



November 24, 2021

*By Electronic Delivery Through the FHFA Website*

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

**Re: Comments/RIN 2590-AB17 – Proposed Rulemaking on Enterprise Regulatory Capital Framework – Prescribed Leverage Buffer Amount and Credit Risk Transfer**

Dear Mr. Jones:

Freddie Mac is pleased to submit our enclosed comments on the Federal Housing Finance Agency's proposed rule that would amend the Enterprise Regulatory Capital Framework by refining the prescribed leverage buffer amount and credit risk transfer.

Freddie Mac appreciates the opportunity to provide our views on the proposed rule. Please do not hesitate to contact me if you have any questions.

Sincerely,

Christian M. Lown  
Executive Vice President and Chief Financial Officer

Enclosure



# **Freddie Mac**

***Comments on the Proposed Enterprise Regulatory Capital Framework Rule –  
Prescribed Leverage Buffer Amount and Credit Risk Transfer by the Federal  
Housing Finance Agency***

***November 24, 2021***

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## I. Introduction

Freddie Mac greatly appreciates the opportunity to provide comments on the Federal Housing Finance Agency’s (“FHFA’s”) recently proposed amendments to the Enterprise Regulatory Capital Framework (“ERCF”) (the “Proposal”).<sup>1</sup> Freddie Mac strongly supports a resilient, risk-sensitive capital framework to incentivize robust risk management. This will firmly bolster the Enterprises’ mission to provide liquidity, stability, and affordability to the U.S. housing market in all economic conditions and to all communities. We believe that adoption of the Proposal would further advance these significant objectives.

In order to fulfill Freddie Mac’s statutory mission, as well as meet its capital requirements under the ERCF and related provisions of our Senior Preferred Stock Purchase Agreement with the U.S. Department of the Treasury, Freddie Mac recommends that certain foundational principles guide revisions to the ERCF. Specifically, Freddie Mac recommends that, in amending the ERCF, FHFA should: (1) ensure that risk-based principles govern the capital framework; (2) tailor the framework to the business models and risks inherent to the Enterprises; (3) include only necessary applicable countercyclical measures within the framework; and (4) minimize unintended effects and potentially distortionary impacts on the market and on the Enterprises’ ability to fulfill their statutory mission. Freddie Mac believes that such guiding principles should apply across all modifications to the ERCF, including potential further enhancements as suggested under Section V of these comments.

Mindful of these principles, Freddie Mac very much supports FHFA’s proposed amendments to the ERCF. The Proposal properly focuses on the Enterprises’ incentives to help ensure that the binding capital constraint normally is the risk-based requirement (rather than the leverage requirement) and that Credit Risk Transfer (“CRT”) transactions are not unduly constrained. Both elements will allow the Enterprises to build capital in a safe and sound manner, while also ensuring that U.S. taxpayers and the broader U.S. housing market do not bear undue risk. In addition, Freddie Mac offers a number of other recommendations that we believe will help further enhance the ERCF framework.

In the subsequent sections below, Freddie Mac provides our comments and recommendations:

- Part II addresses the proposed revisions to the Prescribed Leverage Buffer Amount (“PLBA”).
- Part III addresses the proposed revisions to the treatment of retained CRT exposures.
- Part IV includes our responses to FHFA’s questions concerning mitigation of the pro-cyclicality of requirements for multifamily exposures and the ERCF risk-weight floors for single-family and multifamily exposures.
- Part V includes our recommendations for additional enhanced modifications to the ERCF; such potential refinements include proposed changes to the stress and stability capital buffers under the risk-based requirements, reconsideration of the advanced approaches for credit and market risks, extending the ERCF reporting compliance date, and certain technical revisions to multifamily look-up tables and risk multipliers.

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<sup>1</sup> FHFA, Enterprise Regulatory Capital Framework Rule—Prescribed Leverage Buffer Amount and Credit Risk Transfer, 86 Fed. Reg. 53230 (Sep. 27, 2021).

## II. Comments and Recommendations Related to Proposed Prescribed Leverage Buffer Amount (“PLBA”) Revisions

### A. *In response to Question 2 in the Proposal, Freddie Mac recommends that FHFA adopt the proposed PLBA equal to 50% of an Enterprise’s stability capital buffer*

The ERCF includes a leverage ratio of Tier 1 capital to Adjusted Total Assets (“ATA”) of 2.5%.<sup>2</sup> In addition, each Enterprise is required to maintain a fixed Tier 1 capital PLBA equal to at least 1.5% of ATA in order to avoid limitations on capital distributions and discretionary bonus payments, consistent with the banking capital framework.<sup>3</sup> The Proposal would replace the current fixed PLBA with a more dynamic PLBA buffer equal to 50% of an Enterprise’s stability capital buffer calculated in accordance with 12 CFR 1240.400.<sup>4</sup> Freddie Mac very much supports the adoption of this proposed revision to the PLBA, as we believe that it is more aligned with the spirit and intent of the leverage ratio, as well as with the international banking standards as adopted by the Basel Committee on Banking Supervision (“BCBS”) and by U.S. regulators.

Freddie Mac believes that the proposed PLBA increases the incentives for an Enterprise to transfer and reduce risk in comparison to the current PLBA specified in the ERCF framework.<sup>5</sup> When leverage capital is consistently the binding capital constraint, it provides an incentive for an institution to increase risk-taking activities, as such actions are not reflected in commensurately higher capital requirements (given that leverage is binding). When leverage capital exceeds risk-based capital, high-risk exposures and low-risk exposures have the same capital requirements, so an Enterprise has an incentive to acquire higher-risk, higher-yielding mortgages, all else being equal – which could generate potentially distortionary and unintended consequences for the Enterprises over time. The proposed change aligns with the U.S. banking model and is generally consistent with existing domestic and international banking standards. For example, to help reduce the incentive for firms to take on greater risks, U.S. banking regulators in 2020 removed a proposed Stress Leverage Buffer (“SLB”) in favor of a singular, streamlined Stress Capital Buffer (“SCB”) as a means to further bolster and integrate a risk-sensitive capital framework.<sup>6</sup>

Furthermore, our current risk transfer strategy is supported by lowering the long-run risk-based capital target for our book. A dynamic leverage buffer that expands and contracts with an Enterprise as it evolves in size and strategy can function and ultimately serve as an effective backstop to risk-based capital requirements. Furthermore, as recognized by FHFA, a dynamic PLBA tied to the stability capital buffer continues to align the current ERCF framework with existing international and proposed U.S. banking standards, which endorses the notion that systemically important banks hold a Tier 1 capital leverage ratio buffer equal to half of each firm’s Global Systemically Important Bank (“G-SIB”) capital surcharge.<sup>7</sup>

#### *Technical Comment*

Freddie Mac recommends that FHFA revise proposed Section 1240.11(a)(6) so that the cross-reference to subpart G for purposes of calculating the PLBA refers to Sections 1240.400(b)(1)-(4) only.

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<sup>2</sup> 12 CFR 1240.10(f).

<sup>3</sup> 12 CFR 1240.11(a)(6).

<sup>4</sup> Proposed 12 CFR 1240.11(a)(6).

<sup>5</sup> The Proposal specifically asks the following: “Question 2: Is the proposed PLBA appropriately formulated? What adjustments, if any, would you recommend?” 86 Fed. Reg. at 53238.

<sup>6</sup> See Board of Governors of the Federal Reserve System, Press Release, “Federal Reserve Board approves rule to simplify its capital rules for large banks, preserving the strong capital requirements already in place” (Mar. 4, 2020) (available at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm>).

<sup>7</sup> See 86 Fed. Reg. at 53238.



This revision (*i.e.*, excluding Section 1240.400(b)(5)) results is a calculation that is a percentage rather than a dollar amount.

*B. In response to Question 3 of the Proposal, Freddie Mac believes that the proposed PLBA supports the ERCF's leverage framework as a credible backstop to the risk-based capital requirements and Prescribed Capital Conservation Buffer Amount ("PCCBA"); however, the PLBA may need to be further calibrated per any revisions made to the current risk-based requirements (including any prospective changes to the Stability Capital Buffer)*

We support the proposed PLBA revisions as establishing a credible backstop to the risk-based capital requirements and the PCCBA.<sup>8</sup> Tailoring an Enterprise's leverage ratio to its business activities and risk profile allows for leverage to remain a credible backstop to risk-based capital requirements without discouraging the Enterprise from participating in low-risk activities. If the proposed amendments to the PLBA are adopted, Freddie Mac's Tier 1 leverage requirement would be approximately 2.87% of ATA, based on Freddie Mac's current market share, with the company's current stability capital buffer estimated to be approximately 73.6 basis points.<sup>9</sup>

A credible backstop should serve as a "floor" and should not become a routinely binding capital constraint. Generally, the risk-based requirement should be binding under most scenarios, with the exception of economic conditions marked by sustained mortgage acquisition volume and housing price increases. In order for the PLBA to act as a credible backstop, the binding constraint should shift from the risk-based capital requirement to the leverage requirement under a constant positive housing price appreciation ("HPA") environment where risk density (risk-weighted assets ("RWA") / ATA) declines beyond a critical point (*i.e.*, the point at which the risk-based requirement is exactly equal to the leverage requirement).

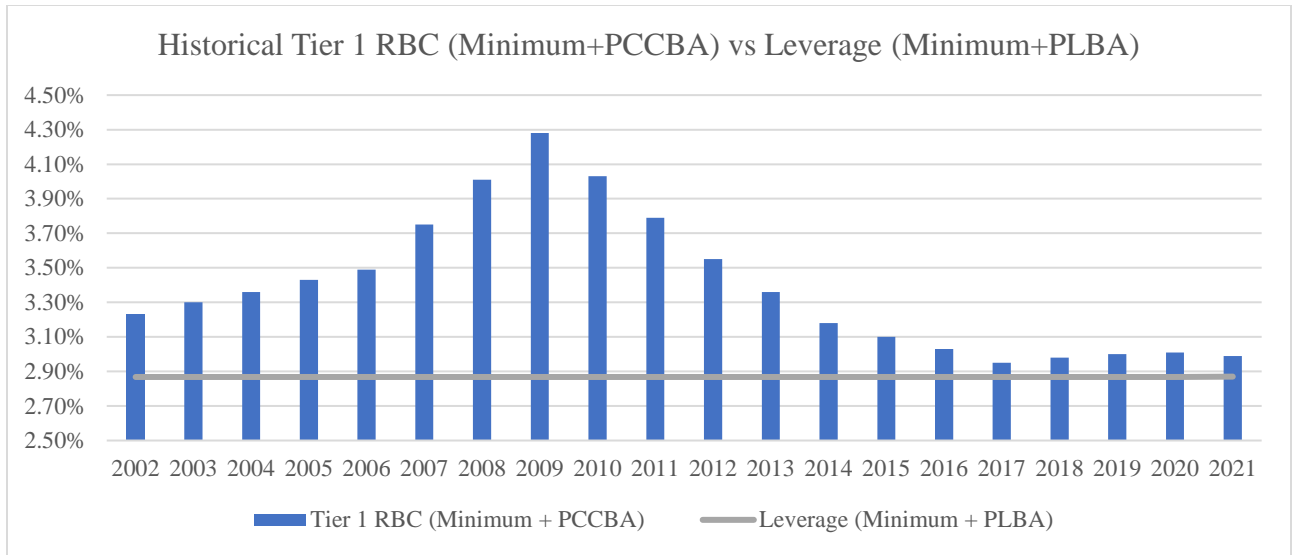
Freddie Mac's review of the Proposal's PLBA requirements (which are similar to the U.S. banking capital framework's supplementary leverage ratio ("SLR") requirements, with both on- and off-balance sheet items captured equally within the ATA denominator) and with no changes to the current risk-based capital requirement leads to Freddie Mac's conclusion that the proposed leverage framework would function as a credible backstop. It is important to note that this conclusion assumes no changes to the risk-based capital requirements, including the risk-weighted floors; if there are changes to risk-based requirements, further calibration of the PLBA may be justified and necessary.

