Fannie Mae®

March 9, 2021

By Electronic Delivery to FHFA Website

Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, SW
Washington, D.C. 20219
Attention: Clinton Jones, General Counsel

Re: Comments/RIN 2590-AB13
Proposed Rule on Resolution Planning

Ladies and Gentlemen:

I. Introduction and Executive Summary

Fannie Mae appreciates the opportunity to comment on the Federal Housing Finance Agency's ("FHFA") proposed resolution plan rule for Fannie Mae and Freddie Mac (the "Enterprises") published on January 8, 2021 (the "Proposed Rule").[1] Fannie Mae agrees that resolution planning is important to safeguard the housing finance system and enable the Enterprises to operate in a safe and sound manner so that they can fulfill their unique public mission through all market conditions.

Fannie Mae strongly supports the policy goals behind the Proposed Rule, which are to improve the Enterprises' resolvability on a standalone basis, provide for the continued operation of an Enterprise's core business lines should the need for a receivership arise, and dispel public misperceptions about creditor risk and how the Enterprises would be resolved.[2] In support of these goals, Fannie Mae will work to implement the operational capabilities and address impediments in its resolution planning. Fannie Mae believes that the Proposed Rule would be more effective in advancing its policy goals, however, if the final rule further clarified:

- the scope of the assumption against the continuation of the Senior Preferred Stock Purchase Agreements (the "PSPAs");

- that FHFA retains the discretion to permit the Enterprises to assume the continuation of any existing government support during a transition period while addressing certain existing impediments to rapid and orderly resolution;

[1] *Resolution Planning*, Federal Housing Finance Agency, 86 Fed. Reg. 1326 (Jan. 8, 2021).

[2] *Id.* at 1329.

- that existing impediments to a rapid and orderly resolution of an Enterprise identified in the Enterprise's resolution plan will not be grounds for rejecting the plan under FHFA's credibility standard, if the plan identifies the actions or steps needed to remediate the existing impediments, explains why such actions or steps are feasible and who is responsible for taking them, and specifies a time frame for doing so;

- the meaning of the rapid and orderly resolution requirement;

- the treatment of third parties supporting core business lines;[3]

- the content of the public sections of the Enterprise resolution plans; and

- the type of feedback that would be considered a "shortcoming" through the creation of a formal category for such feedback.

Each of these recommendations is described in the remainder of this comment letter.

II. Recommendations

A. The final rule should clarify the scope of the prohibited assumption against the continuation of the PSPAs.

The Proposed Rule would prohibit the Enterprise resolution plans from assuming "the provision or continuation of extraordinary support by the United States to the Enterprise to prevent either its becoming in danger of default or in default …, including the [PSPAs]."[4] Fannie Mae agrees with this general principle. However, there is the potential for ambiguity regarding the scope of the assumption. To eliminate this ambiguity, Fannie Mae believes that the final rule should clarify that this prohibited assumption means that the PSPAs would be assumed to have been terminated in their entirety. This would include being able to assume that without the PSPAs there are no restrictions on the Enterprises' freedom to raise debt or equity or transfer all or any portion of their assets without the U.S. Treasury Department's consent, and that the senior preferred stock will have been retired at no additional cost to the Enterprises. Otherwise, these restrictions could operate as impediments to the rapid and orderly resolution of the Enterprises or to actions or steps designed to remediate other impediments.

For example, having to assume the continued restrictions under the PSPAs on the issuance of debt and equity securities and the transfer of assets could interfere with the Enterprises' ability to take actions similar to those taken by the U.S. global systemically important bank holding companies ("U.S. G-SIBs") under 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[5]

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[3] *Id.* at 1330 [*hereinafter* "Core Business Lines"].

[4] *Id*. at 1344, Proposed Rule Section 1242.5(b)(2).

[5] 12 C.F.R. Pts. 243, 381; *Final Guidance for the 2019 and subsequent resolution plan submissions by the eight largest, complex U.S. banking organizations*, 84 Fed. Reg. 1438 (Feb. 4, 2019) ("U.S. G-SIB Resolution Planning Guidance").

and their subsidiary banks[6] under the Federal Deposit Insurance Act ("FDIA"),[7] to remediate various impediments to their rapid and orderly resolution. These actions include (1) accumulating or raising sufficient capital and liquidity to meet their modeled capital and liquidity needs in resolution, and (2) pledging a sufficient amount of assets to structurally subordinate their long-term debt to the claims of their short-term creditors and beneficiaries of their mortgage guarantees. Similarly, if the Enterprises were still bound by the obligations under the PSPAs, in a resolution plan they would have to take into consideration potential adverse actions by third parties owing to the fact that holders of Enterprise debt and mortgage-backed securities have, under the PSPAs, the right to pursue a cause of action against an Enterprise for failing to make draws on the commitment of the U.S. Treasury Department to provide the Enterprise with financial support.[8]

B. The Final Rule should clarify that FHFA retains the discretion to permit the Enterprises to assume the continuation of any government support during a transition period for purposes of a particular resolution plan submission.

Fannie Mae agrees with the general principle articulated in the Proposed Rule that Enterprise resolution plans should assume no extraordinary government support,[9] as is the case under the resolution planning regimes for the U.S. G-SIBs.[10] However, Fannie Mae suggests that the final rule give FHFA the flexibility and discretion to permit, if FHFA deems it useful, the Enterprises to assume the continuation of the PSPAs on a transitional basis (i.e., for one or more particular resolution plan submissions), while the Enterprises work to complete the actions or steps necessary to remediate impediments to rapid and orderly resolution identified in their resolution plans, as required by the Proposed Rule.[11]

Fannie Mae believes that FHFA's retention of such discretion is important because the Enterprises do not currently have sufficient properly structured capital and long-term debt resources to make a rapid and orderly resolution feasible. The creation of each Enterprise's resolution plan will require scenario analyses driven by underlying key assumptions, including, for example, the state of an Enterprise's balance sheet and the Enterprise's outstanding external debt as of the date upon which the resolution plan financial assumptions will be modeled. In the plans submitted by the U.S. G-SIBs, that balance

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[6] *See* 12 C.F.R. § 360.10.

