MORTGAGE BANKERS ASSOCIATION

November 24, 2020

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

Re: Market Disruption Concerns Regarding the GSE Conservatorships

Dear Secretary Mnuchin:

The Mortgage Bankers Association (MBA),[1] which represents all elements of the real estate finance industry, welcomes the opportunity to continue our dialogue with the Treasury Department (Treasury) and other stakeholders regarding the conservatorships of Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs). Our focus, on behalf of our diverse membership of lenders, servicers, investors, and other mortgage industry participants, remains on potential reforms to improve the GSEs' safety and soundness, conduct in the marketplace, and ability to further their statutory missions. We appreciate the constructive engagement with Treasury on these important matters, and, in the comments below, we expand on our recent discussions.

For the past several years, MBA has led industry efforts to seek a responsible end to the GSEs' conservatorships. We have put forth detailed recommendations containing both legislative and administrative options for GSE reforms to address many of the vulnerabilities that led to the ongoing conservatorships.[2] Among the numerous critical considerations for policymakers is the need to ensure that any reforms be undertaken in a manner that does not disrupt the broader housing finance system.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] MBA, "GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market," April 20, 2017. Available at: https://www.mba.org/assets/Documents/Policy/17305_MBA_GSE_Reform_Paper.pdf.

We write today to share our views on potential steps that Treasury, along with the Federal Housing Finance Agency (FHFA), could take to ensure progress towards an end to the conservatorships while avoiding market disruptions. We firmly believe that the GSEs' premature exits from conservatorship – before much-needed reforms are in place – would jeopardize market stability and access to affordable mortgage credit for consumers. Treasury and FHFA instead should pursue steps, such as targeted amendments to the Senior Preferred Stock Purchase Agreements (PSPAs), that further two key objectives: 1) codifying critically important market conduct reforms that should be in place prior to the GSEs' exits from conservatorship; and 2) continuing to gradually raise limits on the GSEs' ability to retain earnings and organically build their capital reserves.

The Danger of Premature Exits from Conservatorship

The process by which the GSEs exit conservatorship presents significant risks of potential disruptions and therefore must be executed with great care and deliberation. A well-functioning agency mortgage-backed securities (MBS) market[3] requires investors to have a clear understanding of the level of government support for the GSEs and the securities they issue. Actions that call this support into question – such as a premature end to the conservatorships – carry a significant risk of roiling this market.

In the absence of carefully communicated information from Treasury and FHFA, it is likely that investors would interpret the GSEs exiting conservatorship as a diminution of government support for the GSEs, their debt, and the agency MBS market. Indeed, recent analysis from Moody's Investors Service highlighted that an exit from conservatorship "would likely decrease the probability of government support in excess of the U.S. Treasury's current commitment" which "could result in a downgrade of the two companies' Aaa unsecured debt ratings."[4]

Under such a scenario, investor demand likely would wane, including with respect to foreign institutions that require more explicit government support in their investor guidelines. Reduced investor demand would increase borrowing costs for both consumers and the GSEs, while reduced liquidity and declining valuations in the agency MBS market could trigger margin calls or other strains on a variety of market participants. Domestic investors would suffer in the form of lower valuations on assets that support pension funds, 401(k) accounts, mutual funds, and other investment vehicles.

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[3] Throughout these comments, references to "agency MBS" will signify MBS issued and guaranteed by Fannie Mae and Freddie Mac – not securities guaranteed by Ginnie Mae.

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

These dynamics would run counter to extraordinary efforts in place through the Federal Reserve to purchase agency MBS, reduce mortgage interest rates, and deliver economic relief and stimulus to consumers in the form of lower mortgage payments. These Federal Reserve actions have been an important component of the broader economic recovery from the effects of the COVID-19 pandemic, but a premature end to the GSE conservatorships would threaten the efficacy of these efforts. Beyond the offsetting impact on bond yields and mortgage interest rates, it is not immediately clear that the Federal Reserve could or would continue its agency MBS purchases if the GSEs were released from conservatorship – potentially limiting a necessary monetary policy tool to support financial markets and the economy if COVID-19 impacts persist.

