

March 2, 2021

Federal Housing Finance Agency  
400 7th Street, SW  
Washington DC 20024

Re: Public Comment Letter for Proposed Rule on Resolution Planning RIN-2590-AB13; 12 CFR Part 1242

The Federal Housing Finance Agency (FHFA) has proposed a rulemaking (RIN-2590-AB13) that would require Fannie Mae and Freddie Mac (the Enterprises) to develop plans to facilitate their rapid and orderly resolution in the event that the FHFA is appointed receiver. This letter supports the rulemaking as a necessary component of the FHFA's statutory obligations, particularly those under the Housing and Economic Recovery Act (HERA).<sup>1</sup>

The HERA placed regulatory control of the Enterprises under the power of the FHFA, an agency with the newly created power to liquidate the Enterprises through a receivership process. This receivership process is intended to dispose of the Enterprises' assets, whereas the conservatorship process created under the HERA is designed to preserve their assets.<sup>2</sup> In the case of receivership, the HERA states that the FHFA shall:

place the Enterprises in liquidation and proceed to realize upon the assets of the regulated entity in such manner as the Agency deems appropriate, including through the sale of assets, the transfer of assets to a limited-life regulated entity established under subsection (i), or the exercise of any other rights or privileges granted to the Agency under this paragraph."<sup>3</sup>

Once the Enterprises enter receivership, the FHFA Director may begin the liquidation process, including the transfer of Enterprise assets and liabilities into newly chartered limited-life regulated entities (LLREs)<sup>4</sup>, with a board of directors appointed entirely by the FHFA. Moreover, the LLRE's board is required to adopt bylaws approved by the FHFA.<sup>5</sup>

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<sup>1</sup> Housing and Economic Recovery Act of 2008, <https://www.govinfo.gov/content/pkg/PLAW-110publ289/pdf/PLAW-110publ289.pdf>, (accessed March 2, 2021).

<sup>2</sup> Conservatorship is a temporary mechanism to conserve the assets of a regulated entity and help place that entity on a sound financial footing in lieu of liquidating the firm via receivership. The HERA makes this distinction by requiring that "The appointment of the Agency as receiver of a regulated entity under this section shall immediately terminate any conservatorship established for the regulated entity under this chapter." 12 U.S. Code §4617(a)(4)(D). Statements by the Treasury Secretary upon enactment of the conservatorship reflect recognition of this distinction. See, for example, U.S. Department of the Treasury, "Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers," September 7, 2008, <https://www.treasury.gov/press-center/press-releases/pages/hp1129.aspx> (accessed March 2, 2021).

<sup>3</sup> 12 U.S. Code § 4617(b)(2)(E).

<sup>4</sup> 12 U.S. Code § 4617(b)(2)(E).

<sup>5</sup> 12 U.S. Code §4617(i)(2)(D).

An Enterprise charter is immediately transferred to the LLRE upon the LLRE's creation,<sup>6</sup> and each LLRE assumes the powers and attributes of the Enterprise being liquidated during its temporary period of operation. The remaining assets and liabilities of the Enterprises can be transferred to the respective LLREs in one or more transfers<sup>7</sup> which need no "further approval under Federal or State law."<sup>8</sup> The FHFA has just two years to wind up all the affairs of the LLRE, unless granted an extension by the Director. The Director may grant three additional one-year periods, so the maximum wind-up time is five years.<sup>9</sup>

Separately, the law specifies an expedited period for complete wind-up, depending on how quickly the FHFA sells at least 80 percent of the LLRE's capital stock to third parties. Once the sales meet this threshold, the LLRE terminates automatically.<sup>10</sup> The FHFA must then divest any remaining capital stock of the former LLRE within one year unless the Director extends the deadline.<sup>11</sup>

The receivership process is intricately tied to the Enterprises' capital framework. As the FHFA noted in 2008:

The capital requirements and classification process articulated in statute are established as part of a prompt corrective action framework that requires supervisory actions to be taken promptly and in a graduated manner that culminates, in the most serious cases, in the appointment of a conservator or receiver. While in conservatorship status, the Enterprises will not be subject to other prompt corrective action requirements."<sup>12</sup>

As with any company, the Enterprises' capital acts as a cushion against insolvency and helps to absorb losses. The law imposes two capital requirements on the Enterprises. The first is a risk-based *total* capital requirement set by the FHFA Director<sup>13</sup> and designed to keep the Enterprises solvent through a "stress period."<sup>14</sup> The second is a *core* capital requirement determined according to a statutory formula.<sup>15</sup> The FHFA waived capital classifications and capital requirements for the duration of the conservatorships, but these will be reinstated upon release.<sup>16</sup>

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<sup>6</sup>12 U.S. Code § 4617(i)(2)(A).

<sup>7</sup>12 U.S. Code § 4617(i)(7)(A)(ii) and 12 USC § 4617(i)(1)(A).

