Center for Responsible Lending

National Community Stabilization Trust

National Housing Conference

The Leadership Conference on Civil and Human Rights

Consumer Federation of America

Comment to the Federal Housing Finance Agency on the Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer

12 CFR Part 1240, RIN-2590-AB17

November 26, 2021

We, the Center for Responsible Lending (CRL),[1] the National Community Stabilization Trust (NCST),[2] the Consumer Federation of America,[3] the National Housing Conference, and The Leadership Conference on Civil and Human Rights, appreciate the opportunity to comment on the proposed rule to amend the Enterprise Regulatory Capital Framework (ERCF) by refining the prescribed leverage buffer amount (PLBA) and the credit risk transfer (CRT) securitization rules for Fannie Mae and Freddie Mac (the Government-Sponsored Enterprises (the GSEs)).

Overview and Executive Summary

We support the Federal Housing Finance Agency (FHFA) helping the GSEs further their mission by:

- Refining the PLBA to reduce the GSEs' excessive leverage capital requirements. This will equip the GSEs to promote responsible mortgage credit for more people to enter homeownership, including borrowers of color in underserved communities.
    - However, we oppose linking the PLBA to GSE market share through the Stability Capital Buffer (SCB), as this hamstrings the GSEs' countercyclical role stabilizing the mortgage market and economy. Linkage burdens the GSEs with greater capital requirements, and borrowers with higher costs, when the GSEs valuably fill the lending void caused by private capital receding in crises.
    - We do not believe that FHFA needs to impose a PLBA, since the leverage capital requirement of 2.5 percent of GSE total adjusted assets is sufficient without one. If FHFA believes that it needs to layer on top of the 2.5 percent capital requirement a PLBA of approximately 50 percent the SCB capital level, we suggest a simple buffer of 0.5 percent of GSE total adjusted assets. This does not penalize the GSEs for playing a countercyclical role and mandates about the same amount of leverage capital.

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[1] Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. For 40 years, Self-Help has created asset-building opportunities for low-income individuals, rural communities, women, and families of color. In total, Self-Help has provided over $9 billion in financing to 172,000 homebuyers, small businesses, and nonprofit organizations and serves more than 160,000 mostly low-income families through 72 credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, Washington, and Wisconsin.

[2] The National Community Stabilization Trust (NCST) is a national non-profit that supports families and communities by restoring distressed single-family homes, strengthening neighborhoods, and increasing sustainable, affordable homeownership. NCST does this by facilitating sales of distressed homes to community-based partners, providing technical assistance and capital for single-family rehab, and conducting federal policy advocacy grounded in our knowledge of local housing markets.

[3] The Consumer Federation of America (CFA) is an association of nearly 300 non-profit consumer organizations. Established in 1968, CFA works to advance the consumer interest through research, advocacy, and education.

- Allowing more market-sensitive treatment of CRT in lowering the prudential floor on any retained CRT exposure to 5 percent, and not requiring that the GSEs apply an overall effectiveness adjustment to retained CRT exposures. This encourages the GSEs to disperse credit risk among investors instead of holding it themselves where taxpayers are ultimately liable. Transferring more risk away from the GSEs bolsters their safety and soundness and that of the mortgage market, which furthers a core component of the GSEs' mission.

Further Recommendations

We believe, as stated in our comment on the proposed ERCF rule,[4] that the overall framework needs substantial revision well beyond the changes offered for comment. For future rulemaking, we recommend that FHFA, among other revisions:

- Eliminate the procyclical SCB that disincentivize the GSEs from critical lending in crises when private capital recedes and that raise mortgage prices;
- Remove from the ERCF rules not specifically designed for GSE regulation;
- Set leverage capital requirements of 1.5 percent of GSE trust assets and 4 percent of GSE retained portfolio;
- Count a portion of GSE guarantee fee revenue for ongoing loans towards risk-based capital requirements;
- Not make the GSEs comply with any non-public methodologies in calculating their risk-weighted assets;
- Revisit the countercyclical adjustment (CA) to ensure that it will not have unintended negative consequences; and
- Regulate the GSEs as utilities if and when the GSEs exit conservatorship.