If the proposed amendments had been in effect, the leverage measurement (2.5% of ATA plus the PLBA) would not have been the historically binding capital constraint over the past two decades, as seen in the table below.

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<sup>8</sup> The Proposal specifically asks the following: "Question 3: Is the PLBA necessary for the ERCF's leverage framework to be considered a credible backstop to the risk-based capital requirements and PCCBA?" 86 Fed. Reg. at 53238.

<sup>9</sup> An Enterprise must calculate its stability capital buffer annually. 12 CFR §1240.400(b).



*Note: Freddie Mac historical data is provided for 2002, 2006, 2009, 2012, 2014, 2017, and 2019. Data between years provided was interpolated to complete the data set.*



### III. Comments and Recommendations Related to Proposed Credit Risk Transfer (“CRT”) Exposure Revisions

- A. *In response to Question 5 in the Proposal,<sup>10</sup> Freddie Mac agrees that the 5% prudential floor is generally appropriately calibrated (although Freddie Mac would like FHFA to consider a more nuanced approach to CRT, as described in Section III.C below). Freddie Mac recommends that FHFA adopt the proposed 5% prudential floor on the risk weight for a retained CRT exposure, with the adjustments to the approach on credit risk capital requirements specified below, as well as the proposed elimination of the Overall Effectiveness Adjustment (“OEA”)*

The ERCF includes limits on the amount of capital relief provided by CRT transactions. One such limit is a 10% risk weight floor on all retained CRT exposures.<sup>11</sup> A second limit is the OEA, which reduces the risk-weighted assets of transferred CRT tranches, thereby reducing the capital relief afforded by executing CRT activities.<sup>12</sup> The Proposal would reduce the prudential floor from 10% to 5% on the risk weight assigned to any retained CRT exposure, and it would remove the OEA requirement.<sup>13</sup> Freddie Mac supports these revisions to the ERCF, subject to the recommended adjustments to the approach on credit risk capital requirements specified below, which are analytically justified.

In the preamble to the Proposal, FHFA describes some limitations of CRT.<sup>14</sup> We agree that Freddie Mac retains credit risk to the extent it retains CRT exposures. We also agree that a prudential risk weight floor is an appropriate mechanism to capture this risk. That being said, Freddie Mac also proposes a more nuanced approach to the proposed flat 5% CRT floor, recommending that FHFA consider a sliding scale of 0-5% for the floor. Our response in Section III.C below provides more details on our recommendation, which we believe can be analytically justified.

- B. *In response to Question 6 of the Proposal, Freddie Mac believes that the proposed removal of the OEA in the CRT securitization framework is appropriate in light of the proposed rule’s 5% prudential floor on the risk weight for retained CRT exposures<sup>15</sup>*

Freddie Mac agrees that the removal of the OEA in the CRT framework is an appropriate change as it ensures the ERCF properly incentivizes the use of CRT without compromising safety and soundness. Any fundamental advantages that equity capital offers over CRT are adequately captured by the 5% prudential floor.

- C. *In response to Question 7 of the Proposal, Freddie Mac believes that further adjustments to the proposed approach to determine the credit risk capital requirements should be considered in order to ensure greater risk sensitivity, and Freddie Mac recommends that FHFA include an adjustment*

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<sup>10</sup> Question 5 in the preamble of the Proposal asks: “Is the 5 percent prudential floor on the risk weight for a retained CRT exposure appropriately calibrated? What adjustment, if any, would you recommend?” 86 Fed. Reg. at 53239.

<sup>11</sup> 12 CFR 1240.44(e).

<sup>12</sup> 86 Fed. Reg. at 53235-36; 12 CFR 1240.44(f) and (i).

<sup>13</sup> See 86 Fed. Reg. at 53238-39.

<sup>14</sup> 86 Fed. Reg. at 53238.

<sup>15</sup> Question 6 in the preamble of the Proposal asks: “Is the removal of the overall effectiveness adjustment within the CRT securitization framework appropriate in light of the proposed rule’s 5 percent prudential floor on the risk weight for retained CRT exposures?” 86 Fed. Reg. at 53239.

*in the ERCF to determine the credit risk capital requirements for the retained CRT exposures.<sup>16</sup> Freddie Mac estimates that this potential revision, which would provide a more nuanced approach to CRT treatment, could lead to potential capital savings of approximately \$3 billion for the Enterprise*

Freddie Mac believes that FHFA’s proposed approach to determine credit risk capital requirements for retained CRT exposures could be further enhanced by the following refinements:

If a retained CRT tranche<sup>17</sup> attaches higher than collateral Stress Default Cost (“SDC”), the Tranche Risk Weight (“Tranche RW”) is calculated using Equation 1. If a retained CRT tranche attaches at or below collateral SDC, the Tranche RW is calculated using Equation 2.

Tranche RW = 5% \* MAX (1-(A-SDC)/(0.25\*SDC),0) ..... **Equation 1**

Tranche RW = MAX (1250%\*(SDC - A),5%) ..... **Equation 2**

SDC = Sum of KA and AggEL%. Or ERCF Capital from the Grids + Expected Loss

Tranche RW = RW associated to a tranche per the ERCF rules

Parameter A= Attachment point for the exposure, which represents the threshold at which credit losses will first be allocated to the exposure

The above equations are applicable only to a retained CRT tranche above Credit Enhancement detach (“CE detach”), which is the attachment point of the retained CRT tranche. For other tranches, Tranche RW equations in the ERCF stay unchanged. The other details of translating Tranche RW to the credit risk requirement for retained CRT exposures remain as provided in the ERCF.

Equations 1 and 2 use the 5% prudential floor on the risk weight for a retained CRT tranche and adjust it for the following reasons:

- Current ERCF equations when applied to calculate the Tranche RW of the retained CRT exposure translate to a fixed securitization penalty<sup>18</sup> that is not necessarily sensitive to the underlying riskiness of the collateral. For example, if a structure detaches at 300 bps, the securitization penalty is fixed at about 40 bps for any level of collateral SDC (see second chart below). Equation 1 addresses this issue when SDC falls lower than CE detach point. The rationale supporting Equation 1 is that the gap between SDC and CE detach point acts as a buffer against model/idiosyncratic risk that is discussed in the ERCF. As this gap increases, the exposure of the retained CRT tranche to model/idiosyncratic risk gets lower. We believe that the variance around the stress-scenario loss expectation is less than 25% and, therefore, the 25% threshold used in Equation 1 is sufficiently conservative.
- When CE detaches lower than SDC, Equation 2 provides that the portion of SDC within the retained CRT tranche offsets some or all of the securitization penalty. The rationale supporting Equation 2 is that when CRT detaches well within collateral SDC exposure, a material portion of capital will

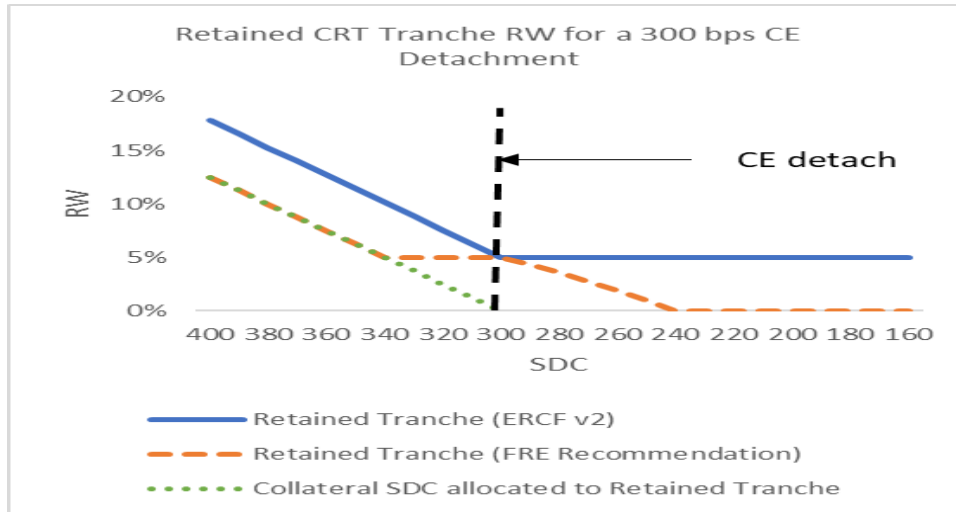
<sup>16</sup> Question 7 in the preamble of the Proposal asks: “Is the proposed approach to determining the credit risk capital requirement for retained CRT exposures appropriately formulated? What adjustments, if any, would you recommend?” 86 Fed. Reg. at 53239.

<sup>17</sup> Retained CRT tranche is the same as retained CRT exposure. This comment uses these terms interchangeably.

<sup>18</sup> Securitization penalty is calculated in bps of the collateral UPB and captures the haircut to CRT relief resulting from a 5% prudential floor applied to the retained CRT exposure.

be raised through equity. In this case, the retained CRT Tranche is not exposed to model/idiosyncratic risk, as the fungible equity which is part of the capital stack will offset it.

The following chart compares the Tranche RW calculation for a retained CRT tranche using the current ERCF and Freddie Mac’s recommended adjustment.

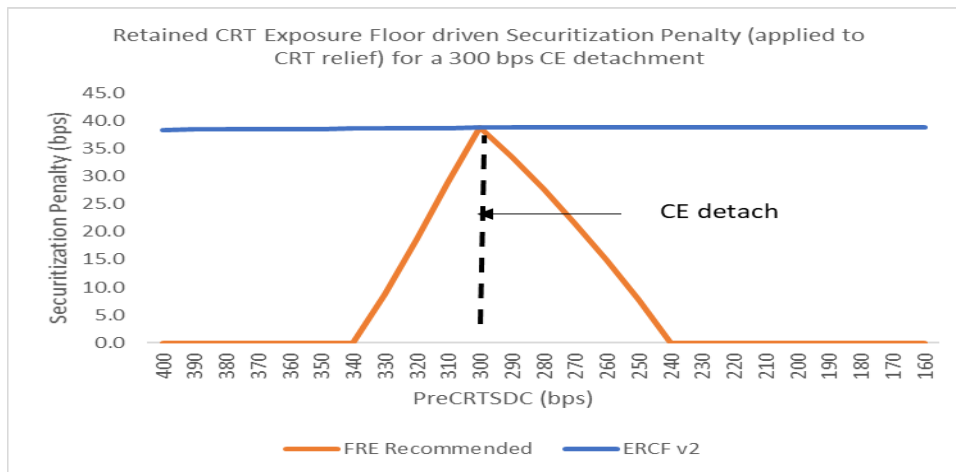


Notes

1. If the retained CRT tranche attaches higher than SDC, the current ERCF is flat at 5% and is agnostic to the gap between SDC and CE detach. On the other hand, Freddie Mac’s recommendation remains sensitive to this gap and gradually slides down from 5% to 0%, justifying a potential downward shift of the CRT floor of between 0% and 5%.
2. If the retained CRT tranche attaches lower than SDC, a portion of the collateral SDC is allocated to the retained CRT tranche.<sup>19</sup> The ERCF Tranche RW calculation (blue line) is consistently higher than the RW of the collateral SDC allocated to the retained CRT tranche and remains agnostic to the gap between collateral SDC and CE detach. In contrast, as the gap between collateral SDC and CE detach widens, Freddie Mac’s recommendation (orange line) has the Tranche RW converging to the RW of the collateral SDC allocated to the retained CRT tranche.

Tranche RW calculations are used to quantify credit capital requirements for the retained tranche. The following chart compares the magnitude of the credit risk capital requirement in basis points of the collateral attributed to the retained CRT tranches under the current ERCF and Freddie Mac’s recommended adjustment.

