



Insight

Supreme Court Rules FHFA Structure Unconstitutional

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Executive Summary

- The Supreme Court has ruled that the governance structure of the Federal Housing Finance Agency (FHFA) is unconstitutional.
- As a result, the president is free to replace the FHFA director, and it appears that decision is impending.
- The FHFA was born in the midst of the housing crisis at the heart of the Great Recession, when Congress passed the Housing and Economic Recovery Act of 2008 (HERA) and in so doing created the FHFA as a new supervisory agency to regulate the housing market.
- Structured so that the single director could only be fired for cause and insulated from the traditional appropriations process, the FHFA has seen significant constitutional challenge from inception.
- The Supreme Court also dismissed a separate suit brought by shareholders alleging that the FHFA exceeded its statutory authorities by requiring Fannie Mae and Freddie Mac, previously private entities, to direct the entirety of their profits to the Department of Treasury.

Context

In the wake of the financial collapse of 2008, the federal government created new regulatory bodies to oversee aspects of the financial services industry, most notably the Federal Housing Finance Agency (FHFA) and the Consumer Financial Protection Bureau (CFPB).

From their inception, scholars and courts have questioned the constitutionality of both agencies, as their structure significantly insulated them from traditional oversight. The FHFA has also come under legal challenge following its actions taken as the conservator of Fannie Mae and Freddie Mac, the housing finance government-sponsored enterprises (GSEs). In particular, shareholders challenged the decision of the FHFA to send all the profits of the housing giants directly to the Department of Treasury (and, relatedly, *all* decisions of the FHFA in the light of its unconstitutional structure). The Supreme Court has now at last opined on most of these questions; first [considering the CFPB in *Seila Law vs. Consumer Financial Protection Bureau*](#) and now the FHFA in [Collins vs. Yellen](#).

In both cases the Supreme Court has held that provisions preventing the president from firing the director of either agency at will are unconstitutional, but in both cases preserved the existence of the agency by severing the problematic provisions from the law otherwise empowering them. The Supreme Court also dismissed a separate suit brought by shareholders of Fannie Mae and Freddie Mac, noting that in determining the distribution of profits the FHFA had acted within its powers as conservators of the GSEs.

On the Constitutionality of its Governance Structure

Created in the midst of the housing crisis under the [Housing and Economic Recovery Act of 2008](#) (HERA), the FHFA is the primary regulator of mortgage giants Fannie Mae and Freddie Mac. Beyond overseeing the GSEs, FHFA is mandated to ensure liquidity, stability, and access in the housing market.

Hoping to insulate the FHFA from political pressures, Congress designed it to be led by a single director. Under this system the director is given near unilateral powers and can be removed by the president only “for cause,” [in cases of](#) “inefficiency, neglect of duty or malfeasance in office.” This structure is quite unlike that of other financial regulators such as the Securities and Exchange Commission (SEC) or Commodity Futures Trading Commission (CFTC), which have five-person bipartisan boards. Congress also determined that the FHFA be funded outside the traditional budgetary process. In this the FHFA, while unlike the SEC or CFTC, has much in common with the CFPB, created by the Dodd-Frank Act in 2010 to oversee the consumer finance industry.

These governance features were no accident or oversight and represent the will of Congress in seeking to isolate the FHFA from political pressures. Nonetheless, the structure of the FHFA (as well as the CFPB) spurred a decade of legal challenge as to whether the FHFA governance structure violates the separation of powers doctrine.

For the CFPB, at least, this question finally came before the Supreme Court in June 2020 in *Seila Law vs. Consumer Financial Protection Bureau*; the Court voted [5-4 that the CFPB governance model was unconstitutional](#). Chief Justice John Roberts noted that “The structure of the CFPB violates the separation of powers,” and that the director “must be removable by the President at will.” The Court chose, however, to simply sever the for-cause removal limitation from the statute, otherwise preserving the CFPB as is.

Similar if not identical rationales appear to have guided the judges in making the same decision for the FHFA in a split decision in *Collins vs. Yellen*. “The Constitution prohibits even ‘modest restrictions’ on the President’s power to remove the head of an agency with a single top officer,” wrote Associate Justice [Samuel Alito](#) in the court’s opinion. “The President must be able to remove not just officers who disobey his commands.” Again mirroring its decision relating to the CFPB, the Supreme Court has not otherwise altered the structure or operations of the FHFA.

On The Legality of the Net Worth Sweep

For years shareholders of the GSEs Fannie Mae and Freddie Mac have petitioned the courts for lost financial gains in relation to the financial arrangement between the GSEs and Treasury. At the height of the Great Recession, the GSEs received an emergency cash infusion of \$100 billion and became wards of the state. In return, shareholders of the GSEs were promised compensation in the form of [senior preferred stock](#), with priority over all other investors. That agreement was however modified in 2012 when the FHFA under the Obama Administration created the “net worth sweep” requiring the GSEs to transfer the totality of profits to Treasury, beyond required capital reserves. Investors allege that the FHFA amended the agreement knowing that the GSEs were on the verge of once again becoming profitable (since 2008 the GSEs have repaid dividends to Treasury of [\\$301 billion](#)).

