CHASE

November 19, 2021

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

Re: Amendments to the Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer; RIN-2590-AB17

Dear Mr. Jones:

JPMorgan Chase Bank, N.A. ("Chase," "we," or "our") appreciates the opportunity to comment on the Federal Housing Finance Agency ("FHFA") Amendments to the Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer; RIN-2590-AB17 (the "Amended Capital Rule"). Chase is one of the largest originators and servicers of residential mortgages in the United States and JPMorgan Chase & Co., through its subsidiaries, is active in all aspects of the U.S. housing finance industry, including as an originator, purchaser and seller of home loans, as well as an underwriter, issuer, distributor, and investor in mortgage-backed securities ("MBS"). Accordingly, we draw on a broad base of experience in offering our comments to the Amended Capital Rule.

A sound regulatory capital framework should be designed so it is durable through economic cycles and unaffected by any potential post-conservatorship end state. To meet this objective, the capital framework for Fannie Mae and Freddie Mac's (the "Enterprises") should adhere to the following five core principles:

1. Facilitate the transfer of as much risk as possible to private investors to optimize the Enterprises' capital use, lower overall risk and, therefore, safeguard taxpayers from mortgage credit risk while ensuring robust, nationwide access to mortgage credit for American families.
2. Leverage credit risk transfers to integrate market feedback in the calibration of guarantee fees.
3. Preserve the smooth functioning of the To-be-Announced ("TBA") market in a wide range of economic environments, including, if and when applicable, through and after a transition out of conservatorship.
4. Be as clear and simple as possible to ensure durability under stress, preserving optionality to optimize the post-conservatorship end state.
5. Provide for transparency and appropriate monitoring by FHFA.

This letter underscores our belief on the importance of a robust Enterprise credit risk transfer ("CRT") program as being foundational to enabling the Enterprises to continue to perform their critical mission in times of stress while limiting the risk to U.S. taxpayers. Accordingly, we incorporate by reference in this supplemental comment letter our August 26, 2020, comment letter in its entirety.[1]

[1] https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15586

CRT Is Essential for Prudent Guarantee Fee Pricing

Chase applauds the FHFA's prompt action to amend the capital rule finalized in January 2021 (the "January 2021 Capital Rule"). The Amended Capital Rule recognizes the risks inherent in significantly reducing the Enterprises' incentives to transfer credit risk to private investors. FHFA's own estimates show that under the January 2021 Capital Rule the additional capital charges and 10% risk-weight floor reduce the benefits of CRT roughly by half.[2] Given the binding constraint on the Enterprises' balance sheets imposed by the leverage ratio before recalibration under the Amended Capital Rule, under most economic conditions, the January 2021 Capital Rule, if left unamended, would have encouraged the Enterprises to retain more credit risk, unnecessarily increasing risks for U.S. taxpayers.

Credit Risk Transfer ("CRT") allows for prudent risk management and the introduction of private capital in a way that is otherwise unavailable to the Enterprises through more efficient means. Increased stability at the Enterprises enhances their ability to focus on their mission, particularly broadening access to affordable lending. CRT is a critical feature of modern risk management and helps incorporate market feedback in risk pricing decisions.[3] A well-designed CRT program also could facilitate targeted reductions to mortgage guarantee fees by enabling the generation of return on equity ("ROE") thresholds acceptable to equity investors while increasing the Enterprise's capacity to support the U.S. housing market. A framework that acknowledges the efficacy of CRT would allow the Enterprises to meet their overall level of required capital in a more efficient manner than a capital model that shifts the mitigation of mortgage credit risk to higher-cost corporate equity.[4]

The Amended Capital Rule CRT creates incentives for the Enterprises to scale CRT usage and should encourage FHFA to consider the benefits that would inure from increased private capital supporting the Enterprises' mission through CRT.[5] A CRT program that includes a predictable, programmatic introduction of private capital into the Enterprises' risk management goals would significantly de-risk the Enterprises' overall balance sheet. The Federal Reserve Bank of New York's research has highlighted how the Enterprises' CRT programs have "improved the stability of the housing finance system and advanced a number of important objectives of GSE reform. In particular, the CRT programs have meaningfully reduced the federal government's exposure to mortgage credit risk without disrupting the liquidity or stability of secondary mortgage markets."[6]

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[2] See Table 3 in Parrott et.al. at https://www.urban.org/sites/default/files/publication/102595/fhfa-capital-rule-is-a-step-backward_0.pdf

[3] SFA White Paper "Economics of Freddie Mac and Fannie Mae Credit Risk Transfer", available at https://structuredfinance.org/wp-content/uploads/2021/09/SFA-CRT-White-Paper-FINAL-FORMAT.pdf

[4] Additional focus on modernizing and recalibrating servicing rules, particularly by implementing a fee-for-service model, can materially assist the enterprises mitigate potential credit losses and reduce the need for loss absorption capital.