<sup>19</sup> The dotted green line converts Pre-CRT SDC to an equivalent RW allocated to the retained CRT tranche.



D. In response to Question 8 in the Proposal, Freddie Mac believes that the proposed amendments to the CRT securitization framework should provide the Enterprises with sufficient incentives to engage in CRT transactions<sup>20</sup>

In comparison to current ERCF requirements, Freddie Mac believes that the proposed amendments to the CRT securitization framework provide the Enterprises with sufficient incentives to engage in CRT transactions. FHFA’s proposed amendments take significant strides in the direction of recognizing the risk-reducing nature of CRT and FHFA’s historical policy support for the development of CRT programs. As of the third quarter 2021, the proposed changes to the CRT treatment in the ERCF decrease Freddie Mac’s RWA by \$100 billion. This results in approximately \$8 billion of risk-based capital savings in terms of total capital (per CRT modification amendments in the Proposal). More broadly, from a consolidated view, CRT (inclusive of both single family and multifamily) provides \$31 billion of capital savings (in terms of total capital) as of 3Q21,<sup>21</sup> which would further increase if certain additional recommendations in our comments were to be adopted.

Freddie Mac’s recommended adjustments to the proposed amendments (described in Section III.C) would go a step further and allow greater capital relief. The following table compares credit risk capital benefit of the prior proposed (“ERCF v1”), FHFA’s proposed amendments (“ERCF v2”), and Freddie Mac’s recommended adjustments with a sliding 0% to 5% CRT floor.

<sup>20</sup> Question 8 in the preamble of the Proposal asks: “Will the proposed amendments to the CRT securitization framework provide the Enterprises with sufficient incentives to engage in more CRT transactions without compromising safety and soundness?” 86 Fed. Reg. at 53239.

<sup>21</sup> The \$31 billion CRT relief is calculated assuming that the ERCF framework proposed by FHFA were in effect. This relief would be further amplified should FHFA adopt our proposed CRT relief.

2021 Q3 Freddie Mac SF Portfolio – CRT comparison

| Portfolio Cycle | CRT Portfolio Unpaid Principal Balance (“UPB”) | CRT ERCF Capital Relief (“ERCF v1”) | CRT ERCF Capital Relief (“ERCF v2”) | CRT ERCF Capital Relief (Proposed Amendments with 0% to 5% sliding scale) |
|-----------------|--|-------------------------------------|-------------------------------------|---|
| 2021 Q3         | \$1,174 B                                      | \$13 B                              | \$18 B                              | \$22 B  |

The economics of CRT depend on multiple factors beyond the regulatory capital framework and take into consideration other variables such as market conditions and credit characteristics of guaranteed collateral. All else being equal, the proposed amendments to the CRT securitization framework combined with Freddie Mac’s proposed adjustments significantly improve the economics of these transactions and create an incentive for the Enterprises to execute CRT transactions.

The following table compares the cost of raised capital at deal issuance of a typical CRT transaction for the prior version of the ERCF and the proposed amendments.

Cost of Raised Capital for a Typical CRT Deal<sup>22</sup>

| Deal      | Reference Pool UPB | “ERCF v1”   |                        | “ERCF v2”   |                        | ERCF with Freddie Mac Proposed Adjustments |                        |
|-----------|--------------------|-------------|------------------------|-------------|------------------------|--|------------------------|
|           |                    | ERCF Relief | Cost of Raised Capital | ERCF Relief | Cost of Raised Capital | ERCF Relief                                | Cost of Raised Capital |
| 2021 HQA3 | \$38 B             | 175-185 bps | 5% - 5.5%              | 246 bps     | 4.1%                   | 285 Bps                                    | 3.5%                   |

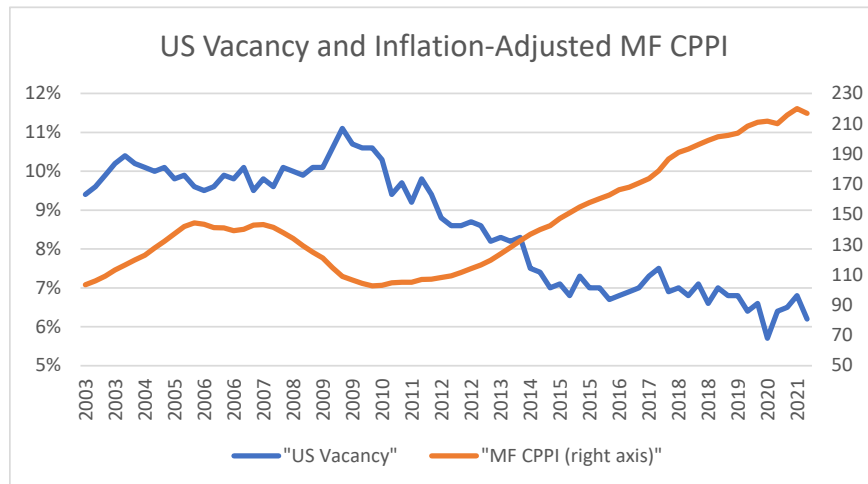
<sup>22</sup> Cost of Raised Capital under ERCF v2 and Freddie Mac’s recommended adjustments have not factored in the additional benefit provided by time-based calls which were not permitted under ERCF v1.

#### IV. Additional Responses to FHFA Questions (1 and 4) in the Proposal

A. In response to Question 1 in the Proposal regarding what, if any, non-proprietary data or indices FHFA should consider in order to mitigate the pro-cyclicality of the credit risk capital requirements for multifamily mortgage exposures, Freddie Mac recommends that FHFA look to use long-term vacancy rates, which Freddie Mac believes would help mitigate procyclicality

The multifamily framework of the ERCF does not include an adjustment to mitigate the pro-cyclicality of the aggregate risk-based capital requirements.<sup>23</sup> FHFA had previously explained that it did not adopt such an adjustment in the ERCF because “FHFA has not identified sufficient public domain data to develop a reliable long-term trend for multifamily property values.”<sup>24</sup> FHFA observed that it sees “considerable merit” to such an adjustment<sup>25</sup> and, in the Proposal, it specifically asks: “What approach that relies only on non-proprietary data or indices should FHFA consider to mitigate the pro-cyclicality of the credit risk capital requirements for multifamily mortgage exposures?”<sup>26</sup>

In response to FHFA’s inquiry, Freddie Mac recommends that FHFA incorporate into the ERCF a multifamily countercyclical adjustment using long-term vacancy rates, based on the negative correlation of such rates with multifamily home pricing. This metric is a key indicator of operating performance, and there is a publicly available government-published index with vacancy data that could be used to calibrate the capital framework.



CPPI = Commercial Property Price Indices

As depicted in the chart above, vacancy rates are negatively correlated with price increases. This correlation is captured in the following table:

| Correlation       | NCREIF Return (1978-Current) |         |        | Moody's (2003-Current) |             | CPI Adjusted (2003-Current) |             |
|-------------------|------------------------------|---------|--------|------------------------|-------------|-----------------------------|-------------|
|                   | Total                        | Capital | Income | CPPI                   | CPPI Change | CPPI                        | CPPI Change |
| US Rental vacancy | -0.25                        | -0.21   | -0.26  | -86%                   | -38%        | -81%                        | -35%        |

NCREIF = National Council of Real Estate Investment Fiduciaries

<sup>23</sup> FHFA, Enterprise Regulatory Capital Framework Rule, 85 Fed. Reg. 82150, 82175 (Dec. 17, 2020).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> 86 Fed. Reg. at 53237 (Question 1).

We recommend the adjustment be applied when realized long-term vacancy rates fall outside a prescribed band of 6-9%. When vacancy rates are below the band (*i.e.*, market conditions are better than normal), Debt Service Coverage Ratios (“DSCRs”) would be reduced and Mark-to-Market Loan-To-Values (“MTMLTVs”) would be increased, and when vacancy rates are above the band (*i.e.*, market conditions are worse than normal), DSCRs would be increased and MTMLTVs would be reduced. In either direction, 25% of the total adjustment amount would be applied to the DSCR, while 75% of the total adjustment amount would be applied to the MTMLTV. When vacancy rates are within the 6-9% band, the base risk weights would apply.

- Adjusted DSCR = DSCR \* (1+ adjustment\*25%)
- Adjusted Loan to Value (“LTV”) = LTV / (1 + adjustment\*75%)

The effect of this proposed adjustment for an individual loan is illustrated here:

| MF Loan (FRM) IO<br>Severely Adverse | Without adjustment |       |               | With Adjustment |      |                    | Cumulative |             | DCR Adjustment | LTV Adjustment |
|--------------------------------------|--------------------|-------|---------------|-----------------|------|--------------------|------------|-------------|----------------|----------------|
|                                      | DCR                | LTV   | Capital (bps) | DCR             | LTV  | Adj. Capital (bps) | NOI trend  | Price Trend |                |                |
| 2019.4                               | 1.40               | 70.0  | 523           | 1.40            | 70.0 | 523                |            |             |                |                |
| 2020.1                               | 1.40               | 72.2  | 561           | 1.40            | 72.2 | 561                | 0.3%       | -3%         | 0.0%           | 0.0%           |
| 2020.2                               | 1.42               | 73.7  | 561           | 1.42            | 73.7 | 561                | 1.1%       | -5%         | 0.0%           | 0.0%           |
| 2020.3                               | 1.42               | 76.9  | 603           | 1.42            | 76.9 | 603                | 1.1%       | -9%         | 0.0%           | 0.0%           |
| 2020.4                               | 1.41               | 81.4  | 603           | 1.41            | 81.4 | 603                | 0.5%       | -14%        | 0.0%           | 0.0%           |
| 2021.1                               | 1.38               | 86.4  | 671           | 1.38            | 85.9 | 671                | -1.7%      | -19%        | 0.2%           | 0.6%           |
| 2021.2                               | 1.35               | 92.1  | 770           | 1.40            | 81.5 | 671                | -3.8%      | -24%        | 4.3%           | 13.0%          |
| 2021.3                               | 1.32               | 100.0 | 770           | 1.41            | 81.6 | 671                | -6.0%      | -30%        | 7.5%           | 22.5%          |
| 2021.4                               | 1.29               | 104.5 | 927           | 1.39            | 85.3 | 671                | -7.9%      | -33%        | 7.5%           | 22.5%          |
| 2022.1                               | 1.27               | 107.7 | 927           | 1.37            | 87.9 | 671                | -9.2%      | -35%        | 7.5%           | 22.5%          |
| 2022.2                               | 1.28               | 107.7 | 927           | 1.37            | 87.9 | 671                | -8.7%      | -35%        | 7.5%           | 22.5%          |
| 2022.3                               | 1.28               | 107.7 | 927           | 1.38            | 87.9 | 671                | -8.5%      | -35%        | 7.5%           | 22.5%          |
| 2022.4                               | 1.29               | 106.1 | 927           | 1.38            | 86.6 | 671                | -8.1%      | -34%        | 7.5%           | 22.5%          |
| 2023.1                               | 1.30               | 104.5 | 927           | 1.37            | 89.0 | 671                | -7.3%      | -33%        | 5.8%           | 17.4%          |

At critical points in time, the effect is illustrated here:

|                             | <u>January 1, 1982</u> | <u>January 1, 2008</u> | <u>January 1, 2019</u> |
|-----------------------------|------------------------|------------------------|------------------------|
| Real Vacancy                | 5.3                    | 10.1                   | 7                      |
| Low Band                    | 6                      | 6                      | 6                      |
| High Band                   | 9                      | 9                      | 9                      |
| Counter-Cyclical Adjustment | (-12%)                 | 12%                    | 0%                     |

Adjusted MTMLTV = MTMLTV/(1+75%\*Counter-Cyclical Adjustment)

|        |     | <u>Adjusted MTMLTV</u> |                        |                        |
|--------|-----|------------------------|------------------------|------------------------|
|        |     | <u>January 1, 1982</u> | <u>January 1, 2008</u> | <u>January 1, 2019</u> |
| MTMLTV | 60% | 66%                    | 55%                    | 60%                    |
|        | 80% | 88%                    | 73%                    | 80%                    |
|        | 95% | 104%                   | 87%                    | 95%                    |

Adjusted DSCR = DSCR\*(1+25%\*Counter-Cyclical Adjustment)

|      |      | <u>Adjusted DSCR</u>   |                        |                        |
|------|------|------------------------|------------------------|------------------------|
|      |      | <u>January 1, 1982</u> | <u>January 1, 2008</u> | <u>January 1, 2019</u> |
| DSCR | 1.60 | 1.55                   | 1.65                   | 1.60                   |
|      | 1.40 | 1.36                   | 1.44                   | 1.40                   |
|      | 1.20 | 1.17                   | 1.24                   | 1.20                   |



*B. In response to Question 4 in the Proposal,<sup>27</sup> Freddie Mac believes that the 20% risk-weight floor for single-family and multifamily mortgages should be modified in order to account for Freddie Mac's improved balance sheet and product mix relative to those of 2007 (given the substantial change of Freddie Mac's offerings since the financial crisis). Accordingly, we recommend reducing the 20% risk weight floor to 5% for single-family and multifamily mortgage exposures*

The ERCF imposes a 20% floor on the risk weights of single-family and multifamily mortgage exposures.<sup>28</sup> Freddie Mac believes that this floor is excessive. The 20% floor should be calibrated based on activities that are permissible for the Enterprises today without undermining the risk sensitivity of the risk-based capital requirements. Notably, the floor currently represents the binding constraint for a substantial portion of the single-family portfolio.

