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MORTGAGE BANKERS ASSOCIATION

November 23, 2021

Sandra L. Thompson  
Acting Director  
Federal Housing Finance Agency  
400 7<sup>th</sup> Street, SW  
Washington, DC 20219

**Re: Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer**

Dear Acting Director Thompson:

The Mortgage Bankers Association (MBA)<sup>1</sup> thanks the Federal Housing Finance Agency (FHFA) for the opportunity to respond to its notice of proposed rulemaking on further enhancements to the regulatory capital framework applicable to Fannie Mae and Freddie Mac (the Enterprises).<sup>2</sup>

In comments submitted to FHFA in August 2020, MBA identified significant concerns with the regulatory capital framework proposed at the time, including: 1) the frequency with which the leverage ratio requirements, rather than the risk-based capital requirements, would serve as a binding capital constraint on the Enterprises; and 2) the punitive treatment of credit risk transfer (CRT) mechanisms that would discourage the Enterprises from transferring credit risk to private investors in a meaningful manner.<sup>3</sup>

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 1,900 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: [www.mba.org](http://www.mba.org).

<sup>2</sup> Federal Housing Finance Agency, "Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer," 86 Fed. Reg. 53230, September 27, 2021. Available at: <https://www.federalregister.gov/documents/2021/09/27/2021-20297/enterprise-regulatory-capital-framework-rule-prescribed-leverage-buffer-amount-and-credit-risk>.

<sup>3</sup> MBA, "RE: Enterprise Regulatory Capital Framework," August 31, 2020. Available at: [https://www.mba.org/Documents/Letters%20to%20Legislators/MBA\\_FHFA\\_Enterprise\\_Capital\\_Framework\\_August2020.pdf](https://www.mba.org/Documents/Letters%20to%20Legislators/MBA_FHFA_Enterprise_Capital_Framework_August2020.pdf).

We therefore welcome FHFA’s efforts to address both of these concerns through targeted amendments to the Enterprises’ regulatory capital framework. The changes to this rule, if finalized as proposed, will encourage the Enterprises to operate as prudent managers and distributors of mortgage credit risk while promoting both safety and soundness and broad access to sustainable credit for borrowers.

### **Prescribed Leverage Buffer Amount**

In the proposed rule, FHFA acknowledges that the current iteration of the Enterprises’ regulatory capital framework, as finalized in December 2020, features a risk-insensitive leverage ratio requirement that may be a binding constraint on the Enterprises more frequently than would be appropriate. While the minimum leverage ratio of tier 1 capital to adjusted total assets is 2.5 percent, the Enterprises must meet a threshold of at least 4 percent to avoid limits on capital distributions and discretionary bonus payments. As such, the effective minimum leverage ratio to which the Enterprises will guide their businesses is 4 percent.

As of March 31, 2021, this 4 percent minimum leverage ratio exceeds all three risk-based capital ratio requirements for Freddie Mac and two out of three risk-based capital ratio requirements for Fannie Mae. FHFA correctly notes that the leverage ratio requirement is based on the Enterprises’ adjusted total assets – a relatively stable measure over time – which should result in “the current relationships between leverage and risk-based capital at the Enterprises [continuing] for the foreseeable future.”<sup>4</sup> Said differently, the leverage ratio will threaten to serve as the binding capital constraint for the Enterprises on a consistent basis.

This outcome is problematic because a binding capital constraint that is risk-insensitive will encourage the Enterprises to seek higher-yielding, riskier assets in order to optimize their operations (from a capital perspective). A binding leverage ratio also reduces incentives to engage in CRT – again encouraging a build-up of risk in the Enterprises’ portfolios. An appropriately-calibrated leverage ratio, therefore, should serve as a credible backstop to the risk-based capital requirements rather than as the primary means for determining Enterprise capital levels.

To achieve this objective, the proposed rule would amend the prescribed leverage buffer amount that, in the existing framework, increases the effective leverage ratio from 2.5 percent to 4 percent. Rather than setting the buffer at a static 1.5 percent of adjusted total assets, the proposed rule features a dynamic buffer set at 50 percent of an Enterprise’s stability capital buffer. Using March 31, 2021 data, this reduces the

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<sup>4</sup> 86 Fed. Reg. 53231.

total leverage requirement from 4 percent to approximately 3 percent for both Enterprises.<sup>5</sup>

This amended leverage buffer improves the capital framework in three distinct ways: 1) it reduces the likelihood that the leverage ratio requirements will serve as the binding capital constraint on the Enterprises; 2) it allows the leverage ratio requirements to fluctuate in a manner similar to the risk-based capital requirements; and 3) it better aligns the Enterprises' leverage ratio requirements with those of large banks subject to the Basel III framework.

