MORTGAGE BANKERS ASSOCIATION

March 9, 2021

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

**Re: Resolution Planning**

Dear Director Calabria:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to provide input on the Federal Housing Finance Agency (FHFA) notice of proposed rulemaking with respect to resolution planning for Fannie Mae and Freddie Mac (the Enterprises).[2] MBA recognizes the importance of ensuring that FHFA is well-equipped to address the potential insolvency of one or both Enterprises, while also acknowledging the existence of the Senior Preferred Stock Purchase Agreements (PSPAs) that make support available from the U.S. Treasury Department (Treasury) to the Enterprises. The establishment of resolution plans is a reasonable and prudent step to advance this objective.

Detailed and specific resolution plans should help FHFA undertake receivership activities in the most efficient manner in the event it ever were required to do so. Despite this expected benefit of the proposed rule, however, FHFA should acknowledge that it is highly unlikely that the development of resolution plans would prevent severe market disruption if one or both Enterprises were to be put into receivership. FHFA notes its desire to facilitate a "rapid and orderly" resolution of an Enterprise as needed. Resolution plans may help FHFA achieve a more efficient process of instituting receivership, but they are unlikely, on their own, to make such a

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 1,700 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] FHFA, "Resolution Planning," January 8, 2021, 86 FR 1326. Available at: https://www.federalregister.gov/documents/2021/01/08/2020-28812/resolution-planning.

receivership process "rapid and orderly" with respect to the broader impact on both the primary and secondary mortgage markets.

The inability of well-crafted resolution plans to avert market turmoil in the event of an insolvent Enterprise, however, is not a reason for FHFA to abandon this effort. FHFA instead should recognize this reality in its own preparations for a potential receivership of one or both Enterprises. More broadly, the expected market turmoil due to an insolvent Enterprise highlights the critical need for reforms – many of which are legislative in nature – that would reduce the likelihood of an Enterprise's insolvency or reduce the severity of any resulting market disruption. These reforms include those related to an improved safety-and-soundness framework, utility-style regulation, FHFA chartering authority for new guarantors, and an explicit federal guarantee on pass-through securities issued by the Enterprises.

***The Value – and Limits – of Resolution Planning***

The value of a defined process for Enterprise resolution planning has been articulated both by FHFA and Treasury. As FHFA observed, "The Treasury *Housing Reform Plan* noted the importance of developing a credible resolution framework for the Enterprises to protect taxpayers, enhance market discipline, and mitigate moral hazard and systemic risk."[3] FHFA further states that "…the goals of Enterprise resolution planning are to facilitate the continuation of Enterprise functions that are essential to maintaining stability in the housing market…and to allocate losses to creditors in the order of their priority."[4]

These objectives reflect the importance of the Enterprises to the functioning of the national housing finance system and the significant challenges that the failure of either Enterprise would pose. Concerns regarding potential instability stem from the Enterprises' roles as liquidity providers to large segments of the single-family and multifamily markets. In the single-family market, the Enterprises have represented 40-50 percent of the first-lien secondary market in recent years, with that share rising above 60 percent during the COVID-19 pandemic.[5] Similarly, in the multifamily market, the Enterprises account for approximately 45 percent of outstanding mortgage debt.[6]

[3] Id., 86 FR 1329.

[4] Ibid.

[5] Urban Institute Housing Finance Policy Center, "Housing Finance at a Glance: A Monthly Chartbook – February 2021." Available at: https://www.urban.org/sites/default/files/publication/103746/housing-finance-at-a-glance-a-monthly-chartbook-february-2021_0.pdf.

[6] Enterprise Quarterly and Annual Results. MBA Commercial/Multifamily Real Estate Finance Database. Available at: https://www.mba.org/news-research-and-resources/research-and-economics/commercial/-multifamily-research/commercial/multifamily-real-estate-finance-database.

While other capital and liquidity sources likely could fill voids created by some level of Enterprise pullback from the market (albeit with potentially adverse impacts on the cost of credit), a complete and sudden departure of one or both Enterprises from the market almost certainly would lead to a steep increase in the cost and reduction in the availability of mortgage credit, as well as severe stress in fixed-income and equity markets. The scale of these problems could result in sharp declines in economic output, employment, and financial stability.

