sifma
Invested in America

May 12, 2023

Submitted electronically

Clinton Jones
General Counsel
Attention: Comments/ RIN 2590–AB27
Federal Housing Finance Agency
400 Seventh Street SW, Washington, DC 20219.

Re: RIN 2590-AB27 - Enterprise Regulatory Capital Framework Amendments

Dear Mr. Jones,

SIFMA[1] submits this letter in response to the FHFA's Notice of Proposed Rulemaking on Enterprise Regulatory Capital Framework Amendments ("NPR"). Our comments are limited to the provisions in the NPR related to capital requirements for commingled security guarantees. [2]

1. Summary

SIFMA members continue to believe that the fee charged by the Enterprises for commingled security issuance should be eliminated, as it limits investor and other market participant flexibility and breaks a fundamental underpinning of the UMBS construct, which is the fungibility of the two Enterprises' MBS. We suggest two ways to achieve this: (1) eliminate the provisions in the capital rules that drive the commingling fee, or (2) the Enterprises internalize the capital charges.

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] Federal Housing Finance Agency, *Enterprise Regulatory Capital Framework Amendments* (February 23, 2023), available here: https://www.fhfa.gov/SupervisionRegulation/Rules/RuleDocuments/ERCF%20NPRM%20for%20Web.pdf

2. Commingling Fees Impair the Fungibility of UMBS and Undermine its Fundamental Premise

In June 2022, the Enterprises enacted a 50bp fee on commingled resecuritizations, at least partially in response to capital charges that apply to these instruments.[3] This created significant concern in the market and SIFMA expressed its concerns to FHFA.[4] While we will not delve into this in detail in this letter, SIFMA members view the implementation of this fee to be a fundamental change to the previously agreed upon UMBS construct that a broad spectrum of investors, liquidity providers, originators, service providers, the Enterprises, and the official sector developed collaboratively over a period of more than five years. It risks illiquidity in stressed scenarios, and in the worst case could put the market on a path that would reverse some or all of the benefits of the UMBS program. The fees do not just affect TBA trading; they also impede the ability of dealers and investors to structure CMOs with collateral from both Enterprises, and more generally limit the ability of investors to manage counterparty risk and aggregate collateral.

In January 2023 the Enterprises announced a reduction in this fee to 9.375bp. While SIFMA members appreciated the responsiveness of the Enterprises and FHFA to industry concerns and agree that a smaller fee is less disruptive than a larger fee (on the margin), SIFMA members remain steadfast that any fee is inappropriate and carries longer-term risks to the UMBS initiative.

The capital charges that drove the imposition of the commingling fees stem from FHFA's 2020 finalization (under the previous Director) of capital rules which include a charge for commingled issuances. SIFMA objected to this charge in its 2020 comments on that FHFA rule proposal, noting that "the key to UMBS is the belief that the securities issued by the agencies are homogeneous enough to be traded interchangeably" and further that "the UMBS construct limits…flexibility in some areas, such as this one."[5]

The 2023 NPR proposes to change the capital requirements for commingled securities from a 20% risk weight / 100% credit conversion factor to a 5% risk weight / 20% credit conversion factor. FHFA estimates that the GSEs would be required to hold $5.1 billion less capital as a result of this change.[6]

Regardless of the capital framework that underlies the Enterprises' activity, we believe the priority of the Enterprises and FHFA should be to maximize the liquidity, resilience, and attractiveness of the UMBS market, including TBAs, specified pools, and CMOs. It is from these markets that liquidity is provided to lenders, and from that liquidity benefits cascade to borrowers, such as lower rates, rate locks, and a national mortgage market.

---

[3] See e.g., Fannie Mae statement from June 14, 2022: https://capitalmarkets.fanniemae.com/mortgage-backed-securities/new-fee-structure-certain-structured-transactions

[4] See SIFMA's August 28, 2020 letter to FHFA, available here: https://www.sifma.org/wp-content/uploads/2020/08/SIFMA-Nareit-2020-GSE-Capital-Proposal-Final.pdf, at 10-11.