The reduction in the capital required by virtue of the leverage ratio requirements is a sensible adjustment. At an aggregate level, based on March 31, 2021 data, the lower leverage ratio requirements would leave Fannie Mae's minimum required capital (including buffers) unchanged at \$190 billion, while it would reduce Freddie Mac's minimum required capital from \$126 billion to \$122 billion – a slight 3.2 percent decline.<sup>6</sup> The changes to the leverage buffer, therefore, are unlikely to undermine Enterprise safety and soundness with respect to aggregate capital (while also improving safety and soundness for the reasons outlined above).

The other way FHFA could have reduced the likelihood of a frequently-binding leverage ratio would have been to increase the risk-based capital requirements. Such a change, however, would not be aligned with the losses likely to emerge from a severe stress event. The risk-based capital requirements equate to minimum capital of \$190 billion for Fannie Mae and \$126 billion for Freddie Mac as of March 31, 2021. These figures represent 4.5 percent and 3.8 percent, respectively, of adjusted total assets. The results of the most recent Dodd-Frank Act Stress Tests for the Enterprises – which posit severely adverse conditions including a 55 percent drop in equity prices, a 23.5 percent drop in national home prices, and a 35 percent drop in commercial real estate prices – estimate losses in total comprehensive income of \$7.5 billion for Fannie Mae and \$3.4 billion for Freddie Mac.<sup>7</sup> These losses, which represent a sliver of the capital required of the Enterprises, reflect strong underwriting standards for Enterprise-backed loans and significant use of CRT to mitigate severely adverse economic scenarios. The natural conclusion from the stress test results is that raising the risk-based capital requirements is unnecessary to protect the Enterprises' safety and soundness.

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<sup>5</sup> 86 Fed. Reg. 53237.

<sup>6</sup> These figures reflect the proposed changes to the leverage buffer in isolation – not in concert with the proposed changes to the treatment of CRT.

<sup>7</sup> FHFA, "Dodd-Frank Act Stress Test Results – Severely Adverse Scenario," August 13, 2021. Available at: [https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Final\\_2021-Public-Disclosures\\_FHFA\\_SA.pdf](https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Final_2021-Public-Disclosures_FHFA_SA.pdf).

In our August 2020 comments, MBA noted that it was not possible to provide a complete analysis of the interplay between the risk-based capital requirements and the leverage ratio requirements due to the lack of historical data provided by FHFA and the Enterprises. While one can make reasonable assumptions regarding the likelihood of a binding leverage ratio over an extended period, this is not a substitute for data showing how a particular set of requirements would have constrained the Enterprises in prior quarters. The proposed framework appears to generate few scenarios in which the leverage ratio would serve as a binding capital constraint, but MBA recommends that FHFA and the Enterprises provide the historical data needed to affirm this point.

### **Credit Risk Transfer**

The proposed rule also includes amendments to the existing framework that are intended to encourage continued use of CRT mechanisms by the Enterprises. FHFA proposes to reduce the prudential floor on the risk weights assigned to retained CRT exposures from 10 percent to 5 percent and eliminate the overall effectiveness adjustment (OEA) applicable to retained CRT exposures. These amendments – in particular the reduction in the risk weight floor – should result in more appropriate treatment of CRT that generates the incentives needed for ongoing use by the Enterprises.

The single-family CRT programs developed and refined by the Enterprises over nearly a decade have proven to be successes. During this time, the Enterprises have transferred a portion of the credit risk on loans with over \$4 trillion in unpaid principal balance.<sup>8</sup> They have done so utilizing a variety of structures, including capital markets, insurance/reinsurance, senior/subordinate, and lender collateralized recourse transactions. These activities have complemented the long-running use of CRT in the Enterprises' multifamily businesses. The Enterprises have begun to diversify their multifamily CRT mechanisms in recent years, as well.

These tools allow the Enterprises to disperse mortgage credit risk across willing sources of private capital rather than concentrating this risk in their portfolios. By doing so, the Enterprises can operate as through-the-cycle managers and distributors of mortgage credit risk, which improves their safety and soundness, protects taxpayers, and enhances price discovery. Any capital framework to which the Enterprises are subject should encourage this business model.

