August 28, 2020

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590–AA95
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW
Washington, DC 20219

Re: Enterprise Regulatory Capital Framework

Dear Mr. Pollard,

SIFMA[1] and Nareit, on behalf of its Mortgage REIT (mREIT) Council,[2] appreciate the opportunity to provide comments on FHFA's proposed capital framework[3] ("Framework") for the Enterprises (GSEs). SIFMA represents a variety of participants active in all aspects of the agency MBS markets. In addition, SIFMA maintains many market practices and guidelines designed to assist in the smooth and liquid function of the trading markets for the GSEs' mortgage-backed securities (MBS), in particular the TBA market. Nareit's mREIT Council members play an important role in the U.S. housing finance sector by investing in, financing, and managing agency MBS and non-Agency securities. Residential mREITs have been an important permanent source of liquidity for agency MBS through recent credit cycles and currently hold 3.5% of U.S. MBS.[4] Accordingly, we are primarily focused on aspects of the proposed framework that have the most direct impact on the trading markets for MBS and other GSE securities such as credit risk transfer ("CRT").[5]

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).
[2] Nareit is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community. Nareit's mREIT Council, which includes both residential and commercial mREITs, advises Nareit's leadership on mREIT matters
[3] FHFA "Enterprise Regulatory Capital Framework", available: https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-11279.pdf
[4] Federal Reserve, Financial Accounts of the United States) 2019: Q4.
[5] This letter is focused on the single-family activities of the GSEs. As regards multifamily MBS, SIFMA members have reviewed and generally endorse the suggestion set forth in the CREFC letter that the multi-family risk weights would benefit from additional discussion prior to finalization.

FHFA has clearly taken a thorough look at the 2018 framework, and has proposed revisions to it aligned with its current view of what is needed to ensure the safety and soundness of the enterprises and the secondary mortgage markets more broadly. FHFA notes three reasons for re-proposing the 2018 Framework:

1. Furthering the process of ending the conservatorships;
2. Improving the quality and quantity of capital; and
3. Mitigating pro-cyclicality in the 2018 rules. [6]

In this letter we provide comments on the aspects of the proposal that are the most critical for FHFA to consider and address. Our comments are largely focused on the first two reasons mentioned above.

SIFMA and Nareit are broadly supportive of efforts to ensure the GSEs are appropriately capitalized. That said, ending their conservatorships presents great risks and must be sequenced very carefully. These concerns transcend issues of capital and risk management, and are grounded in the GSEs' ability to fulfill their chartered purpose of facilitating a liquid secondary market for residential mortgages. Satisfying these concerns may impact the timing and nature of GSE capital raising efforts. Our guiding principle is that in the setting of capital standards (and the broader process of conservatorship exit), no harm should be done to the TBA market.

While nominally aimed at protecting taxpayers and leveling the playing field with banks, we believe this Framework misses the mark. It is overly complicated; it does not effectively create a level playing field, instead retaining significant advantages for the GSE; it could harm MBS liquidity; and it poses risks to valuable mechanisms to transfer risk away from taxpayers.

We will address a number of issues in the discussion that follows:

1. Our support for efforts of the GSEs to build a more robust capital base in the context of doing no harm to TBA market liquidity;
2. High level considerations regarding FHFA's rationale of furthering the process of ending the conservatorships;
3. The treatment of CRT should be reconsidered;
4. The 20% risk weight for cross-GSE exposures could threaten UMBS liquidity and needs to be revised;
5. Misalignments with bank capital requirements

[6] https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Webinar_642020.pdf, at 2.

