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National Association of Federally-Insured Credit Unions

April 22, 2022

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

RE: Re-Proposal to Enhance Eligibility Requirements for Enterprise Single-Family Seller/Servicers

Dear Mr. Jones:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Federal Housing Finance Agency's (FHFA) re-proposal to enhance eligibility requirements for the government-sponsored enterprises' (GSEs) single-family seller/servicers. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 130 million consumers with personal and small business financial service products. NAFCU applauds the FHFA for considering the lessons learned from the COVID-19 pandemic and adjusting the proposal to include those lessons. NAFCU generally supports the proposal and its changes but recommends that the FHFA raise the capital ratio requirement to 10 percent and clarify some of the requirements for large non-depository seller/servicers.

General Comments

In this proposed rule, the FHFA explains that it largely relies on banking regulators' prudential capital and liquidity standards as financial requirements for the GSEs' depository counterparties. On the other hand, the FHFA must mitigate the risk presented by the GSEs' non-depository counterparties to promote stability and readiness for more challenging market conditions. Although a GSE seller/servicer must meet minimum financial requirements, these requirements do not suffice as measures of capital and liquidity adequacy. Consequently, the FHFA must impose more specific capital and liquidity requirements on its counterparties as part of its risk management process.

Non-depository financial institutions are not regulated by a prudential federal regulator but are subject to regulation by state supervisory authorities, which may vary state by state and may not include capital and liquidity standards. Non-depository financial institutions are not subject to safety and soundness examinations, but if they are large enough, may be subject to the supervisory authority of the Consumer Financial Protection Bureau (CFPB). Due to this under-regulation, non-depository financial institutions pose a systemic risk to the financial system, more specifically the secondary housing market.

Non-depository mortgage lenders and servicers play an important part in the housing finance system, especially in helping low- and moderate-income individuals obtain mortgage credit. But non-depository mortgage lenders also played a big part in the 2008 financial crisis that led to the Great Recession. Since that time, the number of non-depository mortgage companies has increased in number and in their share of mortgages originated and sold to the GSEs, consequently representing a greater risk to the housing finance system. For example, in 2020, the non-depository share of mortgage originations reached approximately 60 percent.[1]

The Financial Stability Oversight Council (FSOC) has expressed that many non-depository mortgage companies rely on short-term funding and therefore remain vulnerable to adverse market conditions.[1] Further, these non-depository mortgage companies do not have access to government backstops such as the Federal Reserve discount window and Federal Home Loan Bank system advances.

The business models of non-depository mortgage companies subject them to fragilities that credit unions and other depository financial institutions are typically not subjected to. As a result, these companies have a limited ability to absorb economic shocks. With inflation on the rise, financial institutions should be mitigating risks to ensure the health and stability of the housing finance system and protect taxpayers. In an economic downturn, a lack of capital and liquidity by non-depository mortgage lenders can have ripple effects in the secondary mortgage market. This would have negative consequences for not only non-depository institutions but also depository institutions like credit unions.

The 2021 FSOC annual report also stated that many mortgage companies have limited loss-absorbing capacity in the face of adverse economic shocks. Therefore, disruption to non-depository mortgage companies could interrupt mortgage servicing operations, especially for nonperforming loans. The FHFA should be collecting data from non-depository institutions to identify and mitigate risks in the instance of an economic downturn. A capital or liquidity shortfall at a large non-depository servicer could, in turn, impact the GSEs' cash flows and threaten the stability of the entire mortgage market.

A recent study by the Federal Reserve Board showed that non-depository mortgage companies' lack of liquidity affected borrowers during the pandemic. The study determined that non-depository mortgage companies were about 9 percentage points less likely to offer forbearance to a past-due borrower, while credit unions were about 13 percentage points more likely, which is consistent with a liquidity-based mechanism.[2] The same study explains the lower forbearance extension from non-depository mortgage companies as a deliberate strategy to address strained liquidity:

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[1] *2021 Financial Stability Oversight Council Annual Report*, https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf.
[2] Kim, You Suk, Donghoon Lee, Tess Scharlemann, & James Vickery, *Intermediation Frictions in Debt Relief:Evidence from CARES Act Forbearance*, Finance and Economics Discussion Series 2022-017, Washington: Board of Governors of the Federal Reserve System (2022), https://doi.org/10.17016/FEDS.2022.017.

