March 27, 2023

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Prohibition against Conflicts of Interest in Certain Securitizations
Rel. No. 33-11151; File No. S7-01-23

Dear Ms. Countryman:

The attached letter is being submitted jointly by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") in response to the Commission's request for comments regarding proposed Rule 192 (the "Re-Proposed Rule") under the Securities Act of 1933 (the "Securities Act"). The Re-Proposed Rule is designed to implement Section 27B of the Securities Act, a provision that prohibits "material conflicts of interest" relating to certain asset-backed securities ("ABS"), including synthetic asset-backed securities, subject to certain exceptions.

We appreciate this opportunity to offer our thoughts and recommendations, and thus to seek clarification regarding the potential application of the Re-Proposed Rule to synthetic ABS we issue to mitigate our credit risk. We welcome the opportunity to further address any questions or concerns the Commission or its Staff may have regarding these matters.

Sincerely,

FANNIE MAE

By: _____
Name: Wells M. Engledow
Title: Enterprise Deputy General Counsel & Senior Vice President

FREDDIE MAC

By: _____
Name: John Glessner
Title: Senior Vice President – Investments & Capital Markets

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Dear Ms. Countryman:

This letter is being submitted jointly by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, the "Enterprises") in response to the Commission's request for comments regarding proposed Rule 192 (the "Re-Proposed Rule") under the Securities Act of 1933 (the "Securities Act").[1] The Re-Proposed Rule is designed to implement Section 27B of the Securities Act, a provision that prohibits "material conflicts of interest" relating to certain asset-backed securities ("ABS"), including synthetic asset-backed securities, subject to certain exceptions.[2]

We appreciate this opportunity to seek clarification regarding the potential application of the Re-Proposed Rule to synthetic ABS we issue to mitigate our credit risk and to offer our thoughts and recommendations.

I. Executive Summary

The Enterprises' primary comments, as set forth below, are few in number, but important in significance to the Enterprises. Specifically:

1. We propose clarifying language, consistent with the commentary in the Proposing Release, to ensure that, during conservatorship, the Enterprises can continue to engage in security-based credit-risk transfer transactions that could otherwise be considered "conflicted transactions" under the Re-Proposed Rule.

[1] *See* Prohibition Against Conflicts of Interest in Certain Securitizations, Rel. No. 33-11151, reprinted in 88 Fed. Reg. 9678 (Feb. 14, 2023) (the "Proposing Release"). The Re-Proposed Rule supersedes proposed Rule 127B (the "2011 Proposed Rule"). *See* Prohibition Against Conflicts of Interest in Certain Securitizations, Rel. No. 34-65355, reprinted in 76 Fed. Reg. 60319 (Sept. 28, 2011) (the "2011 Proposing Release").

[2] *See* 15 U.S.C. 77z-2a.

2. We propose a conditional extension of the exclusion for the Enterprises from the definition of "sponsor" (the "Sponsor Exception")[3] so as not to create a potential obstacle to transitioning the Enterprises out of our FHFA conservatorship. In this vein, we propose a conditional extension of the Sponsor Exception because, as discussed below, the use of synthetic ABS to mitigate Enterprise guaranty risk would not in our view violate Section 27B so long as our status as government sponsored enterprises is maintained. Alternatively, we request that, so long as we continue to be government sponsored enterprises, our synthetic ABS issuances be permitted to qualify under the proposed risk-mitigating hedging exception. Under a third potential approach, we propose that the Sponsor Exception remain in place for at least 24 months following the Enterprises' exit from conservatorship (in lieu of automatic termination), to permit the Commission to make its determinations after the nature of the post-conservatorship landscape becomes clear.

II. The Enterprises' Statutory Missions

Fannie Mae and Freddie Mac were created by Congress to perform an important public mission: providing liquidity, stability and affordability to the U.S. residential mortgage market. We achieve our mission primarily by purchasing, on a continuous basis, under all market conditions, single-family and multifamily mortgage loans originated by third-party mortgage lenders. We package these loans into single-family or multifamily mortgage-backed securities and guarantee the timely payment of principal and interest on the underlying mortgages (such guaranteed mortgage-backed securities collectively, the "Enterprise Mortgage Securities").

Issuances of Enterprise Mortgage Securities are central to the fulfillment of our statutory missions and are subject to rigorous oversight by the FHFA, our primary regulator and, since September 2008, our conservator. These issuances attract to the secondary mortgage market investors who might not otherwise invest in mortgages, thereby expanding the pool of funds available for housing. For the year ended December 31, 2022, Fannie Mae and Freddie Mac together reported outstanding Enterprise Mortgage Securities with an aggregate principal balance of over $7.3 trillion dollars.

In the trillion-dollar TBA ("to-be-announced") market for single-family mortgages, Fannie Mae and Freddie Mac Uniform Mortgage-Backed Securities ("UMBS") are traded based on a limited number of enumerated criteria and often trade prior to the origination of the underlying mortgage loans themselves. This permits lenders to offer lock-in rates to borrowers, reducing the interest rate risk for lenders and lowering interest rate costs for borrowers.

Since the enactment of the Housing and Economic Recovery Act of 2008, the scope and magnitude of the Enterprises' regulatory framework have been significantly expanded, including via the

[3] The Sponsor Exception excludes each of the Enterprises from the definition of "sponsor" with respect to an asset-backed security that is fully insured or fully guaranteed as to the timely payment of principal and interest by the applicable Enterprise, provided the Enterprise is operating under the conservatorship or receivership of the Federal Housing Finance Agency ("FHFA") with capital support from the United States.

imposition of specific capital requirements.[4] Similarly, the underwriting and mortgage servicing standards governing the Enterprises' mortgage acquisitions have been strengthened in response to the financial markets crisis and guidance from FHFA. Those prudential processes include ongoing loan quality reviews and mortgage servicer monitoring pursuant to well-defined procedures and subject to FHFA supervision.

