April 22, 2022

Dear Acting Director Thompson,

The Structured Finance Association[1] ("SFA") appreciates the opportunity to provide comments to the FHFA's Re-Proposal to Enhance Eligibility Requirements for Enterprise Single-Family Seller/Servicers dated February 24, 2022 (the "Proposal"). We applaud FHFA's wide-ranging efforts to ensure the safety and soundness of Fannie Mae and Freddie Mac ("GSEs" or the "Enterprises"), and in turn, our nation's housing finance system.

SFA's members support the idea that firms engaged at various levels of our nation's housing finance system need capital and liquidity at appropriate levels that ensure the safety and soundness of the system and maintain efficient mortgage financing options for American homeowners. Given the vital role that servicers play in the system, their ability to maintain financial solvency during times of stress is imperative. Overarching discussions about the appropriate amounts of capital necessarily involve discussions about which entities must hold that capital. However, the requirement to hold capital cannot simply rest with the end investor, whether that investor is the Enterprises, the U.S. taxpayers who support these institutions while they operate in conservatorship, or private investors. We welcome this discussion about appropriate levels of net worth, capital and liquidity across the housing finance system and applaud the FHFA's leadership on this important issue.

Recently, the unprecedented nature of COVID-19 demonstrated areas of strength and areas that warrant further discussion to ensure mortgage markets function in times of stress. There are lessons to be learned, particularly pertaining to capital and liquidity requirements based on the applicable remittance schedules in the underlying servicing agreements. We recommend that FHFA continue to monitor developments and update requirements accordingly.

SFA is mindful that the FHFA has not issued the Proposal in a vacuum. Concerns over liquidity crises in this space have been a point of discussion for some time.[2] In this regard, the Financial Stability Oversight Council ("FSOC"), of which the FHFA is a member, in the past has highlighted the significant role played by nonbank mortgage companies in the housing finance system, the potential risk to the broader financial system should they experience financial stress and its recommendations that relevant federal and state regulators continue to

[1] The Structured Finance Association is the leading securitization trade association representing over 370 member companies from all sectors of the securitization market. Our core mission is to support a robust and liquid securitization market and help its members and public policymakers grow credit availability and the real economy in a responsible manner. SFA provides an inclusive forum for securitization professionals to collaborate and, as industry leaders, drive necessary changes, advocate for the securitization community, share best practices and innovative ideas, and offers professional development for industry members through conferences and other programs. For more information, visit www.structuredfinance.org.

[2] See, (https://www.brookings.edu/wp-content/uploads/2018/03/KimEtAl_Text.pdf)

coordinate closely to collect data, identify risks, and strengthen oversight of nonbank companies involved in the origination and servicing of residential mortgages.[3] Last year, Ginnie Mae issued a Request for Input on its proposed changes to its net worth, capital and liquidity requirements for eligible issuers, which it has not finalized, and it also has incorporated stress testing into its oversight of issuers.

This enhanced governmental scrutiny of nonbank servicers' financial strength is further illustrated by the model language for uniform adoption by individual states contained in the Final Model State Regulatory Prudential Standards for Nonbank Mortgage issued in July 2021 by the Conference of State Bank Supervisors ("Proposed Prudential Standards"). The "financial condition" component of the Proposed Prudential Standards would require covered nonbank servicers to satisfy the then applicable net worth, capital and liquidity requirements imposed by the FHFA on seller/servicers, regardless of whether they are approved to service for Fannie Mae or Freddie Mac.[4]

It is clear from a review of these materials that the FHFA has coordinated its efforts with other federal and state initiatives, and we appreciate this approach. While FHFA appropriately acts as regulator and conservator of the Enterprises, we urge the FHFA to continue this collaboration and coordination in order to avoid the possibility of an inconsistent patchwork of net worth, liquidity and capital mandates and to facilitate synchronized standards to achieve a common goal. For example, when the FHFA retains discretion to increase these minimum standards in individual cases without revealing in advance the methodology it might employ (as we describe below), it is not at all clear what impact, if any, the existence or exercise of this discretion may have on a nonbank, seller/servicer's compliance with state requirements where the state has adopted the Proposed Prudential Standards. While this may be more of a state licensing law issue than an FHFA one, transparency by the FHFA in the factors it employs in the exercise of discretion could lessen this potential ambiguity.

