November 30, 2020

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

Dear Secretary Mnuchin,

We have appreciated the Treasury's active engagement on GSE and housing finance issues and we support many aspects of the Treasury's 2019 Housing Reform Plan. Most significantly, we agree that *"existing Government support should…be made clearer and better tailored. The PSPA commitment should be replaced with an explicit, paid-for guarantee backed by the full faith and credit of the Federal Government."*[1] We believe finality and certainty are the central goal of any housing finance reform effort, and this cannot be achieved without clarity on the level of federal support for mortgage markets.

We write to reiterate and emphasize some concerns regarding the conservatorships of the GSEs that we expressed to you, and other members of the Administration, last year.[2] Our members are concerned that changes to the status of the GSEs are being contemplated without the benefit of an open and transparent market discussion, risking harm to the TBA market which is the most important vehicle for financing mortgage lending.

As you know, SIFMA's primary focus in housing finance reform is that the TBA market, which has so ably served mortgage borrowers, lenders, investors, and the economy for the last 40 years, remains a liquid and effective mechanism to transfer risk and fund mortgage lending. The TBA market facilitates risk management for originators, rate locks and an affordable national mortgage market for borrowers, and investment opportunities for a vast number of mutual fund, pension fund, and other global investors. The TBA market is the crown jewel of the U.S. mortgage finance system.

While 2020 has been a difficult year throughout the economy, the resilience of the housing markets and financial system, including the TBA market, has been a bright spot. In 2020, mortgage markets have seen extremely high volumes and activity in the TBA market has risen apace – from a daily trading average of $228BN/day in 2019 to $270BN/day year to date in 2020.[3] In light of the challenges facing the economy in coming years, we strongly believe that a diminution of the TBA market would represent a major step backward for a sector that has served as a key supporter of our economy.

It is in this context of housing and mortgage finance being a key driver of positive economic activity that we write today. We understand that the GSEs are nearing their caps on retained capital and discussions

[1] See: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf, at 9
[2] See SIFMA letter to Treasury, et. al ("SIFMA letter") here: https://www.sifma.org/wp-content/uploads/2019/07/SIFMALetterReGSEs_final20190711.pdf
[3] SIFMA analysis, available here: https://www.sifma.org/resources/research/us-sf-trading-volume/

are reportedly underway relating to restructuring the PSPA agreements.[4] FHFA has also discussed the possibility of the GSEs operating outside conservatorship under consent decrees that would limit and guide their activities.[5] In other words, there is contemplation that the GSEs could be moved out of their conservatorship and returned to the private sector with the remaining, finite PSPA backstop serving as the "guarantee" on their MBS and debt.

As we wrote to you in 2019, we believe such a move would be premature and would create great risk to the housing market, MBS market, and broader economy. We wrote then, and still believe , *"that absent Congress and the President legislatively enacting an explicit guarantee applicable to the GSEs' existing and new MBS, and without the finality provided by comprehensive housing finance reform, moving the GSEs out of conservatorship and back into the private markets would dramatically heighten the risk of a liquidity disruption for existing and new MBS."*[6]

Our members remain concerned *"that market participants will no longer consider an implicit guarantee, even if supported by the remaining --but limited-- PSPA, as equivalent to an explicit guarantee…[I]t is reasonable to expect investors would once again question the commitment of the U.S. government to the GSEs and their MBS. In contrast to the desire to project a nearly explicit guarantee when the GSEs entered conservatorship in 2008, such a move without legislation may be considered by some an explicit non-guarantee."*[7]

We further note that FHFA itself stated in the Enterprise Capital Rule that *"Treasury's commitment under the PSPAs is finite and cannot be replenished, <u>and that commitment could be inadequate to ensure each Enterprise would remain a viable going concern during and after a severe economic downturn</u>, particularly to the extent that an Enterprise's liabilities and other obligations were to grow relative to that fixed commitment."*[8]

We agree with FHFA with respect to the PSPA commitment and its possible insufficiency in the coming decades. However remote these scenarios may be, GSE MBS are a rates product with an investor base that does not have an interest in taking on credit risk. The GSEs' regulator has now indicated that PSPA support may not be sufficient for the GSEs to remain a going concern which can only exacerbate the concerns market participants already have. We believe non-US investors would be the first to exit the market, as they did in the face of uncertainty in 2008, and that there is material and near-term risk that domestic investors would change the size, scope, and/or pricing of their investments in the GSE MBS sector. This change is not an issue of a long-term rotation out of MBS; it would be a near-term shift in demand out of the sector.

