Heartland
Credit Union Association

August 31, 2020

Alfred M. Pollard, General Counsel,
Attention: Comments/RIN 2590–AA95
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW
Washington, DC 20219

Re: Enterprise Regulatory Capital Framework/RIN 2590–AA95

Dear Mr. Pollard:

On behalf of the 2.2 million credit union members we represent, the Heartland Credit Union Association (HCUA) appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA's) notice of proposed rulemaking and request for comments on updated capital requirements for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac, and together with Fannie Mae the GSEs).

On September 6, 2008, in response to solvency concerns that arose when the financial crisis severely crippled America's housing market, FHFA placed the GSEs into conservatorship. One day later, the U.S. Department of the Treasury entered into Senior Preferred Stock Purchase Agreements (SPSPAs) with the GSEs to provide stability to the financial markets; prevent disruptions in the availability of mortgage finance; and protect the taxpayer. The SPSPAs were amended three times after that, and in total Fannie Mae and Freddie Mac drew down billions of dollars.

The inadequacy of GSEs previous capital reserves is commonly cited as a significant factor in their inability to withstand mortgage losses during the financial crisis. Recently, FHFA and the Treasury have taken significant steps to recapitalize the GSE in preparation for an end to the long running conservatorship. On December 21, 2017, Treasury and the GSEs entered into a letter agreement to allow the GSEs to retain a $3 billion capital reserve, quarterly. On June 12, 2018, FHFA issued a proposed rule for GSE capital requirements, which would "implement a new framework for risk-based capital requirements and a revised minimum leverage capital requirement for the Enterprises." At the time, FHFA explained that the new capital requirements would be suspended until the conservatorship ends, but invited views from industry stakeholders, including HCUA, on the potential impacts of the framework. On September 30, 2019, Treasury and FHFA announced amendments to the certain Treasury-held GSE stock certificates that permitted Fannie Mae to maintain capital reserves of $25 billion and Freddie Mac to maintain capital reserves of $20 billion. That announcement coincided with a broader Treasury plan for reforming and recapitalizing the GSEs and ending the conservatorship.

On June 30, 2020, FHFA published this new regulatory capital framework, which builds upon the foundation of the 2018 proposal. In this re-proposed framework, FHFA provides a detailed set of enhancements to the 2018 outline, including changes to definitions, required inputs for financial calculations, capital cushions, and overlapping capital thresholds that the GSEs will need to meet. This proposal also emphasizes certain types of high-quality reserves that are more readily able to absorb unanticipated losses.

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This detailed proposal requests comment on 107 questions related to the adequacy and effectiveness of these changes to the GSE capital requirements, many of them of a technical nature regarding detailed financial constructs and calculations.

HCUA supports FHFA's efforts to ensure that Fannie Mae and Freddie Mac have strong capital requirements that will allow them to withstand an economic downturn and provide liquidity to the mortgage market without taxpayer intervention. We applaud this continued effort to ensure capital requirements are part of a strong supervisory regime that ensures the safety and soundness of the GSEs during various economic cycles.

We respectfully offer the following general comments and specific responses to questions posed in the proposal.

Balance Mortgage Affordability with GSE Capital Requirements

Like the 2018 proposal, this framework does not contain an explicit analysis of the potential impact the proposed alternative capital reserve approaches and leverage ratios may have on mortgage pricing. As not-for-profit, financial cooperatives, credit unions have a specified mission to meet the credit and savings needs of consumers, especially persons of modest means. While credit unions and their members, like other participants in the mortgage market, must be prepared to pay the GSEs somewhat higher guarantee and loan level fees than they otherwise would in the absence of substantial capital requirements, the amount paid should be no higher than necessary for the GSEs to have reasonable capital reserves that allow them to responsibly carry out their mission.

While it is understandable and even laudable that this proposal uses the financial crisis that caused the GSEs to be placed into conservatorship as a baseline for measuring the efficacy of its capital proposals, doing so runs of the risk of overemphasizing the lessons of that crisis and requiring more capital reserves than necessary for reasonable market fluctuations. If the GSEs keep more capital on hand than necessary, those funds are not available to invest in and carry out their core mission of providing liquidity to the primary mortgage market.