Despite best hopes by investors, the Supreme Court decided in *Collins* that the FHFA did not overstep its mandate as conservator, noting “we conclude only that under the terms of the Recovery Act, the FHFA did not exceed its authority as a conservator, and therefore the anti-injunction clause bars the shareholders’ statutory claim.”

Implications

For the FHFA

The *Collins* decision will fundamentally expose the FHFA to enhanced political pressure, particularly from the president and the executive branch. These pressures will likely impact the work of the FHFA going forward. It is not just future agency rulemaking, however, that will likely be impacted. Controversial historic FHFA decisions made by directors with removal protections may become [invalid](#) or at least are likely to be litigated. Even the Supreme Court's decision to sever only part of the relevant statute may provide cause for concern regarding the legal underpinnings of the FHFA – or, even, at the most extreme view, constitute “re-writing” HERA.

One example of a joint FHFA/CFPB initiative thrown into some doubt by this decision is the [ongoing set of proposals](#) to modify the [Qualified Mortgage \(QM\) rule](#) that allows the GSEs to breach CFPB rules by providing mortgages to individuals with significant debt. The new standard is not expected to be finalized until later this year at the earliest, which could potentially be under new directors at both agencies. A Biden-appointed FHFA director could prevent the QM rule from lapsing at all.

Critics of the FHFA, however, will note that this decision, in addition to preserving the separation of powers doctrine and therefore being “correct,” will likely have the advantage of significantly increasing transparency and accountability at the agency. The *Collins* decision will also be supported by critics of government regulatory overreach, although this critique is more pointedly a criticism of the CFPB and Dodd-Frank rather than the FHFA.

For FHFA Director, Dr. Mark Calabria

The [Washington Post](#) and [Wall Street Journal](#) have reported that the White House has asked Director Calabria to resign, although official notice to this effect has not yet been seen. Director Calabria released a press statement through the FHFA noting “his honor to serve as Director of the Federal Housing Finance Agency alongside world-class staff.” It is likely that President Biden will elevate one of the three FHFA acting directors until a nomination can be made.

At the CFPB, Director Kathy Kraninger stepped down as President Biden assumed office at his request. Biden since named Rohit Chopra, a current FTC commissioner, to the role, and Chopra awaits Senate confirmation.

For Consumers

As noted above, the work of future directors will necessarily be more informed by political winds, and these pressures will directly impact the work of the FHFA and the products that it chooses to focus on. It is likely that a Biden-appointed FHFA director will again modify the net-worth sweep and in particular will focus on once again expanding the footprint of the GSEs to reach more of the market in service of affordable housing goals. While a commendable policy goal, the GSEs remain the wrong tool for the job, and expanding the role of the GSEs will only [make reform more difficult](#).

For GSE Reform

In his press release Director Calabria noted, “When the housing markets experience a significant downturn, Fannie Mae and Freddie Mac will fail at their current capital levels.” This warning would be ominous enough against any backdrop, but it is particularly telling coming from a director who has done more to advance the cause of the GSE reform than [any in the last decade](#). While the shape or direction of reform remains unclear, Director Calabria made several vital steps in the correct direction, from rebuilding capital at the GSEs to

reducing the risk they pose to the housing market. While these initiatives were slowed by the change in administration and the coronavirus pandemic, under a different director they are likely to stall entirely.

Next Steps

The legal case heard in *Seila* and then *Collins* hinged on a 1935 law that permits “Congress to give for-cause removal protection to a **multimember body of experts** who were balanced along partisan lines” (emphasis added). Independent agencies with a degree of insulation from political interference are possible, and do exist, in the U.S. regulatory system, from the Federal Reserve to the SEC and more. What differentiates these bodies from the CFPB and the FHFA is their bipartisan commission structure – a structure that existed in early drafts of the congressional statutes creating at least the CFPB, and is an issue that Congress has [explicitly considered since](#). The benefits and detriments of restructuring the FHFA and the CFPB along these lines will likely feature in policy discussions over the next year, but it is extraordinarily unlikely that there will be appetite in Congress to consider a proposal in the current legislative climate.

Conclusions

The intent of Congress in attempting to shield the FHFA and the CFPB from political influence was not in and of itself a concern; Congress just failed in its approach to the problem. Although the Supreme Court has undoubtedly reached the correct decision, its verdict will have wide-ranging ramifications for not just the FHFA and CFPB, but all other independent agencies. Furthermore, lessons learned from the unconstitutional construction of agencies and regulations constructed hastily in response to a financial crisis are more necessary than ever.