Core Business Lines and the Rationale for Resolution Planning

Any steps that FHFA reasonably can take to promote market functioning in such a scenario, therefore, should be explored and pursued. A well-designed resolution framework would leave FHFA better prepared to ensure that the core business lines of the Enterprises remain in operation during receivership. Under statutory parameters for this process, FHFA would establish limited-life regulated entities (LLREs) that could purchase certain Enterprise assets and assume certain Enterprise liabilities, largely at the discretion of FHFA in its capacity as receiver. These LLREs would assume the Enterprises' charters, enabling them to operate the Enterprise business lines deemed to be "core."

Because the receivership process requires the establishment of an LLRE to carry out certain of the insolvent Enterprise's functions, perhaps the most important decisions to be made by FHFA as receiver entail the "informed division of assets and liabilities between the Enterprise receivership estate and a newly established LLRE."[7] The primary benefit of the advance preparation of resolution plans by the Enterprises, therefore, is the identification of core business lines that should be assumed by the LLRE to preserve a well-functioning market. FHFA appropriately emphasizes this feature of the proposed Enterprise resolution plans. Given the likely overlap with the concept of "core business lines," FHFA also appropriately declines to add superfluous defined terms, such as "critical operations" or "critical services," to the proposed rule. These additions only would complicate further an already complex set of resolution planning requirements.

The Need for an Iterative Process

As is envisioned in the proposed rule, the initial development of resolution plans will necessitate an iterative process to arrive at the lengthy, detailed documents that are required. FHFA's intention to evaluate the early submissions by the Enterprises through the lenses of completeness and thoughtful consideration is a reasonable standard, as there is little to be gained from overly harsh evaluations of a new process that is meant to be refined.

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[7] 86 FR 1330.

Required Assumptions within Resolution Plans

For purposes of resolution planning, FHFA is correct to require the assumption that the resolution process may occur in a severely adverse economic environment. As is noted above, it is difficult to foresee a scenario in which the resolution of either Enterprise as currently constituted could occur in anything other than a severely adverse economic environment.

FHFA should, however, clarify the other required assumption in the proposed rule, which prohibits the Enterprises 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."[8]

It is not clear from this requirement how FHFA is addressing the support provided to the Enterprises through the PSPAs. The PSPAs, while finite in magnitude, exist to help ensure the Enterprises maintain a positive net worth. The duration of the support provided by the PSPAs, as well as the broader duration of the conservatorships, is unclear at this juncture. The terms of the PSPAs cannot, however, be amended or waived to reduce the commitment amount or otherwise be revised in a manner that would adversely affect holders of Enterprise debt or beneficiaries of Enterprise mortgage-backed security obligations.[9]

While it therefore may be a useful discipline for FHFA to require the Enterprises to assume no support from the PSPAs in their resolution planning, FHFA should clarify that this rulemaking does not constitute any weakening – real or perceived – of the existing PSPAs. Without this clarification, investors may doubt the ongoing government support for the Enterprises and pull back from their participation in the secondary market.

[8] Id., 86 FR 1334.

[9] Senior Preferred Stock Purchase Agreements, Section 6.3: "*Amendments; Waivers.* This Agreement may be waived or amended solely by a writing executed by both of the parties hereto, and, with respect to amendments to or waivers of the provisions of Sections 5.3, 6.2 and 6.11, the Conservator; provided, however, that no such waiver or amendment shall decrease the aggregate Commitment or add conditions to funding the amounts required to be funded by Purchaser under the Commitment if such waiver or amendment would, in the reasonable opinion of Seller, adversely affect in any material respect the holders of debt securities of Seller and/or the beneficiaries of Mortgage Guarantee Obligations, in each case in their capacities as such, after taking into account any alternative arrangements that may be implemented concurrently with such waiver or amendment. In no event shall any rights granted hereunder prevent the parties hereto from waiving or amending in any manner whatsoever the covenants of Seller hereunder."

<u>The Limits of Resolution Plans in Averting Market Stress</u>

The likely market stress that would accompany the receivership of one or both Enterprises should inform the content of the resolution plans, including the identification of core business lines. The Enterprises, while critical to smooth market functioning at all times, are particularly necessary during periods of volatility. Market participants rely on the Enterprises to play a countercyclical role and provide liquidity when other sources may retreat. To this end, the Enterprise resolution plans should, to the extent possible, prepare one or more LLREs to perform functions for which there is likely to be an acute, short-term market need.

