WAZEE STREET
CAPITAL MANAGEMENT

July 29, 2020

Federal Housing Finance Authority
Eighth Floor
400 Seventh Street, SW
Washington, DC 20219
Re: RIN-2590-AA95

To Whom it May Concern:

Wazee Street Capital Management LLC ("WSCM") manages several investment funds that are common shareholders of Federal Home Loan Mortgage Corporation ("Freddie Mac") and Federal National Mortgage Association ("Fannie Mae" and with Freddie Mac, each an "Enterprise").[1]

I am writing to comment on your request for comment on RIN-2590-AA95, "Enterprise Regulatory Capital Framework" (the "Proposed Rule"). We are not housing finance policy experts, and as United States citizens are pleased to support the Federal Housing Finance Authority ("FHFA") and Director Calabria in the policy they conclude is best for our country.

Our comments, therefore, address five questions in the Proposed Rule pertaining to execution and process once FHFA puts its desired policy in place. Execution and process are surprisingly important in this instance because the United States Department of the Treasury ("Treasury") is wearing several hats when it comes to the Enterprises, and it is only with elegant solutions that FHFA can achieve its goals as well as treat Treasury fairly for support provided the Enterprises.

Treasury has two investment interests in the Enterprises: senior preferred stock issued pursuant to purchase agreements initially dated as of September 7, 2008 ("Senior Preferred Stock") and warrants to purchase 79.9% of the Enterprises' common stock.

For FHFA to achieve the goals set forth in the Proposed Rule and comply with the Housing and Economic Recovery Act of 2008 ("HERA"), the current outstanding Senior Preferred Stock liquidation preference (the "Liquidation Preference") must be retired. Were the Liquidation Preference to remain outstanding, FHFA's attempts to comply with HERA would be subverted, the Proposed Rule would be academic, and taxpayers would be forever exposed to mortgage market risk.

Fortunately, there is a "win-win" approach available in which the Liquidation Preference is eliminated in accordance with its contractual terms, FHFA achieves its policy goals, and taxpayers come out ahead.

Because Treasury owns effectively 79.9% of the Enterprises' common stock, implementing FHFA's capital plan appropriately is the key to achieving this outcome. What may be considered "lost" by deeming the Liquidation Preference retired per its terms is more than offset by a combination of Treasury's common shareholdings, corporate taxes, and a periodic commitment fee.

[1] WSCM is also the lead plaintiff in two jurisdictions challenging the propriety of the Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of August 17, 2012, between each of the Enterprises and the United States Department of the Treasury. Those amendments purported to convert a 10% dividend due to Treasury into a requirement for each of the Enterprises to pay substantially all of its net worth to Treasury every quarter (the "Net Worth Sweep"). In addition to those matters, we are working closely with Boies Schiller Flexner LLP and Kessler Topaz Meltzer & Check LLP in the United States District Court for the District of Columbia to challenge the Net Worth Sweep as a breach of contract, specifically the implied covenant of good faith and fair dealing.

Implementing the Proposed Rule appropriately is key to that outcome and sits at the heart of our comments to the Proposed Rule. Our comments are as follows.

- ***Question 8. Alternatively, should the enforcement of the risk-based capital requirements during the implementation of a capital restoration plan be tailored through a consent order or other similar regulatory arrangement, and if so how?***

We believe that a consent order or other similar regulatory arrangement enables FHFA to overcome the "chicken-or-egg" issue that may otherwise be its most intractable problem – how to recapitalize the Enterprises without a difficult capital raise that simultaneously raises required equity capital and terminates the conservatorship.

It is highly unlikely private investors would invest in the Enterprises while undercapitalized and in conservatorship. With a consent decree, FHFA could fulfill its mandate under HERA and end the conservatorships while maintaining a high level of oversight until clear milestones were met. Private investors could invest knowing that requisite contractual and fiduciary rights were in place, shortening the time required for an Enterprise to achieve the regulatory capital amounts contemplated by the Proposed Rule.

- ***Question 27. Should the payout restrictions be phased-in over an appropriate transition period? If so, what is an appropriate transition period?***

We do not believe it would be appropriate to phase in payout restrictions to shareholders over time. Existing shareholders in the Enterprises (both common and preferred) do not have a right to distributions if the Enterprises are undercapitalized. Furthermore, there is no benefit to the Enterprises or taxpayers from doing so.

Employment-based discretionary bonus payments, however, are a different matter. All stakeholders have an interest in the Enterprises attracting the best employees they can. The Enterprises are among the world's largest and most important commercial enterprises and it is not only appropriate, but of paramount interest, that they be able to attract commensurate talent. Furthermore, the amounts would be immaterial relative to Enterprise profits and regulatory capital.

- ***Question 28. Should the payout restrictions provide exceptions for dividends on newly issued preferred stock, perhaps with any exceptions limited to some transition period following conservatorship?***

Absolutely. The current rate environment offers a compelling opportunity to issue fixed income instruments. FHFA and the Enterprises should move to take advantage of this opportunity with all deliberate haste. The benefits of paying dividends on newly issued preferred stock (the ability to issue the securities in a low rate environment and accelerate recapitalization of the Enterprises) substantially outweigh the costs of doing so (the costs being the dividends themselves, which would not delay recapitalization as the dividends would be materially smaller than the par value received upon issuance).

