IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF KENTUCKY
SOUTHERN DIVISION AT PIKEVILLE

ARNETIA JOYCE ROBINSON, Plaintiff, v. THE FEDERAL HOUSING FINANCE AGENCY, in its capacity as Conservator of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, MELVIN L. WATT, in his official capacity as Director of the Federal Housing Finance Agency, and THE DEPARTMENT OF THE TREASURY, Defendants.	Civil Action No. 7:15-cv-00109-ART-EBA

SUPPLEMENTAL BRIEF OF DEFENDANTS FHFA AND MELVIN L. WATT IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS

Pursuant to the Court's order dated June 8, 2016 (Doc. # 51), Defendants Federal Housing Finance Agency ("FHFA") and Melvin L. Watt (collectively, "FHFA") submit the following supplemental brief in further support of their motion to dismiss. Doc. # 23. This brief explains why 12 U.S.C. § 4623(d) provides an additional jurisdictional bar on Plaintiff's claims, and thus an additional reason the Court should grant FHFA's motion to dismiss.

This supplemental brief was precipitated by an inquiry from the U.S. Court of Appeals for the D.C. Circuit on the morning of oral argument in *Perry Capital LLC, et al. v. Lew, et al.*, No. 14-5243 (D.C. Cir.) (argued April 15, 2016). The court asked the parties to be prepared to address at oral argument "the applicability of 12 U.S.C. § 4623(d)'s jurisdictional provision to these cases." At the conclusion of oral argument, the court requested supplemental briefing on

the issue, which FHFA provided on April 25, 2016. In that briefing, FHFA explained that Section 4623(d) bars the plaintiffs' claims, and thus provides the Court of Appeals with another independent basis to affirm the district court's decision dismissing plaintiffs' claims (*Perry Capital LLC v. Lew*, 70 F. Supp. 3d 208 (D.D.C. 2014)).

Because Plaintiff's claims in the present case are materially identical to the claims at issue in *Perry Capital*, Section 4623(d) applies equally here. Thus, in addition to the two separate statutory bases for dismissal advanced in FHFA's motion to dismiss—namely, Sections 4617(f) and 4617(b)(2)(A)(i)—Section 4623(d) independently bars Plaintiff's claims. It provides that "no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of any classification or action of the Director under this subchapter (other than appointment of a conservator under section 4616 or 4617 of this title . . .) or to review, modify, suspend, terminate, or set aside such classification or action." 12 U.S.C. § 4623(d). Contrary to Section 4623(d), adjudicating Plaintiff's claims would require the review (and, if Plaintiff has her way, nullification) of an FHFA regulatory decision, separate and apart from the Third Amendment, to suspend capital classifications and allow Fannie Mae and Freddie Mac (together, the "Enterprises") to rely solely on the Treasury commitment for capital during conservatorship. For this reason, in addition to the reasons set forth in FHFA's motion to dismiss, Plaintiff's complaint should be dismissed with prejudice.

FACTUAL AND STATUTORY BACKGROUND

On October 9, 2008, one month into the conservatorships, FHFA's then-Director James B. Lockhart III announced that he had "determined that it is prudent and in the best interests of the market to suspend capital classifications of Fannie Mae and Freddie Mac during the conservatorship, in light of the United States Treasury's Senior Preferred Stock Purchase

Agreement." FHFA News Release: *FHFA Announces Suspension of Capital Classifications During Conservatorship* (the "Oct. 2008 Action"), *available at* http://goo.gl/MzpAUH (attached as **Exhibit A**). In announcing this action, taken pursuant to his supervisory powers over the Enterprises, the Director declared: "***the existing statutory and FHFA-directed regulatory capital requirements will not be binding during the conservatorship***." Oct. 2008 Action (emphasis added). The Director also announced that "[i]n accordance with the Senior Preferred Stock [Purchase] Agreement[s]"—which were designed to prevent the Enterprises from falling to a negative net worth position—the Conservator "has directed the Enterprises to focus on managing to a positive stockholder's equity. Both Enterprises during conservatorship will work to ensure that they fulfill their mission of providing liquidity, stability and affordability to the mortgage market." *Id*. Plaintiff acknowledges this action of the Director in the Amended Complaint. Am. Compl. ¶ 125 ("FHFA has announced that, during the conservatorship, existing statutory and FHFA-directed regulatory capital requirements will not be binding on the Companies.").

