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March 8, 2021

Mr. Clinton Jones
General Counsel
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, SW
Washington, DC 20219

Re: Comments on Enterprise Liquidity Requirements, RIN 2500-AB09

Dear Mr. Jones:

The Housing Policy Council ("HPC")[1] appreciates the opportunity to comment on the Enterprise Liquidity Requirements proposed by the Federal Housing Finance Agency ("FHFA").[2]

As noted in the preamble to the proposed rule, liquidity risk management is an essential part of the regulatory safety and soundness framework for all financial institutions, including the Enterprises.[3] We support FHFA's efforts to address the need for minimum regulatory liquidity standards and believe that the proposed rule is an appropriate step in that direction. Importantly, the proposed rule would impose quantitative requirements on Fannie Mae and Freddie Mac (the "Enterprises") to maintain sufficient liquidity even in a market panic.

While HPC supports the proposed rule, there are some areas in which we believe FHFA should consider modifications or clarifications. For example, FHFA should modify the stressed cash flow scenario and the fixed $10 billion daily excess liquidity requirement. Finally, HPC also believes that the proposed rule highlights the need for Congress to definitively address the future of the Enterprises.

HPC supports the proposed rule. The standards are appropriately aligned with the duration of liquidity risk, will help to maintain the safe and sound operations of the Enterprises, and will mitigate the systemic risk they pose to the financial system.

The proposed rule appropriately recognizes the duration of liquidity risk by imposing near, intermediate, and longer-term liquidity requirements on the Enterprises. Specifically,

[1] HPC is a trade association comprised of the nation's leading mortgage lenders, servicers, mortgage insurers, and title and data companies. HPC advocates for the mortgage and housing finance interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable home ownership opportunities that lead to long-term wealth-building and community-building for families.
[2] 86 Fed. Reg. 1306 (January 8, 2021).
[3] Id, at 1307.

FHFA is proposing that the Enterprises meet: (1) A short-term liquidity requirement based upon cash outflows under stressed conditions over a 30-day period; (2) An intermediate liquidity requirement based upon cash outflows under stressed conditions over a 365-day period; (3) A simple long-term liquidity and funding requirement based on the amount of an Enterprise's long-term unsecured debt divided by the amount of its less-liquid assets; and (4) A model-based long-term liquidity and funding requirement based on an Enterprise's spread duration of its unsecured debt divided by the spread duration of its retained portfolio assets. This approach is consistent with the approach applied by federal banking regulators to the nation's largest banking organizations.

The proposed rule, in combination with FHFA's recently finalized capital rule, is consistent with the obligation of each Enterprise to operate in a safe and sound manner, especially after conservatorship.[4] Managing liquidity risk is vital to the prudent financial operation of the Enterprises.[5] As FHFA has acknowledged, insufficient liquidity was a significant contributing factor to the establishment of the conservatorships of the Enterprises in 2008.[6]

The proposed rule also will help to reduce the systemic risk posed by the Enterprises. One of the goals of conservatorship has been to mitigate the systemic risk of the Enterprises, which arises from the concentration of market functions performed by the two entities.[7] Yet, as HPC stated in its November 2018 comment letter on FHFA proposed capital requirements for the Enterprises: "… the level of systemic risk posed by the Enterprises is greater today than it was at the start of the conservatorship because of the overall growth in their size, the scope of their activities, and their role as quasi-regulators of other participants in the housing finance market."[8] The stress testing features embedded in the proposed rule, and the ability of FHFA to require liquidity beyond the minimum requirements in the proposed rule, will help to mitigate this systemic risk.

FHFA should revise the proposed cash inflow assumptions based upon the failure of nonbank seller servicers and the proposed $10 billion excess liquidity requirement.

FHFA is proposing that, when calculating cash inflows for purposes of the liquidity requirements, an Enterprise must assume the failure of its top-five largest non-bank servicers.[9]

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[4] §1241.1(a) of the proposed rule states that the purpose of the rule is to ensure the safety and soundness of the Enterprises. The preamble to FHFA's resolution planning rule, which was released on the same day as the liquidity rule, also notes that the resolution planning rule, the capital rule, the liquidity rule, stress testing requirements, as well as enhanced oversight, are all part of the agency's on-going effort to develop a robust prudential regulatory framework for the Enterprises that will be critical to FHFA supervision of the Enterprises after they exit the conservatorships. See 86 Fed. Reg. 1326 (January 8, 2021.)

