

Summary of Treasury's September 2019 Report on Housing Finance Reform
2019-09-05 v.1

Link: <https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf>

High-level summary of key points*

- Congress should pass legislation including these features (this is not the entire list):
 - an explicit, paid-for guarantee on MBS provided by GNMA;
 - allowing FHFA to charter and supervise additional guarantors;
 - cash windows being maintained now and in the future;
 - affordable housing goals replaced with something else, possibly an assessment that is appropriated by Congress;
 - Reduction in the multifamily footprint;
 - FHLB membership criteria should be reexamined with an eye towards expanding it.
- In the meantime PSPA support should continue;
- Reforms should not wait or depend upon Congress, administrative action should be taken pending legislative action, and Treasury supports FHFA efforts to make administrative changes;
 - A plan to recapitalize the GSEs should be developed / the GSEs should be recapitalized;
 - PSPAs should be adjusted to provide to the retention of earnings and the payment of a commitment fee for PSPA support;
 - The GSEs should be put on a path to eventually exit conservatorship - subject to meeting a series of conditions laid out in the report - note that a timeframe is not specified;
 - One of these conditions is *"Appropriate provision has been made to ensure there is no disruption to the market for the GSE's MBS, including its previously issued MBS"*
 - FHFA capital requirements should be finalized (with a hint in the paper that the Watt-proposed requirements were not strong enough);
 - Regulatory biases favoring the GSEs should be removed, reformed, or reduced to help boost private label securitization and increase competition;
 1. This includes things like capital rules, disclosure requirements (Reg AB2), risk retention, etc...
 2. The QM patch should expire, appendix Q should be reworked or eliminated, and QM should be the outer limits of eligible loans for GSEs -- they should not necessarily be able to purchase all QMs.
 - GSEs' scope of activities should be narrowed and focused, and HUD/FHA overlap addressed;
 - GSE multifamily footprint should be reduced;

** This is very high-level summary and does not capture all of the important points in the report*

Section-by-Section of Treasury Report

Key

1. Items in *italics* are quotes from the report
2. Treasury recommendations are in ***bold italics***

I. Summary

This section provides an overview of the report. It reiterates the Administration's housing finance reform goals contained in the Presidential Memorandum (which was the genesis of this report and HUD's report):

1. *ending the conservatorships of the Government-sponsored enterprises (each, a "GSE") upon the completion of specified reforms;*
2. *facilitating competition in the housing finance market;*
3. *establishing regulation of the GSEs that safeguards their safety and soundness and minimizes the risks they pose to the financial stability of the United States; and*
4. *providing that the Federal Government is properly compensated for any explicit or implicit support it provides to the GSEs or the secondary housing finance market. This plan includes legislative and administrative reforms to achieve each of these goals.*

Some quotes:

- *While this plan includes both legislative and administrative reforms, Treasury's preference and recommendation is that Congress enact comprehensive housing finance reform legislation. Although Treasury does not believe a Government guarantee is required, Treasury would support legislation that authorizes an explicit, paid-for guarantee backed by the full faith and credit of the Federal Government that is limited to the timely payment of principal and interest on qualifying mortgage-backed securities ("MBS").*
- *Legislation could also achieve lasting structural reform that tailors that explicit Government support of the secondary market and repeals the GSEs' congressional charters and other statutory privileges that give them a competitive advantage over private sector competition.*
- *At the same time, reform should not and need not wait on Congress. FHFA already has expansive statutory authorities to implement reforms in the absence of further Congressional action, and the housing finance system has functioned for some time, and continues to function, without an explicit full faith and credit guarantee by the Federal Government.*
- *Pending legislation, Treasury will continue to support FHFA's administrative actions to enhance the regulation of the GSEs, promote private sector competition, and satisfy the preconditions set forth in this plan for ending the GSEs' conservatorships.*

II. Background

This section is a background on the GSEs, conservatorship, etc. and we've not summarized it here.

III. Defining a Limited Role for the Federal Government

A. Clarifying existing government support (12)

1. 30-year fixed rate mortgage loan.