[5] FHFA Reopens GSE Capital Rule: Nature is Healing, Kaustub Samant, 9/15/2021 https://www.jpmm.com/research/content/GPS-3863085-0.pdf

[6] Federal Reserve Bank of New York's research available at https://www.newyorkfed.org/medialibrary/media/research/epr/2018/epr_2018_credit-risk_finkelstein.pdf.

The 5% CRT Capital Charge is Reasonable

We support the Amended Capital Rule's recalibration of the risk-weight floor for CRT from 10% to 5%. A review of hypothetical marginal returns in CRT structures shows that the recalibration of the risk-weight floor would create clear incentives for the Enterprises to use CRT while providing reasonable protection from modeling risk. The table below shows that, while a 10% risk-weight floor generates marginal returns below the cost of capital, a 5% risk-weight floor allows for clear positive returns in excess of the cost of capital and avoids over-incentivizing CRT creation given potential model precision risk.

		CRT 2021 NPR				
Illustrative	No CRT	0% Floor	5% Floor	10% Floor	15% Floor	20% Floor
Loan RWA (A)	38.2%	38.2%	38.2%	38.2%	38.2%	38.2%
CRT Capital Relief (B)	0.0%	36.4%	31.5%	26.7%	21.8%	17.0%
CRT-Adjusted RWA (C = A-B)	38.2%	1.8%	6.7%	11.5%	16.3%	21.2%
Loan G-fee (D)	56	56	56	56	56	56
CRT Credit Costs (E)	0	9	9	9	9	9
Treasury All. + Costs (F)	25	25	25	25	25	25
Net G-fee (G = D-E-F)	31	22	22	22	22	22
Total Capital Ratio (H)	8%	8%	8%	8%	8%	8%
CRT-Adjusted Capital (I = C*H)	3.06%	0.15%	0.53%	0.92%	1.31%	1.69%
RBC Buffers (J)	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
Final ROE (G/(I+J))	6.8%	13.4%	10.8%	9.1%	7.9%	6.9%
ROE impact vs no CRT		**6.6%**	**4.0%**	**2.3%**	**1.0%**	**0.1%**

JPMorgan Research [7]

CRT Provides Loss Absorption Capacity at a Lower Cost Than Other Forms of Capital.

Under most market conditions, we believe that CRT costs will likely be lower than the cost of equity and other forms of capital. A well-designed CRT program should be an essential component to calibrate the right mix of common equity, buffers and other capital sources that are required to optimize the overall cost of capital protecting MBS investors while lowering the overall cost of mortgages and protecting U.S. taxpayers. We believe that to be the case because a well-designed CRT program would provide the Enterprises an essential real-time, market-informed view regarding guarantee fees,[8] and allow FHFA and the Enterprises to respond and recalibrate guarantee fees appropriately.[9]

[7] Assumes losses of 25bp, which results in 100% B3 write down and it not contributing to the implied g-fee in this illustrative analysis. Actual implied g-fee will be higher due to B3 coupon payments prior to full tranche write-down. Model WAL calculated at new issue to call. 15bp "other costs" reflects 7bp residual risk (e.g. operational risk, term risk and counterparty risk) and 8bp admin expense, sourced from Q42017 FHFA CRT Progress Report.

[8] White paper available at http://www.freddiemac.com/fmac-resources/perspectives/pdf/CRT-GFee-White-Paper-Final.pdf.

[9] To further calibrate market signaling. FHFA should consider reviewing the impact of the current risk multipliers that require the Enterprises to hold additional capital for loans that are TPO rather than retail. These risk multipliers could lead, in certain cases, to a situation in which an identical mortgage loan draws variable risk-based capital not driven by underlying credit risk –

The table below provides a hypothetical illustration based on prevailing market conditions for large U.S. banks (capitalization over 100 Billion) as of this writing.