FHFA acknowledges this risk by noting that a disproportionate share of the Enterprises' crisis-era credit losses which arose from certain single-family mortgage exposures that are no longer eligible for acquisition by the Enterprises. Despite this recognition, however, many details of this proposal are examined and described in the context of what it would have meant to the GSEs during the Great Recession. If the primary metric for the efficacy of these proposed changes are the types of losses that occurred in the prior crisis without explicit recognition of the marked improvements to the mortgage regulatory environment in the intervening years, then the capital requirements are likely to be larger than necessary to protect the GSEs from reasonable current risks.

This is particularly a concern for credit unions, who were not significantly involved with the toxic subprime loan products that were used extensively by correspondent lenders and commercial banks in the run up to that crisis. As a result of their maintenance of sound underwriting requirements for its members, credit unions fared better than banks and correspondent lenders during that challenging housing cycle

RESPONSES TO QUESTIONS

Below are HCUA's aggregate responses to some of FHFA's questions that most impact credit unions.

Modified Loans Reperforming Beyond 4 Years Should be Reclassified as Performing Loans for Purposes of Establishing Base Risk Weights and Certain Forbearance and Payment Forgiveness Programs Should Not be Classified as Modified Re-Performing Loans – Questions 32, 33, 37 and 38.

In a one proposed approach for calculating the GSEs credit risk capital needs, this notice states that the standardized credit risk-weighted assets for each single-family mortgage exposure would be determined using grids and risk multipliers that together would assign an exposure-specific risk
weight based on the risk characteristics of the single-family mortgage exposure. This standardized approach involves a table of base risk weights indicating GSE exposure to various types of single-family mortgages, including (from lowest risk to highest) performing loans, non-modified re-performing loans, modified re-performing loans and non-performing loans. While we recognize that, for some period of time, a modified re-performing loan may be at an elevated risk of becoming non-performing again, the table of base risk weights should recognize that, after a certain amount of time has passed, modified loans become performing loans again. This decision is rendered even more puzzling by the fact that a non-modified re-performing loan can be classified as a performing loan after 4 years of timely payments.

In their capacity as loan servicers, credit unions and credit union service organizations work hard to modify loans for borrowers and find solutions that allow borrowers in financial distress to stay in their homes with manageable payments. Like all mortgage servicers, they perform those modifications in the context of significant regulatory and contractual obligations, and any resulting modifications often require a trial period to determine if it is a sustainable solution for that borrower. In recognition of these facts, modified non-performing loans that lead to sustainable payments over a 4-year period have essentially become performing loans again and should be classified as such in the risk-based capital reserve structure contemplated by this proposal. This approach would also better aligns with the “Risk Multipliers,” that this proposal also uses to help determine capital requirements, particularly given FHFA’s recognition that in general, higher payment reductions tend to reduce the likelihood of future default, so single-family mortgage exposures with higher payment reductions from modifications would have a lower capital requirement.

Given the interplay of the “Base Risk Weights” and “Risk Multiplier” treatment of modified re-performing loans, it may be simpler and more effective to simply allow some types of modifications to remain outside of the modified re-performing loan definition. In particular, the FHFA’s COVID-19 payment deferral program, which allows temporary forbearances due to COVID-related reductions to simply be treated as deferred payments due upon sale or refinancing of the home or at the end of the loan term, should not be considered a modified loan for the purposes of this framework. Similar payment forbearance programs should be granted the same classification as nonmodified reperforming loans or performing loans, because the temporary forbearance combined with deferred repayment should not substantially raise the risk of borrower default on the forborne amounts.

The Various Capital and Leverage Requirements of this Rule and Enforcement Activity Should be Phased in Over an Extended Period of Time to Allow for Capitalization of the GSEs Without Disrupting the Mortgage Market – Questions 7, 29, 89, 90 and 105.

On several occasions, this proposal asks about time periods for the GSEs to adopt certain requirements in this proposal, or for FHFA to exercise its enforcement powers. Consistent with our principle that there be a reasonable and orderly transition to a new housing finance system, we believe that this re-capitalization of the GSEs should be a gradual one that takes place over several years to ensure that there is no disruption of the current mortgage market. In addition, the slow and careful implementation of this important rule will allow FHFA to refine and make adjustments to changing conditions or new information, and will allows credit unions and other originators to absorb any changes and underwrite loans based on a full understanding of the impact this long awaited effort will have on pricing.

As always, we appreciate the opportunity to review this issue. We will be happy to respond to any questions regarding these comments.

Sincerely,

Bradley D. Douglas

Brad Douglas
President/CEO