- *It is possible that the 30-year fixed-rate mortgage loan could remain widely available and at similar prices under a market structure that does not depend on Government support. Jumbo mortgage loans remain a sizeable portion of the market and at roughly the same risk-adjusted pricing as conforming mortgage loans. (Figure 4) There might also be other mechanisms for separating credit risk and interest rate risk, for example, covered bonds. Alternatively, the United States could perhaps follow the lead of other countries and rely more on portfolio lending...However, any proposal to fundamentally change the housing finance system should take careful account of the risks posed by the transition, particularly as housing-related activity represents a significant share of United States economic activity. Stability in the housing finance system is crucial, and generally counsels in favor of preserving what works in the current system, including the longstanding support of the 30-year fixed-rate mortgage loan.*
- *The explicit Government guarantee should be available not only to the GSEs but also to any other potential guarantors that would be chartered by FHFA. Congress should authorize Ginnie Mae to extend this explicit guarantee on MBS backed by conventional mortgage loans, as it already has experience in marketing and administering MBS guarantee programs.*
- Recommendations
 1. ***Congress should authorize an explicit, paid-for guarantee by Ginnie Mae of qualifying MBS that are collateralized by eligible conventional mortgage loans. (legislative)***
 2. ***Pending legislation, to avoid market disruption, Treasury should continue to maintain its ongoing commitment to support each GSE's single-family MBS through the PSPAs, as amended as contemplated by this plan. (administrative)***

2. Underserved Renters

- *As with the single-family market, this existing Government support should be made clearer and better tailored. In the place of the PSPA commitments, Congress should authorize Ginnie Mae to provide an explicit, paid-for guarantee of the timely payment of principal and interest on any qualifying multifamily MBS of a GSE or any potential competitor guarantor that might be chartered by FHFA.*
- Recommendations
 1. ***Congress should authorize an explicit, paid-for guarantee by Ginnie Mae of qualifying MBS that are collateralized by eligible multifamily mortgage loans. (legislative)***
 2. ***Pending legislation, to preserve support for low- and moderate-income and other historically underserved renters, Treasury should continue to maintain its ongoing commitment to support each GSE's multifamily MBS through the PSPAs, as amended as contemplated by this plan. (administrative)***

3. Catastrophic Backstop

- *Each guarantor should set its own price for credit enhancing each mortgage loan, so that market discipline and price discovery would tend to mitigate the risk of capital misallocation, safety and soundness risk, and systemic risk posed by underpricing mortgage-related risks.*
- *Similarly, pending legislation, Treasury and FHFA should ensure that Treasury's ongoing commitment under each PSPA could be drawn upon only in exigent circumstances by arranging for significant first-loss private capital to stand in front of Treasury's commitment. The GSEs' CRT already provide some of that private capital. The GSEs also should be recapitalized so that additional private capital bears first-loss risk.*
- **Recommendations**
 1. ***Congress should condition the availability of the Government guarantee of qualifying MBS on a GSE or other FHFA-approved guarantor taking the first-loss position on the Government-guaranteed MBS through specified credit enhancement on the mortgage collateral securing the MBS. (legislative)***
 2. ***Pending legislation, each GSE should be recapitalized so that private capital takes the first-loss position on the GSE's exposure to risk and loss. (administrative)***
 3. ***FHFA and Ginnie Mae should identify and assess the operational and other issues posed by authorizing Ginnie Mae to guarantee the timely payment of principal and interest on qualifying MBS, including any necessary enhancements to existing securitization and bond administration infrastructure. (administrative)***

4. Taxpayer compensation

- *In setting and adjusting the fees for Government guarantees of qualifying MBS, FHFA should consider: the expected fees and payments under the guarantee so as to endeavor to reduce the cost of the program, discounted on a risk-adjusted basis, to zero over a period that contemplates fluctuations in economic conditions consistent with historical experience; the conditions affecting the housing finance system so as to provide for reasonable stability in the fee, notwithstanding the varying risk through fluctuations in housing and economic conditions during that period; and any available pricing information associated with relevant private sector transactions (e.g., CRT transactions of guarantors)*
- **Recommendations**
 1. ***Congress should authorize FHFA to set and from time to time adjust fees for Government guarantees of qualifying MBS so that the compensation paid to the Federal Government is, to the extent it might be feasible, consistent with the pricing of similar risk by private sector market participants (accounting for Government support in other market segments). (legislative)***
 2. ***Pending legislation, each PSPA should be amended to compensate the Federal Government for the continued support of the GSEs through an appropriately priced periodic commitment fee. (administrative)***

B. Support of single-family mortgage lending (16)

- *[G]uarantors should be monoline businesses limited to the business of securitizing Government-guaranteed MBS, which could be statutorily defined to include credit enhancing the mortgage collateral securing Government-guaranteed MBS and ancillary activities such as operating a cash*

window, loss mitigation on mortgage loans, and holding and disposing of property acquired in connection with collecting on mortgage loans.