[7] Resolution Planning, *supra* note 1, at 1329. *See also* the bank resolution provisions of the FDIA and the resolution provisions in 12 U.S.C. § 4617.

[8] *See* Fannie Mae Amended and Restated Senior Preferred Stock Purchase Agreement ¶ 6.1 (Sept. 26, 2008), available at https://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/FNM/SPSPA-amends/FNM-Amend-and-Restated-SPSPA_09-26-2008.pdf ("Fannie Mae PSPA"); Freddie Mac Amended and Restated Senior Preferred Stock Purchase Agreement ¶ 6.1 (Sept. 26, 2008), available at https://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/FRE/SPSPA-amends/FRE-Amended-and-Restated-SPSPA_09-26-2008.pdf ("Freddie Mac PSPA").

[9] *Id*. at 1330.

[10] 12 C.F.R. §§ 243.4(h)(2), 381.4(h)(2).

[11] *See infra* text accompanying note 22.

sheet date is typically required to be the last full financial year before a resolution plan is filed,[12] meaning that the financial assumptions and scenarios start with an actual, and recent, balance sheet update.

By contrast, a resolution plan that does not assume the existence of the PSPA would require an Enterprise to assume a scenario and a balance sheet that differs substantially from current conditions and from key considerations in the U.S. Treasury Department's latest statement on the Enterprises.[13] For instance, while both Enterprises are in the process of building capital to comply with the Enterprise Regulatory Capital Framework, they currently have very limited capital or long-term debt to support the recapitalization of any operations transferred to a limited-life regulated entity ("LLRE").[14] Moreover, because that long-term debt is not currently subordinated to the claims of short-term creditors or the beneficiaries of mortgage guarantees, there is substantial uncertainty about whether FHFA would have the legal authority under 12 U.S.C. § 4617 to impose losses on an Enterprise's long-term debt without also imposing losses pro rata on the Enterprise's short-term creditors and beneficiaries of its mortgage guarantees.[15] Unless and until that long-term debt is structurally, contractually or statutorily subordinated to the claims of short-term creditors and beneficiaries of those mortgage guarantees, FHFA may find it useful to exercise its discretion to permit the Enterprises to assume the continuation of the PSPA on a limited and temporary basis, thereby allowing the Enterprises to prepare and submit resolution plans that satisfy FHFA's credibility standard.

Preparing a credible resolution plan is not simply an academic exercise. Rather, each Enterprise would need to maintain *ex ante* during business as usual the appropriate resources necessary to support the recapitalization of the essential functions transferred to each LLRE. As the experience with the U.S. G-SIBs shows, these resources would need to be maintained during normal business as usual and so impact the balance sheet even outside of any resolution event. In an actual resolution, a recapitalization requires that the Enterprises transfer their core assets to an essentially debt-free LLRE, creating the

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[12] While this requirement is no longer explicit in the resolution plan rule or guidance, resolution plans are required to address developments through the end of the year prior to submission. *See, e.g.*, 2021 Targeted Resolution Plan Template Letter at 7 ("Please discuss [] linkages between the Covered Company's coronavirus response and resolution-related capabilities through December 31, 2020"), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200701a1.pdf. Previously applicable guidance included a more explicit requirement. *Guidance for 2013 §165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012* (Apr. 15, 2013), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20130415c2.pdf ("In cases where financial data is used to support analyses, the discussion should use financial statement information as of, or for the period ended, December 31, 2012 …").

[13] *Treasury Department Blueprint on Next Steps for GSE Reform*, U.S. Department of the Treasury Office of Public Affairs (Jan. 14, 2021), available at https://home.treasury.gov/system/files/136/BlueprintonNextStepsforGSEReform.pdf (acknowledging that the capital structure of the Enterprises, including the PSPAs, present difficulties in the Enterprises' raising of private capital, and further acknowledging that the PSPAs are still presently necessary to support the Enterprises' fulfillment of their mission).

[14] While the Proposed Rule is not explicit on this point, it seems to imply that the resources required to support this recapitalization should be at a level sufficient to meet relevant regulatory capital requirements without taking into account the regulatory and management capital buffers that would be in place during business-as-usual. Fannie Mae believes that would be appropriate and would align with the expectations for resolution planning under Title I of the Dodd-Frank Act.

[15] *See* 12 U.S.C. § 4617(c)(2) (requiring FHFA to treat similarly situated creditors in a similar manner unless certain conditions are satisfied).

necessary capital by leaving a sufficient amount of equity and long-term debt behind in the receivership to absorb losses in accordance with the priority of the claims represented by these instruments, as the U.S. G-SIBs would do in their single-point-of-entry ("SPOE") resolution plans.[16] If FHFA did not retain the discretion to allow the Enterprises to assume the continuation of the PSPAs on a transitional basis, the Enterprises would need to attract enough capital and properly subordinated long-term debt on market terms now during business as usual in order to be in a position to model the financial resources necessary for a credible resolution plan. Recall that the financial resources that would be needed in a credible resolution plan are modeled on the most recent actual balance sheet.

