CATO INSTITUTE | Center for Monetary and Financial Alternatives

November 12, 2021

Clinton Jones, General Counsel,
Attention: Comments/RIN 2590–AB17,
Federal Housing Finance Agency, 400
Seventh Street SW, Washington, DC 20219.

Re: Notice of Proposed Rulemaking: Request for Comments; Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer; RIN-2590-AB17; Document Number 2021-20297

Dear Mr. Jones:

My name is Norbert Michel and I am the Director of the Cato Institute's Center for Monetary and Financial Alternatives. I appreciate the opportunity to submit comments to the Federal Housing Finance Agency. The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace, and the Center for Monetary and Financial Alternatives today's centralized, bureaucratic, and discretionary monetary and financial-regulatory systems and to identifying, studying, and promoting alternatives more conducive to a stable, flourishing, and free society. The opinions I express here are my own.

In its recent request for comments on a notice of proposed rulemaking (the proposed rule), the Federal Housing Finance Agency (FHFA) announced it sought to amend the Enterprise Regulatory Capital Framework (ERCF) by "refining the prescribed leverage buffer amount (PLBA or leverage buffer) and credit risk transfer (CRT) securitization framework for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)."[1] If the FHFA finalizes the amendments in the proposed rule, it will materially weaken the enterprises' (Fannie Mae's and Freddie Mac's) capital requirements.

[1] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of proposed rulemaking, *Federal Register*, Vol. 86, no. 184, September 27, 2021, https://www.govinfo.gov/content/pkg/FR-2021-09-27/pdf/2021-20297.pdf.

The goal for any FHFA amendments to the ERCF should be to improve the enterprises' safety and soundness, and the proposed rule does not achieve that objective. Instead, the proposed rule would weaken the enterprises' safety and soundness.[2] To avoid weakening the enterprises' safety and soundness, I recommend the following:

- The FHFA should not reduce the 10 percent risk weight floor on retained credit risk transfer (CRT) exposures.
- The FHFA should not recalibrate the 20 percent risk weight floor on mortgage exposures.
- The FHFA should not reduce the prescribed leverage buffer amount (PLBA)

The remainder of this comment letter provides further details and suggestions that apply to each of these points.

The 10 Percent Risk Weight Floor on Retained Credit Risk Transfer (CRT) Exposures

The FHFA's proposed rule is slanted too heavily toward promoting the use of credit risk transfers (CRTs) rather than promoting the enterprises' safety and soundness. For instance, the proposed rule states that the "FHFA believes that the current CRT risk weight floor may not achieve the proper balance between permitting CRT and safety and soundness."[3] It is not the FHFA's responsibility to "balance" permitting CRT use against the enterprises' safety and soundness. It is the FHFA's responsibility to promote safety and soundness. The FHFA should not view permitting CRT use as a goal in itself – that approach *promotes* the use of CRT and is an inappropriate goal because (among other reasons) CRT use is not riskless.[4]

The cottage CRT industry has long called for a zero risk weight floor on CRT exposures, which is equivalent to treating them as risk-free investments as safe, or safer, than U.S. Treasuries. That

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[2] Interestingly, industry advocates have consistently pushed the FHFA to lower the enterprises' capital requirements, often in the name of promoting the use of credit risk transfers (CRTs). Norbert J. Michel, "The New FHFA Capital Rule Is A Great First Step Toward Financial Sanity For Fannie and Freddie," *Forbes*, July 24, 2020, https://www.forbes.com/sites/norbertmichel/2020/07/24/the-new-fhfa-capital-rule-is-a-great-first-step-toward-financial-sanity-for-fannie-and-freddie/?sh=7182ebfe7f38; Norbert J. Michel, "The New FHFA Capital Rule Is A Great First Step Toward Financial Sanity For Fannie and Freddie: Part 2," *Forbes*, July 29, 2020, https://www.forbes.com/sites/norbertmichel/2020/07/29/the-new-fhfa-capital-rule-is-a-great-first-step-toward-financial-sanity-for-fannie-and-freddie-part-2/?sh=4633d57a589c; and, Norbert J. Michel, "Strict Bank-Like Capital Rules Needed for Fannie Mae and Freddie Mac," *Heritage Foundation*, Backgrounder no. 3474, March 9, 2020, https://www.heritage.org/markets-and-finance/report/strict-bank-capital-rules-needed-fannie-mae-and-freddie-mac. Also see Thomas M. Hoenig, "Comment on FHFA Proposed Capital Framework," *Mercatus Center*, August 26, 2020, https://www.mercatus.org/publications/financial-markets/comment-fhfa-proposed-capital-framework.

