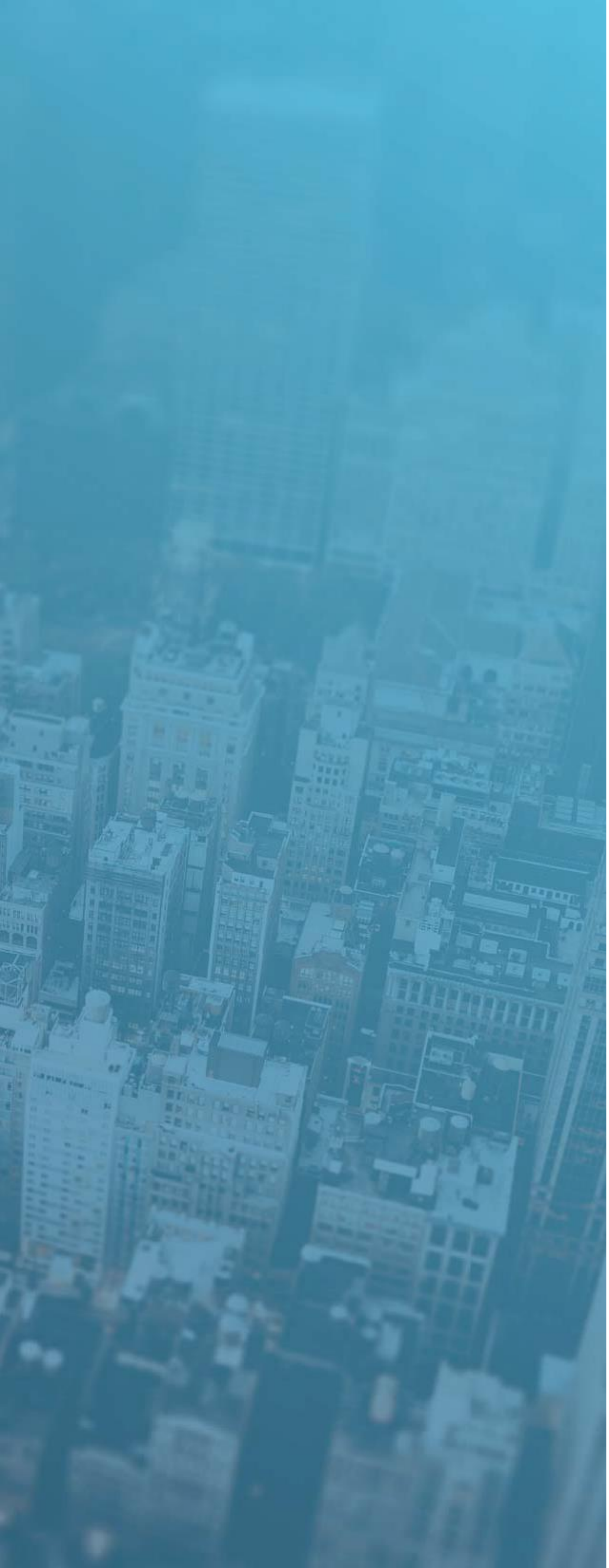

SFIG Principles for Administrative Reform: Ten-Year Anniversary of the Conservatorship of Fannie Mae and Freddie Mac

November 6, 2018

September 6th, 2018 marked the 10th anniversary of the two Government Sponsored Enterprises (GSEs)—Fannie Mae and Freddie Mac—being placed into conservatorship by the Federal Housing Finance Agency (FHFA). At that time, it would have been difficult to predict that ten years later, the GSEs would remain under government control. The conservatorship has outlasted two Presidential administrations, and is currently on its third. It has outlasted Congresses with Democratic majorities, Congresses with Republican majorities, and divided Congresses. It has outlasted the FHFA Director that began the conservatorship, the subsequent Acting FHFA Director, and is on the verge of outlasting another FHFA Director. The enduring conservatorships of the GSEs speaks not only to the difficulty of resolving the underlying issues, but also of how prominent a role—for better and for worse—the GSEs have played in serving as the primary source of mortgage credit for the last 10 years. As Structured Finance Industry Group (SFIG) Head of Mortgage Policy Dan Goodwin testified before Congress last year:

> While the overall economic environment, and housing finance in particular, has recovered substantially since the crisis nearly 10 years ago and home prices in most markets have largely recovered, private capital's role in that recovery has been comparatively small, in historical terms, in relation to the government's role. The disproportionately large role of the government in today's housing finance system is the outcome of many factors but it is inarguably in an unhealthy condition.[1]

Given the prominence of the GSEs in the secondary market, any GSE reform efforts should seek not only to solve the issues laid bare during the last financial crisis, but to do so in a way that preserves the relative stability currently in existence. Such reforms should continue to seek ways to minimize risk to the US taxpayer, utilizing methods of disseminating mortgage credit in the capital markets (e.g. the CRT programs). Moreover, such reform efforts should be holistic, involving the entire range of Federal policymakers and regulators—including not only the FHFA, but also the Department of the Treasury, the Department of Housing and Urban Development, Ginnie Mae, and the Bureau of Consumer Financial Protection—whose interrelated programs and policies define the contours of the mortgage market. As SFIG stated in its response to Congressional Questions for the Record to the House Financial Services Committee, "An orderly, transparent process that is telegraphed well in advance will enable existing lenders to ramp up their processes and encourage private capital currently on the sidelines to enter the PLS market."[2] It is with this view in mind that SFIG has previously written[3] on some of the guiding principles that we believe are critical to ensuring a stable transition to a future secondary market that appropriately balances the role of government and the need for private capital. These principles are:

- Preserving a deep and liquid secondary market, including the TBA market.
- Maintaining stability through all credit cycles, and throughout the transition process to the new system.
- Ensuring transparency of risk in the system with capital standards and safeguards that appropriately account for and are tailored to that risk.
- With limited public-policy based exceptions, allowing private capital to compete on a level playing field with taxpayer-backed funding[4].

[1] https://financialservices.house.gov/uploadedfiles/hhrg-115-ba04-wstate-dgoodwin-20171102.pdf. Note that in this context, the role of private capital specifically refers to the role of private capital in assuming mortgage credit risk.
[2] http://www.sfindustry.org/images/uploads/pdfs/QFR_Final.pdf
[3] https://financialservices.house.gov/uploadedfiles/hhrg-115-ba04-wstate-dgoodwin-20171102.pdf
[4] SFIG's advocacy of a level playing field recognizes that the public purpose of the GSEs may require certain concessions to a level playing field approach in the pursuit of public policy goals. Such goals include, but are not limited to, housing affordability,

- Developing a self-sustaining system which does not require future government bailouts.
- Providing access to credit at competitive rates through all market cycles, including provision of the 30-year fixed rate mortgage, with transparent and fully-funded support for affordable housing.

Previously, application of these principles was typically discussed in terms of legislative reform to the GSEs. Despite various attempts by Congress to reform the GSEs, however, the political landscape of the past decade has stymied progress on the legislative front. Thus, as we approach the end of current FHFA Director Mel Watt's tenure as conservator of Fannie Mae and Freddie Mac, the focus now shifts to Administrative reform, including a discussion of how a new FHFA Director—nominated by the President, and confirmed by the Senate—could implement administrative changes.

Under the Housing and Economic Recovery Act of 2008 (HERA), the statute which enabled FHFA to place the GSEs in conservatorship, the FHFA has broad authority in regulating, managing, overseeing, conserving, and preserving Fannie Mae and Freddie Mac. Acting Director Ed DeMarco testified to Congress in 2011 that "As conservator, FHFA stands in the place of each company's shareholders, boards, and management."[5] In practice, this means that the FHFA exercises a level of control both as regulator and conservator of financial institutions that is without parallel across the Federal Government.

