3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

November 15, 2018

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th St., SW, 8th Floor
Washington, D.C. 20219

RE: Enterprise Capital Requirements (RIN 2590-AA95)

Dear Mr. Pollard:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing to you in regard to the Federal Housing Finance Agency's (FHFA) proposed rule to establish capital requirements for Fannie Mae and Freddie Mac (the GSEs). NAFCU supports the overall intent of the proposal because it would provide a smoother transition to a future housing finance system and establish a safer, more predictable environment for consumers, lenders, and investors, despite some concerns regarding cross-subsidization and the use of alternative credit scoring models. NAFCU and its member credit unions support the development of capital restoration plans and encourage the FHFA and the U.S. Department of the Treasury (Treasury) to permit the GSEs to develop capital plans and begin a modest recapitalization effort. Such action should only be taken if Congress fails to act on a comprehensive reform package and agrees to codify certain reforms made during conservatorship. In the short term, NAFCU recommends the FHFA work with the Treasury to permit the GSEs to retain larger capital buffers.

General Comments

The FHFA was established as part of the *Housing and Economic Recovery Act of 2008* (HERA) to supervise, regulate, and provide oversight of the GSEs, the Federal Home Loan Bank System (FHLB), and the Office of Finance of the FHLB. HERA amended the *Federal Housing Enterprise Financial Safety and Soundness Act of 1992* (1992 statute), which created the Office of Federal Housing Enterprise Oversight (OFHEO), FHFA's predecessor agency. OFHEO last established capital rules for the GSEs in 2001.

HERA afforded the FHFA the authority to develop a new risk-based capital standard, an increased minimum leverage requirement as necessary, and to temporarily increase the minimum capital level for a regulated entity to address periods of heightened risk. HERA also provided the FHFA with the authority to establish capital or reserve requirements for various products and activities, enhanced the 1992 statute's prompt-corrective action provisions, and added the FHFA's conservatorship and receivership authorities. Under HERA, the FHFA may also direct the GSEs to submit capital restoration plans.[1]

After the GSEs were placed in conservatorship in 2008, the FHFA suspended the existing capital classifications and regulatory capital requirements. This proposed rule would supersede the OFHEO regulations on minimum capital (leverage ratio) and risk-based capital requirements. Since entering conservatorship, and consistent with the terms of the Senior Preferred Stock Purchase Agreements (PSPAs) with the Treasury, the GSEs' portfolio business has been dramatically reduced. The GSEs' guarantee business has taken on a much larger role with the GSEs reducing their retained portfolios by over 60 percent since 2009. The GSEs have also expanded their use of credit risk transfer (CTR) transactions with private investors. Most recently, in December 2017, the PSPAs were revised to allow the GSEs to each retain a small capital buffer of $3 billion. The GSEs still had to draw on their Treasury line of credit in early 2018 due to net losses incurred as a result of the *Tax Cuts and Jobs Act*'s effect on the GSEs' calculations of their deferred tax assets.[2]

NAFCU's member credit unions support a capital framework for the GSEs that accounts for both short- and long-term fluctuations in economic conditions. As far as the substance of the proposed rule, the FHFA should continue to develop the statutorily mandated framework for accepting multiple credit scoring models and recalibrate the rule as necessary to account for risk based on scores other than Classic FICO. Prior to the finalization of the rule, the FHFA should permit the GSEs to prepare and submit for approval detailed capital restoration plans. Such plans should not be approved, however, until Congress has agreed to codify certain improvements that have been made to the GSEs' purchasing practices during conservatorship. Additionally, to avoid future draws on their Treasury lines of credit, NAFCU recommends the FHFA and Treasury amend the PSPAs to permit the GSEs to begin rebuilding capital as soon as possible.

Credit Unions Generally Support the Proposed Rule

NAFCU and its member credit unions generally support the proposed rule as it seeks to create a safer and sounder housing finance system once the GSEs are released from conservatorship.

---

[1] 12 U.S.C. 4622.

[2] Fannie Mae suffered a net loss of $6.5 billion in the fourth quarter of 2017 and requested a draw of $3.7 billion. Freddie Mac suffered a $2.9 billion net loss and requested a draw of $312 million.

NAFCU commends the FHFA for its comprehensive evaluation of the Basel capital standards for commercial banks, the *Federal Deposit Insurance Act* prompt corrective action process, and the Federal Reserve Board's annual Comprehensive Capital Analysis and Review (CCAR) assessment as points of comparison in the development of this proposed rule. The proposed rule's recognition and appreciation of these standards will likely lead the GSEs into a regulatory regime that aligns with international banking standards, which is most appropriate for institutions of their size and complexity.

NAFCU also recognizes the advantages of the FHFA's authority to temporarily increase minimum leverage requirements and adjust risk-based capital requirements during periods of heightened risk. In order to effectively execute such adjustments, NAFCU recommends the FHFA establish processes and procedures as part of this rulemaking. Set procedures to address changing capital requirements during a stress event would help to eliminate unnecessary delay and confusion. Once these procedures are developed, the FHFA should publicly release them and provide an opportunity for comment.