[3] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," p. 53238.

[4] The FHFA even recognizes that CRT use is not riskless. The proposed rule states "Because CRT tranches, even senior CRT tranches, are not risk-free, each Enterprise should maintain regulatory capital to absorb losses on those retained CRT exposures." Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," p. 53238.

treatment is a mistake because CRTs are structured debt securities – bonds – tied to pools of mortgages. Moreover, bonds are inherently riskier than equity capital because they increase a firm's financial obligations. If the enterprises get into financial trouble, for any reason, they will be responsible for larger financial obligations than if they had, instead of issuing CRTs, issued equity.

Even though the proposed rule states that "CRT is an effective mechanism for distributing credit risk," the FHFA provides no evidence for this assertion. Moreover, this view ignores that CRT use can enhance the enterprises' safety and soundness only if CRT transactions are appropriately structured and priced, and only when the retained residual risk is appropriately capitalized. Conversely, CRT transactions can *undermine* safety and soundness when they do not meet these conditions.

Financial institutions' experience with novel securitizations during the 2008 financial crisis further bolsters this point. Multiple securitizations during that period failed to transfer risk to third parties even though they were designed to do so. The FHFA would be derelict in its duties if it calibrated the CRT risk weight framework without fully accounting for such failures. Indeed, even though both the proposed rule (issued on June 30, 2020)[5] and the final rule for the ERCF (issued on December 17, 2020)[6] did discuss these failures, the FHFA's new proposed rule does not.

The proposed rule expresses a clear desire to increase the use of CRTs even though its proposed amendments to the ERCF would reduce the capital required for the enterprises' retained CRT exposures. Yet, the proposed rule *does not offer any evidence* that the current capital requirements for retained CRT exposures are excessive relative to the retained risk. If the FHFA believes that the current ERCF requires excessive capitalization for (even some of the) retained CRT exposures in a manner inconsistent with the enterprises' safety and soundness, it should provide evidence for that view. Moreover, the FHFA should acknowledge and rationalize any departure from the greater capital requirements for similar retained exposures in the U.S. banking agencies' implementation of the Basel III framework, explicitly stating why the FHFA's approach is more laxed.[7]

In the proposed rule, the FHFA provides no evidence that the current 10 percent risk weight floor is excessive relative to the risk on retained CRT exposures. The FHFA merely asserts that the 10 percent floor "unduly decreases the capital relief provided by CRT and reduces an

[5] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Notice of Proposed Rulemaking, Federal Register, Vol. 85, no. 126, June 30, 2020, p. 39,330 (n. 74), https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-11279.pdf.

[6] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, Federal Register, Vol. 85, no. 243, December 17, 2020, p. 82177 (n. 46), https://www.govinfo.gov/content/pkg/FR-2020-12-17/pdf/2020-25814.pdf.

[7] This issue is discussed in both the 2020 proposed rule and the 2020 final rule. See Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Notice of Proposed Rulemaking, p. 39330; and, Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,178.

Enterprise's incentives to engage in CRT."[8] Given that federal banking agencies have reviewed similar securitizations and assigned a 20 percent risk weight floor to such exposures, it is especially difficult to rationalize how further reducing the risk weight floor (from 10 percent) can do anything other than materially harm the enterprises' safety and soundness. The FHFA should revisit its rationale for proposing to further reduce the 10 percent risk weight floor for retained CRT exposures, and it should make safety and soundness – not increasing the use of CRTs – its objective.