III. CRT Securities Efficiently Reduce Enterprise Reliance on U.S. Government Support Without Creating Material Conflicts Under Section 27B

A. *CRT Securities Issuance Background and Current Activities*

Although the Enterprises' prudent origination and servicing standards and ongoing monitoring measures are protective, our guarantees result in the retention of 100% of the credit risk relating to Enterprise Mortgage Securities (*i.e.*, mortgage default risk). In response to FHFA guidance[5] and sound business practice, we are continually seeking ways to mitigate that risk both efficiently and effectively. Consistent with the Strategic Plan for the Enterprises,[6] FHFA encouraged the Enterprises to develop credit risk transfer ("CRT") activities with a view to reducing future reliance on the government's financial support of the Enterprises.[7]

One of the primary means of mitigating credit risk with respect to our Enterprise Mortgage Securities guarantees is the issuance of synthetic asset-backed securities ("CRT Securities") that reference specific pools of mortgage loans (each, a "Reference Pool") backing Enterprise

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[4] *See* Enterprise Regulatory Capital Framework, 12 C.F.R. Part 1240 (Dec. 17, 2020) (hereinafter, the "Enterprise Capital Framework").

[5] *See* Federal Housing Finance Agency, 2023 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions (Dec. 2022) at 5 (establishing the expectation that the Enterprises "[m]aintain effective risk management systems appropriate for entities that need to minimize risk to capital as they rebuild their capital buffers").

[6] *See* A Strategic Plan for Enterprise Conservatorships, Feb. 21, 2012, avail. at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/20122021_Strategic_Plan_Conservatorships_508.pdf ("Establishing a path for shifting mortgage credit risk from the Enterprises (and, thereby, taxpayers) to private investors is central to the Strategic Plan").

[7] Members of Congress also have weighed in. *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").

Mortgage Securities.[8] As of December 31, 2022, the Enterprises have transferred to private capital markets a portion of the credit risk on mortgage loans with an aggregate unpaid principal balance of over $4.8 trillion.

We employ special purpose vehicles ("SPVs") to issue CRT Securities that link the return of investor principal to the performance of the related Reference Pools.[9] Each Reference Pool is selected pursuant to established programmatic criteria designed to avoid selection bias. Interest payments owed by the applicable SPV to the investors are made from payments by the applicable Enterprise to the SPV pursuant to contractual agreements between the Enterprise and the SPV as well as from investment income on highly liquid, short-term collateral (the "SPV Collateral") purchased by the SPV using the proceeds of the CRT Securities offering. A specified portion of the guaranty risk on a Reference Pool is transferred to CRT Security investors via the SPV's obligation to make payments to the applicable Enterprise. This SPV payment obligation is satisfied through liquidation of requisite amounts of SPV Collateral following the occurrence of specified credit events relating to the applicable Reference Pool.[10]

In connection with any such payment to the Enterprise, CRT Securities investors may incur write-downs of their principal; at the same time, the applicable Enterprise will incur losses with respect to the relevant Enterprise Mortgage Securities as a result of its guarantee obligations, in an amount that always will exceed the amount of any such write-downs of CRT Securities. Accordingly, the CRT Securities transactions do not provide the Enterprises with a means to "profit from" or speculate on the adverse performance of the loans in a Reference Pool.[11] Instead, the CRT Securities merely perform a loss mitigation function for the Enterprises, while providing institutional investors with a significant market for investment in Enterprise guaranty risk.

To ensure that our interests are aligned with those of the CRT Securities investors, each of the Enterprises retains a "vertical slice" of the credit risk associated with the Reference Pool for each CRT Securities offering. Accordingly, any write-downs of principal applied to CRT Securities will also be incurred by the applicable Enterprise to the extent of its risk retention component.

To help CRT Securities investors make informed decisions regarding the sharing of credit risk, the Enterprises publish extensive historical loan-level performance data dating back 20 years or more. Moreover, detailed loan-level data is provided on the Reference Pools as part of the initial transaction disclosure and is updated monthly as part of CRT Securities reporting. Given the

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[8] The other primary means we currently utilize to mitigate credit risk with respect to our guaranteed Enterprise Mortgage Securities consists of transferring to insurers and reinsurers certain credit risk on specified Reference Pools of mortgages that back Enterprise Mortgage Securities.

[9] The current structure of using SPVs to issue the CRT Securities commenced in 2018. Prior to that time, the Enterprises issued CRT Securities as notes that were direct debt obligations of the applicable Enterprise. Those notes were linked to a specified Reference Pool and reflected payment characteristics similar to those of the current SPV-issued CRT Securities.

[10] Please see Exhibit A for a schematic description of the typical CRT Securities structures.

[11] Indeed, the Enterprises' loss mitigation functions for loans are performed in an identical manner, regardless of whether the related loan is in the Reference Pool for a CRT Security or not.

complexity of the CRT Securities structures and the absence of an Enterprise guarantee, those securities may be sold only to sophisticated institutional investors.[12]

The Enterprises' CRT Securities transactions are also subject to ongoing FHFA oversight and, as noted above, are implemented in furtherance of FHFA's regulatory objectives. Our mortgage underwriting standards and loan quality review procedures are developed and administered independent of our issuance of CRT Securities; and neither Enterprise engages in "adverse selection" in connection with the formation of the Reference Pools. Instead, Reference Pools are formed by applying CRT eligibility criteria to randomly selected mortgage loans backing Enterprise Mortgage Securities.