<sup>8</sup>12 U.S. Code § 4617(i)(7)(A)(iii).

<sup>9</sup>12 U.S. Code § 4617(i)(6)(A) and (B).

<sup>10</sup>12 U.S. Code § 4617(i)(6)(C)(i).

<sup>11</sup>The Director can extend this deadline for up to two years. 12 U.S. Code § 4617(i)(6)(C)(ii).

<sup>12</sup>The FHFA, "FHFA Announces Suspension of Capital Classifications During Conservatorship," News Release, October 9, 2008, <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Suspension-of-Capital-Classifications-During-Conservatorship-and-Discloses-Minimum-and-RiskBased-Cap.aspx> (March 2, 2021).

<sup>13</sup>12 U.S. Code § 4611(a)(1).

<sup>14</sup>12 CFR § 1750.13. The regulation defines the "stress period" as "a hypothetical ten-year period immediately following the day for which capital is being measured, which is a period marked by the severely adverse economic circumstances defined in 12 CFR 1750.13 and appendix A to this subpart."

<sup>15</sup>12 U.S. Code § 2279bb(2).

<sup>16</sup>In October 2008, the FHFA announced a suspension of capital classifications and binding capital requirements for the duration of the conservatorship. News release, "FHFA Announces Suspension of Capital Classifications During Conservatorship," Federal Housing Finance Agency, October 9, 2008, <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Suspension-of-Capital-Classifications-During->

Based on the success in meeting these two capital requirements, the FHFA Director classifies each Enterprise into one of the following four categories: (1) adequately capitalized, (2) undercapitalized, (3) significantly undercapitalized, or (4) critically undercapitalized.<sup>17</sup>

The authority of the FHFA Director to intervene in Enterprise operations widens as capital classification levels deteriorate, culminating with the discretionary power to place the Enterprises into receivership and liquidate their assets if they are classified as critically undercapitalized.<sup>18</sup>

The HERA states that the FHFA director shall classify the Enterprises as critically undercapitalized if they (1) fail to maintain an amount of total capital that is equal to or exceeds the risk-based capital level established by the FHFA, and (2) fail to maintain an amount of core capital that is equal to or exceeds its critical capital level.<sup>19</sup> Thus, explicit and transparent agency rules and regulations for resolution planning are a necessary component of a complete capital framework for the Enterprises.

Finally, it is critical that the FHFA’s resolution planning does *not* include the support currently provided to the Enterprises by their Preferred Stock Purchase Agreements (PSPAs). Including such support would be inconsistent with planning for a rapid and orderly resolution of the Enterprises by its receiver. The following passage in the FHFA’s proposal signifies the (proper) recognition of this approach:

Importantly, each Enterprise would be prohibited from assuming that any extraordinary support from the United States government would be continued or provided to the Enterprise to prevent either its becoming in danger of default or in default, including support obtained or negotiated on behalf of the Enterprise by FHFA in its capacity as regulator, conservator, or receiver of the Enterprise through the PSPAs with the Treasury Department. Likewise, each Enterprise’s resolution plan would be required to reflect statutory provisions that the Enterprise’s “obligations and securities, together with interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or any agency or instrumentality thereof other than [the Enterprise].”<sup>20</sup>

Thank you for the opportunity to provide comments on the proposed rules. The views I express in this letter are my own; they should not be construed as representing any official position of The Heritage Foundation.

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[Conservatorship-and-Discloses-Minimum-and-RiskBased-Cap.aspx](#) (accessed September 16, 2019). Also see Federal Housing Finance Agency, “Enterprise Regulatory Capital Framework,” RIN 2590–AA95, Final Rule, Federal Register, Vol. 85, No. 243, Thursday, December 17, 2020, <https://www.govinfo.gov/content/pkg/FR-2020-12-17/pdf/2020-25814.pdf> (accessed March 2, 2021).

<sup>17</sup>The capital levels and capital classifications can be found at 12 U.S. Code § 4612–§ 4614.

<sup>18</sup>12 U.S. Code § 4617(a)(3)(K).

<sup>19</sup>12 U.S. Code § 4614(a)(4). The *critical capital* level is essentially a statutory formula that is the sum of 1.25 percent of total on-balance sheet assets, 0.25 percent of the unpaid principal balance of outstanding mortgage-backed securities (and their equivalent) that are off-balance sheet, and 0.25 percent of other off-balance sheet obligations, although the FHFA director can adjust this last percentage. See 12 U.S. Code § 4613(a).

<sup>20</sup>Federal Housing Finance Agency, “Resolution Planning,” Proposed Rules, Federal Register / Vol. 86, No. 5 / Friday, January 8, 2021, P. 1334, <https://www.govinfo.gov/content/pkg/FR-2021-01-08/pdf/2020-28812.pdf> (accessed March 2, 2021).

Sincerely,

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