Separately, the FHFA should not remove the overall effectiveness adjustment, a feature that accounts "for the fact that a CRT does not provide the same loss-absorbing capacity as equity financing."[9] As the FHFA discussed in its 2020 proposed rule:

> [The] FHFA agrees that CRT transfers credit risk only on a specified reference pool, while equity financing is available to ''cross cover'' credit risk on other exposures of the Enterprise. FHFA also agrees that CRT transfers only credit risk, while equity financing can absorb losses arising from operational and market risks. Related to this, an Enterprise generally may pause distributions on equity financing during a financial stress but typically must continue debt service or other payments on CRT instruments. Therefore, equity financing provides more robust safety and soundness benefits across exposures and risks than a similar amount of credit exposure transferred through CRT.[10]

In the proposed rule, the FHFA justifies the removal of the overall effectiveness adjustment by arguing that "in the context of the totality of the proposed CRT framework and a credible leverage ratio requirement as a backstop," the "overall effectiveness adjustment is not needed."[11] The FHFA does not discuss, however, how the "totality of the proposed CRT framework" accounts for the fact that "a CRT does not provide the same loss-absorbing capacity as equity financing."[12] Furthermore, nothing in the calibration of the leverage ratio requirement accounts for the fact that "a CRT does not provide the same loss-absorbing capacity as equity financing," and it is unlikely that the PLBA would remain a credible backstop to the risk-based requirements *if it is amended as in the proposed rule*. It stands to reason that if the FHFA continues to believe that "a CRT does not provide the same loss-absorbing capacity as equity financing," the ERCF should continue to impose an adjustment that accounts for this fact.

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[8] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,238. Given that the FHFA's own report on CRT performance questions the benefits to the enterprises from these transactions and acknowledges that "CRTs remain untested by a serious loss event," this assertion is irresponsible. See Federal Housing Finance Agency, "Performance Of Fannie Mae's And Freddie Mac's Single-Family Credit Risk Transfer," May 2021, p. 5, https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Overview-05172021.pdf.

[9] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,179.

[10] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Notice of Proposed Rulemaking, p. 39,330.

[11] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of proposed rulemaking, p. 53,239.

[12] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,179.

The 20 Percent Risk Weight Floor on Mortgage Exposures

In Question 4 of the proposed rule, the FHFA asks:

> In light of the proposed changes to the PLBA and the CRT securitization framework, is the prudential risk weight floor of 20 percent on single-family and multifamily mortgage exposures appropriately calibrated?[13]

Significantly, the preamble of the proposed rule includes no discussion of the critical role played by this risk weight floor in ensuring that the enterprises are appropriately capitalized. Based on the FHFA's 2020 final rule, it is clear that any reduction in the 20 percent risk weight floor on mortgage exposures would result in a material reduction in the enterprises' risk-based capital requirements. Along with the 2020 final rule, the FHFA published a fact sheet that states "As of June 30, 2020, approximately 55 percent of the unpaid principal balance (UPB) of single family mortgage exposures were subject to the risk weight floor…"[14]

Moreover, the 20 percent risk weight floor mitigates the *model risks* inherent in the risk-sensitive methodology that the FHFA used to calibrate the risk weights for mortgage exposures. The 2020 final rule discusses such model risks in great detail. The risks include: (1) the model risk posed by excluding from the historical data used to calibrate mortgage exposure risk weights the enterprises' crisis-era losses that arose from some single-family mortgage exposures that are no longer eligible for acquisition by the enterprises; (2) the risk that the risk-based capital requirements are not calibrated to reflect the credit losses that would result in a severe economic downturn that did not entail a repeat of the unprecedented support by the federal government of the housing market and the economy and also the declining interest rate environment of the 2007-2011 period; and, (3) the material risks that are not assigned a risk-based capital requirement.

Absent the 20 percent risk weight floor, these model risks would have resulted in credit risk capital requirements for some mortgage exposures that are far less than what other federal prudential regulators have determined to be appropriate for capitalizing similar credit risks. This gap, therefore, is cause for concern about the underlying calibration methodology for mortgage exposure risk weights. As of September 30, 2019, absent the 20 percent risk weight floor, the average credit risk capital requirement for the enterprises' single-family mortgage exposures would have been 1.7 percent, or less than half of the 4 percent required by federal banking regulators on similar exposures (and barely more than half of the 2.8 percent currently required by the Basel rules.[15] With rising home prices, this gap will have materially increased since September 2019.[16]

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[13] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,238.

[14] Federal Housing Finance Agency, "Fact Sheet: Final Rule on Enterprise Capital," June 2020, p. 7, https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/FS-Final-Rule-on-Ent-Capital.pdf.

[15] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,173 (n. 41).