While alternative means of effecting credit risk transfers exist, those means generally have been determined to be less cost-efficient and less effective. For example, if we were to utilize multi-class, non-synthetic cash securitizations with non-guaranteed subordinate tranches ("Senior/Sub Securities") in lieu of fully guaranteed Enterprise Mortgage Securities with respect to single-family mortgages, we would anticipate severe disruptions to the systemically important TBA market.[13] Another alternative would be to effect CRT transactions through the sale of unsecured direct debt obligations of the Enterprises[14]; however, this would require investors to continually assess the creditworthiness of the issuing Enterprise as their sole source of repayment. The foregoing increased costs and inefficiencies would be imposed on the mortgage finance system even though, as discussed below, the CRT Securities do not present a material conflict of interest of the sort Section 27B was enacted to address.

B. CRT Securities Do Not Present a Material Conflict of Interest with Enterprise Mortgage Securities Investors

As noted in the Proposing Release, the Enterprises submitted comments on the 2011 Proposed Rule emphasizing our need to effect CRT transactions to hedge the credit exposure we assume as guarantors of our Enterprise Mortgage Securities and expressing our concern that a broad interpretation of "material conflict of interest" could preclude us from engaging in CRT Securities transactions.[15] In the Proposing Release, the Commission appears to take the view that, although the Enterprises would be prohibited from engaging in "conflicted transactions" with respect to

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[12] The CRT Securities are offered only to qualified institutional buyers ("QIBs"), as defined in Rule 144A under the Securities Act.

[13] This is because the terms of those Senior/Sub Securities, as compared to Enterprise Mortgage Securities, are not fully guaranteed and would necessarily vary widely from issuance to issuance, thereby preventing them from being eligible for TBA trading and eroding the liquidity of the TBA market.

[14] *See* footnote 9, *supra*. In addition, it is noteworthy that, under the Enterprise Capital Framework, the Enterprises may not recognize for risk-based capital purposes, CRT transactions structured as direct debt obligations. *See* Enterprise Capital Framework, 12 C.F.R. 1240.2: "Eligible funded synthetic risk transfer means a credit risk transfer in which (1) A CRT SPE that is bankruptcy remote from the Enterprise and not consolidated with the Enterprise under GAAP is contractually obligated to reimburse the Enterprise for specified losses on a reference pool of mortgage exposures of the Enterprise upon designated credit events and designated modification events…"

[15] *See* Proposing Release, *supra* note 1, at 9688.

investors in the CRT Securities,[16] the Sponsor Exception would excuse CRT Securities from being "conflicted transactions" with respect to the Enterprise Mortgage Securities while the Enterprises operate under FHFA conservatorship with capital support from the United States.[17]

Although the Proposing Release appears to preserve our ability to issue CRT Securities while we remain in conservatorship,[18] we are very concerned that the Re-Proposed Rule would bar us from engaging in CRT Securities transactions post-conservatorship.[19] We note that the Proposing Release states that, if the Enterprises exit conservatorship, the Enterprises "might have to re-structure or abandon their CRT offerings to comply with the re-proposed rule."[20] The Proposing Release also casts serious doubt on the ability of other securitization participants[21] to issue synthetic asset-backed securities (including as bona fide hedges for legitimate business activities).[22] The Proposing Release expresses the view that synthetic ABS transactions were "the focus of Congressional scrutiny in connection with the financial crisis of 2007-2009"[23] and that the "securitization participant would perform a central role in creating, structuring, and/or marketing the relevant synthetic ABS," thereby likely obtaining "additional benefits such as arranger or manager compensation" and creating other conflicts of interest.[24]

In our view, a blanket prohibition on the use of synthetic ABS as a tool for legitimate credit risk mitigation represents an overly broad approach that is not required by Section 27B. If implemented, this approach will impair the ability of the Enterprises to undertake legitimate credit risk reduction activities, post-conservatorship, that are integral to achieving our Congressional mandates.

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[16] *Id*.

[17] *See* Proposing Release, *supra* note 1, at 9688 (noting that the Sponsor Exception "should address concerns that, absent such an exception, an Enterprise might be prohibited from engaging in a security-based CRT transaction"); s*ee also id.* at 9716 (noting that the Sponsor Exception "would continue to allow the Enterprises to transfer credit risk to private investors to lower the Enterprises' capital requirements….").

[18] Note that Section IV.A. below requests Commission clarification as to a potential ambiguity relating to this conclusion.

[19] The Re-Proposed Rule provides that the Sponsor Exception will automatically terminate if the Enterprises exit FHFA conservatorship.

[20] *See* Proposing Release, *supra* note 1, at 9718.

[21] Other mortgage industry participants, such as mortgage insurance companies, also issue CRT securities as a risk and capital management tool.

[22] *See, e.g., See* Proposing Release, *supra* note 1, at 9698 (stating that "[u]nder the re-proposed rule, the issuance of a synthetic ABS where a securitization participant enters into the short side of the transaction with the issuing entity… would be a "conflicted transaction" because the securitization participant would be entitled to payment if the referenced assets, and thus the ABS, perform poorly"); *Id.* at 9700 (expressing the view that the initial issuance of an ABS, such as a synthetic ABS, would not constitute "risk-mitigating hedging" and that the Re-Proposed Rule "prohibits a securitization participant from creating and/or selling a new synthetic ABS to hedge a position or holding").

[23] *Id.* at 9700.

[24] *Id.*

Section 27B appears to have been enacted to prevent securitization participants from "profiting from" securities that were intentionally designed to fail[25] and, as the Proposing Release repeatedly notes, to prohibit transactions that effectively represent "a bet against a securitization."[26] Section 27B and the legislative history thereto do not evidence Congressional concern regarding synthetic ABS that are constructed to hedge legitimate business risks relating to assets that are fairly and randomly selected and are offered in a manner that fully discloses the nature of the securities.[27]

Because Section 27B directs the Commission to adopt "implementing" rules, we believe that section grants the Commission latitude to identify the fact patterns that fall outside the intended scope of Section 27B and, as an inherent part of that process, to make a distinction between synthetic ABS that represent a "bet against" a securitization and those that are responsibly-constructed to serve a legitimate hedging purpose.[28] The legislative history specifically observes that the Commission "has sufficient authority to define the contours of the rule in such a way as to remove the vast majority of conflicts of interest from [ABS] transactions while also protecting the healthy functioning of our capital markets."[29]

The Enterprise's CRT Securities clearly fall outside the scope of Section 27B because they do not represent a "bet against" the relevant Enterprise Mortgage Securities, do not provide a means for the Enterprises to "profit from" the adverse performance of mortgage loans included in a Reference Pool and do not otherwise promote or incentivize any actions by the Enterprises that by design are detrimental to investors in Enterprise Mortgage Securities. Rather, the CRT Securities serve merely as a hedge against a specified portion of the credit risk assumed by the Enterprises in connection with our guarantees of Enterprise Mortgage Securities.

