March 9, 2021

Submitted Electronically

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590–AB09
Federal Housing Finance Agency
400 Seventh Street SW, Washington, DC 20219

Re: Enterprise Liquidity Requirements / RIN 2590–AB09

Dear Sir,

SIFMA[1] appreciates the opportunity to respond to FHFA's proposed rule on Enterprise Liquidity Requirements ("Proposal").[2] Ensuring that the Enterprises have sufficient levels of high quality liquid assets ("HQLA") is critical to ensuring that they will be able to fulfill their statutory mandates to provide liquidity, stability, and affordability to the U.S. housing market, in good times and in bad. The central role the Enterprises play in our housing finance and financial system demands that they be able to do so.

We write today regarding one aspect of the Proposal that has generated concern among our members – the prohibition on HQLA credit when lending cash through repurchase agreements secured by Agency MBS, even when they are cleared and risk managed at the FICC.[3] We disagree with this prohibition, and believe it is premised on faulty reasoning as we will discuss below. Furthermore, we believe this prohibition would be detrimental to both the Enterprises' ability to fulfill their statutory mandates as well as to the mortgage borrowers their charters are designed to serve.

To review, the Enterprises' charter requires that they, among other things:[4]

- *provide stability in the secondary market for residential mortgages;*
- *respond appropriately to the private capital market;*
- *provide ongoing assistance to the secondary market for residential mortgages…by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing;*

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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] Available here: https://www.govinfo.gov/content/pkg/FR-2021-01-08/pdf/2020-28204.pdf. The provision at issue may be found on page 1312.
[3] Please note that this letter is focused solely on one specific aspect of the liquidity requirements, and we do not express a view favorable or unfavorable to other provisions in the Proposal.
[4] See, e.g., Fannie Mae's charter (12 U.S.C. 1716 et seq) here: https://www.fanniemae.com/sites/g/files/koqyhd191/files/migrated-files/resources/file/aboutus/pdf/fm-amended-charter.pdf

- *promote access to mortgage credit throughout the Nation…by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.*

Investing in MBS repo aligns with the mission of the Enterprises because it supports the U.S. mortgage market, provides stability to the market, increases the liquidity of mortgage investments, and improves the distribution of investment capital. For example, during periods of high prepay activity, it allows the Enterprises to use cash from mortgage prepayments to support mortgage lending rates by providing temporary liquidity to MBS investors between MBS factor and payment dates. Accordingly, SIFMA believes that Agency MBS repo remains a suitable and charter-focused liquidity investment for the enterprises, subject to the discussion below. The Enterprises should not be artificially and unjustifiably limited from being able to promote liquidity in their MBS markets.

The proposal expresses a concern about wrong way risk in Agency MBS and also repo for Agency MBS, where the primary risk is counterparty credit risk. Counterparty credit risk can be eliminated if the GSEs were limited to receiving HQLA credit for repo that is cleared through FICC, as there is no realistic wrong-way risk with that counterparty. FICC is a "designated market utility" which involves supervision by the SEC and special supervision from the Federal Reserve.[5] It is not, for example, a bank or investment company or any other typical private sector counterparty. FICC maintains and enforces stringent membership requirements, and its members post billions of dollars to clearing funds on a daily basis (and have further dedicated liquidity lines if needed). In 2008, FICC handled the failure of Lehman Brothers and other firms without adding to the already high stress levels in the system at the time. If FICC were to fail, the financial system would stop working, so great effort has been undertaken to ensure its robustness.

SIFMA notes that the Enterprises are net cash providers of MBS repo in the FICC market and their investment is fully collateralized on a mark-to-market basis by the collateral provider. Further, FICC collects margin from the Enterprises using a multi-factor value-at-risk model that evaluates risk sensitivities to interest rates, volatility, and MBS basis risk among other things. Risk sensitivities of U.S. Treasuries and MBS are often aligned and could exist across the entire liquidity portfolio including outright U.S. Treasury holdings. We also note that MBS repo offers a higher yield and may carry generally lower FICC margin posting requirements for the Enterprises than general collateral treasury repo. Excluding Agency MBS repo entirely from the list of appropriate Enterprise assets that receive liquidity credit does not appear to offer greater risk mitigation benefits and is not justified by greater basis risk.

The Proposal draws a comparison to banking regulation while proposing Agency MBS be excluded in full from the high-quality liquid asset category. However, this runs contrary to U.S federal banking regulations like the Liquidity Coverage Ratio which *include* Agency MBS as a level 2A HQLA which are subject to a 15% haircut and cap of 40% of the overall HQLA amount. We do not see any reason why Agency MBS repo should be treated differently in the liquidity framework for the Enterprises.

