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Washington DC.

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Secretariat
Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel, Switzerland
By E-Mail: fsb@fsb.org

Dear Sirs, Mesdames:

Re.: A Large Gap in Global TBTF Reforms

We write in reference to the announcement of the "Evaluation of too-big-to-fail reforms" in your memorandum of May 23, 2019. We respectfully point out that, while the 3 July 2017 *Framework* refers broadly to evaluating "G20 Financial Regulatory Reforms," and the May 23 *Summary Terms of Reference* refer to SIFIs broadly, the May 23 press release calls for evaluation only of Systemically Important *Banks*.

We urge that FSB solicitations with respect to evaluating TBTF reforms must address SIFIs that are not Banks. It could be that, without saying so, that is the intention of the FSB, and we are submitting this comment letter just to be sure. Specifically, we recommend that this Evaluation must include the obviously TBTF firms, Fannie Mae and Freddie Mac.

As is well known, these two grossly undercapitalized firms failed and were bailed out in the financial crisis of 2008, having become one of the most vulnerable points in the financial system.

Fannie Mae and Freddie Mac today have $5.5 trillion in combined assets, representing half the credit risk of the massive U.S. mortgage market. They are unquestionably systemically important, but they have not been designated as SIFIs by the U.S. Financial Stability Oversight Council. On the merits, this seems highly surprising. We believe it represents a major gap in the global response to implementing global systemic risk and TBTF reforms, which the Evaluation should address.

We suggest the following points from your terms of reference are particularly relevant:

1. "The TBTF problem arises when the threatened failure of a SIFI—given its size, interconnectedness, complexity, cross-border activity or lack of substitutability—puts pressure on public authorities to bail it out using public funds."

Fannie Mae and Freddie Mac displayed at the time of their failure and display now the attributes of extremely large size, interconnectedness, complexity, cross-border activity and lack of substitutability.

As demonstrated by the history of the financial crisis, public authorities not only felt overwhelming pressure but did in fact bail them out with $190 billion of public funds.

2. "G20 leaders endorsed the FSB framework for *Reducing the moral hazard posed by SIFIs.*"

Fannie Mae and Freddie Mac continue to represent enormous moral hazard. Since they are now even more dependent on the U.S. Treasury's implicit guarantee than before, the moral hazard they represent is even greater than in 2008.

3. "The evaluation will focus on...requirements for additional loss absorbency through higher capital buffers."

Fannie Mae and Freddie Mac are much more highly leveraged than TBTF banks were in 2008, and now have far less capital than before their collapse. In fact, their equity capital is virtually zero. As of March 31, 2019, their combined capital ratio is a risible 0.2% and they are hyper-leveraged at 500 to 1.

4. "The evaluation will cover...cross-border and cross-sectional effects."

Fannie Mae and Freddie Mac's $5.5 trillion in mortgage-backed securities and debt are sold and traded in global capital markets.

5. "The FSB will engage with relevant stakeholders (market participants, academics, civil society, etc.)."

It would be a pleasure to provide any further information which would be helpful in adding Fannie Mae and Freddie Mac to the scope of the Evaluation.

With sincere thanks for your consideration,

Respectfully submitted,

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Attachment: Brief bios of the authors
Cc: Financial Stability Oversight Council

Attachment

Alex J. Pollock is a distinguished senior fellow at the R Street Institute in Washington, DC. Previously, he was a resident fellow at the American Enterprise Institute from 2004 to 2015, and President and Chief Executive Officer of the Federal Home Loan Bank of Chicago from 1991 to 2004. He is the author of *Boom and Bust* (2011) and *Finance and Philosophy* (2018), as well as numerous articles and Congressional testimony. His work focuses on financial policy issues, financial cycles, risk and uncertainty, housing finance and banking systems, and the interactions of these with politics. Mr. Pollock is a director of CME Group; Ascendium Education Group; and the Great Books Foundation; and a past-president of the International Union for Housing Finance. He is a graduate of Williams College, the University of Chicago, and Princeton University.

Thomas H. Stanton served as President of the Association for Federal Enterprise Risk Management, a member of the federal Senior Executive Service, a board member of the National Academy of Public Administration (NAPA), and as Chair of the NAPA Standing Panel on Executive Organization and Management. In 2017 NAPA honored him with the George Graham Award for Exceptional Service to the Academy. In 2018 he received the Enterprise Risk Management Hall of Fame award. Mr. Stanton teaches as an adjunct faculty member at the Center for Advanced Governmental Studies at Johns Hopkins University. He is the author of *A State of Risk: Will Government Sponsored Enterprises be the Next Financial Crisis?* (HarperCollins, 1991), which presented the idea of contingent capital that is now being applied to reduce vulnerability of financial institutions globally, and of *Why Some Firms Thrive While Others Fail: Governance and Management Lessons from the Crisis* (Oxford University Press, 2012). Mr. Stanton's degrees are from the University of California at Davis, Yale University, and the Harvard Law School. Many of his publications can be found at www.thomas-stanton.com.