MORTGAGE BANKERS ASSOCIATION

August 31, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Enterprise Regulatory Capital Framework

Dear Director Calabria:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to provide observations and recommendations on the Federal Housing Finance Agency (FHFA) proposed rule to implement a new regulatory capital framework for Fannie Mae and Freddie Mac (the Enterprises).[2] MBA particularly appreciates the re-proposal of the framework following important revisions that were made to an earlier version published for public feedback in 2018.[3] In comments submitted with respect to the 2018 proposal, MBA noted the significant number of unanswered questions and the lack of complete information regarding key calculations or assumptions embedded in the framework, which in turn made thorough analysis of the framework very difficult and subject to a high degree of uncertainty.[4] As such, MBA supports FHFA's decision to seek additional public feedback prior to any finalization of this critical framework.

---

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," June 30, 2020, 85 FR 39274. Available at: https://www.federalregister.gov/documents/2020/06/30/2020-11279/enterprise-regulatory-capital-framework.

[3] Federal Housing Finance Agency, "Enterprise Capital Requirements," July 17, 2018, 83 FR 33312. Available at: https://www.federalregister.gov/documents/2018/07/17/2018-14255/enterprise-capital-requirements.

[4] MBA, "Re: Enterprise Capital Requirements," November 16, 2018. Available at: https://www.mba.org/Documents/CREF/MBA_FHFA_GSE_Capital_November2018.pdf.

Executive Summary

Key Takeaways

- It is appropriate and necessary for FHFA to strengthen the Enterprises' capital framework prior to their eventual exits from conservatorship.
- The proposed framework, while carefully considered, remains too complex and lacks transparency in key areas.
- The capital framework should provide incentives for the Enterprises to maintain and expand upon positive changes to their business models over the past decade in furtherance of their vital housing missions, rather than simply operate under their pre-2008 business models (albeit with more capital).

Adjustments to the Framework

- The level of required capital implied by the framework is too high and may be determined too frequently by a leverage ratio rather than risk-based standards. MBA has sought greater clarity regarding the frequency with which the leverage ratio would have served as the binding capital constraint had this framework been in place in prior periods. Absent this information, any public comments will be incomplete, and finalization of the proposed rule would be inappropriate. We encourage FHFA to publish supplemental information and provide a brief opportunity for public input specific to this topic.
- The treatment of credit risk transfer mechanisms is far too punitive and would discourage broad and diversified use of these mechanisms.
- While the framework includes important features to mitigate procyclicality in the single-family market, further steps are needed to address procyclicality in the multifamily market.
- The stress scenarios used to develop the risk grids and multipliers should be based on empirical loan performance data over the same periods for both the single-family and multifamily markets. MBA has requested further information regarding the time period used for the multifamily stress analysis. Absent this information, any public comments will be incomplete, and finalization of the proposed rule would be inappropriate. Again, supplemental information and a brief opportunity for comment would be welcome.

Additional Reforms are Necessary

The development of a stronger, more robust capital framework represents a necessary, but not a singularly sufficient, reform of the Enterprises. Further reforms that Congress should legislate or FHFA should implement or make more durable

prior to the release of the Enterprises from conservatorship, regardless of the form this release takes, include:

- Pricing discounts, favorable underwriting requirements, and credit variances based on the volume, size, or business model of single-family lenders should be prohibited.
- FHFA should facilitate the continuation of the Enterprises' important roles in the multifamily market.
- FHFA should support and facilitate the expansion (both in volume and type) of the Enterprises' credit risk transfer (CRT) programs in a manner that ensures similar levels of protection across differing structures.
- Acquisition of a controlling interest in an Enterprise by a mortgage lender or servicer should be prohibited in order to prevent "vertical integration."
- The standards for the development of new products, activities, and technologies at the Enterprises should be clarified.
- FHFA should promote enhanced public access to Enterprise data beyond the data published in support of the CRT programs.
- A more explicit guarantee on the Enterprises' single-family and multifamily MBS would promote secondary market liquidity and the broad availability of affordable mortgage credit.

Primary Observations and Recommendations

The capital framework to which the Enterprises (and future successor guarantors or new entrants)[5] are subject will influence many features of their operations and activities. This influence will grow upon the Enterprises' exit from conservatorship, as FHFA's direct role in many Enterprise business decisions transitions to a more traditional regulatory role of supervision and oversight. MBA recognizes the importance of the capital framework, as it represents a critical component of the supervisory infrastructure that supports the safety and soundness of the Enterprises.

[5] MBA has consistently supported legislation to provide FHFA with the authority to charter new guarantors to compete with the Enterprises, subject to certain constraints. Any new entrants, for example, should be required to meet substantially similar obligations to those of the Enterprises with respect to serving a national market, ensuring liquidity for loans in underserved markets or to underserved communities, and providing equal access to the secondary market for lenders of all types and sizes. Any new entrants also should adhere to strict limits on "vertical integration" with lenders operating in the primary market – a requirement MBA believes should be extended to the Enterprises, as well. For the remainder of these comments, references to "the Enterprises" shall include any future successors to Fannie Mae or Freddie Mac and any new entrants chartered to compete with Fannie Mae or Freddie Mac.

Similarly, a well-designed capital framework should guide the Enterprises toward operations and activities that reflect the mandates found in their charters.