While FHFA correctly notes in the proposed rule that dollar-for-dollar capital relief is not appropriate for CRT due to counterparty, model, and structural risks, the existing framework is far too punitive in the capital that is required for retained CRT exposures. Much of this overly conservative treatment is derived from the 10 percent risk weight

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<sup>8</sup> 86 Fed. Reg. 53234.

floor assigned to these exposures. As MBA noted previously, this requirement is far higher than necessary and dilutes the benefits that otherwise would encourage greater use of CRT by the Enterprises. With a 10 percent risk weight floor, the cumulative capital required due to the credit risk associated with the retained CRT exposure often is greater than the cumulative capital required for the credit risk associated with the underlying loans or guarantees. By reducing the risk weight floor to 5 percent, the proposed rule addresses this concern and makes it much less likely that the risk weight floor far exceeds the actual credit risk of a given CRT tranche.

Similarly, the elimination of the requirement that the Enterprises apply an OEA to retained CRT exposures should improve the economics associated with CRT. As is noted in the proposed rule, the OEA requirement is functionally duplicative to the risk weight floor. Both requirements address situations in which a CRT does not actually result in a transfer of risk as envisioned upon its consummation. Given the duplicative nature of these requirements, MBA supports FHFA's determination that the OEA can be removed from the Enterprises' regulatory capital framework without sacrificing safety and soundness.

### **Proposals to Address Procyclicality**

MBA appreciates that FHFA continues to express its desire to include a multifamily countercyclical adjustment in the Enterprises' capital framework and is seeking input on how that adjustment should be constructed. In addition to this work, FHFA should continue to monitor the performance of the single-family countercyclical adjustment.

#### *A recommended approach for multifamily*

MBA continues to see the need to include a multifamily countercyclical adjustment in the framework, and we recognize that the approach used in the single-family portion of the framework does not translate appropriately to the Enterprises' multifamily businesses. As we stated in our prior comments on the framework:

“MBA recommends that FHFA consider an approach that limits the capital impact of market declines in values and incomes until they breach the levels associated with the stress scenarios (-35 percent for values and -15 percent for income). Such an approach would operationalize the intent of the capital framework – building capital during market growth and relying on that capital during market declines.”<sup>9</sup>

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<sup>9</sup> MBA, “RE: Enterprise Regulatory Capital Framework,” August 31, 2020. Available at: [https://www.mba.org/Documents/Letters%20to%20Legislators/MBA\\_FHFA\\_Enterprise\\_Capital\\_Framework\\_August2020.pdf](https://www.mba.org/Documents/Letters%20to%20Legislators/MBA_FHFA_Enterprise_Capital_Framework_August2020.pdf).

We note that the multifamily countercyclical adjustment approach described in prior comments from the Delegated Underwriting and Servicing (DUS) Advisory Council would be consistent with MBA's recommendation.<sup>10</sup>

#### *Data to implement the multifamily approach*

In the release of the final rule in December 2020, FHFA noted that, while there remained “considerable merit” in developing a countercyclical adjustment for the Enterprises’ multifamily businesses, “FHFA has not identified sufficient public domain data to develop a reliable long-term trend for multifamily property values.”<sup>11</sup> In this release, FHFA 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>12</sup>

As a starting point for responding to this question, we note that the framework already relies on each Enterprise marking multifamily loans to market for purposes of calculating debt service coverage ratios (DSCRs) and loan-to-value (LTV) ratios. As a result, each Enterprise already has identified data and approaches to track net operating incomes (NOIs) and property values that FHFA has determined are acceptable for this purpose.

We believe the approach described above that has been recommended by MBA and others can rely on the same data already relied upon for other purposes within the framework – subject to FHFA review and approval as appropriate – to identify when market conditions have or have not breached the specified stress scenario levels. FHFA can determine the extent to which any or all of that data or information derived from that data can be released into the public domain.

#### *Analysis of the single-family approach*

The existing framework includes a countercyclical adjustment to the Enterprises’ single-family businesses that moderates the use of mark-to-market LTV ratios for purposes of minimum capital requirements. This adjustment is triggered when national home prices deviate more than 5 percent from the estimated long-term trend. MBA

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<sup>10</sup> DUS Advisory Council, Comments on FHFA Proposed Rule on Enterprise Regulatory Capital Framework, August 31, 2020.

<sup>11</sup> Federal Housing Finance Agency, “Enterprise Regulatory Capital Framework,” 85 Fed. Reg. 82150, December 17, 2020. Available at: <https://www.federalregister.gov/documents/2020/12/17/2020-25814/enterprise-regulatory-capital-framework>.