> "At the start of the pandemic when most forbearance plans began, there were significant concerns about a nonbank liquidity crunch. By discouraging forbearance, nonbanks could induce borrowers to keep making their mortgage payments, thereby mitigating their liquidity outflows due to contractual obligations to forward mortgage payments on nonperforming loans."

This study shows that the risk of a liquidity shortfall affects borrowers who may need assistance most. This may unintentionally and disproportionately impact low- and moderate- income individuals and Black and brown borrowers. Liquidity for non-depository mortgage companies is important to the safety and soundness of the housing finance system as a whole as well as ensuring the continued reduction of the racial wealth gap, so NAFCU supports increased capital and liquidity requirements for these institutions.

Tangible Net Worth

The tangible net worth requirements are the only requirements in this proposal that apply to both depository and non-depository institutions. The proposal modifies the definition of tangible net worth by subtracting deferred tax assets since a company cannot realize the value of a deferred tax asset as a source of capital when experiencing losses during a period of financial stress. The proposal further establishes an incremental tangible net worth requirement that distinguishes between Ginnie Mae and GSE servicing, proposing a higher incremental charge of 35 basis points (bps) for Ginnie Mae servicing because it reflects the higher cost and risk associated with servicing Ginnie Mae portfolios.

Of the small number of credit unions that service Ginnie Mae loans, they are generally larger credit unions and will not be materially impacted by the 10 bps increase. In terms of sharing counterparty risk, increasing the net worth requirements will not make a substantial difference for larger credit unions either. The enhanced net worth standards for both depository and non-depository institutions may level the playing field for credit unions, as it will enhance standards for risky non-depository mortgage lenders. These newly proposed tangible net worth requirements may have a larger impact on smaller credit unions, but those institutions that are small enough to be impacted are not servicing Ginnie Mae loans. As a general matter, NAFCU supports heightened standards for riskier portfolios serviced by non-depository mortgage lenders and appreciates the FHFA's acknowledgment of this risk to the housing market.

Capital Ratio

NAFCU applauds the FHFA for recognizing the need for a capital ratio requirement for non-depository seller/servicers. The proposal requires that all non-depository seller/servicers maintain a capital ratio so that their tangible net worth is not less than 9 percent of their total assets, a 3 percent increase from the current requirements. The FHFA determined that raising this requirement will mitigate the GSEs' counterparty risk exposure to non-depository institutions. A 9 percent capital ratio requirement matches that of the Community Bank Leverage Ratio (CBLR). The FHFA explains that the CBLR provides a reference point to set a more meaningful capital ratio threshold that will not unduly burden smaller non-depository seller/servicers, but ignores the

fact that the CBLR is only available for community banks under $10 billion in assets. To set a capital ratio threshold for all non-depository seller/servicers at 9 percent, regardless of their asset size, is nonsensical, especially considering the CBLR was designed specifically as an off-ramp for banks supervised by the Federal Deposit Insurance Corporation (FDIC) and subject to capital planning oversight, and includes additional qualifying criteria in addition to the 9 percent leverage ratio requirement.[3]

As further comparison, federally-insured credit unions are subject to the NCUA's risk-based capital (RBC) requirements[4], which are comparable to the risk-based capital regulations applicable to banks. The NCUA has provided credit unions with an alternative mechanism for demonstrating risk-based capital adequacy, which consists of a simplified net worth calculation. This approach is called the Complex Credit Union Leverage Ratio (CCULR)[5], and it is similar to the CBLR.

However, the CCULR targets a minimum ratio for credit union *net worth*, which is distinguishable from common equity tier 1 capital insofar as it excludes stock (which credit unions cannot issue) and generally consists of higher quality retained earnings. Complex credit unions that meet certain qualifying criteria, including a net worth ratio of at least 9 percent, are regarded as well capitalized under the CCULR framework and avoid the administrative burden of calculating an RBC ratio as described in the 2015 RBC rule. Credit unions that choose to calculate a risk-based capital ratio (or must because they are ineligible to use the CCULR) must maintain a 10 percent risk-based capital ratio to be regarded as adequately capitalized. Complex credit unions are currently subject to the NCUA's RBC rule.