As noted above, CRT Securities transfer to sophisticated institutional investors a portion of the credit risk relating to mortgages acquired by the Enterprises in accordance with well-defined underwriting criteria and loan review policies and are selected for inclusion in a Reference Pool

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[25] *See. e.g.*, 156 CONG. REC. S5899 (daily ed. Jul. 15, 2010) (statement of Sen. Levin) (noting that "[t]he intent of section 621 is to prohibit underwriters, sponsors, and others who assemble asset-backed securities, from … profiting from the securities' failures" and comparing the fact pattern this section was designed to address to "selling someone a car with no brakes and then taking a life insurance policy out on the purchaser").

[26] *Id. at S5899*; Proposing Release, *supra* note 1, at 6, 8, 63, 71.

[27] We note that the "hedging transaction" discussed in the Merkley-Levin comment letter regarding the 2011 Proposed Rule involved a sponsor's undisclosed desire to hedge the sponsor's risk with respect to assets the sponsor believed were likely to imminently decline in value. *See* comment letter from U.S. Senators Jeff Merkley and Carl Levin (Jan. 12, 2012) at 10-11. That transaction consequently is readily distinguishable from the CRT Securities issuances effected by the Enterprises.

[28] We note, in this regard, that the 2011 Proposing Release did not purport to categorically preclude a securitization participant from taking the "short side" of a synthetic asset-backed security it had created and correctly expressed doubt as to whether a prohibition on transactions of that sort would be "appropriate in all circumstances." *See* 2011 Proposing Release at 60338. The Proposing Release also rightly questions whether it is appropriate to view each issuance of synthetic ABS where the securitization participant takes the short position in the referenced assets as a "conflicted transaction." *See* Proposing Release at 9698.

[29] *See* 156 CONG. REC. S5899 (2010).

pursuant to established programmatic criteria designed to avoid selection bias. It is infeasible for the Enterprises to "cherry pick" loans at either the loan acquisition or Reference Pool formation stages. Rather each Reference Pool represents a random sampling of eligible loans from a much larger body of conforming loans acquired by the applicable Enterprise. As a randomly selected subset of acquired and securitized loans, loans in a Reference Pool are no more likely to fail than are our portfolio loans generally.

We further note that, other than acting as sponsors of our CRT Securities, the Enterprises do not play any additional roles or earn any manager or arranger fees with respect to CRT Securities issuances and thus do not have the types of additional conflicts as to which the Proposing Release expresses concern.

In summary, the Enterprises accrue significant credit risk in furtherance of our statutory missions and are obligated to implement appropriate measures to mitigate that risk, both in response to FHFA policies and as a matter of prudent business management. The ability to issue CRT Securities is central to our credit risk-mitigation effort and provides market benefits and efficiencies that other risk mitigation methods, such as the issuance of direct debt obligations or Senior/Sub Securities, would not. We therefore urge the Commission to recognize the essential role CRT Securities play in the Enterprises' ability to manage our credit risks and the absence of a material conflict of interest with our investors, by permitting those issuances to continue, subject to certain conditions, even if our FHFA conservatorship terminates.

IV. Requested Changes to the Re-Proposed Rule

A. *Request for Clarifying Amendment to Definition of "Conflicted Transaction"*

Although, as discussed in Section III.A. above, the Proposing Release appears to preserve our ability to issue CRT Securities while we remain in conservatorship, subparagraph (a)(3)(iii) of the proposed definition of "conflicted transaction" is extremely broad and includes "entry into a transaction through which the securitization participant would benefit from the actual, anticipated or potential ... adverse performance of the asset pool supporting or referenced by the relevant asset-backed security." In contrast to the section of subparagraph (a)(3)(iii) relating to "the purchase or sale of a financial instrument (other than the relevant asset-backed security)," the language cited above does not expressly exclude "the relevant asset-backed security" from the transactions to be covered as "conflicted transactions."

To avoid ambiguity as to the status of CRT Securities, it is essential for the Commission to amend subparagraph (a)(3)(iii) to confirm that it does not bar the Enterprises from entering into the transaction agreements necessary to effect CRT Securities issuances.[30] Otherwise, the transactions required for the creation of CRT Securities – *e.g.*, agreements between an Enterprise and the issuing securitization trust – may be seen as prohibited "conflicted transactions" with respect to

[30] As currently drafted, subparagraph (a)(3)(iii) raises an issue regarding the "conflicted transaction" status of CRT Securities because the transaction agreements the Enterprises enter into in connection with each such securitization could be deemed to involve "entry into a transaction through which the [Enterprises] would benefit from the actual, anticipated or potential … adverse performance" of the applicable Reference Pool.

investors in those same securities. We request that the Commission amend subparagraph (a)(3)(iii) to make clear that this subparagraph does not encompass the Enterprises' entry into the associated transaction agreements necessary to effect CRT Securities issuances.[31] Such an amendment would be consistent with the Commission's apparent intention to permit the Enterprises to continue issuing CRT Securities for so long as we remain in conservatorship.[32]

B. ***Request for Changes to the Sponsor Exception and Risk-Mitigating Hedging Exception***

1. <u>The Sponsor Exception Should Extend Beyond Conservatorship</u>

Early in the Enterprise conservatorships, FHFA required the Enterprises to develop cost-efficient methods of credit risk transfer to "reduce taxpayer exposure to risks arising from credit guarantees extended by the Enterprises through their normal courses of business."[33] The development, refinement and expansion of Enterprise risk transfer programs have been one factor that has helped to foster reduced reliance by the Enterprises on U.S. government financial support. Although we cannot know the precise contours of a post-conservatorship landscape,[34] there are several indicia that, if present, would support the view that the Sponsor Exception should remain in place following any future exit from conservatorship.

