Fannie Mae®

January 12, 2024

By Electronic Delivery

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064-AF29)
Federal Deposit Insurance Corporation
550 175h Street NW
Washington, DC 20429

Re: OCC Docket ID OCC-2023-0008; Docket No. R-1813, RIN 7100-AG64; RIN 3064-AF29
Regulatory Capital Rule: Large Banking Organizations and
Banking Organizations with Significant Trading Activity

To Whom It May Concern:

Fannie Mae appreciates the opportunity to comment on the above-captioned proposal by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, the "Agencies") to revise the capital requirements applicable to U.S. banking organizations ("Proposed Rule").[1] Appropriately sized and risk-sensitive capital standards for banking organizations are critical to ensuring the stability of the entire financial system, including the residential mortgage market.

Below, Fannie Mae recommends three modifications to the Proposed Rule that we believe would better align the new capital requirements with the risks that certain securities issued by Fannie Mae and Freddie Mac (the "Enterprises") and other market participants present. These modifications would:

[1] 88 Fed. Reg. 64,028, Sept. 18, 2023.

- Reduce the risk weight for exposures to certain credit risk transfer securitizations to account for their unique risk-mitigating features;
- Reduce the market price volatility haircuts for GSE debt securities; and
- Treat Uniform Mortgage Backed Securities ("UMBS") issued by either Fannie Mae or Freddie Mac as interchangeable for purposes of calculating credit spread risk sensitivities for non-securitization positions and correlation trading positions.

I. The Risk Weight For Certain Credit Risk Transfer Securitizations Should Be Reduced

The Agencies propose a new formula for risk-weighting securitization exposures -- the securitization standardized approach ("SEC-SA"). The Agencies also propose a number of exceptions to the SEC-SA to account for certain securitization exposures with unique features and avoid inconsistent outcomes. Fannie Mae appreciates the Agencies' recognition that the proposed SEC-SA would distort the calculation of risk-weighted assets ("RWA") for certain securitization exposures and supports the Agencies' proposal to provide exceptions.

With the support and leadership of the Federal Housing Finance Agency ("FHFA"), Fannie Mae and Freddie Mac each have credit risk transfer ("CRT") securitization programs to transfer credit risk through the issuance of securitizations: Fannie Mae issues Connecticut Avenue Securities® ("CAS") and Freddie Mac issues Structured Agency Credit Risk ("STACR®") securities (collectively, "Enterprise CRT Securitizations"[2]). The proposed SEC-SA formula – like the current standardized supervisory formula approach ("SSFA") – does not have the flexibility to include inputs to account for the structure and features of Enterprise CRT Securitizations that reduce risks for investors of the most senior offered tranches. As a result, almost all tranches of Enterprise CRT Securitizations receive the highest risk weight. Furthermore, on a comparative basis, each tranche of Enterprise CRT Securitizations generally receives the same or higher risk weight as tranches with similar seniority of other securitizations that pose higher risks to investors.

Fannie Mae believes that, applying the SSFA, excessive capital charges have impeded the ability of some banking organizations to act as market-makers for Enterprise CRT Securitizations, thus limiting liquidity for and increasing dealer concentration in this important market. We are concerned that application of the proposed SEC-SA to Enterprise CRT Securitizations would similarly dissuade dealer participation by banking organizations, resulting in upward pressure on spreads and increased dealer concentration risk, and potentially impacting the Enterprises' ability to transfer risk. Accordingly, we recommend the Agencies account for the risk-mitigating features of Enterprise CRT Securitizations and similar securitizations, either by adding inputs to the SEC-SA or by providing an additional exception.

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[2] Fannie Mae and Freddie Mac also transfer mortgage credit risk through CRT programs that do not involve securitization exposures, such as Fannie Mae's Credit Insurance Risk Transfer™ ("CIRT™") program. In CIRT deals, credit risk transfer is accomplished through insurance contracts and no securities are issued. Banking organizations do not issue the insurance coverage.