The Proposal states that U.S. Treasury securities are acceptable investments because of the ease of converting them to cash. However, MBS repo can also be converted to cash in the same manner. In fact, FICC MBS repo and U.S. Treasury repo have performed very much in line with one another in times of repo market stress. Recent periods of repo market stress include December 31, 2018 and September

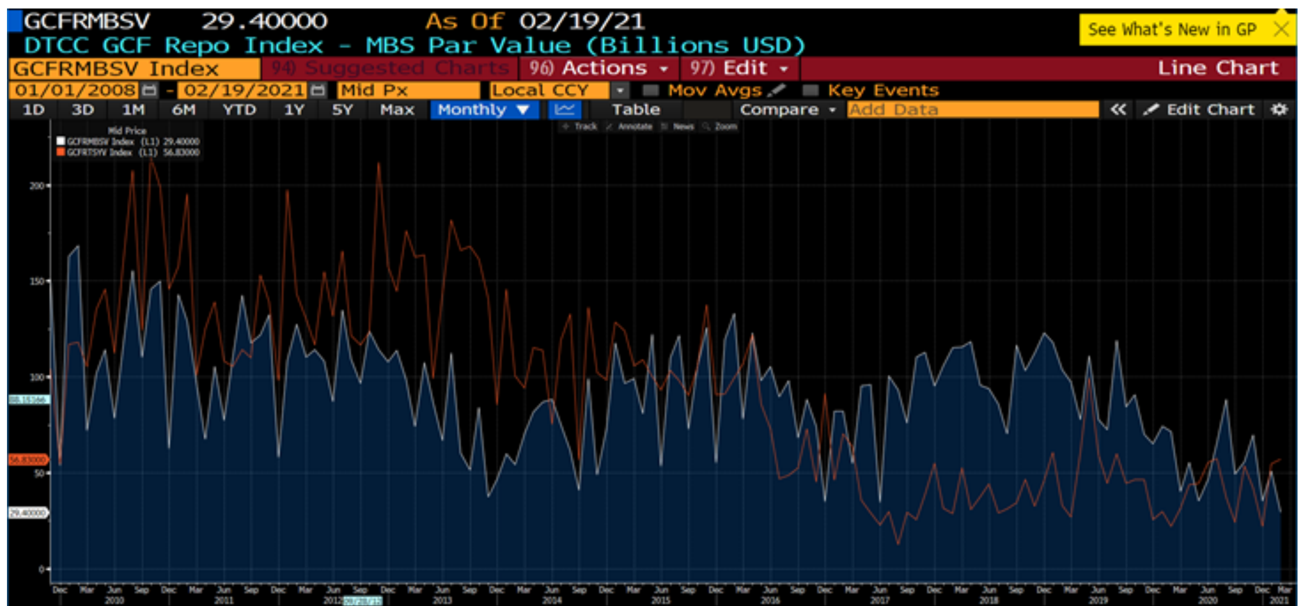
[5] See e.g., https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm

16-17, 2019. When repo rates spiked during these periods, U.S. Treasury and MBS repo rates converged and liquidity remained available in both products.

Charts 1 and 2 show rate and volume information for FICC GCF MBS and GCF U.S. Treasury repo plotted against each other since 2008. These charts illustrate the high degree of correlation between MBS and U.S. Treasury repo rates through a variety of market conditions, including periods of market stress.

Chart 1: DTCC GCF MBS Repo Index and GCF TSY Repo Index Rates *(Source: Bloomberg/DTCC)*

Chart 2: DTCC GCF MBS Repo Index and GCF TSY Repo Index Volume *(Source: Bloomberg/DTCC)*



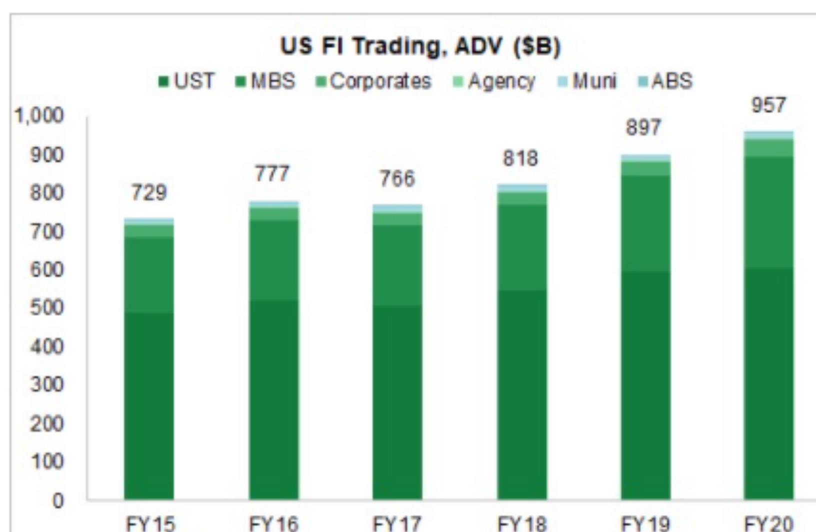
Similarly, volume in the outright market for Agency MBS remained consistent during the recent COVID-19 induced market stress as illustrated by Chart 3, which reflects a year-over-year increase in Agency MBS in the second quarter of 2020 despite showing a 16.8% decline in quarter over quarter volumes quarter-over-quarter.

