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Fannie Mae®

May 9, 2023

By Electronic Delivery to FHFA Website

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

Re: Comments/RIN 2590 – AB27
Proposed Rule on Enterprise Regulatory Capital Framework—Commingled
Securities, Multifamily Government Subsidy, Derivatives, and Other Enhancements

Dear Mr. Jones:

Fannie Mae is pleased to provide comments on the Federal Housing Finance Agency's ("FHFA") proposed rule, Enterprise Regulatory Capital Framework—Commingled Securities, Multifamily Government Subsidy, Derivatives, and Other Enhancements, published on March 13, 2023 (the "Proposed Rule").[1] The Proposed Rule would amend several provisions of the Enterprise Regulatory Capital Framework ("ERCF") for Fannie Mae and Freddie Mac (the "Enterprises"), including modifications to guarantees on commingled securities, multifamily mortgage exposures secured by government-subsidized properties, derivatives and collateralized transactions, credit scores for single-family mortgage exposures, and time-based calls for credit risk transfer ("CRT") exposures, among other items.

Fannie Mae is generally supportive of the ERCF modifications that would be required by the Proposed Rule. We submit these comments to respond to questions posed by FHFA regarding the calculation of representative credit scores, the multifamily government subsidy risk multiplier, and time-based calls for CRTs. We also request that the effective date for the proposed modifications be extended to give the Enterprises additional time to make necessary system changes.

I. Representative Credit Scores Should Be Calculated By Averaging Credit Scores Across All Borrowers Rather Than By Taking The Lowest Score

The current ERCF instructs the Enterprises to use a two-step procedure for identifying the representative credit score on a single-family mortgage exposure. In step one, we select a single score for each borrower on the loan using either the median score (if the borrower has scores from three consumer reporting agencies) or the lowest score (if the borrower has fewer than three scores); in step two, we determine the representative score by selecting the lowest single score across all borrowers from step one. The Proposed Rule would change step one to

[1] 88 Fed. Reg. 15306 (Mar. 13, 2023).

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require the Enterprises to use the average credit score across consumer reporting agencies for each borrower, rather than the median or lowest score. Fannie Mae supports this change, which is more indicative of the risk of the loan and will prevent credit scores from decreasing when the risk of the loan is unchanged.

Question 14 of the Proposed Rule asks if FHFA should consider also changing step two of the methodology for determining a representative credit score by requiring the Enterprises to use the average credit score across borrowers rather than the lowest score. Fannie Mae recommends that FHFA adopt this change as well, as we believe that it would provide a more accurate assessment of credit risk than ERCF's current methodology.

Since September 2021, Fannie Mae's automated underwriting system has been using the average credit scores across borrowers to assess whether a loan meets our minimum credit score threshold of 620. Fannie Mae changed its approach to determining the representative credit score based on a study of historical data that demonstrates that the average score better predicts the likelihood of adverse credit events such as serious delinquency.[2]

We acknowledge that it may not be practical or even feasible for the Enterprises to implement the average-across-borrowers approach at this time due to the need for the Enterprises and FHFA to ensure that capital and risk assessments are properly calibrated. As the Enterprises are currently engaged in a multi-year effort to implement the alternative credit score models that FHFA approved in October 2022,[3] we recommend timing the transition to using average-across-borrowers calculations to correspond to that implementation date.

II. The Government Subsidy Risk Multiplier Should Be Adjusted

We thank the FHFA for reconsidering and restoring the risk multiplier for multifamily mortgage exposures secured by government-subsidized properties. Based on our analysis, loans supported by government subsidy programs have consistently outperformed compared to loans with similar credit profiles that are not subsidized. In general, we believe the proposed 0.6 multiplier is appropriately calibrated. We suggest below that a multiplier greater than 0.6 and less than 1.0 should apply to multifamily mortgage exposures secured by a mix of government subsidized and non-subsidized properties. We also encourage FHFA to consider extending the multiplier to additional subsidy programs using a principles-based approach. We believe that with these changes, the proposed risk multiplier would more appropriately reflect the credit risk associated with loans that include significant, long-term, and continuous subsidy, allowing Fannie Mae to offer pricing and credit structures commensurate with that risk to better support the supply of affordable housing.