A. **Proposed SEC-SA**

The preamble to the Proposed Rule states that the SEC-SA is "substantially similar to the SSFA" with some specific proposed changes.[3] The preamble also states, "[s]ecuritization exposures sometimes contain unique features that, if not accounted for, could produce inconsistent outcomes under the SEC-SA or in some cases make the calculation of the risk weight inoperable."[4] Accordingly, the Agencies propose a number of "additional approaches" (i.e., exceptions) "to account for certain types of securitization exposures, which would more appropriately align the capital requirement with the risk of the exposure."[5]

One proposed exception applies to non-performing loan ("NPL") securitizations, which the Agencies put forward because "the proposed SEC-SA may be inappropriate for the unique risks of such exposures."[6] The Agencies state that using the SEC-SA to determine the RWA for these exposures would result in a capital requirement that does not reflect the "nonrefundable purchase price discount," which is the difference between the unpaid principal balances ("UPBs") on the underlying nonperforming mortgages transferred into the securitization special purpose entity ("SPE") and the price at which the originating banking organization sold these mortgages to the securitization SPE.[7] By treating this difference as additional credit enhancement for the securitization, the Proposed Rule would alter the attachment and detachment points required to be used in the SEC-SA, thereby lowering the RWA for the exposure.[8]

Fannie Mae supports this exception and believes it will facilitate the transfer of NPLs off of bank balance sheets, which will free up those institutions to increase lending to consumers and businesses and to make markets in private label mortgage and other securitizations. Furthermore, this exception will facilitate banking organizations acting as dealers in NPL securitizations because they would need to hold less capital for these trading assets than would otherwise have been required. We compare the impact of this exception on NPL Securitizations to the SEC-SA treatment of Enterprise CRT Securitizations below.

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[3] 88 Fed. Reg. at 64,069.

[4] *Id.* at 64,071.

[5] *Id.*

[6] *Id.* at 64,072. The Proposed Rule defines NPL securitization as: "a traditional securitization, or a synthetic securitization, that is not a resecuritization, where parameter W … for the underlying pool is greater than or equal to 90 percent at the origination cut-off date and at any subsequent date on which assets are added to or removed from the pool due to replenishment or restructuring." *Id*. at 64,185 (proposed § ___.101). A loan is included in the *W* parameter when it meets any of the following adverse performance criteria: 90 days or more past due, subject to bankruptcy or insolvency proceeding, in the process of foreclosure, held as real estate owned, has contractually deferred interest payments for 90 days or more, or is in default. *Id*. at 64,212-213 (proposed § ___.133(b)(1)).

[7] *Id*. at 64,073.

[8] *Id.* at 64,072-64,073.

B. **Enterprise CRT Securitizations**

FHFA has long expected the Enterprises to engage in CRT activities with a view to reducing future reliance on the government's financial support of the Enterprises. As FHFA observed in 2022: "Since the CRT programs were implemented in 2013, CRT transactions have reduced the systemic risk posed by the Enterprises, protected taxpayers from potentially large credit-related losses, increased secondary market liquidity, and promoted market stability by distributing credit risk broadly across the global financial system."[9]

Fannie Mae and Freddie Mac partner with private sources of capital to transfer mortgage credit risk through CAS and STACR securitizations, respectively. The Enterprises and investors in these securities recognize the importance of broad and liquid markets, and the critical role banks play in their capacity as market-makers. By facilitating the flow of private capital between lenders and a diverse group of investors, Enterprise CRT Securitizations provide an opportunity to invest in a portion of the mortgage credit risk that the Enterprises retain when they issue guaranteed single-family mortgage-backed securities. Through the end of 2023, Fannie Mae has transferred a portion of the credit risk to private investors on over $2.1 trillion in single-family residential real estate loans that we acquired.[10]

A typical CAS or STACR securitization references a pool of residential real estate loans that meet the Enterprises' respective seller and servicer requirements and loan eligibility standards under the terms established in their respective selling guides. Each reference pool of loans is divided into tranches, which are entitled to monthly interest based on their respective class coupons and are allocated principal payments and losses based on the loan performance of the underlying reference pool and

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[9] Fact Sheet: Final Rule to Amend the Enterprise Regulatory Capital Framework, Feb. 25, 2022, available at https://www.fhfa.gov/Media/PublicAffairs/Documents/Fact-Sheet-Final-Rule-CRT_2252022.pdf. *See also* Federal Housing Finance Strategic Plan 2022-2026, Apr 14, 2022, available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA_StrategicPlan_2022-2026_Final.pdf (A means for achieving FHFA objective 1.3, which is to "preserve and conserve Enterprise assets while managing the conservatorships," is to "[r]equire the Enterprises to transfer a significant amount of credit risk to private investors").