No amount of proper resolution planning, however, is likely to prevent market turmoil resulting from the failure of one or both Enterprises. Well-designed resolution plans may better enable FHFA to achieve its goal of facilitating a more efficient resolution, which may reduce the duration or severity of the associated market turmoil, but a rapid and orderly resolution is an unrealistic goal. As such, FHFA should amend the objectives of the proposed rule to reflect this reality. To make further progress on this front, FHFA should continue to work with other stakeholders, including Congress, to implement critical reforms to minimize the potential for market disruption in the event of an Enterprise's insolvency.

***Reforms to Minimize the Potential for Market Disruption***

To limit the potential for market disruption, there are two categories of reforms that the necessary authorities should pursue: 1) those that lower the likelihood of an Enterprise entering receivership; and 2) those that lessen the severity of the market disruption caused by an Enterprise entering receivership. FHFA may be able to make incremental progress on some of these reforms through administrative efforts, though many would be implemented more effectively through legislation. In those cases, FHFA should continue to work with Congress and other stakeholders to help develop the necessary reforms.

<u>Reforms to Lower the Likelihood of an Enterprise Entering Receivership</u>

To lower the likelihood of an Enterprise entering receivership, FHFA and legislators should ensure a robust safety-and-soundness framework for the Enterprises and implement utility-style regulation of the Enterprises.

*A Robust Safety-and-Soundness Framework*

In recent years, FHFA has taken several steps to revise the capital and liquidity requirements to which the Enterprises are subject. These updated capital and liquidity requirements accompany annual stress testing, enhanced supervisory processes, and the development of resolution plans under the proposed rule. Together, these are the necessary components of a framework that should limit the capacity for excessive risk taking and reduce the probability of the severe and sustained losses that would lead to receivership. In the period prior to the Enterprises entering conservatorship, some of these components were implemented in a manner that was too weak to constrain Enterprise activities, while others did not exist at all.

Support for strengthened components of this safety-and-soundness framework does not, however, indicate support for all elements of these requirements in their current forms. MBA has provided, for example, recommendations for significant improvements that could be made to the revised capital regulations for the Enterprises,[10] and recommendations for improvements to the revised liquidity regulations are forthcoming. These recommendations would better balance the need for safety and soundness with the need to ensure the Enterprises can provide liquidity to the broader housing finance system pursuant to their charters. Such improvements notwithstanding, the implementation of a more robust safety-and-soundness framework is a critical component in the efforts to avoid an Enterprise's insolvency and the market disruption that would result.

*Utility-Style Regulation*

With respect to utility-style regulation, FHFA should work with legislators to ensure it has the necessary authority to oversee the Enterprises' pricing and activities such that the Enterprises operate in a manner akin to utilities. The basis for this type of framework is the "regulatory compact" through which privately-owned firms "are granted an exclusive or limited number of franchises" and "accept the responsibility (and the regulatory oversight) to serve consumers in an efficient and nondiscriminatory manner."[11] Utility-style regulation of the Enterprises would entail: transparent, publicly posted guarantee fee pricing designed to produce a reasonable rate of return for investors; competition on operational efficiency, product and process improvements, and customer service rather than on pricing; and the prioritization of low-volatility, steady dividends rather than aggressive expansion of market share.

Much like the development of a more robust safety-and-soundness framework, these reforms should limit the capacity for excessive risk taking and reduce the probability of the severe and sustained losses that would lead to receivership. While FHFA maintains

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[10] MBA, "RE: Enterprise Regulatory Capital Framework," August 31, 2020. Available at: https://www.mba.org/Documents/Letters%20to%20Legislators/MBA_FHFA_Enterprise_Capital_Framework_August2020.pdf.

[11] MBA, "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," April 20, 2017. Available at: https://www.mba.org/assets/Documents/Policy/17305_MBA_GSE_Reform_Paper.pdf.

some authority with respect to Enterprise pricing and activities, legislation that further expands and clarifies this authority would be a positive development.

