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HPC
HOUSING POLICY COUNCIL

June 6, 2019

The Honorable Steven Mnuchin
U.S. Secretary of the Treasury
1500 Pennsylvania Ave NW
Washington, DC 20220

RE: Administrative Reforms to Housing Finance System

Dear Mr. Secretary:

The Treasury Department's forthcoming report, mandated by President Trump's March 27, 2019 Memorandum on Federal Housing Finance reform, presents an important opportunity to propose a 21st century framework for the country's housing finance system. I am pleased to submit this letter outlining the views of the Housing Policy Council (HPC) on key issues to be covered by this report. HPC's members request that you consider these views as you develop your report.

The Housing Policy Council agrees with the assessment of the current situation as set forth in the President's memo:

> To date, the GSEs are the dominant participants in the housing finance system and lack real competitors. The lack of comprehensive housing finance reform since the financial crisis of 2008 has left taxpayers potentially exposed to future bailouts and has left the Federal housing finance programs at the Department of Housing and Urban Development potentially overexposed to risk and with outdated operations. Accordingly, it is time for the United States to reform its housing finance system to *reduce taxpayer risks, expand the private sector's role, modernize government housing programs, and make sustainable home ownership for American families our benchmark of success*.[1]

These four objectives – reducing taxpayer risk, expanding the private sector's role, modernizing government housing programs, and ensuring sustainable home ownership opportunities – are the right objectives.

The Housing Policy Council recently sent a letter to Secretary Carson outlining our recommendations for modernizing FHA, the government's flagship housing program. HPC set forth its views regarding the other three objectives in testimony before the House

[1] President's Memo, Page 1. Italics added.

Financial Services Committee on September 6, 2018. Attached is that testimony for your consideration. Rather than repeat those views here, in this letter I will offer the Housing Policy Council's perspective on how the Treasury Department and the Trump Administration should approach accomplishing these objectives.

The President's memo directs the Treasury to report on both legislative and administrative reforms. That is fully appropriate, and both approaches to reform will be needed. But make no mistake – true reform cannot be accomplished without legislation. Thus, legislative reform must be the ultimate focus of the Administration. The objectives of reducing taxpayer risk, expanding the private sector's role, and improving opportunities for sustainable home ownership all require the existing GSE-based system be replaced and only Congress can change or end the GSE charters.

Since the financial crisis, members of Congress have produced multiple, comprehensive reform proposals and the House and Senate have each held numerous hearings on reform ideas and issues. These efforts have been assisted by extensive engagement and input from industry, housing and civil rights advocates, think tanks, and academics. The missing participant has been the Executive Branch. Treasury's report presents the opportunity to reintroduce the Executive branch as a constructive partner in the legislative process, to help forge the compromises needed to complete housing finance reform legislation.

The good news, as explained in the attached testimony, is that the passage of time and the ongoing debate in Congress has produced broad agreement on most of the foundational elements of reform. The issues identified in the President's memo are those needing resolution to achieve broad bipartisan consensus.

Administrative reform should be viewed as a set of activities that Treasury, the Federal Housing Finance Agency (FHFA), HUD, and other regulatory agencies can pursue now to facilitate and motivate a legislative resolution. The attached testimony outlines specific steps that can be taken administratively. The general objectives of these administrative actions should be to:

- Test or develop component elements of reform;
- Prepare the markets and/or the Enterprises for reform;
- Expand the participation of private capital via credit risk transfers, mortgage insurance, and other means;
- Develop private sector capabilities to compete in a post-conservatorship world by:
    - Eliminating the 43 percent DTI requirement in the qualified mortgage rule and, by extension, allowing the GSE Patch to expire and Appendix Q to be retired (an approach that better reflects and reinforces the intent of the Ability-to-Repay and QM provisions of Dodd-Frank);
    - Rewriting the Securities and Exchange Commission's Regulation AB II to remove its onerous and needless elements and establish a uniform, robust disclosure regime applicable to GSE and non-GSE mortgage-backed securities alike;

  - Democratizing GSE mortgage data, allowing access to critical information that will enable private market participants to build new models and perform analytics to evaluate mortgage risk and compete on an equal footing.
- And finally, level the playing field by aligning capital and other regulatory requirements affecting mortgage finance across the numerous federal regulators responsible for one segment or another of this vast market.

This last bullet deserves additional explanation. Pre-conservatorship, Fannie Mae and Freddie Mac operated with regulatory capital requirements that were a fraction of what federal regulators imposed on other regulated entities in the mortgage space. There is no policy rationale for permitting such regulatory capital arbitrage in any future system. While the capital proposal put forward by FHFA last year was an improvement over the GSEs' pre-crisis capital requirements, it fell well short of achieving comparability with other federal prudential capital regulations applied to non-GSE mortgage market participants. It also failed to take account of the unique market concentration risks present in Fannie Mae and Freddie Mac as a duopoly at the center of our housing finance system.

As Treasury Secretary and Chairman of the Financial Stability Oversight Council, you are uniquely positioned to drive a regulatory conversation that leads to stronger and more equitable capital standards and other regulatory comparability across all the regulated participants in the country's housing finance system, whether bank, non-bank, or GSE. The Housing Policy Council's November 16, 2018 comment letter to FHFA on its proposed capital rule is attached for your consideration of these critical capital issues.

This and the other administrative steps aimed at leveling the playing field will lead to a more efficient and effective regulatory regime for housing finance. More than that, such steps will protect taxpayers by enhancing the market's risk-management capabilities while removing opportunities for regulatory arbitrage. It will attract private capital by removing the distortions created by the numerous advantages given to the GSEs and the penalties imposed on banks and mortgage insurance companies relative to the GSEs.

By enhancing opportunities for true market competition and innovation, the goal of creating a more stable housing finance system with greater opportunities for consumers to achieve sustainable home ownership can be realized. The attached testimony includes additional ideas on new approaches to promoting sustainable home ownership opportunities.

As a final comment, the Housing Policy Council believes that terminating the conservatorships should be coordinated with the passage of comprehensive housing finance reform legislation. Given the Enterprises' current capital position, FHFA could terminate the conservatorships by placing the Enterprises into receivership. Absent reform legislation, we believe that receivership would destabilize the housing finance market because the Enterprises would emerge from the process without any explicit support from the Treasury Department.

Alternatively, FHFA and the Treasury Department may be able to modify the agreements governing federal support for the Enterprises so they could rebuild their capital positions and eventually be released from conservatorship. Yet, recapitalizing and releasing them from conservatorship without fundamental changes in law would return the Enterprises to a status that was inherently flawed. This flawed structure encouraged imprudent business decisions and actions that led to their failure and the need for the largest of all taxpayer-funded bailouts.

In sum, we believe that administrative reform actions should establish the foundation for comprehensive housing finance reform legislation, and not preclude such legislation.

Thank you for considering these views as the Treasury Department prepares its report. We would be glad to discuss any of these issues with you or your staff.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
President
Housing Policy Council

Attachments

- Testimony of Edward J. DeMarco, President, Housing Policy Council, before the House Committee on Financial Services, September 6, 2018
- Housing Policy Council Comment Letter to the Federal Housing Finance Agency, November 16, 2018, on FHFA's Proposed Capital Rule