COMMUNITY
Home Lenders Association, Inc.

CHLA Plan for GSE Reform

Excerpted from CHLA Testimony before the House Financial Services Committee on December 21, 2018

A PATH FORWARD ON GSE REFORM

It is important to acknowledge that almost all needed GSE reforms have already taken place. These all but ensure that there will not be a return to the practices that led to conservatorship, or a return to the old system of private gain, public loss. Completed reforms include

1. **Ability to Repay (QM).** A major factor in the GSEs' conservatorship was their purchase of no doc (Alt A) loans. With adoption of QM, no doc loans are a thing of the past.

2. **Credit Risk Sharing.** The GSEs have been doing risk sharing on over 90% of new loans, and to date have transferred $50 billion in credit risk to third party private entities.

3. **Portfolio Wind Downs.** The significant interest rate risk that the GSEs were exposed to before 2008 has largely been eliminated with a major winding down of their portfolios.

4. **Strong Regulator.** The 2008 HERA legislation replaced a weak regulator (OFHEO) with a strong regulator (FHFA) that has focused on effective, proactive regulation.

5. **Taxpayer Compensation for Federal Guarantee.** The pre-2008 deal in which GSEs had an implicit guarantee without compensating fees has been replaced by a full profit sweep under the PSPA – and an expectation of fair guarantee fees under GSE reform.

6. **Common Securitization Platform (CSP)/Common Security.** FHFA is engineering a CSP and single security - to create a more uniform, competitive securitization process.

The one major reform that has not been completed is the recapitalization of Fannie Mae and Freddie Mac, building capital in the GSEs in order to absorb losses and protect taxpayers. This is not because Fannie and Freddie have not been profitable or financially stable. They have paid back their initial taxpayer advance and generated an additional $85 million in profits. However, because of the arbitrary profit sweep under the Preferred Stock Purchase Agreement, Fannie and Freddie were not allowed to retain any profits, except for the tiny $3 billion buffer that FHFA permitted a year ago. Unfortunately, this buffer is insufficient to cover the normal types of earnings variations and accounting adjustments that typically take place.

Therefore, FHFA should immediately increase this buffer to a more reasonable level – e.g to a .5% net worth level for both Fannie and Freddie.

Secondly, the 2008 HERA legislation, under which the GSEs were taken into conservatorship, clearly spells out the authority of FHFA to require Fannie Mae and Freddie Mac to develop a capital restoration plan to show how they could emerge from conservatorship, consistent with the capital standards FHFA is now developing. Development of such plans does not commit them to carry them out. However, as legislators contemplate different GSE reform options, this Committee and the broader public GSE reform debate would benefit from understanding the specifics about how and how long it would take for Fannie and Freddie to be recapitalized.

Therefore, CHLA reiterates its call for FHFA to direct Fannie Mae and Freddie Mac to develop a capital restoration plan.

Third, CHLA continues to support Congress adopting comprehensive GSE legislation. This would be the preferred resolution, both to try to achieve consensus and to address outstanding GSE issues that will likely require legislation, such as:

- Adopting a federal backstop of qualified GSE loans, either through a guarantee of qualified mortgage backed securities (MBS) or a Line of Credit.

- Codifying FHFA's administrative requirement of G fee parity - and extending this to guarantor and risk sharing practices.

- Extend the QM patch (scheduled to expire in 2021) with any appropriate modifications - so that FHFA can continue to set its own QM parameters for the GSEs.

- Retaining, but making any appropriate adjustments to housing goals, Duty to Serve, and the Housing Trust Fund/Capital Magnet Fund - in order to ensure that the GSEs use their federal backstop to focus on low- and moderate-income borrowers and underserved markets, and to prevent them from using that backstop to cherry pick only the best loans.

However, it has been 10 years since Fannie and Freddie went into conservatorship and Congress has, to date, been unable to adopt comprehensive reform legislation**.** Ten years is long enough. Inevitably, there will be an economic downturn, and as Director Watt has warned, there would be negative consequences of a Treasury draw caused by Congress' continuing failure to act.

Therefore, if it becomes clear by some time in 2019 that Congress will once again be unable to enact GSE legislation into law, Treasury and the FHFA should move forward to re-privatize and recapitalize Fannie and Freddie – using the Capital Restoration Plans that HERA authorizes and CHLA is calling on FHFA to require.