Discussion

1. SIFMA and Nareit support efforts by the GSEs to build a more robust capital base in the context of doing no harm to TBA market liquidity

SIFMA and Nareit's mREIT Council members support the efforts of FHFA and the GSEs to build more robust capital bases to the extent that doing so does not harm the ability of the TBA market to provide benefits to consumers. Capital, while not a substitute for an explicit guarantee, is protective insulation for the taxpayers that have provided support for these critical components of our housing finance system. Capital will stand in front of any explicit government guarantee and make it less likely to be used. The GSEs have already been allowed to retain earnings, and this should continue. The GSEs have undertaken efforts, at the direction of FHFA, to explore raising new equity capital from global investors. Within the context of our first principle that no harm be done to the TBA market, we support these efforts. We acknowledge that it may be challenging to raise new equity capital when the fate of the GSEs and GSE reform is uncertain, however. This illustrates the need for comprehensive legislative reform. The mortgage market will benefit from certainty and finality.

We note that the amount and nature of capital required will have many impacts, and we expect that Congress would have great interest in this issue. It will drive the price of the GSEs' guarantees, it will drive the returns equity investors receive (and their interest in and their price for investing), it will drive the balance of activity between GSE programs and FHA/VA, and it will drive the market share of the GSEs vs. banks and other private market participants. These all represent tradeoffs that policymakers must make judgements on prior to the GSEs' release from conservatorship.

2. High level considerations regarding FHFA's rationale of furthering the process of ending the conservatorships

- *The process of ending conservatorships goes far beyond capital; existential issues need to be addressed first*

We agree that having appropriately capitalized enterprises is a necessary part of the process of their exit from conservatorship. The key words in that sentence are "part of the process". Exit from conservatorship is not something that can safely happen without a series of other events falling in to place.

The bigger picture is what is important here - i.e., ensuring an outcome whereby the liquidity of MBS markets, availability of mortgage credit, and protection of the financial system is paramount. We do not believe this can happen without an explicit and permanent government guarantee being available for the GSEs' existing and future MBS. As FHFA knows, the TBA market is critical to the housing finance system – it allows originators to manage risk, allows borrowers to lock in rates at low or no cost and for long terms, and reduces the cost of mortgage credit.

As we have previously detailed in a letter[7] to FHFA, the Department of Housing and Urban Development, and the Department of the Treasury, we believe that the proper sequencing of actions to end the conservatorships of the GSEs is absolutely critical to ensure that the TBA market and broader mortgage markets are not disrupted. SIFMA and Nareit's mREIT Council members believe that the only fully effective solution for resolving the conservatorships is legislative action that implements comprehensive, and conclusive, reform of the GSEs and makes available an explicit guarantee for their MBS. Any other course that lacks an explicit guarantee introduces significant risk into the housing market, mortgage secondary markets, and the financial system. These risks were fully manifested in the financial crisis of 2008, a result of which was Congress enacting the legislation creating the FHFA and its ability to place the GSEs in conservatorship. This was the first step in the sequence toward an explicit government guaranty of MBS. The second step in this sequence was the Senior Preferred Stock Purchase Agreement (PSPA). SIFMA does not see a compelling reason to take the risk of prematurely ending the sequence without an explicit guaranty.

In other words, we generally agree with the Treasury Department:

> *This existing Government support should…be made clearer and better tailored. The PSPA commitment should be replaced with an explicit, paid-for guarantee backed by the full faith and credit of the Federal Government.*[8]

We note that over the years, a bi-partisan consensus on this issue has organically grown in Congress. Legislative reform is a complicated thing to do, of course, but to ensure that the GSEs are able to (1) fulfill their "statutory mission[s] to provide stability and ongoing assistance to the secondary mortgage market across the economic cycle"[9] as FHFA desires and (2) that American residents are able to access affordable credit, it must be done this way.

Some have posited that conservatorship can be safely ended without the application of a government guarantee; in other words that we can rewind the clock back to 2006, add in a limited and contingent PSPA, rely on a belief that the government won't let the housing system crash, and carry on.

We do not agree on two levels – first, a return to an implicit guarantee would be a step backwards and introduce moral hazard and other incentives and risks we saw in the run up to 2008; second, we don't actually think it would work in the first place.

As SIFMA noted in its 2019 letter:[10]

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[7] See SIFMA's 2019 letter here: https://www.sifma.org/wp-content/uploads/2019/07/SIFMALetterReGSEs_final20190711.pdf
[8] Treasury Housing Finance Reform Plan, at 13. https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf.
[9] Framework at 9.
[10] 2019 letter at 2.