*i. Risk-based capital requirements should be calibrated based on activities that are permissible for the Enterprises today and be tailored to the post-financial-crisis business model of the Enterprises*

Reducing the risk-weight floor to 5% is an appropriate calibration given the changes in Freddie Mac's business since the financial crisis. In the preamble of the ERCF, FHFA appropriately notes that a disproportionate share of crisis-era credit losses arose from types of single-family mortgage exposures that are no longer eligible for acquisition by Freddie Mac.<sup>29</sup> Accordingly, the capital framework should account for those revised eligibility requirements when calibrating a risk-weight floor. Concerns that the Enterprises may loosen underwriting standards to acquire high-risk loan products during periods of expanding economic growth and increasing homeownership are addressed by the supervisory and regulatory restrictions added since the financial crisis.

FHFA directed the Enterprises in 2013 to limit single-family acquisitions to mortgages that meet the requirements for a Qualified Mortgage ("QM"). We are now prohibited from acquiring higher-risk mortgages, including those with (i) negative amortization, interest-only payments or balloon features; (ii) total points and fees exceeding 3% of the loan amount; (iii) a term exceeding 30 years; or (iv) little or no documentation required to verify income or other evidence of repayment ability. We have nearly eliminated our holdings of assets that were the primary drivers of crisis-era losses. Loans outside of Freddie Mac's current credit standards represented 35% of our 2007 portfolio Unpaid Principal Balance ("UPB") (and 69% of our financial crisis losses) compared to only 3% of our Q2 2021 portfolio UPB. Furthermore, prior to conservatorship, our investment portfolio included a significant amount of private label securities ("PLS") that contained pools of mortgages that do not meet the QM criteria today (e.g., no- or low-documentation loans and loans that may have fallen into a category characterized by the market as Alt-A). However, we no longer invest in PLS. As of June 2006, Freddie Mac had a PLS portfolio of \$190.5 billion, which has declined by over 99% to \$1.2 billion as of 2Q 2021.

In addition, cumulative comprehensive losses (plus dividends) over the 2008-2012 period for Freddie Mac, based on its actual portfolio during that period, (i) were estimated by FHFA at \$98 billion and (ii) would have been \$49 billion without deferred tax asset adjustments. Excluding legacy securities,

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<sup>27</sup> Question 4 in the preamble of the Proposal 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? What adjustments, if any, would you recommend?" 86 Fed. Reg. 53238.

<sup>28</sup> 12 CFR 1240.33(b)(2) and 1240.34(b)(2).

<sup>29</sup> 85 Fed. Reg. at 82173.



peak cumulative loss (plus dividends) would be reduced to \$24 billion, or the equivalent of 1.2% of UPB. Furthermore, peak cumulative comprehensive losses would be further reduced if one were to adjust for our current permitted product mix for single-family, the reduced size of our retained portfolio, our current level of guarantee fees and our current CRT structure. Our reduction in risk is also evidenced by diminishing losses over time in the Dodd-Frank Act Stress Tests (“DFAST”) severely adverse scenario between 2016-2021. Accordingly, historical losses for these legacy loans and PLS portfolios should not be used to calibrate capital requirements or a floor on a going-forward basis.

In the preamble to the ERCF, FHFA mentions that 20% is the smallest risk weight contemplated by the BCBS for residential real estate exposures.<sup>30</sup> However, the Basel requirements are based on only six LTV bands, of which the lowest band for LTV≤50% is assigned 20% risk weight and the highest band for LTV>100% is assigned 70% risk weight. In comparison, the ERCF’s FICO/LTV base grids have risk weights that are much more granular and range from 2% to 317% for performing loans (versus 20% to 70% in Basel). The Basel framework is designed for a wide array of diversified banking institutions. Unlike the ERCF, it is not targeted to entities that focus on residential mortgages, and it lacks the nuances and granularity that the ERCF captures for mortgage credit risk.

*ii. The single-family grids, multipliers, and countercyclical adjustment to the MTMLTV already incorporate significant conservatism*

The single-family grids in the ERCF were developed using a stress scenario of a 25% drop in house prices.<sup>31</sup> In addition, there is a loan-level countercyclical adjustment to the MTMLTV for single-family exposures that further increases the implicit drop in house prices when prices are well above long-term trends. The combination of grids and the countercyclical adjustment result in an implied 37% stress House Price Index (“HPI”) when applied retroactively to 2007 and 34% when applied to current 2021 Q2 environment. Notably, the realized peak-to-trough house price drop from the financial crisis was 21% according to the Purchase-Only House Price index used for estimating MTM LTV in the ERCF.

Likewise, the 1.2x-1.4x multipliers for single-family cohort burnout<sup>32</sup> impose significant capital charges for loans that have not refinanced (or prepaid) during periods of refinance opportunities, without providing an offsetting capital benefit for loans that do refinance. Loans that come back into our portfolio are lower risk, as exhibited by their approval for new loans, which should offset any assumed credit risk posed by loans that did not refinance (and are therefore deemed subject to cohort burnout). However, the opposite is true under the grids because newly refinanced loans do not receive the benefit of a seasoned loan. Newly refinanced loans have higher capital charges than loans that were paid off due to lack of seasoning and a refinance multiplier. Finally, the cohort burnout multipliers could be procyclical because falling interest rates during stress periods create opportunities to refinance.

*iii. The current 20% floor represents the binding constraint for a substantial portion of single-family portfolio and undermines the risk sensitivity of the risk-based capital requirements*

When applied to Freddie Mac’s portfolio excluding non-QM loans that are no longer permissible for purchase, the ERCF’s 20% risk-weight floor would have covered approximately 45% of our 2007

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<sup>30</sup> 85 Fed. Reg. at 82173; see also Basel Committee on Banking Supervision, Calculation of RWA for credit risk; Standardized approach: individual exposures, CRE 82, Table 11. This Basel framework has an effective date as of January 1, 2023 but it is not clear when or if the U.S. regulators will adopt it. It can be found in: [https://www.bis.org/basel\\_framework/chapter/CRE/20.htm?inforce=20230101&published=20201126](https://www.bis.org/basel_framework/chapter/CRE/20.htm?inforce=20230101&published=20201126).

<sup>31</sup> See FHFA, Enterprise Regulatory Capital Framework Rule, 85 Fed. Reg. 39274, 39303 (Jun. 30, 2020)(preamble to proposed ERCF).

<sup>32</sup> 12 CFR 1240.33(d)(2) (Table 6).

single-family portfolio UPB, and it covers 52% of our 2Q 2021 single-family portfolio UPB (versus 22% and 21% using a 5% risk-weight floor, respectively).

Furthermore, the 20% risk-weight floor almost exclusively applies to loans with high FICO scores and low LTV ratios, increasing the cost of acquiring and carrying these low-risk loans. As such, the current risk weight structure does not optimize a framework for incorporating appropriate risk differentials in pricing purchases and guarantees – thereby potentially skewing the risk and pricing against the safest and best-performing segment of Freddie Mac’s portfolio. The tables below demonstrates this effect by showcasing actual, cumulative credit losses within the December 2007 single-family portfolio as basis points of total UPB. The loans with high FICO scores and low LTV ratios that are affected by the floor experienced loss rates that are only small fractions of the overall prescribed 160 basis points capital requirement floor. (160 basis points is the 20% risk-weight multiplied by the 8% capital requirement.) Given this dynamic, we believe that the risk-weight floor should be calibrated to 5% in order to account for Freddie Mac’s most recent balance sheet and product mix, which have significantly improved since 2007.

**Post-MI 2007 Total Portfolio - Cumulative Loss in basis points**

| FICO/<br>MTMLTV | <=30% | (30%,<br>40%] | (40%,<br>50%] | (50%,<br>60%] | (60%,<br>70%] | (70%,<br>75%] | (75%,<br>80%] | (80%,<br>85%] | (85%,<br>90%] | (90%,<br>95%] | (95%,<br>100%] | >100% |
|-----------------|-------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|-------|
| <620            | 38    | 70            | 139           | 239           | 420           | 623           | 776           | 974           | 1,081         | 1,547         | 1,961          | 1,615 |
| [620, 640)      | 20    | 56            | 104           | 189           | 336           | 474           | 633           | 786           | 947           | 1,404         | 1,877          | 1,394 |
| [640, 660)      | 17    | 42            | 85            | 164           | 294           | 434           | 568           | 729           | 899           | 1,367         | 1,967          | 1,321 |
| [660, 680)      | 11    | 32            | 62            | 120           | 234           | 371           | 507           | 662           | 821           | 1,286         | 1,977          | 1,257 |
| [680, 700)      | 8     | 20            | 43            | 92            | 194           | 309           | 443           | 590           | 732           | 1,176         | 1,943          | 1,222 |
| [700, 720)      | 13    | 23            | 38            | 71            | 156           | 256           | 377           | 506           | 639           | 1,078         | 1,854          | 1,214 |
| [720, 740)      | 3     | 10            | 22            | 51            | 119           | 205           | 312           | 425           | 547           | 954           | 1,745          | 1,048 |
| [740, 760)      | 2     | 6             | 14            | 35            | 85            | 151           | 241           | 338           | 429           | 756           | 1,561          | 911   |
| [760, 780)      | 1     | 4             | 8             | 22            | 60            | 114           | 175           | 249           | 317           | 577           | 1,229          | 781   |
| >=780           | 1     | 2             | 7             | 18            | 44            | 83            | 124           | 181           | 224           | 414           | 890            | 604   |

Note: Shaded cells represent segments affected by the 20% floor but unaffected by the 5% proposed floor as of 2007.

