Making homeownership possible for nearly 65 years

USMI®

U.S. Mortgage Insurers

Contents

November 23, 2021

Mr. Clinton Jones
General Counsel
Federal Housing Finance Agency
400 Seventh Street, S.W.
Washington, D.C. 20219

Attn: Comments/RIN 2590–AB17

Dear Mr. Jones:

I. Introduction

This comment letter is submitted by U.S. Mortgage Insurers (USMI) and our member companies that play a critical role in making it possible for creditworthy low- and moderate-income (LMI) homebuyers to obtain conventional mortgages while providing critical credit risk protection to Fannie Mae and Freddie Mac (the Enterprises) and the U.S. taxpayer.[1]

We appreciate the work that the Federal Housing Finance Agency (FHFA) has undertaken to date to provide for minimum capital requirements for the Enterprises, including the December 2020 final rule to establish a post-conservatorship Enterprise Regulatory Capital Framework (ERCF).[2]

The required minimum capital levels for the Enterprises are of immense importance to the stability of the housing finance system and borrowers throughout the country. The 2008 financial crisis demonstrated that inadequate capital reserves can result in taxpayer-funded bailouts, catastrophic disruptions in housing finance, and reduced access to conventional mortgage credit. Undercapitalized housing finance market participants—especially the Enterprises—can have a profound impact on the national economy and individual homebuyers during an economic downturn.

While a robust capital framework is necessary to ensure a stable housing finance system, overly stringent requirements or ones that do not accurately reflect the risks of the assets held by the Enterprises can also be disruptive to housing markets. Required capital is essentially a cost of doing business for the Enterprises, and excessive capital mandates will increase costs for the Enterprises that will eventually be passed on to future homebuyers. As a result, housing finance in the conventional market will become more expensive, and the number of people who will be able to qualify for a conventional mortgage will decline. This will be especially troublesome for LMI, minority, and first-time homebuyers who are the most sensitive to increased costs.

[1] USMI represents the nation's leading private mortgage insurance companies and USMI membership comprises: Enact Mortgage Insurance; Essent Guaranty, Inc.; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty, Inc. Together, the private mortgage insurance industry has helped more than 35 million homeowners achieve sustainable home ownership since 1957, including more than 2 million in 2020 alone.

[2] 85 Fed. Reg. 82150 (December 17, 2020).

II. The ERCF Final Rule

It is clear that FHFA staff devoted considerable time and effort in developing the ERCF that was finalized last year. We note, with appreciation, that some of the concerns raised in our comment letter sent as part of the 2020 rulemaking[3] were addressed in the final rule. After reviewing the final rule, we believe that it goes a long way to ensure that the Enterprises will have sufficient capital to withstand an economic downturn the magnitude of the 2008 financial crisis, if not an even more severe downturn.

However, we believe that the final rule continues to have flaws that should be addressed, either as part of this rulemaking, or in a separate rulemaking.[4] Additional components of the ERCF that we believe merit reconsideration include:

- Redundant floors and additional capital buffers: These elements of the ERCF are designed to address non-credit risks, such as "model risk," "natural disaster risk," and "political risk," but these risks would be bettered addressed in another manner, such as through an operational risk charge.

- Single-family risk weight floor: The final ERCF includes a 20 percent risk weight floor on single-family mortgage exposures that was increased from 15 percent in the 2020 NPR despite numerous comments from industry stakeholders, that included considerable data demonstrating that even 15 percent was too high.

- Countercyclical Adjustment: This component of the final ERCF is used to adjust the mark-to-market loan-to-value (MTMLTV) ratios and, based on current market conditions, would increase capital charges for several years. Significant home price appreciation (HPA), such as what has been experienced in the last two years, can result in the Countercyclical Adjustment's impact on capital charges to disproportionately impair LMI, minority, and first-time homebuyers' access to affordable credit in the conventional mortgage market. USMI urges FHFA to consider the various recommendations made in stakeholders' 2020 NPR responses.

- Complexity: As noted during previous rulemakings, the ERCF is extremely complex and there is a lack of transparency about the underlying data and methodology. This makes the capital framework somewhat opaque and prevents industry stakeholders from undertaking a comprehensive review of the ERCF.

In light of these concerns, we believe that our prior comment letter for the 2020 NPR is still relevant, and that FHFA can—and should—use this new rulemaking as an opportunity to revisit some of these issues as a way to better calibrate the ERCF and balance robust capital standards with access to affordable mortgage credit.

[3] 85 Fed. Reg. 39274 (June 30, 2020).

[4] Under the Administrative Procedure Act, an agency may consider, and include in a final rule, any matter that is viewed as a logical outgrowth of the NPR. See, e.g. Appalachian Power Co. v. EPA, 135 F.3d 791, 816 (D.C. Cir. 1998) (finding that a final rule that differed from the NPR was acceptable since it was a logical outgrowth of the proposed rule).

In Appendix A to this comment letter, you will find our responses to specific questions posed in the NPR. Appendix B contains an Executive Summary of the concerns and recommendations USMI made in our prior comment letter on the 2020 proposed rulemaking and we ask that it be made part of this rulemaking. We respectfully request that USMI's 2020 NPR comment response also be considered when you are evaluating changes to the 2021 NPR. Appendix C contains an analysis of the single-family risk weight floor. Appendix D contains an impact analysis of the proposed changes to the Enterprises' credit risk transfer (CRT) transactions.

III. The Enterprises' Public Policy Imperatives

The Enterprises are directed by their congressional charters to "provide ongoing assistance to the secondary market for residential mortgages (including activities related to mortgage loans 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."[5]

Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Housing and Economic Recovery Act of 2008 (HERA), the Enterprises are subject to affordable housing goals covering their purchases of single-family mortgages and multifamily mortgages. For single-family purchase mortgages, there are goals for low-income families, very low-income families, and families in low-income areas, as well as a single-family refinance goal.[6] Performance on the single-family home purchase goals is measured as the percentage of the total home purchase mortgages acquired by an Enterprise each year that qualify for each goal.

HERA also mandates a "duty to serve" underserved markets and directs the Enterprises to "provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for mortgages for very low-, low-, and moderate-income families" with respect to three specified underserved markets: (1) manufactured housing; (2) affordable housing preservation; and (3) rural markets.[7]

Most recently, FHFA announced that the Enterprises must prepare and implement Equitable Housing Finance Plans and solicited comments from stakeholders through a "Request for Input," in response to which USMI submitted a comment letter.[8] Under FHFA's oversight, each Enterprise will identify barriers to sustainable housing opportunities, set goals to address those challenges, and undertake meaningful actions to address those barriers.

[5] Fannie Mae Charter, 12 U.S.C. §1716; Freddie Mac Charter, 12 U.S.C. §1451 note.
[6] 12 U.S.C. §4562.
[7] Section 1129 of the Housing and Economic Recovery Act of 2008, codified at 12 U.S.C. §4565.
[8] Federal Housing Finance Agency, "FHFA Announces Equitable Housing Finance Plans for Fannie Mae and Freddie Mac" (September 7, 2021). USMI's comment letter is available at https://www.usmi.org/usmi-submits-comment-letter-on-fhfas-request-for-input-on-enterprise-equitable-housing-finance-plans/.

When establishing capital standards for the Enterprises, it is essential to fully consider the potential impact of those standards on the ability of the Enterprises to successfully meet these statutory and regulatory affordable housing requirements. The safety and soundness of the Enterprises is not the only consideration when developing capital requirements, FHFA must also weigh the impact of the ERCF on the ability of the Enterprises to fulfill all of their statutory and regulatory missions, including housing goals, duty to serve requirements, and equitable housing mandates. It is important that the capital standards do not have the effect of impeding the ability of the Enterprises to accomplish these goals, and that capital standards do not make it impossible for creditworthy LMI families to obtain conventional mortgages. This concern is especially significant in that the risk-based standards will disproportionately impact minority, first-time, and younger homebuyers who have less ability to make large down payments and typically have lower credit scores, resulting in significantly higher capital charges to the Enterprises to acquire their mortgages. We further note that establishing the appropriate capital requirements for the Enterprises also depends on their final state, role in the housing finance system, and whether they are in conservatorship, as this may drive different return considerations for the Enterprises, and different conclusions regarding the Enterprises' ability to access the capital markets for funding throughout the economic cycle.