The GSEs' Public Mission Shapes the ERCF

The GSEs' public mission instructs how the ERCF should be shaped. The GSEs explicitly undertake vital public duties in exchange for Congressional charter and public support. They must promote access to mortgage credit for underserved borrowers, including Black and Latino families, serve countercyclical roles in the mortgage market, and fulfill FHFA's duty to reasonably support the safety and soundness of themselves and the housing finance system. These public duties are in the GSEs' charters and the reason for their very existence.[5]

[4] *See* 85 FR 39274, Enterprise Regulatory Capital Framework, A Proposed Rule by the Federal Housing Finance Agency and the Federal Housing Enterprise Oversight Office on 06/30/2020, available at https://www.federalregister.gov/documents/2020/06/30/2020-11279/enterprise-regulatory-capital-framework.
[5] *See* 12 U.S.C. § 1716; 12 U.S.C. § 1451. The legislated purpose of the GSEs, as stated in their charters, is to:
1. provide stability in the secondary market for residential mortgages;

We take those three legs of the GSEs' mission in turn. First, the GSEs were created to promote access to credit with an emphasis on affordable housing for low- and moderate- income families and underserved communities of color. As such, the GSEs must support fair lending and report to Congress on how their practices "affect the purchase of mortgages for low- and moderate-income families, or that may yield disparate results based on the race of the borrower, including revisions thereto to promote affordable housing or fair lending."[6]

Pooling risk nationally to offer underserved borrowers loans on more favorable terms than they may otherwise receive is a crucial quasi-insurance function of the GSEs. This is within the GSEs' mission to pursue "activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return *that may be less than the return earned* on other activities[.]"[7] The GSEs appropriately earn smaller returns from borrowers who are lower-income or lower-wealth to assist them into homeownership. Indeed, pooling risk is key to the GSEs' ability to reach underserved borrowers and meet their charter goals.

Second, the GSEs have an indispensable countercyclical mandate to provide mortgage credit through all market cycles. Notably, this includes filling in for private capital when it recedes during crises or economic downturns. The GSEs are needed to continue providing credit in crises or the entire housing finance system will freeze and harm the national economy. This vital function is not simply hypothetical. Private-label securities (PLS) vanished from the mortgage market in the financial crisis and ever since. PLS mortgages went from 40 percent of the market in 2006 to about 1 percent in 2008 and have remained at that level.[8] The GSEs and Ginnie Mae picked up the lending slack.[9]

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2. respond appropriately to the private capital market;
3. provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing;
4. promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing;
5. manage and liquidate federally owned mortgage portfolios in an orderly manner, with a minimum of adverse effect upon the residential mortgage market and minimum loss to the Federal Government.

[6] *See* 12 U.S.C. § 1456(f)(2)(G).

[7] 12 U.S.C. §§ 1716(4) and (3) (emphasis added in quote).

[8] Housing Finance Policy Center, *Housing Finance At A Glance - A Monthly Chartbook*, Urban Institute (February 2021), at p. 8, available at https://www.urban.org/sites/default/files/publication/103746/housing-finance-at-a-glance-a-monthly-chartbook-february-2021_0.pdf.

[9] David Min, *How Government Guarantees in Housing Finance Promote Stability*, 50 Harv. J. Legis. 437 (2013), at p. 467, available at https://scholarship.law.uci.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1036&context=faculty_scholarship.

Similarly, the GSEs are playing a critical role during the COVID-19 crisis. During the first six months of 2020, the GSEs added $214 billion in net issuance, while the non-agency market dramatically pulled back because of liquidity concerns.[10] The GSEs' share of the mortgage market grew over 19 percent from 2019 to 2020, while that of depositories shrank 14 percent.[11]

Third, FHFA as GSE regulator must promote the safety and soundness of the GSEs and the housing finance system. Under the *Housing and Economic Recovery Act of 2008* (HERA), FHFA ensures that the GSEs "operate in a safe and sound manner" and that they "foster liquid, efficient, competitive, and resilient national housing finance markets."[12]

I. End the Procyclical PLBA That Hamstrings GSE Lending in Crises

A. Tying the PLBA to the SBC is Procyclical

While welcoming FHFA refining the PLBA to reduce the GSEs' excessive leverage capital requirements, we oppose linking the PLBA to GSE market share through the SCB since this hamstrings the GSEs' countercyclical role stabilizing the mortgage market and economy.

