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Alfred M. Pollard,
General Counsel,
Federal Housing Finance Agency,
Eighth Floor, 400 Seventh Street SW,
Washington, DC 20219

RE: Enterprise Liquidity Requirements RIN 2590–AB09

Dear Sir and Madam:

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA) proposed rule that would implement four liquidity and funding requirements for Fannie Mae and Freddie Mac (the Enterprises). The proposal would establish four quantitative liquidity requirements collectively intended to increase the Enterprises' ability to withstand a liquidity stress over the short, intermediate and longer terms. The proposal is based on the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), quantitative liquidity ratios which apply to the largest banks.[2]

ABA generally supports a robust capital and liquidity regime for the Enterprises, and applauds FHFA's efforts to advance an orderly process of ending conservatorships. As a threshold matter, however, it is difficult to comment on the proposal and its underlying assumptions without a full understanding of the precise form the GSEs will take going forward, and what segments of the market they will serve. These will be critical factors in assessing both the Enterprises' liquidity risk and needs during a stress and the competitive affects such a guarantee would have on other participants. Accordingly, we urge the FHFA to provide greater detail on this and other fundamental factors essential to evaluating the merits of the proposed standards.

We recognize that this is a complex undertaking with multiple stakeholders. However, if FHFA moves forward with the proposal, it must ensure that the rules neither create an unlevel playing field for banking organizations that provide the same services and products nor disrupt the mortgage, Treasury or short-term funding markets. Once the FHFA considers comments -- and additional information and analysis with respect to the liquidity standards' underlying

[1] The American Bankers Association is the voice of the nation's $21.9 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $17 trillion in deposits and extend nearly $11 trillion in loans.
[2] 12 CFR part 50 (OCC) 12 CFR part 249 (Board) 12 CFR part 329 (FDIC)

assumptions are provided– we urge the agency to seek additional public comment. Subsequently, we urge the FHFA to allow the markets sufficient transition time and regularly review the standards to ensure they are not causing market distortions or other unintended consequences, revising them as needed.

With respect to the FHFA's recent capital and resolutions' proposals, effective reform will trigger the need for new proposals that consider both the enhanced regulatory framework and the shape of the entities to which it will be applied. Only when there is a clearer understanding of the segments of the market that the GSEs are expected to serve will it be possible to understand whether all of these rules are the right ones for the mission. Accordingly, we urge the FHFA to issue an updated set of proposals for public comment, to ensure they are appropriate and do not create unintended consequences.

Ensure a Level Playing Field

As critical participants in the mortgage market, the banking industry has a vital interest in the effective functioning of primary and secondary mortgage markets, as well as in the stability of the broader financial system. As a general matter, ABA believes that all financial services firms, including the Enterprises, should be subject to as robust of a regulatory and supervisory framework as that which covers banking organizations. This would mitigate both regulatory arbitrage and systemic risk, helping to ensure activities important to market functioning may continue through periods of stress.

Moreover, given the unique role the Enterprises will likely continue to play in the mortgage markets, additional supervisory and regulatory mechanisms may be needed to ensure the Enterprises effectively limit and manage their risks – and that private market entities, including banks, are not forced to competing on an uneven playing field.

To Mitigate the Introduction of New Systemic and Market Risks, the Liquidity Ratios Need to be Properly Calibrated

The events of 2008 underscored the importance of robust liquidity risk measurement, monitoring, and management in making both financial institutions and the broader financial system more resilient. Banks responded to the crisis by shoring up their own liquidity, while banking regulators created the LCR and NSFR to ensure banks maintained liquidity buffers above a certain level. While the liquidity standards have increased the amount of liquidity banks hold in reserve to withstand a stress, they have also had unintended consequences, including discouraging certain necessary products and services, and contributing to significant volatility in the short-term funding markets. This is largely due their narrow view of liquidity and their mis-calibration of banks' liquidity risk.

Since the liquidity coverage ratio, and other post crisis rules, were implemented, there have been multiple disruptions to the Treasury and short-term markets. Cleary these are complex global markets with many factors driving market conditions. Equally as clear is that liquidity regulations that require a large stockpile of High Quality Liquid Assets (HQLA), comprised predominantly of cash and treasuries, makes bank balance sheets unnecessarily rigid and contributes to distortions in the short-term funding and treasury markets, as the demand for these assets outstrips supply. This was most recently witnessed in March 2020, when, as described by the SEC, "the uncertainty and market volatility from the COVID-19 economic shock caused a sharp, unexpected increase in demand for cash and short-dated, near-cash investments and disrupted the short-term funding markets. This disruption resulted in significantly constrained liquidity, higher funding costs, increased bid-ask spreads, and increased margin requirements and collateral haircuts.[3]"

Currently, the Enterprises play a central and unique role in mortgage and financial markets, where securities issued by the Enterprise are widely viewed as "highly liquid." In order to avoid negative feedback loops and other unintended consequences, we urge the FHFA to allow the market sufficient time to adjust their portfolios. For example, many banking organizations hold Enterprise securities for liquidity and regulatory purposes. An abrupt transition would likely impact banking organization compliance with liquidity regulations including the LCR and NSFR, and adversely impact the liquidity buffers all banks must hold for liquidity management purposes.

In order to prevent market disruptions, we recommend the following:

- **Take a broad view of contingent liquidity.** Demand for cash and Treasuries tends to dramatically increase during times of stress. Regulatory requirements -- across a plethora of firms -- that rely on Treasuries as collateral and a liquidity backstop exacerbate market stress.

- **Ensure the Enterprises' liquidity standards are calibrated correctly.** It is important that the stress scenarios against which the liquidity buffers are calibrated, are realistic and do not require a disproportionate amount of HQLA or impose an unnecessary cost on needed products and activities. Incorrectly calibrated liquidity standards misaligns risk and risk mitigation, leading to trapped liquidity and a disincentive to offer key products and services.

Other Considerations

Additionally, we note the systemic risks posed by nonbank servicers, which came under significant stress at the onset of the pandemic. As lockdowns across the US lead to job losses, a significant number of Americans became unable to make scheduled mortgage payments. This prompted an unprecedented need for borrower forbearance, straining nonbank servicers' liquidity reserves, which were inadequate to handle the stress. As the FHFA is likely aware, the nonbanks servicers have fewer funding options, and limited liquidity risk management expectations compared to banks and other financial institutions. Although the economic conditions resulting from COVID-19 may be improving, and the potential disaster related to margin calls was narrowly averted, this sector will continue to be vulnerable to widespread increases in delinquency or payment forbearance needs brought on by unforeseen contingencies, including economic shocks.

We remind the FHFA that the continued growth of non-bank servicers, without commiserate safety and soundness requirements poses additional liquidity risk to the GSEs as they would need

[3] SEC report on U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock. October 2020.

to step in if there was a major failure. We encourage the FHFA to consult with other market participant regard how to best mitigate the liquidity and other risks nonbank services pose.

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We appreciate and strongly support the FHFA's initiative to ensure that the Enterprises have enough liquid assets to continue supporting the mortgage market during times of severe stress. Thank you for considering the comments and recommendations set forth in this letter. If you have any questions or need further information, please do not hesitate to contact the undersigned at atouhey@aba.com or Joe Pigg, SVP, Mortgage Finance, Fair & Responsible Banking, Jpigg@aba.com.

Sincerely,

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