IV. Enterprise Credit Risk Transfer (CRT) Transactions

The Enterprises' charters stipulate that their secondary market operations shall be financed by private capital to the maximum extent feasible. Private mortgage insurance (MI) has long been used by the Enterprises to provide a second pair of eyes in the underwriting process,[9] as a form of credit risk protection, and to serve as a source of private capital for high loan-to-value (LTV) loans. More recently, FHFA has recognized the benefits of CRT, and as noted in the NPR, FHFA has used its conservatorship strategic plans and scorecards to encourage the transfer of single-family mortgage credit risk to the private sector, thereby reducing risk to taxpayers.[10] The Enterprises have developed various CRT products to access the reinsurance and capital markets to meet the goals established by FHFA.[11]

USMI believes it is appropriate for FHFA to evaluate the risks posed by different credit risk mitigants, including CRT transactions. However, in order to be viable, the capital relief afforded to CRT transactions under the ERCF must outweigh the costs to the Enterprise in terms of interest expense on CAS/STACR deals, premiums paid for CIRT/ACIS agreements, and transaction fees. In short, there is no economic incentive to offload credit risk to a third party if the benefits, primarily in the form of lower capital requirements, are insufficient to make the transaction worthwhile to the Enterprise. While no form of credit risk mitigation and source of private capital is risk free, it is imperative that FHFA balance the

[9] Approximately 50 percent of private MI business is originated through non-delegated writing which involves MI underwriters reviewing lenders' underwriting files and analysis. Prior to the 2008 financial crisis, only 10-15 percent of private MI business was non-delegated.

[10] 86 Fed. Reg. 53234 (September 27, 2021).

[11] Among these goals is that CRT transactions should be economically sensible, repeatable, scalable, and structured to not disrupt the efficient operation of the ''To Be Announced'' (TBA) market. As of September 30, 2021, the Enterprises have collectively transferred risk on more than $4.6 trillion in mortgages using capital markets, reinsurance, and lender-risk sharing transactions.

risks appropriately as to not disincentivize this important risk management tool. The ERCF should promote additional private capital in the housing finance system and incentivize de-risking the Enterprises.

The NPR would make two changes to the treatment of CRT: (1) it would reduce the mandatory risk weight floor of 10 percent for retained CRT positions to 5 percent; and (2) it would remove the "overall effectiveness adjustment" that would otherwise reduce the capital benefit of a CRT transaction.[12] Currently, the final rule imposes a 20 percent risk weight floor on residential mortgages, even if the attributes of the loan warrant a lower risk weight under the look up tables.

We agree with FHFA's proposal to reduce the CRT risk weight floor and remove the overall effectiveness adjustment, as these are appropriate and necessary modifications to the ERCF to incentivize the Enterprises to utilize CRT by providing appropriate capital relief. However, we believe that a 5 percent floor continues to be excessive, especially for the most senior retained tranches that have de minimis to virtually no credit risk. While a 5 percent floor is significantly better than the current 10 percent floor, it can still lead to unintended consequences. In some cases, an Enterprise could decide to restructure a CRT transaction so that less credit risk is transferred to third parties. In other words, an Enterprise could decide that if it has to hold a prescribed amount of capital, it should also retain the concomitant risk, so that it will have the income to support the capital charge. Alternatively, an Enterprise may decide not to enter into a CRT transaction because the 5 percent floor negates the financial incentives to enter into the CRT contract. Neither of these results would further the public policy benefits for using CRT as noted by FHFA in the NPR.

The proposed rule explains that the 5 percent floor is "designed to mitigate certain risks and limitations associated with underlying historical data and models" and the fact that losses to the Enterprises were mitigated by federal government support that may not be repeated during the next crisis.[13] The NPR also noted that banking agencies believe requiring more capital on a transaction-wide basis than would be required if the underlying assets had not been securitized is important in reducing the likelihood of regulatory capital arbitrage through securitizations.

These concerns do not justify the imposition of an arbitrary floor of 10 or even 5 percent. There is always a chance that losses will exceed any capital standard set at a level less than 100 percent. There is no ability to have complete certainty regarding future events, but there is an ability to determine the chances of exceeding a historical loss are extremely unlikely. For example, FHFA should be able to determine, with at least a 97 percent certainty, that losses on retained positions will not exceed a particular level. Further, in light of the dramatic improvement in underwriting requirements, it is highly unlikely that the losses experienced in 2008 will be repeated, no less exceeded. The improvement in mortgage underwriting requirements should also be included in the statistical analysis. A floor that is set closer to the statistically determined risk in a retained position would better align the CRT decision with the underlying economics and risks posed by the transaction, thereby reducing incentives to change CRT

[12] 86 Fed. Reg. 53231 (September 27, 2021).
[13] 86 Fed. Reg. 53238 (September 27, 2021).

structures (so that the Enterprises retain more risk) and should increase incentives to engage in these risk-sharing techniques.

The fact that banking regulators have designed a capital framework in which more capital must be held for securitization positions than for the same asset in an unsecured form is irrelevant to this rulemaking. The Enterprises are not banks and FHFA has a different statutory mission than banking regulators. FHFA should independently determine if it is in the public interest, in light of the Enterprises' unique mission, to require more capital for securitizations than for holding a whole asset. The fact that banking agencies take this approach is simply not applicable to FHFA's duty in setting capital standards for the Enterprises.

In sum, USMI agrees with the proposed changes to reduce the risk weight floor from 10 percent to 5 percent for CRT and to remove the overall effectiveness adjustment. We believe any CRT floor should be designed to consider whether it will have the unintended consequences of discouraging the use of CRT or motivate CRT structures in which the Enterprises retain credit risk simply to justify the arbitrary capital floor. In this regard, FHFA should consider adjusting the CRT minimum risk weight floor lower than 5 percent to a level closer to the statistically determined risk in a retained position to better align the CRT decisioning with the underlying economics and risks posed by the transaction. FHFA should also establish and make public the model used to assess the capital benefit of CRT, the statistical basis for any floor, and an analysis of the impact of the capital treatment of CRT on the statutory goals of the Enterprises.[14]

V. Prescribed Leverage Buffer Amount (PLBA)

The ERCF currently requires the Enterprises to maintain a non-risk adjusted leverage ratio of tier 1 capital to total adjusted assets of 2.5 percent where total adjusted assets include total assets under generally accepted accounting principles (GAAP), with adjustments to include certain off- balance sheet exposures.

To avoid limitations on capital distributions and bonus payments, the Enterprises must also hold a "prescribed leverage buffer amount" (PLBA) equal to 1.5 percent of total adjusted assets.

As USMI commented in 2020, and as FHFA noted in the 2021 NPR, it is important that the leverage ratio not become the usual binding capital requirement. If the leverage ratio becomes the usual binding capital standard, the benefits of a risk-based capital framework will be diminished and the incentives to reduce risk that are inherent in a risk-based system will be reduced.

FHFA has determined that a PLBA of 1.5 percent of adjusted total capital combined with the prescribed leverage ratio would likely become the binding capital constraint. The NPR therefore proposes to change the PLBA from 1.5 percent of total adjusted assets to 50 percent of the Enterprises' Stability Capital Buffer. The Stability Capital Buffer is a varying capital buffer based on the share of an Enterprise's

[14] FHFA should also consider the extent to which mandatory disclosures and standards for CRT structures, including standards for the legal rights of the Enterprises to enforce CRT commitments, reduce the risks to the Enterprises of entering into such contracts.

residential mortgage debt outstanding. The larger an Enterprise's market share, the higher the Stability Capital Buffer.

The intent of the PLBA is to mitigate risks to the national housing finance markets and to "serve as a non-risk based supplementary measure that provides a credible backstop to the combined risk-based capital requirements and prescribed capital conservation buffer amount (PCCBA)…"[15] The Stability Capital Buffer is 5 basis points multiplied by the percent of market share of an Enterprise that is in excess of 5 percent of total mortgage market. The Stability Capital Buffer would have been 1.07 percent for Fannie Mae and 0.66 percent for Freddie Mac as of June 30, 2020.

We emphatically agree that the leverage ratio should not be the usual binding constraint on the Enterprises. However, the NPR does not explain why 50 percent of the Stability Capital Buffer is the appropriate standard. The Stability Capital Buffer itself is an arbitrarily determined capital requirement and no rationale has been provided for why 5 basis points times market share over 5 percent is chosen, how it is related to the risk, or why the threat to the national housing finance system is not adequately dealt with through the other elements of the ERCF.

Further, the PLBA is not intended to provide a margin to protect the national housing finance market, but rather is intended to provide yet another backstop for the risk-based requirements.

In conclusion, we agree that the PLBA needs to be adjusted, and that 1.5 percent is excessive. However, we recommend that FHFA consider alternative methods of determining the amount of the PLBA that more closely relate to risk than the Stability Capital Buffer.