In the event that a legislative process is not successful, it has been suggested that the GSEs could still exit their conservatorships. We believe that absent Congress and the President legislatively enacting an explicit guarantee applicable to the GSEs' existing and new MBS, and without the finality provided by comprehensive housing finance reform, moving the GSEs out of conservatorship and back into the private markets would dramatically heighten the risk of a liquidity disruption for existing and new MBS.

Further, our members believe that market participants will no longer consider an implicit guarantee, even if supported by the remaining --but limited-- PSPA, as equivalent to an explicit guarantee. As such, we believe it is reasonable to expect investors would once again question the commitment of the U.S. government to the GSEs and their MBS. In contrast to the desire to project a nearly explicit guarantee when the GSEs entered conservatorship in 2008, such a move without legislation may be considered by some an explicit non-guarantee.

SIFMA stands by these views and would be pleased to discuss them at greater length.

The bottom line is that an appropriate capital framework, while a necessary part of an end to conservatorship, is insufficient by itself. Indeed, it is less important than other aspects of their release. The recent experience with the coronavirus only serves to underscore the importance of the GSEs. COVID has clearly shown the differences between guaranteed and non-guaranteed markets, and how GSEs (and GNMA) will always be the refuge in the storm.

- *Capital is not a substitute for a guarantee*

Further to the above, we would like to highlight the point that capital is not a substitute for a guarantee. The GSE MBS markets, as FHFA knows, are rates markets. That is, investors in these markets are focused on interest rate risk – not credit risk. No level of capital can substitute for a government guarantee, given that lack of a guarantee necessarily implies the presence of credit risk. Until 2008, investors around the world were generally comfortable with the "implicit" guarantee, believing that when needed the US government would step in to support the GSEs. The government did step in, but some investors, largely foreign ones, exited the market. Despite assurances from the highest levels of the US government that their investments were safe, the imposition of the conservatorships crystallized policy risk, and presented a set of new "known unknowns" which caused those investors to retreat. Over time, some of them have come back, while others have continued to focus on the GNMA markets – which have quadrupled in size since 2008 – allocating less capital to the GSE MBS markets.

$200 billion of PSPA support would make investors feel that a GSE security guarantee is more robust than a GSE security guarantee without it, however, that is not to say that investors would consider this kind of guarantee as anything close to the full faith and credit guarantee on a GNMA MBS. Even in today's market there are pricing disparities between GSE and GNMA MBS related to the guarantee; these would be exacerbated (possibly greatly) in a stressed PSPA-only scenario; i.e. the GSEs out of conservatorship.

It is important to repeat that in 2008, investors left (or otherwise reduced allocations to) the GSE market notwithstanding the US government stepping in to effectively explicitly support the GSEs' MBS and debt. The then-Secretary of the Treasury publicly stated that the purpose of Treasury's investments was to "*ensure that the conserved entities have the ability to fulfill their financial obligations*" and they were designed to "*provide greater stability and certainty to market participants and provide long-term clarity to investors in GSE debt and MBS securities*" (emphasis ours).[11] The PSPA's were designed to ensure that the GSEs could maintain a positive net worth – that is, that they could fulfill their obligations such as guarantees on their MBS – and were amended several times to align the support with needs. But even this wasn't enough for sectors of the investor base.

When we consider the prospect of the GSEs exiting conservatorship supported only by their own capital and an explicitly limited and of contingent duration PSPA (that is currently ensnared in the midst of a multitude of litigation with unknown outcomes), we become concerned that policy risk will be catastrophically aggravated, motivating an even greater number of investors to exit or reduce allocations to the GSE MBS and debt markets. Investors would have cause to question if this arrangement meant that the GSEs were no longer implicitly supported (i.e., that the PSPA support was a red line that could not be crossed), and if as a counterparty they were just a hybrid of a bank and mortgage insurer with a limited capital line from the government. This would conflict with the reality that *"GSE debt and MBS are held by central banks and investors throughout the United States and around the world who believe them to be virtually risk-free."*[12]

We also believe that while capital and PSPA support may be sized to withstand another 2008 event, (1) it is not the case that the next event will necessarily look like or have the effects of 2008, as it could be different or simply greater, and (2) it is cold comfort to a rates investor that an entity 'appears' to be sufficiently capitalized to perform on its obligations in theoretical turbulent markets. Rates investors do not want to take on credit risk, full stop.