Based on the current significantly undercapitalized state of Enterprise capital and balance sheets, Fannie Mae is concerned that Enterprise assets would not be sufficient to give today's market the comfort or returns it would require without the assumption in the resolution plan of the continuation of the PSPAs. If FHFA did not retain the discretion to allow the Enterprises to assume the continuation of the PSPAs, both Enterprises could be forced to prepare for their resolution plan commitments, including any commitments to address impediments as discussed in Section C below, by, during business as usual and in today's conditions, substantially increasing their capital, long-term debt or other total loss-absorbing capacity ("TLAC"), the costs of which could have important implications to the stability and affordability of the national housing finance markets. Moreover, these increases in capital may need to occur faster than the transition period contemplated in the Enterprise Regulatory Capital Framework and may not be possible under the terms of the PSPAs.[17]

To enhance the usefulness of a resolution plan and the operational readiness of each Enterprise to execute that plan, as well as to align with the realities of the housing finance market at the time of submission, the final rule should clarify that FHFA retains the discretion to allow the Enterprises to assume the continuation of any government support that is actually in place at least 12 months before each planned submission date.[18] Fannie Mae believes that such a clarification would preserve FHFA's discretion to allow for changes in, or the termination of, these arrangements over time to be appropriately reflected in future versions of each Enterprise's resolution plan filing.

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[16] *See, e.g.*, Randall D. Guynn, Resolution Planning in the United States, in The Bank Recovery and Resolution Directive: Europe's Solution for "Too Big to Fail"?, 109–63 (Andreas Dombret, Patrick S. Kenadjian, editors, 2013).

[17] *See* Fannie Mae PSPA, *supra* note 8, at ¶¶ 5.2, 5.5; Freddie Mac PSPA, *supra* note 8, at ¶¶ 5.2, 5.5.

[18] For example, if the PSPA is followed or replaced by an explicit, full faith and credit federal guarantee for the Enterprises' mortgage-backed securities for which the government/taxpayers are fully compensated for the risk they are taking by an appropriately calibrated commitment fee, as suggested in the U.S. Treasury's "Blueprint on Next Steps for GSE Reform," that should not be considered extraordinary government support for purposes of the resolution plan rule. *See* Treasury Department Blueprint on Next Steps for GSE Reform, *supra* note 13.

C. The final rule should clarify that currently existing impediments to a rapid and orderly resolution of an Enterprise that are identified in the Enterprise's resolution plan will not be grounds for rejecting the plan under the FHFA's credibility standard, provided that the plan identifies the actions or steps needed to remediate these existing impediments, explains why such actions or steps are feasible and who is responsible for taking them, and specifies a time frame for doing so.

The release accompanying the Proposed Rule emphasizes that the Proposed Rule's purpose is "to facilitate the continuation of Enterprise functions that are essential to maintaining stability in the housing market in" the event of an Enterprise's failure and resolution and to allocate losses to its shareholders and "creditors in the order of their priority."[19] At the same time, the Proposed Rule recognizes that the Enterprises do not currently have the resources necessary to make such a continuation strategy feasible and provides that such impediments need not necessarily undermine the credibility of a resolution plan.[20] Thus, the Proposed Rule would require the strategic analysis in each Enterprise resolution plan to:

> "Identify and describe … (i) Any potential material weaknesses or impediments to rapid and orderly resolution as conceived in the Enterprise's plan; (ii) Any actions or steps the Enterprise has taken or proposes to take, or which other market participants could take, to remediate or otherwise mitigate the weaknesses or impediments identified by the Enterprise; and (iii) A timeline for the remedial or other mitigating action that the Enterprise proposes to take …."[21]

The release accompanying the Proposed Rule also describes the Enterprise resolution planning process, including FHFA's review of the feasibility of the plans, as an iterative process involving ongoing dialogue between FHFA and each Enterprise.[22]

The iterative experience of the U.S. G-SIBs, the Board of Governors of the Federal Reserve System ("Federal Reserve") and the Federal Deposit Insurance Corporation ("FDIC") over several years in identifying and taking the steps to remediate impediments for 165(d) resolution plans, as well as creating a timeline for doing so, is directly applicable to resolution planning by the Enterprises.[23] Some of these iterative actions and steps were taken over a number of years by the U.S. G-SIBs,[24] others by the Federal

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[19] Resolution Planning, *supra* note 1, at 1329.

[20] *Id*. at 1338. (noting that "a resolution plan *may* be 'credible' even if it identifies material weaknesses or impediments to rapid and orderly resolution or if it sets forth steps that an Enterprise indicates it will take to improve the likelihood of its rapid and orderly resolution.") (emphasis added).

[21] *Id*. at 1345, Proposed Rule Section 1242.5(d)(3).

[22] *See Id*. at 1329–30 ("the proposed rule would establish a multi-faceted, iterative Enterprise resolution planning process"); 1331 ("The resolution planning process proposed is an iterative one"); 1339 ("FHFA's approach to resolution planning … will be iterative and involve dialogue between an Enterprise and FHFA").

[23] *See* FDIC and Federal Reserve, Guidance for 2013 § 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012 at 6 (Apr. 15, 2013), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20130415c2.pdf.

[24] For example, the U.S. G-SIBs increased their regulatory capital, long-term debt and other TLAC and caused their parent's long-term debt to be legally subordinated to the group's short-term debt, guarantees and QFCs through a

Reserve and the FDIC,[25] and still others by international bodies such as the Financial Stability Board[26] and the International Swaps and Derivatives Association ("ISDA").[27] As reflected in their latest round of public comments on the 165(d) resolution plans, it appears that the Federal Reserve and the FDIC are satisfied that virtually all of those impediments have now been adequately remediated by the U.S. G-SIBs, the Federal Reserve and the FDIC or one of the international bodies.[28]

Based on the iterative experience of the U.S. G-SIBs, the Federal Reserve and the FDIC in identifying and remediating material impediments to the rapid and orderly resolution of the G-SIBs over several years of submissions, Fannie Mae believes that the following existing conditions could be material impediments to the rapid and orderly resolution of the Enterprises at present, which would need to be addressed in resolution plan submissions:

- Insufficient capital, long-term debt and other TLAC from the private sector to satisfy FHFA's regulatory capital[29] and future TLAC requirements[30] and otherwise satisfy the projected

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combination of clean holding company measures and secured support agreements. *See* Public Summary of 2019 Resolution Plan of JPMorgan Chase, at 34–37, available at https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/investor-relations/documents/events/2019/resolution-plan-2019/Resolution%20Plan%20Public%20Filing%202019.pdf.