MBA offers the following observations and recommendations with respect to the framework proposed by FHFA:

- *It is appropriate and necessary for FHFA to develop a rigorous and risk-sensitive capital framework for the Enterprises prior to their release from conservatorship.*

The Great Financial Crisis[6] revealed that both the quantity and quality of capital that the Enterprises held at the time were inadequate to absorb the impacts of rapidly falling home prices, rising mortgage delinquencies, and dislocations in fixed income markets. The capital framework in place during this period also failed to encourage safe and sound operations (for example, by failing to prevent excessive growth in the Enterprises' retained portfolios and outsized exposure to risk from investments in non-agency mortgage-backed securities (MBS)).

It is clear that a capital framework that better aligns the capital held by the Enterprises and the risks they assume is needed. In order for the Enterprises to carry out the objectives specified in their charters, they must be available to operate at all times, in all market environments, through all portions of the credit cycle – including their countercyclical functions that support the market when the availability of private credit wanes. The required capital levels for the Enterprises therefore must be sufficient to ensure the companies can withstand severe market downturns, such as those associated with the Great Financial Crisis or the COVID-19 pandemic.

- *Policymakers, debt and equity investors, and various market participants must be able to understand the Enterprise capital framework and how its provisions will impact markets across a wide range of economic conditions. This outcome is hindered by the substantial complexity of the proposed framework.*

It is also critical that a capital framework be finalized and well-understood by market participants prior to the Enterprises exiting conservatorship. Any potential equity or debt investors in the Enterprises, for example, would need to understand the capital framework and its implications for Enterprise operations and activities in order to determine the value of their contemplated investment. Given the substantial capital needs of the Enterprises relative to their existing capital levels, as well as their limited ability to increase those levels in a timely manner through retained earnings, external investments of equity capital likely will be necessary.

[6] The "Great Financial Crisis" refers to the period from 2007-2009 in which the global financial system experienced severe stress, which resulted in (among many other actions) the Enterprises being placed in conservatorship.

These investors cannot reasonably be expected to consider making such investments at the necessary scale without a clear understanding of the capital framework that will affect the potential return on their investment in the Enterprises, and the impacts that framework will have across a wide range of activities and market conditions. Similarly, investors in Enterprise debt and other entities that do business with the Enterprises will benefit from a clear understanding of this framework and how it guides Enterprise decision-making. These considerations warrant simplification of the capital framework to the extent feasible.

- *In the period leading to the Great Financial Crisis, the Enterprises generated the bulk of their profits from their portfolio businesses, provided preferential treatment to larger or favored customers, competed on the liquidity of the securities they issued, and retained significant levels of mortgage credit risk. In recent years, the Enterprises have generated most of their profits from their core guarantee businesses, engaged in more equitable treatment of customers, developed a uniform MBS (UMBS), and created mechanisms to more effectively distribute mortgage credit risk. The capital framework should reflect these positive changes and encourage them to be continued wherever possible.*

In the period leading to their eventual conservatorships, the Enterprises engaged in business practices that caused them to fall short of fully satisfying the objectives in their charters. Significant increases in the size of their retained portfolios exposed them to excessive levels of mortgage credit risk. Differential pricing and underwriting standards across lenders led to unequal access to the secondary market and contributed to a concentration in primary market lending and heightened exposure to lenders that obtained the riskiest variances. Competition between the Enterprises was influenced by differences in the liquidity of the otherwise substantially similar MBS issued by each company. Incentives embedded in the Enterprises' prudential requirements rewarded the retention of credit risk rather than the transfer of this risk.

Many of these problematic business practices have been addressed in whole or in part through reforms instituted by FHFA over the past decade. Most of these reforms, however, are reliant on directives issued by FHFA through its conservatorship authorities. We believe these reforms should be codified wherever possible, and FHFA should use the fullest extent of its ongoing charter, safety-and-soundness, and affordable housing authorities to ensure that those reforms are firmly in place prior to the Enterprises exiting conservatorship. In addition, to the extent appropriate, FHFA should align the capital framework with these reforms. While the capital framework is not the primary tool by which these reforms should be achieved or retained, there is some level of interdependence, as the framework will impact these reforms and influence the business practices of the Enterprises and their roles in the market.

- *<u>The proposed capital framework should be modified to encourage the Enterprises to operate as market utilities, with effective incentives to distribute rather than hold mortgage credit risk.</u>*

As a foundation for developing and implementing a revised capital framework, FHFA should clearly define its overall objective, including its expectations for the Enterprises, their place in the market, and the manner in which they will conduct business. In this regard, MBA believes that FHFA should tailor the capital framework – as well as other regulatory and supervisory tools – to encourage the Enterprises to operate as utility-like, through-the-cycle managers and distributors of mortgage credit risk. This approach would best achieve the FHFA mandate that "the operations and activities of each [Enterprise] foster liquid, efficient, competitive, and resilient national housing finance markets…"[7]

Under such an approach, the Enterprises would function more as market utilities than as "growth" companies. FHFA would set target rates of return for the companies, as well as strict requirements related to permissible activities, appropriate market conduct, and acceptable corporate governance standards. The Enterprises would be structured to provide steady earnings – representing an attractive risk-adjusted return for patient-capital investors.[8] The "through-the-cycle" presence of the Enterprises references the need for sufficient capital for the companies to withstand periods of severe market stress and provide countercyclical liquidity in the mortgage market. Finally, the enhanced focus on management and distribution of credit risk (including various approaches to CRT) would reduce the Enterprises' exposure to borrower delinquencies – for example, in favor of transferring that risk to external investors willing to absorb it at reasonable prices.

