BETTER MARKETS

August 31, 2020

Alfred M. Pollard
General Counsel
ATTN: Comments/RIN 2590-AA95
Federal Housing Finance Agency
400 7th Street SW
8th Floor
Washington, DC 20219

Re: Enterprise Regulatory Capital Framework, 85 Fed. Reg. 39,274 (June 30, 2020)

Dear Federal Housing Finance Agency:

Better Markets Inc.[1] appreciates the opportunity to comment on the above-captioned notice of proposed rulemaking ("Proposed Rule" or "Release"), issued by the Federal Housing Finance Agency ("FHFA"). The Proposed Rule would establish a regulatory capital framework, largely modeled on the framework for banks, for the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), each a government-sponsored enterprise ("GSE") charged with promoting housing and supporting a stable housing market.

The Proposal spans over 130 pages in the Federal Register and offers an extraordinary level of detail about the proposed capital requirements. However, it misses the forest for the trees, as it fails to assess how the detailed proposal will serve and balance the important overarching goals that the FHFA must meet: establishing robust capital requirements for the systemically important GSEs to preserve their financial stability and prevent taxpayer bailouts, while at the same time ensuring that creditworthy borrowers have access to affordable mortgages and, ultimately, that

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

there is a stable supply of affordable housing in America.[2] A variety of stakeholders are sure to have views on the right balance to be struck, but to ensure meaningful comment that will aid the rulemaking process and ensure the best possible policy, the FHFA must conduct that analysis in the first instance.

Accordingly, we urge the FHFA to supplement the Proposal with its analysis of how the capital requirements will support the multiple goals of promoting financial stability, protecting against taxpayer bailouts, and ensuring that creditworthy borrowers have access to fair and affordable mortgages. After providing this analysis, the FHFA should extend the comment period for at least 60 more days to allow all interested parties the opportunity to comment on the fully developed proposal.

BACKGROUND

Congress created Fannie Mae, and later Freddie Mac, to ensure "quality housing options by: (a) purchasing qualifying residential loans from mortgage originators to increase home finance market liquidity, and (b) providing capital support to multifamily housing projects."[3] They did this primarily by buying pools of mortgages that met their underwriting standards (so-called "conforming mortgages"), packaging them into securities, and selling them to investors with the inclusion of a guarantee to investors of timely payment of principal and interest, notwithstanding defaults or losses on the underlying loans.[4]

While privately owned, the GSE's are government-sponsored, which confers significant benefits. They enjoy an implicit guarantee of support from the federal government and have been able to borrow on favorable terms. The GSEs grew to both transform and dominate the mortgage market—Fannie's and Freddie's standards for backing mortgages became the de facto mortgage underwriting standards in the industry, with non-conforming mortgages (i.e. mortgages that did not conform to the GSEs' standards) significantly more expensive than conforming mortgages.[5]

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[2] *See* Release at 39,275 ("FHFA is proposing enhancements to establish a post-conservatorship regulatory capital framework that ensures that each Enterprise operates in a safe and sound manner and is positioned to fulfill its statutory mission to provide stability and ongoing assistance to the secondary mortgage market across the economic cycle, in particular during periods of financial stress."); Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1495 (2011).

[4] W. Scott Frame, et al., *The Rescue of Fannie Mae and Freddie Mac*, Federal Reserve Bank of New York Staff Report No. 719 at 3 (Mar. 2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

[5] W. Scott Frame, et al., *The Rescue of Fannie Mae and Freddie Mac*, Federal Reserve Bank of New York Staff Report No. 719 at 5(Mar. 2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

However, by the early-to-mid 2000's as subprime mortgages began to proliferate, the GSE's dominance in the mortgage market began to wane.[6] This is because the GSEs did not generally back subprime mortgages. However, the GSEs could invest, for their own portfolios, in mortgage-backed securities made up of subprime mortgages, and in order to keep up with the market, they increasingly did so.[7] At the same time, while the GSE's were subject to capital requirements, these statutory capital requirements were extraordinarily weak, and the GSEs were significantly overleveraged.[8] Thus (1) the GSEs, already exposed to the soon-to-be crumbling mortgage market through their primary activity of guaranteeing mortgages, exposed themselves even more to the subprime sector in particular, and (2) the GSEs, due to lax statutory capital requirements, were seriously overleveraged. With this toxic mix of ingredients in place, it was inevitable that the GSEs would be facing collapse, absent a government bailout.