The proposed rule presents a robust capital framework that seeks to prevent another government bailout in the event of a severe stress event similar to the 2008 financial crisis. The proposal attempts to align capital with risk but there are areas where it does not successfully do so. For example, with respect to cross-subsidization, the proposal is a vast improvement over the structure that was in place before 2008, but it may not lead to much improvement in the cross-subsidies currently in the system. NAFCU supports efforts to help low-to-moderate income borrowers achieve homeownership and is concerned that cross-subsidies based on Classic FICO scores do little to help such borrowers. Moreover, there are high-income borrowers with low FICO scores that do not present the same risk of default. The FHFA should critically evaluate the quality of the data used to develop these capital standards and modeling of mortgage performance to better align the proposed capital requirements with actual risk.

A Final Rule Should Account for the Use of Alternative Credit Score Models

Prior to the passage of the *Economic Growth, Regulatory Relief, and Consumer Protection Act* (S. 2155), the FHFA began an initiative to evaluate the use of credit score models other than Classic FICO to increase access to credit. Section 310 of S. 2155 requires the FHFA to establish a validation and approval process for the GSEs' use of credit score models. After the enactment of S. 2155, the FHFA announced it would no longer pursue its own alternative credit score initiative to work on implementing Section 310. NAFCU strongly supports the use of alternative models that more accurately capture the creditworthiness of a potential borrower and encourages the FHFA to work quickly to establish a fair and objective validation and approval process.

This proposed rule simply includes a footnote that the FHFA previously issued a Request for Input on GSE credit score requirements, but does not reference the new statutory requirement. Before finalizing this rule, the FHFA should recalibrate its grid for new originations along with any other grids reliant on credit scores. This recalibration would account for the changes required by S. 2155 and provide lenders, investors, and consumers more accurate information regarding the GSEs' base credit risk calculations. NAFCU urges the FHFA to delay finalizing this rule until it has developed a process for validating and approving new credit score models and made available all grids with various credit score models incorporated into the capital requirements.

The FHFA Should Require the GSEs to Submit Capital Restoration Plans

As noted above, HERA permits the FHFA to require the GSEs to submit capital restoration plans. Section 4622 requires capital restoration plans to, among other things: specify the level of capital each GSE will achieve and maintain; describe the actions the GSE will take to become classified as adequately capitalized; establish a schedule for its plan; specify the types and levels of activities in which the GSE will engage during the term of the plan; and describe the actions the GSE will take to comply with mandatory and discretionary requirements. This provision makes clear that 10 years ago, Congress envisioned a path out of conservatorship for the GSEs in the near future. Although, legislative action would be the best route to achieve comprehensive housing finance reform, the FHFA may unilaterally require the GSEs to begin to rebuild capital.

The current political environment also poses serious obstacles to achieving comprehensive housing finance reform through legislative action. As such, the Trump administration has stepped in to evaluate other options. Most recently, Craig Phillips, Counselor to the Secretary of the Treasury, said that the administration is working on a plan to end the conservatorship of Fannie Mae and Freddie Mac. Although NAFCU supports a larger capital buffer to protect against short-term fluctuations, the GSEs should not be fully privatized at this time. NAFCU and its member credit unions are deeply concerned that the gains made during conservatorship will not be codified and the industry will see a return to the system that rewarded large volume sales from big banks and penalized community lenders with smaller volumes of loans. It is critical that as the GSEs are developing their capital restoration plans, Congress codifies a requirement that guarantee fees are not to be linked to the volume of mortgages sold so that credit unions can continue to sell their loans to the GSEs at fair prices.

The GSEs Should Be Permitted to Retain More Capital Now

NAFCU supports a modest capital buffer for the GSEs and commends the Treasury and the FHFA for modifying the PSPA in December 2017 to permit each to retain a $3 billion capital buffer. All other large financial institutions require adequate capital to protect taxpayers during

severe stress events. The GSEs should not be treated differently. Both GSEs have paid back the Treasury's advance from the 2008 financial crisis and have dutifully complied with the net worth sweep; 10 years later, the GSEs remain critically undercapitalized despite being the largest mortgage securitizers in the world. The GSEs should be permitted to retain more capital to protect the American taxpayer during the next economic downturn. This is especially important considering political impediments to achieving comprehensive housing finance reform. Rebuilding adequate capital buffers should be a priority for the FHFA because it is the best means of quickly achieving the level of capital required under this proposed rule.

Conclusion

NAFCU generally supports the capital requirements proposed rule because it would provide greater stability and predictability in the housing finance market post-conservatorship. NAFCU's member credit unions continue to support legislative efforts as the best means of achieving housing finance reform, but support larger capital buffers and the development of capital restoration plans, so long as credit unions' access to the secondary mortgage market is protected. If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2212 or akossachev@nafcu.org.

Sincerely,

Ann Kossachev
Senior Regulatory Affairs Counsel