December 14, 2020

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

Housing and Mortgage Industries' Views Regarding the Status of the GSE Conservatorships

Dear Secretary Mnuchin:

The undersigned associations, which represent mortgage lenders, servicers, investors, home builders, and REALTORS®, as well as other important market participants, write to share our views on the conservatorships of Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs). We believe there are tangible, near-term steps that the U.S. Treasury Department (Treasury) can take, in coordination with the Federal Housing Finance Agency (FHFA), to promote critical reforms of the GSEs and bolster their safety and soundness. We are concerned, however, that other potential actions to release the GSEs from conservatorship without the necessary safeguards would undermine investor confidence, create volatility in the single-family and multifamily mortgage markets, and impede access to credit for consumers.

A stable housing finance system is key to defending housing affordability and facilitating homeownership and rental housing opportunities. In particular, protecting access to credit is necessary for a healthy demand side of the market, and the inventory deficit cannot be improved without the long-term stability necessary to develop land and build homes.

Our associations and the members we serve have worked over the past twelve years to develop reform plans and advance efforts – both legislative and administrative – that would correct structural flaws in the GSEs' pre-conservatorship business models and allow them to transition safely out of conservatorship. We have not supported, nor do we currently support, an "endless" conservatorship. Our position is quite the opposite – we wish to see the GSEs reformed and operating outside of government control. *We therefore favor actions that move the GSEs closer to the preferred end state in a timely manner that does not disrupt the housing finance market and inflict broader economic harm.*

During conservatorship, investors have relied on the Treasury backstop of the GSEs, which totals over $250 billion, as well as the effective control of the GSEs by the federal government. A sudden shift in the government's relationship with the GSEs, which could end conservatorship without an explicit federal backstop in place, could cause investors to reassess the nature of any backstop and result in severe market disruptions. Such market disruptions also are likely to occur if Treasury and FHFA permit the GSEs to exit conservatorship without appropriate levels of capital and before the necessary market conduct and safety and soundness parameters are instituted in a sufficiently durable way. In earlier correspondence, some of our associations provided you with detailed examples of the potential harm that could be caused under this scenario. These examples of potential harm include:

- A sharp pullback in investor demand for GSE mortgage-backed securities (MBS) by investors concerned about a diminution of government support and an associated increase in credit risk exposure;
- Potentially large declines in GSE MBS valuations resulting from lower investor demand, which would represent an immediate shock to $6 trillion in GSE MBS, much of which is held by pension funds, mutual funds, and other investment vehicles used by savers;
- Downgrades of the GSEs from rating agencies, as was recently posited by Moody's,[1] which would raise their borrowing costs and alter the views of potential investors in their debt or MBS;
- Uncertainty regarding the Federal Reserve's ability to acquire GSE MBS through its large-scale asset purchases, thereby limiting its tools to conduct monetary policy;
- Changes to the regulatory treatment – both domestically and abroad – of GSE MBS by virtue of changes in ratings or expectations regarding government support;
- Disruption to the Uniform MBS framework if investors perceive material differences in the credit quality of the two GSEs;
- An increase in mortgage credit costs during economic crises, negatively impacting the GSEs' ability to support the market in the next crisis;
- Less revenue to support underserved markets and communities; and
- Further reduction in mortgage credit availability[2] due to the expiration of the GSE Qualified Mortgage (QM) "Patch" prior to the mandatory compliance date associated with the recent revisions to the QM rule.

These significant concerns would upend the mortgage market at a time when it is one of the few bright spots in an economy heavily impacted by the effects of the COVID-19 pandemic. Over the past several months, consumers across the country have received billions of dollars of economic stimulus in the form of refinances at historically low interest rates, as well as opportunities for long-term wealth accumulation through homeownership. A premature release of the GSEs from conservatorship would threaten these outcomes without clear benefits in terms of the near-term health of the GSEs – that is, from an operational perspective, the GSEs outside of conservatorship but under strict consent decrees would look very similar to the GSEs in conservatorship. There is little to gain from this approach, but, as noted above, much to lose.

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[1] Moody's Investors Service, "Increased capital would reduce GSEs' reliance on government support," November 20, 2020.