[25] *See, e.g.*, Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (Jan. 27, 2017) ("Total Loss-Absorbing Capacity Requirements"); Mandatory Contractual Stay Requirements for Qualified Financial Contracts, 82 Fed. Reg. 56630 (Nov. 29, 2017) (OCC Rule); Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 50228 (Oct. 30, 2017) (FDIC Rule); Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 42882 (Sept. 12, 2017) (Federal Reserve Rule).

[26] *See, e.g.*, Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet, Financial Stability Board (Nov. 9, 2015), available at https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

[27] *See, e.g.*, ISDA 2015 Universal Resolution Stay Protocol, International Swaps and Derivatives Association (Nov. 4, 2015), http://assets.isda.org/media/ac6b533f-3/5a7c32f8-pdf.

[28] Press Release, Federal Reserve and FDIC, Agencies Find No Deficiencies in Resolution Plans from the Largest Banks; Find Shortcomings for Several Firms (Dec. 17, 2019), https://www.fdic.gov/news/press-releases/2019/pr19123.html.

[29] *Enterprise Regulatory Capital Framework*, Federal Housing Finance Agency, 85 Fed. Reg. 82150 (Dec. 17, 2020); 12 C.F.R. Pt. 1240.

[30] Resolution Planning, *supra* note 1, at 1329 ("To facilitate a credible resolution planning framework, the Housing Reform Plan recommends requiring each Enterprise to maintain a minimum amount of total loss absorbing capacity that could be bailed-in in the event of financial distress.") *See* U.S. Department of the Treasury, Housing Reform Plan (Sept. 2019), available at https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf/; *Total Loss-Absorbing Capacity, Long Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations*, Federal Reserve, 82 Fed. Reg. 8266 (Jan. 24, 2017); 12 C.F.R. Pt. 252.

resolution capital execution need ("RCEN")[31] of any LLRE to which all or any portion of the Enterprise's business or essential functions would be transferred pursuant to its resolution plan and 12 U.S.C. § 4617(i), without reliance on the PSPA or any other government capital support;

- The failure of their long-term debt to be structurally, contractually or statutorily subordinated to the claims of their short-term creditors, counterparties on qualified financial contracts ("QFCs") and the beneficiaries of their mortgage guarantees, so that their losses can be imposed on their long-term debt without imposing them pro rata on their short-term creditors, QFC counterparties and the beneficiaries of their mortgage guarantees, which could foster runs, contagion or otherwise have serious adverse effects on the national housing finance markets;

- Insufficient high-quality liquid assets ("HQLAs") to satisfy FHFA's existing and future regulatory liquidity requirements[32] and otherwise satisfy the projected resolution liquidity execution need ("RLEN")[33] of any LLRE;

- The risk that the prohibition in 12 U.S.C. § 4617(d)(10)(B)(i)(II) on the termination of QFCs that have been transferred to and assumed by an LLRE within one business day of the appointment of the FHFA as receiver (1) will not be recognized in non-U.S. courts as binding on non-U.S. counterparties or (2) does not apply to affiliate cross-defaults; and

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[31] RCEN or Resolution Capital Execution Need is defined in the 2019 U.S. G-SIB Resolution Guidance as the amount of capital that allows a U.S. G-SIB's material entities to operate or be wound down in an orderly manner following the parent company's bankruptcy filing. A U.S. G-SIB is expected to have a methodology for periodically estimating the amount of capital that may be needed to support each material entity after the parent's bankruptcy filing. *See* U.S. G-SIB Resolution Planning Guidance, *supra* note 5, at 1450.

[32] "Current FHFA regulations do not require the Enterprises to meet a quantitative liquidity standard. Rather, FHFA evaluates the Enterprises' methods for measuring, monitoring, and managing liquidity risk on a case-by-case basis in conjunction with its supervisory processes and guidance." *Enterprise Liquidity Requirements*, Notice of Proposed Rulemaking, Federal Housing Finance Agency, 86 Fed. Reg. 1306, 1308 (Jan. 8, 2021). "The most significant change made by the proposed rule to the Enterprises' liquidity management regimes would be the addition of certain assumptions involving stressed cash inflows and outflows. Maintaining a sufficient portfolio of high quality liquid assets to meet these stressed cash outflow and limited cash inflow assumptions would position the Enterprises to provide mortgage market liquidity in times of market stress even if they cannot issue debt … . The proposed rule would establish a minimum short-term liquidity requirement that would be similar to the LCR approved by the Office of the Comptroller of the Currency, Department of the Treasury (OCC), Federal Reserve Board, and FDIC (U.S. banking regulators), with some modifications to reflect characteristics and risks of specific aspects of the Enterprises businesses … ." *Id.* at 1307–08.

[33] RLEN or Resolution Liquidity Execution Need is defined in the 2019 U.S. G-SIB Resolution Guidance as an estimated amount of liquidity needed after the parent's bankruptcy filing to stabilize the surviving material entities and to allow those entities to operate post-filing. *See* U.S. G-SIB Resolution Planning Guidance, *supra* note 5, at 1451.