Chart 3: Second Quarter 2020 Trading Volume Information *(Source: SIFMA)*

	2Q20	1Q20	2Q19	Q/Q	Y/Y	2019	2018	Y/Y
Trading (ADV, $B)	**1,018**	**1,078**	**905**	**-5.6%**	**12.5%**	**897**	**818**	**9.7%**
UST	680	686	597	-0.8%	13.9%	594	548	8.4%
MBS - Agency	265	318	250	-16.8%	6.1%	248	218	13.5%
MBS - Non Agency	3.4	4.3	3.2	-19.8%	7.1%	2.7	2.4	13.0%
Corporates	49	46	36	8.0%	36.4%	36	33	8.4%
Agency	6.1	5.5	4.3	11.2%	40.6%	4.1	3.5	18.0%
Munis	12	16	12	-25.9%	-3.8%	12	12	-0.6%
ABS	1.9	2.5	1.6	-22.6%	17.4%	1.5	1.4	7.5%

Chart 4 shows the liquidity of the Agency MBS markets has been consistently robust and second in size only to the U.S. Treasury market.

Chart 4: Annual Fixed Income Trading Volume *(Source: SIFMA)*



Both Agency MBS and U.S. Treasuries enjoy a large and diverse number of market participants. In the outright Agency MBS market participants include banks, broker-dealers, real estate investment trusts, sovereign investment funds and other fixed income asset managers. In the FICC repo market U.S. Treasury and MBS participants are largely similar and include global banks, primary dealers, and independent broker-dealers.

The most significant party in Agency MBS has been the Federal Reserve, which has purchased both U.S. Treasuries and Agency MBS in its quantitative easing ("QE") programs which have supported liquidity in these important markets. The Federal Reserve's implementation of QE programs since 2008 have

enabled the market to better react, price and allocate balance sheet assets to Agency MBS during times of market stress. The Federal Reserve has also purchased both Treasuries and Agency MBS in its open market repo operations and has the ability to use Agency MBS for its Reverse Repo Program. The Agency MBS market never became illiquid in 2008, did not become illiquid in 2020, and seems very unlikely to do so in the future given its central role in the US economy, the housing market, and thousands upon thousands of global fixed income investors' portfolios.

We also note that money market funds under Rule 2a-7 are permitted to invest in Agency MBS, and that the FICC is contemplating a "Sponsored GC" program that would allow money funds to invest in MBS repo through the FICC. It would be incongruous for the Enterprises to be the only short-term liquidity investor effectively precluded from investing in Agency MBS repo. Furthermore, we are concerned about the signaling implications of this proposed restriction – what kind of message will it send to MBS investors that the Enterprises are not allowed to fund their own MBS? At a minimum, this provision would reduce liquidity in the Agency MBS repo markets, and some of our members have expressed concern that there could be knock-on effects in other markets, such as Treasury repo.

SIFMA does agree with FHFA's view, however, that GSE activity should be directly charter and mission driven and not designed simply to earn higher returns on investments as was the case prior to 2008. Our members are also concerned with, and sensitive to, historic and potential future "mission creep" whereby the GSEs take advantage of their low funding costs to enter new markets less directly tied to their core mission (e.g., experiments in funding MSR). Accordingly, although it is appropriate to place limits on their activities, we believe their short-term investment activity should be closely tied to their mission and charters and limit investments to HQLA while focusing on providing liquidity to market participants to ensure the smooth function of the markets, including P+I related repo activity, or serving as a backstop in a time of market stress. This type of activity is consistent with their statutory duty to *"provide stability in the secondary market for residential mortgages".* This should be the primary goal and rationale for any activity the GSEs undertake, including repo activity.

FHFA's full exclusion of Agency MBS repo as an eligible liquidity portfolio investment unnecessarily singles out an entire asset class that otherwise meets any broadly accepted definition of an HQLA. Furthermore, excluding MBS repo will prevent the Enterprises from fully executing their statutorially mandated mission to enhance the liquidity of mortgage investments and the allocation of investment capital to the mortgage markets. The Enterprises have safely and prudently invested over a long period of time in MBS repo, and the FHFA does not provide evidence justifying removal of the asset class from its liquidity options to balance against the harm the prohibition may cause.

For the foregoing reasons, SIFMA strongly believe that this proposed prohibition should be eliminated in the final Enterprise Liquidity Rule. Please contact me with any questions or for more information at ckillian@sifma.org.

Regards,

Chris Killian
Managing Director