[16] Mark-to-market loan-to-value ratios are a key input for assigning risk weights to mortgage exposures.

Given this critical importance of the 20 percent risk weight floor on mortgage exposures, it is clear that the floor remains appropriately calibrated even "in light of the proposed changes to the PLBA and the CRT securitization framework."[17] It is, in fact, strange that the FHFA has posed such a question because the changes to the PLBA and CRT frameworks are analytically severable from the 20 percent risk weight floor on mortgage exposures. The rationale for the changes to the PLBA (described below) and CRT frameworks does not affect the calibration of the 20 percent risk weight floor.[18] Perhaps more importantly, even if there is some rationale for recalibrating the 20 percent risk weight floor "in light of the proposed changes to the PLBA and the CRT securitization framework," the FHFA has not solicited public comments on that rationale.[19]

The 20 percent risk weight floor is also necessary to narrow the gap between the credit risk capital requirements between the enterprises and the large U.S. banking institutions for similar exposures. The FHFA's final rule states that:

> the gap in credit risk capital requirements relative to the Basel and U.S. banking frameworks also suggests that the Enterprises would continue to have a competitive advantage over some other sources of mortgage credit. That would heighten risk to the competitiveness, efficiency, and resiliency of the national housing finance markets.[20]

Thus, it is not surprising that the Financial Stability Oversight Council (FSOC) urged the "FHFA and other regulatory agencies to coordinate and take other appropriate action to avoid market distortions that could increase risks to financial stability by generally taking consistent approaches to the capital requirements and other regulation of similar risks across market participants, consistent with the business models and missions of their regulated entities."[21] The FSOC also found that "risk-based capital requirements and leverage ratio requirements that

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[17] Page 82,173 of the 2020 final rule states that "Mitigation of model risk has figured prominently in FHFA's design of the final rule, including the calibration of the floor." Thus, the 20 percent risk weight floor is necessary to mitigate the model risks inherent to the risk-sensitive methodology used to calibrate the risk weights for mortgage exposures.

[18] In fact, the leverage requirements serve as a backstop to the risk-based requirements, so a reduction to the risk-based requirements could prompt a recalibration of the leverage requirements. There is no rationale for the reverse.

[19] The FHFA has not provided any discussion of the effects from any change to the risk weight floor on mortgage exposures, aside from the potentially significant reductions in the enterprises' risk-based capital requirements associated with reducing the risk weight floor. If the FHFA considers such a change, it should solicit comments on a specific change, and include in its notice a discussion of the implications of that reduction in the risk weight floor (including the change in the risk-based capital and the gap between the credit risk capital requirements of the enterprises and those of other financial institutions for similar risk exposures).

[20] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,173.

[21] Financial Stability Oversight Council, "Financial Stability Oversight Council Statement on Activities-Based Review Of Secondary Mortgage Market Activities," September 25, 2020, p. 2, https://home.treasury.gov/system/files/261/Financial-Stability-Oversight-Councils-Statement-on-Secondary-Mortgage-Market-Activities.pdf.

are materially less than those contemplated by the [2020] proposed rule would likely not adequately mitigate the potential stability risk posed by the Enterprises."[22]

The Prescribed Leverage Buffer Amount (PLBA)

The proposed rule states that the FHFA is "proposing a recalibration of the PLBA because a leverage ratio that exceeds risk-based capital requirements throughout the economic cycle could lead to undesirable outcomes at the Enterprises…"[23] It is true that a leverage-based capital requirement could be problematic if it is binding throughout the economic cycle, but the leverage requirement is explicitly designed as an occasionally binding backstop.[24] The FHFA provides no evidence that the existing ERCF leverage-based requirements would be binding "throughout the economic cycle." The fact (cited by the FHFA in the proposed rule) that the leverage requirement for Freddie Mac exceeds its risk-based capital requirement as of September 30, 2019, and as of March 31, 2021, is irrelevant. Fannie Mae's adjusted total capital requirement *exceeds* its leverage-based requirement on the same dates.