VI. Single-Family Minimum Risk Weight Floor

USMI was very pleased to see FHFA ask a question about the 20 percent prudential risk weight floor for single-family mortgages. While the finalized ERCF is very similar to the framework proposed in 2020, there are several critical differences[16] including that the minimum risk weight for single-family mortgage exposures was increased from 15 percent to 20 percent.

As stated in our 2020 comment letter, the proposed minimum risk weight floor is applied regardless of the risk weight that would otherwise be assigned based on the loan characteristics and historic data. The minimum 20 percent floor creates a dramatic increase in the overall capital required for

[15] The PCCBA comprises the stability capital buffer, the stress capital buffer, and the countercyclical capital buffer. 86 Fed. Reg. 53231 (September 27, 2021).

[16] The final ERCF Rule had a number of changes from the 2020 NPR due to the following modifications: (i) the minimum risk weight for single-family mortgage exposures was increased from 15 percent to 20 percent; (ii) the risk grids became more granular for loans with MTMLTVs between 30 percent and 60 percent; (iii) modified re-performing loans are treated as performing loans after 5 years; (iv) exposures in a repayment plan, including a COVID forbearance plan, are treated as non-modified re-performing rather than modified re-performing; and (v) the *Countercyclical Adjustment* for 5 percent swings in housing prices became tied to a national FHFA house price index that is not seasonally adjusted and does not include refinancing valuations, rather than the all-transactions FHFA house price index originally proposed. The final rule also includes a trigger for re-estimating the long-term trend line if certain conditions are met.

all single-family mortgages—a nearly 50 percent increase in net Enterprise capital for certain loans (see response to Question 4 for more details). For reasons cited in our 2020 comment letter, the rationale that FHFA used for proposing the 15 percent minimum risk weight floor, including basing it on cumulative losses that occurred on a much riskier pool of mortgages (such as 2007 vintages), does not seem appropriate given the dramatic improvement in mortgage lending/underwriting and risk management that has occurred since the 2008 financial crisis. Further, in the 2020 final rule, FHFA states that part of the reason for increasing the minimum risk weight floor to 20 percent was to make the risk-weighted capital binding. However, with the proposed reduction of the minimum risk weight floor from 10 percent to 5 percent and the removal of the overall effectiveness adjustment for retained tranches, the NPR would address many of the challenges of making CRT more economic. Therefore, this increase in the risk weight floor is not necessary.

The final rule further dilutes the ability of the Enterprises to appropriately use and distribute mortgage credit risk to private capital with the introduction of the minimum 20 percent risk weight floor. The impact of the 20 percent floor negates the full capital benefit that should otherwise be realized from private MI (see example in Question 4 below). Any adjustment for counterparty risk is clearly made through the counterparty haircuts already applied to private MIs. This additional reduction in capital benefit does not appropriately account for the risk protection afforded to the Enterprises by private MIs and therefore arbitrarily increases the Enterprises' capital requirements, and thus costs for borrowers. The Enterprises should not be penalized for sharing that risk with private entities that underwrite, manage, distribute, and hold significant capital against that risk—in fact, they should be incentivized to further distribute first-loss credit risk this risk to private MIs.

The 20 percent floor applied to all mortgages, regardless of how strong the borrower credit is, is a "blunt instrument" approach of arriving at an overall capital number that is not grounded in the changes that have occurred post crisis, is risk-insensitive and not analytically justified based on historical analysis. The goal of protecting the Enterprises from all conceivable risks, no matter how remote or unlikely, is inconsistent with the goal of having a strong and liquid secondary mortgage market and would have an immediate adverse impact on consumers.

The minimum 20 percent risk weight floor for single-family mortgages should be reduced to 10 percent or less to more accurately account for the improvements in mortgage lending since the 2008 financial crisis, and to reflect and allow for credit enhancement, while also still requiring the Enterprises to hold an amount of capital against even remote credit risk exposure more accurately. Reducing the single-family risk weight floor to 10 percent or less better achieves this outcome. As such, USMI encourages FHFA to adjust the risk weight floor for single-family mortgages to 10 percent or less.

VII. Countercyclical Adjustment—Impact on Access and Affordability

The final rule includes a requirement to determine LTV ratios on a mark-to-market (MTM) basis, with an adjustment to account for significant inflation or deflation in inflation-adjusted housing prices. Under the final rule, the adjustment to MTM values will be triggered whenever national housing prices

are 5 percent greater or 5 percent less than the "inflation-adjusted long-term trend." In the 2020 final rule, FHFA acknowledges that many commenters recommended changes to the Countercyclical Adjustment (or "MTMLTV adjustment"), which included, regionalizing the MTMLTV by using home prices in each state or metropolitan statistical area, or using asymmetric collars rather than 5 percent collars on both appreciation and depreciation.[17]

In the final rule, FHFA determined to adopt the proposed rule's Countercyclical Adjustment with two changes."[18] FHFA notes that, "the MTMLTV adjustment therefore could apply in circumstances in which house prices deviate significantly from the long-term trend, but there is not simultaneously a build-up of system-wide risk."

USMI appreciates that FHFA aimed to address the procyclicality that was embedded into the 2018 proposed rule, and as stated, USMI believes that it is appropriate for the Enterprises to have a countercyclical element to their capital rule. However, we are concerned that the HPA and inflation correlation adjustment will severely impact high LTV homebuyers, and buyers with lower FICO scores. Since many first-time, and especially first-time minority homebuyers fall into this category, the inflation correlation adjustment will be particularly detrimental to these families.

The Countercyclical Adjustment applies not only to the Enterprises' seasoned portfolio, it also applies to new production. In the current HPA/Consumer Price Index (CPI) environment, this has the impact of increasing required capital for new high LTV loans by 1.4-2.0 times. Charges for this increased capital requirement could be as high as 25 basis points in annual guarantee fees.

In our 2020 comment letter, USMI argued that MTM adjustments should not be made in determining LTV ratios. However, if MTM values are to be used, we agree that some method should be employed to take into account the potential distortions that may occur during a boom in residential housing that is out of proportion to the more general rate of inflation. The HPA experienced over the last two years can be classified as this type of distortion, as it is likely the pandemic that shifted consumer preferences, altered demand in the market, and increased construction cost due to such things as materials shortages and transportation delays, caused discontinuity in the HPA time series.

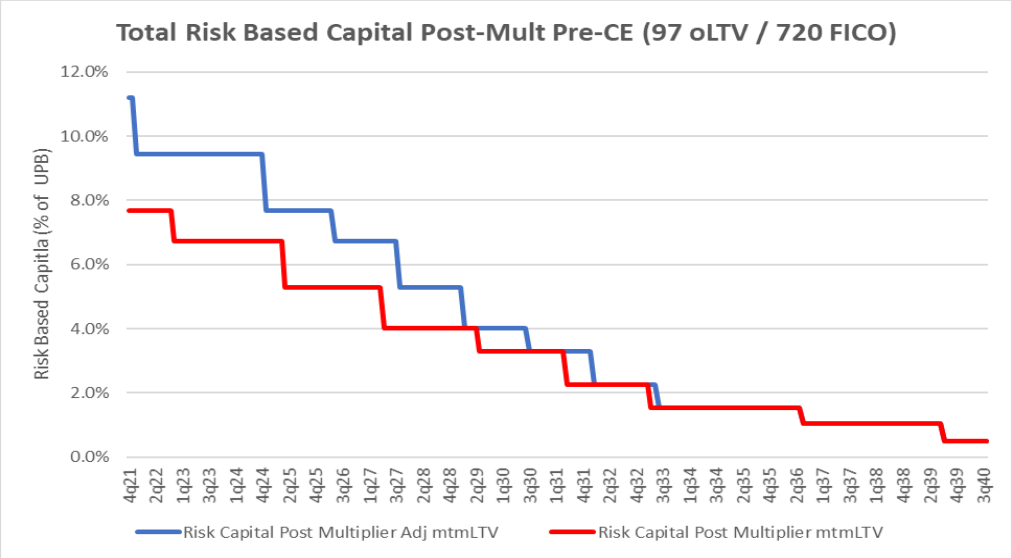
Since our comment letter in 2020 and over the last two years, the housing market has seen significant HPA, providing a real-world example of HPA increasing 5 percent more than the inflation-adjusted long-term trend. In fact, the annual nationwide HPA August 2020 to August 2021 was nearly 19 percent according to FHFA's HPI.[19] While there are several contributing factors to today's current appreciation, the biggest drivers are the lack of housing supply in the market, the significant demand for housing, and low interest rates. As seen in Figure 1, using a straight-forward scenario where future HPA

[17] 85 Fed. Reg. 82170 (December 17, 2020).
[18] The first change made in the final rule by FHFA was to use an expanded-data HPI. Second, the final ERCF rule prescribed a trigger for FHFA to re-estimate the long-term trend line upon a new trough.
[19] Federal Housing Finance Agency, "House Price Index –October 2021."

and CPI equal each other, the Countercyclical Adjustment is 12 percent and remains in place for 12 years, declining approximately 1 percent per year.