The statutory provision about which the D.C. Circuit panel inquired, Section 4623(d), provides that "no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of any classification or action of the Director under this subchapter (other than appointment of a conservator under section 4616 or 4617 of this title . . .) or to review, modify, suspend, terminate, or set aside such classification or action." 12 U.S.C. § 4623(d).[1]

[1] Section 4623(d) is plainly a limitation on subject matter jurisdiction. *See* 12 U.S.C. § 4623(d) (providing "no court shall have jurisdiction . . ."); *see also United States v. Kwai Fun Wong*, 135 S. Ct. 1625, 1633 (2015) (considering whether statute "speak[s] in jurisdictional terms or refer[s] in any way to the jurisdiction of the district courts") (internal quotation marks and citation omitted). "Subject-matter jurisdiction can never be waived or forfeited," and "may be resurrected at any point in the litigation . . . ." *Gonzalez v. Thaler*, 132 S. Ct. 641, 648 (2012).

ARGUMENT

I. Adjudication of Plaintiff's Claims Challenging the Third Amendment Would Violate Section 4623(d) Because It Would Require the Review of the Director's October 2008 Action

The Director, through the October 2008 Action, set the regulatory capital ground rules governing the operations of the Enterprises in conservatorship. Specifically, pursuant to the Director's action, the pre-existing regulatory capital requirements and classification system would not be applicable to the Enterprises in conservatorship. Instead, the hundreds of billions of dollars that Treasury had committed to the Enterprises under the PSPAs would be treated by the FHFA (in its capacity as regulator) as the Enterprises' operating capital, and the regulator's ongoing safety and soundness determinations would accordingly consider the adequacy of Treasury's remaining financial commitment rather than the Enterprises' regulatory capital accounts. In seeking rescission of the Third Amendment by challenging the adequacy of the Enterprises' post-Third Amendment capital levels, Plaintiff seeks to have the Court "affect," "review," "modify," "terminate," and/or "set aside" the Director's October 2008 Action, which established a new regulatory paradigm pursuant to which FHFA as regulator would evaluate the capital adequacy of the Enterprises while in conservatorship by reference to the amount of the remaining Treasury capital commitment to both Enterprises. *See* 12 C.F.R. § 1234.8(a)(1) (joint financial regulator rule acknowledging that the Enterprises in conservatorship are operating "with capital support from the United States"). Section 4623(d) thus bars Plaintiff's claims.[2]

[2] FHFA is not asserting that the Third Amendment is a regulatory action; the Third Amendment was executed by FHFA in its capacity as Conservator. This supplemental brief explains that Plaintiff's claims seek to set aside a separate regulatory action—the Director's October 2008 Action—and thus are barred by Section 4623(d)'s jurisdiction-withdrawal provision.

Plaintiff argues the Conservator acted outside of its statutory powers and functions in agreeing to the Third Amendment because it allegedly will not "put the [Companies] in a sound and solvent condition." Indeed, Plaintiff specifically contends that the Third Amendment is unlawful because it is contrary to sound regulatory practice. According to Plaintiff:

> The Net Worth Sweep's effect on the Companies' capital retention also violates FHFA's obligation to "put the [Companies] in a sound and solvent condition." *Id.* § 4617(b)(2)(D)(i). At the core of American regulation of financial institutions are capital requirements, with capital defined as the excess of assets over liabilities. Such capital serves as a buffer against the inevitable vicissitudes of the economic cycle that affect all financial institutions. Institutions with sufficient capital are deemed safe, and those without capital are deemed unsound. The Net Worth Sweep condemns the Companies into the ranks of the undercapitalized on a permanent basis. It is difficult to imagine a regulatory action more calculated to undermine the "soundness and solvency" of a financial institution than the Net Worth Sweep.

Opp. to Mot. to Dismiss, 34 (Doc. # 32); *see also* Am. Compl. ¶ 99 (alleging the Third Amendment "force[s] the Companies to operate in perpetuity on the brink of insolvency in a manner that federal regulators in other contexts understand to be fundamentally unsafe and unsound"); *id.* ¶ 111 (alleging the Third Amendment "mak[es] [the Enterprises] fundamentally unsafe and unsound"); *id.* ¶ 113 (alleging the Third Amendment "is the antithesis of operating it in a sound manner"); *id.* ¶¶ 25, 112, 125 (similar).