Specifically, if we maintain our status as government sponsored enterprises – *i.e.*, we continue to (i) operate under Congressional charters, including a statutory line of credit with the U.S. Department of the Treasury, as is currently provided under 12 U.S.C. 1455(c) and 12 U.S.C. 1719(c), (ii) fulfill public policy missions and (iii) be subject to the regulatory requirements and oversight of FHFA (or a successor agency) – we believe it would be appropriate to preserve the Sponsor Exception. In that context, our need to fulfill our Congressionally-mandated housing market support function would both require and justify the continued availability of the Sponsor Exception. In addition, the level of FHFA regulatory oversight of Enterprise operations in general and CRT Securities in particular should allay any potential Commission concerns regarding the Enterprises' Reference Pool selection processes. For example, FHFA requirements and the FHFA

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[31] For example, this portion of subparagraph (a)(3)(iii) could be amended to read as follows: "The purchase or sale of any financial instrument (other than the relevant asset-backed security) or entry into a transaction **(other than, in the case of an entity described in (iii)(B) of the definition of "sponsor" in paragraph (c) of this section, a transaction required to effect the issuance of the relevant asset-backed security)** through which the securitization participant would benefit from the actual, anticipated or potential: …." (Proposed new language in bold.)

[32] *See* Proposing Release, *supra* note 1, at 9688.

[33] *See* Credit Risk Transfer, available at https:www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Credit-Risk-Transfer.aspx ("Under FHFA's oversight through guidelines, instructions, strategic plans, and Scorecard objectives, the [credit risk transfer] programs have since become a core part of the Enterprises' single-family guarantee businesses….").

[34] We note, in this regard, the Commission's acknowledgement that "uncertainty persists regarding the nature or timing of the Enterprises' exit from conservatorship [and] private or government participation in the Enterprises after conservatorship…." *See* Proposing Release, *supra* note 1, at 9720.

Enterprise Capital Framework[35] together perform several functions that help preclude material conflicts of interest with Enterprise Mortgage Securities investors, including without limitation:

- supervision of Enterprise Mortgage Securities;
- imposing safety and soundness requirements; and
- requiring FHFA approval before any CRT Securities are eligible to provide capital relief to an Enterprise.

By amending the Sponsor Exception to continue after conservatorship, provided that the Enterprises retain their current status as government sponsored enterprises, the Commission would preserve the Enterprises' ability to engage in the legitimate risk management activities that are supported by the Enterprise Capital Framework and are necessary to the efficient functioning of the single-family and multifamily loan market and the availability of affordable housing, all while operating in a manner consistent with the objectives of Section 27B.

By contrast, automatic elimination of the Sponsor Exception upon an Enterprise's exit from conservatorship – even if the Enterprise continues to be a government sponsored enterprise -- could jeopardize liquidity in the CRT Securities markets long before any future exit from conservatorship, eroding the Enterprises' ability to mitigate the credit risk attendant to our guarantees.

The Proposing Release asks, if the Sponsor Exception were to extend beyond conservatorship, whether there are "any ways that the rule could address the credit risk related to the Enterprise guarantee and the conflicts that could arise from securitization participants engaging in conflicted transactions."[36] The Proposing Release suggests, in this regard, that, if the Enterprises are no longer subject to conservatorship, we may have an incentive to engage in transactions that "benefit private parties" and to "engage in adverse selection of assets."[37] However, if the Enterprises continue to operate subject to the indicia described above, FHFA would retain ample authority to guard against this sort of self-interested conduct.

Moreover, notwithstanding the absence of clarity regarding the contours of a post-conservatorship environment, there is no evidence to support an assumption that such transgressions would occur and, hence, no reason to predicate the automatic elimination of the Sponsor Exception upon such a speculative concern. The merely conjectural nature of such a concern is reflected by the assertion in the Proposing Release that a "post-conservatorship structure might affect the Enterprises' incentives when they participate in securitizations."[38]

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[35] *See* footnote 4, *supra*.

[36] *See* Proposing Release, *supra* note 1, at 9689.

[37] *Id.* 9716.

[38] *Id.* at 9720 (emphasis added).

With respect to the Proposing Release's query as to whether de-linking the Sponsor Exception from any elimination of the Enterprises' conservatorship would be consistent with Section 27B,[39] we note that Section 27B was not designed to address conduct engaged in, or likely to be engaged in, by the Enterprises.[40] Rather, in the event that the Enterprises continue to be government sponsored enterprises, we believe it is unlikely that the proponents of Section 27B would have intended that section to prohibit legitimate risk mitigation activities that facilitate our ability to support the American housing market in a safe and sound manner. In this regard, given the extent to which the Enterprises have – with the encouragement of FHFA and members of Congress -- relied upon CRT Securities transactions to mitigate our credit risks, the consequences of eliminating the Sponsor Exception would be significant. We note, in this regard, the Commission's observation that the CRT Securities market is by far the most active synthetic ABS market.[41] Thus, any elimination of the Sponsor Exception would require careful consideration to prevent unintended, adverse impacts on parties ranging from major market participants to individual mortgage borrowers.

