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August 31, 2020

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th St SW 8th Floor
Washington, DC 20219

RE: RIN 2590-AA95 Enterprise Regulatory Capital Framework

Dear Mr. Pollard,

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the re-proposed Enterprise Regulatory Capital Framework, otherwise known as the GSE Capital Rule. As you are aware, ICBA has been a strong supporter of the Federal Housing Finance Agency (FHFA) and a vocal advocate for establishing strong and prudent capital requirements that protect taxpayers and instill investor confidence, while bolstering the Government Sponsored Enterprises' (GSEs or Enterprises) ability to provide funding for mortgage loans in all markets, in all economic climates. ICBA's 2018 comment letter² stated that "ICBA believes establishing a rigorous capital framework is a necessary precursor to the formal establishment of capital restoration plans by each GSE, both of which are required by Section 1110 of the 2008 Housing and Economic Recovery Act (HERA). These are critical steps that should culminate in ending the net-worth sweep, rebuilding GSE capital in accordance with the capital framework, and eventually releasing the GSEs from their decade-long conservatorship."

Background

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ nearly 750,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$5 trillion in assets, nearly \$4 trillion in deposits, and more than \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

² <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15273>

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FHFA has undertaken several administrative actions since the 2018 proposed capital rule. Those actions include: the retention of up to \$45 billion in GSE earnings to rebuild capital; the hiring of investment advisors at both FHFA and the GSEs to provide advice and guidance on the recapitalization process; the removal of any preferred pricing arrangements to large volume lenders; and maintaining oversight of various GSE pilot programs. The most important action FHFA has taken is to affirm its intention to follow HERA and take those actions needed to safely release the GSEs from conservatorship. ICBA strongly supports all these actions.

FHFA states in its commentary that the proposed rule builds on the foundation of the 2018 proposal that “contemplated risk-based capital requirements based on a granular assessment of credit risk specific to different mortgage loan categories, as well as two alternatives for an updated leverage ratio requirement.”³ Moreover, FHFA decided to re-propose the regulatory capital framework in part due to the organization’s shift to actively ending the conservatorships of the GSEs in a safe and responsible manner. FHFA believes this change of intent is a departure from the 2018 proposal and will incentivize additional interested stakeholders to comment on the enhancements contemplated by the proposed rule.

ICBA has long urged FHFA to follow HERA and end the conservatorships. It should be noted that in 2018 ICBA advised FHFA to move forward with implementing the 2018 capital rule, end the net worth sweep, and start the GSEs on a path to recapitalization and eventual release from conservatorship. ICBA is pleased that FHFA is moving in this direction.

The proposed rule would require a leverage ratio of 4% up from 2.5% from the 2018 proposed rule. To achieve this, the amount of total GSE capital would need increase by \$100 billion to \$280 billion. The increase in capital is driven by a higher leverage ratio, and the addition of several capital buffers targeted to certain risks or practices. While this represents a significant increase in the level of GSE capital, ICBA believes that sound GSE capital restoration plans, along with additional administrative actions will help the GSEs in raising the capital needed to comply with these new requirements.

ICBA Analysis

³ <https://www.govinfo.gov/content/pkg/FR-2018-07-17/pdf/2018-14255.pdf>

The GSEs will have to go to the capital markets to raise this amount of equity, and their success or failure will depend on a multitude of factors: market conditions at the time, the housing economy, the financial health of the GSEs, the resolution of both the net-worth sweep and the Treasury's liquidation preference on the GSE preferred stock purchasing agreements (PSPAs), and the likelihood of the GSEs' ability to reasonably generate earnings per share (EPS) returns to attract and retain investors. The GSEs will also need to have clear roadmaps out of conservatorship – and will likely have already exited conservatorship and commenced operating under a regulatory consent order – to successfully execute what will likely be the largest capital raise in U. S. history.

GSE investors will also need to understand the scope and capability of the GSEs to successfully compete in the housing finance market versus other banks, issuers of private label securities, and loans backed by the Federal Housing Administration, Department of Veterans Affairs, and USDA Rural Development. A key factor will be the new Qualified Mortgage rule currently being proposed by the Consumer Financial Protection Bureau (CFPB). The resulting rule will have a significant impact on the GSEs' market share and credit risk profile versus private and other government entities.

