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National Association of Federally-Insured Credit Unions

November 26, 2021

Clinton Jones
General Counsel
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20219

RE: Enterprise Regulatory Capital Framework Rule (RIN: 2590-AB17)

Dear Mr. Jones:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the proposed rule issued by the Federal Housing Finance Agency (FHFA) that would amend the Enterprise Regulatory Capital Framework (ERCF) by refining the prescribed leverage buffer amount (PLBA) and credit risk transfer (CRT) securitization framework for the government sponsored enterprises (GSEs). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 127 million consumers with personal and small business financial service products. NAFCU strongly supports the continued use of CRT to ensure stability in the housing finance system. NAFCU generally supports the proposed rule's changes to the risk weight for CRT and removing the effectiveness adjustment as proposed in this rule. NAFCU also urges the FHFA to consider an adjustment of the base risk rate for mortgages originated by credit unions.

General Comments

CRT programs were first implemented in the GSEs' business models in 2013 and have since became an integral part of operation. The many benefits of CRT include reduced risk to taxpayers, diversification of risk, and potentially lower cost of capital. CRT transactions help protect taxpayers from potentially large credit-related losses because they transfer a meaningful amount of risk to private investors in severe economic scenarios. Additionally, CRTs distribute credit risk broadly across the global financial system to reduce the systemic risk posed by the large volume of mortgage-backed securities (MBS) the GSEs hold on their books.

According to a report by the Federal Reserve Bank of New York, the use of CRTs has improved the stability of the housing finance system and supported the objectives of GSE reform.[1] CRT programs have created a new financial market for pricing and trading mortgage credit risk, which continues to grow, in size and liquidity. Specifically, CRTs reduce the exposure of the Federal government to mortgage credit risk without disrupting the liquidity or stability of secondary mortgage markets. CRT success can mainly be attributed to the fact that the program does not disrupt the operation of the MBS market or its investors because the GSEs act as a central counterparty, standing in between MBS investors and private CRT investors.

[1] David Finkelstein & Andreas Strzodka & James Vickery, 2018. "Credit risk transfer and de facto GSE reform," Staff Reports 838, Federal Reserve Bank of New York.

Severe stress events are not unfamiliar to the housing market and can undue all the work that has been done to secure the safety and soundness of the GSEs. It is critical that the FHFA establish a robust capital framework that seeks to prevent another government bailout in the event of a severe stress event; the transfer of risk to the private sector is necessary in achieving that goal. NAFCU supports the FHFA's efforts to decrease the burden on taxpayers and transfer the risk to private investors. Overall, the proposed changes to the ERCF will help ensure that smaller lenders like credit unions have guaranteed fair access to the secondary mortgage market. NAFCU continues to urge Congress to enact broader housing reform but supports administrative efforts that focus on moving the GSEs toward more stable financial footing.

NAFCU further supports the FHFA in changing the PLBA to accomplish the objective of having the GSEs' leverage capital requirements provide a credible backstop to risk-based capital requirements. A liquidity backstop will better protect the housing market and allow the GSEs to purchase more loans from credit unions and other smaller community lenders. The ERCF rule as it stands creates unnecessary disincentives to the GSEs to transfer risk through CRT programs therefore heightening the risks for taxpayers. Changing the PLBA is necessary to allow the risk-based capital requirements to work as intended to protect the safety and soundness of the GSEs and provide stability and ongoing assistance to the secondary mortgage market.

CRT offers diversification of those holding mortgage credit risk across a range of private investors, ensuring the resilience of the American housing finance system. CRT has proven to be an important tool for protecting taxpayers while allowing for a thoughtful and considered exit from conservatorship for the GSEs. It is an efficient mechanism for managing capital and liquidity requirements. NAFCU agrees with the FHFA that certain aspects of the current ERCF might create disincentives in the GSEs' CRT programs that may result in taxpayers bearing excessive undue risks while the GSEs are in conservatorship; consequently, NAFCU supports the proposed rule and its changes to the ERCF in expanding the GSEs' use of CRTs.

The FHFA has noted in its proposal that the total CRT volume in 2020 exceeded the 2018 volume, even though CRT transactions were halted in the second quarter of 2020. The CRT market has proven to be resilient to economic shocks because in resuming the use of CRTs for Freddie Mac alone there was more volume than before the pandemic. The FHFA recently issued a proposed rule that increases the housing goals of the GSEs across various market segments. The continued use of CRT programs may assist the GSEs in reaching their 2022-2024 housing goals. Once both GSEs resume offering CRT programs the GSEs will have the ability to purchase more mortgages, especially those made to low- and moderate-income borrowers, which will aid the GSEs in reaching their housing goals.

Limitations on Capital Relief of CRT

The capital relief from CRT is limited by the operational criteria, risk weight floor, and effectiveness adjustments; the risk weight floor having the highest limitation even if there is a small credit risk. NAFCU supports the proposed five percent prudential floor on the risk weight for a retained CRT exposure. Lowering the risk weight floor to five percent will nearly double the capital relief. Decreasing the risk weight floor assigned to any retained CRT exposure to five percent will remove the disincentives to CRT and reduce risks to taxpayers. The current ten percent risk weight floor serves to disincentivize CRT because it is duplicative in nature. The ERCF provides an operational criterion for CRT that requires FHFA to approve each transaction as being effective in transferring the credit risk of mortgage exposures to another party, which mitigates the safety and soundness risks before the risk weight floor is even considered.

The effectiveness adjustment is another limitation on capital relief from the CRT under the current ERCF because it reduces the risk-weighted assets of transferred CRT tranches. NAFCU further supports the proposed rule removing the overall effectiveness adjustment as it is not needed and only creates more disincentives for the GSEs to engage in CRT. The proposed amendments to the ERCF provide the GSEs with sufficient incentives to engage in more CRT transactions without compromising safety and soundness.

Base Risk Weight Adjustment for Credit Union Mortgages

In addition to the GSEs' capital requirements and CRT, NAFCU recommends a pricing specific adjustment. NAFCU urges the FHFA to consider an adjustment of the base risk weight for mortgages originated by credit unions to account for the high quality and historically strong performance of those loans, or at least an adjustment for all lower-risk originator classes. Lower capital requirements attached to these mortgages should translate to a risk-adjusted pricing structure for credit unions. The regulatory capital framework should include a discount for these especially low-risk credit union mortgages in the base risk weight for performing and reperforming single-family mortgage loans. This will incentivize the GSEs to purchase high-quality loans from credit unions and ensure that the cost of credit remains low, allowing credit unions to continue to serve low-income, moderate income, and underserved borrowers. Those savings should be passed on to borrowers in the form of lower guarantee fees for credit unions selling mortgage loans to the GSEs. The recommended risk-adjusted pricing would support the GSEs' goal of ensuring affordable housing and incentivize the origination and sale of high-quality credit union mortgage loans.

Conclusion

NAFCU appreciates the opportunity to comment on this proposed rule and supports the FHFA's efforts to continue the use of the CRT to reduce the burden on American taxpayers. NAFCU supports the proposed rule and urges the FHFA to also consider an adjustment of the base risk rate for mortgages originated by credit unions. If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2268 or amoore@nafcu.org.

Sincerely,

Aminah M. Moore
Regulatory Affairs Counsel