- *Shorter-term fixed-rate mortgage loans and ARMs do not depend to the same extent, if at all, on the GSE- facilitated separation of credit and interest rate risk, and the GSEs' current role in the market for cash-out refinancings, investor loans, and vacation home loans might not align with the core purpose of Government support for the secondary market.*
- *Similarly, Treasury's commitment under the PSPAs is fixed in amount by its terms, and Treasury and FHFA should consider whether to conserve that finite commitment by limiting the support of future GSE acquisitions to specified loan products, purposes, or amounts. Given these considerations, Treasury and FHFA should solicit information on whether to tailor PSPA support for cash-out refinancings, investor loans, vacation home loans, higher principal balance loans, or other subsets of GSE-acquired mortgage loans, potentially exploring legal or other mechanisms for tailoring or otherwise limiting PSPA support to specified loan products, purposes, or amounts or perhaps more directly restricting some of these GSE activities.*
- *[E]ven with the administrative reforms set forth in this report, the GSEs will still have the significant competitive advantages conferred by their congressional charters and other statutory privileges, as well as the benefit of the support from Treasury's PSPA commitment. FHFA should strictly construe the permissible activities authorized by each GSE's charter so that the GSEs' remaining competitive advantages do not crowd out private capital in ancillary markets – for example, the market for loans to non-bank servicers.*
- **Recommendations**
 1. ***Congress should restrict the permissible activities of guarantors to the business of securitizing Government-guaranteed MBS. (legislative)***
 2. ***Pending legislation, FHFA should assess whether each of the current products, services, and other single-family activities of each GSE is consistent with its statutory mission and should continue to benefit from support under Treasury's PSPA commitment (with appropriate amendments to the PSPA), and in particular, FHFA should solicit information on whether to tailor support for cash-out refinancings, investor loans, vacation home loans, higher principal balance loans, or other subsets of GSE-acquired mortgage loans. (administrative)***
 3. ***FHFA should implement a policy and process for approval of the GSEs' new pilot programs and other new activities or products, with that process soliciting public input. (administrative)***

C. Support of Multifamily Mortgage Lending (19)

- *In part because of these broad exemptions, the caps have not been effective in limiting the GSEs' multifamily footprint. The GSEs have grown from owning or guaranteeing 25% of outstanding multifamily debt in early 2008 to almost 40% today. (Figure 7) That share could climb...*
- *a shift to a cap that is based on, among other things, the multifamily guarantors' share of outstanding multifamily debt might be better calibrated to ensure that private sector sources of capital are not crowded out, while also permitting more acquisitions during periods of high refinancings.*
- **Recommendations:**
 1. ***Congress should implement a framework to limit the aggregate footprint of multifamily guarantors. (legislative)***

2. *Congress should limit the multifamily mortgage loans that are eligible to secure Government-guaranteed multifamily MBS to ensure a close nexus to a specified affordability mission. (legislative)*
3. *Pending legislation, Treasury and FHFA should consider amending each PSPA to limit support of each GSE's multifamily business to its underlying affordability mission, including potentially through a revised framework for capping each GSE's multifamily footprint. (administrative)*

D. Additional Support for Affordable Housing (21)

1. Barriers to Housing Development

- Recommendation
 1. *FHFA should revisit the GSEs' underwriting criteria for acquisitions of multifamily loans secured by properties in jurisdictions that adopt rent-control laws or other undue impediments to housing development. (administrative)*

2. Affordable Housing Goals

- *the GSEs' statutory affordable housing goals should be replaced with a more efficient, transparent, and accountable mechanism for delivering tailored support. The goals were a contributing factor to the GSEs' risk taking and losses in the lead up to the financial crisis. Even more importantly, the framework for setting the goals suffers from a lack of transparency and accountability to taxpayers.*
- *An alternative approach would be to collect a periodic assessment from guarantors that Congress would make available through an appropriation to administer on-budget affordable housing programs.*
- *Pending legislation, FHFA should focus on increasing the efficiency of the means employed by the GSEs to achieve the statutory affordable housing goals. The GSEs currently rely to a significant degree on the underpricing of their guarantee fees on mortgage loans to certain borrowers to achieve these goals and other mission-related objectives.*
- Recommendations
 1. *Congress should replace the GSEs' statutory affordable housing goals with a more efficient, transparent, and accountable mechanism for delivering tailored support to first-time homebuyers and low- and moderate-income, rural, and other historically underserved borrowers, with a portion of the associated funding potentially transferred to HUD to expand its affordable housing activities. (legislative)*
 2. *Pending legislation, FHFA should consider more efficient mechanisms for the GSEs to achieve the statutory affordable housing goals. (administrative)*