And, of course, private parties, such as commercial lenders, master servicers, loan purchasers, and securitization trustees, often incorporate the FHFA financial eligibility requirements for seller/servicers into their own contractual eligibility standards and continuing covenants for and on contractual counterparties. Thus, in addition to enhancing overall financial stability, any changes by FHFA to these financial eligibility standards likely will have a "spill-over" effect on the larger housing finance ecosystem.

GENERAL OBSERVATIONS

***Clarity needed on discretion***

A few general points are in order. First, we note that the proposed standards are only minimum standards. For example, Part A4-1-01 of the Fannie Mae Seller Guide describes Fannie Mae's retained contractual right to impose additional financial requirements, including enhanced net

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[3] See, Section 5.2.2 FSOC's 2020 Annual Report

[4] See, https://www.csbs.org/sites/default/files/2021-07/Final%20Model%20Prudential%20Standards%20-%20July%2023%2C%202021%20Board%20Approved_0.pdf

worth, capital, or liquidity requirements based on its view of a seller/servicer's financial strength or its assessment of market condition or other relevant factors. While we understand the desire of the Enterprises to retain the flexibility to react to an individual seller/servicer's perceived adverse circumstances, presently there is no transparency around the potential exercise of this discretion, in terms of when and how it might be executed. Given the detailed review by the FHFA and the Enterprises of the appropriate financial eligibility requirements for seller/servicers, this supplemental, wholesale discretion without any boundaries creates uncertainty for seller/servicers, their owners and potential private investors. We recommend that the FHFA consider clarifying the criteria under which it would impose more stringent requirements on a particular seller/servicer than those required under minimum eligibility requirements.

***Limited Phased-in Approach***

Additionally, we urge the FHFA to consider extending the effective date of any finalization of the Proposal via a phased-in increase. While many of our members already meet these heightened standards, some may need to access the debt and equity capital markets to supplement their current financial conditions. Such initiatives take time to be designed and implemented in a thoughtful, holistic way, particularly evaluating alternative options before finalizing one or more business plans, and also are subject to the vagaries of the market at that time. FHFA might consider permitting the implementation in phases approach whereby 50% of the increase requirement must be met by December 31, 2022 and the other 50% by June 30, 2023. A phased-in approach should also apply to seller/servicers which would be required to get a corporate and/or servicer rating under the proposed eligibility requirements for holders of mortgage servicing rights ("MSRs").

SPECIFIC CONCERNS

While we do not have any specific comments about the actual amounts of net worth, capital or liquidity that approved seller/servicers would be required to maintain, certain of our members have identified four specific concerns relating to calculation of available liquidity, preapproval for liquidity buffer drawdowns, the ratings requirements, and stress testing. All of these comments simply are proposed tweaks to the Proposal, generally preserve the framework established in the Proposal and should not be regarded as a dilution of our strong support for the FHFA's Proposal.

***Available Liquidity***

Many market participants are aware that BASEL 3 was punitive to mortgage servicing rights as a source of liquidity, and efforts to change this have not proven successful. The net effect of that has been to drive many depository institutions out of the business, which is arguably not good for the safety and soundness of the system. While we understand the challenges of mortgage servicing rights as a source of liquidity, some of our members raised concerns regarding the calculation of available liquidity, particularly with respect to the exclusion of the discounted

value of a seller/servicer's servicing portfolio or short term servicing fees payable on and servicing fees reimbursable under such portfolio.

We recognize that this item does not neatly fit within traditional and regulatory definitions of liquidity, and that the decision to not recognize mortgage servicing assets as a source of liquidity is in line with the view of prudential bank regulators. However, we believe that the FHFA has an opportunity to take a more nuanced approach in evaluating the value of MSRs as an asset. In terms of liquidity calculation, this might include evaluating the degree to which servicer advances due to be repaid may serve as a source of near-term liquidity.