Another source of potential market disruption stems from the temporary policy – known as the “GSE Patch” – by which loans that are eligible for delivery to the GSEs are afforded Qualified Mortgage (QM) safe harbor treatment with respect to the Consumer Financial Protection Bureau’s (CFPB’s) Ability-to-Repay rule. Over the past several years, the CFPB has taken a thoughtful approach in reforming the QM general definition to satisfy the objectives of the rule, preserve access to affordable mortgage credit, and remove any reliance on the GSEs’ credit policies. To minimize the potential for market disruption, the CFPB provided a short-term extension of the GSE Patch to “bridge the gap” until the revised QM general definition takes effect – likely next year. Without this short-term extension of the GSE Patch, consumers with higher debt-to-income (DTI) ratios or non-W-2 sources of income (predominantly lower-income or self-employed borrowers) would have difficulty qualifying for affordable mortgage credit during this “gap” period.

This careful sequencing would be upended if the GSEs were to exit conservatorship in the coming months, prior to the effective date of the revised QM general definition. Under this scenario, the GSE Patch would expire automatically, triggering the “gap” in QM availability that the CFPB expressly attempted to avoid. In recent years, approximately one-sixth of all single-family mortgage borrowers have relied on the GSE Patch to obtain a QM loan. These borrowers would face higher costs of mortgage credit, or perhaps an inability to access mortgage credit altogether. In the event of a sudden end to the conservatorships, this problem would be compounded as many existing loans in mortgage pipelines no longer would be eligible for QM status – thereby freezing loans in process and causing major disruptions to borrowers in the midst of the purchase/sale transaction.

These significant risks must be compared to any potential benefits that would come from an immediate end to the GSE conservatorships. In this regard, it is difficult to see how such benefits would justify a hurried release of the GSEs. If the GSEs were to be released in the near term, it seems likely that they would be required to operate under consent decrees that, from a practical standpoint, would govern their day-today business activities in a manner nearly identical to that of conservatorship. It is not clear that there would be any discernible difference in the operations of the GSEs or the oversight role exercised by FHFA. The risks associated with reduced investor demand, strained market liquidity, increased costs of credit, uncertainty in Federal Reserve authority, and decreased availability of QM lending, however, would remain.

As such, a premature end to the GSE conservatorships is an outcome that would harm consumers, lenders, investors, and the broader economic recovery. There is great risk in Treasury and FHFA pursuing this approach, with little offsetting benefit.

Options to Achieve Near-Term Progress

The significant problems associated with a premature end to the conservatorships need not, however, discourage Treasury and FHFA from taking actions that could promote necessary GSE reforms and continue momentum towards an eventual release. There are tools at the disposal of Treasury and FHFA that would make reforms more durable and increase GSE safety and soundness while avoiding market disruption. Specifically, Treasury and FHFA should explore amendments to the PSPAs and the Senior Preferred Stock Certificates that codify key structural and market conduct reforms and allow the GSEs to continue retaining earnings and building capital reserves.

Structural and Market Conduct Reforms

With respect to structural and market conduct reforms, we commend Treasury and FHFA for the steps already taken over the past decade to improve the operations of the GSEs. Actions such as the development of a robust single-family credit risk transfer market and strict limits on the GSEs' retained mortgage portfolios have reduced the companies' exposure to mortgage credit risk. The creation of the Uniform Mortgage-Backed Security has improved single-family market liquidity and reduced trading disparities across the two GSEs' securities. A directive to eliminate favorable pricing or credit policies for the largest single-family seller/servicers and a pending rulemaking to provide greater transparency on new activities and products help ensure that the GSEs promote fair access to the secondary market.