Members of Congress also support Enterprise CRT Securitization. *See, e.g.*, "Housing in America: Oversight of the Federal Housing Finance Agency,"117th Cong. (July 20, 2022) (comments of Rep. Barr (R-KY), complimenting Director Thompson for recalibrating the enterprise regulatory capital framework to enable more credit risk transfers and asking what specifically FHFA was doing "to ensure that the enterprises continued to … shed this risk to private markets through a variety of executions and counterparties to help limit taxpayer risk"); "Prioritizing Fannie's & Freddie's Capital over America's Homeowners & Renters? A Review of the Federal Housing Finance Agency's Response to the COVID-19 Pandemic," 116th Cong. (Sept. 16, 2020) (Rep. Luetkemeyer (R-MO): "[I]n my opinion, CRT has been one of the biggest successes of conservatorship by reducing the concentration of mortgage credit risk at the GSEs."); Letter dated June 10, 2015, to FHFA Director Melvin L. Watt from U.S. Sens. Mark R. Warner (D-VA), Bob Corker (R-TN), Heidi Heitkamp (D-ND), Mike Crapo (R-ID), Jon Tester (D-MT) and Dean Heller (R-NV) (asserting that "the Enterprises should maximize the types of credit risk transfer structures that are tested").

[10] *See* Fannie Mae Press Release, Fannie Mae Prices $609 Million Connecticut Avenue Securities (CAS) REMIC Deal, Nov. 17, 2023, available at https://www.fanniemae.com/newsroom/fannie-mae-news/connecticut-avenue-securities-2023-r08-deal.

priority of payments. Fannie Mae typically offers investors three to four classes with the detachment points approximating the following in recent CAS securitizations: B-2 class is at or below 1.55 percent, B-1 class is at or below 2.75 percent, M-2 class is at or below 3.80 percent, and M-1 class is at or below at 5.30 percent. Fannie Mae generally retains the most junior class (first loss risk) and a vertical slice of all offered classes to ensure aligned interest with investors. We also retain the most senior class (catastrophic risk), which is typically approximately 95 percent of the UPB of the reference pool.

We highlight below features of Fannie Mae's CAS that improve outcomes for investors yet are not inputs in either SSFA or the proposed SEC-SA. While described in the context of Fannie Mae's CAS program, these features are common to all Enterprise CRT securitizations.

- *CAS securitization transfers only the credit risk for residential real estate loans in the reference pool.* While Fannie Mae transfers credit risk to CAS investors, certain other risks associated with the residential mortgage loans in the reference pool are not transferred. For example, Fannie Mae retains the risk that lenders may have breached representations and warranties on the underlying loans. In addition, Fannie Mae does not pass on losses resulting from the inability of mortgage insurers to meet their payment obligations.

  In current CAS securitizations, the proceeds from the issuance of the CAS notes are deposited into a bankruptcy-remote trust account. Amounts in the trust account are invested in government money market funds. Each month, the trustee withdraws amounts from the trust account to pay Fannie Mae any amounts due to it for losses incurred on loans in the reference pool in excess of the first loss position retained by Fannie Mae and to pay principal due on the notes. To the extent there are losses on the mortgage loans in the reference pool in excess of the first loss position, the principal balance of the CAS notes is reduced, thus transferring those losses from Fannie Mae to holders of the CAS notes. Monthly interest on the notes is paid from a combination of earnings on investments in the trust account and periodic credit protection payments from Fannie Mae to the issuing trust. If Fannie Mae ever defaulted under the CAS securitization documents, the amounts in this trust account would be available to repay the principal amount of the CAS securities held by CAS investors.

- *CAS securitizations have a sequential payment structure that results in faster pay offs than other securitization payment structures.* CAS securitizations have a sequential payment structure for the offered classes based on seniority. Principal payments are first allocated pro rata between senior and subordinate notes, then are applied sequentially to the subordinate notes starting with the M-1 class. This typically results in a weighted average life ("WAL") of less than two years for the M-1 offered class and less than five years for the M-2 offered class.[11] All of the M-1 classes have paid off for CAS notes issued through 2020, and all of the M-2 classes have either paid off or are currently paying down for CAS issued through 2020. This payment structure contrasts with other private label residential mortgage-backed securitizations in which principal payments are first allocated to the

[11] WALs for the securitizations discussed in this bullet are determined using multiple factors, including the pricing speed of each securitization and running the bond to maturity.

senior notes, prior to any principal allocation to the subordinated notes.[12] As a result, the senior-most subordinate notes in those deals have WALs of seven to nine years and the other subordinate notes have WALs that are even longer.