**Post-MI 2007 Qualified Mortgage Portfolio - Cumulative Loss in basis points**

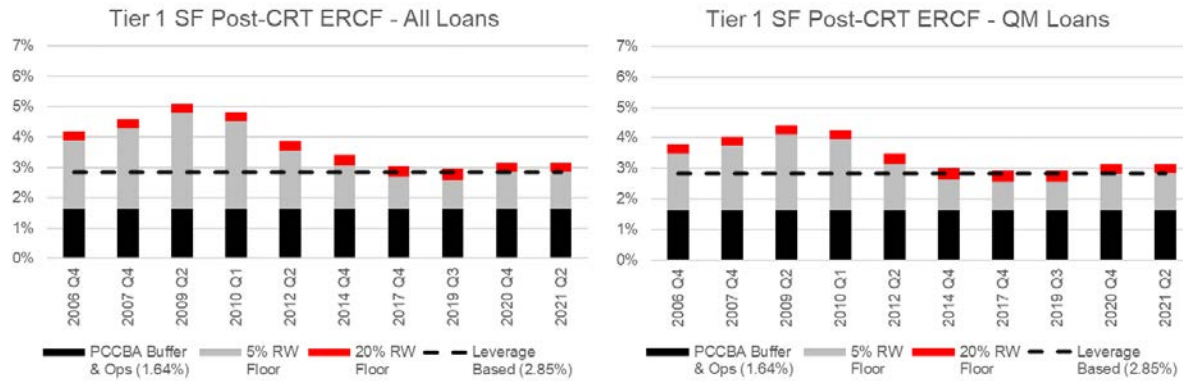
| FICO/<br>MTMLTV | <=30% | (30%,<br>40%] | (40%,<br>50%] | (50%,<br>60%] | (60%,<br>70%] | (70%,<br>75%] | (75%,<br>80%] | (80%,<br>85%] | (85%,<br>90%] | (90%,<br>95%] | (95%,<br>100%] | >100% |
|-----------------|-------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|-------|
| <620            | 40    | 73            | 141           | 239           | 408           | 595           | 721           | 894           | 934           | 1,227         | 1,306          | 1,500 |
| [620, 640)      | 19    | 57            | 104           | 187           | 327           | 438           | 572           | 671           | 782           | 1,057         | 1,176          | 1,251 |
| [640, 660)      | 17    | 42            | 84            | 162           | 278           | 395           | 484           | 608           | 707           | 972           | 1,185          | 1,143 |
| [660, 680)      | 10    | 31            | 62            | 115           | 219           | 324           | 432           | 534           | 615           | 874           | 1,143          | 1,004 |
| [680, 700)      | 8     | 21            | 42            | 86            | 178           | 265           | 358           | 457           | 534           | 774           | 1,082          | 896   |
| [700, 720)      | 14    | 24            | 36            | 66            | 141           | 212           | 299           | 383           | 444           | 694           | 1,035          | 911   |
| [720, 740)      | 3     | 10            | 22            | 48            | 105           | 168           | 238           | 304           | 376           | 597           | 936            | 698   |
| [740, 760)      | 2     | 6             | 14            | 32            | 76            | 119           | 179           | 244           | 290           | 471           | 841            | 581   |
| [760, 780)      | 1     | 4             | 8             | 20            | 52            | 90            | 135           | 178           | 218           | 373           | 682            | 487   |
| >=780           | 1     | 2             | 7             | 17            | 38            | 68            | 97            | 139           | 164           | 280           | 526            | 399   |

Note: Shaded cells represent segments affected by the 20% floor but unaffected by the 5% proposed floor as of 2007.

- iv. Reducing the 20% risk-weight floor to 5% would allow the risk-based capital requirements to be risk-sensitive while other elements of the ERCF, such as the proposed amended PLBA

leverage and buffers on top of risk-based framework, provide a backstop for any residual risks

Our aforementioned recommendation to reduce the 20% risk-weight floor to 5% would allow the overall ERCF risk-based capital requirements to remain effective, appropriately calibrated, and still be binding relative to the ERCF leverage-based requirements under most economic scenarios. When applied retroactively since 2006 based on historical data,<sup>33</sup> Freddie Mac’s Tier 1 (6% of RWA) ERCF risk-based requirement for the single-family portfolio (using the proposed 5% risk-weight floor) remains above the 2.85% total leverage-based requirement under most contracting economic scenarios and sits slightly below under some expansive economic scenarios.



**Tier 1 SF Post-CRT ERCF Risk-Based Capital**  
(w/ 1.64% PCCBA & Ops Risk)

| Portfolio as of Date | Leverage-Based (2.85%) | All Loans   |              | QM Loans    |              |
|----------------------|------------------------|-------------|--------------|-------------|--------------|
|                      |                        | 5% RW Floor | 20% RW Floor | 5% RW Floor | 20% RW Floor |
| 2006 Q4              | 2.85%                  | 3.89%       | 4.19%        | 3.47%       | 3.79%        |
| 2007 Q4              | 2.85%                  | 4.29%       | 4.58%        | 3.74%       | 4.04%        |
| 2009 Q2              | 2.85%                  | 4.81%       | 5.09%        | 4.12%       | 4.40%        |
| 2010 Q1              | 2.85%                  | 4.54%       | 4.82%        | 3.96%       | 4.24%        |
| 2012 Q2              | 2.85%                  | 3.55%       | 3.87%        | 3.15%       | 3.48%        |
| 2014 Q4              | 2.85%                  | 3.07%       | 3.41%        | 2.65%       | 3.00%        |
| 2017 Q4              | 2.85%                  | 2.69%       | 3.05%        | 2.57%       | 2.93%        |
| 2019 Q3              | 2.85%                  | 2.58%       | 2.96%        | 2.55%       | 2.92%        |
| 2020 Q4              | 2.85%                  | 2.84%       | 3.15%        | 2.83%       | 3.13%        |
| 2021 Q2              | 2.85%                  | 2.86%       | 3.16%        | 2.85%       | 3.15%        |

<sup>33</sup> Simplifying assumptions were needed to estimate ERCF retroactively. For example, origination FICOs were used when updated FICOs were unavailable, 2Q 2021 CRT benefit ratios were applied to previous periods, and 2Q 2021 PLBA and PCCBA buffers were also applied to all periods.

## V. Additional Recommendations

In addition to our comments and recommendations addressing the specific eight questions presented in the Proposal, Freddie Mac also recommends that FHFA consider certain other revisions to the ERCF, to be adopted either when it finalizes the Proposal or in future rulemakings. In general, the following comments seek to: (1) increase the risk sensitivity of the capital framework; (2) align the capital standards and application to the Enterprises more closely with the U.S. capital rules applicable to U.S. G-SIBs and BCBS capital guidance; and (3) correlate required capital more closely to the true economic risk of Enterprise exposures.

- A. *Freddie Mac recommends that FHFA modify the single-family countercyclical adjustment to incorporate seasonally adjusted house price and consumer price indices in order to reduce undesirable seasonal fluctuations in capital requirements*

The ERCF includes a single-family countercyclical adjustment that provides, when the national prices are 5% greater or less than the inflation adjusted long term trend, for the base risk weight to be adjusted to reflect additional risk attributes of a mortgage exposure and any loan-level credit enhancement.<sup>34</sup> FHFA developed the countercyclical adjustment using the national, not-seasonally adjusted Expanded-Data HPI deflated by the non-seasonally adjusted Consumer Price Index (“CPI”) for All Urban Consumers, U.S. City Average, All Items Less Shelter.<sup>35</sup> The use of not-seasonally adjusted HPI and CPI introduces undesirable seasonal fluctuations to the single-family countercyclical adjustment and, therefore, to capital requirements. The average seasonal fluctuation observed since 2010 would increase Net Credit Risk Capital (Pre-CRT) by about \$2 billion in Q4 and reduce it by about \$1 billion in Q2 relative to using seasonally adjusted indices.<sup>36</sup> Thus, seasonal effects can prompt \$3 billion (or 4%) swings in Net Credit Risk Capital (Pre-CRT) requirements. These swings can be avoided by using the seasonally adjusted version of the corresponding indices and be consistent with the use of FHFA Purchase-only State-level seasonally adjusted House Price Index to estimate MTMLTV for single-family mortgages.

Another less significant source of undesired volatility comes from the asynchronous application of countercyclical adjustments and MTMLTV adjustments to single-family mortgages with loan age less than six months. Loans with loan age less than six months are not adjusted for changes in the house price index. Instead, Original LTV (OLTV) is used for estimating the credit capital requirements. However, these loans are subject to the countercyclical adjustment that is intended to offset changes in the house price index that are not applicable to these loans. Although the impact on aggregate capital is relatively small (under 1%), Freddie Mac recommends that the ERCF apply both countercyclical adjustments and MTMLTV adjustments to single-family mortgages with loan age less than six months. CRT issuances are concentrated around 4-6 months of seasoning, where this disconnect is most prevalent.

- B. *The stress capital buffer (“SCB”) component should be made more dynamic by replacing the currently static 75 basis points of ATA buffer with a measure based on annual stress testing performance under DFAST and capital stress testing*

The ERCF establishes a stress capital buffer of at least 75 basis points of ATA, which is periodically re-sized to the extent that FHFA’s eventual program for supervisory stress tests determines that an Enterprise’s peak capital exhaustion under a severely adverse stress would exceed 75 basis points of ATA.

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<sup>34</sup> See 12 CFR 1240.33(a) (definition of single-family countercyclical adjustment); see also 85 Fed. Reg. at 82153.

<sup>35</sup> 85 Fed. Reg. at 82170.

<sup>36</sup> House price data availability for ERCF reporting lags by one quarter. For example, reporting as of Q2 uses house price index as of Q1.

Pending the implementation of this program, or in any year in which FHFA does not assign a greater SCB, an Enterprise's SCB would be 75 basis points of ATA.<sup>37</sup> In adopting the ERCF, FHFA indicated that this type of dynamically re-sized SCB (above 75 basis points of ATA) would be more risk-sensitive than a fixed-percent SCB.<sup>38</sup>

We had previously noted in our comments on FHFA's original ERCF proposal against a static SCB, providing analytical explanations of why the SCB should be more risk-sensitive and ought to vary based on market conditions and the Enterprises' own, idiosyncratic stress testing results as well as balance sheets through the credit cycle.<sup>39</sup> In consideration of on-going DFAST exercises and the greater alignment of DFAST/Stress Testing more broadly with capital planning, we recommend that FHFA reconsider its decision and replace the existing SCB with a measure based on an Enterprise's stress testing performance (specifically, its peak-to-trough impact as exhibited under its annual nine quarter results used for stress testing). In support of our recommendation, we have updated and included below certain arguments from our August 2020 Comments in addition to new analysis.

Our proposed approach is generally similar to the Federal Reserve's SCB as finalized in March 2020, which effectively integrates the Federal Reserve's annual stress test results with its non-stress capital requirements applicable for banks (inclusive of the sum of bank holding company's planned common stock dividends (expressed as a dollar amount) for each of the fourth through seventh quarter of the planning horizon).<sup>40</sup> This approach would allow for a more dynamic SCB which would be re-calibrated annually based on the Enterprises' annual DFAST and stress testing performance.

Our proposed approach would more closely resemble the effective elements of the bank holding company's capital framework on which much of the ERCF is based, resulting in a more efficient framework that integrates stress testing and capital requirements. Under that framework, each participating bank's SCB is determined in substantial degree based on the maximum projected decline in its Common Equity Tier 1 ("CET1") capital ratio under a severely adverse stress testing scenario in addition to this planned common stock dividends. Based on recently announced 2021 results, the eight G-SIBs' SCBs would range from 2.5% (due to the SCB floor (which is inclusive of planned dividend pay-out), or 1.4% without the floor for those with smaller peak-to-trough stress losses) to 6.4%. This range between the various SCB outcomes for the US bank holding companies demonstrates the dynamic nature of the Federal Reserve's SCB method, which we believe would deliver equivalent and substantial safety and soundness benefits if applied to the Enterprises. In this regard, we believe that it would make more sense for FHFA to set a similar SCB floor for the Enterprises that is based on stress testing results in lieu of the existing static 75 basis points of ATA currently within the ERCF framework.