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[2] Fannie Mae analyzed the performance of loans acquired from 2000 to 2010. Using the average in the loan level credit score calculation identified roughly 2% more serious delinquent events in the lowest scoring 10% of this population. See Shifman, S., Perspectives Blog, Another Step to Unlock Homeownership for Underserved Borrowers, Sept. 30, 2021, available at *https://www.fanniemae.com/research-and-insights/perspectives/unlock-homeownership-underserved-borrowers*.

[3] See FHFA Announces Validation of FICO 10T and VantageScore 4.0 for Use by Fannie Mae and Freddie Mac, available at *https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Validation-of-FICO10T-and-Vantage-Score4-for-FNM-FRE.aspx.*

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A. Mixed Subsidized/Unsubsidized Properties. Question 10 of the Proposed Rule asks, "Should FHFA consider additional thresholds and/or affordability restrictions for a multifamily mortgage exposure to qualify for a risk multiplier greater than 0.6 but less than 1.0?" Under the Proposed Rule, the 0.6 risk multiplier applies only if every property securing the multifamily mortgage exposure has a government subsidy; otherwise, a 1.0 multiplier applies. We believe that a risk multiplier greater than 0.6 but less than 1.0 is appropriate where some but not all of the properties securing the exposure are subsidized.

Fannie Mae Multifamily, in its normal course of business, often acquires loans secured by portfolios of properties rather than just a single property. In these circumstances, it is common for a given loan to be secured by some properties that would qualify for the proposed 0.6 multiplier while others in the portfolio would not qualify. Fannie Mae recommends that such a loan be given a weighted-average multiplier between 0.6 and 1.0 that corresponds to the pro-rata share of loan proceeds that are secured by the properties that qualify for the multiplier. For example, if 80% of a loan's proceeds are financing government-subsidized properties and the other 20% are not, the weighted-average multiplier for this loan would be [80% of loan amount x 0.6 multiplier] + [20% of loan amount x 1.0 multiplier] = 0.68 final multiplier. This approach would ensure that the capital requirements for a loan reflect the risk attributes of all the underlying properties appropriately.

B. Other Subsidy Programs. The Proposed Rule's definition of "government subsidy" identifies three categories of qualifying subsidy programs: (i) the Low Income Housing Tax Credit (LIHTC) program; (ii) project-based rental assistance programs under Section 8 of the U.S. Housing Act of 1937; and (iii) "State/Local affordable housing programs that require the provision of affordable housing for the life of the loan."[4] The commentary explains:

> For a multifamily mortgage exposure to qualify for the government subsidy multiplier, the properties securing the exposure must have significant, long-term, and continuous government subsidies. LIHTC and project-based Section 8 programs meet these criteria, so to ensure alignment in this regard, the proposed rule would require that qualifying state and local affordable housing programs require affordable housing to be provided for the life of the loan.[5]

Question 11 asks whether FHFA's proposed categories of applicable government subsidies appropriately capture the population of multifamily government subsidies that are significant, long-term, and continuous.

While LIHTC and Section 8 are the primary federal affordability programs, there may be other federal programs now or in the future that meet FHFA's proposed affordability restriction[6] and provide significant, long-term, and continuous subsidies. A specific current example would

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[4] 88 Fed. Reg. at 15320 (proposed definition of "government subsidy").

[5] Id. at 15309-15310.

[6] At least 20% of the property's units must be affordable to tenants with income less than or equal to 80% of the area median income where the property resides. 88 Fed. Reg. at 15320 (proposed definition of "government subsidy").

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be the rural rental housing program under Section 515 of the Housing Act of 1949, which is used to reduce rent paid by very low- to moderate-income families in rural areas.[7] Accordingly, to ensure that the government subsidy multiplier covers all significant, long-term and continuous government subsidies, we suggest that the third category in the proposed definition be amended to include "**Comparable Federal**/State/Local affordable housing programs that require the provision of affordable housing for the life of the loan."