FIGURE 1

Depiction of how Total Risk Based Capital changes through time under forward 0 percent HPA and 0 percent CPI Assumption



Other examples are provided in our response to Question 4 below. Using a number of different realistic future HPA and CPI scenarios, the Countercyclical Adjustment maintains a significant impact for multiple years. The increase in capital driven by the countercyclical adjustment will dampen demand in the housing market during those years when housing prices are well within traditional levels of appreciation compared to the CPI.

The net result is that the Enterprises will be required to hold significantly more capital. Based on today's HPA, the Enterprises would have to hold nearly 1.5 times the gross required capital for years after the recent COVID-19 driven increase in home prices. Loans with higher LTVs will see the largest absolute increase in capital charge, potentially dramatically increasing their required guarantor fees or reducing for the Enterprises.

This impact will also be applied to new originations, meaning future homeowners—those that have not yet benefitted from the HPA that led to the Countercyclical Adjustment being applied—will be paying higher rates for homeownership.

FHFA should further assess the Countercyclical Adjustment and the impact on LMI borrowers and encourages FHFA to consider alterations in this or a future rulemaking. Further, USMI also notes that the Countercyclical Adjustment section of the ERCF is extremely complex and difficult to analyze. It would

benefit all stakeholders if FHFA would approach this section with a more direct and simpler-to-read and analyze language and formulas.

Additionally, USMI urges FHFA to consider the various recommendations made in stakeholders' 2020 NPR responses, including using asymmetric MTMLTV collars and/or allowing for wider collars (perhaps 7.5 or 10 percent) during increased HPA versus when home prices are declining. Based on market data and FHFA's report on why home prices are escalating, it may be appropriate for FHFA to have discretion to limit the Countercyclical Adjustment to no more than 20 percent of the standard capital of the loan when HPA exceeds a certain threshold, rather than allowing for a 40 to 50 percent increase as would be applicable under the final rule's Countercyclical Adjustment in today's market with current market HPA.

Finally, FHFA has access to the greatest amount of housing market data available and could use that information to consider what is driving unusually steep HPA to determine, in its discretion, if and a Countercyclical Adjustment is necessary, and the amount of such an adjustment.

VII. Summary and Conclusions

In conclusion, USMI appreciates and agrees with the direction of the proposed changes in this NPR and urges FHFA to consider the comments, observations, and recommendations in this comment letter to enhance the proposed modifications to the ERCF. We also urge FHFA to lower the single-family minimum risk weight floor, and to recalibrate the Countercyclical Adjustment.

Thank you,

Lindsey D. Johnson

President

Appendix A: Responses to Questions Posed in the NPR

2. ***Is the proposed PLBA appropriately formulated? What adjustments, if any, would you recommend?***

The proposed change to the PLBA is a much better approach because, under the proposed modifications, the leverage ratio would rarely be the binding constraint. While it does not lower the overall capital level by much (estimated $33 billion), it does reduce the increases that were likely to kick-in under the 2020 final rule—those projected increases would not occur nearly as much with these modifications because the risk-based capital amount will more often be the binding constraint. The changes also benefit CRT because of the improvement in the capital relief that will be given to the existing books of CRT.

We emphatically agree that the leverage ratio should not be the usual binding constraint on the Enterprises. However, the NPR does not explain why 50 percent of the Stability Capital Buffer is the appropriate standard. The Stability Capital Buffer itself is an arbitrarily determined capital requirement and no rationale has been provided for why 5 basis points times market share over 5 percent is chosen, how it is related to the risk, or why the threat to the national housing finance system is not adequately dealt with through the other elements of the ERCF.

Further, the PLBA is not intended to provide a margin to protect the national housing finance market, but rather is intended to provide yet another backstop for the risk-based requirements.

We agree that the PLBA needs to be adjusted, and that 1.5 percent is excessive. However, we recommend that FHFA consider alternative methods of determining the amount of the PLBA that more closely relate to risk than the Stability Capital Buffer.

3. ***Is the PLBA necessary for the ERCF's leverage framework to be considered a credible backstop to the risk-based capital requirements and PCCBA?***

See response to Question 2.

4. ***In light of the proposed changes to the PLBA and the CRT securitization framework, is the prudential risk weight floor of 20 percent on single-family and multifamily mortgage exposures appropriately calibrated? What adjustments, if any, would you recommend?***

20 Percent Risk Weight Floor

While not the focus of the proposed changes in the NPR, USMI was very pleased to see FHFA ask a question about the 20 percent prudential risk weight floor for single-family mortgages. The ERCF's basic formula for assigning risk weights is that it assigns a risk weight for single-family

mortgage exposures that is equal to: *(i) a base risk weight*[20] *multiplied by (ii) a risk multiplier*[21] *multiplied by (iii) an adjusted credit enhancement multiplier,*[22] ***subject to a minimum risk weight floor***. The base risk weights and multipliers are set to enable the Enterprises to absorb lifetime unexpected losses on mortgages subject to a price shock similar to the 2008 financial crisis. The base risk weights are in Tables 2-5 of the ERCF final rule and are tied to the *adjusted MTMLTV ("adjusted MTMLTV")*.[23]

While the finalize ERCF is very similar to the framework proposed in 2020, there are several critical differences due to the following modifications: (i) the minimum risk weight for single-family mortgage exposures was increased from 15 percent to 20 percent; (ii) the risk grids became more granular for loans with MTMLTVs between 30 percent and 60 percent; (iii) modified re-performing loans are treated as performing loans after 5 years; (iv) exposures in a repayment plan, including a COVID-19 forbearance plan, are treated as non-modified re-performing rather than modified re-performing; and (v) the ***Countercyclical Adjustment*** for 5 percent swings in housing prices became tied to a national FHFA house price index that is not seasonally adjusted and does not include refinancing valuations, rather than the all-transactions FHFA house price index originally proposed. The final rule also includes a trigger for re-estimating the long-term trend line if certain conditions are met.

As stated in our 2020 comment letter, the proposed minimum risk weight floor is applied regardless of the risk weight that would otherwise be assigned based on the loan characteristics and historic data. The minimum 20 percent floor creates a dramatic increase in the overall capital required for all single-family mortgages—a nearly 50 percent increase in net Enterprise capital as demonstrated in a simple example of a seasoned, high original LTV as shown in Figure 2.

[20] 85 Fed. Reg. 82220 (December 17, 2020).
[21] 85 Fed. Reg. 82221 (December 17, 2020).
[22] 85 Fed. Reg. 82223 (December 17, 2020).
[23] 85 Fed. Reg. 82220, 82221 (December 17, 2020). Table 2 is for performing loans, Table 3 is for non-modified reperforming loans (RPLs), Table 4 is for modified RPLs, and Table 5 is for nonperforming loans (NPLs).

FIGURE 2

Seasoned Loan: 97 Percent Original LTV Loan with MTMLTV of 80 Percent

	FHFA 2020 NPR	FHFA 2020 FINAL RULE	Recommended 10% RW Floor
Original LTV	97	97	97
MTM LTV	**80**	**80**	**80**
Loan Age (months)	60	60	60
FICO (original and Current)	750	750	750
MI Coverage	35%	35%	35%
UPB	$100,000	$100,000	$100,000
Risk in Force	$35,000	$35,000	$35,000
Counter Party Score	4	4	4
Risk Factor (FHFA Table 9/10)	2.64%	2.64%	2.64%
Gross Capital %	**2.64%**	**2.64%**	**2.64%**
Gross Capital $	**$2,640**	**$2,640**	**$2,640**
Credit Enhancement Factor (FHFA Table 16)	53.5%	53.5%	53.5%
Counter Party Factor	14.2%	14.20%	14.20%
CE Credit	60.1%	60.1%	60.1%
Net Capital %	**1.59%**	**1.59%**	**1.59%**
Net Capital $	**$1,587**	**$1,587**	**$1,587**
Implied MI Capital Benefit $	$1,053	$1,053	$1,053
Minimum capital	1.20%	1.60%	0.80%
Net Capital $	$1,200	$1,600	$800
Gross Capital	$2,640	$2,640	$2,640
Net Capital with Floor	$1,200	$1,600	$800

For reasons cited in our 2020 comment response, the rationale that FHFA used for proposing the 15 percent minimum risk weight floor, including basing it on cumulative losses that occurred on a much riskier pool of mortgages (such as 2007 vintages) does not seem appropriate given the dramatic improvement in mortgage lending/underwriting and risk management that has occurred since the financial crisis. Further, in the 2020 final rule, FHFA states that part of the reason for increasing the minimum risk weight floor to 20 percent was to make the risk-weighted capital binding. However, with the proposed changes in the NPR to address CRT with the reduction of the minimum risk weight floor from 10 percent to 5 percent and the removal of the overall effectiveness adjustment for retained tranches, address many of the challenges of making CRT more economic. Therefore, this additional increase is not necessary.