If anything, given the decade long (above average) increasing trend in home prices, the enterprises' leverage-based requirements *should* exceed their risk-based requirements – by design, this relationship would demonstrate that the leverage requirement is, in fact, a credible backstop. Moreover, it is difficult to envision any realistic scenario in which the amendments to the PLBA in the proposed rule would result in a leverage-based requirement that *could* exceed the risk-based requirement. Put differently, the proposed changes to the PLBA would, in fact, fail to achieve "the primary purpose of the ERCF's leverage requirement and PLBA," which, of course, is "to serve as a credible backstop to the risk-based capital requirements and risk-based capital buffers."[25]

Importantly, the FHFA has not explained how the methodology it originally used to calibrate the PLBA might be flawed. According to the 2020 final rule, "The 1.5 percent PLBA is calibrated to ensure that the PCCBA and PLBA have an effective complementary relationship such that each is independently meaningful."[26] In the final rule, the FHFA stated that "[T]he relative sizing of the PLBA is generally consistent with the relative sizing of similar buffers under the U.S. banking framework. A 1.5 percent PLBA for the Enterprises is 37.5 percent of the 4.0 percent PLBA-

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[22] Financial Stability Oversight Council, p. 4.
[23] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,232.
[24] The FHFA final rule acknowledges this feature, stating that "if the leverage ratio requirements are to be an independently meaningful and credible backstop, there will inevitably be some exceptions in which the leverage ratio requirements exceed the risk-based capital requirements." Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,163. Importantly, these exceptions do not pose safety and soundness concerns; the enterprises will make pricing and other economic/operational decisions based on their expected capital requirements for the full duration of their risk exposures, fully aware that their risk-based capital requirements will usually exceed their leverage-based capital requirements.
[25] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,232.
[26] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,168.

adjusted leverage ratio requirement to avoid payout restrictions. The 2.0 percent supplementary leverage ratio requirement of the U.S. banking framework is 40 percent of the 5.0 percent buffer-adjusted leverage ratio requirement to avoid payout restrictions. Finally, FHFA notes that the Federal Home Loan Banks are subject to a 4.0 percent total leverage ratio requirement."[27]

Furthermore, the enterprises' existing leverage-based capital requirements are consistent with the enterprises' historical loss experiences. In the 2020 final rule, the FHFA notes that "[t]he Enterprises' crisis-era cumulative capital losses peaked at the end of 2011 at $265 billion, approximately 4.8 percent of their adjusted total assets as of December 31, 2007."[28] The 2020 final rule also explains that the enterprises' historical loss experience could *understate* the regulatory capital necessary to remain a viable going concern. The 2020 final rule states that "[t]he Enterprises' historical loss experience actually might tend to understate the regulatory capital that would be necessary to remain a viable going concern. The Enterprises' crisis-era losses likely were mitigated to at least some extent by the unprecedented support by the federal government of the housing market and the economy and also by the declining interest rate environment of the period. The calibration of the leverage ratio requirements cannot assume a repeat of those loss mitigants."[29]

Again, the broader point is that the FHFA, in the 2020 final rule, believed that "the risks and limitations associated with the underlying historical data and models used to calibrate the credit risk capital requirements reinforce the importance of leverage ratio requirements that safeguard against model risk and measurement error."[30] Yet, the FHFA's proposed rule fails to explain how the methodology it originally used to calibrate the PLBA might be flawed, and the preamble in the proposed rule fails to acknowledge that the FSOC affirmed the calibration of the leverage-based requirements.[31]

The FHFA tries to justify reducing the enterprises' PLBA by appealing to a recent U.S. banking regulatory proposal, but the FHFA fails to make this case. The FHFA states, for instance, that "Evolutions in the international and U.S. banking frameworks and public comments on FHFA's 2020 re-proposed capital rule support the proposed PLBA recalibration,"[32] and that "Basel III standards require systemically important banks to hold a tier 1 capital leverage ratio buffer in excess of a 3 percent leverage requirement equal to 50 percent of a GSIB's higher loss-

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[27] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,168. Interestingly, the FHFA has not indicated any similar concerns with a binding leverage requirement for the Federal Home Loan Banks.
[28] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,162.
[29] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,162.
[30] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework," Final Rule, p. 82,162.
[31] The FSOC stated that "leverage ratio requirements that are materially less than those contemplated by the proposed rule would likely not adequately mitigate the potential stability risk posed by the Enterprises," and that "it is possible that additional capital could be required for the Enterprises to remain viable concerns in the event of a severely adverse stress…" Financial Stability Oversight Council, p. 4.
[32] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,232.