We believe it is reasonable to consider an outcome where GSE MBS were no longer considered virtually credit risk-free and became more closely aligned with the current market for private label MBS: GSE MBS would no longer trade as a rates product (because the probability of default of a GSE would be greater than zero), GSEs would be treated as corporates and subject to stricter issuer exposure limits, the TBA market would break down and become far less liquid if it continued to operate at all, mortgage rates would increase, mortgage credit availability would be rationed, servicers and originators would have less effective hedging products, real estate and homebuilding activity would decline, 30-year mortgages would be less available, rate locks would be more expensive and shorter in length, and the retirement portfolios of millions of Americans would be harmed.

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[11] See Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers: https://www.treasury.gov/press-center/press-releases/Pages/hp1129.aspx

[12] Ibid.

As mentioned, we do not see a compelling reason to risk the economy in this manner.

3. The treatment of CRT should be reconsidered

Many SIFMA and Nareit mREIT Council members are involved in the GSEs' CRT programs, either as investors, market makers, or underwriters, and thus have a keen interest in how the framework might affect this market. SIFMA and Nareit have been consistent proponents of the GSEs' CRT programs, viewing them as important market signaling and risk management activities.[13] SIFMA and Nareit support the GSEs engaging in a broad range of CRT activities, including capital markets transactions such as the STACR and CAS programs and the recent development of the CAS REMIC CRTs.

As Freddie Mac's former CEO noted in a recent paper, "*the [CRT] program was developed to do business-like capital management, selling off credit risk only when doing so is more economically efficient than holding it. This practice was consistent with the GSEs' being not on-budget government agencies but rather shareholder-owned companies (even if temporarily under government control) operating to efficiently achieve the objectives given by Congress through their charters*."[14] We agree that credit risk transfer is an important part of the current and future risk management programs of the GSEs and any successors thereto, and agree with a 2019 statement of the Treasury Department that "*FHFA should encourage the GSEs to continue to engage in a diverse mix of economically sensible CRT*".[15]

We are concerned, however, that the Framework that has been proposed would do the opposite – that it would significantly limit the ability of the GSEs to achieve capital relief from CRT transactions, would decrease their incentives to engage in them (maybe completely), and would result in the GSEs being required to hold more capital than is otherwise necessary. This would have knock-on effects of putting upward pressure on G-fees, making returns lower, and therefore make the GSEs less attractive to potential equity investors. In other words, the proposed Framework does not follow the Treasury Department recommendation that "*FHFA should, in prescribing regulatory capital requirements, provide for appropriate capital relief to the extent that a guarantor, or a GSE pending legislation, transfers mortgage credit risk through a diverse mix of approved forms of CRT.*"[16]

As shown in the tables in the proposed Framework, the capital relief due to CRT would be roughly cut in half. That cut, combined with a binding leverage ratio, could result in a complete diminution of incentives to do CRT by one or both of the GSEs – which would, perversely, incentivize them to retain more risk and will require more capital, creating greater costs to

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[13] See, e.g., SIFMA letter to Congress on enhancements to CRT, https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-congress-on-crt.pdf; Joint trade Comment to FHFA responding to RFI on Single Family CRT (10/13/16), https://www.fhfa.gov//AboutUs/Contact/Pages/input-submission-detail.aspx?RFIId=466

[14] See Don Layton, "Demystifying GSE Credit Risk Transfer: Part Three", https://www.jchs.harvard.edu/sites/default/files/harvard_jchs_gse_crt_part3_layton_2020.pdf, at 11.

[15] Treasury Housing Finance Reform Plan, https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf, at 30.