This approach would faciliate a greater role in the mortgage market for diverse sources of private capital, more efficiently price mortgage credit risk, limit the systemic risk posed by the Enterprises, and promote broad access to affordable mortgage credit through enhanced secondary market liquidity. These outcomes align closely with the objectives found in the U.S. Department of the Treasury (Treasury) Housing Reform Plan issued in September 2019.[9]

---

[7] 12 U.S.C. §4513(a)(1)(B)(ii).

[8] For more information on the parameters of a "utility model" for the Enterprises, see: MBA, "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," April 20, 2017. Available at: https://www.mba.org/assets/Documents/Policy/17305_MBA_GSE_Reform_Paper.pdf.

[9] U.S. Department of the Treasury, "Housing Reform Plan – Pursuant to the Presidential Memorandum Issued March 27, 2019," September 2019. Available at: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf?mod=article_inline.

To achieve this outcome, FHFA should modify the proposed capital framework by simplifying key features and providing more information on others, recalibrating the quantity and types of required capital, and enhancing the recognition provided to transfers of credit risk. FHFA should also ensure that the framework does not weaken or deter other critical reforms that should be given greater durability prior to the Enterprises' exit from conservatorship.

Simplifying the Capital Framework and Increasing its Transparency

Capital requirements applicable to large financial institutions entail a certain level of complexity in order to appropriately capture risk exposures and provide for adequate loss-absorbing capacity in stressed markets. Such capital requirements, however, also should be as transparent as possible so that market participants, regulators, counterparties, and other stakeholders can understand the objectives and constraints under which the institutions are operating.

This transparency is particularly important for the Enterprise capital framework, given the critical role that the Enterprises play in the infrastructure of financial markets, the availability of affordable housing throughout the country, and the performance of the broader economy. Further, the Enterprises themselves need to understand clearly how various aspects of their capital framework may bind over time, as they develop business strategies that most efficiently deploy their capital.

- *A simpler capital framework would allow for clearer analysis of how various components impact Enterprise business decisions.*

The framework proposed by FHFA is unnecessarily complex, with risk-based capital requirements implemented through various grids and multipliers or internal models, combined with multiple buffers, as well as a separate leverage ratio requirement. Moreover, the Enterprises are required to compare the results from the risk-based grids to those from their internal models and adhere to capital requirements based on the higher of the two approaches. Within the single-family framework, required capital varies based upon current loan-to-value (LTV) ratios, though collars would be placed on the extent to which home price movements can impact these LTV ratios for purposes of required capital.

Taken together, these multiple, complex, overlapping constraints are likely to frustrate FHFA's goals of providing a clear signal to the Enterprises – and to the broader market – regarding how much capital is required for the Enterprises to conduct their businesses safely and soundly, and how they might operate to reduce that requirement, or to more efficiently allocate that capital.

Importantly, it will be nearly impossible for any outside observer, and perhaps the Enterprises themselves, to understand how the capital framework is driving certain decisions or business practices. Consider a housing advocate looking for a clear answer as to why low downpayment mortgages might be priced at a certain level. Could an Enterprise point to a specific cell within a grid as the driver of this pricing? It is unlikely, particularly in a scenario with a binding leverage ratio, which is invariant with respect to risk.

There also is a mismatch between the sophistication and rigorous analysis employed to estimate the grids and multipliers (although greater transparency with respect to the underlying data used in their derivation would be welcome) and the far less precise approach taken to set the various buffers and the leverage ratio. While some level of more subjective caution is certainly warranted, the magnitude of the buffers and the leverage ratio are such that they are likely to determine the binding constraint on the Enterprises. As noted above, FHFA has not provided public commenters any information regarding the frequency with which the leverage ratio would have been binding in prior periods. This data gap represents a significant shortcoming of the proposed rule and prevents public commenters from fully understanding the practical impact of the framework.

The interactions among these various components necessarily will result in an opaque outcome that lessens, rather than enhances, transparency. The level of complexity in the revised proposal far exceeds that which is needed to achieve a robust framework. A recent Federal Reserve Board study, for example, cautions against capital requirements that are overly complex and try to achieve too many competing objectives.[10]

- *Greater transparency in certain of the key assumptions or features of the framework would allow for clearer analysis of the impact of the framework on the Enterprises and the broader market.*

In MBA's response to the 2018 proposal, we raised a number of questions regarding the assumptions underlying FHFA's analysis. We appreciate the increased transparency with respect to certain components of these issues in the revised proposal. More information and greater transparency is still needed, however, in other areas.

[10] Canzoneri, Matthew, Behzad Diba, Luca Guerrieri, and Arsenii Mishin, "Optimal Dynamic Capital Requirements and Implementable Capital Buffer Rules," Finance and Economics Discussion Series 2020-056, 2020, Board of Governors of the Federal Reserve System. Available at: https://www.federalreserve.gov/econres/feds/files/2020056pap.pdf.

- *The leverage ratio as a binding capital constraint*

Importantly, data on, or estimates of, the frequency with which the leverage ratio is the binding capital constraint under the proposed framework is a critical input for understanding how the framework will function. This information will help inform stakeholder views as to how the Enterprises likely would manage their businesses and how each would make decisions regarding the risk profiles of their investments, guarantees, or activities. We believe an understanding of this dynamic is necessary for FHFA before it can finalize the framework in a credible manner. The banking regulators, for example, historically have completed several rounds of quantitative impact studies to gauge how their proposed rules would affect financial markets. FHFA should, at a minimum, perform the analyses necessary for market participants to understand this crucial point and offer limited opportunities for comment.