We believe that our recommendation is appropriate for several reasons. First, generally aligning with bank stress capital requirements should result in greater consistency with bank competitors (and counterparties) that are also subject to a similar SCB framework. Second, our recommendation would replace the ERCF's measure with a more dynamic metric that is expected to utilize scenarios similar to the ones developed by regulators in connection with DFAST that are inherently countercyclical. Third, incorporating stress testing into capital planning would continue to build on Freddie Mac's established

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<sup>37</sup> 12 CFR 1240.11(a)(7); 85 Fed. Reg. at 82164.

<sup>38</sup> 85 Fed. Reg. at 82164.

<sup>39</sup> See Letter from Ricardo Anzaldúa, Freddie Mac, to Alfred Pollard, FHFA (Aug. 28, 2020)(the "August 2020 Comments") at 52-55.

<sup>40</sup> See Board of Governors of the Federal Reserve, Press Release, Federal Reserve Board approves rule to simplify its capital rules for large banks, preserving the strong capital requirements already in place (Mar. 4, 2020)(available at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm>).



practice of integrating stress testing into everyday risk management. It would also ensure that stress testing becomes an ongoing element of FHFA’s capital supervision of the Enterprises. Because poor stress testing performance would result in an effective increase in capital requirements (and a corresponding reduction in return on equity), management would be incentivized to conduct the Enterprises’ businesses with sensitivity to performance in adverse economic conditions at all times. A buffer with a static floor of 75 basis points of ATA, by contrast, provides no incentive to work on stress-scenario risk management and forecasting. In other words, a “stress” buffer should be linked to performances in stress scenarios.

Overall, dynamic calibration of the buffer would provide an additional supervisory tool to FHFA and ensure a diversity of approaches to setting capital that would address any unintended consequences of overreliance on one metric through the variability of the credit cycle. Our approach would operate as follows:

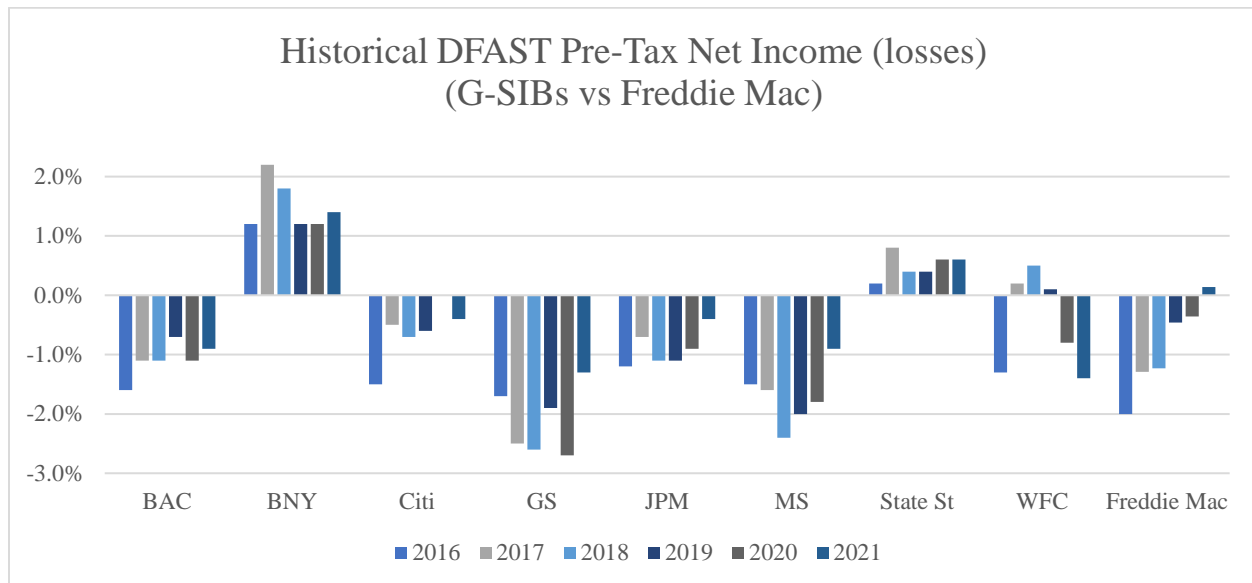
- Apply the DFAST severely adverse scenario;
- Over the nine-quarter stress horizon, observe the quarter with the largest cumulative losses;
- Add to those losses an allowance for projected four quarters of dividends through each of the fourth through seventh quarters of the planning horizon (assumed to be zero for now until an Enterprise is able to distribute capital);
- Continue to express the total as a percentage of ATA (translated from the SCB peak-to-trough results); and
- As a dynamic measure, reset this stress capital component of the PCCBA each year based on this calculation and annual stress testing results.

In a severely adverse scenario, our SCB under the calculation methodology above would be 52 basis points of ATA (or 1.8% of RWA). If we were to assume that Freddie Mac can distribute half of the Last Twelve Months (“LTM”) 3Q21 comprehensive income of \$11.4 billion as dividends, the \$5.7 billion would increase Freddie Mac’s SCB to 70 basis points of ATA (which corresponds to the 2.5% SCB floor per Fed guidance). For comparison purposes, the announced 2021 SCBs for the eight G-SIBs range from 1.4% to 6.4% (with four quarters of expected dividends, but setting aside the banking framework floor), with the lowest being State Street and the highest being Goldman Sachs. Therefore, the potential sizing of Freddie Mac’s SCB buffer at approximately 1.8% of RWA would not be an outlier and would account for the generally lower risk in Freddie Mac’s overall portfolio, through a stress-scenario cycle, relative to the G-SIBs’ balance sheets.

As noted above, the SCB floor for U.S. banking organizations is calibrated and floored at 2.5% of RWA. We further believe that a floor is not necessary for the Enterprises, given that the U.S. bank regulators’ floor was initially set at the Capital Conservation Buffer (“CCB”) level, which was a concept superseded by the SCB. This is not a tailored calibration, but one chosen to apply across the thousands of banks in the United States. The U.S. bank regulators need to take into account considerations different from those that apply to FHFA in its capacity as regulator of two unique Enterprises (both of which contain risk profiles which are lower than the banks). Namely, bank regulators must consider that the Comprehensive Capital Analysis and Review (“CCAR”) bank SCB, as a replacement for the CCB, should not go below the CCB mandated for all banks. FHFA is not subject to such constraints with regard to the unique, domestically focused Enterprises.

Moreover, the overall concept of a dynamic and potentially fluctuating SCB without a floor is appropriate for the Enterprises. Our analysis of recent DFAST results for banks demonstrates that their risk profiles have varied significantly over time and from bank to bank, even for those with similar geographic footprints and business models (per analysis below). This analysis demonstrates that the dynamic

alternative to sizing the SCB that we propose would suitably recognize the stability of (and recent improvements in) our business model, risk management and overall performance. In light of that stability and the clear positive trends, switching to a measure linked to stress testing results would still permit FHFA to realize the benefits that it believes would accompany a proposed stress capital component, while providing for additional calibration, countercyclicality (through the scenarios of the stress tests) and appropriate tailoring.



C. *The stability capital buffer should be set dynamically and in accordance with Basel’s G-SIB surcharge methodology, to internalize our systemic risk and align with internationally accepted framework in evaluating risk profiles such as size, interconnectedness, complexity, cross-jurisdictional activity, and substitutability*

The ERCF includes a stability capital buffer that is based on an Enterprise’s share of total residential mortgage debt outstanding that exceeds a threshold of 5% market share. The current formula for the stability capital buffer, expressed as a percentage of ATA, increases by five basis points for each percentage of market share exceeding that threshold.<sup>41</sup> In adopting the ERCF, FHFA indicated that this market share approach would create incentives for each Enterprise to curb its market share and growth in ordinary times, thereby “preserving room for a larger role during a period of financial stress.”<sup>42</sup> In the preamble to the ERCF, FHFA acknowledged that it carefully considered an alternative approach of calculating the stability capital buffer in a manner analogous to the U.S. banking approach for determining the G-SIB surcharge, but that “limits on available data precluded, at least at this time, the adjustments that would be necessary to ensure a modified U.S. banking framework approach yields an Enterprise-specific stability capital buffer that is reasonably tailored to each Enterprise’s housing finance market stability risk.”<sup>43</sup>

Freddie Mac believes that FHFA should reconsider its decision regarding the stability capital buffer and adopt a more dynamic buffer that is based on the existing systemic risk-scoring methodology that the Federal Reserve uses for G-SIBs, which leverages the Basel framework under Method 1. In our August 2020 Comments, we recommended such an approach, based on our view that the ERCF’s stability buffer

<sup>41</sup> 12 CFR 1240.400.

<sup>42</sup> 85 Fed. Reg. at 82167.

<sup>43</sup> 85 Fed. Reg. at 82167.

should use several risk-based indicators to arrive at a buffer that reflects the risks posed by a mix of overall size and activities. These risk-based indicators fall into the Basel five categories: size, interconnectedness, complexity, cross-jurisdictional activity, and substitutability. Our recommendation contrasts with the ERCF's current approach, which focuses only on size and does not consider that we distribute a significant portion of our credit, liquidity and interest rate risks in a broadly diversified manner (distinct from many of the practices of the G-SIBs).

We acknowledge FHFA's concerns about the challenges of developing appropriate adjustments to the U.S. banking framework's G-SIB surcharge methods, although we believe that the advantages of a dynamic buffer anchored on the Basel standard justify the implementation challenges. FHFA's concerns can be addressed through sourcing the applicable G-SIB score indicator data from the Federal Reserve, the Office of Financial Research in the U.S. Treasury, and the investor relations websites of large banks and the Enterprises. We do not think FHFA's concerns are difficult to resolve because the required information is publicly disclosed and the calculation method is generally straightforward. As such, we can work with FHFA and incorporate FHFA guidance to resolve any concerns. Notably, we were able to calculate risk scores and capital surcharges using the aforementioned approach.

In our August 2020 Comments, we provided a detailed explanation of our recommended approach to use a modified version of the U.S. bank capital framework's consideration of risk-based indicators to determine a G-SIB's systemic risk score and capital surcharge.<sup>44</sup> Using this approach, Freddie Mac calculated an alternative stability capital buffer using the Bank Holding Companies ("BHC") G-SIB framework 2020 year-end data and the denominator from the Federal Reserve's website (note that the G-SIB scoring exercise is only executed on a yearly basis). We made the following assumptions to this stability capital buffer calculation: (1) using the Basel approach rather than the Method 2 approach adopted in the U.S., which replaces Method 1's substitutability category with a measure of a firm's reliance on short term wholesale funding;<sup>45</sup> (2) including all five indicators under the BHC's G-SIB Basel framework; (3) including both Freddie Mac and Fannie Mae data as part of the denominators; and (4) excluding Participation Certificate ("PC") debt from the interconnectedness calculation.

As indicated in the table below, this approach shows Freddie Mac would be required to have an approximate 1% stability capital buffer of RWA based on Freddie Mac's aggregate "G-SIB score" of approximately 200 points, which correlates to approximately 1.0% of RWA per the Basel G-SIB systemic risk scoring methodology. Broadly speaking, the 200 points attributable to Freddie Mac correlates roughly to the 1.0 (130-229 points) and 1.5 (230-329 points) surcharge bands, and the score is reasonably tailored to Freddie Mac's risk profile and "G-SIB score." For reference, G-SIBs subject to the 1.0% G-SIB surcharge include Goldman Sachs, Morgan Stanley, State Street and Bank of New York Mellon, and G-SIBs subject to the 1.5% percent G-SIB surcharge include Bank of America, Barclays and Deutsche Bank. As of November 2020, per the Financial Stability Board ("FSB"), the highest bucket under Basel is 2.0%, which includes Citigroup, HSBC, and JP Morgan Chase. No other G-SIBs score within the 2.5% range, which is where Freddie Mac's Stability Capital Buffer is currently situated.

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<sup>44</sup> See August 2020 Comments at 55-59.