[16] Ibid.

consumers.

FHFA notes a concern that CRT "*could limit the Enterprise's ability to fulfill its statutory mission to provide stability and ongoing assistance to the secondary mortgage market across the economic cycle*".[17] With regards to capital-markets based CRT, we disagree with this concern, and note that the experience with coronavirus provides a case study of a worst-case scenario where the CRT markets became inactive for a period of time that we will discuss more below. In some respects, we believe the proposal paints CRT with a broad brush and does not recognize nuances of, e.g., capital markets CRT vs. other kinds of CRT that involve counterparty risk.

One reason that SIFMA and Nareit have consistently supported STACR and CAS-like capital markets CRT is that it is a form of risk transfer where, similar to some insurance securitization products, investor funds are received up front and used to cover losses on the reference pool of mortgages. There are no contingent issues such as a counterparty deciding not to pay a claim, a counterparty failing and becoming unable to pay a claim, a counterparty being downgraded and triggering some kind of remedial action requirement, or even a need to consider counterparty risk in the first place *because there is none* for the GSE.[18]

The proposal also references concern about decreases in investor demand as a risk and notes that "*some CRT structures could adversely impact an Enterprise's ability to support the secondary mortgage market if an Enterprise were not to have sufficient equity financing to support new acquisitions of mortgage exposures*".[19] The spring of 2020 was a case study regarding investor demand in a stress scenario. For a period of time, market conditions were not favorable to the GSEs' issuance of CRT, so the GSEs did not issue CRT. As noted in the quote above, given that these programs are business programs first, this makes sense. Instead, the GSEs held on to the risk for a bit longer, and issued CRT when market conditions were more favorable. This was the best outcome – a forced issuance into soft markets would have resulted in much higher costs for their transactions than they were ultimately able to achieve.

The GSEs are not funded in such a way that they absolutely need to issue CRT at any point in time – rather, they fund their purchase and guarantee business through the issuance of MBS. Given that their MBS are nearly explicitly guaranteed under conservatorship, they are effectively always available to fund their mortgage market activities. During the worst of times in March and April, liquidity was available in the production TBA coupons, supporting mortgage originations. After all, the GSEs operated for 40 years without any CRT at all, albeit while retaining significantly more risk than they do today.[20]

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[17] Framework at 39330.

[18] On the other hand, there is counterparty risk for the CRT investor, which raises questions whether CRT will still be a viable market if the GSEs exit conservatorship without a guarantee.

[19] Ibid.

[20] A fact which, arguably, should have made it harder for the GSEs to maintain normal operations in stress periods in the past.

We believe the March/April experience shows the flexibility of the GSEs' CRT model. In the alternative, if the GSEs had to rely solely on equity capital we posit that such financing would have been quite expensive to raise during this time. However, there was no need, because the GSEs are able to lay off credit risk in CRT transactions at the appropriate time.

The proposal also expresses a concern that "*some CRT structures might tend to increase the leverage in the housing finance system, especially to the extent some CRT investors themselves rely on short-term debt funding. The disruption in the CRT markets during the recent COVID-19-related financial stress might have been driven in part by leveraged market participants that had invested in CRT rapidly de-levering when confronted by margin calls on short-term financing*."[21] We note that there were multiple factors that impacted investor demand. The most prominent, of course, was broad financial market stress which significantly decreased appetite for all risk assets and even off-the-run rates products. It was not limited to CRT, as there were also strains in Treasury and TBA markets. CRT may be held by leveraged investors, along with equities, municipals, corporates, Treasuries, TBAs, CMOs, foreign government debt, non-agency RMBS and ABS, commodities, derivatives, and real estate assets. CRTs are an insignificant component of the broader equity and fixed income markets by size, and do not materially contribute to overall leverage in the system.