3. Duplication of Support

- *While there inevitably will be some incidental overlap between the GSEs and FHA's support for affordable housing, the duplication of support for affordable housing has unnecessarily increased with the conservatorships, particularly in the last several years.*

- *Ending the conservatorships will be important to reinstating market discipline so as to ensure that the GSEs are focused on mortgage loans that entail a reasonable economic return.*
- Recommendation
 1. ***FHFA and HUD should develop and implement a specific understanding as to the appropriate roles and overlap between the GSEs and FHA, for example, with respect to the GSEs' acquisitions of high LTV and high DTI loans and FHA's underwriting of cash-out, conventional-to-FHA, and other refinancing loans and loans to repeat FHA borrowers. (administrative)***

E. Ending the Conservatorships (26)

1. Preconditions for Ending the Conservatorships (this is basically the whole section)

- *The guiding principle for ending the conservatorships should be that each GSE should remain in conservatorship until FHFA determines that that particular GSE can operate safely and soundly and without posing an undue systemic risk. The specific preconditions for FHFA considering a particular GSE's exit from conservatorship should include, at a minimum, that:*
 - *FHFA has prescribed regulatory capital requirements for both GSEs;*
 - *FHFA has approved the GSE's capital restoration plan, and the GSE has retained or raised sufficient capital and other loss-absorbing capacity to operate in a safe and sound manner;*
 - *The PSPA between Treasury and the GSE has been amended to: (i) require the GSE to fully compensate the Federal Government in the form of an ongoing payment for the ongoing support provided to the GSE under the PSPA; (ii) focus the GSE's activities on its core statutory mission and otherwise tailor Government support to the underlying rationale for that support; (iii) further limit the size of the retained mortgage portfolio of the GSE; (iv) subject the GSE to heightened prudential requirements and safety and soundness standards, including increased capital requirements, designed to prevent a future taxpayer bailout and minimize risks to financial stability; and (v) ensure that the risk posed by the GSE's activities is calibrated to the amount of the remaining commitment under the PSPA;*
 - *Appropriate provision has been made to ensure there is no disruption to the market for the GSE's MBS, including its previously issued MBS;*
 - *FHFA, after consulting with the Financial Stability Oversight Council ("FSOC"), has determined that the heightened prudential requirements incorporated into the amended PSPAs are, together with the requirements and restrictions imposed by FHFA in its capacity as regulator, appropriate to minimize risks to financial stability; and*
 - *Any other conditions that FHFA, in its discretion, determines are necessary to ensure that the GSE would operate in a safe and sound manner after the conservatorship, including as to the GSE's compliance with FHFA's directives or other requirements and also as to the build out of FHFA's supervisory function*
 - *Pending legislation, FHFA should exercise its authority as conservator to begin the process to end each GSE's conservatorship in a manner consistent with the preconditions set forth in this plan. (administrative)*

- *Recommendation*
 1. ***Pending legislation, FHFA should exercise its authority as conservator to begin the process to end each GSE's conservatorship in a manner consistent with the preconditions set forth in this plan. (administrative)***
- 2. **Recapitalizing the GSEs** (this is basically the whole section)
 1. *Potential approaches to recapitalizing a GSE could entail one or more of the following, among other options:*
 - *Eliminating all or a portion of the liquidation preference of Treasury's senior preferred shares or exchanging all or a portion of that interest for common stock or other interests in the GSE;*
 - *Adjusting the variable dividend on Treasury's senior preferred shares so as to allow the GSE to retain earnings in excess of the \$3 billion capital reserve currently permitted;*
 - *Issuing shares of common or preferred stock, and perhaps also convertible debt or other loss-absorbing instruments, through private or public offerings, perhaps in connection with the exercise of Treasury's warrants for 79.9% of the GSE's common stock;*
 - *Negotiating exchange offers for one or more classes of the GSE's existing junior preferred stock; and*
 - *Placing the GSE in receivership, to the extent permitted by law, to facilitate a restructuring of the capital structure.*
 - *Each of these options poses a host of complex financial and legal considerations that will merit careful consideration as Treasury and FHFA continue their effort, already underway, to identify and assess these and other strategic options.*
 2. *Recommendations:*
 1. ***Treasury and FHFA should develop a recapitalization plan for each GSE after identifying and assessing the full range of strategic options. (administrative)***
 2. ***Pending that recapitalization plan, and as an interim step toward the eventual PSPA amendment contemplated by this plan, Treasury and FHFA should consider permitting each GSE to retain earnings in excess of the \$3 billion capital reserve currently permitted, with appropriate compensation to Treasury for any deferred or forgone dividends. (administrative)***