The government, and ultimately the U.S. taxpayers, were forced to do just that. The Housing and Economic Recovery Act was signed into law in July of 2008. It was designed to shore up the mortgage market, which was in turmoil, particularly the subprime sector, and it also authorized the newly-formed FHFA to place the GSEs into conservatorship. The FHFA did so in September of 2008, and the government injected billions of dollars into the GSEs to keep them afloat and to continue supporting the mortgage market, likely preventing an even deeper economic collapse.[9]

MATTHEW SHERMAN, CENTER FOR ECONOMIC AND POLICY RESEARCH, A SHORT HISTORY OF FINANCIAL DEREGULATION IN THE UNITED STATES 12 (July 2009) ("In 2001, there were twice as many agency-conforming loans as there were non-conforming ones. By 2006, the nonconforming market had eclipsed the conforming market in size."), https://www.openthegovernment.org/wp-content/uploads/other-files/otg/dereg-timeline-2009-07.pdf.

7 James H. Carr and Katrin B. Anacker, *The Past and Current Politics of Housing Finance and the Future of Fannie Mae, Freddie Mac, and Homeownership in the United States*, Banking & Financial Services Policy Report at 4 (July 2014) ("Although the GSEs had largely remained on the sidelines with respect to the purchase and securitization of subprime loans that were at the center of the foreclosure crisis,76 they did purchase bonds backed by poorly underwritten subprime loans and later securitized high-risk Alt-A prime mortgages that would eventually contribute to hemorrhaging losses for both GSEs.77 The result was that both GSEs, similar to most Wall Street companies, required substantial financial support from the government to continue operating."), https://staging.community-wealth.org/sites/clone.community-wealth.org/files/downloads/article-carr-anacker.pdf.

8 *See* Release at 39,276; Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1525 (2011) ("Congress made a conscious policy choice to take on more governmental risk in order to promote broader home ownership. Congress was telling Fannie Mae and Freddie Mac to take risks, to spend more capital to help originate still more mortgages, and to promote homeownership and home borrowing. Thus, the capital reserve cushion for the GSEs remained 2.5% of the value of securitized loans, and by 2008 it was clear that this amount was woefully inadequate.")

9 W. Scott Frame, et al., *The Rescue of Fannie Mae and Freddie Mac*, Federal Reserve Bank of New York Staff Report No. 719 at 2 (Mar. 2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

COMMENTS

Better Markets supports robust capital requirements for banks and systemically important non-bank financial firms. Without question, the GSEs are systemically important firms, and so must hold a sufficient amount of capital to ensure that the following goals are met: (1) that the GSEs serve their primary function of supporting the housing market, enabling access to fair and affordable mortgages for creditworthy borrowers; (2) that the GSEs do not pose a risk to the stability of the financial system; and (3) that the GSEs never again require a taxpayer bailout.

However, it is difficult if not impossible to determine whether the Proposal will further those goals. While the Release goes into a great deal of detail about the proposed capital requirements, and how much capital the GSEs would be required to hold under the Proposal, wholly absent from the Release is any analysis about how the Proposal might impact the housing market; access to mortgage credit on fair and equitable terms; and affordable housing. Without the FHFA providing this analysis in the first instance, it will be impossible for stakeholders to provide meaningful comment that will result in the best possible rule. Establishing the right capital requirements is critical to the continued health of the GSEs and to any credible plan for taking them out of conservatorship. In turn, the continued health of the GSEs is critical to both the financial and economic stability of the United States and the continued vitality of the American housing market. Thus, the capital requirements are too important to be set pursuant to a rulemaking that lacks a credible analysis as to how the rule will achieve the multiple public interest goals at stake. We elaborate on these points below.

