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Notice of Proposed Rulemaking
Federal Housing Finance Agency
Enterprise Capital Requirements
RIN 2590-AA95

The Community Home Lenders Association (CHLA) is pleased to submit these comments regarding the Federal Housing Finance Agency's (FHFA) proposed rule to establish Capital Requirements for Fannie Mae and Freddie Mac. CHLA does so in its capacity as the only national association exclusively representing independent mortgage bankers (IMBs), which currently originate over half of all new GSE loans.

CHLA commends FHFA for taking this critical step forward in the continuing progress to date toward completion of necessary housing finance reforms regarding Fannie Mae and Freddie Mac. However, instead of providing technical comments on the details of this proposal, CHLA will focus on a recommendation made in June 2018 in a joint letter from five consumer and four small lender groups, including CHLA, regarding the need for GSE capital restoration plans.

CHLA's comments will focus on that joint request by several small lender and consumer groups that FHFA should immediately use its clear authority under the Housing and Economic Reform Act of 2008 (HERA) to direct Fannie Mae and Freddie Mac to develop capital restoration plans.

Such an action is an essential next step towards the emergence of Fannie Mae and Freddie Mac from conservatorship – whether through Congressional legislation or through administrative action by FHFA and Treasury as CHLA and others have urged.

With this week marking the 10-year anniversary of conservatorship, CHLA believes that every effort should be made to hasten the emergence of the GSEs from conservatorship, instead of waiting for a final Capital Requirements rule or continuing to wait for Congress to act.

FHFA directing Fannie and Freddie to develop capital restoration plans does not constitute FHFA *"taking a position on housing finance reform,"* a concern cited in the draft rule.

It is a *"step towards recapitalizing the Enterprises and administratively releasing them from conservatorship*," another concern mentioned in the rule. However, HERA does not commit FHFA or Treasury to do so. It is merely a blueprint. Development of capital restoration plans would enable Congress, FHFA, Treasury, and the public to make a more informed decision, by demonstrating how Fannie and Freddie could be recapitalized and how long it would take.

FHFA Has Clear Authority Under HERA to Require Capital Restoration Plans

The "Federal Housing Enterprises Financial Safety and Soundness Act," as amended by HERA, explicitly established a procedure for the development of Fannie Mae and Freddie Mac to develop capital restoration plans in the event they have insufficient capital, and FHFA clearly has the authority to direct them to develop such capital restoration plans.

Most of the Necessary Reforms of Fannie and Freddie Have Been Completed

As a result of actions by FHFA and Congress, Fannie Mae and Freddie Mac have made extraordinary strides toward achieving the safety and soundness requirements under the HERA statute. A significant number of critically needed reforms have already been completed:

- **The End of No Doc Loans.** A major cause of the conservatorship was the guarantee of no doc loans or loans without the "ability to repay" the loan. Such loans are a thing of the past, due to the Qualified Mortgage (QM) statutory provision and through strong underwriting standards put in place by Fannie and Freddie and supervised by FHFA

- **Shrinkage of Portfolios and Attendant Interest Rate Risk.** Leading up to 2008, Fannie and Freddie purchased risky securities (instead of loans underwritten to GSE standards) and exposed themselves to significant interest rate risk relating to maturity mismatches between their mortgage portfolio and the loans they took out to finance them. FHFA and the Preferred Stock Purchase Agreement (PSPA) imposed strict limits on the amount of loans Fannie and Freddie can hold in portfolio, with Fannie and Freddie winding down most of their portfolios.

- **Risk Sharing Offloads Risk and Imposes Market Discipline.** At FHFA's initiative and directives, over 90 percent of new Fannie/Freddie loans are now subject to some form of risk sharing, also known as credit risk transfers. Risk sharing reduces taxpayer risk and imposes a form of market discipline, through the involvement of private credit sources.

- **FHFA as a Strong Regulator.** As a result of the HERA statute, Fannie and Freddie now have an independent and respected financial regulator in FHFA. This is a significant and substantive improvement over the Office of Federal Housing Enterprise Oversight (OFHEO), which was plagued by its failures as a regulator and susceptibility to political influence. FHFA is there to make sure the GSEs do not go off a cliff.

- **Improved Housing Goals.** There is a consensus that, through overly aggressive prospective housing goals, the GSEs were forced to stretch too much to generate loans to lower income borrowers. In contrast, FHFA's implementation of housing goals established under HERA, the focus has shifted to comparative lookbacks of HMDA data to ensure the GSEs are not cherry picking the highest credit quality borrowers. Additionally, HERA reduced the need for housing goals to carry the weight for affordable housing objectives – by establishing a Duty to Serve (focusing on underserved but profitable markets like manufactured housing and rental housing, and the Housing Trust Fund), which addresses the toughest affordable rental housing challenges.