We do not believe the PLBA is necessary since the leverage capital requirement of 2.5 percent of GSE total adjusted assets is sufficient as credible backstop to the risk-based capital requirements. If FHFA wishes to layer atop the 2.5 percent capital requirement another buffer of approximately 50 percent of the SCB capital level, we suggest a simple buffer of 0.5 percent of GSE total adjusted assets. This does not penalize the GSEs for playing a countercyclical role and mandates about the same amount of leverage capital.

The PLBA burdens the GSEs with greater capital requirements, and borrowers with additional costs, at the worst time for both: when GSE credit is desperately needed to fill the void caused by receding private capital in crises. This is because the SCB rises as a GSE's market share tops 5 percent and the PLBA adds 50 percent of the SCB to GSE leverage requirements. The SCB charges each GSE 5 basis points per percentage point of mortgage market share above 5 percent. For example, Fannie Mae with a 26 percent market share has a SCB of 105 basis points and PLBA of 52.5 basis points.

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[10] Edward Golding, Laurie Goodman and Jun Zhu, *Analysis of the Proposed 2020 FHFA Rule on Enterprise Capital*, Urban Institute (August 2020), at p. 9, available at https://www.urban.org/sites/default/files/publication/102779/analysis-of-the-proposed-2020-rule-on-enterprisecapital_0.pdf.

[11] Housing Finance Policy Center, *Housing Finance At A Glance - A Monthly Chartbook*, Urban Institute (February 2021), at p. 8, available at https://www.urban.org/sites/default/files/publication/103746/housing-finance-at-a-glance-a-monthly-chartbook-february-2021_0.pdf.

[12] 12 U.S.C. § 4513(a)(1).

Linking the PLBA to the SCB is a highly procyclical policy at odds with the GSEs' mission to stabilize the mortgage market by playing a countercyclical role and lending in economic downturns when private capital retreats.

B. Bank Capital Rules Do Not Justify Tying PLBA to SCB

Making GSE capital requirements analogous to bank capital rules is ill-advised because the GSEs are not like banks. Shoehorning the GSEs into Basel III banking standards is thus an unpersuasive rationale for tying the PLBA to the SCB.[13] Imitating bank rules add pointless complexity to GSE regulation and ignore GSE differences that, for instance, support lower capital requirements. GSE mortgage risks are lower than banks and the GSEs receive government support that banks do not.

1. Bank Capital Rules Adds Pointless Complexity to GSE Regulation

Copying bank rules adds pointless complexity and can hamstring the GSEs, which are fundamentally unlike banks and should be regulated differently. GSEs differ from banks as monoline, relatively simple businesses that are amenable to straightforward rules. But the Basel III banking framework is complicated because banks are complex—they engage in multiple activities, carry various risks, and are operationally intricate. Nothing is gained by imposing Basel III bank regulatory structure, with its complex definitions of capital and their different requirements, on the GSEs.

Shoehorning the GSEs into capital rules designed uniquely for banks permeates the ERCF. Recognizing that the GSEs fundamentally differ from banks is vital to identifying bank-like rules that straitjacket the GSEs and frustrate their public mission.

2. Since the GSEs Are Not Banks They Should Not Hold the Same Capital

The GSEs fundamentally differ from banks in the mortgage context and that should be reflected in their capital requirements. The GSEs differ from banks in two ways that favor lower leverage capital requirements:

i) the GSEs' mortgage risks are lower, and

ii) the GSEs receive government support in crises, unlike banks, through the Preferred Stock Purchase Agreements (PSPAs).

[13] 12 CFR 1240 (September 27, 2021) at 53238.

i. The GSEs' Mortgage Risks are Lower Than Banks

The GSEs ultimately face far less mortgage risk than banks. The loans bought by the GSEs contain less risk overall than those made by banks and the GSEs sell off mortgage risk unlike banks that must cover their losses.

First, the GSEs' credit losses on mortgage loans are much lower than banks. The GSEs suffer lower losses partly because they are better insulated from adverse scenarios with greater diversification of risk by geography and lender. GSE single-family mortgage credit losses from 2007 on were half that of depositories.[14] That trend holds over longer periods. Fannie Mae single-family home mortgage credit loss rates were just 40 percent that of banks—15 basis points compared to bank losses of 37 basis points—between 1992 and 2019.[15]

Further, the risk weight for bank mortgages is inapplicable to GSEs. A 50 percent risk weight may be appropriate for banks but it is inappropriate for the GSEs. If a single risk weight were applicable to the GSEs, it would be half or 40 percent that of the banks' risk weight given their respective mortgage credit losses.