I. ESTABLISHING APPROPRIATE CAPITAL REQUIREMENTS IS CRITICALLY IMPORTANT, BUT THE PROPOSAL DOES NOT PROVIDE ENOUGH INFORMATION TO ALLOW AN ASSESSMENT OF THE SPECIFIC LEVELS PUT FORTH

A. FHFA Must Ensure that the GSEs Are Sufficiently Capitalized to Prevent a Repeat of their 2008 Near-Collapse and Bailout

Better Markets has a lengthy track record of advocating for strong capital requirements, particularly for too-big-to-fail banks and non-bank financial firms.[10] This is because these entities

[10] Better Markets Comment Letter on Regulatory Capital Rule: Eligible Retained Income (May 4, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_Regulatory_Capital_Rule-Eligible_Retained_Income.pdf; Better Markets Comment Letter on Capital Requirements for Swap Dealers and Major Swap Participants (Mar. 3, 2020), https://bettermarkets.com/rulemaking/better-markets-comment-letter-capital-requirements-swap-dealers-and-major-swap-0; Better Markets Comment Letter on Total Loss Absorbing Capacity (June 7, 2019), https://bettermarkets.com/rulemaking/better-markets-comment-letter-frs-fdic-occ-tlac; Better Markets Comment Letter on Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements (Jan. 22, 2019),

perform functions critical to the financial system, the economy, and the quality of life of all Americans. Given their role, there is an implicit expectation that, if those firms get into trouble, the government will bail them out to prevent the financial system and the economy from collapsing—which is what the government and taxpayers had to do in 2008. This is the meaning behind "too-big-to-fail." And it results in a fundamentally unfair asymmetry: The too-big-to-fail financial firms and their executives and shareholders are able to privatize any profits from excessive risk-taking while socializing the losses that occur when those risks take their toll and taxpayers are forced to pick up the tab. This is unacceptable. Accordingly, if those firms cannot be made small enough (or less interconnected) so that their failure does not imperil the financial system, then they must be made as resistant to failure as possible. The key to this is sufficient capital—what stands between a too-big-to-fail firm and failure, and ultimately a taxpayer bailout, is loss-absorbing capital.

This concept applies with equal, if not greater, force to the GSEs, especially as they eventually move out of government conservatorship. The GSEs play such a critical role in the

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https://bettermarkets.com/rulemaking/better-markets-comment-letter-frs-occ-fdic-proposed-changes-applicability-thresholds; Better Markets Comment Letter on Capital, Margin, Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swaps Participants and Capital Requirements for Broker-Dealers (Nov. 19, 2018), https://bettermarkets.com/rulemaking/better-markets-comment-letter-sec-capital-margin-segregation-requirements-security-based; Better Markets Comment Letter on eSLR (June 25, 2018), https://bettermarkets.com/rulemaking/better-markets-comment-letter-occ-frs-eslr; Better Markets Comment Letter on Capital Buffer & Stress Testing (June 25, 2018), https://bettermarkets.com/rulemaking/better-markets-comment-letter-frs-capital-buffer-stress-testing; Better Markets Comment Letter on Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important Bank Holding Companies (Feb. 19, 2016), https://bettermarkets.com/rulemaking/better-markets-comment-letter-frs-total-loss-absorbing-capacity-long-term-debt-and-clean; Better Markets Comment Letter on Proposed Regulatory Capital Rules (Feb. 17, 2015), https://bettermarkets.com/rulemaking/better-markets-comment-letter-proposed-regulatory-capital-rules; Better Markets Comment Letter on Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banks in Resolution (Feb. 2, 2015), https://bettermarkets.com/rulemaking/better-markets-comment-letter-adequacy-loss-absorbing-capacity-global-systemically; Better Markets Comment Letter on Margin and Capital Requirements for Covered Swap Entities (Nov. 24, 2014), https://bettermarkets.com/blog/better-markets-comment-letter-margin-and-capital-requirements-covered-swap-entities-0; Better Markets Comment Letter on Regulatory Capital Rules (Mar. 27, 2013), https://bettermarkets.com/rulemaking/better-markets-comment-letter-regulatory-capital-rules; Better Markets Letter on Capital and Margin Requirements (Nov. 26, 2012), https://bettermarkets.com/rulemaking/better-markets-letter-capital-and-margin-requirements; Better Markets Comment Letter on Regulatory Capital Rules (Oct. 22, 2012), https://bettermarkets.com/rulemaking/better-markets-comment-letter-banking-regulators-regulatory-capital-rules; Better Markets Comment Letter on Margin and Capital Requirements for Covered Swap Entities (July 11, 2011), https://bettermarkets.com/rulemaking/better-markets-comment-letter-margin-and-capital-requirements-covered-swap-requirements.