Fannie Mae also encourages FHFA to consider whether the proposed multiplier should apply where the subsidy sponsor is a non-governmental entity, provided that the subsidies are provided for the life of the loan and the affordability restriction is met. For example, in 2021 Fannie Mae introduced Sponsor-Initiated Affordability ("SIA"), which provides sponsors lower borrowing costs when they create or preserve a minimum of 20% of units in a multifamily property that are affordable to tenants earning 80% of AMI or less for the life of the loan. Given the strong tenant demand for affordable housing, the long-term affordability provided by subsidy programs such as SIA should help ensure that these loans outperform over time relative to loans secured by unsubsidized properties with comparable credit profiles.

III. The Definitions Of "Eligible Time-Based Call" And "Time Based Call" Should Be Modified

The Proposed Rule would clarify that a CRT transaction with an eligible time-based call satisfies the ERCF's operational criteria for CRTs. Question 22 solicits input on the proposed definitions of "time-based call" and "eligible time-based calls." We propose the following technical amendments to these terms.

A. Time-Based Call. The Proposed Rule defines "time-based call" to mean "a contractual provision that permits an originating Enterprise to redeem a *securitization* exposure on or after a specified redemption or cancellation date."[8] We recommend adding "**or credit risk transfer**" after "securitization," consistent with the formulation in the proposed definition of "eligible time-based call," to clarify FHFA's apparent intent to address time-based calls for all CRTs, not just those involving securitizations.[9]

B. Eligible Time-Based Call. The Proposed Rule defines "eligible time-based call" to mean a time-based call that, among other things, "Is exercisable no less than five years after the securitization or credit risk transfer issuance date."[10] We recommend two modifications to this language.

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[7] According to the National Low Income Housing Coalition ("NLIHC"), the vast majority (92%) of Section 515 tenants have incomes less than 50% of area median income. NLIHC, Advocates' Guide '23: A Primer on Federal Affordable Housing & Community Development Programs & Policies, at 4-97.

[8] 88 Fed. Reg. at 15317 (proposed definition of "time-based call"; emphasis added).

[9] The ERCF defines "credit risk transfer" to mean "any traditional securitization, synthetic securitization, senior/subordinated structure, credit derivative, guarantee, or other contract, structure, or arrangement (other than primary mortgage insurance) that allows an Enterprise to transfer the credit risk of one or more mortgage exposures (reference exposure(s)) to another party (the protection provider)." 12 C.F.R. § 1240.2.

[10] 88 Fed. Reg. at 15317 (proposed definition of "eligible time-based call").

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First, we recommend adding "**or effective**" after "issuance". This would provide clarity with respect to CRT transactions that do not involve securitizations, such as Fannie Mae's Credit Insurance Risk Transfer™ ("CIRT™") transactions.

Second, we recommend that the five-year restriction be reduced to four years for certain CRT transactions. The commentary explains that the five-year restriction is intended to ensure a significant length of time before the first prespecified call date.[11] We agree that five years is an appropriate length of time before first call for most CRT transactions, which typically cover pools consisting primarily of 30-year mortgage loans. However, we believe that four years is generally sufficient to cover the period of greatest risk associated with pools comprised of shorter-term mortgage loans, given the faster amortization schedule of such loans. For CRT transactions that cover loans with terms of 15 or 20 years, the option to call the transaction on or after four years would allow Fannie Mae to reduce its premium obligation when the cost of protection exceeds the economic benefit. Since 2016, Fannie Mae has executed four CRT transactions covering loans with terms of 15 to 20 years, all of which were cancellable on or after four years. Accordingly, we recommend further modifying the proposed definition of "eligible time-based call" by adding before the final period the following: "**, or, in the case of a securitization or credit risk transfer involving single-family mortgage exposures with terms less than or equal to 20 years, no less than four years.**"

IV. FHFA Should Extend The Effective Dates To Allow For A Smooth Transition To The Revised ERCF

The Proposed Rule provides for an effective date that is 60 days after the day of publication of the final rule in the Federal Register. We recommend that any amendments to the ERCF become effective no sooner than 270 days after publication of the final rule. This will allow adequate time to modify Enterprise reporting, risk management and other affected systems and processes as necessary to reflect the amendments. The delayed transition will also allow the Enterprises to complete required code modifications, data sourcing enhancements and systems testing, and will reduce reliance on manual processing. We further recommend that an Enterprise be permitted to adopt some or all of the amendments earlier than required upon confirmation by the Enterprise of its ability to produce the required results, and with prior notice to FHFA.