FHFA, moreover, should specify clear expectations with respect to how frequently the leverage ratio should be the binding constraint. FHFA could, for example, maintain a target that, in the x percent of reporting periods when credit risk is deemed to be at its low ebb, the leverage ratio should bind. If, through the course of its analysis, the leverage ratio is found to be binding in 2x percent of reporting periods, it then would be clear that the leverage ratio is set much too high and is not acting as a last-resort backstop. The sensible response would be to lower the leverage ratio, or perhaps to lower the buffer associated with the leverage ratio, until FHFA's target is met.

- *The stress scenarios used to set the single-family and multifamily capital requirements*

A second major concern is that it is unclear whether the framework is set in such a way as to recognize the two distinct guarantee businesses of the Enterprises – their single-family and multifamily businesses. The risk profiles of these businesses are not perfectly correlated, and historically the Enterprises have benefited from some level of diversification across these businesses.

Practically, this dynamic means that the stress scenario used to build the grids should be the same for both businesses. Currently, although there is little transparency with respect to the stress scenario utilized to generate the multifamily grids, the single-family grids are drawn from the Great Financial Crisis loss experience. The multifamily businesses fared much better through that crisis, and yet the multifamily grids appear to derive from a much more severe loss experience.

If the benefits of this diversification are not acknowledged in the framework, FHFA effectively is requiring the Enterprises to operate their single-family and multifamily businesses as standalone operations. Such a requirement is not stated in the framework, nor does it comport with the Enterprises' expected responses to future

stress scenarios – that is, capital is fungible across the businesses within each company and can be deployed as needed to absorb losses stemming from either business segment.

In addition, further details regarding the stress scenario on which the multifamily risk grids are based and a comparison of that loss experience to the Great Financial Crisis are necessary for MBA to determine whether the required amount of capital for the Enterprises' multifamily businesses is appropriate.

- *The liquidity requirements to which the Enterprises are subject*

In their most recent quarterly financial reports, the Enterprises revealed that FHFA has subjected them to new liquidity requirements that will take effect on September 1, 2020.[11] According to the Enterprises, these liquidity requirements include components based on one-month and one-year expected cash flows, long-term debt relative to less-liquid assets, and the relative terms of liabilities and assets. While no other information has been provided regarding this liquidity framework, it appears akin, in some respects, to the approach adopted by federal regulators for certain large banking organizations.

This new liquidity framework is likely to have significant impacts on the business models, operations, activities, and safety and soundness of the Enterprises. The Enterprises, for example, noted the potential for the liquidity requirements to affect their funding costs and net interest income, as well as the size and composition of their retained portfolios.

Because there is no publicly-available information regarding this liquidity framework, it is not possible to evaluate how it would interact with the proposed capital framework. It is not reasonable to assume that the interaction between capital and liquidity requirements for large banks will translate directly to the Enterprises, particularly given the very different funding sources and cash flows for the Enterprises relative to most banks. In the absence of further details regarding this new liquidity framework, public commenters will be providing input to FHFA based on only a partial view of the entire prudential framework envisioned for the Enterprises. These limitations will severely diminish the utility of the public feedback that FHFA evaluates when finalizing the capital framework.

---

[11] Fannie Mae, "Fannie Mae Form 10-Q for the Quarterly Period Ended June 30, 2020." Available at: https://fanniemae.gcs-web.com/static-files/78d7b4ac-d7fd-4d01-9adf-a0ee509a8c61. Freddie Mac, "Freddie Mac Form 10-Q for the Quarterly Period Ended June 30, 2020." Available at: http://otp.investis.com/clients/us/federal_homeloan/SEC/sec-show.aspx?FilingId=14296435&Cik=0001026214&Type=PDF&hasPdf=1.

Recalibrating the Quantity and Types of Required Capital

- *Comparability of Enterprise capital requirements to those in place for banks or other large financial institutions is reasonable with respect to particular risks, though aggregate capital requirements may differ due to variations in institutions' business models or relative importance to the market.*

MBA believes an appropriate system of prudential requirements is one in which the capital requirements for any given mortgage credit risk are aligned across different institutions that hold substantially similar mortgage credit risk. This principle is consistent with recommendations found in the Treasury Housing Reform Plan, which calls for steps to harmonize capital requirements across the Enterprises and banking organizations wherever possible.[12] This report specifically argued that similar credit risks generally should have similar credit risk capital charges across different market participants. Alignment of credit risk capital charges does not, however, necessarily lead to precisely equivalent capital requirements at the aggregate level for different types of institutions.

- *The leverage ratio should serve as the binding capital constraint very infrequently, though more information is needed to determine the relationship between the leverage ratio and the risk-based capital requirements in the framework.*

As was discussed earlier, additional clarification is needed with respect to the dynamics between the risk-based capital requirements and the leverage ratio requirements. Given the information provided, it is unclear how frequently each set of requirements would serve as the binding constraint under the proposed framework. Clarity in this area is critical to the daily operation of the Enterprises. The Enterprises historically have adjusted the nature of their activities, consistent with the incentives embedded in the risk-based capital standards, to optimize their activities and ensure that minimum risk-based capital standards were the binding constraint. While we agree with FHFA that it is appropriate for the risk-based capital requirements to serve as the binding constraint on the Enterprises at most points in time, we are unable to determine whether the framework as proposed achieves this objective.

---

[12] U.S. Department of the Treasury, "Housing Reform Plan – Pursuant to the Presidential Memorandum Issued March 27, 2019," September 2019. Available at: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf?mod=article_inline.