housing market, which in turn plays such a critical role in the functioning of the American economy, that it has always been widely assumed that the government would step in and save them if they got into trouble. And in 2008 this implicit guarantee was made explicit and taxpayers were put on the hook for the GSEs excessive risk-taking and undercapitalization.[11] As the GSEs transition away from government conservatorship, FHFA must ensure that they are required to maintain sufficient capital to protect against failure under extreme, but plausible scenarios. Otherwise, the cycles of financial market stress, inadequate capital, near collapse, and taxpayer bailouts will continue, to the detriment of the American taxpayer, the American economy, and the mission of the GSEs in supporting a stable, fair, and accessible housing market.

B. Sufficient Capital Requirements Are Necessary to Ensure that the GSEs Fulfill Their Mission

Opponents of strong capital requirements often claim that requiring financial institutions to hold sufficient capital to protect against failures and/or bailouts in extreme but plausible scenarios necessarily means sacrificing other goals. They argue that those requirements will decrease lending or make loans and other services banks provide more expensive or less accessible, or that it will reduce bank profits. However, this is a misconception, as the experience of banks following implementation of the Dodd-Frank reforms has demonstrated. Banks are now required to hold more capital than ever before, making them safer than they ever have been, and yet banks are also more profitable than ever and lending has increased significantly.[12] Indeed, studies have shown that banks with more capital lend more.[13] In other words, capital requirements designed to decrease the likelihood of bank failure have coincided with increased bank profitability and greater lending. In reality, the more capital banks hold, the more loans they can make knowing they have sufficient capacity to absorb losses if some of those loans, or even a significant number of those loans, go bad. The more capital they hold, the less shareholders have to worry that, during an economic downturn, they will have to rely on a politically fraught bailout to save them rather than the bank's own loss-absorbing capacity (because, as Lehman's shareholders found out, an implicit guarantee may not end up being worth much).

Similar considerations apply with respect to the GSEs. Once they emerge from conservatorship, the GSEs can only fulfill their mission if they have sufficient capital to protect against failure and/or bailouts in extreme but plausible stress scenarios. Without sufficient capital,

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[11] *See* Wayne Passmore and Alexander H. von Hafften, *GSE Guarantees, Financial Stability, and Home Equity Accumulation*, 24 FEDERAL RESERVE BANK OF N.Y ECON. POLICY REV. 11, 11 (Dec. 2018), https://www.newyorkfed.org/medialibrary/media/research/epr/2018/epr_2018_gse-guarantees_passmore.pdf.

[12] BETTER MARKETS, SPECIAL REPORT, TEN YEARS OF DODD-FRANK AND FINANCIAL REFORM; OBAMA'S SUCCESSES, TRUMP'S ROLLBACKS, AND FUTURE CHALLENGES 46-47 (July 21, 2020), https://bettermarkets.com/sites/default/files/images/BetterMarkets_DoddFrankReport.pdf.

[13] LEONARDO GAMBACORTA & HYUN SONG SHIN, WHY BANK CAPITAL MATTERS FOR MONETARY POLICY (BIS Working Paper 558, Apr. 2016), http://www.bis.org/publ/work558.pdf.

the GSEs will not be in a position to support the housing market during an economic downturn, which in turn will threaten to make an economic downturn more severe than it otherwise would be. This is what we saw in 2008—had the GSEs not received huge cash infusions to continue operations, the housing market would have collapsed completely, and in turn the financial system and economy likely would have collapsed.[14] Setting capital requirements so that the GSEs can continue to support the housing market during an economic downturn is essential.

