Comment Letter - Enterprise Regulatory Capital Framework, 12 CFR Part 1750 RIN 2590-AA95

The Community Mortgage Lenders of America (CMLA) is pleased to weigh in on the crucial topic of the FHFA's re-proposed capital rule for the Government Sponsored Enterprises (GSEs).

1. Introduction

The CMLA has long advocated for common-sense financial intermediary capital policy; for years we watched with incredulity as two of the world's largest financial institutions were forced by the government, inexplicably, to operate with zero capital. At long last the tide has turned and the Washington policy establishment (led by Main Street lenders and those builder, consumer and civil rights organizations understanding how crucial lending is to those Americans seeking opportunity) must set and implement a standard that balances risk control with economic growth and fairness. Demographically, the United States is at a crucial, crucial, juncture. The leading edge of its largest-ever population bulge, the echo-boomers, has just reached its home buying years, and this demand, if served appropriately and safely, will benefit the economy for many years to come. This population bulge is also more diverse than any in history; a careful and nuanced capital policy will stitch together a wide array of Americans into a stronger social fabric dedicated, as a President once stated, to the proposition that all are created equal.

The zero capital policy, which had neither any logical policy nor precedential underpinnings, has finally been left behind, never to see the light of day again. Going forward, the capital plan must not move in the opposite direction, such as a requirement to hold more capital than needed to address housing's actual, measurable risks in the markets, both microeconomic and macroeconomic.

2. To protect community lender business models, actuarial data must be the alpha and omega of capital policy.

As a starting point, the capital needed to survive the prior Great Recession makes eminent sense. The excessive, artificial 2008 GAAP losses imposed by the government (reversed a few short years later) ought not be factored in, directly or indirectly, to the correct amount of capital needed going forward. Capital requirements that move well beyond a credible agency's worst-loss scenario are to be avoided, though overlays that guard against excessive dividend payments, and excessive bonuses to GSE executives, can be justified from a policy (and utility business model) objective, if applied only in extreme circumstances.

We remain highly skeptical of arguments that the GSEs must mirror bank-like capital standards given that they have solidified their business models as insurance companies, with a HERA-empowered regulator better able to keep them in this space relative to the old regulatory model.

Importantly, as community lenders we are obligated to point out one of the greatest business and social risks of excessive capitalization. As many know, community lenders, both banks and IMBs, can choose to sell mortgages to either their correspondent investors or the GSEs directly. As we have stated many times, one crucial role of Fannie Mae and Freddie Mac is to guard the community lender model by supplying a takeout bid that serves as a check on the power of the aggregators, many of which are very large banks.

As we argued during the GSE reform legislative debates, a weakened US secondary mortgage market would empower the largest banks to price-out their small competitors, which is of course the large banks' right to do (if they can do so profitably) under commercial law and practice. But a healthy Fannie Mae and Freddie Mac, ***which by law cannot compete with community lenders,*** protect community lender franchises by limiting the market power of these aggregator investors.

(Mortgage lenders across the country also have the recent example of what happened between March 2020 and May 2020. When the mortgage market was turned upside down due to mortgage-backed-security prices changing overnight, many lenders found themselves unable to sell their pipeline of loans to aggregators because of FICO or loan program restrictions that were introduced without warning. Hundreds of thousands of Americans found themselves temporarily locked out of the market. This occurred at a time when rates were at record lows and many Americans desperately needed assistance lowering their monthly mortgage payments, or managing their household cash budgets. Lenders approved with the GSEs were able to continue assisting their borrowers and providing liquidity to the markets. Aggregators were actively trying to turn business away, or were closing mortgages at higher-than-market rates.)

