



MORTGAGE BANKERS ASSOCIATION

March 9, 2021

The Honorable Mark Calabria  
Director  
Federal Housing Finance Agency  
400 7<sup>th</sup> Street, SW  
Washington, DC 20219

**Re: Enterprise Liquidity Requirements**

Dear Director Calabria:

The Mortgage Bankers Association (MBA)<sup>1</sup> welcomes the opportunity to provide comments and recommendations to the Federal Housing Finance Agency (FHFA) on its notice of proposed rulemaking to implement a revised set of liquidity requirements for Fannie Mae and Freddie Mac (the Enterprises).<sup>2</sup> MBA acknowledges the need for a robust liquidity framework for institutions that are critical to the smooth functioning of the secondary mortgage market. The proposed rule is intended to provide a framework that is far more robust than that which governed the Enterprises' liquidity risk management before 2008.

To achieve this objective, MBA recommends refinements to the proposed rule that would better calibrate the types of assets that satisfy various liquidity requirements. MBA also recommends adjustments to certain assumptions regarding expected cash inflows during stressed economic environments. Finally, FHFA should provide stakeholders with additional information regarding how the requirements and assumptions in the proposed rule differ from those currently in place. This information is necessary to better understand the market impact of the proposed rule.

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 1,700 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: [www.mba.org](http://www.mba.org).

<sup>2</sup> FHFA, "Enterprise Liquidity Requirements," January 8, 2021, 86 FR 1306. Available at: <https://www.federalregister.gov/documents/2021/01/08/2020-28204/enterprise-liquidity-requirements>.

## Liquidity Risk Management and FHFA Discretion on Minimum Requirements

Prudent liquidity risk management for most financial institutions requires the accumulation of sufficient liquid assets during periods of market strength, which would then position institutions to withstand periods of market volatility. The Enterprises are no exception in this regard. FHFA summarizes this concept in the preamble to the proposed rule, stating that it “envisions that an appropriate framework would incent the Enterprises to build their liquidity portfolios in good times, so that it is available to be deployed as necessary in times of stress.”<sup>3</sup>

MBA supports this concept, and as such, supports the provisions of the proposed rule that allow FHFA to temporarily reduce the Enterprises’ minimum liquidity requirements in response to economic or market conditions (*i.e.*, to deploy that liquidity as necessary in stressed environments). Without these provisions, the proposed rule could jeopardize the Enterprises’ ability to provide countercyclical support during market downturns. If an Enterprise, for example, significantly reduced – or altogether ceased – its cash window operations because it was in danger of breaching one or more liquidity requirements, lenders would have to curtail primary market lending or shift to other types of loan products, thereby raising the cost and reducing the availability of credit for borrowers. Such a scenario would represent the exact opposite type of behavior than expected of the Enterprises if they are to meet the obligations of their charters.

In recognition of these core concepts of prudent liquidity risk management, FHFA should ensure that these concepts are applied not only with respect to the Enterprises, but with respect to any Enterprise counterparty requirements, as well. As FHFA considers revisions to the minimum liquidity requirements for non-depository servicers of Enterprise-backed single-family loans, for example, it should adjust existing requirements that are misaligned with the approach taken in the proposed rule.

Non-depository servicers currently are required to meet stricter minimum liquidity requirements during periods in which non-performing loans represent a larger share of total servicing (*i.e.*, periods of market stress).<sup>4</sup> This requirement is in direct contrast to FHFA’s recognition in the proposed rule that the Enterprises (and other financial institutions) would be better served by building liquidity in stronger markets and deploying that liquidity when needed in weaker markets. FHFA proposed to continue this ill-suited construct for non-depository servicers in updated requirements that were put forth for public comment in 2020 and that are expected to be re-proposed in the

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<sup>3</sup> Ibid.

<sup>4</sup> FHFA, “Requirements for Enterprise Seller/Servicers,” January 2015. Available at: <https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/2015-FAQs.pdf>.

near future.<sup>5</sup> In these re-proposed requirements, FHFA should align with the approach taken with respect to the Enterprises and provide incentives for non-depository servicers to engage in well-designed liquidity risk management.