Certain of these and other reforms previously endorsed by Treasury and congressional leaders[5] should be codified more explicitly before the GSEs are permitted to exit conservatorship. Absent formal rulemaking on these matters, any

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[5] Many of the reforms that follow were recommendations made in one or both of the Housing Reform Plan issued by Treasury in September 2019 and the Outline for Housing Finance Reform issued by Senate Banking Committee Chairman Mike Crapo (R-ID) in February 2019. See: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf and https://www.banking.senate.gov/imo/media/doc/Housing%20Reform%20Outline.pdf.

amendment to the PSPAs executed by Treasury and FHFA serves as an opportunity to lock in this progress. Reforms that could be specified in an amendment to the PSPAs include:

- A prohibition on guarantee fee discounts, credit variances, or other favorable terms provided to single-family lenders based on their size, volume of loans delivered, or business model;
- Required availability of a single-family cash window at all times, on a nationwide basis;
- A prohibition on lenders or servicers operating in the primary market from owning a controlling interest in a GSE;
- Further limits on the size and purpose of the GSEs' retained mortgage portfolios; and
- Further public disclosure of the GSEs' historical loan-level and property valuation data.

By codifying these reforms, Treasury and FHFA can ensure the GSEs, upon an eventual exit from conservatorship, are unable to engage in many of the activities or business practices that contributed to their near-failure in 2008.

Retained Earnings and Capital Reserves

With respect to the GSEs' capital reserves, the existing structure of the PSPAs and the backstop from Treasury limit the GSEs' ability to retain earnings as a mechanism to build capital. Specifically, the 2019 Letter Agreements on Capital Reserves between Treasury and FHFA amended the maximum capital reserves of the GSEs to $25 billion in the case of Fannie Mae and $20 billion in the case of Freddie Mac.[6] While a significant increase from previous caps on these capital reserves, the combined $45 billion represents only a fraction of the adjusted total capital requirement of $174 billion and the capital requirement of $283 billion needed to avoid limits on capital distributions and discretionary bonus payments implied by the newly-finalized GSE capital framework.[7]

The GSEs are expected to reach their existing capital reserve thresholds through retained earnings within the next several quarters, after which they will again be required to remit all future earnings to Treasury. To allow the GSEs to continue their

[6] "Treasury Department and FHFA Modify Terms of Preferred Stock Purchase Agreements for Fannie Mae and Freddie Mac," September 30, 2019. Available at: https://home.treasury.gov/news/press-releases/sm786.

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

steady accrual of capital reserves, Treasury and FHFA could further amend the Senior Preferred Stock Certificates to raise these capital reserve thresholds. This approach would serve the dual purpose of eliminating near-term concerns regarding the “net worth sweep” and allowing the GSEs to continue chipping away at the scale of public offerings that may be necessary in the future to fully capitalize the companies. In this scenario, the “net worth sweep” could be replaced by a periodic, market-rate commitment fee paid by the GSEs for the ongoing Treasury support.

Together, these actions would steadily increase the capitalization of the GSEs as they generate positive income. The concerns raised by MBA and others with respect to similar approaches in the past largely derives from a fear that the GSEs would be set on a path to exit conservatorship without the necessary accompanying structural and market conduct reforms. This fear would be allayed by the PSPA amendments described above. Additional oversight could come in the form of reviews of key reforms and their implementation as conditions upon which decisions to further raise the capital reserve thresholds at later dates are made.

To provide further clarity to market participants, Treasury and FHFA also could specify target levels of capital reserves, as well as other criteria as necessary, that would lead to an end to the conservatorships. These steps would address some of the concerns described above with respect to the market uncertainty that a premature end to the conservatorships would entail.

Finally, the additional time in conservatorship would serve several other policy objectives, including provision of further opportunities for FHFA to analyze and model the impact of the new GSE capital framework, as well as further opportunities for the GSEs to adapt to various structural and market conduct reforms while demonstrating their earnings potential to investors.

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By amending the PSPAs as discussed above rather than permitting the GSEs to exit conservatorship before they are fully prepared to do so, Treasury and FHFA can continue the positive momentum for GSE reform without unnecessary disruptions to the U.S. housing market or the broader economy. This approach also could serve to facilitate legislative actions to institute those reforms that can only be put in place by the U.S. Congress – such as an explicit, paid-for, full-faith-and-credit guarantee on securities issued by the GSEs.

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 or pmills@mba.org, and Mike Flood, Senior Vice President of Commercial/Multifamily Policy and Member Engagement, at (202) 557-2745 or mflood@mba.org.

Sincerely,

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President and Chief Executive Officer
Mortgage Bankers Association

cc: Kipp Kranbuhl
Principal Deputy Assistant Secretary for Financial Markets