- *Strong credit quality of residential real estate loans in reference pool.* Reference pools for CAS securitizations are made up of fully-documented and fully-amortizing 30-year fixed rate residential real estate loans with either loan-to-value ("LTV") ratios of between 60 and 80 percent or LTV ratios between 80 and 97 percent where each mortgage loan was covered by private mortgage insurance (i) as of the cut-off date for the transaction or; (ii) at the time of acquisition, which subsequently either terminated as required by law or cancelled as permitted by law and Fannie Mae's Servicing Guide.[13] In addition, the mortgage loans in CAS reference pools generally have average debt-to-income ("DTI") ratios of less than 40 percent and average FICO scores of 750, though the DTI ratios and FICO scores for individual loans may vary from these averages. They also all meet the definition of Qualified Mortgage ("QM"), under the Ability to Repay regulations of the Consumer Financial Protection Bureau.[14]

- *Enterprises' origination and servicing standards and ongoing monitoring measures are protective.* The Enterprises have long-established mortgage originator and servicer oversight standards and processes. Fannie Mae requires sellers to represent and warrant that residential real estate loans meet our extensive underwriting guidelines and credit policies. Fannie Mae also requires its servicers to follow comprehensive servicing guidelines, and servicers are subject to ongoing review. For example, Fannie Mae's Servicer Total Achievement and Rewards ("STAR") program assesses servicers' performance and compliance through monthly credit risk metric scorecards and annual operations reviews.

- *Deep granularity and geographic diversity of reference pool.* The reference pool of a CAS securitization has tens of thousands of loans and the aggregate UPB amounts of underlying residential real estate loans is measured in the multiple billions of dollars, whereas other private label mortgage-backed securitizations often have less than 1,000 loans with aggregate UPBs of $300 to $500 million. As a result, there is significantly more geographic diversification in a CAS securitization. Loans with mortgages on properties in the top five states of the reference pool typically represent between 35 percent and 45 percent of the reference pool. Contrast this with other real estate securitizations in which the concentration from the top five states often is significantly

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[12] Some private label securitization payment structures provide for small amounts of principal payments to subordinate bondholders in an initial period when more senior bondholders are still receiving payments.

[13] A reference pool may contain some loans with amortization periods of between 20 and 30 years. Under Fannie Mae's High LTV Refinance program, certain loans that are refinanced may remain part of the reference pool despite having LTV ratios that differ from these and may or may not have private mortgage insurance. Also, in the case of certain mortgage loans secured by mortgaged properties in the State of New York, private mortgage insurance at the time of acquisition is not required under Fannie Mae's Selling Guide.

[14] *See* 12 C.F.R. § 1026.43.

higher. Moreover, Fannie Mae publishes historical performance on loans it has acquired dating back more than 20 years, which provides investors with unparalleled performance information.[15]

C. **Comparison of Enterprise CRT Securitizations to Other Private Label Securitization**

An objective way to compare securitizations is to evaluate over time how securities issued in different tranches are priced relative to an underlying benchmark. For example, Enterprise CRT is priced at a spread in excess of the secured overnight financing rate ("SOFR").[16]

Fannie Mae compared the pricing spreads for Enterprise CRT Securitizations to the pricing spreads for private label securitizations not issued by the Enterprises or Ginnie Mae and comprised mostly of non-QM loans ("Non-QM PLS") issued during similar time periods since 2019. We compared tranches as follows:

- The senior-most of the mezzanine and subordinate bonds for the CAS deals, STACR deals, and Non-QM PLS deals;
- The second-most senior of the mezzanine and subordinate bonds for the CAS deals, STACR deals, and Non-QM PLS deals; and
- The third-most senior of the mezzanine and subordinate bonds for the CAS deals, STACR deals, and Non-QM PLS deals.

After taking into account differences in structures and features of Enterprise CRT securitizations and Non-QM PLS, we determined that the pricing spreads for Enterprise CRT Securitizations were significantly tighter.[17] For both CAS and STACR, the pricing spreads for the M1 tranches were, on average, more than 100 basis points lower than the pricing spreads for the most senior mezzanine and subordinate tranches of Non-QM PLS.

Institutional investors that purchase Enterprise CRT and other private label securitizations are effective at determining the relative quality of different types of securitizations. The fact that Enterprise CRT Securitizations are consistently issued at spreads to benchmarks that are significantly

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[15] *See* Data Dynamics site available at http://www.fanniemae.com/DataDynamics.