[5] "Liquidity is the lifeblood of any institution, but it is particularly crucial to highly leveraged entities…" Comptroller's Safety and Soundness Handbook: Liquidity, Office of the Comptroller of the Currency, Version 1.0, 2012, p.4.

[6] 86 Fed. Reg. 1307 (January 8, 2021).

[7] "The goals of conservatorship are to restore confidence in the Enterprises, enhance the Enterprises' abilities to fulfill their missions, and mitigate the systemic risk that contributed directly to the instability during the financial crisis." 83 Fed. Reg. 33318, July 17, 2018.

[8] Letter to Alfred Pollard, General Counsel, Federal Housing Finance Agency, from Edward DeMarco, President, HPC, November 16, 2018. FHFA's 2019 Strategic Plan for the Conservatorships of the Enterprises similarly stated that "The Enterprises have only grown more dominant in our housing finance system since entering conservatorships."

[9] §1241.10(d)(7).

While a simple metric for modeling, it is also too simplistic and may well mis-calibrate the GSEs' actual liquidity risk from the failure of one or more of their mortgage servicing counterparties. Never mind that the five largest nonbank servicers may well be among the less risky non-bank servicing counterparties facing the GSEs. Just because the top five's market share could vary widely over time even if the market share of all non-bank servicers were stable, this approach may leave the GSEs with either an excessive or inadequate assumption about cash flows in the model.

HPC recommends that FHFA adopt a simpler and more stable modeling assumption. We suggest two possible approaches. One, FHFA could simply assume that [x percent] of nonbank servicing fails, resulting in a lack of cash inflows from such servicers that the GSEs would have to cover. Two, FHFA could create two or three simple risk buckets for all GSE servicers (bank and non-bank) and apply different failure assumptions to each bucket, based on each bucket's relative risk.[10] Added up, it would provide a market-wide risk calculation about missed cash flows for liquidity stress modeling purposes.

FHFA also proposes a $10 billion daily excess liquidity requirement as a supplement to the short-term requirement to address the possibility of errors and other unforeseen operational errors.[11] Again, we invite FHFA to reconsider this requirement. It is unclear what the $10 billion threshold is based upon and hardwiring such an adjustment in the rule could prove problematic over time. Alternative approaches could help FHFA achieve its intended goal of having some added buffer. For example, if $10 billion is meant to reflect some percentage of the 30-day requirement, the added amount could be expressed as a simple percentage add-on, rounded to the nearest billion dollars. Or, in the rule, FHFA could stipulate that it will review and adjust this add-on annually, based on market experience, supervisory reviews, inflation, and changes in the nominal size of the servicing portfolios. We are concerned that a "hard-wired" amount is arbitrary and may have less relation to actual liquidity risk over time.

FHFA Should Clarify the $250 Billion Requirement for Deposits.

The proposed rule includes as liquid assets up to $10 billion of cash held in overnight bank deposits, provided the bank has at least $250 billion in assets. However, the proposed rule also states that the bank must be subject to quarterly reporting requirement FR Y-15. However, the FR Y-15 is a holding company report, not a report filed by the depository institution. As a result, it is not clear if the $250 billion in assets is applied at the holding company level or at the bank level. We suggest that the appropriate standard is at the holding company level and ask that the final rule clarify this issue.

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[10] For example, bank and nonbank servicers are subject to different resolution procedures and banks have access to certain liquidity backstops unavailable to non-banks, which suggest relative differences in risk to the GSEs.
[11] §1241.11(a)(2)(ii).

The proposed rule highlights the need for Congress to definitively address the future of the Enterprises.

The proposed liquidity rule is just one of several initiatives FHFA has taken to position the Enterprises for eventual exit from conservatorship. While each of these initiatives has merit, they collectively highlight the need for Congress to definitively address the future of the Enterprises. Absent Congressional action, the scope of federal support for the Enterprises will be uncertain, which could have a detrimental impact on housing finance if investors in Enterprise debt and mortgage securities pursue other investment options. Because the Enterprises are Congressionally chartered, only Congress can address this issue.

Conclusion

Thank you for your consideration of these recommendations. If you have any questions or would like to discuss these comments, please contact Meg Burns, EVP for the Housing Policy Council, at 202-589-1926.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
President
Housing Policy Council