Illustrative:	Approximate cost of capital – U.S. banks compared to CRT				
	CRT	Senior	Sub	<4yr callable preferred	Equity
Thickness of tranche	3%				
Interest cost	2.99%				
Total cost	**0.09%**	**2.89%**	**3.15%**	**4.76%**	**10%**

Source: JPM Research

CRT Program Features

FHFA and the GSEs should formally adopt predictable, programmatic CRT issuances. This is an important element for the engagement of private capital investors and the development of liquidity for CRT programs and a feedback lookback for the pricing of guarantee fees. We believe that capital market feedback can offer valuable signals for calibrating guarantee fees.

CRT programs should be clear about the definition and allocation of losses. Additionally, FHFA and the Enterprises should consider piloting CRT programs that align collateral disclosures with emerging ESG loan level standards to deepen CRT liquidity by attracting ESG investors that typically could not invest in mortgage credit risk but seek to support investments with social purpose.

The Enterprises' CRT programs should ensure that, under all circumstances, each CRT issuance definitively, and without recourse, transfers significant credit risk to investors upon issuance. The final Enterprise capital rule should reduce capital charges commensurately with the risk transferred.[10] Investor cashflows from each CRT issuance should be linked to the performance of a defined pool of underlying loans, providing the originating Enterprise with first loss protection on the reference pool. Cash proceeds from each CRT issuance should be commensurate with the investors' obligation to absorb a defined level of credit losses on the reference pool.[11]

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the opposite of what should occur to promote the development of more precise CRT market feedback mechanisms. See Table 14 in https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-11279.pdf.

[10] " …. In setting and adjusting the fees for Government guarantees of qualifying MBS, FHFA should consider:

- the expected fees and payments under the guarantee so as to endeavor to reduce the cost of the program, discounted on a risk-adjusted basis, to zero over a period that contemplates fluctuations in economic conditions consistent with historical experience.
- the conditions affecting the housing finance system so as to provide for reasonable stability in the fee, notwithstanding the varying risk through fluctuations in housing and economic conditions during that period; and
- any available pricing information associated with relevant private sector transactions (e.g., CRT transactions of guarantors)." Treasury Reform Plan at p.15-16.

[11] "Treasury Recommends: … FHFA should, in prescribing regulatory capital requirements, provide for appropriate capital relief to the extent that a guarantor, or a GSE pending legislation, transfers mortgage credit risk through a diverse mix of approved forms of CRT. (administrative)" Treasury Reform Plan at p.15-16.

CRT program features worth preserving or enhancing include:

- Day-1, first-loss (net of MI coverage) risk transfer
- REMIC eligibility
- TBA eligibility
- Cash collateral
- No implied support from the issuer
- Reflect actual, realized losses
- One-to-one reduction of RWA commensurate with risk of loss transferred
- Revising the treatment of loss mitigation programs to ensure CRT reflects realized losses
- Align call requirements with prevailing market practices (10% clean-up call
- Work with prudential banking regulators to ensure public policies support CRT by ensuring that CRT holdings and secondary support through trading are not disadvantaged by capital rules.

Conclusion

Chase supports the proposed amendments to the Enterprises' Capital Framework, as their overall size would be primarily bound by risk-based capital calculations rather than leverage. A well-designed CRT program will help ensure that the Enterprises will be better able to serve the entire housing market through prudent credit risk management rather than more arbitrary limitations on balance sheet size predicated on leverage.

The Enterprises' amended CRT risk weight floor creates valuable incentives for the GSEs to pursue at scale CRT and engage in prudential credit risk management through CRT. We see CRT as an important tool for the Enterprises to achieve their housing mission and support a longer-term strategic vision to potentially exit conservatorship with lessened capital requirements.

A robust CRT program that aligns with prevailing industry practices will increase the Enterprises' resilience in adverse market conditions. Importantly, a robust CRT program would enable the Enterprises to further their mission by lowering their overall capital costs, facilitating the generation of appropriate ROEs to attract equity investors, and increasing the overall capacity of the Enterprises to guarantee MBS and generate guarantee fee income with the same level of equity capital, thereby improving liquidity in the TBA market, and lowering mortgage costs for more American families.

Sincerely,

Mark W. O'Donovan
CEO Home Lending