July 31, 2020

Federal Housing Finance Authority

Eighth Floor

400 Seventh Street, SW

Washington, DC 20219

Re: RIN-2590-AA95

Ladies and Gentlemen:

My name is Christian S. Herzeca. I am a corporate finance and securities attorney with substantial expertise and experience in equity underwritings and other capital markets transactions. I am now retired from the active practice of law, and I own shares of a GSE junior preferred stock.

I have previously submitted comments to FHFA regarding RIN-2590-AA95, addressing principally Questions 26 and 27. See <https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15531>

I would now wish to submit this additional comment to address 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?”*

I will answer this question as it relates to the financeability of the proposed capital rule… the GSEs’ ability to execute the substantial capital raising transactions that will be required in order to satisfy this capital standard.

In order to raise the substantial equity capital required to satisfy FHFA’s proposed rule’s capital standards, the capital market must understand the legal framework under which the GSEs are raising this capital, and this legal framework must be conducive to that capital raising.

These conditions do not exist currently because there is i) complete legal uncertainty regarding the powers of FHFA, as conservator, and this ii) this legal uncertainty has been exacerbated by FHFA’s own actions, asserting a legal position that is antagonistic to any capital raise.

FHFA was a petitioner for a writ certiorari before the Supreme Court of the United States seeking to overturn the Collins APA decision of the 5th Circuit. See <https://www.supremecourt.gov/DocketPDF/19/19-563/120380/20191025201313249_Mnuchin%20FINAL.pdf>

This cert petition was recently granted by SCOTUS. Now, FHFA is to appear before SCOTUS seeking to reverse the 5th Circuit legal judgment that the Collins plaintiffs may go back to District Court to prove that the Net Worth Sweep is invalid, because HERA imposes a duty upon FHFA, as conservator, to return the GSEs to a safe and sound financial condition, and the Net Worth Sweep violates this conservator duty. FHFA, by continuing this litigation, is seeking to have SCOTUS adopt the Perry DC Circuit Court of Appeals holding that FHFA, as conservator, has unlimited power under HERA to operate the GSEs, and the conservator has no duty to rehabilitate the GSEs.

The GSEs will not be able to raise a dime in the equity capital markets with the GSEs remaining in conservatorship under a conservator having unbounded legal powers that, if FHFA is successful in Collins before Scotus, are antithetical and antagonistic to a successful capital raise.

To add cognitive dissonance to FHFA’s official legal position before SCOTUS that is antagonistic to GSE capital raising, Director Calabria has on numerous occasions stated that he believes that he, as Director, is under a duty to rehabilitate the GSEs while they are in conservatorship under HERA, and that he intends to have FHFA proceed upon a course of action under which the GSEs may be recapitalized.

Obviously, this is an untenable state of affairs for the GSEs to raise substantial equity capital.

Now, one pathway to achieving a legal foundation upon which the GSEs may raise substantial equity capital is for SCOTUS to affirm the Collins 5th Circuit decision. This case will likely be argued early 2021 and decided early summer 2021. This legal clarity should permit the execution of substantial equity capital raises, at the cost of a year’s delay. Of course, this pathway runs the risk that even if FHFA goes to the mat and eventually loses before SCOTUS, the capital markets will not take solace from the SCOTUS holding and ignore that FHFA insisted on maintaining its capital markets’ antagonistic (and ultimately unsuccessful) legal position.

The saner approach, especially given Director Calabria’s own understanding of the duty of FHFA as conservator, is for FHFA to enter into consent orders and decrees with Treasury and the respective GSEs. These consent orders and decrees would simultaneously release the GSEs from conservatorship and require them to satisfy the terms and conditions of the consent decrees and orders.

I envision the consent orders and decrees to comprise, at a minimum, the following:

1. The consent decrees and orders must release the GSEs from conservatorship, subject to the terms and provisions of the decrees and orders, set forth the GSEs respective capital restoration plans and empower the GSEs to execute capital raising in connection with these plans. When these plans have raised sufficient capital to satisfy the binding capital requirements of FHFA’s final rule, the consent decrees and orders must terminate.
2. FHFA must settle the ongoing shareholder litigation in order to finalize the GSEs’ capital structures under which the capital is to be raised. No investor will invest into an uncertain capital structure. The consent decrees and orders must incorporate the terms and provisions of those litigation settlements, and the consent decrees and orders would be filed with the respective courts in connection with the termination of the various litigations.
3. The consent decrees and orders must make clear that during their pendency the GSEs’ boards of directors are restored to full corporate power and authority that existed prior to conservatorship, and are subject to their normal state law fiduciary duties.
4. The consent decrees and orders must not be able to be changed or amended without the written consent of the respective GSEs, FHFA and Treasury. There shall be a provision that the respective GSE shareholders shall be intended third party beneficiaries of the consent decrees and orders.

If you have any questions, please feel free to contact me at cherzeca@gmail.com.

Thank you.

Sincerely,

Christian S. Herzeca