- *The Advanced Approach should be removed from the framework. FHFA should continue to review the Enterprises' internal models and – to the degree new information and insights are found – integrate this information into the Standardized Approach.*

The Advanced Approach would establish a duplicative process that would reduce transparency and draw attention and resources from the effective implementation of the Standardized Approach. The Enterprises have analyses and models that are used internally for pricing, accounting, capital management, and other purposes. In its role as regulator of the Enterprises, FHFA should continue to review the Enterprises' analyses and models and – to the degree new information or insights are developed that would improve the Standardized Approach – incorporate this information into the capital framework.

- *MBS guaranteed by another Enterprise should carry a 0 percent risk weight to ensure no disruption in the UMBS market.*

The framework deviates from the 2018 proposal by increasing the risk weights associated with certain exposures of an Enterprise to another Enterprise – namely, exposure to MBS guaranteed by a different Enterprise. While it is reasonable to require higher levels of capital for exposure to an Enterprise than exposure to the U.S. government, the framework should reserve these higher risk weights for the unsecured debt of an Enterprise – not the MBS that it guarantees.

MBA supports FHFA's view that the consolidated UMBS market "will lead to a more efficient, resilient, and liquid secondary mortgage market."[13] MBA also concurs that fungibility between UMBS issued by each Enterprise in the eyes of investors and other market participants is necessary for a well-functioning UMBS market. A key component of this fungibility is the re-securitization of UMBS, which in some cases leads to one Enterprise providing a guarantee on securities backed by securities issued by another Enterprise.

The framework should not include any provisions that could deter the Enterprises from engaging in the re-securitization of UMBS or from treating UMBS issued by another Enterprise as less than fully fungible with its own UMBS. While the risk weights associated with these cross-exposures in the framework are not high, any difference between the required capital for an Enterprise's own securities relative to those issued by another Enterprise could lead to different treatment and actions that weaken the aggregate UMBS market.

---

[13] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," June 30, 2020, 85 FR 39274. Available at: https://www.federalregister.gov/documents/2020/06/30/2020-11279/enterprise-regulatory-capital-framework.

Further, as will be discussed in greater detail below, MBA believes FHFA and Treasury should re-calibrate the existing, unused Treasury support for the Enterprises to provide a more explicit federal backstop for Enterprise-issued MBS (in the absence of legislation providing an explicit, full-faith-and-credit federal guarantee of these MBS). Under such a model, the credit risk associated with these securities would resemble more closely the credit risk associated with U.S. government obligations, such as Treasury securities. This approach would provide additional justification for a 0 percent risk weight for Enterprise-guaranteed MBS.

- *The framework should be modified to address procyclicality in the multifamily mortgage market, limiting the impact of market declines in values and incomes until they breach the stressed level.*

The framework recognizes the need for a countercyclical adjustment for multifamily operations but stops short of proposing a specific adjustment. MBA applauds FHFA for recognizing the need for a countercyclical adjustment for the Enterprises' multifamily operations, and we recommend that FHFA include a functional countercyclical mechanism prior to finalization of the framework. In considering potential options proposed by commenters, FHFA should remain cognizant of the fact that the mark-to-market collars provided in the single-family market do not translate well to the multifamily market.

The assessment of any countercyclical proposal is made difficult by what appear to be excessive overall risk-based requirements for the multifamily businesses, as is discussed further below. In addition, in their present incarnation, the multifamily risk-based grids appear to magnify the procyclicality of the framework relative to the approach taken with respect to the single-family businesses, as both dimensions (LTV ratio and debt-service-coverage-ratio (DSCR)) of the multifamily risk grids are marked-to-market. This dual mark-to-market feature accentuates the impacts of both rising and falling markets.

MBA recommends that FHFA consider an approach that limits the capital impact of market declines in values and incomes until they breach the levels associated with the stress scenarios (-35 percent for values and -15 percent for income). Such an approach would operationalize the intent of the capital framework – building capital during market growth and relying on that capital during market declines.

We understand such an approach will require additional time and effort to fully develop, but we also note the importance of a functioning countercyclical mechanism for the multifamily businesses, particularly given the critical role the Enterprises play in refinancing maturing loans during downturns.

- *The proposed risk grids for the multifamily businesses should be based on empirical multifamily loan performance data and on the same economic assumptions and analytical approaches as the single-family risk weights. The risk grids and multipliers should be adjusted regularly as additional multifamily loan performance history becomes available.*

For the capital framework to be effective, the multifamily risk weights should be based on empirical multifamily loan performance data and on the same economic assumptions and analytical approaches as the single-family risk weights. To the degree FHFA is developing the framework for Enterprises that operate in both the single-family and multifamily markets, the framework also should be consistent with regard to the stress scenarios it contemplates for the combined businesses. This approach does not appear to be used in the framework, and MBA recommends that FHFA revise the multifamily risk grids to meet these criteria.

We also recommend that FHFA establish a formal process through which the grids are updated regularly, based on additional historical loan performance data as it becomes available. This approach would help ensure that the grids continue to evolve with the market as more information becomes available.

Enhancing the recognition provided to transfers of credit risk

- *The development of the CRT programs at the Enterprises has successfully transferred significant levels of mortgage credit risk to the private sector. These programs should be retained, improved, and expanded.*

MBA has consistently advocated for the Enterprises to engage in significant levels of risk transfer, utilizing a diversified approach that features mortgage insurance, lender risk retention, capital markets, reinsurance, and other mechanisms to disperse credit risk across the market, rather than concentrate it at the Enterprises. In recent years, FHFA similarly has strongly supported the Enterprises' expansion of their single-family and multifamily CRT programs.

