STRUCTURED FINANCE ASSOCIATION

November 23, 2020

Secretary Steven Mnuchin
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

RE: Preferred Stock Purchase Agreements and Releasing GSEs from Conservatorship

Dear Secretary Mnuchin,

I write on behalf of the 370 institutional members of the Structured Finance Association ("SFA") in regards to recent reports that steps are being contemplated to put Fannie Mae and Freddie Mac (the Government Sponsored Enterprises, or "GSEs") on a calendar-driven accelerated path out of their current status in conservatorship. We call upon Treasury to take responsible steps to avoid the potentially destructive effects of releasing the GSEs prematurely.

I. Introduction

As noted in SFA's response[1] to the Treasury's Housing Finance Plan, SFA is very supportive of the goals set forth by this Administration as it relates to housing finance reform generally, and GSE reform specifically. SFA believes that private capital can and should take on a much more meaningful role in providing credit to borrowers seeking mortgages, and the Treasury Department's initial report listed many sound objectives and benchmarks.

To that end, over the past year, SFA has submitted comments and engaged with regulators and legislators in efforts to increase the role of private capital. Such initiatives include:

- Providing feedback to the Consumer Financial Protection Bureau ("CFPB") on Ability to Repay/Qualified Mortgage Rules,
- Working with our issuer and investor members to respond to a request from the Securities and Exchange Commission ("SEC") on asset level disclosures to optimize market efficiency for private label residential mortgage backed securities ("RMBS"), and
- Engaging with regulators to create an overall equitable framework for capital treatment across financial institutions.

[1] https://structuredfinance.org/wp-content/uploads/2019/09/Structured-Finance-Association-Treasury-Housing-Finance-Summary.pdf

These are necessary steps, and the significant progress that has been made on these important issues is a testament to the power of industry collaborating with regulators to achieve the goals laid out in Treasury's Housing Finance Plan.

However, as we stated in our analysis of the Treasury plan, the preconditions necessary to making that happen could take years to effectuate. Notwithstanding the substantive progress that has been made, the market participants and investors who will be charged with operating and managing risk within our nation's housing finance system believe that serious questions and concerns remain unanswered or ignored. While we believe that responsible, incremental steps as part of a holistic and well-understood housing finance reform plan should continue to proceed, SFA urges the Treasury Department to not make any sudden, major substantive changes to the Preferred Stock Purchase Agreements ("PSPAs") that would place the GSEs on an irrevocable path out of Conservatorship until these questions have been answered and concerns resolved.

II. Outstanding Questions on GSE Reform

As noted above, despite the admirable progress that has been achieved to date, serious questions remain unanswered to the satisfaction of market participants. Such questions include:

1. What level and form of government support should mortgage-backed securities ("MBS"), GSE debt, GSE credit risk transfer ("CRT"), and GSE equity investors price in.
2. Will Congress approve any changes to the PSPAs or make permanent and explicit the government's role?
3. How will the capital rules for banks—particularly for Liquidity Coverage Ratio ("LCR") rules change for agency MBS—change post-conservatorship, especially since banks are among the largest holders of these securities?
4. What will regulators and leaders at the GSEs tell RMBS investors and GSE equity investors regarding the ability of the GSEs to fail or become insolvent? And how will each group of investors react to that information?
5. Currently, GSE MBS are rated the same as U.S. sovereign debt. Should this be expected to change? If so, how do you expect that to impact funding costs and therefore mortgage rates?
6. How would the Federal Reserve treat agency MBS post-conservatorship in the context of Quantitative Easing ("QE") programs? Will there be market appetite to purchase the volumes needed to support affordable housing upon the change in ratings?
7. How will the Uniform Mortgage Backed Security ("UMBS") market – where mortgage backed securities issued by each GSE are commingled - be expected to continue to function if the GSEs are privatized as corporate entities?
8. What restrictions in place during conservatorship will continue post-conservatorship such as portfolio limits, restrictions against volume discounts, coordinated data and reporting standards, servicing alignment, and so on?

9. What disclosures do you anticipate making to potential equity investors regarding these questions prior to initiating any capital raise? And will these be consistent with the disclosures given to MBS and Agency debt investors?

One of the assurances that has repeatedly been given to industry stakeholders, policymakers, and Members of Congress is that releasing the GSEs from conservatorship "is not going to be calendar-dependent"[2] or that any decision will be "driven by process, not the calendar"[3]. And yet, given the rapidly compressing timelines and hastily comprised mile-markers put into place just before a presumed transition to a new Administration, there is nothing we can assume other than that this is precisely what the current exercise would be. While we appreciate the desire to effectuate the goal of releasing the GSEs from conservatorship, it is more important that such a monumental step be undertaken with the due care and consideration that is required for something of this magnitude.

III. Treasury Should not Amend PSPAs at This Time

At the time policymakers placed the GSEs into conservatorship, steps were taken to ensure that adequate reform had taken place—both within the GSEs themselves, as well as within the larger housing finance system—before they were released as private enterprises. The market has long taken comfort in the fact that both FHFA and Treasury must agree to changes to the PSPAs. The market has also taken comfort in the fact that Congress and Treasury have made clear that final resolution to conservatorship requires Congressional action on many important issues.

At times commentary by FHFA political leadership disrupted MBS markets and even threatened UMBS. During these instances, Treasury provided calm and steady commentary that allowed markets to stabilize. This dynamic has reduced the risk that any one party is able to act rashly, which has allowed the roughly $7 trillion of investment in MBS to remain stable and withstand constantly shifting Washington political dynamics. While we are very aware of this FHFA's intense interest in getting the GSEs out of conservatorship immediately, we believe that move is premature for the reasons mentioned above. We hope the Treasury Department will ensure that the transition to the next phase of housing finance is a stable and healthy one, not one that whipsaws investors back and forth, is tethered to politics of the moment, and is difficult to explain to asset managers with strong fiduciary responsibilities to the pension plans and 401k investments under their responsibility.

IV. Conclusion

[2] https://www.fhfa.gov/Media/PublicAffairs/Pages/Prepared-Remarks-of-Dr-Mark-A-Calabria-Director-of-FHFA-at-Mortgage-Bankers-Association-National-Secondary-Market-Conference-Expo-2019.aspx
[3] https://structuredfinance.org/wp-content/uploads/2020/09/HFSC-FHFA-Memo-9.16.2020.pdf

Predicting exactly how markets will react in the wake of policy change is difficult. We may witness a sudden impact in MBS, a sustained repricing of risk that degrades UMBS liquidity and mortgage rates over time, or some combination of both. Regardless, the groundwork necessary to prepare the market for such a drastic change in the GSEs legal status has not been conducted, and therefore this would be a dangerous experiment.

Again, SFA reiterates our support for the ultimate goal of releasing the GSEs from conservatorship and to increase the role of private capital in our nation's housing finance system in a responsible manner. We applaud the work you have done to-date to help transition the system to more stable footing. However, a hastily thrown together exit from conservatorship based on the political calendar risks undoing the positive work that has been accomplished and is currently underway. We call upon Treasury to secure the accomplishments that have been made to-date, and to chart a course that will allow a responsible transition for the GSEs and orderly revisions across the financial landscape. SFA and our members stand willing to aid and engage in this important work.

Best,

Michael Bright
CEO, Structured Finance Association