But non-depository seller/servicers and community banks and credit unions are not created equal. The primary distinction between community banks and credit unions versus non-depository institutions is federal insurance and federal safety and soundness supervision and examinations. Non-depository financial institutions should have higher capital requirements than community banks, insured by the FDIC, and credit unions, insured through the National Credit Union Share Insurance Fund. Non-depository, uninsured financial institutions pose higher risks to the financial system, warranting higher capital requirements to protect the financial system and American taxpayers. Therefore, NAFCU urges the FHFA to revise the proposed rule to raise the capital ratio requirement to match Ginnie Mae's new proposed risk-based capital ratio requirement of 10 percent.

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[3] *See e.g.*, 12 CFR § 324.122 (bank capital plan requirements). The CBLR requires qualifying community banking organizations to limit their off-balance sheet exposures to 25 percent or less of consolidated assets. *See* Community Bank Leverage Ratio Framework, Regulatory Capital Rule: Temporary Changes to and Transition for the Community Bank Leverage Ratio Framework (Oct. 9, 2020), https://www.federalregister.gov/documents/2020/10/09/2020- 19922/regulatory-capital-rule-temporary-changes-to-and-transition-for-the-community-bank-leverage-ratio.
[4] 12 CFR § 702.
[5] *See* Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital (Dec. 23, 2021), https://www.federalregister.gov/documents/2021/12/23/2021-27644/capital-adequacy-the-complex-credit-union-leverage-ratio-risk-based-capital.

Ginnie Mae does not currently require a risk-based capital ratio analysis for its non-depository issuers, but recently released a Request for Input floating the idea of a 10 percent requirement for non-depository single family MBS issuers.[6] Ginnie Mae rationalized a 10 percent capital ratio for non-depository financial institutions because the risk characteristics, such as the increased size of the guaranteed portfolios, the changing profile of the issuer base, and a greater systemic vulnerability to economic stress and liquidity shocks, have changed. These changes require a more rigorous set of financial requirements than was in place during the 2008 financial crisis. Ginnie Mae further explains that its risk-based capital requirements reflect the varying risk associated with different asset types and the differences in mortgage balance sheets. The FHFA should similarly recognize that these non-depository seller/servicers, that now play an even larger role in the housing system, should be subject to stronger capital standards by increasing the capital ratio to 10 percent.

Supplemental Standards for Large Non-depository Seller/Services

The proposed requirements define a large non-depository seller/servicer as a non-depository institution with $50 billion or more in total single-family servicing unpaid principal balance at the end of any quarter, where the servicer is the master servicer of record. The proposal explains that large non-depository seller/servicers account for a substantial portion of industry and GSE servicing, consequently posing a higher counterparty risk than their smaller counterparts due to their size and business model complexity. NAFCU supports these supplemental standards for large non-depository seller/servicers as this will establish a stronger supervisory framework for these institutions, commensurate with the risk they pose to the housing system.

More specifically, NAFCU supports the FHFA's discretionary authority to designate a non-depository as a large seller/servicer based on the circumstances. NAFCU further supports the additional standards for large non-depository seller/servicers because the annual capital and liquidity plan requirements will provide a more complete picture of the internal oversight and governance of these non-depository institutions and better allow the FHFA and GSEs' to manage the risks associated with these institutions. However, the FHFA may wish to clarify in a definition who constitutes a "qualified, independent, third-party" that shall provide to the GSEs an annual assessment of the seller/servicer's performance and creditworthiness. Currently, the re-proposal does not define this term in the description of the requirement nor in the Frequently Asked Questions portion.

Conclusion

NAFCU and its members appreciate the opportunity to comment on this proposal and applaud the FHFA for including the lessons learned from the COVID-19 pandemic. NAFCU generally supports the proposal as non-depository seller-servicers pose a heightened risk to the financial system. To impose more robust supervision of these institutions, NAFCU recommends that the FHFA raise the capital ratio requirement to 10 percent and clarify some of the requirements for

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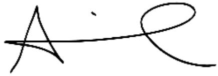
[6] Ginnie Mae Request for Input Eligibility Requirements for Single Family MBS Issuers.
https://www.ginniemae.gov/newsroom/publications/Documents/Financial%20Requirements%20RFI_v2.pdf.

large non-depository seller/servicers. 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
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