IV. Protecting Taxpayers Against Bailouts

A. Capital and Liquidity Requirements (28)

1. **Capital Requirements**
 - *each GSE or guarantor should be subject to FHFA-prescribed regulatory capital requirements that require it to be appropriately capitalized by maintaining capital sufficient to remain viable as a going concern after a severe economic downturn and also to ensure that shareholders and unsecured creditors, rather than taxpayers, bear losses.*

- *similar credit risks generally should have similar credit risk capital charges across market participants. To manage the limitations of risk-based capital requirements, the regulatory capital framework also should contemplate a simple, transparent, non-risk-based leverage restriction*
- *It is unclear based on publicly available information whether FHFA's proposed capital rule satisfies these principles. 61.*
- Footnote 61 reads, in part: *There is perhaps even some basis for doubt on that score.*
- Recommendations
 1. ***Congress should repeal the existing statutory definitions relating to the GSEs' regulatory capital that restrict FHFA's discretion in prescribing regulatory capital requirements, and those definitions should not be incorporated into future legislation. (legislative)***
 2. ***FHFA's eventual regulatory capital requirements should require that each guarantor, or each GSE pending legislation, be appropriately capitalized by maintaining capital sufficient to remain viable as a going concern after a severe economic downturn and also to ensure that shareholders and unsecured creditors, rather than taxpayers, bear losses. FHFA's eventual regulatory capital requirements also should include a simple, transparent leverage restriction that supplements the risk-based capital requirements. (administrative)***
 3. ***In connection with the new FHFA Director's ongoing re-assessment of the proposed capital rule, FHFA should disclose additional information on the calibration of the regulatory capital requirements. (administrative)***

2. Credit Risk Transfers

- *In particular, the reduction in retained credit risk that is achieved through CRT generally should be reflected in FHFA's regulatory capital requirements. At the same time, each of the existing CRT structures has strengths and weaknesses, and it remains unclear how CRT will function over the long term. FHFA should therefore encourage the GSEs to continue to engage in a diverse mix of economically sensible CRT, including by increasing reliance on institution-level capital.*
- Recommendation
 1. ***FHFA should, in prescribing regulatory capital requirements, provide for appropriate capital relief to the extent that a guarantor, or a GSE pending legislation, transfers mortgage credit risk through a diverse mix of approved forms of CRT. (administrative)***

3. Liquidity Requirements

- *the GSEs still do maintain more than \$400 billion in outstanding debt, and they also retain meaningful liquidity risk with respect to the funding needs that relate to their cash window operations and their purchases of non-performing loans out of securitization pools. The latter funding need is a particularly notable liquidity risk, as it should be expected to increase significantly during a period of economic stress when funding markets might cease to function*

- Recommendation
 1. ***FHFA should prescribe liquidity requirements that require each guarantor, or each GSE pending legislation, to maintain high quality liquid assets sufficient to ensure it operates in a safe and sound manner. (administrative)***

B. Resolution Framework (31)

- *The importance of a credible resolution framework for the GSEs is heightened by the historical precedent set by the decision to place the GSEs in conservatorship instead of receivership and also by the statutory exclusion of the GSEs from the Federal Deposit Insurance Corporation's ("FDIC") orderly liquidation authority under Title II of the Dodd-Frank Act.⁶⁴*
- Recommendations
 1. ***Congress should authorize FHFA to require each large guarantor, or a holding company of the large guarantor, to maintain convertible debt or other similar loss-absorbing instruments sufficient to ensure there is adequate total loss-absorbing capacity to facilitate resolution. (legislative)***
 2. ***Pending legislation, Treasury and FHFA should consider amending each PSPA to require each GSE to maintain convertible debt or other similar loss-absorbing instruments sufficient to ensure there is adequate total loss-absorbing capacity to facilitate resolution. (administrative)***

