The Honorable Mel Watt
Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington, DC 20219

Dear Director Watt:

We are writing to you in your capacity as Fannie Mae and Freddie Mac's conservator and safety and soundness regulator, to urge suspension of the payment of dividends on the senior preferred stock held by the U.S. Treasury. The purpose of this suspension would be to allow the GSEs to build a capital buffer to deal with potential earnings volatility driven by external economic developments rather than by actions or missteps by the GSEs, in order to protect consumers and housing markets.

The plunge in interest rates during this first quarter, with the potential for possible negative interest rates going forward, creates a reasonable fear that one or both GSEs may report a loss due to non-cash hedging charges. These losses could very well require an additional draw from the U.S. Treasury pursuant to the Preferred Stock Purchase Agreements (PSPAs). As you are aware Freddie Mac reported a loss in the third quarter driven by non-cash hedging charges. Freddie Mac was able to avoid another draw under its PSPA because it had a sufficient capital cushion to absorb the loss. Going forward however the current terms of the PSPAs, which require the GSEs to steadily reduce their existing capital cushions, may see one or both GSEs experience a non-cash hedging charge of a magnitude sufficient to exhaust their thin capital cushions. This event could occur as early as May 2016 when the GSEs report their first quarter results.

Unexpectedly falling interest rates, combined with the ever-declining capital reserves at both GSEs, create political risk for these huge financial institutions at a time when the US housing market already suffers from uncertainty, which in turn has softened the US recovery since 2008-10.

Given the above, we strongly urge FHFA to consider reserving any fourth quarter 2015 net positive earnings onto the books of the GSEs, as well as moving forward with the creation of a plan for the GSEs to rebuild capital - something FHFA has the absolute ability to do, in its sole discretion.

As you know, Section 2(a) of each GSE PSPA reads:

"For each Dividend Period from January 1, 2013, holders of outstanding shares of Senior Preferred Stock shall be entitled to receive, ratably, ***when, as and if declared by the Board of Directors, in its sole discretion, out of funds legally available therefor,*** cumulative cash dividends in an amount equal to the then-current Dividend Amount." (bold added)

Otherwise, the funds forwarded as a result of fourth quarter 2015 earnings would go into US general obligations, and may be dearly needed by one or both GSEs less than 90 days later. This seems the opposite of sound prudential management.

We hope no draws become necessary, but clearly the odds have risen that one may occur. The GSEs have already returned over $241 billion after drawing $187 billion from the Treasury. And all regulated U.S. financial institutions retain capital cushions precisely to guard against surprise negative outcomes such as the one described herein.

Thank you for your attention and we look forward to discussing this as soon as practical.

Sincerely,

Community Home Lenders Association

Community Mortgage Lenders of America

Independent Community Bankers of America