- Restrictions in the PSPAs on raising additional debt or equity or transferring all or any portion of their assets without the consent of the U.S. Treasury.[34]

Fannie Mae believes that these are the sort of impediments that the Proposed Rule would require the Enterprises to identify and describe in their resolution plans, together with the actions and steps required to remediate them and who is responsible for taking them, and the time frame for doing so.

Over time, the U.S. G-SIBs remediated an impediment substantially similar to the first impediment by raising additional capital in compliance with the Federal Reserve's regulatory capital rules[35] and TLAC rule,[36] and by maintaining sufficient resolution capital adequacy and positioning ("RCAP")[37] to satisfy the projected RCEN of the material entities in their resolution plans under section 165(d) of the Dodd-Frank Act.[38] They remediated an impediment substantially similar to the second impediment through a combination of raising additional capital or long-term debt in compliance with the Federal Reserve's TLAC rule and entry into a secured support agreement that makes the claims of holders of the long-term debt of their bank holding company parents structurally subordinate to the claims of virtually all of their short-term creditors, third-party counterparties on QFCs and beneficiaries of any parent-company guarantees.[39] They remediated an impediment substantially similar to the third impediment by enhancing their liquid assets in compliance with the Federal Reserve's regulatory liquidity rules[40] and by maintaining sufficient resolution liquidity adequacy and positioning ("RLAP")[41] to satisfy the projected

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[34] *See* Section II.A for discussion as to whether this impediment will be included in the Enterprises' resolution plan submissions and Section II.B for discussion as to how this impediment may not be applicable for a particular resolution plan submission.

[35] *See Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies*, 80 Fed. Reg. 49082 (Aug. 14, 2015); 12 C.F.R. Pts. 208, 217. *See also Regulation Q; Regulatory Capital Rules: Risk-Based Capital Surcharge for Global Systemically Important Holding Companies*, 84 Fed. Reg. 69744 (Dec. 19, 2019).

[36] Total Loss-Absorbing Capacity Requirements, *supra* note 25.

[37] RCAP is defined in the 2019 U.S. G-SIB Resolution Guidance as an adequate amount of loss-absorbing capacity to recapitalize a covered bank holding company's material subsidiaries. *See* U.S. G-SIB Resolution Planning Guidance, *supra* note 5, at 1450.

[38] *See, e.g.*, JPMorgan Chase, *supra* note 24, at 92.

[39] In particular, the clean holding company requirements in the Federal Reserve's TLAC rule prohibits the parent holding company from having any material amount of short-term debt or QFC or guarantee obligations to third parties at the parent company level. Total Loss-Absorbing Capacity Requirements, *supra* note 2525, at 8272 ("Under the final rule, a covered BHC [bank holding company] and covered IHC [intermediate holding company] are prohibited from issuing short-term debt instruments to third parties (including deposits); entering into [QFCs] with third parties; having liabilities that are guaranteed by the covered BHC's subsidiaries or subject to contractual offset rights for its subsidiaries' creditors; or issuing certain guarantees of its subsidiaries' liabilities if the liability provides default rights based on the resolution of the covered BHC or covered IHC. This last prohibition has been revised from the proposal to exempt guarantees of liabilities that are subject to any future rule of the [Federal Reserve] or another Federal banking agency restricting default rights.").

[40] 12 C.F.R. Pts. 50, 249 and 329.

[41] RLAP is defined in the 2019 U.S. G-SIB Resolution Guidance as the standalone liquidity position of each material entity. *See* U.S. G-SIB Resolution Planning Guidance, *supra* note 5, at 1450.

RLEN of the material entities in their resolution plans under section 165(d) of the Dodd-Frank Act.[42] They remediated an impediment substantially similar to the fourth impediment through a combination of adherence to the 2018 U.S. ISDA Resolution Stay Protocol[43] and compliance with the Federal Reserve's QFC stay rule.[44] They did not need to remediate an impediment substantially similar to the fifth impediment because they are not currently subject to any agreements with the government similar to the PSPA.

Remediating each of these impediments was critical to the ultimate credibility of the resolution plans of the U.S. G-SIBs after several years of working with the regulators. If they did not have sufficient capital and TLAC, their SPOE recapitalization resolution strategies would not be credible because they could not credibly assume that they would have enough resources to recapitalize the businesses expected to be transferred to a bridge bank holding company under an SPOE resolution strategy. Nor would their resolution plans be credible if their long-term debt was not structurally subordinated to the claims of their short-term creditors, counterparties on their QFCs or the beneficiaries of their guarantees. Without such subordination, it would not be credible for them to assume that losses could be imposed on their long-term debt without imposing them pro rata on their short-term creditors, their QFC counterparties or the beneficiaries of their guarantees. If that assumption were not credible, then it would not be credible to assume that their resolution plans could be implemented without fostering runs, fire sales of collateral or contagion or otherwise without having serious adverse effects on the U.S. financial system. If they did not have sufficient HQLAs, their SPOE recapitalization resolution strategies would not be credible because they could not credibly assume that they would have enough liquidity for their material entities to be stabilized and be able to continue to operate under an SPOE resolution strategy. If the fourth condition were not true, they could not assume that they could execute their SPOE resolution strategies without fostering runs, fire sales of collateral or contagion. The fifth condition is critical so that they would not be subject to any government-imposed impediment on their ability to raise additional capital or long-term debt or structurally subordinate their long-term debt to their runnable liabilities.

Since, under the Proposed Rule, the Enterprises will almost certainly need to identify each of the impediments described above as material impediments to their rapid and orderly resolution at the present time,[45] and consistent with the principle that the Enterprise resolution process is supposed to be iterative,[46] Fannie Mae believes that the final rule should clarify that these existing impediments and others similarly identified in the course of preparing the early resolution plan submissions will not be grounds for rejecting the Enterprises' resolution plans under FHFA's credibility standard, provided that their resolution plans also identify the actions and steps needed to remediate each of them, explain why such actions and steps are feasible and who is responsible for taking them, and include a timeline for doing so.