C. Retained Mortgage Portfolios (31)

- *guarantors should be prohibited from maintaining investment portfolios except to the limited extent necessary to engage in the business of securitizing Government-guaranteed MBS. Guarantors also should be permitted to invest in Government securities and other high quality liquid assets to the extent necessary to comply with the liquidity requirements prescribed by FHFA.*
- *Each PSPA's cap is also above the amount necessary to support the securitization business and could be further reduced over time, with a different cap for each GSE.*
- Recommendations
 1. ***Congress should prohibit each guarantor from investing in mortgage-related assets or other investments except to the limited extent necessary to engage in the business of securitizing Government-guaranteed MBS. (legislative)***
 2. ***Pending legislation, Treasury and FHFA should amend each PSPA to further reduce the cap on the GSE's investments in mortgage-related assets, setting a different cap for each GSE, and also to restrict the GSE's retained mortgage portfolio to solely supporting its business of securitizing MBS. (administrative)***

D. Credit Underwriting Parameters (33)

- *While the GSEs' credit underwriting parameters have improved, there is no guarantee that the GSEs will not relax their underwriting requirements. Indeed, over the last few years the GSEs have increased their acquisitions of high DTI mortgage loans and high LTV loans, as well as mortgage loans with risk-layering.*
- Recommendations

1. ***Congress should restrict the mortgage loans eligible to secure Government-guaranteed MBS to loans that have been originated in compliance with safe and sound underwriting restrictions approved or prescribed by FHFA, including as to responsible down payment requirements, DTI limits, insurance, and credit enhancement on high LTV loans. (legislative)***
2. ***FHFA should conduct an assessment of the credit and other risks posed by the GSEs' underwriting parameters, including acquisitions of single-family mortgage loans with greater risk characteristics such as high LTV, high DTI, or risk layering, and that assessment should guide underwriting restrictions to be prescribed by FHFA. (administrative)***

V. Promoting Competition in the Housing Finance System

A. Leveling the Playing Field (34)

- *The implementation of the Basel III reforms has increased the gap between the regulatory capital requirements of banking organizations and the GSEs. The adoption of the QM patch in 2014 provides mortgage lenders greater legal protections for GSE-eligible loans, particularly for conventional mortgage loans with DTI above the 43% qualified mortgage threshold. Similarly, the special treatment afforded to the GSEs under the disclosure, risk retention, and other regulations governing securitization transactions has heightened their competitive advantage over private sector securitizers. Harmonizing the regulatory frameworks across market participants will be critical to establishing a level playing field that permits the private sector to resume its historical role as the primary source of funding in the housing finance system.*

1. Harmonizing Regulatory Frameworks

- *The single best step FHFA can take to level the playing field with other market participants would be, consistent with the statutory requirement under the Temporary Payroll Tax Cut Continuation Act of 2011,⁶⁹ to more fully align the GSEs' credit risk capital charges with those of other fully private regulated financial institutions for holding similar assets.*
- *While the GSEs' CRT provide meaningful capital relief under FHFA's proposed rule, there is considerable doubt as to whether the banking regulators' capital rules would permit a banking organization to achieve similar capital relief by structuring a CRT-like transaction as a synthetic securitization. Even for securitizations that do conform to the banking regulators' capital rules, the credit risk capital charges on a banking organization's retained securitization exposures generally are considerably greater than the credit risk capital charges on the exposures retained by a GSE in connection with CRT, especially for the more senior interests.*
- *FSOC might potentially have a role in convening discussions on these interagency issues and identifying and remediating unwarranted differences in the regulatory frameworks.*
- **Recommendation:**
 1. ***FHFA should, in consultation with the other federal financial regulators, endeavor to harmonize the regulatory requirements applicable to the GSEs and other participants in the housing finance system, including with respect to the capital relief provided to GSEs and banking organizations for their transfers of mortgage credit risk to third parties. (administrative)***