### **Classification of Agency MBS and Agency MBS Repo**

The proposed rule defines the set of assets deemed to be “high quality” and “liquid” for purposes of the minimum Enterprise requirements as Federal Reserve Bank balances, U.S. Treasury securities, Treasury repo agreements cleared through the Fixed Income Clearing Corporation or offered by the Federal Reserve Bank of New York, and a limited amount of unsecured overnight deposits held at large banks. Agency mortgage-backed securities (MBS) and repo agreements secured by agency MBS, however, are not included in this category of “high quality” and “liquid” assets.

FHFA explains that the exclusion of these assets is due in part to concerns regarding “wrong-way” risk – that is, the risk that these assets would lose value and become less liquid during periods in which the Enterprises are experiencing liquidity pressure. While it is appropriate for FHFA to raise these concerns and consider them in developing a liquidity framework for the Enterprises, the *complete exclusion* of agency MBS and agency MBS repo from the universe of high quality, liquid assets – and therefore from consideration in the proposed 30-day liquidity requirement – represents a significant overstatement of the liquidity risks they carry.

In the preamble to the proposed rule, FHFA notes that agency MBS have exhibited strong levels of liquidity and large trading volumes. Agency MBS also feature other characteristics of high quality, liquid assets, such as a diverse set of active buyers and sellers, as well as tight bid-ask spreads. Indeed, the agency MBS market is second in size only to the U.S. Treasury market among fixed-income markets, and it historically has been well supported by a broad range of participants through all parts of the credit cycle.

Because of these indicators of deep liquidity, agency MBS are considered allowable assets for purposes of FHFA’s minimum liquidity requirements for non-depository servicers of Enterprise-backed single-family loans.<sup>6</sup> Agency MBS also are granted treatment as high quality, liquid assets under the Liquidity Coverage Ratio (LCR) for larger banks – the framework upon which the proposed short-term liquidity requirement for the Enterprises is based. In the final rulemaking implementing the LCR, the federal

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<sup>5</sup> FHFA, “Frequently Asked Questions: Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers,” January 2020. Available at: <https://www.fhfa.gov/Media/PublicAffairs/Documents/Servicer-Eligibility-FAQs-1302020.pdf>.

<sup>6</sup> FHFA, “Requirements for Enterprise Seller/Servicers,” January 2015. Available at: <https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/2015-FAQs.pdf>.

banking agencies concluded that agency MBS are “highly liquid instruments that trade in deep and active markets.”<sup>7</sup>

Under the LCR, agency MBS are considered “Level 2A” assets that are subject to a 15 percent haircut and a 40 percent concentration limit.<sup>8</sup> These policies reflect the argument presented by FHFA in the proposed rule that Enterprise obligations should not be afforded the same treatment as U.S. Treasury obligations. FHFA relies on logic similar to that used by the federal banking agencies in developing the LCR, but FHFA proposes no credit for agency MBS under the Enterprise liquidity framework – as opposed to the 15 percent haircut applied by the federal banking agencies. While the consideration of “wrong-way” risk with respect to agency MBS is more applicable to the Enterprises than to banks, it does not justify such vastly different – and punitive – treatment of agency MBS in the Enterprise framework.

To better align these frameworks and acknowledge the deep liquidity of the agency MBS market, FHFA should include agency MBS and agency MBS repo in the set of assets that the Enterprises may rely upon to meet their new liquidity requirements. In doing so, FHFA could implement a haircut that is calibrated to the 15 percent haircut featured in the LCR, as well as a concentration limit that is calibrated to the 40 percent limit featured in the LCR, to address its stated concerns.