<sup>45</sup> In general, Method 2 is not as applicable to the Enterprises as they do not adhere to the same business model as the U.S. G-SIBs.



|   | G-SIB score | Buffer as % of |      | Buffer Amount (\$B) |
|---|-------------|----------------|------|---------------------|
|   |             | ATA            | RWA  |                     |
| 1. ERCF market share approach ( <i>existing methodology</i> )                             | N/A         | 0.68%          | 2.6% | 22.6                |
| 2. Alternative systemic risk-scoring method ( <i>Freddie Mac's proposed methodology</i> ) | 200         | 0.26%          | 1.0% | 8.8                 |

Based on internationally agreed measures for relative risk among large financial institutions, Freddie Mac poses less risk to the financial system than many of the U.S. and international G-SIBs that are in higher bands using the same G-SIB systemic risk scoring methodology.

**G-SIBs Required Level of Additional Buffer as of November 2020 as published by the Financial Stability Board (“FSB”)<sup>46</sup>**

| G-SIB Buckets and Rankings | G-SIB Categorization  |
|----------------------------|---|
| <b>5 (3.5% RWA)</b>        | (Empty)   |
| <b>4 (2.5% RWA)</b>        | (Empty)   |
| <b>3 (2.0% RWA)</b>        | Citigroup, HSBC, JP Morgan Chase  |
| <b>2 (1.5% RWA)</b>        | Bank of America, Bank of China, Barclays, BNP Paribas, China Construction Bank, Deutsche Bank, Industrial and Commercial Bank of China, Mitsubishi UFJ FG   |
| <b>1 (1.0% RWA)</b>        | Agricultural Bank of China, Bank of New York Mellon, Credit Suisse, Goldman Sachs, Groupe BPCE, Groupe Crédit Agricole, ING Bank, Mizuho FG, Morgan Stanley, Royal Bank of Canada, Santander, Société Générale, Standard Chartered, State Street, Sumitomo Mitsui FG, Toronto Dominion, UBS, UniCredit, Wells Fargo |

*D. Freddie Mac recommends that FHFA reconsider its decision to include a 20% risk weight for commingled and crossholdings of Enterprise MBS; instead, FHFA should apply a 5% risk weight floor to such exposures, consistent with our recommended prudential risk weight floor for single-family and multifamily mortgage exposures*

Currently, the ERCF assigns a 20% risk weight to the exposure of one Enterprise to the other.<sup>47</sup> In consideration of our other comments (specifically, those raised in Section IV.B on the prudential risk weight floor for single-family and multifamily mortgage exposures), we respectfully ask that FHFA reconsider its 2020 decision and apply a 5% risk weight floor for commingled securities and crossholdings, consistent with potential re-calibration for other risk-weight floors. This 5% risk weighting should be more than sufficient to cover the residual counterparty risk that exists on commingled and crossholdings, given that

<sup>46</sup> Note that this data is based on Method 1 and is updated annually. We expect the FSB to release its latest G-SIB scorecard results and bucket rankings later this year.

<sup>47</sup> See 85 Fed. Reg. at 82183. Equity exposures and acquired CRT exposures would not be subject to this risk weight.

both Enterprises will be well capitalized because of other requirements of the ERCF. In addition, we want to emphasize the potential policy concern that putting any risk weighting on commingled exposure can pose to the single security market.

The development of UMBS, resecuritization and To-Be-Announced (“TBA”) products is premised on the Enterprises issuing securities that are fungible and on eliminating any incentives for an Enterprise to favor its own collateral over any other. A capital charge on commingled exposure could disrupt this level playing field, potentially leading to: (1) pricing differences between commingled securities, 100% Freddie and 100% Fannie securities; and (2) the eventual reemergence of segregated markets. These developments would make it harder for the Enterprises to fulfill their mission to provide liquidity to and ensure the affordability of the U.S. housing market. Such a disruption could take any of the following forms:

- Each Enterprise in its portfolio holdings stipulates delivery of its own UMBS in TBA trades,<sup>48</sup> rather than provision excess capital to cover charges associated with the receipt of the other Enterprise’s UMBS. This could lead to a diminishing of commingling and a devaluation of existing commingled securities.
- The 20% risk weight disincentivizes the Enterprises from issuing commingled UMBS. If the capital charges are passed on to investors and Real Estate Mortgage Investment Conduits (“REMIC”) underwriters, it could effectively eliminate all future commingling in Supers and REMICs as investors will take their collateral to the original issuing Enterprise.
- The lack of commingling will harm the commingling of security characteristics in the TBA deliverable and could lead to immediate devaluation of commingled securities as investors will demand 100% Freddie or 100% Fannie securities for structured products.
- Investors who are nearing name concentration limits with one Enterprise will be forced to stipulate trades as they will no longer be able to freely resecuritize securities they receive with the other Enterprise, if needed.

*E. Freddie Mac recommends that FHFA consider eliminating the advanced approaches for credit, market risk, and operational risk requirements for purposes of estimating risk-weighted assets*

The ERCF includes a requirement that each Enterprise develop a models-based advanced approach to calculate RWAs for credit, market risk, and operational risk.<sup>49</sup> In adopting the ERCF, FHFA indicated that the advanced approaches requirements would ensure that the Enterprises enhance their risk management systems and not simply rely on the standardized approach’s lookup grids and multipliers to define credit risk tolerances, measure credit risk, or allocate economic capital.<sup>50</sup> We took the position in our August 2020 Comments that FHFA should remove the advanced approaches requirement. In adopting the ERCF, although noting that it would continue to consider advanced approaches, FHFA delayed the implementation of advanced approaches until 2025. Given this prospective delay, and given that banks themselves are more generally further relying on the standardized approach to calculate credit, market, and operational risk requirements, we recommend that FHFA reconsider its overall position concerning the adoption of advanced approaches requirement. In support of our recommendation, we have enhanced and included below our arguments from our August 2020 Comments.

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<sup>48</sup> The Enterprises purchase UMBS to support liquidity in the secondary housing market. The 20% risk weight would apply to these investments, disincentivizing additional liquidity in the market. In order to avoid receiving a security subject to the capital charge, each Enterprise could add a stipulation to a TBA trade that blocks receipt of the other’s securities.

<sup>49</sup> See 85 Fed. Reg. 82183-85.

<sup>50</sup> 85 Fed. Reg. at 82184.

The ERCF requirement that an Enterprise’s risk-based requirement be based on the higher of the RWA calculated under the standard or advanced approach tends to blunt the benefits of the more tailored standard risk measurement process. The standardized approach incorporates significant risk sensitivity, particularly with regard to mortgage exposures that make up most of the Enterprises’ assets. Notably, domestic and international bank regulatory bodies have been moving away from the advanced approaches to risk-weight measurement, so not incorporating the advanced approaches for credit, market and operational risk requirements would be consistent with recent bank regulatory developments.<sup>51</sup>

*i. The use of the Collins Floor is unsuitable for the Enterprises*

The ERCF requires the Enterprises to calculate RWA using both the standardized approach and the models-based advanced approach, with risk-based capital requirements based on the higher of the RWA calculated under the two methodologies. This is similar to the existing Collins Amendment, otherwise known as the “Collins Floor” applicable to G-SIBs (whereby G-SIBs must calculate their risk-weighted assets in accordance with both standardized and advanced approaches and take the higher of the two for purposes of calculating their regulatory capital requirements).

The history of capital regulation of banking organizations is complex, with primary goals differing over time. The Collins Floor, which requires that banking organizations not be subject to capital regulations that could yield lower capital requirements than the “generally applicable capital requirements,” has a number of purposes, none of which are applicable to the Enterprises.

First, the Collins Floor directs bank regulators not to create a capital framework that would have the effect of lowering capital requirements from those in effect just before the 2007–09 financial crisis. In the ERCF, FHFA has already incorporated the statutory capital requirements applicable to the Enterprises, in addition to the newly proposed supplemental risk-based measures.

Second, the Collins Floor was intended to ensure that large, sophisticated institutions with resources to develop risk-based capital models were not treated more advantageously than banking organizations subject to the standardized or generally applicable framework. In the context of the Enterprises, there are only two, and each will be subject to the standardized approach set forth in the ERCF.

Third, the Collins Floor was intended to ensure that the capital requirements applicable to holding companies would be no different from, and no lower than, those applicable to their depository institution subsidiaries. This objective is not relevant in the context of the Enterprises.

*ii. The standardized approach for the Enterprises has incorporated significant risk sensitivity, particularly with regard to mortgage exposures that make up most of the Enterprises’ assets*

The standardized approach under the ERCF is significantly more granular and risk-sensitive with respect to mortgage exposures (the Enterprises’ primary asset exposure) than the standardized approach applicable to banking organizations. The standardized approach uses a robust framework of look-up grids and risk multipliers, developed with significant input from the Enterprises over several years, and is based generally on existing internal models produced at the Enterprises. The standardized approach also includes

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<sup>51</sup> See, e.g., Department of the Treasury, Federal Reserve System and Federal Deposit Insurance Corporation, Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019); see also Board of Governors of the Federal Reserve System, Speech by Vice Chairman for Supervision Randal K. Quarles, “Early Observations on Improving the Effectiveness of Post-Crisis Regulation” (Jan. 19, 2020) (available at <https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm>).



MTMLTV measures, which reflect changing risk and are more risk-sensitive than the original LTV measures used under the standardized approach applicable to banking organizations.

Requiring the creation of a different set of models than those already incorporated in the standardized approach would be inefficient and duplicative. The required development of a *separate, second* set of models different from those currently in use by the Enterprises would entail a significant investment of time and resources that would delay full compliance with the proposed required capital levels.

With respect to market risk, the standardized approach provides multiple methodologies that are designed to capture the primary drivers of spread risk for different covered positions. Over half of Freddie Mac's market-risk RWA as of 3Q 2021 is already calculated through the Internal Models approach, which incorporates suitable risk granularity designed to measure the specific spread risk of the products in Freddie Mac's portfolio with the most complex risk profiles and risk factors.

Among the remainder of assets, those using the Spread Duration approach have a reasonable level of risk differentiation because the spread durations are calculated through internal models that also incorporate assumptions around other risk factors (*e.g.*, prepayment risk). Finally, the assets whose market risk is calculated under the Single Point approach (primarily re-performing loans and Non-Performing Loans ("NPL") for Freddie Mac) have a relatively high amount of credit risk, over a range of credit risk differentiation, and are not as sensitive to other risk factors such as prepayment risk. In addition, even if more risk differentiation in the market risk component of these loans were required, historical data on spreads that would be necessary for a reasonable market risk advanced approach (*e.g.*, value-at-risk or expected shortfall measures) are not generally available.

In Freddie Mac's view, FHFA did not provide sufficient justification in adopting the ERCF for requiring use of the advanced approaches, other than potentially to improve risk management techniques. Risk management can be improved through FHFA's supervisory process and the Enterprises' existing internal modeling. We also note that the Enterprises are separately subject to significant risk discipline. In addition to the more granular standardized approach, the Enterprises are subject to DFAST and are required to use supervised internal models that both inform capital sufficiency and obviate the need for parallel models-based capital analyses for our monoline, non-complex activities.

While we agree with the flexibility that FHFA would incorporate into an advanced approach regime, that flexibility can be harnessed as a supervisory matter through interactions between FHFA and the Enterprises, rather than as a regulatory requirement. DFAST and the supervised internal models could be integrated into this dynamic supervisory approach. We also recognize the value of continually improving our internal models so that they may inform the calibration of the standardized approach.

If FHFA is concerned that the standardized approach metrics may become stale, Freddie Mac is willing to suggest improvements and revisions to the standardized approach's look-up grids and risk multipliers. To the extent that FHFA has not incorporated into the ERCF a process for the periodic modification of the standardized approach, we would support such a provision in the amendments to the ERCF in order to keep the standardized approach up-to-date and efficient.