Irrespective of whether the effective date for all amendments is delayed as recommended, we recommend an extended implementation timeline for the amendments that impact the treatment of derivatives and collateralized transactions and representative credit score determinations.

A. <u>Derivatives and collateralized transactions</u>. Under the current ERCF, the Enterprises are required to use the current exposure methodology ("CEM") for calculating the exposure amount of derivative contracts. The Proposed Rule would replace CEM with the standardized approach for counterparty credit risk ("SA-CCR"), consistent with the U.S. banking framework. U.S. banking agencies adopted SA-CCR as a replacement for CEM in January 2020, making it

[11] *Id.* at 15313.

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mandatory for advanced approaches banking organizations to use in calculating standardized total risk-weighted assets.[12] However, the agencies delayed the mandatory compliance date by two years, noting:

> [T]he agencies recognize that the implementation of SA–CCR requires advanced approaches banking organizations to augment existing systems or develop new ones … Accordingly, the final rule includes a mandatory compliance date for advanced approaches banking organizations of January 1, 2022, to permit these banking organizations additional time to adjust their systems, as needed, to implement SA–CCR.[13]

Implementing SA-CCR poses similar operational challenges for the Enterprises, as SA-CCR achieves its objective of increased risk sensitivity through calculations that require more transaction level data and analysis. The implementation timeline should take account of the effort required for data collection, model validation, system integration and training. We therefore request that the Enterprises be given the same transition period given to banking organizations to update our systems as needed before we are required to report capital requirements under SA-CCR. Specifically, we request that mandatory compliance with SA-CCR be delayed until two years after finalization of this rule, with continued use of CEM permitted until then.

In addition, and for similar reasons, we request a two-year delay for mandatory compliance with the simple value-at-risk ("VaR") methodology for collateralized transactions. The simple VaR approach requires detailed transaction-level information as well as analysis of historical data to estimate the potential future exposure of a netting set based on extreme market movements with a 99th percentile, one-tailed confidence interval. The implementation timeline should thus account for the efforts required for data collection, model validation, system integration and training.

B. Credit Scores. The Proposed Rule would modify the current procedure for selecting a representative credit score to reflect the future transition to the bi-merge credit score requirement. The commentary explains that this proposed change was intended to "position the Enterprises to account for the new [bi-merge credit score] requirement *upon* implementation."[14] However, because the Proposed Rule does not specify an effective date for the proposed change, it is possible that it could become effective *before* this new requirement has been implemented. Misalignment of the effective dates of ERCF requirements and industry-wide bi-merge requirements could result in reliance on data that is not yet available from industry sources and could lead to confusion among stakeholders. Accordingly, we recommend clarifying in the final rule that the effective date of the new procedure for selecting a representative credit score will coincide with the implementation date for the bi-merge credit score requirement. For the period before the implementation date, the Enterprises should continue to select the median score if the borrower has three scores or the lowest score if the borrower has fewer than three scores.

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[12] Standardized Approach for Calculating the Exposure Amount of Derivative Contracts, 85 Fed. Reg. 4362 (Jan. 24, 2020).

[13] *Id.* at 4369.

[14] 88 Fed. Reg. at 15311 (emphasis added).

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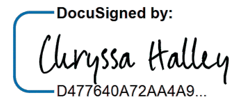
If you have questions regarding the matters addressed in this letter, please contact the undersigned at *chryssa_c_halley@fanniemae.com*.

Sincerely,



Chryssa Halley
Executive Vice President and Chief Financial Officer