---

[4] See, e.g., https://www.wsj.com/articles/fannie-freddie-overseer-seeks-to-end-federal-control-before-trump-leaves-11605873600

[5] See, e.g., https://www.bloombergquint.com/politics/fannie-freddie-could-be-freed-by-2022-23-fhfa-s-calabria-says, "*The consent decree will be able to give that window where they can go to market, do an offering and still operate under a way where we've got some prudential safeguards."* See also FHFA's final capital rule ("Enterprise Capital Rule") (https://www.fhfa.gov/SupervisionRegulation/Rules/RuleDocuments/Enterprise%20Capital%20Final%20Rule%20for%20Website.pdf), which provides that the effective date of certain provisions *"will be the later of the date of the termination of the conservatorship of the Enterprise…and any later compliance date provided in a consent order or other transition order applicable to the Enterprise."*

[6] Ibid.

[7] Ibid.

[8] Enterprise Capital Rule at 40.

These credit concerns could likely also impair the functionality of the UMBS construct, whereby the GSEs' MBS are considered fungible and delivered into a single TBA contract. This may break down as investors analyze the credit of the GSEs separately. In sum, we are concerned that TBA liquidity would be reduced, potentially materially. These outcomes would be detrimental to the mortgage finance system, to investors, and to the economy more broadly.

Our members have also raised questions about the potential impact of such a change on Federal Reserve policies vis-à-vis Fannie Mae and Freddie Mac MBS – e.g., whether there would be a change in prudential treatment, whether there would be pricing changes at the discount window, and whether or not this action would impact the MBS purchase program executed by the New York Federal Reserve.

Furthermore, this change would happen alongside of the implementation of the final Enterprise Capital Rule, for which we note that many concerns raised by SIFMA and others were not addressed, such as those with respect to CRT and cross-guarantee capital requirements that may diminish the viability of UMBS trading in a single TBA contract.[9]

Accordingly, we ask that you consider these concerns as you discuss with FHFA the appropriate approach to the restructuring of the PSPA agreements and the conservatorship of the GSEs. Any amendments to the PSPAs should be mindful of their potential impact on TBA market liquidity, especially as we are approaching year-end where funding pressures tend to increase and liquidity tends to decrease, with recognition that normal market signals may be somewhat muted by the robust activity from Federal Reserve QE operations. Adding to the risk is the ongoing broader economic downturn caused by the pandemic.

SIFMA's careful analysis over the last decade demonstrates that there should not be premature action to end the conservatorships and return the GSEs to the private sector until all of the building blocks are in place. The correct approach is a comprehensive approach that creates long-term certainty and stability in the MBS market and the mortgage lending that it enables. This should include a full and explicit government guarantee for MBS.

The risk of the status quo is that the GSEs remain in conservatorship for some additional period of time. Removing them from conservatorship without laying the appropriate groundwork will risk disrupting MBS markets to the point that they contract considerably. The positive force that the housing markets have provided in the economy throughout 2020 would be at best lessened and at worst disappear. Given that housing represents one-fifth of GDP and 35% of all private, non-financial debt in the US, this is a very significant risk.[10]

We thank you for your consideration of this matter. We believe our recommendations are aligned with the Treasury's interest in a robust U.S. economy, the stability of the housing finance system, and with the broad construct outlined in the Housing Reform Plan. As I mentioned previously, we greatly appreciate Treasury's focus on and contributions to housing finance reform and we stand ready to assist with your efforts.

---

[9] See SIFMA letter to FHFA, August 28, 2020 here for a discussion of our concerns with the capital rule: https://www.sifma.org/wp-content/uploads/2020/08/SIFMA-Nareit-2020-GSE-Capital-Proposal-Final.pdf
[10] SIFMA letter at 2.

With kindest personal regards,

Kenneth E. Bentsen, Jr.
President & CEO
Securities Industry and Financial Markets Association