Housing Finance and Regulatory Affairs
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March 8, 2021

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
8th Floor
400 7th Street, SW
Washington, DC 20219

**RE: Enterprise Liquidity Requirements (RIN 2590-AB09)
Notice of Proposed Rulemaking; Request for Comments**

Submitted by Electronic Delivery to: RegComments@fhfa.gov

Dear Mr. Pollard:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to provide comments in response to the Notice of Proposed Rulemaking ("proposed rule" or "NPR"); Request for Comments on Enterprise Liquidity Requirements. As the Federal Housing Finance Agency (FHFA) continues its efforts to provide prudential oversight of Fannie Mae and Freddie Mac (the Enterprises) and ensure their safety and soundness and wherewithal to support a robust mortgage market, NAHB welcomes this focus on liquidity. A well-designed liquidity framework should provide the market with confidence in the Enterprises' ability to fulfill their mission, provide countercyclical support to housing finance markets in times of stress and further minimize the likelihood they will need future taxpayer support.

NAHB is a Washington DC-based trade association representing more than 140,000 members involved in all aspects of the development and construction of for-sale single-family homes, including homes for first-time and low- to moderate-income home buyers, as well as the production and management of affordable rental housing. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on a sound and efficiently operating housing finance system.

Background

Liquidity is the availability of liquid assets that allow a company to meet its funding needs. Liquidity risk management at financial institutions has received increased attention since the crisis in the financial markets beginning in 2007 demonstrated a troubling lack of liquidity at many financial institutions. The Liquidity Coverage Ratio (LCR) for U.S. banks was introduced as a component of Basel III's post-crisis reform of banking supervision regulations to ensure sufficient liquidity by banks to respond to an economic crisis. The LCR mandates banks maintain high-quality liquid assets equal to projected cash outflows over a 30-calendar-day period. The net stable funding ratio, also introduced in Basel III, is a liquidity standard requiring banks to hold enough stable funding to cover the duration of their long-term assets.

At the same time banking regulators were considering enhanced liquidity standards for banks, FHFA was considering similar standards to address substantial weaknesses in the liquidity risk management and liquidity positions at Fannie Mae and Freddie Mac that were revealed during the mortgage and financial crisis. FHFA established minimum 30-day and 365-day liquidity requirements for the Enterprises in a supervisory letter to the Enterprises in December 2009.

In June 2020, FHFA imposed new, more conservative liquidity standards on Fannie Mae and Freddie Mac like those for banks with more than $250 billion in assets. The new requirements called for the Enterprises to hold more liquid assets than had been required under the previous requirements. At the time, both Enterprises said the new requirements could result in higher funding costs and negatively impact net interest income. The effective date for the new requirements was December 2020. According to a statement by Fannie Mae in its 2020 Year-End Results/Annual Report on Form 10-K, the current NPR is in line with the 2020 updated requirements and both Enterprises acknowledged in their year-end financial statements the negative impact to their company's net interest income, as predicted.

Proposed Rule

The proposed liquidity rule is a companion requirement to the Enterprises' recently finalized regulatory capital framework. Together, increased capital and prescribed management and availability of liquid assets are intended to better position the Enterprises to comply with their mission to provide countercyclical support to the secondary mortgage market during times of severe stress and protect taxpayers.

According to FHFA, the most significant proposed change to the Enterprises' liquidity management regimes would be the addition of certain assumptions involving cash inflows and outflows during stressed market conditions to determine the necessary portfolio of high-quality liquid assets. In effect, FHFA proposes to require that certain contingencies like additional cash outflows be prefunded and backed by an appropriately sized portfolio of U.S. Treasury securities and other high-quality liquid assets.

The proposed rule would establish four quantitative minimum liquidity requirements, require daily management reporting of the Enterprises' liquidity positions, monthly public disclosure reporting requirements, and other cash flow and liquidity-related requirements.

The four minimum liquidity requirements proposed are:

- Two cash-flow based requirements:
    - A short-term 30-day requirement that, similar to the banking framework's LCR rule, requires each Enterprise to meet expected cash outflows and continue to provide liquidity to the market over a 30-day period of stress, which includes a complete inability to issue debt, plus an additional $10 billion cushion requirement that must be met by highly liquid assets; and
    - An intermediate 365-day requirement extending the short-term cumulative cash outflow analysis to a full year. Over this intermediate term, the Enterprises may count borrowings against certain fixed income instruments the Fixed Income Clearing Corporation (FICC) deems eligible collateral (subject to a haircut) they cannot count under the 30-day requirement, i.e. mortgage-backed securities (MBS). There is no separate excess cushion required for this metric.

