Aug. 31, 2020

Alfred M. Pollard

General Counsel

Federal Housing Finance Agency

Eighth Floor

400 Seventh Street, SW

Washington, DC 20219

**RE: R Street Institute and Taxpayers for Common Sense Response to RIN 2590-AA95**

Dear Mr. Pollard:

Our organizations welcome the opportunity to provide comment on the FHFA’s 2020 Proposed Capital Rule. The R Street Institute and Taxpayers for Common Sense are both 501c3 research organizations (“think tanks”) interested in fiscal and regulatory policy that protects taxpayers and ensures healthy and competitive markets.

In that vein, we commend the Agency for seeking to craft capital rules that ensure the safety and soundness of Fannie Mae and Freddie Mac, which continue to represent nearly half the U.S. mortgage market with $6.1 trillion of exposures. The FHFA should be lauded for its success in reducing the enterprises’ leverage ratios over the past year from 1,000-to-1 to 250-to-1. The 2020 proposal’s goal of a 25-to-1 ratio, enabled by a $243 billion capital raise, marks a bold step toward ensuring that they could weather a serious housing downturn.

However, we do have concerns with the proposal’s treatment of credit risk transfer (CRT) transactions, which we believe have been effective in protecting taxpayers. In particular, we fear that relative to the 2018 proposal, the 2020 proposal’s leverage ratio cap, risk-weight floor and overall effectiveness adjustments for CRT threaten to make private CRT significantly more difficult to transact. Should the increased cost of GSE loans because of this change divert mortgage volume toward the Federal Housing Administration, our fear is that taxpayer exposure to losses would be magnified.

In recent years, the enterprises have completed more than $100 billion of CRT on more than $3 trillion of single- and multifamily mortgages. These have included use of the capital markets and structured debt issuances, as well as insurance and reinsurance programs such as Fannie Mae’s Credit Insurance Risk Transfer and Freddie Mac’s Agency Credit Insurance Structure. Over the past seven years, the global insurance and reinsurance market has provided more than $30 billion of CRT to the enterprises.

The benefits of these transactions are myriad, including reduced earnings volatility, better management of liquidity risk, offering multiple durable sources of capital through the cycle, and protection of both taxpayers and equity shareholders. By incorporating price signals and the due diligence of private actors, they also serve to enforce market discipline. Given this success, we had imagined the Agency would see that CRT can serve as an effective bridge toward the enterprises’ recapitalization.

While the 2018 proposal maintained capital neutrality across risk transfer, the 10 percent prudential risk weight floor proposed here represents a departure from strict capital neutrality. The effect is to increase risk weights on retained CRT exposures by adding an 80-basis point capital charge. More credit risk capital would be required at the inception of CRT than if the mortgage exposures were not in the CRT. But by shaving the potential for returns, the result will be to make the enterprises less attractive to investors and make it more difficult for them to raise capital.

We support the goal of better-capitalized enterprises that compete in the market on as close to equal terms with private actors as is possible. However, we fear that the reduced capital relief offered for CRT in the proposed rule would so disincentivize what has been a successful example of shifting risk to private actors as to raise potential burdens on taxpayers should credit conditions deteriorate. This is of particular concern should the rule have the expected effect of diverting mortgage loans to the FHA, which has not, to date, engaged the private sector through risk transfer.

Sincerely,

R.J. Lehmann
Director of Finance, Insurance and Trade Policy
R Street Institute

Steve Ellis
President
Taxpayers for Common Sense