[16] Prior to SOFR and until 2023, Enterprise CRT Securitizations were compared to the London Interbank Offered Rate ("LIBOR").

[17] Enterprise CRT Securitizations have lower attachment and detachment points than the Non-QM PLS we compared because the Non-QM PLS have more credit enhancement. All things equal, this would result in lower risk weights for the Non-QM PLS. However, Enterprise CRT Securitizations deals have higher credit quality collateral than Non-QM PLS, which generally have a high percentage of limited documentation loans, and may include a small percent of delinquent or previously delinquent loans at the time of issuance. This results in a higher K_G for Non-QM PLS, which, all else equal, would result in higher risk weights. Enterprise CRT Securitizations have higher credit quality collateral and generally have comparable or better credit ratings. For the second-most senior grouping that we compared, many of the Enterprise CRT Securitizations have investment grade ratings (BBB or BBB-) whereas many of the Non-QM PLS are non-investment grade (BB rated).

tighter, or lower, than the spreads of Non-QM PLS issued during similar time periods demonstrates that they view Enterprise CRT Securitizations to be of higher quality and lower risk than Non-QM PLS. This trend of institutional investor behavior, in our view, is attributable to the risk-mitigating features of CRT securitizations discussed above. However, these features are not inputs in either SSFA or the proposed SEC-SA.

D. Capital Treatment of Enterprise CRT Securitizations and Recommendation

Under current SSFA and the proposed SEC-SA, most classes of Enterprise CRT Securitizations that are offered to investors, except for the most senior offered classes, receive the highest risk weight of 1,250 percent. The K_G input under both SSFA and SEC-SA is the weighted average capital requirement associated with the underlying exposures, which would be the reference pool of residential real estate loans in Enterprise CRT Securitizations. The Proposed Rule would require residential real estate loans with LTV ratios of 60 percent or higher to receive risk weights of at least 50 percent.[18] Since reference pools for Enterprise CRT Securitizations are made up exclusively of loans with LTV ratios at origination ("original LTV") of more than 60 percent, the risk weight for these loans would be at least 50 percent. The weighted average risk weight for each offered class would have a K_G input in the proposed SEC-SA of at least 0.04.[19] Thus, any tranche that has a detachment point of 4 percent or below, i.e., the bottom 4 percent of the securitization structure, would receive the highest risk weight of 1,250 percent.

For example, a CAS securitization that could be considered typical has a reference pool that contains $20 billion in UPB of residential real estate loans with original LTV ratios between 60 and 80 percent and detachment points of 1.55 percent (B-2 class), 2.60 percent (B-1 class), 3.75 percent (M-2 class) and 5.3percent (M-1 class). As discussed above, the risk weights of the underlying loans would be at least 50 percent, the K_G input under the SEC-SA for each offered class in the securitization would be at least 0.04, and any offered class with a detachment point of less than or equal to 4 percent would receive a 1,250 percent risk weight. Thus, in this example, only the M-1 class would receive a risk weight of less than 1,250 percent, and even for that class, the risk weight would exceed 1,000 percent.

By way of comparison, the attachment and detachment points for the subordinate tranches of a non-GSE private-label mortgage securitization backed by prime jumbo mortgage loans would be similar to the attachment and detachment points for a CAS securitization, while the attachment and detachment points for a Non-QM PLS deal would be higher. Thus, the Non-QM PLS risk weights would be comparable to, or somewhat lower than, the CAS risk weights. Yet Non-QM PLS have credit parameters that pose higher risks to investors than CAS securitizations. The expected pay off time for the most senior of the subordinate tranches can be more than seven years due to the senior/subordinate payment structure, the pools have far less geographic diversification and size, and the credit quality of the underlying loans varies. Moreover, the loans are not subject to the same lending, servicing, and loss mitigation standards as the loans that are in the reference pools of CAS securitizations. However, these differences ultimately are not accounted for in the RWA calculation.

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[18] *See* 88 Fed. Reg. at 64,190 (proposed Table 5 to § ___.111—Risk Weights for Regulatory Residential Real Estate Exposures Not Dependent on Real Estate Cash Flows).

[19] This calculation is done by taking the 50 percent risk weight on the underlying asset and dividing it by 1,250 percent, the highest risk weight to be assigned under both the SSFA and the SEC-SA.