FHFA's Strategic Plan, for example, includes an objective to "promote credit risk transfers that reduce taxpayer risk by attracting private capital."[14] FHFA's 2020 Scorecard for the Enterprises includes the directive for the Enterprises to "continue to transfer a significant amount of credit risk to private markets in a commercially reasonable and safe and sound manner" as an explicit safety-and-soundness

[14] FHFA, "FHFA Strategic Plan: Fiscal Years 2018-2022," January 29, 2018. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/StratPlan_Final_1292018.pdf.

objective.[15] Similarly, the second strategic goal of FHFA's 2014 Conservatorship Strategic Plan focused on reducing taxpayer risk, including by continuing efforts to transfer single-family and multifamily credit risk to the private sector.[16]

These concerted efforts by FHFA and the Enterprises have led to great success. As FHFA observed in its 2018 Scorecard Progress Report, "the Enterprises' credit risk transfer programs have become a core part of the Enterprises' single-family credit guarantee business," and "transferring credit risk to the private sector is an integral part of the multifamily business model for both Enterprises."[17] The development of the various CRT offerings has altered the manner in which the Enterprises conduct business in a fundamental and positive manner, as they now are more attuned to market signals of risk and must disclose more information regarding the performance of their portfolios.

The resulting transfer of a substantial portion of their credit risk has helped transform the Enterprises' business models. The Enterprises now more closely resemble lower-risk utility providers of securitization services and brokers for the government's assumption of catastrophic risk through a backstop provided by Treasury. Previously, the Enterprises had been buy-and-hold investors in mortgage credit risk in their guarantee businesses and interest rate risk in their portfolio businesses. During their conservatorships, the Enterprises' guarantee businesses have greatly increased their use of CRT, while the portfolio businesses have been reduced substantially. This direction of reform has the potential to promote the Enterprises' viability as privately-owned companies outside conservatorship because it reduces the amount of economic capital required and reduces the volatility of earnings over time. A steadier earnings stream should be a significant "selling point" for future investors in more utility-like Enterprises post-conservatorship.

Based on the success to date, and in the absence of any changed circumstances at the Enterprises, MBA does not believe a reversal in the existing course of action is warranted. If anything, greater use of CRT would better align with the objectives of decreased systemic risk, increased private capital standing ahead of taxpayer support, and more "utility-like" behavior.

---

[15] FHFA, "2020 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions," October 2019. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2020-Scorecard-10282019.pdf.

[16] FHFA, "The 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac," May 13, 2014. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf.

[17] FHFA, "2018 Scorecard Progress Report," April 2019. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2018-Scorecard-Progress-Report.pdf.

As such, it is unclear why the framework is so harsh in its treatment of CRT. In certain situations, for example, use of CRT by an Enterprise not only would fail to reduce required capital under the framework, but instead would increase it. This outcome is perplexing and counterintuitive given the broad public support for CRT from FHFA and other government stakeholders. As is noted above, FHFA continues to include the growth and refinement of CRT in its objectives for the Enterprises, and senior FHFA officials continue to highlight the success of CRT in speeches and commentary. Treasury noted the benefits of risk distribution in its Housing Reform Plan, recommending that regulators align the level of capital relief attributable to CRT among the Enterprises, banks, and other types of financial institutions.[18] MBA strongly agrees with this assessment.

FHFA is correct to recognize that, even if properly constructed, there is an outer limit to the benefits CRT can and should provide in terms of capital relief. CRT, whether capital markets- or counterparty-based, can reduce the amount of required risk-based capital. At some point, as was the case for one Enterprise with respect to the September 30, 2019 data shown in the proposal, the leverage ratio becomes the binding constraint. As discussed previously, MBA believes that the buffer associated with the leverage ratio is set at too high a level, which likely results in the leverage ratio serving as the binding constraint too frequently. Even if FHFA revises the overly conservative approach in the framework, however, there are additional reforms that are necessary to provide for appropriate recognition of CRT.

- *The 10 percent risk weight floor should be reduced significantly and more narrowly targeted.*

The 10 percent risk weight floor for capital markets CRT is far higher than necessary and dilutes the benefits that otherwise would encourage greater use of CRT by the Enterprises. While in some cases CRT should not be recognized as providing full (100 percent) capital relief, the leverage ratio is in place and already serves this safeguard function. To the extent that FHFA believes there must be some risk-based capital “buffer” applied to CRT, this floor should be reduced significantly, and should be targeted more narrowly to those activities that *do* include some element of uncertainty of CRT effectiveness and *do not* already include adjustments for the certainty of collection (as is done with the counterparty haircut).

[18] U.S. Department of the Treasury, “Housing Reform Plan – Pursuant to the Presidential Memorandum Issued March 27, 2019,” September 2019. Available at: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf?mod=article_inline.

- *Under FHFA's direction, the Enterprises have pursued a variety of effective CRT techniques. The proposed capital framework should be modified to recognize the importance of the various CRT offerings and the specific effects and capital needs of each.*

As MBA highlighted in our comments on the 2018 proposal, we believe that the capital framework should provide tangible relief for CRT, regardless of – but specific to – its form. We believe the 2018 proposal leaned heavily in favor of capital markets CRT, whereas the revised framework is punitive to all forms of risk transfer.