In substance, then, Plaintiff seeks to nullify the Director's October 8, 2008 action suspending the applicability of regulatory capital requirements on the Enterprises, and to substitute its judgment with regard to safety and soundness determinations for that of the FHFA as regulator. Indeed, Plaintiff's efforts to rescind the Third Amendment depend on a challenge to the prudence of the Director's October 2008 Action because, according to Plaintiff, it permits the Enterprises in conservatorship to operate at unsafe and unsound capital levels. But Congress delegated such judgments concerning the Enterprises' safety and soundness to the FHFA as

regulator, and Plaintiff's claims would interfere with FHFA's supervisory process. In Section 4623(d), Congress specifically precluded judicial review of FHFA's supervisory actions aimed at maintaining the Enterprises' soundness and solvency, including with respect to the Enterprises' capital requirements: "Except as provided in this section, no court shall have jurisdiction to affect, by injunction or otherwise, the issuance or effectiveness of any classification or action of the Director under this subchapter . . . or to review, modify, suspend, terminate, or set aside such classification or action." 12 U.S.C. § 4623(d) (emphasis added). [3]

Here, Plaintiff's request that the Court rescind the Third Amendment would necessarily "affect" "review," "modify," "terminate," and/or "set aside" the Director's October 2008 Action to suspend pre-conservatorship regulatory capital requirements. Section 4623(d) plainly bars Plaintiff's claims challenging the Third Amendment as inconsistent with sound and solvent operations or the purported statutory obligations and duties of FHFA as Conservator or regulator.

CONCLUSION

For the foregoing reasons—in addition to the bar against challenges to Conservator actions set forth in Section 4617(f), and the succession to all shareholder rights set forth in

[3] Section 4623(d)'s jurisdictional bar is consistent with the well-established principle that courts lack the ability to review supervisory decisions concerning capital requirements because such decisions are inherently discretionary in nature. *See, e.g.*, *Frontier State Bank Oklahoma City, Okla. v. FDIC*, 702 F.3d 588, 595, 596-97 (10th Cir. 2012) (finding no standard to review FDIC order relating to bank's capital levels, explaining, "[t]his lack of standard is, in large part, a result of the subjectivity inherent in invested capital determinations. . . . The amount of capital a bank needs to weather uncertainty is a subjective judgment dependent on an informed analysis of the magnitude and likelihood of the attendant risks. . . . Reasonable minds will differ as to appropriate capital levels because they reasonably differ on their assessment of the attendant risks.") (internal citation and quotation marks omitted); *United Liberty Life Ins. Co. v. Ryan*, 985 F.2d 1320, 1327 (6th Cir. 1993) (finding no jurisdiction to review third party's claim that challenged OTS decision not to enforce an institution's compliance with agreement to maintain certain capital levels); *FDIC v. Bank of Coushatta*, 930 F.2d 1122, 1129-30 (5th Cir. 1991) (finding no standard to review the FDIC's exercise of discretion to issue capital directive to bank).

Section 4617(b)(2)(A)(i)—this Court should dismiss Plaintiff's complaint with prejudice because Plaintiff's challenge to the Director's capital determination is precluded by Section 4623(d).

Dated: June 16, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of June, 2016, I electronically filed the foregoing through the Court's ECF system, which will send a notice of electronic filing to all parties to this action.

/s/ Howard N. Cayne

News Release

FHFA Announces Suspension of Capital Classifications During Conservatorship

Discloses Minimum And Risk-Based Capital Classifications As Undercapitalized For The Second Quarter 2008 For Fannie Mae And Freddie Mac

FOR IMMEDIATE RELEASE

10/9/2008

Washington, D.C. – James B. Lockhart III, Director of the Federal Housing Finance Agency (FHFA), the safety and soundness regulator for Fannie Mae and Freddie Mac and the Federal Home Loan Banks, placed Fannie Mae and Freddie Mac into conservatorship on September 7, 2008. The capital requirements and classification process articulated in statute are established as part of a prompt corrective action framework that requires supervisory actions to be taken promptly and in a graduated manner that culminates, in the most serious cases, in the appointment of a conservator or receiver. While in conservatorship status, the Enterprises will not be subject to other prompt corrective action requirements. The Treasury Department, in conjunction with the conservatorship, provided two facilities to support the Enterprises. The GSE Credit Facility is available to provide liquidity through secured loans as needed. The Senior Preferred Stock Purchase Agreement ensures that for the very long-term that both entities will have positive net worth. The Director is, therefore, announcing several capital-related decisions impacting future reporting processes.