As another point of comparison, under the Proposed Rule, classes of NPL Securitizations would receive lower risk weights than comparable tranches of CAS securitizations. A hypothetical deal structure for an NPL Securitization could be a pool of mortgage loans with an aggregate UPB of $100 million sold to a special purpose entity at a price of $50 million. The securitization has two offered classes, a senior tranche and an equity tranche. Assume the attachment point for the equity tranche would be 0 percent and the detachment point would be 20 percent. For the senior tranche, the attachment point would be 20 percent and the detachment point would be 100 percent. Applying the proposed exception to the SEC-SA, those amounts would rise to an attachment point of 50 percent and a detachment point of 60 percent for the equity tranche and the attachment point for the senior tranche would rise to 60 percent. Thus, the risk weight for the senior tranche would be 100 percent and the risk weight for the equity tranche – the first tranche in the securitization exposed to losses – would be approximately 1,000 percent.[20] Moreover, the underlying loans are non-performing and generally seriously delinquent.[21] Contrast this with the high credit quality performing loans in the reference pools of CAS securitizations.

Fannie Mae believes that the risk weights for securitizations like Enterprise CRT Securitizations are excessive and that the SEC-SA should account for the risk-mitigating features discussed above. We are concerned that the SEC-SA requires a banking organization to hold the same amount or somewhat more capital for securitizations of mortgage loans that are expected to experience lower losses than for comparable loan securitizations expected to experience higher losses. Thus, we recommend the Agencies either add inputs to the SEC-SA to account for these features or provide an additional exception to the application of the SEC-SA.

One option Fannie Mae recommends is modifying the K_G input and the p supervisory calibration parameter of the SEC-SA for Enterprise CRT Securitizations and securitizations with similar risk-mitigating features. As discussed above, an investor in an Enterprise CRT Securitization acquires the credit risk of the underlying reference pool but does not take on the administrative risk that accompanies the underlying exposures, such as the risk that lenders will breach underwriting representations and warranties they made on the underlying loans or that servicers will not remit principal and interest payments on loans. Consequently, we believe a lower K_G is warranted, especially when also considering the quality of loans in the reference pool, the strong, longstanding Enterprise oversight of sellers and servicers, and the sequential payment structure of Enterprise CRT Securitization tranches. We urge the Agencies to consider revising the SEC-SA so that risk weights of 1,250 percent would apply only for those offered classes with detachment points below 2.4 percent. We believe this would be a conservative estimate, even under the internal ratings-based and advanced approaches in the Agencies' current capital regulations, and would reduce risk weights for the more senior offered classes to values more commensurate with their risk profiles. In the CAS securitization example above, the B-1 and B-2 classes would still receive risk weights of 1,250 percent, or close to that amount, but lower risk weights would apply for both the M-1 and M-2 classes – not just the M-1 class.

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[20] RWAs are calculated using the SEC-SA formula, W of 90 percent, *p*-factor of 1.0, $100 million pool UPB, $40 million senior tranche, and $10 million equity tranche.

[21] For the proposed NPL Exception to apply, at least 90 percent of the loans in the reference pool must meet adverse credit criteria.

We also recommend that the *p* parameter be set to 0.25 for Enterprise CRT Securitizations and securitizations with similar risk-mitigating features. The *p* input in the SEC-SA formula is a supervisory calibration parameter that the Agencies propose to change for securitizations from 0.5 in the current SSFA to 1.0 in the SEC-SA. Essentially, the *p*-variable applies a capital surcharge for holding exposures as tranches of a securitization instead of holding the underlying exposures directly on balance sheet.

The Agencies say that this increase "would help to ensure that the framework produces appropriately conservative risk-based capital requirements when combined with the reduced risk weights applicable to certain underlying assets under that proposal that would be reflected in lower values of K_G and the proposed reduction in the risk-weight floor under SEC-SA for securitization exposures that are not resecuritization exposures."[22] Fannie Mae respectfully submits that these reasons do not apply to Enterprise CRT Securitizations. As discussed above, Fannie Mae limits residential real estate loans in reference pools to only those loans that have LTV ratios between 60 and 80 percent or between 80 and 97 percent where mortgage loans are covered by private mortgage insurance, as described above. Under the Proposed Rule, subordinate securitization exposures backed by these loans would receive higher, not lower, risk weights. Furthermore, no tranches of CAS securitizations would have risk weights low enough for risk weight floors to be triggered. Accordingly, Fannie Mae urges the Agencies not to increase the *p* parameter for Enterprise CRT Securitizations. Rather, we recommend that the Agencies *lower* the *p* parameter for these types of securitizations, at least for the most senior offered tranches. We note the European Union's provisional agreement on Basel III implementation sets a *p* factor of 0.25 for simple, transparent and standardized ("STS") securitizations, as compared to a *p* factor of 0.5 for non-STS securitizations.[23] Similarly, we believe a *p* input of 0.25 for Enterprise CRT Securitizations would be appropriate in light of the risk-mitigating features described above, which are not otherwise accounted for by the SEC-SA as proposed.