- Two long-term liquidity and funding requirements:
    - A ratio of long-term unsecured debt to less-liquid assets must be greater than 120 percent. Less-liquid assets are those that are not eligible to be pledged as collateral to the FICC. This requirement is designed to encourage an appropriate amount of long-term unsecured debt to support less-liquid retained portfolio assets so the Enterprises have the ability to hold such assets for at least a year without having to sell them into potentially distressed markets; and
    - The ratio of the spread duration of unsecured debt to the spread duration of retained portfolio assets must be greater than 60 percent. This requirement is designed to encourage the Enterprises to issue an appropriate amount of longer-term unsecured debt to support all retained portfolio assets, not just less-liquid assets.

The stressed cash flow assumptions included in the proposed rule take into account the potential impact of idiosyncratic and market-wide shocks, including those that would result in: (1) A complete loss of the Enterprise's ability to issue unsecured debt during the relevant period; (2) An increased cash outflow associated with additional daily single-family and multifamily cash window or whole loan conduit purchases to support the mortgage market; (3) A decreased cash inflow due to the assumed increase in the number of borrowers who fail to make their scheduled payments to their servicer; (4) An increased cash outflow requirement to fund delinquent loan buyouts; (5) An increased cash outflow based on the Enterprise's best estimate of the collateral needed to be posted to support FICC-related activities for the next month; (6) An increased cash outflow from unscheduled draws on committed liquidity facilities that the Enterprises have provided to their clients related to variable-rate demand bonds; and (7) A decreased cash inflow due to the assumed failure of the Enterprise's five top non-bank servicers by unpaid principal balance (UPB) to make timely payments to the Enterprises during the next month.

To determine decreased cash inflows and increased cash outflows due to higher numbers of delinquent borrowers and to higher loan buy-outs from MBS trusts, the proposed rule would require the Enterprises to formulate their projections assuming stressed conditions corresponding to the more severe of FHFA's Dodd-Frank Act Stress Test (DFAST) assumptions or other supervisory stress assumptions as ordered by FHFA.

FHFA would define high-quality liquid assets as (i) Cash held in a Federal Reserve Bank account; (ii) U.S. Treasury securities; (iii) Short-term secured loans through U.S. Treasury repurchase agreements that clear through the FICC or are offered by the Federal Reserve Bank of New York; and (iv) A limited amount of unsecured overnight deposits with eligible U.S. banks.

As a source of cash to meet the 365-day liquidity requirement, FHFA proposes to allow the Enterprises to augment the high-quality liquid asset portfolio discussed above with cash inflows from pledging FICC-eligible collateral using a repurchase agreement that clears through the FICC.

The proposed rule would exclude agency MBS issued by the Enterprises and repurchase agreements backed by agency MBS from high-quality liquid assets for the 30-day liquidity requirement for the Enterprises.

NAHB Comments

Adequate liquidity, like adequate capital, is critical to the safety and soundness of the Enterprises. The lack of sufficient liquidity and capital during the mortgage and financial crisis in 2008 led to the insolvency of both Enterprises and the resulting conservatorships. NAHB appreciates FHFA believes these concerns must be addressed through a strengthened regulatory regime, however, we caution against establishing overly aggressive requirements and causing the Enterprises to restrict mortgage purchases or raise interest rates and fees to borrowers. Establishing prudential regulations implies regulations that will allow the Enterprises to effectively balance their mission requirements to provide liquidity, stability and affordability to the housing market with FHFA's supervisory responsibility to ensure their safety and soundness and prevent another taxpayer bailout.

Impact on the Cost of Credit

NAHB is concerned that both Fannie Mae and Freddie Mac noted in their 2020 end-of-year financial statements that the liquidity framework imposed beginning in December 2020 (on which this current NPR is based) increased their net funding costs and decreased interest income. However, it is unclear to NAHB whether the requirements proposed in the NPR are identical to those imposed last year, without public notice, and effective in December 2020 or whether the NPR introduces new requirements. NAHB urges FHFA to analyze how this proposed rule may impact interest rates and/or fees charged to lenders and consequently impact mortgage affordability. If it is determined it will decrease mortgage purchases by the Enterprises or increase the cost of mortgage credit, NAHB urges FHFA to consider changes in a final rule that will ensure home buyers and home owners are not negatively affected.