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[42] *See* JPMorgan Chase, *supra* note 24, at 96.

[43] *ISDA 2018 U.S. Resolution Stay Protocol*, International Swaps and Derivatives Association (Jul. 31, 2018), available at https://www.isda.org/a/6EjEE/3431552_40ISDA-2018-U.S.-Protocol-Final.pdf.

[44] *Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations*, Federal Reserve, 82 Fed. Reg. 42882 (Sept. 12, 2017).

[45] With the possible exception of the fifth impediment, as discussed in Sections II.A and II.B.

[46] *See supra* note 22.

D. The final rule should clarify that the Proposed Rule's requirement for a "rapid" resolution would apply only to the initial recapitalization and stabilization phase of a resolution.

The Proposed Rule requires that a resolution plan provide for a "rapid and orderly resolution," which is defined as "a process for establishing a [LLRE] … such that succession by the [LLRE] can be accomplished promptly and in a manner that substantially mitigates the risk that the failure of the Enterprise would have serious adverse effects on national housing finance markets."[47] As drafted, both "rapid" and "orderly" would be applicable requirements for all stages of a resolution plan. Fannie Mae believes that the final rule should draw a distinction between the various stages of a resolution strategy and should recognize that only certain of those stages need to be conducted rapidly for an orderly resolution to occur, namely, the initial recapitalization and stabilization phase, often referred to as the "resolution weekend."[48]

There is no statutory requirement that the resolution of an Enterprise be conducted rapidly. Where the relevant statutory text does describe an Enterprise's resolution process, it makes reference to "the *smooth and orderly* liquidation or other resolution of" an Enterprise, neither of which equate with "rapidly."[49] The paramount concern for any resolution of the Enterprises should be ensuring that there is no material adverse impact on the stability of the U.S. housing finance market or the broader U.S. financial system as a result of runs, fire sales or contagion, i.e., that the resolution process is smooth and orderly.

Achieving such an outcome will require rapidity during only certain stages of the resolution process, especially in the initial phases of implementing a resolution plan, but not in others. After the new entity has been recapitalized and stabilized, the claims process through a receivership will necessarily take place over a longer period. Any attempt to impose rapidity on these stages of the resolution would come at the expense of their orderliness, and could undermine the stability of the U.S. financial system. Notably, the public sections of 165(d) resolution plans for the U.S. G-SIBs contemplate a quick resolution weekend, but discuss an overall resolution process of one to two years.[50] These plans have not been found to be "not credible" by the Federal Reserve and FDIC, which implicitly means that they meet both the rapid and orderly requirements of the 165(d) Rule.

Incorporating a more narrowly tailored scope for the "rapid" requirement in "rapid and orderly resolution" in the Proposed Rule would address these concerns and ensure that the orderly resolution of an Enterprise would not destabilize the housing market or the broader U.S. financial system.

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[47] Resolution Planning, *supra* note 1, at 1343, Proposed Rule Section 1242.2.

[48] *See, e.g.*, Ryan Tetrick, *Resolution framework for global systemically important banks*, presented at the FDIC Systemic Resolution Advisory Committee Meeting (Oct. 1, 2020), https://www.fdic.gov/about/advisory-committees/systemic-resolutions/pdfs/2020-10-01-resolution-framework-gsib.pdf ("Authorities in the U.S., UK, and European Banking Union maintain a cross-border work program on GSIB resolution focusing on key resolution challenges and coordination during 'resolution weekend.'").

[49] *See* 12 U.S.C. § 4617(c)(3)(B) (emphasis added).

[50] *See, e.g.*, JPMorgan Chase, *supra* note 24, at 18 (contemplating a 24-month wind-down strategy for a derivatives and trading portfolio); Wells Fargo 2019 165(d) Plan Public Section, https://www.federalreserve.gov/supervisionreg/resolution-plans/wells-fargo-2g-20190701.pdf, at 44 (contemplating a 12-month wind-down period for a derivatives portfolio).

E. The final rule should provide flexibility regarding the treatment of third parties.[51]

Fannie Mae believes the treatment of third parties[52] in the Proposed Rule could benefit from additional flexibility such that the resolution plan strategic analysis can focus only on those key third parties necessary to support the continuity of the Core Business Lines. Specifically, Fannie Mae believes that FHFA should clarify through guidance (or in the final rule) that (1) Third Parties should not be included within the concept of "supports" in the definition of Core Business Lines,[53] and (2) resolution planning with respect to Third Parties would not impose obligations beyond a need to maintain resolution-friendly contracts and an ability to pay Third Parties to maintain access to critical outsourced services during resolution.

Fannie Mae believes that a Core Business Line should be defined with reference only to the Enterprise itself and not including external Third Parties. Folding Third Parties into the definition of "supports" would render them effectively part of the Core Business Line instead of treating them as distinct entities outside of the Enterprises' corporate organizations.[54] Therefore, Fannie Mae believes the inclusion of Third Parties in the definition of "supports" is not needed and suggests that the final rule should include a definition of Third Parties to capture those external service providers necessary to support the Core Business Lines.

In addition, Fannie Mae believes that the Proposed Rule would impose undue burdens on the Enterprises with respect to their required Third Party analysis, e.g., regarding to the ability of Third Parties to function during the Enterprises' resolution.[55] As an initial matter, this analysis would require information that the Enterprises might not have access to and which would be difficult to assess. Requiring an analysis of the ability of Third Parties to function during the Enterprise's resolution[56] would expand the scope of the Enterprises' resolution plans to include a detailed understanding of the business and operations of unrelated Third Parties. The same would be true if service providers and counterparties

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[51] This section is responsive to the Proposed Rule's request for comment on the proposed definition of "core business line." Resolution Planning, *supra* note 1, at 1331.