Suspension of Capital Classifications During Conservatorship

The Director has determined that it is prudent and in the best interests of the market to suspend capital classifications of Fannie Mae and Freddie Mac during the conservatorship, in light of the United States Treasury's Senior Preferred Stock Purchase Agreement. FHFA will continue to closely monitor capital levels, but the existing statutory and FHFA-directed regulatory capital requirements will not be binding during the conservatorship.

Management During Conservatorship

In accordance with the Senior Preferred Stock Agreement FHFA, as conservator, has directed the Enterprises to focus on managing to a positive stockholder's equity. Both Enterprises during conservatorship will work to ensure that they fulfill their mission of providing liquidity, stability and affordability to the mortgage market.

Disclosure of Capital Positions During Conservatorship

During the conservatorship, FHFA will not issue a quarterly capital classification. The Enterprises will continue to submit capital reports to FHFA during the conservatorship. Relevant capital figures (minimum capital requirement, core capital, and GAAP net worth) will be available in the Enterprises' quarterly 10-Q filings, as well as on FHFA's website to ensure market transparency. FHFA does not intend to publish critical capital, risk-based capital, or subordinated debt levels during the conservatorship. In light of its new authority under the Housing and Economic Recovery Act, FHFA will be revising minimum capital and risk-based capital requirements.

Second Quarter Capital Classification

Director Lockhart is classifying Fannie Mae and Freddie Mac as of June 30, 2008, prior to the conservatorship, as undercapitalized using FHFA's discretionary authority provided in the statute. Both Fannie Mae and Freddie Mac have publicly released financial results for the second quarter 2008. Although both Enterprises' capital calculations for June 30, 2008 reflect that they met the FHFA and statutory requirements for capital, the continued market downturn during late July and August raised significant questions about the sufficiency of capital. The following factors, which led to the need for conservatorship, support the Director's decision to downgrade the classification to undercapitalized:

- Accelerating safety and soundness weaknesses, especially with regard to credit risk, earnings outlook, and capitalization;
- Continued and substantial deterioration in equity, debt, and MBS market conditions;
- The current and projected financial performance and condition of each company as reflected in its second quarter financial reports and our ongoing examinations;
- The inability of the companies to raise capital or to issue debt according to normal practices and prices;
- The critical importance of each company in supporting the country's residential mortgage market; and
- Concerns that a growing proportion of their respective statutory core capital consisted of intangible assets.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Federal Housing Finance and Regulatory Reform Act, Division A of the Housing and Economic Recovery Act, Public Law No. 111-289, Stat. 2654 (2008) requires the FHFA Director to determine the capital level and classification of the Enterprises not less than quarterly, and to report the results to Congress. FHFA classifies the Enterprises as adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized. The Enterprises are required by federal statute to meet both minimum and risk-based capital standards to be classified as adequately capitalized. The Director has the authority to make a discretionary downgrade of the capital adequacy classification should certain safety and soundness conditions arise that could impact future capital adequacy. This classification requirement serves no purpose once an Enterprise has been placed into conservatorship.

SECOND QUARTER CAPITAL RESULTS

Minimum Capital

Fannie Mae's FHFA-directed capital requirement on June 30, 2008 was $37.5 billion and its statutory minimum capital requirement was $32.6 billion. Fannie Mae's core capital of $47.0 billion exceeded the FHFA-directed capital requirement by $9.4 billion.

Freddie Mac's FHFA-directed capital requirement on June 30, 2008 was $34.5 billion and its statutory minimum capital requirement was $28.7 billion. Freddie Mac's core capital of $37.1 billion exceeded the FHFA-directed minimum capital requirement by $2.7 billion.

Enterprise Minimum Capital Requirement (Billions of Dollars) (a,b)				
	Fannie Mae		**Freddie Mac**	
	30-Jun-08	31-Mar-08	30-Jun-08	31-Mar-08
Minimum Capital – Statutory Requirement	32.631	31.335	28.709	26.937
Minimum Capital – FHFA Directed Requirement	37.525	37.602	24.451	32.324
Core Capital	46.964	42.676	37.128	38.319
Surplus (Deficit) (based on FHFA Directed Requirement)	9.439	5.074	2.676	5.995
Surplus as a Percent of FHFA Directed Requirement	25.2%	13.5%	7.8%	18.5%

a. Numbers may not add due to rounding.

b. FHFA has directed both Fannie Mae and Freddie Mac to maintain additional capital in excess of the statutory minimum capital requirement. The excess capital requirement has been in place since January 28, 2004, for Freddie Mac and since September 30, 2005, for Fannie Mae. For both Enterprises the requirement was reduced from 30% to 20% on March 19, 2008. On May 19, 2008 the requirement was further reduced for Fannie Mae to 15%. The FHFA-directed minimum capital requirements and capital surplus numbers stated in these charts reflect the inclusion of the additional FHFA-directed capital requirements of 15% for Fannie Mae and 20% for Freddie Mac for the quarter-end June 30, 2008.