The Commission observed that the rules adopted in 2014 to implement the credit risk retention requirements of Section 941 of the Dodd-Frank Act ("Regulation RR") contain an exception for the Enterprises that terminates if and when the Enterprises exit conservatorship,[42] subject to potential revisiting and modification "after the future of the Enterprises and of the statutory and regulatory framework for the Enterprises becomes clearer."[43] We note that application of Regulation RR to the Enterprises post-conservatorship would require the Enterprises to retain a specified portion of the credit risk relating to our securitizations, but would not prohibit the Enterprises from effecting those transactions. By contrast, application of the Re-Proposed Rule, in its current form, could well prohibit the Enterprises from effecting CRT Securities transactions on which the Enterprises depend to mitigate our credit risks. Accordingly, we believe it is essential to assure that application of the Re-Proposed Rule to the Enterprises will not represent an overly broad, unsupported application of Section 27B and will avoid unnecessary market disruption during conservatorship as well as in a post-conservatorship environment. In our view, Regulation RR does not serve as a useful precedent for this purpose.

2. The Risk-Mitigating Hedging Exception Should Be Available for the CRT Securities Following Conservatorship, Subject to Conditions Identified in the Re-Proposed Rule

As an alternative to the foregoing approach, we suggest amending the risk-mitigating hedging exception set forth in subsection (b)(1) of the Re-Proposed Rule to permit the Enterprises to continue to engage in CRT Securities issuances following conservatorship, provided that they

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[39] *See* Proposing Release *supra* note 1, at 9689.

[40] *See id.* at 9679 (noting that the Re-Proposed Rule focuses on "the types of transactions that were the subject of regulatory and Congressional investigations and were among the most widely cited examples of ABS-related misconduct during the lead up to the financial crisis of 2007-2009").

[41] *See* Proposing Release at 9717-9718 (expressing the view that "there is [not] a significant amount of activity in the synthetic … securitization markets outside of the Enterprises' CRT market….").

[42] *Id.* at 9688 n.81.

[43] *Id.*

retain their status as government-sponsored enterprises. As would be the case with a continuation of the Sponsor Exception, the availability of the risk-mitigating hedging exception would be both necessary and well-justified in the event that the Enterprises continue to perform important public policy roles, pursuant to Congressional charters, and continue to be regulated and supervised by FHFA (or a successor federal agency). In this scenario, the protections provided by FHFA regulation and oversight would work in tandem with the need to comply with the requirements of the risk-mitigating hedging exception, to provide assurance that the issuance of CRT Securities would not implicate the chief concerns underlying Section 27B.

Should the Commission deem it desirable, the availability of the risk-mitigating hedging exception for our CRT Securities could be subject to conditions in addition to those contained in the risk-mitigating hedging exception, including some or all of the following:

> (1) that the reference assets be underwritten pursuant to prudent and clearly-defined "safety and soundness" criteria and procedures;
>
> (2) that the reference assets be selected in an established programmatic manner that is designed to avoid selection bias;
>
> (3) that the issuance of the securities not result in the creation of a "net short position" for the Enterprises in respect of the referenced assets;
>
> (4) that the securities be sold only to sophisticated institutional investors; and/or
>
> (5) that full disclosure be made regarding all material risks associated with the securitization and potential conflicts of interest.[44]

Our CRT Securities do not implicate the concerns underlying Section 27B and do not jeopardize the Commission's investor protection goals. Consequently, we believe our CRT Securities should not be swept, post-conservatorship, into a "one-size-fits-all" prohibition on synthetic ABS in which the sponsor takes the "short position." From the perspective of sophisticated institutional investors, synthetic securitizations offer investment features very similar to those of non-synthetic securitizations. The Commission's initial analysis of the CRT Securities should thus be to assure that it does not foreclose the Enterprises' ability to effect non-abusive and economically beneficial synthetic ABS issuances merely because (i) the resulting securities provide synthetic exposure to the reference assets, rather than cash exposure, and (ii) certain synthetic ABS fall within the ambit of Section 27B.[45]

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[44] Although we understand that the Commission has been reluctant to rely solely upon disclosure to address Section 27B concerns, we believe disclosure plays a helpful role, when coupled with other features designed to address the concern underlying Section 27B.

[45] We anticipate that other commenters also will be addressing the treatment of synthetic ABS in which a securitization participant has a "short position." Should the Commission determine that those securitizations could, under certain circumstances, occur in a manner consistent with the requirements and objectives of Section 27B, we would support such a view.

3. The Sponsor Exception Should Not Terminate Immediately Upon the Enterprises' Exit from Conservatorship

Although the strong preference of the Enterprises is for the Commission to adopt the changes requested in IV.B.1 or 2, an alternative thereto is for the Commission to amend the Re-Proposed Rule to defer the elimination of the Sponsor Exception until 24 months following an Enterprise exit from conservatorship (subject to extension of this "transition period," should the Commission deem an extension desirable). Permitting the Sponsor Exception to remain in place for this time period would allow the Commission to evaluate the actual circumstances of the post-conservatorship landscape and conduct a fully-informed weighing of the costs, benefits and anticipated effects on efficiency, competition and capital formation, among other factors, of preserving, modifying or eliminating the Sponsor Exception. It would thus be consistent with the Commission's investor protection and market preservation goals.

The Proposing Release acknowledges the "ongoing activity related to reforming the Enterprises" and indicates that "if appropriate, the Commission may 'revisit and modify' the Sponsor Exception."[46] In our view, providing for a period of transition would facilitate the Commission's ability to effect this type of analysis, while reducing the market disruption that would arise in connection with an immediate termination of the Sponsor Exception. Unlike the immediate termination of the Sponsor Exception, a transition period also would support a more orderly transition from conservatorship, while avoiding the potential delays relating to any reinstatement of the Sponsor Exception following an immediate termination, should the Commission deem reinstatement appropriate.

