Treasury and HUD Propose Housing Finance Reforms

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The Treasury Department ("Treasury") and the Department of Housing and Urban Development ("HUD") have released complementary proposals that, if implemented, would result in extensive changes to federal regulation of housing finance. The plans respond to a Presidential Memorandum[1] of March 27, 2019, directing Treasury and HUD to develop housing reform proposals consistent with the goals that the memorandum sets out.

Among other things, under the Treasury Plan,[2] Fannie Mae and Freddie Mac (two government-sponsored enterprises or "GSEs") would be recapitalized by the private sector, leave their conservatorships, and have more limited powers in the mortgage market. The GSEs would be re-chartered with a charter issued by the Federal Housing Finance Agency ("FHFA"), the agency that now oversees and acts as conservator for the GSEs. This charter would also be available to other guarantors of mortgage-backed securities ("MBS"). The plan recommends that the implicit guarantees of the GSEs be replaced by an explicit paid-for guarantee from Ginnie Mae of the repayment of principal and interest on qualifying MBS collateralized by eligible mortgage loans. Ginnie Mae, a government corporation within HUD, already provides such a guarantee to MBS collateralized by affordable loans issued under various government programs.

The HUD Plan[3] urges that the Federal Housing Administration ("FHA") be restructured as an autonomous government corporation within HUD and that FHA's various programs be revised in several respects.

The two plans include well over 100 recommendations for legislative and regulatory changes. While several of the proposals would require Congressional action, many may be effected through rulemaking or other agency action. Whatever the form in which the proposed changes are implemented, the recommendations are complex, and the impact of the changes will very much depend on the particulars of new legislation or regulation.

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The Treasury Plan

The Treasury Plan focuses on the GSEs and FHFA. The plan fleshes out four goals stated in the Presidential Memorandum:

1. Ending the GSE conservatorships;
2. Facilitating competition in the housing finance market;
3. Enhancing regulation of the GSEs; and
4. Providing appropriate compensation to the federal government for the support it provides to the secondary housing finance market.

The legislation that Treasury has proposed would require recapitalization and re-chartering of the GSEs together with termination of the conservatorships. The legislation would replace the support for the GSEs in the Senior Preferred Stock Purchase Agreements ("PSPAs") with an explicit paid-for guarantee from Ginnie Mae of the timely payment of principal and interest on qualifying MBS. This new guarantee would be available, subject to approval by the FHFA, to other guarantors of MBS that are collateralized by eligible single family or multifamily mortgage loans. The legislation would require the payment of fees to the federal government for the full-faith-and-credit guarantee.

The GSEs and other guarantors would be subject to risk-based and leverage capital on an economic par with capital requirements for other participants — e.g., banks — in the mortgage industry. (FHFA has already proposed capital requirements, but these differ from the recommendations in the Treasury Plan.) The legislation additionally would require the GSEs and other guarantors to maintain a nationwide cash window through which small lenders could sell loans for cash, and the GSEs and guarantors would be prohibited from offering volume-based pricing discounts or other incentives. The GSEs have already opened cash windows and adhere to a no-discount standard.

Many of these reforms could be implemented through agency action. While the impact on the industry would be less than that of legislative changes, it still would be considerable. There are at least two entry points for change, which enable Treasury and the FHFA to take a wide range of administrative actions: FHFA acts both as regulator and conservator of the GSEs (which have been in conservatorship since 2008), and the PSPAs (through which Treasury has provided financial support to the GSEs) contain several restrictions on the GSEs' business. For example, FHFA in its capacity as conservator could agree with Treasury on extensive amendments to the PSPAs without any involvement by the boards or management of the GSEs.

Even without Congressional action, the conservatorships could be terminated, the GSEs recapitalized, and greater restrictions imposed through amendment of the PSPAs. FHFA also could substantially revise the capital rules that it already has proposed. Either FHFA or Treasury through an amendment to the PSPAs could commit the GSEs to establishing cash windows and providing equal secondary market access to all lenders. However, other changes would require legislation, including a new charter for the GSEs (and others) and a Ginnie Mae explicit full-faith-and-credit guarantee.

The Treasury Plan also addresses the "QM patch," a provision in the ability-to-repay regulation of the Consumer Financial Protection Bureau ("CFPB") that presumes that a home mortgage eligible to be purchased or guaranteed by a GSE is in compliance with the ability-to-repay rule. Under the CFPB regulations, the QM patch is set to expire on January 10, 2021. The Treasury Plan supports the expiration but also recommends a new bright line safe harbor that would be available to all qualifying loans regardless of their GSE eligibility.

The HUD Plan

In its housing finance role, HUD is involved with two entities, the Federal Housing Administration ("FHA") that is part of HUD's Office of Housing and that supports a wide range of affordable mortgage loans, and Ginnie Mae, a corporation within HUD that guarantees the timely payment of principal and interest on qualifying MBS backed by eligible affordable housing loans. These loans include not only FHA loans but also loans made through programs of the Veterans Administration and the Agriculture Department.

The HUD Plan addresses three goals stated in the Presidential Memorandum: (i) refocusing FHA and GNMA on their primary responsibility to provide housing finance support to low- and moderate-income families that cannot be fulfilled through traditional underwriting; (ii) improved risk management, and (iii) modernization of the operations and technology of FHA and Ginnie Mae.

The HUD Plan also discusses and proposes reforms that cover six items identified in the Presidential Memorandum:

1. The plan includes several changes to FHA's reverse mortgage program, the Home Equity Conversion Mortgage program ("HECM"), in order to improve its financial viability;
2. The plan considers the risks and benefits of assistance to first-time homebuyers, including down payment assistance, and suggests changes;
3. The plan considers the appropriate role of FHA in multifamily mortgage finance;
4. The plan recommends diversification of FHA lenders by permitting registered depository institutions to participate;
5. The plan proposes enhancements to the requirements and standards for participation in the Ginnie Mae program; and
6. The plan includes reforms to reduce abusive and unsound loan origination or servicing practices for loans in the Ginnie Mae program.

The HUD Plan additionally recommends rechartering FHA as an autonomous government corporation within HUD and calls for additional capital reserves in the Mutual Mortgage Insurance Fund ("MMIF").

As with the Treasury Plan, a comprehensive statute would have a significant impact on the ways in which affordable housing loans are made and sold into the secondary market. HUD could affect many of the same results through rulemaking and guidance, however. Indeed, the explicit guarantee for Ginnie Mae and the re-chartering of FHA are the only major items that appear to require legislation. Legislation would also be necessary to amend existing statutory provisions that deal with specific aspects of affordable loans and FHA operations. Without legislation, HUD may make changes to the terms and conditions of FHA loans, impose new requirements for participating lenders, and adopt higher risk-based capital requirements for the MMIF. All of the recommended changes for Ginnie Mae's management of counterparty risk and its securitization platform may be implemented administratively. HUD also may make certain changes to the HECM program, but a robust reform of the program would require legislation.

NOTES:

[1] https://www.govinfo.gov/content/pkg/FR-2019-04-01/pdf/2019-06441.pdf.

[2] https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf.

[3] https://www.hud.gov/sites/dfiles/Main/documents/Housing-Finance-Reform-Plan0919.pdf.