks of the Enterprises' non-trust assets and the lower funding risks of the Enterprises' trust assets while increasing the capital requirements for both relative to the current statutory requirements.

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KEY CONSIDERATIONS

In developing the proposed rule, FHFA considered the following factors:

- The Enterprises should operate under a robust capital framework that is similar to capital frameworks applicable to banks and other financial institutions, but that appropriately differentiates the Enterprises' capital requirements based on the actual risks associated with the Enterprises' businesses.

- The capital requirements should ensure the safety and soundness of the Enterprises while also supporting their statutory missions to foster and increase liquidity of mortgage investments and promote access to mortgage credit throughout the Nation.

- FHFA considers it prudent to have risk-based capital requirements that:
  - Include components of credit risk, market risk, operational risk, and a risk-invariant going-concern buffer;
  - Require full life-of-loan capital for each loan at the time of acquisition;
  - Are calculated to cover losses for different loan categories in a severe stress event comparable to the recent financial crisis, but with house price recoveries that are somewhat slower than what occurred in many markets following the recent crisis; and
  - Do not count future Enterprise revenue toward capital.

- FHFA has proposed providing capital relief for credit risk transfers (CRTs) based on the loss-absorbing capacity of the CRTs. This differs from bank regulatory treatment of CRTs.

- It may be necessary in the future for FHFA to revise a final rule or to develop a separate capital planning and liquidity rule to address more fully the stress testing of the Enterprises and other factors. FHFA would also assess the need to make revisions to any final rule upon completion of housing finance reform.

IMPACT OF THE PROPOSED RULE

- **2007 book of business:**
  - FHFA applied the proposed rule's risk-based capital requirements to the Enterprises' 2007 books of business and found that capital requirements for each Enterprise would have exceeded their respective peak cumulative losses stemming from the financial crisis. Peak cumulative capital losses are defined as cumulative losses up to the quarter in which an Enterprise no longer required draws from the Department of the Treasury to eliminate negative net worth. For Fannie Mae this was the fourth quarter of 2011, and for Freddie Mac this was the first quarter of 2012. Peak cumulative capital losses include the Enterprises' valuation allowances on deferred tax assets (DTAs) and revenues earned between 2008 and the respective quarters mentioned above.

- **2017 book of business:**
  - Proposed risk-based capital requirements: FHFA estimates a combined risk-based capital requirement of $180.9 billion, 3.24 percent of the Enterprises' total assets and off-balance sheet guarantees. *See Table 1.*
  - Proposed minimum leverage capital requirements: *See Table 3*
    - Under the 2.5 percent alternative (Alternative 1): FHFA estimates a combined minimum leverage capital requirement for both Enterprises of $139.5 billion.
    - Under the bifurcated alternative (Alternative 2): FHFA estimates a combined minimum leverage capital requirement for both Enterprises of $103.5 billion.

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SELECTED TABLES

Table 1: Fannie Mae and Freddie Mac Estimated Risk-Based Capital Requirements as of September 30, 2017 – by Risk Category

	Fannie Mae Capital Requirement			Freddie Mac Capital Requirement			Enterprises' Combined Capital Requirement		
	$billions	bps	Share, %	$billions	bps	Share, %	$billions	bps	Share, %
Net Credit Risk	$70.5			$41.5			$112.0		
Credit Risk Transferred	($11.5)			($10.0)			($21.5)		
Post-CRT Net Credit Risk	$59.0	176	51%	$31.5	142	48%	$90.5	162	50%
Market Risk	$9.5	28	8%	$9.9	44	15%	$19.4	35	11%
Going-Concern Buffer	$24.0	72	21%	$15.9	71	24%	$39.9	72	22%
Operational Risk	$2.6	8	2%	$1.7	8	3%	$4.3	8	2%
Other (DTA) *,**	$19.9	59	17%	$6.8	31	10%	$26.8	48	15%
Total Capital Requirement	$115.0	343	100%	$65.9	296	100%	$180.9	324	100%
Total Assets and Off-Balance Sheet Guarantees	$3,353.1			$2,226.0			$5,579.0		

** The proposed DTA capital requirement is a function of Core Capital. Both Enterprises have negative Core Capital as of September 30, 2017. In order to calculate the DTA capital requirement, we assume Core Capital is equal to the Risk-Based Capital Requirement without consideration of the DTA capital requirement.*

*** Both Enterprises' DTAs were reduced in December 2017 as a result of the change in the corporate tax rate. The proposed risk-based capital requirement for DTAs as of December 31, 2017 would be $10.0 billion or 30 bps for Fannie Mae and $1.2 billion or 5 bps for Freddie Mac.*

Table 2: Fannie Mae and Freddie Mac Combined Estimated Risk-Based Capital Requirements for the Enterprises as of September 30, 2017 – by Asset Category

	Capital Requirement		
	$billions	bps*	Share, %
Single-family Whole Loans, Guarantees and Related Securities	$130.5	273	72%
Multifamily Whole Loans, Guarantees and Related Securities	$13.9	278	8%
PLS	$3.4	2,336	2%
CMBS	$0.02	279	0%
Other (DTA)	$26.8	811	15%
Other Assets	$6.3	192	3%
Total Capital Requirement	$180.9		100%

** Basis points (bps) are calculated based on the unpaid principal balance of the respective asset category.*

Table 3: Fannie Mae and Freddie Mac Estimated Minimum Leverage Capital Requirement Alternatives as of September 30, 2017

	$billions		
	Fannie Mae	Freddie Mac	Enterprises Combined
2.5% Minimum Capital Alternative			
2.5% Minimum Capital Alternative Requirement	$83.8	$55.6	$139.5
% of Total Assets and Off-balance Sheet Guarantees	***2.5%***	***2.5%***	***2.5%***
Bifurcated Minimum Capital Alternative			
Bifurcated Minimum Capital Alternative Requirement	$60.4	$43.1	$103.5
% of Total Assets and Off-balance Sheet Guarantees	***1.8%***	***1.9%***	***1.9%***
Requirement for Non-Trust Assets	$16.1	$15.5	$31.6
% of Non-Trust Assets	***4%***	***4%***	***4%***
Requirement for Trust Assets	$44.3	$27.6	$71.8
% of Trust Assets	***1.5%***	***1.5%***	***1.5%***
Total Assets Plus Off-balance Sheet Guarantees	$3,353	$2,226	$5,579
Non-Trust Assets	$403	$388	$791
Trust Assets	$2,950	$1,838	$4,788