- *Mortgage insurers*

The Enterprises' charters require them to utilize mortgage insurance or other credit enhancement for loans with LTV ratios above 80 percent. Mortgage insurers provide significant capital to bear these risks, and it is appropriate for the Enterprises to closely monitor their counterparties. The establishment and ongoing refinement of the Private Mortgage Insurer Eligibility Requirements (PMIERs) should ensure that mortgage insurers remain strong counterparties to the Enterprises. It is logical for the framework to recognize that mortgage insurers are exposed to the same concentration risk in mortgage credit as the Enterprises, and it does so. Similarly, the framework recognizes the important difference between mortgage insurers that meet the PMIERs requirements and those that do not.

The financial strength standards for mortgage insurers, however, remain quite opaque. MBA recommends that FHFA directly, or through direction to the Enterprises, provide specific guidelines regarding the criteria associated with the different levels of financial strength. By articulating more clearly how a counterparty could achieve stronger ratings, FHFA and the Enterprises could create a virtuous cycle of competition that leads to stronger and, hence, more reliable counterparties.

MBA has been a consistent proponent of deeper mortgage insurance coverage, as well. The framework should provide capital relief to the Enterprises if financially strong mortgage insurers take on risk for loans with LTV ratios below 80 percent, or offer deeper coverage on loans with higher LTV ratios.

- *Multifamily counterparties*

With respect to the multifamily market, Fannie Mae Delegated Underwriting and Servicing (DUS) lenders also would be subject to evaluation under the counterparty risk approach. The framework acknowledges the value of lenders' servicing portfolios and restricted liquidity and keeps in place counterparty haircuts as a proxy for risk. It appears from the rule that the overall effectiveness adjustment (OEA) would be

functionally duplicative of the counterparty haircut for DUS lenders, in which case the OEA should not apply.

It is important to note that the Fannie Mae and Freddie Mac multifamily programs are quite different in their approaches to CRT. Both approaches, however, are critically important to the success of the broader market, and the capital framework should not favor one approach relative to the other.

- *"Cash" CRT*

While some CRT transactions ensure that cash is on hand as collateral or that a counterparty is in place to absorb or compensate for future losses, other transactions eliminate certain risks entirely. Structured securities, such as the Freddie Mac K-deals, in which future principal and interest cash flows are sold to investors, are an example. There are valid concerns that market disruptions may affect the future demand from investors for such instruments, but such concerns are addressed through the various buffers and do not change the fact that the current risks effectively have been removed. The framework should recognize and account for situations in which capital markets or other transactions have not only mitigated or insured against future losses, but have removed the cash flows (and the risks associated with them) from the Enterprises.

- *Other capital markets CRT*

Capital markets CRT transactions have a number of benefits. Cash raised from sales of securities can be segregated and held in trust with the confidence that it will be available to absorb credit losses should they arrive. To date, the Enterprises have raised significant capital from structured CRT transactions like Structured Agency Credit Risk (STACR) securities and Connecticut Avenue Securities (CAS). Capital markets CRT transactions, however, have certain drawbacks. Principally, the capital is tied to certain reference portfolios, and hence is not fungible and is unable to absorb losses across the broader businesses. Capital markets CRT transactions, moreover, depend upon functioning capital markets. At times, this form of transfer may not be available. Over-reliance on capital markets CRT transactions could result in a large cohort of loans being held on Enterprise portfolios until market conditions have improved, thereby requiring more equity capital during downturns. This need to increase equity capital in difficult market conditions is mitigated by the presence of capital buffers that ensure these loss-absorbing resources are available.

Given these advantages and drawbacks, MBA believes that capital markets CRT transactions, including the existing programs, have been successful. They have helped to develop an asset class that mortgage insurers, banks, and other financial institutions are now using to manage their credit risk exposures more adroitly. We

believe that these programs should continue, and should not be treated in a manner that discourages their use by the Enterprises.

- *Reinsurers*

The Enterprises have increased their use of CRT through diversified reinsurers in both the single-family and multifamily businesses. This pool of capital is quite large, and these sophisticated organizations could play a larger role either through direct CRT or as investors in CRT securities. The recommendations described above with respect to transparency associated with the financial strength targets and objectivity with respect to concentration risk would help grow the role of these reinsurers in the CRT programs.

Ensuring that other critical reforms to the Enterprises are made as durable as possible prior to the Enterprises' exits from conservatorship

Refining and strengthening the capital framework of the Enterprises is a worthwhile and critical step in the effort to reform the companies more comprehensively. While MBA has long advocated for a stronger capital framework to govern the Enterprises, it is important to note that a more robust framework should be viewed as only one component of a broader set of necessary and sustainable reforms to the Enterprises. Following the Great Financial Crisis, FHFA used its conservatorship authorities to identify additional steps that reinforce the strengths and mitigate the weaknesses in the Enterprises' activities and operations. These steps, while helpful, in many cases are not sufficiently durable in light of the Enterprises' future exits from conservatorship.

The following reform priorities focus on market stability, ample liquidity, broad access to sustainable credit, fair competition, and the safety and soundness of the Enterprises and the housing finance system. MBA believes that, in addition to promulgating strengthened capital requirements, FHFA should take steps to "lock in" these reforms as a prerequisite to releasing the Enterprises from conservatorship.

- *Pricing discounts, favorable underwriting requirements, and credit variances based on the volume, size, or business model of single-family lenders should be prohibited.*

The Enterprises should facilitate access to the secondary market on equal terms for lenders of all sizes and business models. Such an approach is key to promoting access to mortgage credit throughout the nation and discouraging concentration in the primary mortgage market that is divorced from market-based factors. Through recent directives, FHFA has taken steps to ensure that guarantee fee discounting or other favorable treatment is not provided to market participants based on their

volume, size, or business model. Any directives issued under FHFA's conservatorship authority are not permanent and should be codified through the notice-and-comment rulemaking process.