Establishing the right capital requirements has other potential implications as well. For example, if FHFA requires insufficient capital and the GSEs are not able to withstand the next economic downturn, there is always the danger that the implicit guarantee will not be made explicit, and that the GSEs will be allowed to fail. While the government may yet again come to the rescue, that scenario would fundamentally change the debate over the fate of the GSEs. For example, it might fuel the contention that the GSEs should become purely private and fend for themselves without any promise of a taxpayer rescue, or that they should be eliminated altogether. Either of these outcomes would likely hurt the housing market as a whole and leave a significant number of creditworthy borrowers without access to affordable and fair mortgages. Whatever merit these contentions may have, the FHFA must grapple with such considerations as it formulates the GSE capital framework.

However, it is not the case that **any** level of capital above what the GSEs would reasonably need to survive an extreme but plausible scenario is appropriate. Capital levels should be commensurate with the risk profile of the GSEs (which, as pointed out below, is different than banks). If FHFA sets capital levels at an arbitrarily high level, rather than a level reasonably designed to ensure the safety and soundness of the GSEs, the result could be that fewer creditworthy borrowers will have access to credit on fair terms, which will itself undermine the critical statutory mission of the GSEs. In other words, while FHFA must endeavor to ensure that capital requirements protect against GSE failure or taxpayer bailouts, it must also ensure that capital requirements are calibrated to maintain sufficient access to affordable, fair mortgages for creditworthy borrowers.

C. The Proposal Fails to Affirmatively Account for the GSEs' Housing Mission

As demonstrated above, the twin goals of the FHFA, to protect against failure or taxpayer bailouts of the GSEs, and to promote homeownership, are complementary and interdependent rather than competing goals; and indeed, fulfilling the former is necessary to ensuring the latter. At the same time, while these goals are not necessarily in tension, they are certainly distinct goals, and if FHFA places insufficient weight on one goal in setting the capital requirements, the resulting framework will undoubtedly undermine the other objective. Indeed, we saw this during the crisis,

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14 Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1526 (2011) ("Rescuing Fannie Mae and Freddie Mac in 2008 was necessary to keep the residential mortgage market machinery from grinding to a halt and to mitigate the impact of the crash on homeowners and homebuyers.").

when the statutory capital requirements, set far too low in an attempt to further homeownership, put the GSEs on a course for failure.[15]

The Proposal indicates that the FHFA is not adequately accounting for its mandate to promote and support the housing market. While there is, laudably, a significant amount of attention in the Release on analyzing how much capital the GSEs would be required to hold under the proposed capital requirements, and how such capital requirements would have affected them during the financial crisis, there is little meaningful analysis of how the capital requirements will impact the mortgage and housing markets that the FHFA is statutorily bound to promote. This lack of analysis renders the Proposal flawed in several critical ways.

First, the lack of any meaningful analysis regarding the impact of the Proposal on the housing market undermines the ability of the public to provide meaningful comment on the Proposal. Meaningful public comment is the linchpin of administrative rulemaking. Opening up proposed rules for public comment ensures that stakeholders are able to challenge and critique the assumptions and analyses made by agencies in promulgating a rule or policy from a variety of perspectives, ensuring that the agency considers the impact of its proposed actions from all angles.[16] However, commenters can only meaningfully critique an agency's analysis underlying a proposal to the extent the agency actually makes that analysis known. Here, without any analysis explaining how the Proposal might promote (or undermine) the GSEs' statutory mission of promoting and supporting the housing market, commenters are deprived of a meaningful opportunity to comment on a critical aspect of the Proposal. With FHFA having failed to provide commenters with a reasonable baseline for analyzing the likely impact of the Proposal, the result will almost certainly be a less effective rule.