In the absence of this reasonable treatment under the Enterprise liquidity framework, FHFA would be making it more difficult for the Enterprises to satisfy the obligations of their charters and their mission to support the secondary market. FHFA also would be sending inappropriate signals to investors regarding the depth of the agency MBS market. While these securities do not maintain an explicit guarantee from the U.S. government, investors view the Enterprises’ guarantees as commitments that correspond to very low levels of credit risk on agency MBS. This dynamic leads to highly-liquid markets for agency MBS, and any perception that FHFA does not view agency MBS in this manner could reduce investor demand and lead to a self-fulfilling decline in liquidity. The lack of recognition of repo agreements secured by agency MBS is likely to reduce Enterprise participation in the repo market, as well. A pullback from repo lending by the Enterprises, in turn, would lead to reduced market liquidity and result in higher interest rates for borrowers.

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<sup>7</sup> Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, “Liquidity Coverage Ratio: Liquidity Risk Management Standards,” October 10, 2014, 79 FR 61439. Available at: <https://www.federalregister.gov/documents/2014/10/10/2014-22520/liquidity-coverage-ratio-liquidity-risk-measurement-standards>.

<sup>8</sup> Ibid.

As such, FHFA should amend the proposed rule to provide credit for agency MBS and agency MBS repo in the Enterprise liquidity framework, subject to potential haircuts or concentration limits as described above.

### **Treatment of Independent Mortgage Bank Counterparties**

Among the assumptions regarding Enterprise cash inflows and outflows under stressed conditions, the proposed rule would require the Enterprises to assume failure of each Enterprise's five largest non-depository (independent mortgage bank, or IMB) servicers to make timely payments of principal, interest, taxes, and insurance during the following month.

The proposed rule does not provide details regarding the scenario by which these IMB servicers fail to make timely payments in the same given month, but then repay these amounts the following month. FHFA instead focuses on the financial stress that IMB servicers can experience in periods of low market liquidity, citing both the financial crisis and the market volatility associated with the COVID-19 pandemic. It is not clear, however, that these events indicate a need for additional scrutiny of IMB servicers.

During the financial crisis, large depository and non-depository servicers alike became insolvent, and losses were driven primarily by non-agency securities backed by loans with risky product features that no longer are permitted. With respect to the COVID-19 pandemic, the early concerns regarding servicer liquidity did not translate into failures of servicers to make required advances on agency-backed loans. While the financial support provided to borrowers and certain actions by market regulators eased aggregate liquidity pressures, the ability of IMB servicers to raise capital and improve their liquidity positions during this period shows a level of resiliency that is not recognized in the proposed rule.

More broadly, FHFA should refrain from basing Enterprise financial requirements on the business models of Enterprise counterparties. This cash inflow assumption effectively forces the Enterprises to alter their liquidity risk management practices in response to the relative size of depository and IMB servicers at any given point. This assumption, for example, would have vastly different impacts on Enterprise liquidity risk management if the five largest IMB servicers were the Enterprises' five largest servicers relative to a scenario in which the five largest IMB servicers were outside the Enterprises' top twenty servicers.

The Enterprises, through FHFA, have put in place financial requirements for IMB servicers of Enterprise-backed single-family loans, which are meant to ensure adequate counterparty strength. It is unclear, therefore, why FHFA effectively would penalize the Enterprises for maintaining counterparty relationships with large IMBs – particularly when these IMBs are likely to be subject not only to the financial

requirements imposed by FHFA and the Enterprises, but also heightened financial and stress testing requirements by Ginnie Mae (and, in some cases, state regulators). This assumption is misaligned with other FHFA requirements regarding counterparty exposures, as well. A notable example is the annual requirement in the Enterprise stress tests to assume the failure of each Enterprise's largest counterparty – regardless of business model.

If FHFA seeks to ensure the Enterprises' capacity to manage large counterparties defaulting on their obligations, it should amend the proposed rule to assume the failure of the Enterprises' largest servicers without consideration of these servicers' business models. Because the proposed requirement could lead to widely different outcomes depending on the relative sizes of the largest depository and IMB servicers, FHFA should reduce the number of failed counterparties in this assumption, but focus on the largest counterparties at any point in time. Under this construct, the proposed rule may only require the assumed failure of the top two or three servicers in order to provide the same level of protection against Enterprise liquidity risk.