- ***Question 29. Should the payout restrictions provide an exception for some limited dividends on common stock over some transition period?***

In line with our answer to Question 28 above, absolutely not. Common stock provides a residual interest in a company and is not a fixed income security. There is no need for dividends until the Enterprises are in compliance with FHFA's requirements as their safety and soundness regulator.

Furthermore, there is approximately $33 billion of perpetual, non-cumulative Enterprise preferred stock outstanding on which dividends need not be paid (nor accumulated) until dividends are paid on Enterprise common stock. By refraining from paying dividends on common stock, the Enterprises can also retain funds that would otherwise be paid as dividends on preferred stock. This is an important point as the Enterprises must work to achieve requisite capitalization as quickly as reasonably possible. Retaining earnings and refraining from making distributions on existing equity securities (both common and preferred) is an important part of this process.

- ***Question 107. In addition to the questions asked above, FHFA requests comments on any aspect of the proposed rule.***

We have one additional comment that is not addressed by any of the stated questions within the Proposed Rule.

It is not clear to us why 100% of the Prescribed Capital Conservation Buffer Amount (the "PCCBA") need, or should, be composed of CET1 capital.

Per the Proposed Rule, we believe that the standard against which the various proposals are measured is set forth at the beginning of Section III.B.2: "[E]ach Enterprise must be capitalized to remain a viable going concern both during and after a severe economic downturn." Furthermore, the Proposed Rule makes it clear that FHFA is concerned that the prior, 2018 proposal "did not limit the extent to which preferred shares could satisfy the risk-based capital requirements" and lacked a "requirement that retained earnings and other common equity be the predominant form of capital, as under the Basel framework."

Table 1 on page 19 of the Proposed Rule shows CET1 capital composing 100% of the PCCBA. We believe that need not be the case. Requiring that CET1 capital make up the predominant (but not exclusive) share of PCCBA satisfies FHFA's goals as we understand them.

Furthermore, allowing preferred stock to satisfy a portion of the PCCBA requirement would help FHFA to achieve other goals as well. A number of commentators have expressed concern that the capital implied by the Proposed Rule would require an increase in guarantee fees to satisfy return requirements on such capital. Given the lower return requirements on preferred stock versus CET1 capital, allowing preferred stock to satisfy a portion of the PCCBA requirements would decrease the Enterprises' cost of capital and allow for lower guarantee fees.

The following table shows one possible approach.

WAZEE STREET CAPITAL MANAGEMENT LLC						
$ Billions			Adjusted Total	Preferred Stock Capacity		
FHFA Proposal	**CET1**	**Tier 1**	**Capital**	**Total**	**Existing**	**Incremental**
Capital Requirement	$76	$101	$135			
Prescribed Buffer (PCCBA)	$99	$99	$99			
Total	$175	$200	$234	$59	$33	$26
CET1 and Tier 1 as a percentage of "Adjusted Total Capital"						
Capital Requirement	56%	75%	100%			
Prescribed Buffer (PCCBA)	100%	100%	100%			
Total	75%	85%	100%			
Same Ratable Share as Above, Applied to PCCBA (One Potential Alternative to FHFA Proposal)						
Capital Requirement	$76	$101	$135			
Prescribed Buffer (PCCBA)	$56	$74	$99			
Total	$132	$175	$234	$102	$33	$69
CET1 and Tier 1 as a percentage of "Adjusted Total Capital"						
Capital Requirement	56%	75%	100%			
Prescribed Buffer (PCCBA)	56%	75%	100%			
Total	56%	75%	100%			

Based on Table 1 (p. 19) of the Proposed Rule

In the above table, we have made the simplifying assumption that CET1 capital compose the same ratable share of the PCCBA as its share of the Capital Requirement, both in relation to Adjusted Total Capital. Using the same assumptions as set forth in the Proposed Rule, CET1 capital would contribute $56 billion towards the buffer ($43 billion less than under FHFA's proposal) and the $43 billion differential could be satisfied with preferred stock, lowering the Enterprises' funding costs. Given the existing $33 billion of preferred stock, that would allow the Enterprises to raise an additional $69 billion of preferred stock while CET1 would still be the predominant form of capital.

Additionally, the Proposed Rule notes on page 98 that "FHFA deems it important that the buffer-adjusted risk-based and leverage requirements are also closely calibrated to each other so that they have an effective complementary relationship." Again in Table 1, the Prescribed Leverage Buffer Amount ("PLBA") comprises entirely Tier 1 capital which, under the Basel framework, includes the par value of preferred stock. Permitting preferred stock to satisfy a portion of the PCCBA furthers FHFA's goal of closely calibrating the buffer-adjusted risk-based (PCCBA) and leverage (PLBA) requirements. It also ensures that the Enterprises would be regarded as going concerns even during severe downturns and minimizes guarantee fees.

Thank you very much for your time and attention.

Sincerely,

R. Michael Collins
President & Chief Investment Officer
Wazee Street Capital Management LLC