Second, the lack of meaningful analysis about how the Proposal furthers the GSEs' statutory mission of supporting the housing market indicates that FHFA has failed to give this important issue the attention it deserved as it formulated the Proposal. This is, obviously, unacceptable policymaking—FHFA cannot expect to get the capital requirements right if it has failed entirely to analyze how those requirements affect its statutory mission. And beyond being flawed policymaking, this approach conflicts with one of the most fundamental principles governing the rulemaking process: It is black letter administrative law that an agency acts in an

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15 Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1525 (2011) ("Congress made a conscious policy choice to take on more governmental risk in order to promote broader home ownership. Congress was telling Fannie Mae and Freddie Mac to take risks, to spend more capital to help originate still more mortgages, and to promote homeownership and home borrowing. Thus, the capital reserve cushion for the GSEs remained 2.5% of the value of securitized loans, and by 2008 it was clear that this amount was woefully inadequate.")

16 *See Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 35 (D.C. Cir. 1977).

arbitrary and capricious manner when it has "entirely failed to consider an important aspect of the problem."[17]

Third, FHFA's failure to analyze how the Proposal would further the goal of supporting the housing market necessarily means it has also effectively failed to adequately consider how the Proposal furthers the goal of promoting the safety, soundness, and stability of the financial system. The very reason for the existence of the GSEs is the importance of a stable and fair housing market to both everyday Americans looking to achieve the American dream and to the economy as a whole.[18] Without understanding how the proposed capital requirements will impact the very markets that the GSEs are intended to promote, and in which they are the dominant players, it is impossible to say that the proposed capital requirements actually will support, rather than undermine, the safety and soundness of the GSEs themselves and of the economy and financial system.

Put differently, we may know, from the analysis provided, that the first order effects of the capital requirements would be to increase the amount of capital held by the GSEs, and there may be a reasonable basis for determining that those capital levels would be sufficient to improve the stability of the GSEs and to absorb losses similar to what the GSEs experienced during the financial crisis.[19] But without any analysis of the impact of those capital requirements on the housing market, we simply cannot say whether (1) the capital requirements will allow the GSEs to fuel a housing bubble, similar to what we experienced in the runup to the 2008 financial crisis, (2) the capital requirements will depress the housing market, in a way that will have an unnecessarily negative impact on economic growth, or (3) the capital requirements will promote a stable and fair housing market, which will in turn support stable economic growth. And without any reasonable basis for knowing which of those impacts on housing are most likely, there is no reasonable basis for concluding that the Proposal would promote the other goal of stability and safety and soundness.[20] In short, the GSEs' mission are closely connected and interdependent, and by failing adequately to account for one—housing—the FHFA has also failed adequately to account for the other—stability.

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17 *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, (1983).

18 *See* W. SCOTT FRAME, ET AL., THE RESCUE OF FANNIE MAE AND FREDDIE MAC 1 (Federal Reserve Bank of New York Staff Report No. 719) (Mar. 2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

19 Release at 39,278-84.

20 Release at 39,275.

II. THE FHFA MUST PROVIDE A MORE CREDIBLE BASIS FOR USING BANK CAPITAL REQUIREMENTS AS THE BLUEPRINT FOR THE PROPOSED GSE CAPITAL REQUIREMENTS

Another major area of concern with the Proposal is that it is, by design, modeled on the bank capital regime.[21] This decision has some superficial appeal—as a result of the Dodd-Frank Act reforms to the bank capital regime, banks are safer, with more capital, than they have ever been. At the same time, as explained above, banks were seeing record profitability, and lending had steadily increased, prior to the COVID-induced economic downturn.[22] Moreover, the current economic downturn has put the bank capital regime to the test, and as of yet the system has fared relatively well. Despite the steep decline in economic activity, and sharp rise in unemployment, the banking system has remained stable, and the downturn has not become a financial crisis.[23]

