Treasury Rolls Out Huge Fannie/Freddie Reform Plan

By: Jann Swanson | Fri, Sep 6 2019, 11:24 AM

The Treasury Department released the Trump Administration's long-awaited plan for reforming the nation's housing finance system on Thursday. Treasury says the Plan "includes nearly 50 recommended legislative and administrative reforms to define a limited role for the Federal Government in the housing finance system, enhance taxpayer protections against future bailouts, **and promote competition in the housing finance system**."

The plan is a response to a March 2019 Presidential Memorandum directing Treasury Secretary Steven T. Mnuchin to develop a framework for administrative and legislative reforms to address what it called the last unfinished business of the financial crisis. The Treasury Department said it met with a wide range of stakeholders including affordable housing advocates; broker-dealers; investors; mortgage lenders, servicers, and insurers; think tanks; trade associations; and other interested parties in developing the plan. The Department also consulted with Federal Housing Finance Agency (FHFA), the Department of Housing and Urban Development (HUD), and other government agencies.

Treasury says it prefers that Congress enact comprehensive reform legislation and would support legislation that authorizes an explicit, **paid-for government guarantee limited to paying principal and interest on mortgage-backed securities** (MBS), but adds that the housing finance system has functioned for some time, and continues to function, without such a guarantee. Preferred legislation could also achieve lasting structural reform that tailors an explicit guarantee to support the secondary market, repeals Fannie Mae and Freddie Mac's (the GSE's) congressional charters and other privileges that advantage them over the private sector.

However, Treasury adds that reform should not and need not wait on Congress. FHFA has the statutory authority to take action. It was immediately clear that a legislative solution could continue to be difficult to achieve. Democrats quickly assailed the plan, specifically its treatment of the GSE's current mandate to provide affordable housing and several of Treasury's solutions run counter to bills introduced by Republicans when they controlled the House.

Mnuchin said, "The Trump Administration is committed to promoting much needed reforms to the housing finance system that will protect taxpayers and help Americans who want to buy a home. An effective and efficient Federal housing finance system will also meaningfully contribute to the continued economic growth under this Administration."

Here are some of the highlights of the Treasury plan.

General Proposals

- The existing Government support of the secondary market should be explicitly defined, tailored, and paid-for, and **the 11-year conservatorship of the GSEs should come to an end.** The FHFA and HUD should develop and implement a specific understanding as to the appropriate roles and overlap between the GSEs and the Federal Housing Administration (FHA).
- Reforms should enhance taxpayer protections against future bailouts by ensuring that the GSEs and their successors are appropriately capitalized to withstand a severe economic downturn and ensure that shareholders and unsecured creditors, rather than taxpayers, bear any losses.
- Private sector competition in the housing finance system **will be encouraged by leveling the playing field.** Recommended reforms include simplifying the Consumer Financial Protection Bureau's (CFPB's) qualified mortgage (QM) rule and eliminating the QM patch, reducing unnecessary regulatory impediments to responsible private-label securitization (PLS), and limiting certain GSE activities for which Government support is not necessary or justified. The QM patch should be replaced with a bright line safe harbor that does not rely on the GSEs' practices.

Suggestions for Legislative Reforms

- Support of each GSE under its Senior Preferred Stock Purchase Agreement (PSPA) with Treasury should be replaced with an explicit, paid-for government guarantee limited to the timely payment of principal and interest on qualifying MBS. The explicit Government guarantee should be available to the re-chartered GSEs and to any other FHFA-approved guarantors of properly collateralized MBS. **The guarantee would be triggered only in exigent circumstances.**
- Guarantors should be supervised and regulated by FHFA and that agency would require each guarantor to be appropriately capitalized to remain viable as a going concern after a severe economic downturn and also to ensure that shareholders and unsecured creditors, rather than taxpayers, bear losses.
- Single-family guarantors should be required to maintain a nationwide cash window through which small lenders can sell loans for

cash, and also should be prohibited from offering volume-based pricing discounts or other incentives to their lender clients.
- The reformed regulatory framework should not create capital arbitrage or other regulatory incentives that bias mortgage lenders toward securitizing their loans through guarantors. In particular, similar credit risks generally should have similar credit risk capital charges across market participants.

Suggested Administrative Reforms

- Treasury expects that it will be necessary to maintain limited and tailored Government support for the GSEs by leaving the PSPA commitment in place after the conservatorships. Treasury should be compensated for its continued support through the periodic commitment fee, as originally established by the PSPAs.
- The GSEs should be recapitalized with significant first-loss private capital to ensure Treasury's ongoing commitment could be drawn upon only in exigent circumstances. Consideration should be given to adjusting the current "net worth sweep."
- FHFA should begin the process of ending the GSEs' conservatorships. An eventual end is also necessary to reduce the far-reaching Government influence over the housing finance system inherent in FHFA's management of the GSEs through the conservatorships.
- Even after recapitalization, taxpayers will still bear some risk of a future draw on the PSPA commitment and **that agreement should be amended so Treasury can mitigate the risk of such a draw**. Other PSPA amendments should ensure that each GSE continues to be subject to appropriate mission and safety and soundness regulation after the conservatorship and to limit future GSE activities to those that have a close nexus to the underlying rationale for Government support.

Proposals for Affordable Housing

- The GSEs should continue to support affordable housing for low- and moderate-income, rural, and other similar borrowers but FHA and the Government National Mortgage Association (Ginnie Mae) have primary responsibility for **providing affordable housing support that cannot be fulfilled through traditional underwriting.**
- Consistent with its charter, each GSE's role should be to perform activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities. As set forth in this plan and HUD's reform plan, FHFA and HUD should develop and implement a specific understanding consistent with these defined roles for the GSEs and FHA so as to avoid duplication of Government support.

Maxine Waters (D-CA), chair of the House Financial Services Committee, issued a statement late Thursday in response to the Treasury plan. It said in part, "Reforming our system of housing finance is a proposition that has very serious implications for millions of Americans, including those aspiring to become homeowners as well as renters. It is an immense responsibility, and it is critical that housing finance reform proposals do not diminish opportunities for homeownership, increase housing costs, or make housing less available. However, Trump's plan appears to do just that.

"The proposal raises serious concerns about the future of housing in this country, particularly affordable housing. One of the most egregious parts of this proposal-and one which could cause significant damage for low-income persons and communities of color-is the replacement of the affordable housing goals with a fee that would fail to adequately support affordable housing. **This would hamper the ability of millions of underserved families to achieve the dream of homeownership.**"

A statement of support came from the Mortgage Bankers Association (MBA). Robert D. Broeksmit, its president and CEO said, "MBA applauds the Administration for releasing these reports, which highlight the critical need for comprehensive housing finance reform. We are gratified that the reports reflect many of the important priorities that MBA has long recommended, including:

- protecting taxpayers from future bailouts,
- an explicit government guarantee on qualified mortgage-backed securities for single-family and multifamily loans,
- increased competition and consumer choice via potential additional guarantors, and
- ensuring a level playing field for lenders of all sizes and business models.

"The reports recognize the need to better coordinate the roles of FHA and the GSEs. Such coordination must preserve affordable financing options for a wide range of borrowers and reflect the vital role FHA plays in the larger housing finance system."

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