### **Further Information Regarding Previously-Implemented Liquidity Requirements**

In the preamble to the proposed rule, FHFA describes the existing liquidity risk management framework to which the Enterprises are subject. This framework includes 2009 supervisory guidance from FHFA regarding short- and medium-term liquidity requirements, as well as measurement of cumulative net daily cash needs. This guidance was adopted by the Enterprises as board liquidity risk limits. FHFA further notes its Prudential Management and Operations Standards and its regulation related to Enterprise corporate governance as part of the framework for Enterprise liquidity risk management. A 2018 FHFA advisory bulletin also details expectations regarding Enterprise corporate governance, cash-flow projections, stress testing, and measurement of liquidity needs.

FHFA goes on to describe the minimum liquidity requirements in the proposed rule as "more conservative than the Enterprises' existing board risk limits."<sup>9</sup> The only additional information provided is FHFA's acknowledgement that the proposed rule provides more defined quantitative thresholds and adds certain assumptions involving stressed cash inflows and outflows, effectively requiring that certain outflows be prefunded with liquid assets.

In their investor reporting for the second quarter of 2020, both Enterprises disclosed that FHFA in June 2020 directed them to comply with new liquidity requirements to take effect in September 2020. Fannie Mae described the four components of these

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<sup>9</sup> 86 FR 1309.

requirements, which mirrored the four components of the proposed rule.<sup>10</sup> Fannie Mae went on to note that “FHFA’s directive requires us to hold more liquid assets than are required under our current metrics” and that “we will in the future be required to hold more liquidity than we would have under our current framework, which we expect will negatively impact our net interest income.”<sup>11</sup> Freddie Mac similarly noted that the “updated liquidity guidance is more stringent than our existing liquidity requirements and liquidity requirements of banks and other depository institutions, which could result in higher funding costs in the future and may negatively affect our net interest income.”<sup>12</sup>

It is unclear, based on the information provided in the proposed rule, how and to what magnitude the minimum liquidity requirements in the proposed rule differ from the Enterprise liquidity framework in place prior to 2020, as well as from the new requirements instituted by FHFA in 2020. FHFA does not, for example, provide analysis regarding the expected impact of the proposed rule on Enterprise liquidity during stressed periods or on Enterprise net interest income or profitability. FHFA also does not provide information regarding changes to the Enterprises’ actual liquidity positions following implementation of its 2020 directive. If the requirements in the 2020 directive were indeed similar (or perhaps identical) to those in the proposed rule, public stakeholders should understand the Enterprises’ experiences under this new regime before it is codified through rulemaking.

More broadly, the lack of data, information, and analysis presented by FHFA makes it difficult for commenters to evaluate the practical impact of the proposed rule on the Enterprises’ safety and soundness, as well as their ability to serve the market at all points in the credit cycle. Prior to the issuance of a final rule, FHFA should supplement the proposed rule with such data, information, and analysis to allow commenters the opportunity to base their recommendations on a more detailed understanding of its expected effects.

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<sup>10</sup> These four requirements were described in broad terms in the Fannie Mae quarterly filing, so it is unknown whether there are differences between the 2020 requirements and those detailed in the proposed rule.

<sup>11</sup> Fannie Mae, “Form 10-Q, for the Quarterly Period Ended June 30, 2020,” July 30, 2020. Available at: <https://www.fanniemae.com/media/35286/display>.

<sup>12</sup> Freddie Mac, “Form 10-Q, for the Quarterly Period Ended June 30, 2020,” July 30, 2020. Available at: <http://www.freddiemac.com/investors/financials/sec-filings.html>.

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Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Dan Fichtler, Associate Vice President of Housing Finance Policy, at (202) 557-2780 or [dfichtler@mba.org](mailto:dfichtler@mba.org).

Sincerely,

A handwritten signature in black ink, appearing to read "R. Broeksmit", with a stylized flourish at the end.

Robert D. Broeksmit, CMB  
President and Chief Executive Officer  
Mortgage Bankers Association