Second, and more importantly, banks hold credit, interest rate, and prepayment risks on their mortgages, while the GSEs sell those risks to investors in mortgage-backed securities (MBS). Virtually all GSE mortgages are packaged into MBS that are purchased by outside investors, leaving the GSEs with none of the associated risks to cover.

In contrast, banks fund the long-term mortgages they hold with short-term deposits or debt. This leaves banks vulnerable to runs on deposits or disruptions in funding markets. Banks also face excessive prepayments if interest rates fall and borrowers repay loans early. Conversely, they risk negative interest rate spreads if rates rise, which famously felled the savings and loan industry. These pitfalls exceed mortgage credit risks in potential severity over time.[16] While FHFA stated in its re-proposed rule last year that bank funding and interest rate risks are handled through supervision, that is not the same as transferring those risks entirely, as the GSEs do, nor is it the same as requiring capital for these risks by rule.

Illustrating the GSEs' advantages, and their more than sufficient capitalization, are their combined net income of $10.8 billion in the 2021 stress test under a "severely adverse

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[14] Jim Parrott, Bob Ryan and Mark Zandi, *FHFA's Capital Rule is a Step Backward*, Urban Institute (July 2020), at p. 6, Table 4, available at https://www.urban.org/sites/default/files/publication/102595/fhfa-capital-rule-is-a-step-backward_0.pdf.

[15] Enterprise Regulatory Capital Framework, Comment Letter to FHFA from Tim Howard (2020), available at https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15548.

[16] *See* Edward Golding, Laurie Goodman and Jun Zhu, *Analysis of the Proposed 2020 FHFA Rule on Enterprise Capital*, Urban Institute (August 2020), at pp. 6-7, available at https://www.urban.org/sites/default/files/publication/102779/analysis-of-the-proposed-2020-rule-on-enterprisecapital_0.pdf.

scenario,"[17] assuming they would not need to establish a valuation reserve to cover their deferred tax assets, which they likely would not.[18] The annual stress test gauges how well or not the GSEs would fare in crisis and thus what capital protection may be necessary. Even in "a severe global recession" with "stressed" real estate markets, the GSEs would not need capital reserves to cover their losses because they instead turned profits. The capital requirements under the ERCF are thus all in reserve and would not be needed by the GSEs even in a crisis similar to that of the Great Recession.

Smaller retained mortgage portfolios also distinguish the GSEs from banks. The GSEs drastically reduced the size of their retained portfolios to below $400 billion combined, as required by FHFA and the PSPAs between the U.S. Department of the Treasury and each GSE.[19] Further, legislative and regulatory reforms to the financial system, including substantial changes to the regulation of the mortgage market, have reduced overall systemic risk. For example, the GSEs are limited to purchasing qualified mortgages, which exclude the no- and low-documentation, interest-only, negatively-amortizing, and teaser-rate adjustable loans that caused substantial losses in the private-label securities market and to the GSEs in the wake of the crisis.[20] This helps eliminate the need for capital fortresses to safeguard the GSEs from losses they would not face.

ii. Government Supports the GSEs in Crises Unlike Banks

As the GSEs' risk is substantially lower than in the past, and their capital is substantially greater, their failure is tremendously unlikely. In addition, the ERCF ignores that the government supports the GSEs in crises, which instills investor and creditor confidence in them. Yet the GSEs are required to maintain bank-level capital, in part, to maintain investor and creditor confidence.[21] Conversely, banks do not enjoy equivalent governmental support. They can fail and no longer remain going concerns, so non-deposit creditors must find confidence in bank

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[17] *See* FHFA, *Dodd-Frank Act Stress Test Results, Severely Adverse Scenario* (August 13, 2021) at p. 6, available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Final_2021-Public-Disclosures_FHFA_SA.pdf.