The final rule further dilutes the ability of the Enterprises to appropriately use and distribute mortgage credit risk private capital with the incorporation of the minimum 20 percent risk weight floor. The impact of the 20 percent floor negates the full capital benefit that should otherwise be realized from private MI (see Figure 2). Any adjustment for counterparty risk is clearly made through the counterparty haircuts already applied to private MIs. This additional reduction in capital benefit does not appropriately account for the risk protection afforded to the Enterprises by private MIs and therefore arbitrarily increases the Enterprises' capital requirements, and thus costs for borrowers. The Enterprises should not be penalized for sharing that risk with private entities that underwrite, manage, distribute, and hold significant capital against that risk— in fact, they should be incentivized to further distribute first-loss credit risk this risk to private MIs.

The 20 percent floor applied to all mortgages, regardless of how strong the borrower credit is, is a "blunt instrument" approach of arriving at an overall capital number that is not grounded in the changes that have occurred post crisis, is risk-insensitive and not analytically justified based on historical analysis. The goal of protecting the Enterprises from all conceivable risks is inconsistent with the goal of having a strong and liquid secondary mortgage market and would have an immediate adverse impact on consumers.

Similar to the proposed change to reduce the minimum 10 percent floor on CRT to 5 percent, as not doing so otherwise makes CRT uneconomical, the minimum 20 percent risk weight floor for single-family mortgages should be reduced to 10 percent or less to account for the improvements in mortgage lending since the 2008 financial crisis, and to more accurately reflect and allow for credit enhancement, while also still requiring the Enterprises to hold an amount of capital against remote credit risk exposure. Reducing the single-family risk weight floor to 10 percent or less better achieves this outcome. As detailed in Appendix C, on a sample of 100,000 Fannie Mae loans, roughly 25 percent of the loans hit the risk weight floor when it is set to 20 percent. Conversely, by establishing a risk weight floor of 10 percent, 11 percent of loans hit the floor.

Recommendation: The 20 percent risk weight floor on single-family mortgage exposures should be reduced to 10 percent or less.

Countercyclical Adjustment

One particularly troubling aspect of the ERCF's additional capital buffer is related to the MTMLTV Countercyclical Adjustment that creates risk and capital distortions. USMI understands and supports the Enterprises having countercyclical elements to their capital framework given the significant role the Enterprises play in the housing market. While USMI commented on the Countercyclical Adjustment and our concerns in our 2020 comment letter, we can currently see the dramatic impact that the Countercyclical Adjustment would have in today's market based on the market's HPA using the required MTMLTV ratios.

USMI believes that this component of the ERCF could negatively impact future homeowners, and in particular LMI, underserved, and minority borrowers during periods of increased HPA. It is clear based on more recent real-world scenarios that FHFA should re-examine the Countercyclical Adjustment and that this component of the final rule may need to be recalibrated to avoid negative impacts on future homeowners and to account for appreciation that is caused by supply-demand dynamics and other economic fundamental drivers.

The single-family Countercyclical Adjustment adjusts MTMLTV when national house prices deviate by more than 5 percent above or below an inflation-adjusted long-term trend. The Countercyclical Adjustment is a blunt approach that can have distorting effects on loan risk and the capital that is required for future borrowers. The Countercyclical Adjustment becomes very problematic in years where there is strong HPA, even when that HPA is due to basic economic fundamentals, such as an imbalance of supply and demand, which has occurred nationwide throughout 2020 and 2021.

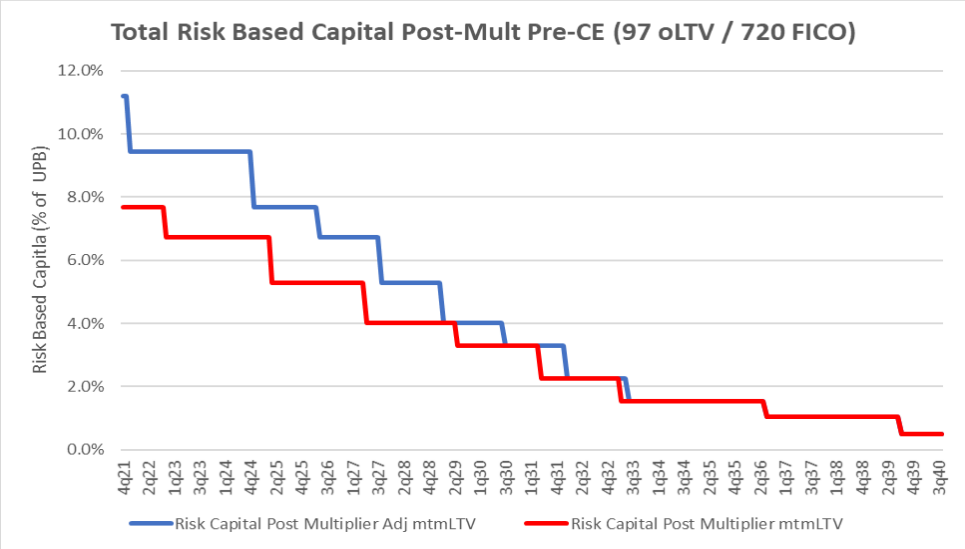
Further, the Countercyclical Adjustment is not just a feature of HPA, but HPA as it is deflated by inflation as tracked by the CPI. Given the significant role the Enterprises play in the housing market, it is understandable why FHFA would want to include a Countercyclical Adjustment to dilute housing bubbles, such as where home prices skew beyond a normal projected baseline. However, it is unclear whether FHFA's baseline is accurate, and there are scenarios where HPA is not based on a bubble scenario, but rather driven by market dynamics such as supply-demand imbalances such as we see in the market today. There are also times when a 5 percent collar and the required Countercyclical Adjustment will have distortive effects, specifically for new originations.

Increasing HPA creates a situation where loans will have higher MTMLTV ratios, which will require the Enterprises to hold additional capital against these loans, likely resulting in increased pricing of these loans. This impact will be greatest for borrowers with higher LTVs (>80 percent) as these loans are likely to have increased capital charges from elevated LTVs that will be even higher due to MTMLTVs.

FHFA's HPI noted that home prices increased nearly 19 percent from August 2020 to August 2021.[24] Figure 3 below is an example of a new origination where, using HPA that is consistent with the current housing market,[25] a 97 percent MTMLTV loan moves to just over 111 percent Adjusted MTMLTV due to the 12 percent countercyclical adjustment. Using a straight-forward scenario where future HPA and CPI equal each other, the Countercyclical Adjustment will last for 12 years, decreasing approximately 1 percent per year.

[24] Federal Housing Finance Agency, "House Price Index –October 2021."
[25] Based upon the most recent FHFA data release which is 4/1/2021.

FIGURE 3



The chart below illustrates additional realistic scenarios of future HPA of 3 percent with CPI at four percent (Scenario 1 in Figure 4) and how it takes 6 years for HPA to come back to the HPI trend-line collar, which eliminates the Countercyclical Adjustment. If future HPA exceeds future CPI by 1 percent, the Countercyclical Adjustment is applied in perpetuity and does not diminish over time (Scenario 3 in Figure 4).

