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Treasury and HUD Submit Housing Finance Reform Plans to President

[31958]

September 11, 2019 TO: ICI Members
Fixed-Income Advisory Committee
SEC Rules Committee SUBJECTS: Fixed Income Securities
Trading and Markets RE: Treasury and HUD Submit Housing Finance Reform Plans to President

On September 5th, the US Department of Treasury and the US Department of Housing and Urban Development (HUD) submitted plans on housing finance reform to the President.[1] The plans respond to a March 27th memorandum from President Trump directing Treasury and HUD to develop plans for administrative and legislative reforms to achieve specified housing reform goals ("Presidential Memorandum").[2] The plans reflect a concern that the US housing finance system requires significant reform to reduce the role of the federal government, increase private sector competition, refocus federal housing agencies on their core missions, and protect taxpayers from the risk of future bailouts.[3]

We have summarized, below, those aspects of the plans that may be of most interest to registered investment companies. We have attached to this memorandum, as an appendix, a complete list of the plans' recommended legislative and administrative reforms.

Following the plans' publication, the US Senate Committee on Banking, Housing, and Urban Affairs held a hearing on September 10th, entitled "Housing Finance Reform: Next Steps."[4] Testifying at the hearing were Steven Mnuchin, Secretary of the Treasury; Benjamin Carson, Secretary of HUD; and Mark Calabria, Director, FHFA.

US Department of the Treasury Housing Reform Plan

The Treasury Housing Reform Plan recommends legislative and administrative reforms to achieve each of the housing reform goals set out in the Presidential Memorandum, including: (i) ending the conservatorships of the Government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, upon the completion of specified reforms; (ii) facilitating competition in the housing finance market; (iii) establishing regulation of the GSEs that safeguards their safety and soundness and minimizes the risks they pose to the financial stability of the United States; and (iv) providing that the federal government is properly compensated for any explicit or implicit support it provides to the GSEs or the secondary housing finance market.

The Treasury plan recommends reforms to define a limited role for the federal government in housing finance. It would end the conservatorships of the GSEs, subject to preconditions intended to ensure that each GSE can operate safely and soundly without posing an undue systemic risk. Among other things, this would include measures to avoid disruption to the market for the GSE's mortgage-backed securities (MBS), including previously-issued MBS.

Treasury recommends legislation that would replace existing Treasury support of the GSEs through Senior Preferred Stock Purchase Agreements with an explicit, paid-for guarantee issued by the Government National Mortgage Association ("Ginnie Mae"), backed by the full faith and credit of the federal government with respect to the timely payment of principal and interest on qualifying MBS. Thus, the plan contemplates expanding Ginnie Mae's current role as guarantor for certain limited types of MBS to also serving as guarantor for MBS backed by eligible single- and multi-family housing mortgages.

The plan recommends that each GSE be recapitalized with significant first-loss private capital so that Treasury's commitment could be drawn upon only in exigent circumstances. Treasury notes that the GSEs' credit risk transfer (CRT) programs are an existing source of private capital and directs FHFA to encourage the GSEs to continue to engage in a diverse mix of economically sensible CRT programs. Treasury also recommends measures to enhance the GSEs' liquidity risk management requirements.

The Treasury plan seeks to encourage private sector competition in the housing finance system by leveling the playing field between the GSEs and private sector competitors. For example, Treasury recommends that the "Qualified Mortgage (QM) patch" in the Consumer Financial Protection Bureau's ability-to-repay rule be allowed to expire and be replaced with a bright line safe harbor. The QM patch provides favorable regulatory treatment with respect to loans eligible to be purchased or guaranteed by the GSEs while they operate under conservatorship. The Treasury plan also recommends expanding permitted MBS guarantors to include not only the re-chartered GSEs, but other FHFA-approved guarantors of MBS collateralized by eligible mortgage loans.

The plan also recommends that the GSEs continue to support affordable housing goals, but that FHFA and HUD develop and implement an understanding regarding the appropriate roles for the GSEs and the Federal Housing Administration (FHA) to avoid duplication of Government support.

HUD Housing Finance Reform Plan

The HUD Housing Finance Reform Plan recommends legislative and administrative reforms to achieve each of the housing reform goals set out in the Presidential Memorandum, including: (i) seeking to ensure that FHA and Ginnie Mae assume primary responsibility for providing housing finance support to low- and moderate-income families that cannot be fulfilled through traditional underwriting; (ii) reducing taxpayer exposure through improved risk management and program and product design; and (iii) modernizing the operations and technology of FHA and Ginnie Mae.

To reduce taxpayer exposure, HUD recommends that FHA undertake reforms to improve its risk monitoring capabilities and reduce risk to the FHA portfolio. HUD recommends, among other things, that Congress direct it to evaluate options, feasibility, and the economics of a CRT program similar to those recently implemented by the GSEs. It also recommends that Congress enact legislation to restructure FHA as an autonomous government corporation within HUD.

The HUD plan notes key areas where Ginnie Mae will continue to focus on improving its risk management and facilitating liquidity in the housing finance system. HUD recommends a series of reforms intended to strengthen and modernize Ginnie Mae's internal approach to risk, program guidelines, and securitization platform to better serve and protect borrowers, investors, issuers, and taxpayers. The plan notes that Ginnie Mae's guaranty fee was set by statute in 1987 and recommends that Congress pass legislation granting Ginnie Mae the authority to administratively adjust its guaranty fee within a narrow, permissible range.

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Attachment

endnotes

[1] The Treasury Department plan is *available at* https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf and the HUD plan is *available at* https://home.treasury.gov/system/files/136/HUD-Housing-Finance-Reform-Plan-September-2019.pdf.

[2] *See* https://www.whitehouse.gov/presidential-actions/memorandum-federal-housing-finance-reform/.

[3] The day after the plans were published, an *en banc* panel of the US Federal Court of Appeals for the Fifth Circuit issued a ruling in a case brought by shareholders of Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac") against the Department of Treasury and its Secretary, and the Federal Housing Finance Agency (FHFA) and its Director. A majority of the *en banc* court: (i) upheld against dismissal the plaintiffs' claim that the 2012 amendments by Treasury and FHFA to their financing agreements to require Fannie Mae and Freddie Mac to pay their profits to the US Treasury (commonly known as the "net worth sweep") exceeded FHFA's authority and (ii) held that FHFA's design, as an independent agency with a single director removable only "for cause," is unconstitutional. A different majority of the *en banc* court held that the plaintiffs' remedy for their second claim is to obtain a declaration that FHFA's structure is unconstitutional. *See Collins v. Mnuchin*, No. 17-20364 (5th Cir. 2019). We will continue to closely monitor developments in this case, including any appeal.

[4] *See* https://www.banking.senate.gov/hearings/housing-finance-reform-next-steps.