II. GSE Debt Securities Should Be Treated Differently Than Corporate Debt Securities For Purposes of the Market Price Volatility Haircuts

Under the Proposed Rule, banking organizations are permitted to recognize financial collateral as a credit risk mitigant, subject to new market price volatility haircuts. The Proposed Rule generally would increase existing market price volatility haircuts, which would have the effect of reducing banking organizations' recognition of the risk-mitigating benefits of financial collateral.

For debt securities that serve as financial collateral, different haircuts are prescribed based on residual maturity and the identity of the issuer under proposed Table 1 to § ___.121.[24] "Securities issued by a sovereign or an issuer described in § ___.111(b)" – which includes certain supranational entities and multilateral development banks ("MDBs") -- would receive lower haircuts than other debt securities. This category also would include public sector entities ("PSEs") that are treated as

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[22] 88 Fed. Reg. at 64,070.

[23] *See* Council of the European Union, Provisional agreement on the regulation on supervisory powers, sanctions, third-country branches, and environmental, social and governance risk (CRR), Dec. 4, 2023, p. 596, available at https://data.consilium.europa.eu/doc/document/ST-15883-2023-INIT/en/pdf.

[24] 88 Fed. Reg. at 64,206 (proposed Table 1 to § ___.121—Market Price Volatility Haircuts).

sovereigns by the national supervisor.[25] GSE debt and MBS would be treated the same as corporate investment grade issuances and receive higher haircuts, notwithstanding that GSE debt and MBS is of higher credit quality and has deeper liquidity in the market than corporate debt.

The proposed treatment of GSE debt and MBS in §___.121 is inconsistent with the treatment of GSE debt securities in other areas of the regulatory capital framework for U.S. banking organizations. Exposures to GSE debt receive lower risk weights than other general debt securities under the standardized approach for RWAs in the Agencies' current capital rules[26] and in the Proposed Rule.[27] Furthermore, GSE debt is distinguished from other corporate debt under the specific risk-weighting factor for calculating RWA for market risk,[28] as well the separate default risk weights that would apply to GSE debt positions under the proposed framework for default risk capital.[29] The Agencies' liquidity coverage ratio ("LCR") rule also assigns lower haircuts to GSE debt securities than to corporate or municipal debt securities.[30]

Accordingly, for purposes of market price volatility haircuts, Fannie Mae recommends that the GSEs be included in the same category as sovereigns, supranationals, MDBs and PSEs. This can be accomplished by revising the heading to the third column in Table 1 to § ___.121 to read, "Securities issued by a sovereign or an issuer described in § ___.111(b) **& (c)** (in percent)." We note that under this approach, GSE debt and MBS would still carry higher haircuts than securities issued by sovereigns and other entities that receive general risk weights of zero percent.[31]

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[25] *Id*. at 64,062, fn. 118. Fannie Mae recommends including this footnote, which appears in the preamble to the Proposed Rule, in §___.121 of the final rule text.

[26] *Compare, e.g.,* 12 C.F.R. § 3.32(c)(1) (20 percent risk weight for an exposure to a GSE, other than an equity exposure or preferred stock) *with id*. § 3.32(f)(1) (100 percent risk weight for corporate exposures, other than certain qualifying central counterparty exposures).

[27] *See* 88 Fed. Reg. at 64,188 and 64,192 (proposed § ___.111 (c) and (h)).

[28] *See, e.g.,* 12 C.F.R. § 3.202 (excluding GSEs from the definition of "corporate debt position").

[29] *See* 88 Fed. Reg. at 64,264 (proposed Table 1 to § ___.210, Default Risk Weights for Non-Securitization Debt or Equity Positions by Credit Quality Category).