2. QM Patch Replacement

- Besides conferring a competitive advantage on the GSEs, the QM patch also gives the GSEs a quasi-regulatory role in defining ATR requirements that, while arguably appropriate on a temporary basis while the GSEs were in conservatorship, would be inappropriate if continued on a permanent basis or after the end of the GSEs' conservatorships.
- Treasury also supports further revisions to the ATR rule to ensure that mortgage lenders continue to have a bright line safe harbor after expiration of the QM patch. In particular, Appendix Q, which was adopted from the outdated manual underwriting guidelines once used by FHA, lacks the clarity and detail necessary to provide a bright line safe harbor and should be either revised or removed.
- Congress and the CFPB should consider alternative approaches to establishing bright line safe harbors for ATR compliance that do not rely on prescriptive underwriting requirements. One approach might be to use the pricing of the mortgage loan as a proxy for the risk that a borrower does not have the ability to repay the loan – for example, by deeming any mortgage loan that has a financing cost below a specified threshold to conclusively be a qualified mortgage...Another approach, perhaps as a complement to the first, might be to provide that a mortgage loan conclusively becomes a qualified mortgage after a specified seasoning period under the rationale that most defaults after that period would be a result of a change in the borrower's circumstances and not due to the lender's initial assessment of the borrower's ability to repay.
- QM should be the outer limits of GSE/guarantor activity. In other words, the GSEs, and any other guarantors after legislative reform, should not necessarily be permitted to acquire any and all qualified mortgages, particularly given the Government backing that would support those acquisitions.
- Recommendations
 1. **Congress should amend the Truth in Lending Act to establish a clear bright line safe harbor for compliance with the required ability-to-repay determination. (legislative)**
 2. **Pending legislation, the QM patch should expire, as contemplated by the CFPB's July 2019 advance notice of proposed rulemaking, and the CFPB should amend its ability-to-repay rule to establish a clear bright line safe harbor that replaces the QM patch. FHFA and the CFPB should continue to coordinate their efforts to avoid market disruption in connection with the expiration of the QM patch and the implementation of any amendments to the CFPB's ability-to-repay rule. (administrative)**
 3. **Following any change to the CFPB's ability-to-repay rule, FHFA should revisit the determination as to which single-family mortgage loans should be eligible for acquisition by the GSEs (with appropriate amendments to the PSPAs) or, following legislation, should be eligible to secure Government-guaranteed MBS. (administrative)**

3. Private Label Securitization

- The special treatment afforded to the GSEs under the disclosure, risk retention, and other regulations governing securitization transactions has also heightened the GSEs' competitive advantage over private sector securitizers, particularly to the extent that regulatory impediments adopted following the Dodd-Frank Act might have prevented PLS from playing a larger role.

- Re: Reg ABII: *Critically, the GSEs' MBS issuances are not subject to these disclosure requirements, which has heightened the GSEs' competitive advantage over PLS issuers. Requiring each GSE to conform its disclosure to Regulation AB II could help level the playing field.*
- Recommendations:
 1. ***The federal financial regulators should review the regulatory capital treatment of PLS exposures and the risk retention rules for securitizations, as recommended in Treasury's Core Principles Report – Capital Markets. (administrative)***
 2. ***The CFPB should provide guidance or other regulatory comfort as to the extent and management of the assignee liability of passive secondary market investors under applicable federal consumer financial laws, as recommended in Treasury's Core Principles Report – Banks and Credit Unions. (administrative)***
 3. ***The SEC should review Regulation AB II to assess the number of required reporting fields and to clarify the defined terms for registered PLS issuances. (administrative)***
 4. ***FHFA should consider whether to require each GSE to conform its loan-level disclosures to Regulation AB II after the regulation is reviewed by the SEC. (administrative)***
 5. ***FHFA should determine the extent and manner of the feasible disclosure of the GSEs' historical loan-level data and property valuation data to the public, taking into account any privacy and safety and soundness risks. (administrative)***

B. Competitive Secondary Mortgage Market (40)

- A competitive secondary market would have several compelling benefits.
 - *First, ending the duopoly may help protect taxpayers against future bailouts. Having multiple guarantors could reduce the systemic importance of any single guarantor and enhance the resolvability of an insolvent guarantor, thereby mitigating moral hazard, increasing market discipline, and enhancing taxpayer protections.*
 - *Second, the duopoly market structure has reinforced the perception of an implicit Government guarantee that has given the GSEs a competitive advantage over private sector competition. Ending the duopoly would be a step toward leveling the playing field.*
 - *Third, there is some question as to whether the benefits of any subsidy conferred on the GSEs accrue to their shareholders instead of borrowers.*
 - *Fourth, a competitive secondary market could promote innovation and market dynamism, not just with respect to the underwriting and pricing of mortgage loans, but also with respect to the services provided to each guarantor's lender clients.*
- *It remains, however, an open question whether private sector entities would be competitive with the GSEs, and also whether the risk-adjusted returns would be sufficient to attract entrants.*
- *Barriers to entry might be heightened, for example, if Congress requires guarantors to assume nationwide service requirements immediately after beginning business without some transition period, or if the legislation leads to significant economies of scale among*