There will always be some level of political risk with the GSEs – the ability to remove the FHFA director without cause, for example – resulting from any change in Administration. ICBA has been an advocate for Congress to change the GSE charters, making them financial utilities and helping to avoid political interference. However, after 12 years of conservatorship, Congressional action is unlikely.

The level and type of capital must be sufficient to protect taxpayers against loss and support the GSEs' housing mission as an affordable source of liquidity for the housing industry. Achieving that balance is a dynamic process that must be flexible enough to change based on market conditions and the overall economy. Capital levels must be realistic and reasonable so as to not create perverse incentives that conflict with the GSEs' mission or hamstring GSE management from effectively running their enterprises.

ICBA Recommendations

While ICBA generally supports the proposed framework, FHFA should consider certain recommendations or changes to make the framework easier to implement and manage, resulting in a more stable secondary housing market.

Reconsider including future guarantee fees or future revenues towards capital.

The 2018 proposed rule and the re-proposed rule both exclude future guarantee fees or revenue as capital. While FHFA seeks to ensure that both GSEs have sufficient capital to absorb financial shocks – such as the current economic shock caused by the COVID pandemic – it is crucial to recognize that the GSEs’ guarantee fees provide a substantial level of “claims paying ability” and protect against losses similar to capital buffers. Not including them or severely discounting their value makes it more challenging for the GSEs to successfully manage their businesses in a manner that provides a competitive, liquid market at all times.

Adjust the treatment of CRTs to better reflect low counterparty risk.

One of the more positive aspects of the housing finance reform efforts over the past decade has been the development of the credit risk transfer (CRT) market for GSE credit risk. These transactions allow the GSEs to transfer substantial amounts of credit risk on new originations to credit investors and have become a valuable tool for managing credit exposure. These transactions are currently structured to carry very little counterparty risk and seem to be holding up well during the current recession. The CRT market seems to be more resilient than many (including ICBA) had originally expected. The proposed rule appears to severely discount their value, resulting in a disincentive for the GSEs to use this tool to manage credit risk. We urge the FHFA to consider improving the capital treatment of these transactions.

Eliminate the capital charge for cross-GSE guarantees.

Since the 2018 proposed rule, the GSEs have successfully launched the Uniform Mortgage Backed Security (UMBS) as the common vehicle for securitizations of 10- to 30-year fixed rate mortgages they acquire. The UMBS was developed to improve liquidity primarily for Freddie Mac securities with the intention of improving overall market liquidity for GSE MBS. Fundamentally, a UMBS comprised of either GSEs’ loans or securities would be considered “good delivery” into a UMBS trade. This comingling requires one GSE to provide some level of cross guarantee of loans from the other GSE. The proposed rule assesses a 20% risk weight to these guarantees. ICBA believes this is inappropriate since the GSEs are forced to provide this cross guarantee to facilitate a UMBS trade.

While the GSEs are two separate companies with their own credit risk frameworks, FHFA, as their prudential regulator, controls their products and programs and closely monitors their respective performance. That oversight, along with the mission imposed by their charters and the requirements to maintain alignment on UMBS performance, dictates that their respective credit performance be similar in negating the need for a separate capital charge. ICBA urges FHFA to adopt a zero-capital charge as in the 2018 proposed rule on cross-GSE guarantees.

To conclude, ICBA supports the actions of FHFA to move forward with the recapitalization of the GSEs, in accordance with HERA, and generally supports this re-proposed Enterprise Regulatory Capital Framework. This framework will be used by the GSEs to formulate their respective capital restoration plans as they prepare to embark on their respective capital raises. ICBA urges FHFA to quickly finalize this proposed rule and take all steps necessary to amend the PSPAs, end the sweep of GSE profits to the U.S. Treasury, and position the GSEs to emerge from a 12-year conservatorship. ICBA looks forward to working with FHFA as this process moves forward.

If you have any questions regarding the content of this letter, please contact the undersigned at ron.haynie@icba.org.

Sincerely,

/s/

Ron Haynie
Senior Vice President, Mortgage Finance Policy

The Nation's Voice for Community Banks.[®]

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