



# Treasury and HUD Release Sweeping Blueprint for Comprehensive Housing Finance Reform

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## Executive Summary

- The Departments of the Treasury and Housing and Urban Development have, at the direction of the White House, released proposals for the reform of the housing finance market, including reforms to Fannie Mae and Freddie Mac, the housing finance government-sponsored enterprises (GSEs).
- Although broader in scope than expected, the reform plans remain light on the details that matter, leaving many key questions – e.g., the process of recapitalization – unanswered.
- The reform plans are a significant milestone, providing detailed instructions to both Congress and the Federal Housing Finance Agency as to the path toward GSE reform.

## Introduction

In March 2019, the White House directed the Departments of the Treasury and Housing and Urban Development (HUD) to develop plans for administrative and legislative reforms to the housing finance market with a view to ending the federal conservatorships of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Just one day short of the 11-year anniversary of the GSEs' being put into conservatorship, Treasury and HUD have published these [proposals for reform](#).

The reform plans provide breadth, if not depth, touching on many of the aspects [outlined in the presidential memo](#), including GSE capital requirements, affordable housing, the role of the Federal Housing Administration (FHA), and promoting private competition. The reform plans also are clear on whether its recommendations are legislative, and addressed to Congress, or administrative, and in the main addressed to the Federal Housing Finance Agency (FHFA) (Treasury itself, in assigning responsibilities, shoulders amusingly few of them). What the reform plans do not provide is any real degree of detail as to how these recommendations should be achieved, and the reform plans remain as such merely a well-organized to-do list.

Perhaps most crucially, both reform plans are silent on the future of the GSEs beyond removing them from conservatorship. This suspicion is only reinforced by the recommendation that the Treasury financial backstop remain in place (albeit “limited and tailored”) and provided by Ginnie Mae. With even a limited and tailored line of credit to Treasury, the GSEs will retain much of the flavor of, well, GSEs.

Proponents of the idea that the GSEs be razed to the ground and have their fields salted will not find much in the report to reassure them other than a number of strong policy suggestions that seek to improve the standing of private operators and level the mortgage playing field.

## The Treasury Reform Plan

The Treasury reform plan reiterates its preference that Congress enact comprehensive housing finance reform but notes that reform “should not and need not wait on Congress.” As such, the reform plan divides its recommendations into legislative and administrative reforms.

### *Legislative Reforms*

Congress must authorize an explicit guarantee of qualifying mortgage-backed securities (MBS) that must only trigger in “exigent circumstances” as a true catastrophic backdrop. This explicit guarantee would be made available to a re-chartered Fannie Mae and Freddie Mac, via Ginnie Mae, and also extended to additional, new guarantors who would compete with the GSEs and also be regulated by the FHFA. Guarantors would be charged a fee in exchange for the federal guarantee. The reform plan recommends that FHFA must have additional discretion to set the capital requirements of these guarantors, including the GSEs, although reference is made that any decisions here must be in coordination with the Financial Stability Oversight Council (FSOC), recognizing that such entities would likely be systemically important. Congress should also replace the GSEs’ existing statutory affordable-housing goals with “a more efficient, transparent, and accountable mechanism for delivering tailored support.”

Of course, it does not need to be said that these detailed and numerous recommendations represents a tall order for a divided Congress, particularly in the run-up to an election. The inclusion of commentary relating to affordable housing also make Treasury’s recommendations significantly more politically complex. Senator Sherrod Brown and Congresswoman Maxine Waters have both released [statements](#) recently indicating that any housing reform must not “undermine” the housing market or decrease housing affordability, presumably even if doing so would remove systemic risk from the housing market.

### *Administrative Reforms*

Interestingly, the administrative reform section of the Treasury reform plan begins with what must not, actually, be reformed: Treasury’s financial backstop or line of credit to the GSEs. Government support for the GSEs is to remain in place, and in so doing the reform plan envisages that the preferred stock purchase agreement (PSPA) that governs the support Treasury provides to the GSEs simply be amended rather than removed. Treasury had previously committed to amending the PSPA by the end of 2019; this reform plan provides no further detail.

The reform plan continues by making it clear that recapitalization is the key to decreasing the risk the GSEs pose and the reliance of the GSEs on Treasury. GSE recapitalization has become something of a theme of GSE reform and is [a top priority](#) of FHFA Director Mark Calabria. Despite this, the reform plan is disappointingly light on proposals for recapitalization. The Treasury report lists a number of wildly different options for recapitalization (via common equity, or convertible debt, or by placing the GSEs into receivership) but does not indicate a preference or any degree of analysis, suggesting that on the most significant reform factor, Treasury does not have a plan.