[52] *Id*. ("When identifying associated operations, services, functions, and supports, an Enterprise should consider those functions that it performs directly and those that are performed by an affiliate or provided by a third party, including third parties whose direct relationship is with the borrower, but whose function may benefit an Enterprise (such as the provider of borrower loan-level mortgage insurance).") [hereinafter "Third Parties"].

[53] *Id*. at 1332. *See also* Proposed Rule Section 1242.2 (definition of "core business line").

[54] Fannie Mae believes that any other important third parties will be identified through other resolution plan requirements in the Proposed Rule. For example, § 1242.5 "Informational content of a resolution plan; required and prohibited assumptions" (f) "Organizational structure, interconnections, and related information" requires the Enterprise to list in (i): "[a] list of all affiliates and trusts within the Enterprise's organization that identifies for each affiliate and trust (legal entity) … " and in (11): "providers with which the Enterprise has significant business connections … and describe the business connections, dependencies and relationships with such …." *Id.* at 1345—46.

[55] *Id*. at 1335 ("The ability of each affiliate or third party providing operations, services, functions or supports to function during the Enterprise's resolution should be assessed.").

[56] *Id.*

were included in the scope of Third Parties, as contemplated by the Proposed Rule.[57] Fannie Mae believes that for resolution planning purposes with respect to Third Parties, the Enterprises should only be required to maintain, consistent with the 165(d) Rule Guidance,[58] resolution-resilient contracts and access to sufficient resources to continue to pay for necessary services in resolution.

F. The final rule should clarify that the public and confidential portions of the resolution plan should help preserve public confidence while avoiding commercial disadvantages.[59]

Fannie Mae supports the concept in the Proposed Rule that there will be both public and confidential sections to a resolution plan and suggests that certain information not form part of the public section requirements in the final rule. This clarification will help facilitate information flow regarding the Enterprises' resolvability without putting the Enterprises at a potential commercial disadvantage.

In particular, Fannie Mae believes the scope of the public section, while important, should also be relatively limited in order to allow more candid disclosure and discussion in the comprehensive confidential section of a resolution plan. The Enterprises operate in a market with relatively few competitors. Identification of key third-party relationships, such as public disclosure regarding the Enterprises' service providers or material counterparties, could have significant effects on the Enterprises' commercial relationships. To prevent such potentially negative effects, the final rule should clarify that information on specific service providers or counterparties will not be shared in the public section of any resolution plan submission, and should only be included in the confidential section of such plans. This would be consistent with the 165(d) Rule public section, which does not require such disclosure.[60]

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[57] *Id*. at 1336 ("The Enterprises would be required to report on their credit risk exposures to counterparties identified in the proposed rule, including significant sellers of mortgage loans to an Enterprise, significant servicers, and providers of loan-level mortgage insurance. Enterprise resolution plans would be required to analyze whether the failure of a third-party provider would likely have an adverse impact on the Enterprise or likely result in the Enterprise becoming in danger of default or in default.").

[58] *See* U.S. G-SIB Resolution Planning Guidance, *supra* note 5, at 1453 ("The firm should (A) evaluate the agreements governing these services to determine whether there are any that could be terminated despite continued performance upon the parent's bankruptcy filing, and (B) update contracts to incorporate appropriate terms and conditions to prevent automatic termination and facilitate continued provision of such services during resolution. Relying on entities projected to survive during resolution to avoid contract termination is insufficient to ensure continuity. In the plan, the firm should document the amendment of any such agreements governing these services.").

[59] This section is responsive to the Proposed Rule's request for comment on "whether an Enterprise should be required to identify significant third-party providers and major counterparties in the public section of its resolution plan." Resolution Planning, *supra* note 1, at 1337.

[60] *See* 12 C.F.R. § 381.11(c)(2) ("The public section of a full or targeted resolution plan shall consist of an executive summary of the resolution plan that describes the business of the covered company and includes, to the extent material to an understanding of the covered company: (i) the names of material entities; (ii) a description of core business lines; (iii) consolidated or segment financial information regarding assets, liabilities, capital and major funding sources; (iv) a description of derivative activities and hedging activities; (v) A list of memberships in material payment, clearing and settlement systems; (vi) A description of foreign operations; (vii) The identities of material supervisory authorities; (viii) The identities of the principal officers; (ix) A description of the corporate governance structure and processes related to resolution planning; (x) A description of material management information

The public section of a resolution plan submission complements the confidential section by helping to preserve public confidence that the Enterprises can be smoothly and orderly resolved. For example, the public sections of 165(d) plan submissions[61] help promote market discipline and financial stability. The express purpose of 165(d) public section is "to inform the public's understanding of the firm's resolution strategy and how it works.[62] As such, the public portion of resolution plan submissions for the Enterprises can serve as a key communication device to the public and multiple stakeholders including Congress, rating agencies, shareholders and bondholders. Public sections also help promote market discipline and market stability by emphasizing the potential allocation of losses in a resolution and clearly documenting the institution's plans for orderly resolution.

G. The final rule should include a formal category for "shortcomings" to help ensure a productive, iterative submission process.[63]

Fannie Mae suggests that the final rule would benefit from the creation of a formal category for "shortcomings," or criticisms, that do not rise to the level of "deficiencies."[64] The FHFA proposed that shortcomings be conveyed through routine communications processes, rather than as a formal category.[65] Fannie Mae believes this formal distinction would provide a useful, additional feedback mechanism for assessing resolution plans.