V. Dollar Roll Transactions Should Qualify for the Liquidity Commitments Exception

To help support immediate needs for liquidity in the secondary mortgage market, FHFA has authorized the Enterprises to enter into dollar roll transactions, which effectively provide Enterprise Mortgage Securities investors with short-term financing of their positions. The transactions are conducted via an auction or similar mechanism to ensure that they occur at a fair market price. In a dollar roll transaction, an investor commits to sell its security to a buyer (which may be an Enterprise or other financial institution) and to purchase another security with the same prefix and coupon back from the buyer on a specified date in the future. The transaction functions as a form of short-term financing not unlike a repurchase agreement; however, unlike in a repurchase agreement, a similar security may be returned to the seller rather than the original security. Such similar security may perform more or less favorably than another Enterprise Mortgage Security with the same prefix and coupon. If such security performs less favorably, the parties to the dollar roll transaction should not be subject to liability under the Re-Proposed Rule for its selection. Consequently, we request that the Commission specify in the Re-Proposed Rule that dollar roll transactions for Enterprise Mortgage Securities fall within the exception for liquidity commitments.

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[46] *See* Proposing Release, *supra* note 1, at 9688.

VI. "Sponsor" Status of Multifamily "B-Piece Buyers"

The Proposing Release indicates that certain types of investors should not be deemed sponsors under the Proposed Rule.[47] Freddie Mac notes, in this regard, that many of the Freddie Mac multifamily Enterprise Mortgage Securities transactions include subordinate, non-guaranteed securities (*e.g.*, "B-Pieces'") that are sold to a single sophisticated investor (a "B-Piece Buyer"). As the investors that will be first to experience losses as a result of losses on the underlying mortgage loans, these B-Piece Buyers often have rights that exist before the transaction is initiated. For example. B-Piece Buyers may request that the sponsor remove certain assets from the final pool that are perceived as too risky. However, the B-Piece Buyer has no contractual or other right to direct the structure, design, or assembly of the securities. It cannot direct the sponsor to offer securities with certain features or direct the sponsor to offer any securities at all. Freddie Mac therefore seeks confirmation that those B-Piece Buyers will not be deemed to be "sponsors" of the applicable multifamily mortgage-backed securities. Freddie Mac is concerned that any ambiguity regarding this point could make it significantly more difficult to find third-party buyers for the most subordinate tranche of its multifamily Enterprise Mortgage Securities. This difficulty could arise as those parties (as well as their affiliates and subsidiaries) might become reluctant to purchase these subordinate securities. Compliance with the Re-Proposed Rule could require monitoring and limitation of their activities across their entire organizations. Such compliance could be a costly and time-intensive process that would not otherwise have to be undertaken.

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We appreciate your willingness to give consideration to our concerns and welcome the opportunity to further address any questions or concerns the Commission or its Staff may have regarding these matters.

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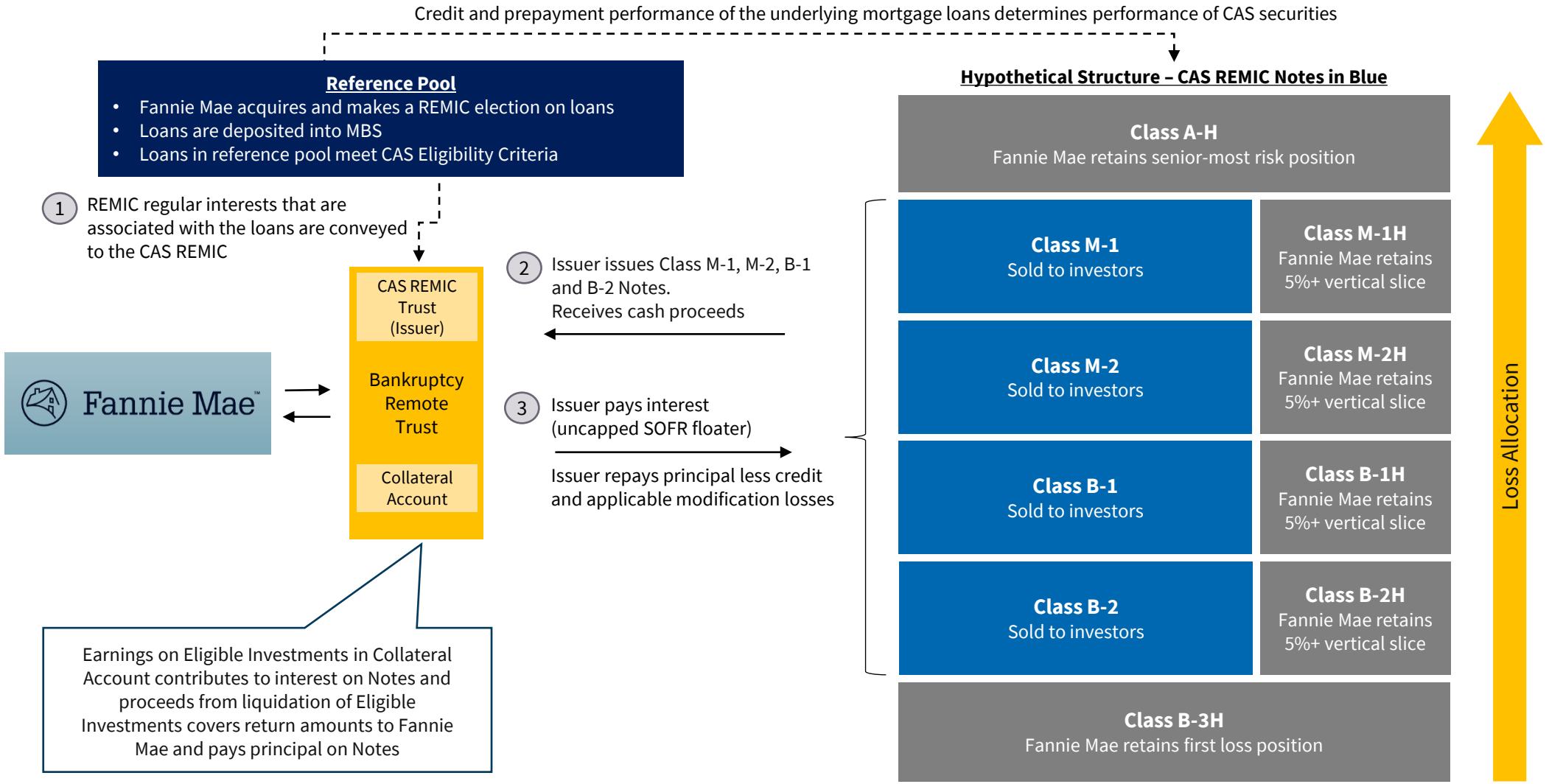
[47] "An ABS investor that is acquiring a long position in the relevant ABS would be expected to provide input with respect to the structure of the ABS investment or the underlying pool of assets for the purpose of maximizing the expected value of its ABS investment. For example, investors in certain ABS markets may have stipulations regarding general characteristics of the composition of the underlying pool of an ABS that must be satisfied in order for that investor to agree to acquire the relevant securities, including to ensure that the ABS investment would comply with its investment guidelines. Therefore, an ABS investor that is interested in acquiring a long position in an ABS would not be considered to direct the composition of assets merely because such investor expresses its preferences regarding the assets that would collateralize its ABS investment." *Id.* at 9686.