- iii. *U.S. banking agencies and the Basel Committee have largely disfavored the advanced approaches, particularly over the past decade, and FHFA, as part of its broader ERCF framework consideration, should reflect this consensus within the regulatory community*

U.S. banking agencies and the Basel Committee have increasingly limited their application of the advanced approaches to banking organizations. U.S. banking agencies adopted a final rule in November 2019 that requires application of the advanced approaches only for large, international banks with at least \$700 billion in total consolidated assets, up from the original \$250 billion threshold.<sup>52</sup> This move limits application of the advanced approaches to the largest banks that are engaged in complex, international activities and halved the number of advanced approaches banks.

Of all U.S. banking organizations, only eight G-SIBs are subject to the advanced approaches and the dual risk-based capital framework. Furthermore, there is a concern that banks' internal models are not a reliable tool for capturing true risks and setting capital requirements, chiefly because such models can be an effective way for banks to game their respective capital requirements. In addition, the BCBS, under modifications of Basel III known as "Basel IV" reforms, recently removed the requirement for national authorities to implement internal model-based approaches (*i.e.*, advanced approaches); any jurisdiction that implements only the standardized approach will now be compliant with the Basel framework.<sup>53</sup>

The Federal Reserve has been leading efforts to deemphasize the internal-models approach and the historical latitude banks have received to use their own models – in particular as the U.S. regulatory agencies are looking to adopt and implement Basel IV in the immediate future. In place of internal models and advanced approaches, U.S. banks and U.S. regulators have highlighted the importance of stress testing, promoting stress testing as a better alternative to determining going concern loss absorbency and bank health.<sup>54</sup> Consistent with this effort, we highly recommend that FHFA also consider utilizing an Enterprise's annual DFAST and internal stress testing exercises as a means to evaluate the health of its balance sheet against market conditions and a prospective economic downturn.

The Enterprises are generally non-complex entities whose activities are limited in geographic scope compared to the internationally active banks subject to the advanced approaches. As such, we do not believe it is efficient or cost-effective to require the Enterprises to undertake a significant investment to build duplicative internal modeling systems to support a risk-based capital methodology that is increasingly disfavored.

- F. *We recommend that FHFA extend the reporting compliance date, given that the ERCF amendments are unlikely to be finalized before the end of 2021 and that the reporting requirements begin in the first quarter of 2022*

The ERCF provides a staggered schedule of compliance dates, the first of which commences on January 1, 2022, and applies to reporting requirements.<sup>55</sup> Because the comment deadline for the Proposal

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<sup>52</sup> See 84 Fed. Reg. 59230 (Nov. 1, 2019).

<sup>53</sup> See BCBS, High-level summary of Basel III reforms at 12 (Dec. 2017).

<sup>54</sup> See, *e.g.*, Board of Governors of the Federal Reserve System, Speech by Vice Chairman for Supervision Randal K. Quarles, "Early Observations on Improving the Effectiveness of Post-Crisis Regulation" (Jan. 19, 2020) (available at <https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm>); see also, Board of Governors of the Federal Reserve System, Press Release, "Federal Reserve Board approves rule to simplify its capital rules for large banks, preserving the strong capital requirements already in place" (Mar. 4, 2020) (available at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm>).

<sup>55</sup> 12 CFR 1240.4(b). Subsequent compliance dates apply to regulatory capital and buffer requirements, among others, and are dependent, in part, on the Enterprises' exit from conservatorship. See, *e.g.*, 12 CFR 1240.4(d)(1) and (d)(2).

is November 26, 2021, it appears unlikely that the Proposal will be finalized before the reporting compliance date (January 1, 2022), and finalization may potentially take place sometime later in the spring of 2022. We therefore recommend that FHFA provide a brief postponement of this reporting compliance date from January 1 to July 1, 2022. Doing so would allow the Enterprises sufficient time to analyze and prepare their reports based on the requirements of the final amendments to the ERCF.

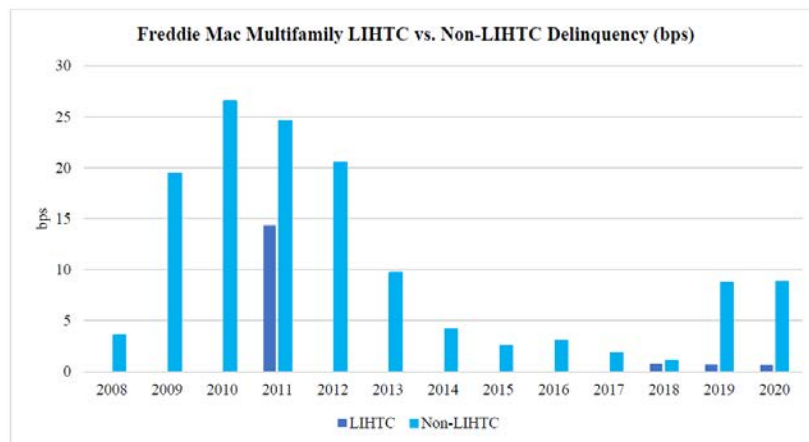
*G. Recommended revisions to multifamily look-up grids and risk multipliers*

In general, the ERCF requires an Enterprise to calculate the risk-weighted assets for each of its multifamily mortgage exposures using lookup grids and risk multipliers to assign an exposure-specific risk weight based on the characteristics of the mortgage.<sup>56</sup> We recommend that FHFA make three discrete changes to the look-up grids and risk multipliers that are used to calculate multifamily mortgage exposures.

*i. A 0.60 risk multiplier should apply to multifamily properties that are funded through Low-Income Housing Tax Credit (“LIHTC”) programs*

We recommend that FHFA add a 0.60 multiplier for exposures to multifamily properties that are funded through LIHTCs, which are the main source of new affordable rental housing construction in the United States. These loans tend to perform particularly well due to strong commitment from local governments and housing authorities to the acquisition, rehabilitation, or new construction of rental housing targeted to lower-income households. Governments encourage the use of LIHTC programs to fund these projects.

Foreclosure history also warrants a 0.60 multiplier. According to Freddie Mac historical data (see chart below), only two LIHTC loans out of more than 3,000 have gone to foreclosure since 2008, which is a cumulative foreclosure rate of less than 0.07%.



*ii. The multifamily base risk weights for adjustable-rate mortgages should be based on a multiplier approach*

While we agree that the capital charges for Multifamily Adjustable-Rate Mortgages (“Multifamily ARMs”) should be slightly higher than for fixed-rate mortgages to account for increased payments in a rising rate environment, the underlying credit risk should be within a narrow range between different interest rate types for a same property.

<sup>56</sup> See 12 CFR 1240.34.



Key multifamily loan characteristics change with the interest rate environment, especially for the adjustable-rate grid. Because of the dramatic drop in interest rates since the grids were created, the adjustable-rate grid no longer appropriately captures risk. To avoid the need for future frequent recalibration, we recommend utilizing the fixed rate grid with slight adjustment for adjustable-rate products. Based on our internal model results, as a proxy, we recommend using a 1.1 multiplier.

*iii. The multifamily look-up grids for the base risk weights should be modified*

The multifamily pre-CRT credit capital levels are high relative to actual historical loan performance. The grids were developed several years ago and have not been calibrated since that time. In light of the pandemic-related stress to the economy and the multifamily market, updated performance information should be considered. Based on internal model results, as a proxy, we recommend a 25% reduction to the base risk weights.

*H. Recommended additional ERCF treatments related to Time-based call options and Early Redemption features in senior-subordinated structures*

*i. Time-based call options*

Currently, the ERCF does not specifically address the capital treatment of time-based call options. The time-based call option is a key tool for managing program costs in environments where the associated credit risk has greatly diminished, thereby creating an uneconomic outlook for a deal in which projected premium payments outweigh the benefit of retaining coverage. Freddie Mac engages in a variety of CRTs, including Agency Credit Insurance Structure (“ACIS”) and Structured Agency Credit Risk (“STACR”). The time-based call option utilized in an ACIS or STACR transaction is solely in the discretion of Freddie Mac to execute at the appointed time (beginning at year 5). No additional premium is required to continue coverage in the event that the call is not exercised, and the transaction continues under the same terms. The type of call option deployed in Freddie Mac’s CRT transactions is designed to allow an opportunity to review deal performance to date, consider the benefit of retaining coverage, and cancel our CRT coverage, where appropriate.

We recommend that FHFA amend Sections 1240.41(a), (b) and (c) of the ERCF to allow that time-based call option CRTs with contractual provisions that permit an originating Enterprise to call exposures related to any traditional securitization, synthetic securitization, or credit risk transfer on or after a stated date should be qualified for capital relief under the ERCF. We further recommend that FHFA include a provision that would require an Enterprise to give appropriate notice to FHFA prior to the execution of a time-based call option.

*ii. Early redemption features in senior-subordinated structures*

Freddie Mac believes that the current ERCF framework should be updated in order to clarify that early redemption rights held by junior investors in (multifamily and single-family) senior-subordinated structures that meet the requirements of 12 CFR 1240.41(a) do not disqualify those structures from capital relief under the ERCF unless the underlying mortgages include open-end credits and the early redemption rights constitute an early amortization provision as defined in the ERCF.<sup>57</sup>

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<sup>57</sup> See 12 CFR 1240.2 (definition of early amortization provision); 12 CFR 1240.41(a)(4).

## Glossary - Acronyms

| Acronym         | Definition   |
|-----------------|--|
| ACIS            | Agency Credit Insurance Structure                      |
| ATA             | Adjusted Total Assets                                  |
| BCBS            | Basel Committee on Banking Supervision                 |
| BHC             | Bank Holding Companies                                 |
| CCAR            | Comprehensive Capital Analysis and Review              |
| CCB             | Capital Conservation Buffer                            |
| CE detach       | Credit Enhancement detach                              |
| CET 1           | Common Equity Tier 1                                   |
| CPI             | Consumer Price Index                                   |
| CPPI            | Commercial Property Price Indices                      |
| CRT             | Credit Risk Transfer                                   |
| DFAST           | Dodd-Frank Act Stress Tests                            |
| ERCF            | Enterprise Regulatory Capital Framework                |
| FHFA            | Federal Housing Finance Agency                         |
| G-SIB           | Global Systemically Important Banks                    |
| HPA             | Housing Price Appreciation                             |
| HPI             | House Price Index                                      |
| LIHTC           | Low-Income Housing Tax Credit                          |
| LTM             | Last Twelve Months                                     |
| MBS             | Mortgage-Backed Securities                             |
| Multifamily ARM | Multifamily Adjustable-Rate Mortgages                  |
| MTMLTV          | Mark-to-Market Loan-To-Value                           |
| NCREIF          | National Council of Real Estate Investment Fiduciaries |
| NPL             | Non-Performing Loan                                    |
| OEA             | Overall Effectiveness Adjustment                       |
| QM              | Qualified Mortgage                                     |
| PC              | Participation Certificate                              |
| PCCBA           | Prescribed Capital Conservation Buffer Amount          |
| PLBA            | Prescribed Leverage Buffer Amount                      |
| PLS             | Private Label Securities                               |
| PSPA            | Preferred Stock Purchase Agreement                     |
| REMIC           | Real Estate Mortgage Investment Conduits               |
| RWA             | Risk-Weighted Assets                                   |
| SCB             | Stress Capital Buffer                                  |
| SLB             | Stress Leverage Buffer                                 |
| SDC             | Stress Default Cost                                    |
| SLR             | Supplementary Leverage Ratio                           |
| STACR           | Structured Agency Credit Risk                          |
| TBA             | To-Be-Announced  |
| Tranche RW      | Tranche Risk Weight                                    |
| UMBS            | Uniform Mortgage-Backed Securities                     |
| UPB             | Unpaid Principal Balance                               |