[18] Don Layton, *The GSE Stress Test Results: Good News But Troubling Decisions*, Joint Center for Housing Studies of Harvard University (August 31, 2021), available at https://www.jchs.harvard.edu/blog/gse-stress-test-results-good-news-troubling-decisions. The stress tests measure profits or losses over a nine-quarter period.

[19] 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.

[20] See Mark Zandi, Gus Harris, Ruby Shi and Xinyan Hu, *Who Bears the Risk in Risk Transfers*, Moody's Analytics (August 2017) at Table 1, p. 2 (from 2006 to 2014, GSE loans realized losses of 3.1 percent of their outstanding balance at the start of the crash, year-end 2007, while private-label securities faced losses of 24.2 percent and depository institution portfolio loans had losses of 6.3 percent), available at https://www.economy.com/mark-zandi/documents/2017-08-02-who-bears-the-risk.pdf. It was the GSEs' late entrance into purchasing Alt-A no documentation loans and also buying non-QM-compliant subprime mortgage-backed securities that caused their significant credit losses during the crisis. In 2008, for example, Alt-A loans comprised 45.6 percent of Fannie Mae's single-family guarantee credit losses, while making up just 10.1 percent of its book of business. See Fannie Mae, *2008 Credit Supplement* (February 26, 2009) at p. 5, available at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2008/2008_10K_credit_summary.pdf.

[21] *See*, e.g., 85 Fed. Reg. 39274, 39293 (June 30, 2020).

capital reserves.[22] This underscores that governmental guarantees should not be overlooked in calculating GSE capital needs.

II. Market Treatment of CRT Improves GSE Safety & Soundness

We support FHFA allowing more market-sensitive treatment of CRT in lowering the prudential floor on the risk weight assigned to any retained CRT exposure to 5 percent, and not requiring that the GSEs apply an overall effectiveness adjustment to their retained CRT exposures. This encourages the GSEs to disperse credit risk among investors instead of holding it themselves where taxpayers are liable.

Transferring more risk away from the GSEs bolsters their safety and soundness and that of the mortgage market, which furthers a core component of the GSEs' mission.

Further Recommendations

While further changes to the ERCF will require FHFA to propose and finalize revisions, we want to take this opportunity to identify areas that we believe warrant amendment.

1. End the Procyclical SCB That Hamstrings GSE Lending in Crises

We recommend eliminating the procyclical SCB to the risk-based capital rule along similar lines as the PLBA, discussed in (I) above. The SCB burdens the GSEs with greater capital requirements and borrowers with additional costs at the worst time for both: when GSE credit is desperately needed in crises. The SCB charges each GSE 5 basis points per percentage point of mortgage market share above 5 percent.

The SCB is a highly procyclical policy at odds with the GSEs' mission to stabilize the mortgage market by playing a countercyclical role and lending in economic downturns when private capital retreats. The SCB is also an unnecessary layer to GSE capital requirements and is predicted to raise mortgage prices. The Urban Institute reports that the SCB alone likely increases mortgage interest rates 10 basis points by increasing the risk-based capital requirement.[23]

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[22] For discussion of the failures of IndyMac and Washington Mutual, *see* David Min, *How Government Guarantees in Housing Finance Promote Stability*, 50 Harv. J. Legis. 437 (2013), at p. 478, fn 227, available at https://scholarship.law.uci.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1036&context=faculty_scholarship.

[23] Edward Golding, Laurie Goodman and Jun Zhu, *Analysis of the Proposed 2020 FHFA Rule on Enterprise Capital*, Urban Institute (August 2020), at pp. 8-9, available at https://www.urban.org/sites/default/files/publication/102779/analysis-of-the-proposed-2020-rule-on-enterprisecapital_1.pdf.

2. Remove From the ERCF Rules Not Designed for GSE Regulation

We believe that FHFA should streamline the ERCF by removing rules designed for banks and that are unnecessary for GSE regulation. As discussed in (I)(B) above, adopting bank rules while ignoring key differences between the GSEs and banks adds pointless complexity to GSE regulation and hamstrings the GSEs in fulfilling their public mission.

3. Lower the ERCF's Leverage Capital Requirements

Simplifying the ERCF to remove rules that were designed for banks and not GSEs, we believe supports, among other reforms, leverage capital requirements of 1.5 percent of GSE trust assets and 4 percent of GSE retained portfolio. This is based on the discussion in (I)(B) and (2) immediately above, and was an alternative presented in the 2018 rule.