Perhaps the most interesting detail – or, any detail – can be found in sections relating to the promotion of competition in the housing finance system. The Treasury report goes surprisingly far in its recommendations, which include decreasing the regulatory burdens on private industry mortgage lending, noting that the regulatory framework is “biased in favor of GSE-supported mortgage lending,” a “potentially unwarranted gap.” Given this, FHFA should seek to “harmonize” regulatory frameworks applicable to the GSEs and private

lenders operating in the same regulatory space. Staggeringly, Treasury also recommends that the GSEs' risk-capital charges be "align[ed]" to private regulatory financial institutions holding "similar assets." The FHFA should also implement a process soliciting public comment on any new pilot programs or extensions to the GSEs' footprint.

The Treasury reform plan also goes further than expected in addressing the Qualified Mortgage (QM) rules. Unsurprisingly, Treasury recommends that the Consumer Finance Protection Bureau (CFPB) allow the [QM Patch](#) (which allowed the GSEs an exception to the rule that lenders not provide mortgages to consumers with debt-to-income ratios exceeding 43 percent) to expire. What is perhaps unexpected, however, is the degree to which Treasury is prepared to countenance reform to the entire system that governs ability-to-repay (ATR) requirements, and in particular the much-maligned Appendix Q rules, in favor of a new rule that benefits private mortgage operators. Treasury directs the CFPB to consider "alternative approaches" that "do not rely on prescriptive underwriting requirements."

As one slightly more niche aside, the Treasury reform plan also directs FHFA to consider any overlap or duplication between the roles and functions performed by the GSEs and by the Federal Housing Administration. Treasury is silent, however, on what the division of those roles should be, although HUD provided a little more detail.

## **The HUD Reform Plan**

The HUD reform plan will attract, perhaps unfairly, significantly less attention. It too contains a mix of legislative and administrative reform proposals, almost entirely aimed internally at "refocusing" FHA. This has two major implications: first, reduction in risk of the FHA portfolio; and second, improving FHA's technology. HUD approached these goals via four headings: I. Refocus FHA to its Core Mission; II. Protect American Taxpayers; III. Provide FHA and GNMA Tools to Appropriately Manage Risk; and IV. Provide Liquidity to the Housing Finance System.

### *Legislative Reforms*

The vast majority of reform proposals in the HUD reform plan target FHA and, to a significantly lesser extent, Ginnie Mae. The plan's limited legislative reforms seek to address highly specific matters of some technical complexity, from establishing statutory limitations on FHA cash-out refinances to addressing the suspension periods and civil money penalties that FHA uses when assessing penalties. Two perhaps more curious legislative proposals include restructuring FHA as an autonomous government corporation within HUD and providing the funding for a "strategic modernization plan" to overhaul FHA's IT systems.

### *Administrative Reforms*

FHA must maintain an "appropriate" level of capital reserves, with HUD noting that it is and would be "unacceptable" for FHA to draw on taxpayer funds to sustain its book of business. FHA must also "ensure that borrowers are creditworthy."

FHA must also improve its risk management capabilities and, in particular, must “transform” its data analytics and “modernize” its 40-year old technology. It is perhaps surprising that HUD notes that the significant expansion in FHA’s footprint over the last decade, and the resulting creaking architecture on which it rests, must be modernized rather than downsized.

HUD notes that the technology concerns of FHA do not apply to Ginnie Mae, which has a “secure and robust” technology platform. Ginnie Mae, however, must work toward eliminating loan churning, or the process by which mortgage holders unnecessarily and expensively refinance their mortgages.

Additionally, FHA and the FHFA must work together to ensure that “government-supported mortgage programs are not competing and do not crowd private capital out of the marketplace.” FHA will also work with the Department of Justice to encourage private lenders to return to the FHA by clarifying the use of the False Claims Act.

## **Conclusions**

The Treasury and HUD housing finance reform proposals do an admirable job of indicating the desired direction for reform, although they do so without providing the level of detail hoped for on key reform details including the recapitalization of the GSEs. It is encouraging that the plans are consistent with the administration’s comments to date and specifically lead toward removing the GSEs from conservatorship. It is perhaps disappointing, however, that the GSEs are likely to retain much of the advantages (and inherent systemic riskiness) post-conservatorship that characterizes them now, although the reforms plans are likely to be considered a win for private industry with a number of policy proposals that would significantly improve their position in the marketplace.

It is wildly optimistic to think that this Congress will act on any of the suggestions directed toward it, and all eyes now are focused on the next two milestones in GSE reform: amending the PSPAs and confirming the GSE Capital Rule, both due to occur before the end of the year.