Reforms to Lessen the Severity of the Market Disruption Caused by an Enterprise Entering Receivership

To lessen the severity of the market disruption caused by an Enterprise entering receivership, FHFA and legislators should permit the chartering of additional guarantors to compete with the Enterprises and institute a full-faith-and-credit federal guarantee of timely payment of principal and interest on Enterprise pass-through securities.

*Chartering of Additional Guarantors*

With respect to the chartering of additional guarantors to compete with the Enterprises, FHFA appropriately has called for legislative action to obtain this chartering authority.[12] The Enterprises' duopoly effectively is locked in through their existing congressional charters, which cannot be replicated without legislation. A reformed framework would allow FHFA to grant charters in a manner similar to that of the federal banking and credit union regulators – without a need for legislation each time a new entrant is chartered.

The presence of additional competitors, or even the threat of additional competitors, would "encourage dynamism and spur the [Enterprises] to provide better service to their seller/servicers and ultimately to consumers."[13] More relevant to the risk of market disruption associated with an Enterprise entering receivership, a greater number of guarantors – all else equal – would result in a smaller market share for any particular guarantor. Should a single guarantor become insolvent, this smaller market share should reduce the impact of its failure on the primary or secondary market.[14] The presence of multiple competitors also would provide more institutions that are available to stabilize the market upon the failure of a single guarantor. As such, reforms to permit the chartering of new entrants hold the potential to decrease the severity of the resolution of a guarantor.

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[12] FHFA, "2019 Report to Congress," June 15, 2020. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA_2019_Report-to-Congress.pdf.

[13] MBA, "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," April 20, 2017. Available at: https://www.mba.org/assets/Documents/Policy/17305_MBA_GSE_Reform_Paper.pdf.

[14] While the similar business models of the guarantors could imply that stress at any particular guarantor likely would be experienced by all guarantors, there are many reasons for the insolvency of a single guarantor – including but not limited to cyberattacks or fraud.

*Full-Faith-and-Credit Federal Guarantee*

With respect to the full-faith-and-credit federal guarantee of timely payment of principal and interest on Enterprise pass-through securities, the proposed rule would require the Enterprises' resolution plans to clearly indicate that their securities (and their debt) are not guaranteed by the federal government. While this is true under current law,[15] Congress should legislate an explicit guarantee on the Enterprises' single-family and multifamily pass-through securities. By doing so, it could remove investor uncertainty regarding federal support of the Enterprises, improve liquidity for Enterprise securities in the secondary market, and, as a result, lower costs and increase the availability of mortgage credit for consumers.

With the federal guarantee supporting the securities that are issued by the Enterprises rather than their debt or other obligations, investors would understand clearly that while these securities would maintain a backstop identical to Ginnie Mae securities, the Enterprises themselves could become insolvent and enter receivership. If one or more Enterprises entered receivership under the current construct, fixed-income markets likely would experience severe stress. The existing Enterprise pass-through securities, largely perceived by investors as nearly risk-free from a credit perspective, suddenly would feature high levels of credit risk. Many investors purchase these securities specifically because of their minimal credit risk and would seek to sell them quickly, creating negative feedback loops and rapidly declining valuations.

If the Enterprises' pass-through securities were provided with an explicit guarantee, however, there should be no reason for investors to change their perceptions of the credit risk associated with these securities if an Enterprise were to become insolvent. While the supply of new securities to the market could be disrupted by the failure of an Enterprise, investors would have assurance of timely repayment on their existing holdings, which would reduce potential instability that could have propagated throughout the financial system in the absence of an explicit guarantee. Legislation that provides such an explicit guarantee therefore would lessen the potential market disruption that could occur in the event of an Enterprise's resolution.

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[15] See, for example, 12 U.S.C. § 1719(b): "The corporation shall insert appropriate language in all of its obligations issued under this subsection clearly indicating that such obligations, together with the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the corporation"; 12 U.S.C. § 1455(h)(2): "The Corporation shall insert appropriate language in all of the obligations and securities of the Corporation issued under this section and section 305 [12 U.S.C § 1454] clearly indicating that such obligations and securities, together with the 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 Corporation."

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Dan Fichtler, Associate Vice President of Housing Finance Policy, at (202) 557-2780 or dfichtler@mba.org.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association