[30] A security issued by (or guaranteed as to the timely payment of principal or interest by) an Enterprise that is investment grade generally is treated as a level 2A liquid asset under the LCR. By contrast, an investment grade corporate debt security is treated as a level 2B liquid asset. Under the LCR, a 15 percent haircut is applied to level 2A liquid assets and a 50 percent haircut is applied to level 2B liquid assets. *See* 12 C.F.R. Parts 50 (OCC); 249 (Board); and 329 (FDIC). We also note that under the Federal Reserve's supervisory stress test methodology, MBS issued by an Enterprise are assumed not to be subject to credit losses, unlike securitizations by corporate and other nongovernmental entities. Federal Reserve, 2023 Stress Test Methodology, p. 54 (June 2023), available at https://www.federalreserve.gov/publications/files/2023-june-supervisory-stress-test-methodology.pdf.

[31] Under Table 1, column 2, exposures to issuers with risk weights of zero percent, like sovereigns, would carry a lower haircut than exposures to issuers with higher risk weights. Exposures to GSEs carry a risk weight of 20 percent under proposed § ___.111(c). 88 Fed. Reg. at 64,188.

III. The Final Rule Should Treat Fannie Mae UMBS And Freddie Mac UMBS As Interchangeable Under Proposed § ___.209

Fannie Mae and Freddie Mac issue UMBS that are eligible for trading in the to-be-announced ("TBA") market. UMBS is part of FHFA's Single Security initiative, which is intended to ensure both Fannie Mae UMBS and Freddie Mac UMBS are fungible for deliveries into a single TBA market. Previous to FHFA's Single Security initiative, the Fannie Mae TBA market was separate from the Freddie Mac TBA market. Today, given the fungibility of UMBS, market participants can deliver either a Fannie Mae UMBS or a Freddie Mac UMBS in a TBA trade, assuming the UMBS meets the other trade parameters, and the recipient of the security in that trade will accept either issuer's UMBS as good delivery.

The Agencies propose significant changes to market risk capital requirements for banking organizations, including a new standardized measure for calculating capital to be held against market risk, known as the sensitivities-based method. Proposed § ___.209 would prescribe aggregation formulas for calculating risk factors within risk buckets and across risk buckets.[32] The aggregation formulas would prescribe offsetting and diversification benefits via correlation parameters.

For two of the risk buckets -- credit spread risk for non-securitization positions and credit spread risk for correlation trading positions --the Agencies would treat UMBS as a separate name from Fannie Mae and Freddie Mac and apply a 35 percent intra-bucket correlation factor. The preamble to the Proposed Rule notes:

> In the [TBA] market, Freddie Mac and Fannie Mae securities are not interchangeable and would be treated as separate names under the proposal. As part of the single security initiative, UMBS allows for either Fannie Mae or Freddie Mac to deliver, thus creating the basis risk between the Enterprises for such securities. [33]

Question 124 in the preamble requests comments on the proposed 35 percent correlation factor for UMBS.[34]

Under the current bank capital framework, hedging UMBS with TBA securities requires minimal capital, as the positions are effectively interchangeable. The proposed 35 percent correlation factor would significantly reduce the effectiveness of hedging UMBS with TBA. Fannie Mae is concerned that this would negatively impact the depth and liquidity of the UMBS market and undermine the central purpose of UMBS and the Single Security initiative.

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[32] The Agencies explain in the preamble: "For each risk bucket, the proposed risk factors reflect the specific market variables that impact the value of a position. The risk factors are separately defined to measure their individual impact on market risk covered positions' value from small changes in the value of a risk factor (the movement in price (delta) and, where applicable, the movement in volatility (vega)), and the additional change in the positions' value not captured by delta for each relevant risk factor (curvature) in stress." 88 Fed. Reg. at 64,112.

[33] *Id.* at 64,123.

[34] *Id.* at 64,124.

Accordingly, Fannie Mae recommends that the Agencies treat Fannie Mae UMBS and Freddie Mac UMBS as interchangeable for purposes of applying the proposed framework for credit spread risk for non-securitization positions and correlation trading positions. This would be consistent with the treatment of mortgage pools that are UMBS-eligible and TBAs under the Agencies' proposed standardized default risk framework. In that context, the Agencies have observed, "As the single security initiative led by Fannie Mae and Freddie Mac has homogenized the mortgage pool and security characteristics for [UMBS], the proposal would allow the banking organization to fully offset [UMBS] that are issued by two different obligors."[35]

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If you have questions regarding the matters addressed in this letter, please contact the undersigned at chryssa_c_halley@fanniemae.com.

Sincerely,

Chryssa C. Halley

Chryssa Halley
Executive Vice President & Chief Financial Officer
Fannie Mae

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[35] *Id.* at 64,125.