Risk Weight Floor - The proposal changes the risk weight floor for CRT from 2018's 0% to 10%. We agree that it makes sense for there to be a minimum risk weight. We would suggest it be set to 7%, which is the original Basel floor. We note that the Basel floors for bank investments are intended to protect banks from the unknown – as bank investors generally aren't the originators of the assets. The GSEs, on the other hand, will have run each mortgage loan through their underwriting system and should fully understand the risks presented by the mortgage loans. They will also control the servicing and loss mitigation of the loans, creating further protection for the GSEs when compared to a bank investor. Accordingly, we believe a lower risk weight is appropriate.

Leverage Ratio - Given non-zero minimum risk weights, we question first why the leverage ratio is needed. Assuming FHFA desires to implement one, we strongly object to it being binding. As proposed, the leverage ratio will obviate the capital benefit of CRT for the GSEs and we expect they would halt issuance of the product. As the experience with CRT since 2014 has shown, a regular issuance program is critical for garnering and maintaining investor interest in a product. The GSE took pains at the outset of the STACR/CAS programs to set forth issuance calendars and to assure investors that the market would remain active over the longer term. Large, global investors will not allocate significant amounts of capital to an illiquid, inactive market. Under this proposed rule, the GSEs would be incented to issue CRTs only when the leverage ratio becomes non-binding – but this would come only after a prolonged period of inactivity of issuance. In that time, investors would have moved on and the GSEs would have to work to re-open the market, and it is likely that investor interest would be permanently lower than it is today. They would have to start over.

[21] Framework at 39330.

Accordingly, CRT would become more expensive, and GSEs would have to rely on more expensive forms of credit protection or capitalization. The Framework calls this a "backstop" leverage requirement, but we argue that being binding on day one is hardly a backstop. 2.5% of assets plus a 1.5% buffer is excessive - this buffer is higher than the buffer for most GSIBs under Basel rules (which is set at 50% of their risk based capital buffer).[22] If FHFA desires to implement a leverage ratio, we would suggest a lower, non-binding total number such as 3% (e.g. the 2.5% requirement + a .5% buffer).

Reduction in Risk Assets Sold for Capital Calculations - The proposal includes a 10% reduction in the amount of risk assets sold for the purposes of capital calculations for CRT. This is on top of the "penalty" multiplier for securitization to account for model and other complexity risk, and the imposition of a minimum risk weight also mentioned above. This is proposed because CRT is viewed as less protective than capital. We believe the reduction in risk assets sold provision double counts risk, given the minimum risk weight, and it should be removed from the final rules. At a minimum, it should not apply to capital markets transactions where GSEs receive the full amount of cash in advance and *do not face counterparty risk*, such as STACR and CAS.

4. The 20% risk weight for cross-GSE exposures could threaten UMBS liquidity

The proposed Framework would apply a 20% risk weight to crossholdings of the other Enterprise's MBS and also to guarantees of the other Enterprise's MBS (as in a Super). The 2018 proposal set this number at 0%. The proposed Framework aligns itself with the bank regulators, who apply a 20% RW to GSE MBS. Importantly, it is also noted in the proposed Framework that the key to UMBS is the belief that the securities issued by the agencies are homogeneous enough to be traded interchangeably.

On a conceptual level, it makes sense that the GSEs would hold capital against guarantees or exposures to the other GSEs' MBS. We expect that this would be required from a regulatory perspective and also from the perspective of potential equity investors. However, we are concerned that this requirement could materially disrupt the UMBS trading market, because a 20% RW on guarantees will create a disincentive for a GSE to super the other GSE's MBS. All else equal, it will increase the cost to the GSE of a super (vs. a 0% RW), and at some point, could cause a GSE to not want to engage in supers at all, price them prohibitively high, or even be prohibited to Super because they cannot increase RWAs because of other aspects of the capital rules. Additionally, it may also drive differences in pricing between the GSEs due to different capital costs and balance sheet capacity, or provide a convenient scapegoat for a GSE to do so.