But here is the catch: we remain concerned that what cannot be accomplished by legislation, that is the structural hobbling of Fannie Mae and Freddie Mac, might be accomplished by an excessive capital requirement. Such an outcome would not eliminate the GSE cash window of course, but it could diminish the window's reach and allow aggregators to price away a greater percentage of a community lender's net profits. ***Given that the regulatory burden on community lenders has increased dramatically in the last ten years, an additional loss of net income due to more expensive, and thus less effective, cash window operations would be a major blow to the business franchises of smaller lenders.***

And while we believe Fannie Mae and Freddie Mac owe it to taxpayers and policymakers to remain safe and sound, in finance there is always a balance. And the balance here is that overcapitalized, super-safe Fannie and Freddie may never need a taxpayer bailout—but they may hasten lender consolidation and leave even more Americans prey to the shoddy practices we saw leading up to the 2008 meltdown, where mortgages outside the GSE channels failed at much greater rates than GSE mortgages. The world of liar loans, exploding ARMs, CDOs and CDO^2 all were born and accelerated outside the GSE channels, and not only stripped away the equity of many unsuspecting Americans, but directly seeded the out-of-control worldwide leverage that collapsed and ruined many economies. To date, this very fact is still not fully appreciated in Washington, precisely because many Washington DC "Think Tanks" are merely lobby shops by a different name, funded by the nation's largest banks and Wall Street firms, eager to hide their roles in the subprime and CDO run-up that ruined so many economies and US families' livelihoods.

3. Actual losses in the 2008-09 downturn?

Footnote 16, on page 39281 of the Federal Register dated June 30 2020, cited peak losses leading to Treasury draws, but a large bulk of these were government-induced accounting losses that reversed before long; the flawed nature of the confiscatory PSPAs allowed the imposition of these artificially-juiced GAAP losses to be capitalized into PSPA principal, while the (not unexpected) reversal of the exact same GAAP numbers counted only as interest, and not repayment of principle. This kind of Washington chicanery is especially distasteful to small businessmen and businesswomen who depend on the secondary market to protect them as outlined above; the capital rule must at least recognize that actual GSE sunk (cash) losses were much smaller, which is not surprising given the performance of the GSE mortgages relative to private-label and FHA mortgages.

4. What is the right capital number in normative times?

The higher capital level of $243B triggered by "excess distributions" is an interesting concept so long as it is not abused by a regulator; as noted above, incentives to control management from granting non-utility-like dividends and/or executive bonuses make sense to community lenders. (The regulator here may point out fairly that the responsibility to avoid this excess capital charge rests with GSE management teams. But it's also true that the trigger mechanism and thresholds remain in the regulator's hands.) As a general matter, overall capital near 4% cannot be justified by any model or data sets; a level that high is "conceptual risk" only, because conceptual risk by definition is not rooted in analyzed experiential data. An overall ratio of 3% deemed as (adequate) operational capital in normative times is arguably too high as well, but closer to the experiential number; in today's Washington, which has sat on the companies in an awkward conceivership that has gone on far too long, a slightly elevated capital number may not be ideal economically, but it may be "the price" the mortgage market has to pay to finally resume normal, statutory-following operations. The housing market in the last decade has not buoyed the economy as it normally would; the lack of capital at the companies, combined with the general uncertainty of their status overall, has contributed materially to this sector's underperformance. At this point, we all need to move forward, and not wallow in underperforming stasis.

5. Guaranty-fee reserves as regulatory capital?

The CMLA urges that the FHFA allow g-fee reserves to be counted toward regulatory capital, as we understand this to be typical in financial-services capital policy.

6. Conclusion: a generational opportunity

The Community Mortgage Lenders of America closes by agreeing that the prior capital construct (prior to 2008) fell short of a suitable standard; since then the political prism has made safety and soundness calls harder, not easier, as a constant lobby campaign has distorted not only the true performance of the GSE books of business, but the actual role played by the non-GSE channels in the years preceding the 2008 meltdown.

The regulator/conservator has a generational opportunity to rely on hard numbers and actuarial data sets to get this right. Doing so will not only assure a robust and more fair America, as we detailed above, but preserve the key role of community lenders that stay close to their customers and survive not by slick marketing and hidden lobbying, but by consistently careful underwriting time and time—and time—again.