FIGURE 4

Duration of Future Countercyclical Adjustment

SCENARIO 1	
Future CPI	4.0%
Future HPA	3.0%
Adjustment	
Month	Adj
4/1/2021	-12.0%
4/1/2022	-10.2%
4/1/2023	-8.4%
4/1/2024	-6.5%
4/1/2025	-4.6%
4/1/2026	-2.6%
4/1/2027	-0.7%
4/1/2028	0.0%
4/1/2029	0.0%
4/1/2030	0.0%
4/1/2031	0.0%

SCENARIO 2	
Future CPI	0.0%
Future HPA	0.0%
Adjustment	
Month	Adj
4/1/2021	-12.0%
4/1/2022	-11.1%
4/1/2023	-10.1%
4/1/2024	-9.2%
4/1/2025	-8.2%
4/1/2026	-7.2%
4/1/2027	-6.2%
4/1/2028	-5.3%
4/1/2029	-4.2%
4/1/2030	-3.2%
4/1/2031	-2.2%

SCENARIO 3	
Future CPI	2.0%
Future HPA	3.0%
Adjustment	
Month	Adj
4/1/2021	-12.0%
4/1/2022	-11.9%
4/1/2023	-11.9%
4/1/2024	-11.8%
4/1/2025	-11.7%
4/1/2026	-11.6%
4/1/2027	-11.6%
4/1/2028	-11.5%
4/1/2029	-11.4%
4/1/2030	-11.4%
4/1/2031	-11.3%

SCENARIO 4	
Future CPI	5.0%
Future HPA	3.0%
Adjustment	
Month	Adj
4/1/2021	-12.0%
4/1/2022	-9.3%
4/1/2023	-6.6%
4/1/2024	-3.8%
4/1/2025	-0.9%
4/1/2026	0.0%
4/1/2027	0.0%
4/1/2028	0.0%
4/1/2029	1.0%
4/1/2030	4.1%
4/1/2031	7.2%

As noted in Figure 5, the required gross capital is nearly 1.5 times what would otherwise be required without the Countercyclical Adjustment for some loans. Future borrowers will pay for the HPA that other homeowners have benefited from, as the Enterprises will be required to hold nearly 1.5 times capital for these same loans due to the Countercyclical Adjustment, inevitably increasing pricing— both ongoing fees (guarantee fees) and upfront loan level price adjustments (LLPAs)— to accommodate for the increased capital charges.

FIGURE 5

Enterprise Gross Credit Risk Capital Pre-Credit Enhancement as of June 30, 2021

oFICO	No Countercyclical Adjustment oLTV			
	85	90	95	97
680	5.36%	7.04%	8.72%	10.00%
720	4.00%	5.28%	6.72%	7.68%
760	2.56%	3.44%	4.48%	5.20%

With Countercyclical Adjustment oLTV			
85	90	95	97
10.00%	12.00%	12.00%	14.08%
7.68%	9.44%	9.44%	11.20%
5.20%	6.56%	6.56%	7.92%

Countercyclical Capital Impact oLTV			
85	90	95	97
1.87x	1.70x	1.38x	1.41x
1.92x	1.79x	1.40x	1.46x
2.03x	1.91x	1.46x	1.52x

Given FHFA has a central role in monitoring the housing market, and already reports monthly a Home Price Index, FHFA can and should evaluate whether national increasing home prices is due to fundamental economics such as supply/demand imbalances, low interest rates,

or other features, rather than speculative lending/borrowing or other distortive reasons. It is apparent in this way that the blunt application of a MTMLTV 5 percent collar may not appropriately capture the fundamentals of what is driving HPA.

FHFA has access to the greatest amount of housing market data available and could use that information to consider what is driving unusually steep HPA to determine, in its discretion, if and a Countercyclical Adjustment is necessary, and the amount of such an adjustment. However, FHFA states in the final rule, that the "application of the MTMLTV would not depend on a determination by FHFA. Rather the Countercyclical Adjustment as an automatic trigger such that an Enterprise would be required to make the adjustment when national house prices increased or decreased by more than 5 percent from the long-term trend."[26] The public policy benefit of having a countercyclical adjustment locked in place, as opposed to being within the discretion of FHFA, is not obvious.

Finally, while we have concerns about the impact of this blunt approach being applied to the MTMLTVs for loans held or guaranteed by the Enterprises, we also have significant concerns that this will create an economic disparity between Federal Housing Administration (FHA) and conventional loans. This disparity will be triggered whenever the Countercyclical Adjustment is applied to Enterprise mortgages, but not to FHA insured loans, potentially making the FHA loans less expensive. Borrowers who otherwise would have access to finance in the conventional market to be priced out of the market and left only with an FHA mortgage.

Recommendations:

- *FHFA should reconsider and recalibrate the Countercyclical Adjustment*. We also recommend that FHFA re-examine and consider revising the Countercyclical Adjustment to ensure the outcome of this adjustment meet FHFA's policy objectives and considers real-world scenarios where there is significant home price appreciation above or below an inflation-adjusted long-term trend.

- *Given FHFA's access to data and market information, FHFA should report on whether significant HPA is based on market fundamentals or something else*. While FHFA specifically notes in the final rule that it does not have discretion around the Countercyclical Adjustment, this should be re-evaluated. Based on market data and FHFA's report on why home prices are escalating, it may be appropriate for FHFA to have discretion to cap capital increases to up to 20 percent when HPA exceeds a certain threshold, rather than allowing for a 40 to 50 percent increase as would be applicable in today's market with today's market HPA.

- *Based on the reassessment, FHFA should consider recalibrating the Countercyclical Adjustment*. FHFA should also consider a number of the different recommendations made

[26] 85 Fed. Reg. 82171 (December 17, 2020).

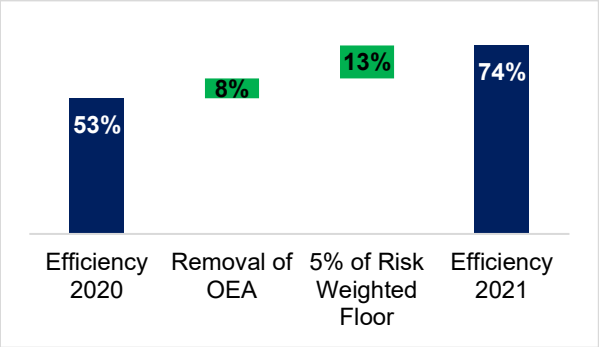
in the 2020 NPR responses, including using asymmetric MTMLTV collars, and/or allowing for wider collars (perhaps 7.5 or 10 percent) during increased HPA versus when home prices are declining.

- *Simply the language and formula for the Countercyclical Adjustment*. Finally, the Countercyclical Adjustment element of the ERCF is extremely complex and difficult to analyze. It would benefit all stakeholders if FHFA would approach this section with a more direct and simpler to read and analyze.

5. ***Is the 5 percent prudential floor on the risk weight for a retained CRT exposure appropriately calibrated? What adjustment, if any, would you recommend?***

The Enterprises' CRT programs are critical tools for managing their risk, reducing taxpayer exposure to mortgage credit risk, and increase private capital in the housing finance system. It is appropriate for FHFA to evaluate the risks posed by different credit risk mitigants, including CRT transactions. Accordingly, USMI agrees with the proposed changes in the NPR to reduce the 10 percent risk weight floor to 5 percent and remove the overall effectiveness adjustment. These modifications to the ERCF would help improve the capital benefit afforded to the Enterprises' CRT transactions by 30 to 40 percent, and in some cases by nearly 50 percent (see Appendix D for more details on the analysis).

FIGURE 6



Further, as Figure 6 demonstrates, while both the removal of the overall effectiveness adjustment and the reduction of the risk weight floor improve the capital efficiency of CRT for the Enterprises by 8 percent and 13 percent, respectively, it is clear that the greater capital efficiency comes from the reduction in the risk weight floor. USMI supports the direction of reducing the CRT risk weight floor from 10 percent to 5 percent, but continues to believe that a 5 percent floor continues to be excessive, especially for the most senior retained tranches that have de minimis credit risk, which may lead to unintended consequences. In some cases, an Enterprise could decide to restructure a CRT transaction so that less credit risk is transferred to third parties. In other words, an Enterprise could decide that if it has to hold a prescribed amount of capital, it should also retain the concomitant risk, so that it will have the income to support the capital

charge. Alternatively, an Enterprise may decide not to enter into a CRT transaction because the 5 percent floor negates the financial incentives to enter into the CRT contract. Neither of these results would further the public policy benefits for using CRT as noted by FHFA in the NPR.

Recommendations:

- *FHFA should consider adjusting the CRT minimum risk weight floor lower than 5 percent* to a level closer to the statistically determined risk in a retained position to better align the CRT decision-making with the underlying economics and risks posed by the transaction.

- *FHFA should also establish and make public the model used to assess the capital benefit of CRT*, the statistical basis for any floor, and an analysis of the impact of the capital treatment of CRT on the statutory goals of the Enterprises.

6. ***Is the removal of the overall effectiveness adjustment within the CRT securitization framework appropriate in light of the proposed rule's 5 percent prudential floor on the risk weight for retained CRT exposures****?*

   See response to Question 5.

7. ***Is the proposed approach to determining the credit risk capital requirement for retained CRT exposures appropriately formulated? What adjustments, if any, would you recommend?***

   See response to Question 5.

8. ***Will the proposed amendments to the CRT securitization framework provide the Enterprises with sufficient incentives to engage in more CRT transactions without compromising safety and soundness?***

   See response to Question 5.

Appendix B: 2020 Comment Letter

USMI's full comment letter on the 2020 re-proposed Enterprise Regulatory Capital Framework is available on the FHFA submission portal[27] and below is the executive summary of our response.