However, while FHFA certainly should try to emulate (or improve upon) this apparent success story when setting capital requirements for the GSEs, it is far from clear that the specific bank capital requirements would be appropriate if applied to the GSEs. GSEs and banks are vastly different businesses. The GSEs are monoline businesses, engaged exclusively in buying, packaging, and selling mortgages. Banks do this, but also engage in a wide variety of other activities. This may make the GSEs more risky than banks—because the GSEs are not diversified—or it may make them less risky than banks, because mortgages are a comparatively safe and familiar asset class. Moreover, banks are largely funded through deposits, funds that can be withdrawn at any time and which would, accordingly, be subject to runs absent deposit insurance. Again, this may make banks riskier than the GSEs—because of the inherent and persistent maturity mismatch in being funded by demand deposits—or it may make them less risky—because of the existence of FDIC deposit insurance that effectively prevents runs. But in any event, whether GSEs are more or less risky than banks, they simply do not have the same risk profile, and so it is unclear whether the capital regime for banks, as well as it appears to have worked, can be appropriately superimposed on the GSEs.

Moreover, FHFA's proposal to apply the bank capital regime to the GSEs is based on the premise that the GSEs should essentially be subject to the same conditions as banks so they compete on the same grounds.[24] However, this premise is fundamentally flawed for a number of

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21 Release at 39,275.

22 BETTER MARKETS, SPECIAL REPORT, TEN YEARS OF DODD-FRANK AND FINANCIAL REFORM; OBAMA'S SUCCESSES, TRUMP'S ROLLBACKS, AND FUTURE CHALLENGES 46-47 (July 21, 2020), https://bettermarkets.com/sites/default/files/images/BetterMarkets_DoddFrankReport.pdf.

23 *See* DENNIS KELLEHER & TIM CLARK, BETTER MARKETS, NO FINANCIAL CRASH YET THANKS TO DODD-FRANK AND BANKING REFORMS (July 7, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_White_Paper_Dodd-Frank_Banking_Reforms%20%289%29.pdf.

24 LAURIE GOODMAN, JIM PARROTT & MARK ZANDI, THE TRUMP ADMINISTRATION'S PERPLEXING PLANS FOR FANNIE AND FREDDIE 2 (Oct. 2019) ("Treasury focuses instead on reducing the GSEs'

reasons. First, as noted above, the GSEs simply are not banks.[25] If GSEs are less risky than banks, they should not necessarily be subject to the same regulatory constraints as banks, including the same capital requirements, simply to preserve an abstract form of competitive parity, despite the fact that GSEs and banks are not equivalent types of financial institutions.

Second, in establishing the GSEs, Congress apparently made a judgment that other entities, including banks, were not adequately promoting housing. That judgment appears to have been vindicated by experience—for decades the GSEs helped maintain a stable and liquid housing market and an increase in home ownership through responsible lending.[26] The irresponsible mortgages that fueled the financial crisis were not promoted by the GSEs, although the GSEs, as noted above, invested in these toxic securities to keep up with the market.[27] Using bank-like capital requirements to place the GSEs on the same footing as banks may cause the GSEs to lose market share to banks and other participants in the mortgage market. That in turn may result in a mortgage market that is less liquid, more risky, less able to provide fair and equitable mortgages to creditworthy borrowers, and more predatory. FHFA must grapple with this possibility before it can reasonably impose bank-like capital requirements on the GSEs.

CONCLUSION

We hope these comments are helpful.

Sincerely,

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dominance by exposing them to competition from outside the government-backed channel, from banks and the private-label securities market."), https://www.urban.org/sites/default/files/publication/101282/the_trump_administrations_perplexing_plans_for_fannie_and_freddie_0.pdf.

25 LAURIE GOODMAN, JIM PARROTT & MARK ZANDI, THE TRUMP ADMINISTRATION'S PERPLEXING PLANS FOR FANNIE AND FREDDIE 2 (Oct. 2019) https://www.urban.org/sites/default/files/publication/101282/the_trump_administrations_perplexing_plans_for_fannie_and_freddie_0.pdf.

26 Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1509 (2011) (explaining that the GSEs spent "four decades of providing safe, well-underwritten loans for single family and multifamily housing").

27 Christopher L. Peterson, *Fannie Mae, Freddie Mac, and the Home Mortgage Foreclosure Crisis*, 10 LOY. J. PUB. INT. L. 149, 162-64 (2009).

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