<sup>12</sup> 86 Fed. Reg. 53237.

supports this provision of the framework, as it offsets the procyclicality associated with the use of mark-to-market LTV ratios (by limiting the decrease in minimum required capital during periods of rising home prices and the increase in minimum required capital during periods of falling home prices).

The recent acceleration in national home prices has outpaced the long-term trend by a wide margin, in large part due to persistent and significant imbalances between housing supply and demand. This period, therefore, will provide FHFA with an important test of the performance of the single-family countercyclical adjustment. Because home prices remain well above the long-term trend, the gap between the minimum required capital implied by mark-to-market LTV ratios and the minimum required capital as calculated using the countercyclical adjustment is quite large and likely will take many years to close, even if home price growth decelerates rapidly. FHFA should monitor this development and continue to analyze whether any further fine-tuning is needed with respect to the single-family countercyclical adjustment.

### **Impact of the Senior Preferred Stock Purchase Agreements**

In the proposed rule, FHFA notes that the Senior Preferred Stock Purchase Agreements (PSPAs) between the U.S. Department of the Treasury (Treasury) and each Enterprise include amended terms as of January 2021 that require the Enterprises to comply with the regulatory capital framework finalized in December 2020, “disregarding any subsequent amendment or other modifications to that rule.”<sup>13</sup> FHFA further elaborates that any changes to this arrangement “will require agreement between the Treasury and FHFA...”<sup>14</sup>

While many of the January 2021 amendments to the PSPAs proved disruptive for the Enterprises, lenders, borrowers, and stakeholders across the housing finance system, perhaps the most baffling provision was the requirement that the Enterprises abide by a point-in-time capital framework. We are not aware of any other situation in which an agency explicitly has required a regulated entity to comply with a prior version of a rule despite amendments to that rule proposed and finalized *by the same agency*.

Any changes to the regulatory capital framework undertaken by FHFA will require a proposed rule, a compelling rationale, data and evidence to support these changes, and an opportunity for public comment. As such, it is entirely unclear why the PSPAs should require the Enterprises to adhere to what would be an outdated capital

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<sup>13</sup> Treasury, “Treasury Department and FHFA Amend Terms of Preferred Stock Purchase Agreements for Fannie Mae and Freddie Mac,” January 14, 2021. Available at: <https://home.treasury.gov/news/press-releases/sm1236>.

<sup>14</sup> 86 Fed. Reg. 53231.

framework. Indeed, this provision seems to be directed at binding the hands of future FHFA leadership rather than promoting the sound operations of the Enterprises.

In September 2021, FHFA and Treasury announced the suspension of several provisions of the PSPAs, as amended in January 2021.<sup>15</sup> The suspensions of PSPA limitations on the Enterprises' acquisitions of loans secured by second homes and investment properties, loans with multiple risk factors, and multifamily loans, as well as limitations on the Enterprises' use of the cash windows, were critically important to restore the smooth functioning of the housing finance system.

The September 2021 directive did not, however, alter the PSPA provision requiring adherence to the December 2020 version of the Enterprises' regulatory capital framework. Without any changes to this provision, the problematic nature of the binding leverage ratio and the punitive CRT treatment would continue to serve as constraints on the Enterprises' operations – regardless of whether the current proposal is finalized by FHFA.

FHFA and Treasury therefore should prioritize the suspension or removal of the point-in-time capital framework from the PSPAs. This action should be taken no later than the effective date of any changes made to the regulatory capital framework, though ideally this action should occur as soon as possible to allow the Enterprises to adjust their businesses accordingly.

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Thank you in advance for your consideration of these observations and for your continued efforts to ensure an appropriate regulatory capital framework for the Enterprises. Should you have questions or wish to discuss further, please contact Bruce Oliver, Vice President of Commercial/Multifamily Policy, at (202) 557-2840 or [boliver@mba.org](mailto:boliver@mba.org) or Dan Fichtler, Associate Vice President of Housing Finance Policy, at (202) 557-2780 or [dfichtler@mba.org](mailto:dfichtler@mba.org).

Sincerely,



Robert D. Broeksmit, CMB  
President and Chief Executive Officer  
Mortgage Bankers Association

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<sup>15</sup> FHFA, "FHFA and Treasury Suspending Certain Portions of the 2021 Preferred Stock Purchase Agreements," September 14, 2021. Available at: <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-and-Treasury-Suspending-Certain-Portions-of-the-2021-Preferred-Stock-Purchase-Agreements.aspx>.