- *FHFA should facilitate the continuation of the Enterprises' important roles in the multifamily market.*

The Enterprises serve as an important source of capital for financing multifamily housing. FHFA's post-conservatorship multifamily regulatory requirements and standards should support liquidity in all parts of the credit cycle, while recognizing the important role of fair competition in financing multifamily housing. Given the strong diversification of capital sources in multifamily finance at this time, FHFA's regulatory actions should continue to support an appropriate role for the Enterprises in facilitating liquidity and long-term stability for workforce rental housing, while also promoting the role of private capital.

- *FHFA should support and facilitate the expansion (both in volume and type) of the CRT programs in a manner that ensures similar levels of protection across differing structures.*

FHFA should use its existing authority to issue regulations encouraging deeper levels of risk sharing by the Enterprises on an ongoing basis, unless waived due to exigent economic or financial circumstances. CRT transactions have proven to be a valuable mechanism to protect the Enterprises from substantial credit risk, and a rulemaking in this area would ensure the current program remains strong and continues to grow and diversify. Such a rulemaking should be supplemented by appropriate recognition of the benefits of CRT transactions in any revised Enterprise capital framework, as has been discussed extensively in the comments above.

- *Acquisition of a controlling interest in an Enterprise by a mortgage lender or servicer should be prohibited in order to prevent "vertical integration."*

MBA believes that guardrails should be put in place to ensure the Enterprises are not subject to undue influence by any individual shareholder that also operates in the primary mortgage market. If one or more mortgage lenders holds a substantial portion of an Enterprise's equity, they could potentially use their influence to provide themselves with certain advantages over their competitors in the primary market – for example, by driving policies that provide them with better secondary market

executions or favorable technology integration from that Enterprise relative to the options available to other lenders.[19]

- *The standards for the development of new products, activities, and technologies at the Enterprises should be clarified.*

As the Enterprises continue to partner with other market participants to innovate by developing new products and activities, it is important that the processes by which these measures are undertaken are fair, transparent, and supportive of the overall market. FHFA should enhance the approval process for new Enterprise products, activities, and technologies by instituting clear criteria for FHFA's evaluation, as well as provide clear parameters on the process by which the Enterprises offer pilot programs or other "early-to-market" opportunities. Similarly, FHFA should ensure that any new technologies developed or used by the Enterprises support, not supplant, primary market activities. Together, these steps would appropriately balance the need for innovation with the need for the Enterprises to support the broader market.

- *FHFA should promote enhanced public access to Enterprise data beyond the data published in support of the CRT programs.*

In recent years, the Enterprises have invested tremendous resources in the collection and analysis of loan-level collateral and performance data that covers several dimensions of the market. MBA encourages FHFA to build on existing regulations to ensure public-use databases provided by the Enterprises are truly accessible to the public at a reasonable cost. Further, while some of this data is made available through CRT disclosures, FHFA could take steps to require more complete disclosures by the Enterprises.

- *A more explicit guarantee on the Enterprises' single-family and multifamily MBS would promote secondary market liquidity and the broad availability of affordable mortgage credit.*

MBA believes it is crucial to establish a permanent, paid-for federal government backstop on MBS issued by the Enterprises. While the most effective manner of providing such a backstop is through legislation, FHFA and Treasury could leverage the limited explicit guarantee already in place through the Senior Preferred Stock Purchase Agreements (PSPAs) to do so, as well. The PSPAs effectively provide an explicit guarantee of Enterprise-issued MBS; they achieve this objective, however, by

---

[19] As was noted in MBA's "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," a 10 percent ownership limitation to prevent undue influence would be comparable to a provision in Federal Reserve regulations that establishes a rebuttable presumption of control when a person, or persons acting in concert, acquire a 10 percent interest in a state member bank or bank holding company.

committing to provide funds to support all Enterprise obligations, rather than focusing on those obligations linked to MBS. Restructuring the commitment under the PSPAs would enable the explicit guarantee to apply to Enterprise-backed MBS in a more direct and targeted manner. A more explicitly-defined guarantee is a critical element of any reform effort, as it promotes the broad availability of affordable mortgage credit and the capacity of the Enterprises to support the market through all parts of the credit cycle.

MBA believes that these reforms, in conjunction with a strong capital framework that supports FHFA's CLEAR (competitive, liquid, efficient, and resilient) housing finance mandate, will create a solid foundation for the Enterprises to operate safely and effectively outside of conservatorship. To ensure this foundation is fully implemented and will guide the operations of the Enterprises, adequate capital cannot be the sole benchmark that triggers the end of the conservatorships. MBA believes that the Enterprises should not be permitted to exit conservatorship until the systematic, wholesale, and long-term reforms described above are sufficiently permanent.

* * *

MBA appreciates the opportunity to provide observations and recommendations on the re-proposed Enterprise capital framework, particularly in light of our prior request for a multi-stage comment process. A robust capital framework is critical to ensuring the Enterprises can operate in a safe and sound manner that supports and strengthens the housing finance system following their exits from conservatorship. MBA believes FHFA should take all necessary steps to ensure that the post-conservatorship Enterprises cannot and do not revert to their business models and activities of the past. The development of a framework that encourages the Enterprises to operate as market utilities will allow them to meet their obligations both to shareholders and to the public.

Thank you again for the opportunity to comment. We look forward to working with FHFA in the coming months as this framework is refined further.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association