USMI Executive Summary of Comment Letter to the FHFA on Proposed Enterprise Capital Framework (ECF)

Overarching Observations and Concerns

- **The Regulation Should Not Preempt Congressional Reforms.** Without congressional action, it is appropriate for the Federal Housing Finance Agency (FHFA) to take regulatory steps to ensure that the government sponsored enterprises (GSEs or Enterprises) will not present undue risks to the taxpayer when released from conservatorship. However, it is also important that FHFA regulatory actions do not effectively preempt potential congressional reforms. For example, Congress may determine that an explicit government backstop for catastrophic losses represents the best way to balance the public benefits provided by the GSEs and protection of taxpayers.

- **Capital Requirements Should Be Transparent and Analytically Justified.** The public and affected industry participants should be able to understand the basis for particular risk weights, haircuts, and other elements of the proposal. Models used to determine these factors should be fully disclosed and empirically justified based on historical data. Transparency would provide credibility for the rule's requirements and an ability for the public to identify errors and to suggest improvements in the methods and models.

- **Insurance Capital Framework Should Be Used for Insurance Risks.** The proposed rule, even more so than the 2018 version, relies on a "mash up" of capital frameworks and incorporates many aspects of bank regulation, which is wholly inappropriate for the GSEs given that their core business activities and risk exposures are more akin to insurance. The bank business model is fundamentally different than the GSEs' business model and the risks assumed by banking organizations are not the same as the risks assumed by the GSEs.

- **Capital Requirements Must Be Balanced.** Capital requirements for the GSEs must be balanced, taking into account the impact of higher capital on housing finance and the risks to the taxpayer of the GSEs' activities. We are concerned that the proposed rule fails this standard by requiring capital levels that are significantly higher than necessary even under a severely stressed scenario. The proposed rule represents a significant increase (approximately $100 billion) in the overall capital required compared to the 2018 proposed rule and the FHFA increased the base credit risk grids without providing its rationale. The proposed 15% risk weight floor alone would increase required capital by 30% over the 2018 proposal.

[27] https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15664.

- **Capital Requirements Should Reduce, Not Merely Shift, Overall Risk to the Taxpayer.** The proposed capital requirements will not reduce risk in the housing finance system but merely shift origination volume and credit risk to government-insured channels, namely the Federal Housing Administration (FHA). Many consumers, primarily lower wealth borrowers, could find themselves priced out of the conventional market and migrate to the 100% taxpayer-backed FHA. The reduced capital benefit of private mortgage insurance (MI), overly punitive treatment of the GSEs' credit risk transfer (CRT) transactions, and the proposed floors on mortgage exposures would all reduce the incentives for the GSEs to de-risk in the future.

- **The Credit Risk-Based Capital Framework Should Be as Sensitive to Credit Risk as Possible.** The proposed rule dilutes the credit risk- adjusted nature of the capital framework by combing risk-adjusted capital requirements with non-risk adjusted buffers and a binding non-risk adjusted leverage ratio. The layering of requirements— including various buffers, risk weight floors, penalties for CRT transactions, multipliers, and haircuts— results in a credit risk standard that includes non-credit risk concerns and demands higher amounts of capital than is warranted by the GSEs' actual risk exposures. A credit risk-based framework should be as sensitive as possible to credit risk, yet the leverage ratio would be a binding capital requirement and supersede the risk-based elements of the framework.

- **Proposed Rule Continues to Be Procyclical.** The use of mark-to- market loan-to-value (MTMLTV) ratios and refreshed credit scores would result in a procyclical risk-based capital framework in which less capital would be required during good economic times (and thereby fuel the expansion) and more restrictive capital requirement in bad economic times (and thereby reduce credit availability and dampen economic recovery). The FHFA has proposed a countercyclical adjustment to address the use of MTMLTV but it is an overly complex element that is based on national house prices.

- **Proposed Rule Should Promote Private Capital Through the Use of Loan Level Credit Enhancement (CE) and Responsible CRT.** The 2020 proposed rule disincentivizes private capital from playing its important role in the housing finance system by diminishing the capital benefit the Enterprises receive from first loss loan level credit enhancement from private MI and from additional CRT. The reduced capital benefit of private MI, overly punitive treatment of the GSEs' CRT transactions, and the proposed floors on mortgage exposures would all reduce the incentives for the GSEs to de-risk in the future.

- **Improper Treatment of GSE Counterparties.** Counterparty haircuts are based on an opaque rating system what will result in subjective determinations that pick "winners and losers." The framework should rely on transparent and objective benchmarks for purposes of assessing counterparty strength and applying any counterparty haircuts.

- **Proposed Rule Fails to Provide Accurate Capital Benefit for MI.**

- *Capital Relief for Mortgage Insurance Should Be Objectively Determined, Consistent with Historical Data.* Based on historical data, the CE Multipliers for guide level and charter level coverages should be 0.469 and 0.717 respectively, which is significantly lower than the CE Multipliers of 0.845 and 0.916, respectively, as proposed in the 2018 proposed rule, and also in the 2020 proposal. This needs to be corrected.

- *Capital Benefit Should Be Considered for Deeper MI.* The 2020 proposal codifies only charter level and guide level coverage and does not contemplate MI coverage that could go beyond those two levels. There is no question that deeper insurance protection continues to reduce loss in the event of a default, and this increased benefit can be statistically determined through an analysis of available data. This reduction in loss reduces risk and should be recognized in any risk- based capital framework.

- *Determination of Creditworthiness and Concentration in Mortgage Risk is Subjective and Unjustified.* This proposal applies counterparty haircuts based on a subjective determination, by the GSEs, of counterparty creditworthiness and concentration in mortgage credit risk. Secret and subjective determinations of this nature have the potential of causing great harm to the GSEs and to the housing markets. Further, the nature of these ratings is fundamentally unfair in that counterparties have no visibility as to how to improve their GSE-determined creditworthiness rating.

- *15% Minimum Risk Weight Floor and MTMLTV Have Unintended Consequence of Diminishing the Risk Reducing Benefit the GSEs Should Receive from Private MI.* The minimum 15% risk weight floor on single-family mortgages will reduce the capital benefit of MI when the net capital required under the proposed rule would otherwise be below the 15% minimum floor. The same is true of the MTMLTV requirements, which under the proposed rule would kick-in after only six months after the loan is originated. The proposal also could diminish the MI benefit because of inaccurate assumptions made about MI coverage cancellation based on an amortization schedule that does not take into account other factors related to MI cancellation.

- **Credit Risk Transfer.** We support the use of CRT transactions as a tool to transfer a meaningful amount of credit risk in exchange for an appropriate amount of compensation. Properly priced and executed CRT transactions can meaningfully reduce the GSEs' risk, increase their capacity to provide liquidity, and protect taxpayers for mortgage credit risk losses. However, the proposed treatment of CRT represents a significant disincentive for the GSEs to use the transactions and would result in credit risk being more concentrated at the GSEs rather than distributed to other market participants. Two aspects of the proposed rule that are particularly concerning and negatively affect the economic feasibility of CRT are: (1) the 10 percent risk weight floor on retained security positions; and (2) the requirement that the GSEs calculate its risk-weighted assets as if 10% of the risk sold off was still on balance sheet.

Recommendations for Modifications to the Proposed Rule

- **Capital Requirements Should Be Tailored to Reflect the Core Business of the GSEs.**

    1. The GSEs' primary function is that of a guarantee business, which is an insurance function, and therefore the Enterprises should be subject to insurance capital framework. If necessary, adjustments can be made to account for systemic risk.

    2. The exclusion of future revenue on the Enterprises' existing books of business from the capital available to meet the credit risk capital requirements should be reconsidered. The NPR explicitly states that the capital framework is intended to ensure the Enterprises have going-concern levels of capital and, accordingly, the framework should recognize and give credit for the Enterprises' revenue.

- **The Capital Rule Should Be Completely Transparent and Analytically Justified.**

    3. FHFA should make public all of the assumptions, models, and underlying calculations used to create the proposed framework in order to provide an opportunity for interested parties to understand the basis for the rule and submit comments.

    4. There are layers upon layers of over-conservatism laced throughout the proposed rule. The current proposed capital levels are far above what was proposed in 2018, which also had elements of over-conservatism. The current proposal requires too much capital for the risks inherent in the GSEs' post crisis business and does not reflect the improved loan underwriting required by the GSEs. The capital charges should be adjusted to reflect the new underwriting required by the Dodd-Frank Act.