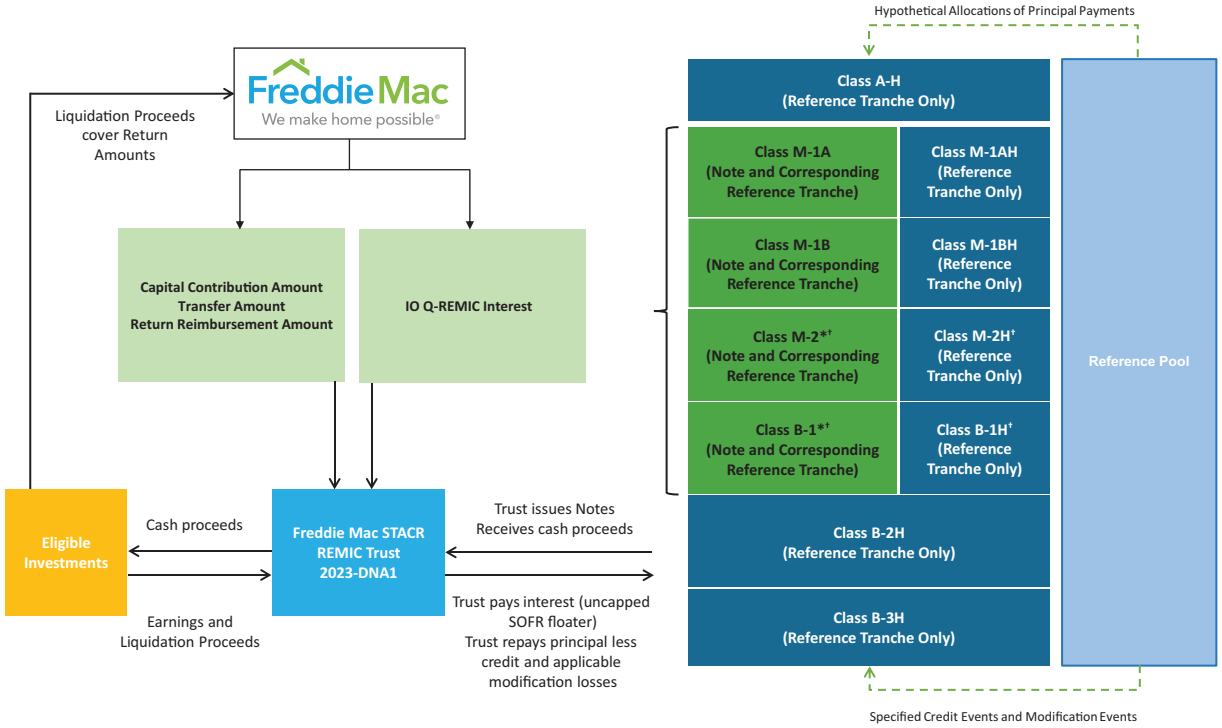
EXHIBIT A

SCHEMATIC OF TYPICAL CRT SECURITIES STRUCTURES

Fannie Mae structure



Freddie Mac structure



* The Class M-2A and Class M-2B Notes and corresponding Reference Tranches relate to the Class M-2 Notes; and the Class B-1A and Class B-1B Notes and corresponding Reference Tranches relate to the Class B-1 Notes. The Class M-2A and Class M-2B Notes are exchangeable for the Class M-2 Notes, and vice versa, pursuant to Combination 1 described in Table 2; and the Class B-1A and Class B-1B Notes are exchangeable for the Class B-1 Notes, and vice versa, pursuant to Combination 18 described in Table 2. In addition, certain Classes of MACR Notes can be further exchanged for other Classes of MACR Notes, and vice versa, as described in Table 2.

† The Class M-2H Reference Tranche illustrated in the transaction diagram above represents the combination of the Class M-2AH and Class M-2BH Reference Tranches. The Class M-2 Notes and corresponding Reference Tranche illustrated in the transaction diagram above represent the combination of the Class M-2A and Class M-2B Notes and the corresponding Reference Tranches. The Class B-1H Reference Tranche illustrated in the transaction diagram above represents the combination of the Class B-1AH and Class B-1BH Reference Tranches. The Class B-1 Notes and corresponding Reference Tranche illustrated in the transaction diagram above represent the combination of the Class B-1A and Class B-1B Notes and the corresponding Reference Tranches.