***Liquidity Buffer***

The requirement for large, non-depositories to maintain as a buffer even greater liquidity than the base requirement also raises concerns. As drafted, the Proposal does not give the approved seller/servicer the unilateral discretion to draw down on the liquidity buffer in times of financial or economic stress. Rather, unless the FHFA at its discretion directs the Enterprises to allow drawdowns for all large non-depositories when adverse market conditions and systemic liquidity shortages warrant such action, the seller/servicer must obtain prior approval from the Enterprises and only against the submission of a remediation plan documenting how the seller/servicer will return to full compliance.

We'd request that the prior approval requirement be replaced with a prior notice requirement. The Enterprises could specify in their respective Guides the circumstances in which an approved seller/servicer may drawdown on the liquidity buffer without required prior approval by the FHFA, making clear that any such drawdown constitutes a representation and warranty or certification by the seller/servicer of its compliance with such explicit criteria. For example, one such criteria could be that the drawdown of the liquidity buffer is a last resort after exhaustion of other available liquidity and without which drawdown the seller/servicer is reasonably likely to default on its advance obligations. Under this approach, the remediation plan could be required to be submitted within a specified number of business days from the drawdown (e.g., 5 business days). Underlying this request is the desire for certainty on the ability of a seller/servicer to access its own liquid assets when confronting an acute financial or economic stress and to avoid default.

***Ratings***

We request that the FHFA permit approved seller/servicers to rely on the requisite primary servicer ratings of the sub-servicer(s) that they may use when an approved seller/servicer is a passive holder of mortgage servicing rights. While these passive holders may neither have nor be eligible for a primary servicer rating, its sub-servicer must both be an approved seller/servicer and have the requisite primary servicer rating. We do not see the need to have "double" ratings with respect to the same pools of servicing rights, as long as the one engaged in the actual servicing function has the requisite rating. Of course, a master servicer must have appropriate third party vendor oversight of its sub-servicer, and the Enterprises already audit such master servicers to ensure the oversight framework is in place.

Ginnie Mae presently permits a master servicer to "delegate" to its approved issuer the requirement to maintain a specific primary servicer rating, with Ginnie Mae's prior approval.[5] We request that the FHFA adopt a similar approach, with one variation. Rather than an Enterprise determining a seller/servicer's exemption from this primary servicer rating on a case-by-case base, we request that the FHFA consider establishing the circumstances up front under which a master servicer may rely on its' sub-servicer's rating in lieu of obtaining one itself, without the need to request prior approval.

***Stress Testing***

An annual liquidity stress test is required to be included in the annual capital and liquidity plans that large non-depositories must submit to the Enterprises under the Proposal. It does not, however, specify either the required design of such stress tests or how the results of these tests would or could inform potential enhanced financial strength requirements. It would be helpful for the final Proposal to clarify any design requirements for the testing methodology as well as the explicit relationship, if any, between such results and any potential additional capital and liquidity requirements.

As examples of what the methodology might look like, Ginnie Mae previously issued a Request for Input on its proposed methodology for stress testing. While it ultimately initiated a stress testing methodology, it never issued a final report in response to its Request for Input. Referring to the Federal Reserve Board's Comprehensive Capital Analysis and Review and its Dodd-Frank Act stress testing review also may be relevant in identifying the appropriate testing methodology. Indeed, the GSEs own stress test requirements may serve as a useful starting point on questions relating to stress test methodologies as they apply to nonbank seller/servicers. Prior to implementation, any proposed methodology should undergo careful review, data-driven analysis, and comprehensive testing, and should include input from stakeholders. Regardless of the methodology employed, the confidentiality of stress test results (and the larger annual capital and liquidity plans) is critically important.

SFA looks forward to continuing our engagement with FHFA on these important questions, and again offers our appreciation for the FHFA's leadership on this important issue and our ability to comment on the Proposal.

Best,

Michael Bright
CEO, Structured Finance Association

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[5] See, (https://www.ginniemae.gov/issuers/program_guidelines/MBSGuideLib/Chapter_03.pdf)