[2] Such a reduction would come at a time when mortgage credit availability is near its lowest level since 2014 after suffering a severe decrease over the past year. For further information, please see the Mortgage Bankers Association's Mortgage Credit Availability Index at: https://www.mba.org/2020-press-releases/december/mortgage-credit-availability-increased-in-november.

We will reiterate, however, that our associations are not endorsing the status quo with respect to the conservatorships. We believe there are steps that Treasury and FHFA can and should take to continue with housing finance reform efforts. These steps will better prepare the GSEs and the market for a post-conservatorship future without risking severe market disruptions.

First, Treasury and FHFA can address the fact that the GSEs are likely to soon reach the caps on their allowable capital reserves under the terms of the Senior Preferred Stock Purchase Agreements (PSPAs) and the 2019 Letter Agreements on Capital Reserves. Once these caps – which together equate to $45 billion in capital – are reached, the GSEs will be denied the ability to retain earnings and further build their capital buffers. As you rightly indicated in recent Congressional testimony, it is important for the GSEs to build appropriate levels of capital prior to their release from conservatorship. The finalized FHFA capital framework for the GSEs indicates that, as of June 30, 2020, the GSEs would need a combined $283 billion in capital to be adequately capitalized and meet the buffers necessary to avoid other limitations on dividends or bonus payments.[3] While public offerings likely will be necessary to reach this level of capital, the GSEs can lower the necessary size of these equity raises by continuing to accrue capital organically. Simple modifications to the PSPAs and the Letter Agreements could adjust these capital reserve thresholds higher, removing a barrier to further progress toward an end to the conservatorships.

Treasury and FHFA should also continue their efforts to institute market conduct reforms that ensure the GSEs, once released from conservatorship, do not operate as they did pre-conservatorship. Many of these reforms have been implemented in some fashion over the past decade, but some remain unfinished, while others are in their nascent phase. Treasury and FHFA should find ways to more thoroughly "lock them in" through rulemakings, amendments to the PSPAs, or other durable mechanisms. These critical reforms, many of which were recommended by Treasury in its 2019 Housing Reform Plan,[4] include:

- Equal secondary market access for all lenders, regardless of their size, business model, or volume of loans delivered to the GSEs;
- Strict limits on the size and use of the GSEs' mortgage investment portfolios to limit opportunities for excessive risk-taking;
- Availability of cash window delivery of loans at all points in the credit cycle;
- Opportunities to promote or codify the use of credit risk transfer offerings;
- A prohibition on primary market participants owning a controlling stake in the GSEs; and
- Greater transparency regarding the GSEs' activities, data collection, and market data analysis.

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[3] FHFA, "Enterprise Regulatory Capital Framework," November 18, 2020. Available at: https://www.fhfa.gov/SupervisionRegulation/Rules/RuleDocuments/Enterprise%20Capital%20Final%20Rule%20for%20Website.pdf.

[4] U.S. Department of the Treasury, "Housing Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019," September 5, 2019. Available at: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf.

Treasury and FHFA also should provide more detail regarding the specific "footprint" or markets that they envision the GSEs serving in a post-conservatorship environment. The new capital framework suggests a larger role for the Federal Housing Administration (FHA) and the private market, as well as the elimination or discouragement of certain existing GSE offerings. Greater specificity with respect to these issues will help primary market participants and investors prepare for a post-conservatorship environment.

Together, the raising of the GSEs' capital reserve thresholds, the implementation of much-needed market conduct reforms, and a clearer picture of the GSEs' expected roles in the market will represent tremendous progress toward housing finance reform by Treasury and FHFA.

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Our associations thank you for your ongoing efforts to implement reforms to the GSEs and move them closer to a state in which they can safely exit conservatorship. While the GSEs are not yet in such a state, important progress has been made in recent years, and we hope you will continue this critical work. Efforts to further build capital reserves and implement key reforms are natural next steps in this process – steps that will benefit the housing finance system and the broader economy while avoiding unnecessary market disruptions. Ultimately, we concur with Treasury that Congressional action is critical to complete the reform process.

We look forward to our continued work on our shared interest of promoting a healthy, robust housing market for all Americans. Thank you in advance for your consideration of our views.

Sincerely,

American Bankers Association
Building Success. Together.

American Bankers Association

MBa
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Mortgage Bankers Association

NAHB
National Association of Home Builders
National Association of Home Builders

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cc: Dr. Mark Calabria, Director, Federal Housing Finance Agency