[5] Id. at 10-11.

[6] NPR at 11.

As we have said in numerous forums dating back to the first conception of UMBS in the early 2010s, this can be achieved in the context of UMBS by creating an efficient securitization framework whereby the Enterprises' MBS are viewed as (and are) interchangeable by investors and other market participants. If investors are asked to be indifferent between the delivery of a Fannie Mae bond vs a Freddie Mac bond, there should be no friction if an investor desires to switch a guarantor from one to the other, or to combine MBS from each guarantor into a larger security. Similarly, the regulatory framework around the Enterprises should treat them as the same risk.

In other words, UMBS TBA trading requires investors to accept the premise that the Enterprises are the same risk so as to be indifferent to the delivery of either MBS, and it follows that their fates must be inextricably linked. On the other hand, the capital charges each Enterprise must hold against exposures to the other signal the exact opposite — that the Enterprises are not the same, and that their fates are not inextricably linked.

This fundamental contradiction challenges the very foundation of UMBS that the market accepted after much time and effort was spent collectively designing the program and its successful launch. Additionally, the imposition of the commingling fee and subsequent significant adjustment to the fee caused market participants to recognize that the charge may change again in the future, potentially significantly (particularly if the capital charges imply a higher or lower fee level). Such a change could happen in a time of stress, such as increasing the charge at the very moment when fungibility is most important to investors.

SIFMA members believe that this NPR provides the opportunity for FHFA to correct the flaws in the 2020 Enterprise Capital Framework and address this problem.

3. FHFA Should Revise the Enterprise Capital Framework to Eliminate Capital Charges Related to Commingling, or Cause the Enterprises to Internalize Them, in Order to Maximize the Benefit and Resilience of UMBS

SIFMA suggests two paths forward to restore the fungibility of the UMBS program to its pre-2022 state, maximizing the attractiveness of the program to investors and thereby maximizing the benefit to the tens of millions of borrowers served by the GSEs.

A. Eliminate the source of the commingling fee from the Enterprise capital framework.

SIFMA objected to the 2020 proposal to create capital charges related to commingling, and we stand by those comments. FHFA should eliminate these provisions (both charges directly related to commingling and any other provisions in buffers or elsewhere that have the same effect) in the Enterprise capital framework.

B. *Alternatively, require that the GSEs internalize capital charges related to commingling.*

Based on discussions since the imposition of the commingling fee in 2022, SIFMA understands that even at the 50bp level, the commingling fee did not completely offset the charges resulting from the Enterprise Capital Framework and the Enterprises internalized a significant amount of the charge. The fee has now been significantly lowered — by more than 80% from its original level — which means that the Enterprises are internalizing nearly all of the capital charges at this point. We believe the GSEs could simply internalize the small remaining portion of the capital charges, as they did for a number of years prior to June 2022.[7]

In other words, if the Enterprises and FHFA desire that the market operate under the UMBS construct, the capital charges related to commingling should be considered a cost of doing business.

Our goal with these suggestions is to maximize liquidity and borrower benefit, and also to ensure that UMBS markets are as robust as possible over the longer term. After all, it is liquidity and stability from these markets that provides benefits in good times and bad to consumers, originators, and everyone else in the housing finance ecosystem.[8]

SIFMA appreciates the ongoing engagement with FHFA on these issues and would be pleased to further discuss these comments at your convenience.

Sincerely,

Christopher B. Killian
Managing Director
Securitization and Credit

[7] To the extent that FHFA does not want the Enterprises to internalize the entire charge, there are other more tailored approaches that could be considered including only charging a fee for very large transactions (outside of the size one would expect to see in normal market operations). In any case, ordinary-course investor and market maker transactions should not be charged a commingling fee.

[8] With respect to each of our suggestions above, we believe the bare minimum outcome should be that any capital charges are aligned with the current 9.375bp level of the fee, so as to alleviate concerns that the Enterprises may increase the fee in the future (possibly without notice as we saw with its imposition in 2022).