absorbency risk-based requirements."[33] The FHFA then states that it intended to amend the PLBA "in a manner similar to the U.S. banking regulators' proposal to set the eSLR buffer to one-half of the GSIB surcharge,"[34] and that "a dynamic PLBA that is tied to the stability capital buffer would further align the ERCF with Basel III standards."[35]

Yet, the PLBA amendments in the proposed rule do not achieve the FHFA's stated goals, and they are not similar to, or aligned with, the federal banking regulators' proposal *or* the Basel III standards.[36] The GSIB surcharge is a percent of *risk-weighted assets*, and the stability capital buffer is a percent of *adjusted total assets*. To align the PLBA with federal regulators' proposal and the Basel III framework, the enterprises' stability capital buffer would have to be converted to an equivalent metric expressed as a percent of risk-weighted assets (one that is then divided in half to determine the dynamic PLBA).

Under such an approach, based on the information in the fact sheet that accompanied the proposed rule, as of March 31, 2021, Fannie Mae would have had a PLBA-adjusted leverage ratio requirement of 4.1 percent (rather than 3.0 percent), and Freddie Mac would have had a PLBA-adjusted leverage ratio requirement 3.5 percent (rather than 2.9 percent).[37] Thus, the risk-based adjusted total capital requirement for each of the enterprises' would have *exceeded* its PLBA-adjusted leverage requirement. Using this approach would result in leverage-based

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[33] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, pp. 53,232-53,233.

[34] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,237.

[35] Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer," Notice of Proposed Rulemaking, p. 53,238.

[36] See, for instance, Basel Committee on Banking Supervision, "Leverage Ratio Requirements for Global Systemically Important Banks," 40.2, effective January 1, 2023, https://www.bis.org/basel_framework/chapter/LEV/40.htm?inforce=20220101&published=20191215.

[37] In the fact sheet that the FHFA released with the proposed rule, the FHFA states that "Under the amended rule, as of March 31, 2021, Fannie Mae's PLBA would decrease from approximately $62 billion, or 1.5 percent of adjusted total assets, to approximately $23 billion, or 0.53 percent of adjusted total assets. Freddie Mac's PLBA would decrease from approximately $46 billion, or 1.5 percent of adjusted total assets, to approximately $11 billion, or 0.35 percent of adjusted total assets." Federal Housing Finance Agency, "Proposed Rule to Amend Enterprise Regulatory Capital Framework," Fact Sheet, September 23, 2021, https://www.fhfa.gov/Media/PublicAffairs/Pages/Proposed-Rule-to-Amend-Enterpise-Regulatory-Capital-Framework.aspx. These figures imply a stability capital buffer, expressed as a percent of adjusted total assets, of 1.06 percent and 0.70 percent of adjusted total assets for Fannie Mae and Freddie Mac, respectively. These stability capital buffers can be converted to an equivalent metric expressed as a precent of risk-weighted assets by dividing each by the respective enterprise's average risk weight. Although the FHFA has not publicly released the enterprises' average risk weight (as of March 31, 2021), the data provided in the fact sheet implies an average risk weight (risk-weighted assets divided by adjusted total assets) of 33 percent for Fannie and 32 percent for Freddie (both as of September 30, 2020). Using these average risk weights, Fannie's stability capital buffer was 3.27 percent of risk weighted assets (as of March 31, 2021), and Freddie's stability capital buffer was 2.10 percent of risk weighted assets (as of March 31, 2021). Dividing in half, consistent with federal regulators' proposal and the Basel III framework, results in a PLBA of 1.63 percent for Fannie and 1.05 percent for Freddie, as well as a PLBA-adjusted leverage ratio requirement of 4.1 percent for Fannie and a PLBA-adjusted leverage ratio requirement of 3.5 percent for Freddie.

capital requirements that, unlike those using the approach in the proposed amendments, could serve as a credible backstop to the risk-based capital requirements.

Again, I appreciate the opportunity to submit comments to the Federal Housing Finance Agency. The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace, and the Center for Monetary and Financial Alternatives today's centralized, bureaucratic, and discretionary monetary and financial-regulatory systems and to identifying, studying, and promoting alternatives more conducive to a stable, flourishing, and free society. The opinions I express here are my own.

Sincerely,

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Vice President and Director,
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