- **The Risk-Adjusted Capital Rule Should Be Based on Credit Risk.**

    5. The risk-adjusted capital rule should be as risk sensitive as possible. Elements in the risk-adjusted rule that reduce risk sensitivity should be removed or made more risk sensitive. The capital added for non-credit risks, such as interest rate risk, global warming risks, and hypothetical political risk should be deleted. These non-credit risk concerns should be dealt with through separate regulatory requirements, such as the recently adopted liquidity standard, or through an operational risk requirement or supervisory oversight.

    6. The leverage ratio is a back-stop for unusual circumstances. It should not be set so high as to be the binding capital requirement at the initiation of a new risk-adjusted framework. It should also be based on GAAP assets and calculated in a manner that reflects the mortgage risk actually held by the Enterprises and recognizes the credit risk that is transferred to other market participants, such as MI and CRT.

    7. The use of MTMLTV ratios does not appropriately capture regional bubbles and can have a dramatic impact on capital required. FHFA should modify the rule so that the

countercyclical adjustments for single-family mortgage exposures are based on original LTV for the first 3-5 years, after which national or, preferably, regional MTMLTV house price deviations could be used.

8. The buffers should be based on risk-adjusted assets. The minimum 15% floor for single-family mortgages should be removed. The minimum 10% floor on CRT will make CRT uneconomical and should be removed.

- **FHFA Should Reevaluate the Treatment of Counterparties to Create a Transparent and Objective Assessment Framework**

Private MI

9. The proposed regulation includes a completely subjective determination of counterparty creditworthiness and mortgage risk concentration. Counterparties that meet the requirements of the GSEs' Private Mortgage Insurer Eligibility Requirements (PMIERs) should not be subject to subjective determinations of creditworthiness and should not be subject to a haircut. The single-family risk multipliers and credit enhancement multipliers should be revised in certain respects.

10. The CE Multipliers on seasoned loans with cancellable MI need to be re- calibrated to distinguish loans in which the MI has actually been cancelled and loans that are still covered by MI, notwithstanding the 80% cancellation and 78% termination triggers.

11. In addition to the procyclical and overly conservative effects that the proposed 15% risk weight floor and MTMLTV requirements have on overall capital, they have significant, and presumably unintended, consequences on the benefit that the Enterprises attain from this source of important underwriting and capital standing in a first-loss position. As previously stated, the 15% risk weight floor should be removed. The MTMLTV requirement should be adjusted to use original LTV for 3-5 years, after which MTMLTV could be used.

CRT

12. The proposed 10% floor on CRT will make the transactions uneconomical and should be removed. To ensure that CRT deals meet supervisory expectations without the implementation of punitive capital treatment, the FHFA or GSEs should establish and make public: a transparent model to assess the capital benefit for CRT; and (2) a specific set of disclosures and requirements for CRT structures.

Appendix C: Single-Family Risk Weight Floor Analysis

Note: Analysis of the impact of a minimum risk weight floor at 20 percent and 10 percent based on a 100,000 Fannie Mae loan sample.

FIGURE 7

20 Percent Risk Weight Floor— Floor Hit Rate by Vintage

- Figure 7 is a set of 100,000 Fannie Mae loans across vintages from 2013 to 2021.
- Overall ~25 percent of loans (~20 percent using balance) were hitting the Risk Weight Floor with older vintages experiencing higher hit rates as expected.

Vintage	Floor Balance	Total Balance	Floor Hit Rate
2013	$ 51,904,779	$ 62,956,024	82.4%
2014	$ 29,281,543	$ 44,414,263	65.9%
2015	$ 66,687,349	$ 96,097,258	69.4%
2016	$ 103,715,074	$ 162,481,447	63.8%
2017	$ 65,315,055	$ 155,759,477	41.9%
2018	$ 20,304,695	$ 155,745,631	13.0%
2019	$ 15,459,706	$ 279,642,396	5.5%
2020	$ 60,774,756	$ 947,260,808	6.4%
2021	$ 50,030,000	$ 423,810,000	11.8%
TOTAL	**$ 463,472,958**	**$ 2,328,167,303**	**19.9%**

Vintage	Floor Hit Count
2013	353
2014	212
2015	407
2016	591
2017	364
2018	119
2019	80
2020	237
2021	170
TOTAL	**2,533**

FIGURE 8

20 Percent Risk Weight Floor— All Vintage Floor Hit Distribution by Count

- Figure 8 is a dataset of 100,000 Fannie Mae loans expanded to the entire book of loans which broadens expand the range of FICOs and MTMLTV buckets hitting the Risk Weight Floor.
- This is driven by any areas of the Base Risk Weight grids that are below 20 percent. This is generally in the ≥700 FICO and ≤70 percent MTMLTV area of the grids.

Count or Floor Hits	620	640	660	680	700	720	740	760	780	850	Grand Total
30			2	2	3	9	8	7	11	50	92
40	0	1	2	6	5	7	9	13	21	39	103
50	2	5	6	11	12	24	32	34	44	65	235
60	0	2	5	15	25	39	81	83	80	159	489
70	1	0	5	9	23	48	82	144	158	**233**	**703**
75	0	0	0	2	6	10	31	49	80	113	291
80	0	0	0	0	0	5	10	29	35	99	178
85	0	0	0	0	0	2	11	15	29	79	136
90	0	0	0	0	0	0	0	2	14	111	127
95	0	0	0	0	0	0	0	0	17	112	129
100	0	0	0	0	0	0	1	0	7	40	48
110	0	0	0	0	0	0	0	0	0	2	2
Grand Total	**3**	**8**	**20**	**45**	**74**	**144**	**265**	**376**	**496**	**1,102**	**2,533**

FIGURE 9

10 Percent Risk Weight Floor— Risk Weight Floor— Floor Hit Rate by Vintage

- Figure 9 is a set of 100,000 Fannie Mae loans across vintages from 2013 to 2021.
- Dropping the Risk Weight Floor to 10 percent drops the hit rate to ~11 percent.

Vintage	Floor Balance	Total Balance	Floor Hit Rate
2013	$ 35,384,681	$ 62,956,024	56.2%
2014	$ 15,904,294	$ 44,414,263	35.8%
2015	$ 33,456,194	$ 96,097,258	34.8%
2016	$ 51,640,275	$ 162,481,447	31.8%
2017	$ 19,386,786	$ 155,759,477	12.4%
2018	$ 3,376,538	$ 155,745,631	2.2%
2019	$ 3,517,505	$ 279,642,396	1.3%
2020	$ 7,614,413	$ 947,260,808	0.8%
2021	$ 422,000	$ 423,810,000	0.1%
TOTAL	**$ 170,702,686**	**$ 2,328,167,303**	**7.3%**

Vintage	Floor Hit Count
2013	256
2014	122
2015	221
2016	317
2017	122
2018	28
2019	21
2020	45
2021	1
TOTAL	**1,133**

Appendix D: Impact Analysis of Proposed Changes to CRT

Inputs	UPB	$100,000,000,000	$100,000,000,000
	Base	8%	8%
	Expected Losses	0.75%	0.75%
	Unexpected Losses	3.00%	3.00%
	Expected + Unexpected Losses	3.75%	3.75%
	Risk Weighted Assets on Pool	$37,500,000,000	$37,500,000,000
	Capital on Pool	$3,000,000,000	$3,000,000,000
	Tier 0%	0.00%	0.00%
Detach	B Detach	0.75%	0.75%
	M1 Detach	**3.50%**	**3.75%**
	A Detach	100%	100%
Tier	B Tier	0.75%	0.75%
	M1 Tier	2.75%	3.00%
	A Tier	96.50%	96.25%
	Total Risk Weighted Assets	$ 1,405,875,000	$ 1,653,875,000
	CRT Benefit Risk Weighted Assets	$ 1,594,125,000	$ 1,346,125,000
	Total Risk Weighted Assets	$ 1,170,750,000	$ 1,418,750,000
	CRT Benefit Risk Weighted Assets	$ 1,829,250,000	$ 1,581,250,000
	Total Risk Weighted Assets	$ 784,750,000	$ 1,033,750,000
	CRT Benefit Risk Weighted Assets	$ 2,215,250,000	$ 1,966,250,000
	Total Risk Weighted Assets	$ 648,750,000	$ 725,750,000
	CRT Benefit Risk Weighted Assets	$ 2,351,250,000	$ 2,274,250,000

Efficiency Adjustment/ Risk Weight Floor	
10% Effectiveness Adjustment	53%
10% Risk Weight Floor	61%
5% Risk Weight Floor	74%

Efficiency 2020	53%		
Removal of OEA	53%	8%	Improvement in capital efficiency
5% of Risk Weighted Floor	61%	13%	Improvement in capital efficiency
Efficiency 2021	74%