Risk-Based Capital

As of June 30, 2008, Fannie Mae's risk-based capital requirement was $36.3 billion. Fannie Mae's total capital of $55.6 billion on that date exceeded the requirement by $19.3 billion.

As of June 30, 2008, Freddie Mac's risk-based capital requirement was $20.1 billion. Freddie Mac's total capital of $42.9 billion on that date exceeded the requirement by $22.8 billion.

Enterprise Risk-Based Capital Requirement (Billions of Dollars) (a)								
Interest Rate Scenario	**Fannie Mae**				**Freddie Mac**			
	30-Jun-08		31-Mar-08		30-Jun-08		31-Mar-08	
	Up	Down	Up	Down	Up	Down	Up	Down
Risk Based Capital Requirement	6.196	36.288	14.344	23.099	0.237	20.139	5.127	26.060
Total Capital		55.568		47.666		42.916		42.173
Surplus (Deficit)		19.280		24.567		22.777		16.113

a. Numbers may not add due to rounding.

DEFINITION OF CAPITAL STANDARDS

Core Capital is the sum of outstanding common stock, perpetual, noncumulative preferred stock, paid-in capital, and retained earnings. Core capital does not include Accumulated Other Comprehensive Income (AOCI), which is captured as part of stockholder's equity.

Total Capital is the sum of Core Capital plus the allowance for loan losses.

Minimum Capital represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. For purposes of minimum capital, an Enterprise is considered by law adequately capitalized if core capital—common stock; perpetual noncumulative preferred stock; paid in capital; and retained earnings—equals or exceeds minimum capital. The minimum capital standard is 2.5 percent of assets plus 0.45 percent of adjusted off-balance-sheet obligations, including guaranteed mortgage securities.

The FHFA-directed capital requirement is the amount of capital the Enterprise is required to maintain to compensate for increased operational risks including systems, accounting, and internal control risks. The level is prescribed by the Director of FHFA. This requirement is calculated by multiplying the statutory minimum capital requirement by 1.x times, where x equals the percentage requirement in effect for the time period. On March 19, 2008, FHFA announced an agreement with the Enterprises to reduce the FHFA-directed capital requirement from 30 percent to 20 percent in recognition of the significant remediation efforts and the commitments by the Enterprises to raise significant new capital and to retain substantial surpluses over the FHFA-directed requirement. The FHFA-directed requirement as of June 30, 2008 was 1.20 times the statutory minimum capital requirement for Freddie Mac and 1.15 times the statutory minimum capital requirement for Fannie Mae.

FHFA's risk-based capital requirement is the amount of total capital—core capital plus a general allowance for loan losses less specific reserves—that an Enterprise must hold to absorb projected losses flowing from future adverse interest-rate and credit-risk conditions specified by statute, plus 30 percent mandated by statute to cover management and operations risk. The risk-based capital standard is based on stress test results calculated for the two statutorily prescribed interest rate scenarios, one in which 10-year Treasury yields rise 75 percent (up-rate scenario) and another in which they fall 50 percent (down-rate scenario). Changes in both

scenarios are generally capped at 600 basis points. The risk-based capital level for an Enterprise is the amount of total capital that would enable it to survive the stress test in whichever scenario is more adverse for that Enterprise, plus 30 percent of that amount to cover management and operations risk.

The **critical capital** level is the amount of core capital below which an Enterprise must be classified as critically undercapitalized and generally must be placed in conservatorship. Critical capital levels are computed consistent with the Federal Housing Enterprises Safety and Soundness Act of 1992 as follows: One-half of the portion of minimum capital requirement associated with on-balance-sheet assets plus five-ninths of the portion of the minimum capital requirement associated with off-balance-sheet obligations. The critical capital trigger is irrelevant during the conservatorship period.

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