This negative incentive strikes at the core of what SIFMA and Nareit mREIT Council members and other market participants viewed as critically important in UMBS – the ability to efficiently

[22] https://www.fsb.org/wp-content/uploads/P221119-1.pdf

and with the least amount of friction possible super one GSE's MBS by the other.[23] For example, an investor with name concentration limitations on Freddie Mac could receive a delivery of Freddie Mac securities on a TBA settlement, and need to quickly super those to obtain a Fannie Mae top-level guarantee and remain in line with investment guidelines or regulatory requirements. However, the capital charge and issues noted in the previous paragraph could make this more expensive, impossible, or even create an arbitrage opportunity if the GSEs had different costs for these supers.

At a minimum it adds friction – at the extreme it threatens UMBS. We believe that an explicit guarantee, by leveling out costs of raising capital, would help reduce this problem. We also believe that the ability to create Supers needs to be as frictionless as possible. If UMBS liquidity is impaired, the entire mortgage market will suffer. The UMBS construct limits policymaker flexibility in some areas, such as this one.

5. The proposal would require GSEs to hold far more capital, but misalignments with key bank capital requirements would remain

We generally agree with Treasury's statement that "*To foster a level playing field with private sector competition, similar credit risks generally should have similar credit risk capital charges across market participants*"[24] and further note their statement that "*The single best step FHFA can take to level the playing field with other market participants would be … to more fully align the GSEs' credit risk capital charges with those of other fully private regulated financial institutions for holding similar assets.*"[25] Without a level playing field, banks and other lenders will never be able to truly compete with the GSEs. If the GSEs have material capital or other advantages, they will always win.

The Framework would require the GSEs to retain far more capital than they do today. As noted, we support the GSEs building capital to further protect taxpayers. However, while the GSEs would be required to raise significant capital, fundamental misalignments with bank requirements would remain.[26] These gaps confer significant advantages on the GSEs in terms of pricing vs. banks.

We note the conundrum FHFA faces here. To equalize the RWs, the GSEs would require significantly more capital and this would reduce returns to GSE equity investors and make raising equity capital more difficult. This would come on top of the host of buffers and adjustments also prescribed in the rule. It would also put upward pressure on pricing, especially in the absence of an explicit guarantee on MBS. On the other hand, leaving the levels

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[23] See, e.g., SIFMA's letter to FHFA available here: https://www.sifma.org/wp-content/uploads/2018/07/Single-Security-%E2%80%93-Priority-Issues-to-be-resolved-before-launch.pdf, at 6.
[24] Treasury Housing Finance Reform Plan, at 28.
[25] Ibid. at 35.
[26] For example, we note in the proposal that: (1) Minimum mortgage risk weights are 50% for US banks under general capital rules, but have a floor of 15% for GSEs; (2) the operational risk capital requirement is floored at 15bp for GSEs, while the proposal notes that the smallest bank requirement is 69bps (for banks over 500bn in size).

as-proposed will cement a significant advantage for GSEs over banks.

We believe this conundrum, and the previously mentioned issues with cross-GSE guarantee capital, highlight the need for comprehensive legislative action on GSE reform. Only Congress can solve all of these problems at the same time, and this will put their imprimatur on the appropriate market share of GSE/government programs vis-à-vis the private sector, and additionally ensure their attention to and confirmation of the appropriate cost of mortgage credit from the GSEs that they chartered decades ago.

6. Conclusion

SIFMA and Nareit appreciate the opportunity to comment on this important Framework. As discussed, while we support efforts to increase taxpayer protection through enhancements to GSE capital requirements, we remain firm in our belief that the first priority must be the protection of the TBA and the broader mortgage market. Following that, we have significant concerns about the Framework's impact on CRT.

We strongly believe that the least risky, most effective, and most efficient path is for Congress to address many of the policy questions that the GSE conservatorships present. Only Congress can create an explicit guarantee, and only Congress can express its policy priorities on the cost thereof, and the appropriate role of the GSEs in the housing finance system.

If you wish to discuss any of our comments further, please contact Chris Killian at SIFMA (ckillian@sifma.org) or Victoria Rostow at Nareit (vrostow@nareit.com).

Sincerely,

Christopher B. Killian
Managing Director
Securitization and Credit

Nareit
Senior Vice President, Regulatory Affairs &
Deputy General Counsel