At various points during conservatorship, that broad authority has been used to raise the guarantee fee charged by the GSEs[6], to implement a move towards more risk-based pricing across the GSE's loan-level price adjustment (LLPA) matrices[7], and to prevent the GSEs from engaging in principal reduction[8]. That same authority has also been used to halt previously announced increases to the guarantee fee[9], to allow the GSEs to expand the credit box by offering mortgages to borrowers with higher debt-to-income (DTI) ratios and lower down payments, and to direct the GSEs to explore credit scoring mechanisms and define, through rulemaking, the standards and criteria the Enterprises will use to validate credit score models.[10]. In short, the power of the FHFA conservatorship is plenary and expansive.

With a new FHFA Director comes new policy priorities and new decisions. While we do not yet know what those priorities will be, nor do we know what steps an as-yet-unnamed Director will undertake in furtherance of those priorities, there have been various proposals offered for what kinds of actions a new FHFA Director could plausibly take under the powers vested under HERA. Some examples of those actions might include:

- Lowering the conforming loan limits, or reducing the rate at which the loan limits are increased on an ongoing basis

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counter-cyclicality, industry standardization, and systemic liquidity owing to GSE operations. However, a level regulatory playing field between the GSEs and private capital in areas where they overlap and compete should promote a return to historical norms in the mix of capital funding the mortgage markets, and minimize or prevent future disruptions.

[5] https://financialservices.house.gov/uploadedfiles/120111demarco.pdf

[6] https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Guarantee-Fees-History.aspx

[7] https://www.fhfa.gov/Media/PublicAffairs/Pages/Results-of-Fannie-Mae-and-Freddie-Mac-Guarantee-Fee-Review.aspx

[8] https://www.fhfa.gov/mobile/Pages/public-affairs-detail.aspx?PageName=Letter-to-Congress-Summarizing-FHFAs-Determination-on-Principal-Forgiveness-as-Loss-Mitigation-tool.aspx

[9] https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/GfeeRFI060514F.pdf

[10] https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Credit-Scores.aspx

- Altering the risk-based pricing in the LLPAs either to reduce or increase the amount of subsidization provided to lower-credit borrowers by higher-credit borrowers
- Reducing or eliminating certain GSE products, or introducing new products offered by the GSEs
- Incentivizing borrowers towards targeted products in furtherance of public policy goals
- In conjunction with the Bureau of Consumer Financial Protection, phasing out the GSEs Qualified Mortgage Patch, which is currently set to expire in 2021
- Implementing statutory directives on credit scoring initiatives
- Introducing new structures or methods of transferring mortgage credit risk to capital markets

As these are merely some of the proposals that have been discussed, SFIG has not taken a definitive position on these topics. The manner of how these (or other) actions are implemented, along with the policy rationale behind such actions, will ultimately inform SFIG's policy and advocacy agenda around any administrative action. In establishing this agenda, SFIG Members will look to the above-mentioned principles as well as their direct experience in the secondary market.

It is generally acknowledged that GSE Reform – and housing finance reform more broadly – is the great, unfinished project following the financial crisis. The fact that it remains unfinished ten years out is testimony to the level of the challenge. However, time goes by, and our collective memories dim, and housing finance reform, to some, may no longer look like the priority that it is. We collectively cannot let that happen, as the results of continued inaction may not be pleasant. We at SFIG—both membership and staff—are eager to work with FHFA leadership and the Administration, as well as continuing our outreach to legislators on Capitol Hill, not only to keep housing finance reform at the forefront of the national agenda, but actually to accomplish it. As always, we will seek to safeguard a robust mortgage market. Such a system should ensure that private capital, and not the taxpayers, plays a crucial role in providing mortgage credit and assuming the related risk, while also supporting competitive markets that provide broad access to competitively priced credit, ultimately benefitting our nation's borrowers, renters and homeowners.