STRUCTURED FINANCE ASSOCIATION

Key Points Summary:

Treasury Department's Housing Finance Reform Plan Delays Meaningful Action Toward Replacing the GSEs

Main Takeaway

Both the Bush and Obama administrations repeatedly spoke of a congressional process to "wind down and replace the GSEs (government-sponsored entitites)" with a better system. For the Trump administration, that is officially no longer the plan, according to SFA's analysis of the U.S. Department of the Treasury Housing Reform Plan released last fall.

While Treasury prefers congressional action to effectuate many of its stated goals, it is SFA's analysis that no such legislation will occur prior to a new Congress in 2021, and thus meaningful action will require an administrative route. It could take a decade to put in place all of the recommendations in Treasury's plan, and thus this plan becoming real is linked inextricably to the reelection of the Trump administration.

Background

On September 5, 2019, Treasury released its long-awaited process for ending the conservatorship of the GSEs, Fannie Mae and Freddie Mac. Since then, some elements of the Treasury plan have begun being put into effect — for example, allowing the GSEs to retain earnings and build capital on the way to their eventual release from taxpayer ownership.

Immediately after the Treasury report was issued, SFA provided its members a summary of the proposal.

While events will unfold in the months ahead, the SFA summary of the Treasury's proposal can serve as a helpful guide to understanding the administration's path to housing finance reform and an end to GSE conservatorship, providing basic grounding for all those following this vital process.

SFA's Key Points

- The Treasury plan supports legislation that authorizes an explicit, paid-for government guarantee limited to the timely payment of principal and interest on qualifying mortgage-backed securities.
    - This would replace support provided via the Preferred Stock Purchase Agreement (PSPA) under which the GSE conservatorship operated.
    - Such a paid-for guarantee would be available to guarantors approved by the Federal Housing Finance Agencey (FHFA) with significant first-loss exposure.
- Pending legislation, the Treasury plan supports FHFA's administrative actions to enhance the regulation of the GSEs, promote private sector competition, and satisfy recommended preconditions for ending the GSEs' conservatorships.
    - It would still leave the PSPA in place after the end of GSE conservatorships, with the government being compensated via a periodic commitment fee.
    - The PSPA would be drawn upon only in exigent circumstances.
    - To facilitate GSE recapitalization, Treasury and FHFA should consider adjusting the variable divided ("net worth sweep") required by Treasury's senior preferred shares. (Note: the Treasury Department announced this as policy on September 30, 2019.)
    - The PSPAs should be amended to enhance Treasury's ability to mitigate the risk of a draw on the commitment after the conservatorships.
- The plan recommends that FHFA and the U.S. Department of Housing and Urban Development develop defined roles for the GSEs and FHA to avoid duplication of government support.
- To achieve a level playing field and private sector competition, the regulatory frameworks governing the GSEs and other market participants should be harmonized, and in particular, the qualified mortgage, or QM, patch should be replaced with a bright line safe harbor that does not rely on the GSEs' practices.

Read the full SFA summary of the Treasury report.