GSE leverage capital requirements should be lower than that of banks to reflect their fundamental differences. The GSEs' face lower credit risk and uniquely enjoy solid government support under the PSPAs.

4. Count a Portion of GSE Guarantee Fee Revenue Towards Capital Requirements

A portion of GSE guarantee fee revenue for ongoing loans should count towards capital requirements. This revenue stream proved reliable in absorbing GSE losses during the 2008 financial crisis and logically counts as capital.

At minimum, two- or three-years' worth of future guarantee fees, less general and administrative expenses, should count towards GSE capital requirements. That is under half the average duration of a mortgage and so guarantee fees for that time are appropriate to include.

Guarantee fees on performing loans provide the GSEs revenue to offset losses and preserve capital levels, so logically they should count toward capital requirements.[24] Even during the financial crisis, fully 92 percent of GSE borrowers were current on their loans. Less capital cushion is needed with higher than lower revenue because greater income shields more losses. If revenue had no impact on required capital levels, then it would follow that the same amount of paid-in capital should be required regardless of guarantee fees being 5 basis points or 500. It does not. Clearly, higher guarantee fees better protect paid-in capital from having to cover losses than lower guarantee fees.

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[24] *See* Enterprise Regulatory Capital Framework, Comment Letter to FHFA from Mike Molesky, available at https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15587, for a discussion of the importance of considering revenues in setting capital requirements, as well as the importance of better-performing vintages of seasoned loans to offset losses from high-loss years.

Two examples where use of guarantee fees count towards capital demonstrate why guarantee fees themselves should be included. First, guarantee fee income that purchase loss protection through CRT appropriately reduces paid-in capital requirements. Second, if the GSEs created and sold interest-only (IO) strips of guarantee fee revenue the proceeds count towards capital (although given the GSEs would have transferred the prepayment risk to investors, if they kept their guarantee fee revenues and retained this risk they would need to discount the amount that counts as capital). Ignoring these fees in capital calculations encourages the GSEs to create IO securities and bear deadweight transaction costs.

Both the GSE stress tests, and the Dodd-Frank Act stress tests for banks, recognize revenue towards capital requirements. Revenue may cover much loss before capital is needed if, indeed, the GSEs' even suffer any loss. Recall, the GSEs' 2021 Dodd-Frank stress tests showed combined profits under a "severely adverse scenario" of $10.8 billion.[25] This assumes that the GSEs do not have to establish a valuation allowance for deferred tax assets, which it appears they would not.[26]

5. Stop Requiring the GSEs to comply with Non-Public Methodologies

We recommend that FHFA not make the GSEs comply with any non-public methodologies in calculating their risk-weighted assets. Currently, a GSE must comply with the higher of its risk-weighted assets calculated under the standardized approach and the advanced approach using its internal model. The advanced approach involves proprietary calculations and is not transparent unlike the standardized approach that FHFA publishes.

6. Ensure that the Countercyclical Adjustment Will Not Have Negative Consequences

We suggest revisiting the CA to ensure that it will not have unintended negative consequences. We do not have specific suggestions but are concerned that the CA may not work as intended. At minimum, we believe that FHFA should retain discretion in implementing the CA should problems occur.

7. Regulate the GSEs as Utilities

FHFA as conservator currently mandates an assumed return on the GSEs' required implicit capital. This return, along with GSE capital levels FHFA establishes via the ERCF, help set GSE guarantee fees that borrowers ultimately pay. FHFA and Treasury should install the

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[25] *See* FHFA, *Dodd-Frank Act Stress Test Results, Severely Adverse Scenario* (August 13, 2021) at p. 6, available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Final_2021-Public-Disclosures_FHFA_SA.pdf.

[26] Don Layton, *The GSE Stress Test Results: Good News But Troubling Decisions*, Joint Center for Housing Studies of Harvard University (August 31, 2021), available at https://www.jchs.harvard.edu/blog/gse-stress-test-results-good-news-troubling-decisions. The stress tests measure profits or losses over a nine-quarter period.

infrastructure necessary to regulate the GSEs as utilities, and do so regardless of whether the GSEs remain in or exit conservatorship. This position enjoys broad stakeholder support.[27]

Like electric utility regulation, FHFA would set a band of fair rates of GSE return that are neither too high in harming borrowers nor too low in threatening GSE safety and soundness. Given that the GSEs are a duopoly with economies of scale and government advantages, and provide essential national services, they should not be permitted to maximize returns just as utility companies cannot price gouge. In contrast, the GSEs' returns on equity generally exceeded 20 percent from 1992 until the financial crisis, which spurred them into taking excessive risks.