guarantors. In light of these considerations, Congress should consider the implications for the likelihood of achieving a competitive secondary market when determining what legal requirements and restrictions should be applicable to newly chartered guarantors.

- Recommendations
 1. ***Congress should authorize FHFA to charter competitor guarantors to the GSEs and should direct FHFA to re-charter each GSE on the same charter available to these potential competitors. Effective as of its re-chartering, each GSE's statutory charter should be repealed. (legislative)***
 2. ***Congress should give FHFA appropriate authorities to foster competition with the re-chartered GSEs. (legislative)***
 3. ***Congress should take into account the effects on secondary market competition when considering the legal requirements or restrictions it imposes on guarantors. (legislative)***

C. Competitive Primary Mortgage Market (42)

1. Equitable Access to the Secondary Market

- *cash window-facilitated aggregation provides for better pricing to the smaller lenders than would be obtained in a relatively small lender swap transaction...Legislative reform should preserve this practice by requiring single-family guarantors to offer a similar cash window for small lenders*
- *In addition to operating a cash window, single-family guarantors generally should be required to offer to acquire mortgage loans from across the nation.*
- *Cash window and nationwide service requirements could, however, pose a barrier to entry to new single-family guarantors, and Congress might wish to consider a phased-in transition period for newly chartered single-family guarantors.*
- Recommendations
 1. ***Each single-family guarantor should be required to operate a cash window for small lenders, should be prohibited from offering volume-based pricing discounts or other similar incentives, and should be required to maintain a nationwide presence. (legislative)***
 2. ***Pending legislation, Treasury and FHFA should amend each PSPA to require each GSE to maintain a nationwide cash window for small lenders and to prohibit volume-based pricing discounts or other similar incentives. (administrative)***

2. FHLB Support of the Primary Market

- *While there might be unique counterparty or other safety and soundness risks posed by advances to mortgage lenders that are not subject to comprehensive prudential regulation, those risks potentially could be managed through enhanced collateral haircuts, capital requirements, or other counterparty risk management practices (e.g., bankruptcy-remote funding structures).*
- Recommendations
 1. ***Congress should consider permitting additional classes of mortgage lenders to become FHLBank members. (legislative)***

2. *Pending legislation, FHFA should revisit its rule excluding captive insurance companies from FHLBank membership in light of the continued evolution of the housing finance system. (administrative)*

VI. Conclusion (this is the entire section)

- *Treasury reiterates its preference and recommendation that Congress enact comprehensive housing finance reform. Congress can address this last unfinished business of the financial crisis in a way that preserves what works in the current system, protects taxpayers, and reduces the influence of the Federal Government in the housing finance system. To that end, Treasury recommends that Congress authorize Ginnie Mae to offer an explicit, paid-for guarantee of the timely payment of principal and interest on MBS backed by eligible conventional loans and eligible multifamily mortgage loans and also that Congress authorize FHFA to charter competitors to the GSEs as guarantors of these Government-guaranteed MBS. That legislation should also allow for enhancements to the regulatory framework of the GSEs and any newly chartered competitors to safeguard their safety and soundness, minimize risks to financial stability, protect equitable access for all mortgage lenders, and support affordable housing for both borrowers and renters.*
- *Pending legislation, Treasury will continue to support FHFA's administrative actions to lay the foundation for eventual legislation, enhance the regulation of the GSEs, promote private sector competition, and satisfy the preconditions for ending the GSEs' conservatorships. FHFA should begin the process of ending the decade-long conservatorships of the GSEs – including by beginning the process of recapitalizing the GSEs. In parallel, FHFA should continue to implement reforms that promote private sector competition in the housing finance system by leveling the playing field across market participants. Implementing these reforms will accomplish the housing reform goals set forth in the Presidential Memorandum and strengthen the United States' growing and dynamic economy, while expanding affordable homeownership.*