- **An End to Private Gain, Public Loss.** The implied government guarantee prior to 2008 meant that Fannie and Freddie enjoyed the benefits of – but did not have to pay for – a government backstop. This encouraged risky behavior. This has been replaced with an explicit federal role, through a federal line of credit – and as a result, taxpayers have received a gain of $85 billion to date in GSE net profits, AFTER repaying the 2008 federal advance. And, all GSE reform proposals going forward envision taxpayers being compensated for their government wrap.

Adequate Capital is the One Significant Unfinished GSE Reform

One critical GSE reform remains unaccomplished: the need for Fannie Mae and Freddie Mac to have sufficient capital to protect them from short term fluctuations in revenues and earnings, and the ups and downs of normal business operations and over the longer term, to insulate taxpayers from risk in whatever form they provide a government backstop. Almost no one in Washington questions the principle that large financial institutions should have adequate capital. Fannie Mae and Freddie Mac are no exceptions.

FHFA recently took a good first step in allowing Fannie and Freddie to retain $3 billion each in capital, to cover small quarterly fluctuations in earnings. In short order this year, both Fannie Mae and Freddie Mac have funded this very small capital cushion out of excess profits. CHLA and many other small lender and consumer groups believe a larger cushion is needed, even in the absence of full recapitalization, and therefore CHLA continues to urge FHFA to suspend dividends to reach a more reasonable cushion.

However, the reality is that at some point there will be an economic downturn – posing a clear risk that in the absence of Fannie and Freddie having significant private capital, federal taxpayers will be forced to absorb losses.

Therefore, the development of sufficient capital on the part of Fannie Mae and Freddie to meet the type of capital requirements being promulgated in this rule remains the one major unfinished GSE reform.

A prerequisite to achieving this objective is the capital requirements being developed in this rule. A further prerequisite is the development of capital restoration plans on the part of both Fannie Mae and Freddie Mac – as CHLA is recommending.

The Role of Congress

CHLA strongly supports the prerogative of Congress to adopt comprehensive GSE reform legislation. However, the reality is that after 10 years, Congress has failed to act, due to both political and policy reasons, and experts are not that optimistic that results from the next Congress will be much different.

As part of its effort to assert its authority to make major reform decisions, Congress has even gone so far as to limit the authority of FHFA and the Treasury to act – through the so-called Jump Start provision a few years ago, which prohibited disposition of the Treasury's preferred stock holding.

While Congress has the authority to make sweeping GSE reform decisions, FHFA and Treasury should not wait indefinitely to take action to take Fannie and Freddie out of conservatorship. Similarly, with 10 years having passed without Congressional action, it is not appropriate for Congress to prevent such action merely to assert it has the sole prerogative to take such actions.

The simple fact is that 10 years ago, Congress – through adoption of the HERA legislation – gave FHFA the authority to take actions to have Fannie and Freddie emerge from conservatorship.

Moreover, while there are some unresolved policy questions, there is a broad consensus that Fannie Mae and Freddie Mac should recapitalize and should emerge from conservatorship, strengthened in their ability to continue serving a strong securitization role in our single family mortgage markets.

Therefore, at a minimum, CHLA continues to believe that interim administrative steps should be taken to further advance progress to that end – particularly FHFA development of capital requirements and Fannie and Freddie development of capital restoration plans. As noted in this letter, the second of these two actions no more interferes with Congress' prerogative to undertake GSE reform than the first action does.

CHLA also believes that FHFA and Treasury should – sooner rather than later - complete the task of GSE recapitalization and emergence from conservatorship if Congress continues to fail to act.

Moreover, this can take place consistent with the effective oversight and concurrence of Congress. Congress can hold hearings on plans being developed, introduce legislation to signal its intent on specific issues, and even act to bar actions with which it disagrees. Over the last 10 years, such activities have had a real impact in influencing the actions of FHFA, and also given that agency assurance that there is support for its actions (risk sharing being a case in point). After a capital restoration plan is started, Congress can also adopt legislation to codify existing reforms and make modifications to proposed plans.

Congressional actions in this capacity may or should include:

- Providing a full statutory basis for whatever government backstop is best – whether that is a line of credit or a full guarantee of qualified MBS;

- Codifying a requirement for G Fee parity, which FHFA has put in place administratively;

- Making clear that Fannie and Freddie should operate under a utility model, which focuses their activities on a core securitization role to facilitate mortgage origination among all lenders, and constrains their ability to go "off the rails" into primary market and risky activities;

- Making any necessary reforms or tweaks to existing statutory Housing Goals, Duty to Serve, and Housing Trust Fund provisions; and

- Codifying other reforms made administratively, e.g. dealing with risk sharing. the common securitization, platform, and others – in an appropriately flexible and transparent fashion.

In closing, CHLA appreciates consideration of these comments and recommendations.

Sincerely,

COMMUNITY HOME LENDERS ASSOCIATION