In particular, Fannie Mae believes that the final rule should include a formal category for those shortcomings that do not rise to the level of deficiencies.[66] The Proposed Rule states that the

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systems; and (xi) A description, at a high level, of the covered company's resolution strategy, covering such items as the range of potential purchasers of the covered company, its material entities, and its core business lines"); *Resolution Plans Required,* 84 Fed. Reg. 59194, 59228 (Nov. 1, 2019).

[61] *Id*. at 59227 ("The public section … shall consist of an executive summary of the resolution plan … that describes the business … and includes, the extent of an understanding of the company: (i) the names of material entities; (ii) a description of core business lines; (iii) a description, at a high level, of the … company's resolution strategy, referencing the applicable resolution regimes for its material entities …. To the extent permitted by law, information comprising the Confidential Section of a resolution plan will be treated as confidential.").

[62] U.S. G-SIB Resolution Planning Guidance, *supra* note 5, at 1460.

[63] This section is responsive to the Proposed Rule's request for comment on whether the final rule should include a process for the identification of a shortcoming in addition to a deficiency and, if so, whether that definition should be similar to that in the 165(d) Rule. Resolution Planning*, supra* note 1, at 1338.

[64] *Id*. ("The proposed rule would define 'deficiency' as an aspect of the Enterprise's resolution plan that FHFA determines presents a weakness that, individually or in conjunction with other aspects, could undermine the feasibility of the Enterprise's resolution plan.").

[65] *Id.* ("FHFA does not propose a similar concept because, as the proposed rule indicates, FHFA could inform an Enterprise through routine communications of any concerns with its resolution plan that do not yet rise to the level of a 'deficiency,' but which could rise to such a level if unaddressed in future plans. FHFA requests comment on whether a final resolution planning rule should include a process for FHFA identification of a 'shortcoming,' in addition to a 'deficiency' and, if so, whether FHFA should adopt a definition of 'shortcoming' similar to that contained in the DFA section 165 rule.").

[66] This could be modeled on the distinctions in the 165(d) Rule. *See* Resolution Plans Required, *supra* note 60, at 59226. These are also defined by the agencies in the public statement *Resolution Plan Assessment Framework*, FDIC (Mar. 13, 2016), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160413a2.pdf.

"determination of a shortcoming in a resolution plan would not trigger the requirement to submit a revised plan, but unaddressed shortcomings could become deficiencies in subsequent plans."[67] It further contemplates these shortcomings being addressed in routine communications between FHFA and the Enterprises,[68] rather than as feedback specific to an Enterprise resolution plan. To help reduce potential ambiguity regarding the level of Enterprise action necessary to respond to routine communications, Fannie Mae believes that the articulation of a formal category for shortcomings would provide a useful tool to distinguish between such shortcomings and less significant concerns.

The creation of a formal distinction between shortcomings and other types of feedback modeled on how these terms are used in the 165(d) Rule would provide a useful additional feedback mechanism for assessing the Enterprises' resolution plans.[69] As currently written, the Proposed Rule suggests there may exist a category below "deficiencies," but does not create a distinct category for this level of concern.[70] This is referenced as "other feedback."[71] The 165(d) Rule goes further, defining a deficiency as "an aspect of a firm's resolution plan that the agencies jointly determine presents a weakness that individually or in conjunction with other aspects could undermine the feasibility of the firms plan" and a shortcoming as "a weakness or gap that raises questions about the feasibility of a firm's plan, but does not rise to the level of a deficiency."[72] Adopting a similar formal distinction in the final rule would promote iterative improvements to an Enterprise's resolution plan in response to FHFA feedback where such feedback does not require the resubmission of a resolution plan. A shortcoming could, for example, be used as a feedback mechanism during the time that the Enterprises are taking actions or steps necessary to remediate impediments to rapid and orderly resolution that may be identified in their resolution plans. Fannie Mae believes adopting the formal category of "shortcoming" similar to that contained in the 165(d) Rule, would help give the FHFA the ability to provide more nuanced feedback on the Enterprises' resolution plans through three distinct categories: other feedback, shortcomings, and deficiencies.

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[67] Resolution Planning, *supra* note 1, at 1338.

[68] *See supra* note 65 and accompanying text.

[69] *Id.*

[70] *Id*. at 1331 ("FHFA would review a received and complete resolution plan and provide notice to the Enterprise identifying deficiencies in its resolution plan, if any, as well as actions or changes set forth by the Enterprise in its resolution plan that FHFA agrees could facilitate a rapid and orderly resolution. *FHFA may also provide other feedback*, such as on the timing of actions or changes to be undertaken by the Enterprise. An Enterprise receiving a notice of deficiency would be required to submit a revised resolution plan that corrects the deficiency, or addresses what actions will be taken to correct it.") (emphasis added).

[71] *Id.*

[72] Resolution Plans Required, *supra* note 60, at 59225–26 ("A deficiency is an aspect of a … company's resolution plan that the Board and Corporation jointly determine presents a weakness that individually or in conjunction with other aspects could undermine the feasibility of the covered company's resolution plan … if a shortcoming is not satisfactorily explained or addressed before or in the submission of the … company's next resolution plan, it may be found to be a deficiency.").

III. Conclusion

Fannie Mae appreciates the opportunity to comment on the Proposed Rule. The recommended changes in this comment letter are intended to further FHFA's stated objectives. With these changes, Fannie Mae believes that FHFA could achieve an effective resolution planning framework to appropriately balance the objectives of (1) enhancing the resolvability of the Enterprises, (2) supporting the Enterprises' mission, and (3) supporting the responsible end of the conservatorships. If you have questions or require additional clarifications or supporting analysis, please contact the undersigned at terry_theologides@fanniemae.com. In addition, Fannie Mae would be pleased to facilitate a discussion of this response.

Sincerely,

Stergios "Terry" Theologides
Executive Vice President, General Counsel,
and Corporate Secretary
Fannie Mae