NAHB urges the FHFA to consider the impact of tight regulations on the ability of the Enterprises to provide broad access to mortgage credit for all credit worthy home buyers. Instituting liquidity requirements that are unnecessarily restrictive will cause an increase in interest rates charged to borrowers and this has a very real impact on home buyers. NAHB estimates for 2020 show that 25 basis points added to the mortgage rate at a 30-year fixed rate of 3.75 percent would price out around 1.3 million households[1]. In addition, multifamily deals to construct or substantially rehabilitate affordable rental housing will not get done if the cost of financing is too expensive.

Treatment of Agency MBS

NAHB does not believe the proposed rule should entirely exclude agency MBS issued by the Enterprises and repurchase agreements backed by agency MBS from high-quality liquid assets for the 30-day liquidity requirement for the Enterprises. We understand FHFA believes the potential for "wrong-way risk" on agency MBS may cause securities collateralized by mortgage loans to trade at significant discounts during a housing-related crisis, however, that is not the same as being illiquid. The agency MBS market continued to trade in 2008 and continued to trade in 2020 when the COVID-19 pandemic caused market disruptions. We also ask FHFA to consider whether the proposed exclusion could impact the Enterprises' purchase of agency MBS and have a detrimental effect on the price of the securities. NAHB recommends a less severe treatment of agency MBS in the Enterprises' liquidity standards.

[1] Zhao, Na. February 2021 "NAHB Priced-Out Estimates for 2021" Special studies for housingeconomics.com

As we acknowledge agency MBS also are somewhat disadvantaged by banks when determining risk-based capital and LCR, NAHB could support FHFA's alignment of its treatment of agency MBS with banks' LCR requirement. We would recommend FHFA allow agency MBS, with a 15 percent haircut, to count toward high-quality liquid assets and the total of agency MBS and repurchase agreements backed by agency MBS limited to no more than 40 percent of the total high-quality liquid assets.

NAHB believes excluding repurchase agreements backed by agency MBS from high-quality liquid assets for the 30-day liquidity requirement also unnecessarily eliminates a valid source of liquidity for the Enterprises. The Enterprises' investment in agency MBS repurchase agreements benefits the mortgage market by contributing to the liquidity of the MBS market. As stated above, we do not agree that "wrong-way risk" would cause illiquidity or a level of risk that would outweigh the benefits to the MBS market such that it warrants prohibiting the use of the investments as high-quality liquid assets.

The agency MBS market has a large and diverse number of market participants, which contributes to the liquidity of the market. NAHB believes this significant participation further supports the recommendation that agency MBS issued by the Enterprises and repurchase agreements backed by agency MBS investments should be considered high-quality liquid assets for the 30-day liquidity requirement.

Flexibility

NAHB appreciates that FHFA has incorporated flexibility in the proposed 30-day minimum liquidity standards to allow temporary reductions in the Enterprises' required liquidity during extremely stressed economic or market conditions. During these periods, the Enterprises may be needed to provide extraordinary support to the secondary mortgage market. If the Enterprises were to incur penalties for falling below the minimum required liquidity, they would be effectively prohibited from providing the needed support to the market, in direct opposition to their mission. FHFA does not indicate a specific process or timeframe for authorizing a temporary reduction in the minimum liquidity requirement, which NAHB believes is appropriate. A situation calling for a temporary reduction would generally be assumed to require immediate and undisputed action.

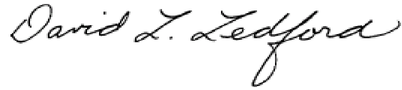
Conversely, FHFA may determine an Enterprise's liquidity and funding requirements should be temporarily increased due to economic, market, or Enterprise- specific circumstances. In this situation, FHFA would notify the Enterprise in writing of the proposed increase and provide the Enterprise with an opportunity to respond. An Enterprise would have 30 days to respond in writing to any or all of the matters addressed in the FHFA's notice. NAHB believes the process outlined by FHFA is appropriate. Increasing the liquidity requirements could have a significant impact on the Enterprises and the mortgage market. The Enterprises should have the ability and a sufficient timeframe to consider the consequences of increased requirements and raise any concerns with FHFA prior to a definitive decision by FHFA.

Conclusion

The Enterprises liquidity requirements should not negatively impact the Enterprises charter requirements to provide liquidity to the mortgage markets. To the extent the proposed requirements cause the Enterprises to raise rates and/or fees, curtail purchases of mortgage loans, or discourage purchase of agency MBS for their portfolios because they are not considered high-quality liquid assets, NAHB asserts the proposed liquidity requirements would be too conservative and urges to FHFA to develop a more balanced regulation.

Thank you for your consideration of NAHB's comments. For more information, please contact Rebecca Froass, Director of Financial Institutions and Capital Markets at rfroass@nahb.org.

Sincerely,



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