Utility regulation also protects against the risks of duopoly instability, one or the other of which is likely at any given time: 1) downward pressure to cut prices to earn market share, which threatens each entities' safety and soundness, or 2) upward pressure through implicit collusion by the two entities to raise consumer prices extraordinarily high.

By regulating the GSEs as utilities, investors will appreciate that the GSEs' current low-risk business model is stable and see the GSEs as value stocks with sustainable dividend capacity, requiring lower ROEs. But removing control on GSE returns would lead to less risk pooling among borrowers, more segmented risk-based pricing, more risk-taking to maximize returns, higher prices for homebuyers as the GSEs exploit their duopoly power, and more restricted mortgage credit. This inevitably would widen already large racial homeownership disparities and the racial wealth gap, and reduce the GSEs' long-term safety and soundness threatening system stability.

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[27] *See* Eric Stein and Bob Ryan, *Treat the GSEs as Utilities*, Center for Responsible Lending (March 2020), available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-gse-utilities-report-mar2020.pdf; Richard Cooperstein, Ken Fears, and Susan Wachter, *Working Paper: A Vision for Enduring Housing Finance Reform*, The National Association of REALTORS®, (February 7, 2019) at pp. 22–29, available at https://www.nar.realtor/sites/default/files/documents/2019-Working-Paper-A-Vision-For-Enduring-Housing-Finance-Reform.pdf; Don Layton, *Why is the Administration not Talking About Utility-Style Regulation of G-fees?*, Joint Center for Housing Studies of Harvard University (July 16, 2019), available at https://www.jchs.harvard.edu/blog/why-is-the-administration-not-talking-about-utility-style-regulation-of-g-fees/; Treasury Secretary Paulson on the Role of the GSEs in Supporting the Housing Recovery, at p. 8 (January 7, 2009), available at https://www.economicclub.org/sites/default/files/transcripts/paulson_transcript%20JF%20Revision.pdf ("[E]stablishing a public utility-like mortgage credit guarantor could be the best way to resolve the inherent conflict between public purpose and private gain. Under a utility model, Congress would replace Fannie Mae and Freddie Mac with one or two private-sector entities. The entities would purchase and securitize mortgages with a credit guarantee backed by the federal government and would not have investment portfolios. These entities would be privately owned, but governed by a rate-setting commission that would establish a targeted rate of return, thereby addressing the inherent conflicts between private ownership and public purpose that are unresolved in the current GSE structure."); Press Release, *Treasury Department Blueprint on Next Steps for GSE Reform*, U.S. Department of the Treasury (January 14, 2021), p. 2, available at https://home.treasury.gov/system/files/136/BlueprintonNextStepsforGSEReform.pdf ("**Establish Appropriate Pricing Oversight**: The GSEs have significant pricing power over mortgage credit in the United States, due to their size and privileged access to federal support. Post-conservatorship, FHFA should continue its conservatorship-era practice of pricing oversight.").

Conclusion

We support the proposed rule's direction except for creating a procyclical PLBA via the already procyclical SCB. In our view, the PLBA is an unnecessary layer atop capital requirements that hampers GSE lending in crises and should be eliminated. If FHFA believes more leverage capital is necessary, we suggest a single buffer of 0.5 percent of GSE total adjusted assets.

We also support the rule lowering the prudential floor on retained CRT exposure to 5 percent, and removing the requirement that the GSEs apply an overall effectiveness adjustment to their retained CRT exposures.

For future rulemaking, we propose eliminating the SCB, removing the influence of bank rules on the ERCF, refining leverage capital requirements to 1.5 percent of GSE trust assets and 4 percent of GSE retained portfolio, counting a portion of GSE guarantee fee revenue towards risk-based capital requirements, not making the GSEs comply with any non-public methodologies, re-assessing the impact of the CA, and regulating the GSEs as utilities if and when they exit conservatorship.