FHFA AND SENATE PROPOSALS BRING GSE REFORM INTO SHARPER FOCUS

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On January 16, 2018, Federal Housing Finance Agency ("FHFA") Director Melvin L. Watt sent a document to Senate Banking Committee Chairman Mike Crapo (R-ID) and Ranking Member Sherrod Brown (D-OH) that describes the FHFA's views about housing finance reform. In a letter accompanying the document, Director Watt indicated that, "[i]n recent months, perhaps attributable to the growing perception that reform could be achievable this year, FHFA has received a number of new or renewed requests for our views." Although Director Watt reiterates in the letter his "strongly held view that it is the prerogative and responsibility of Congress, not FHFA, to decide on housing finance reform," he also states that the FHFA seeks to outline its perspectives "independently and transparently" while continuing to furnish technical assistance to the Banking Committee as it considers various proposals.

In the document, the FHFA states that its ongoing conservatorship of Fannie Mae and Freddie Mac, both of which are Government-Sponsored Enterprises ("GSEs"), "is not sustainable and needs to end." The FHFA proposes the establishment of Secondary Market Entities ("SMEs") to be "private, shareholder-owned institutions … [that] issue government-guaranteed mortgage-backed securities." Under the proposal, the "government would provide an explicit and paid-for catastrophic guarantee on mortgaged-backed securities issued by regulated SMEs." The FHFA proposes creating a Mortgage Insurance Fund ("MIF") to "cover catastrophic losses on mortgage-backed securities ahead of remote losses covered by the government guarantee."

Among the other notable features of the FHFA's proposed future housing finance system are (1) preserving the 30-year fixed-rate, pre-payable mortgage; (2) attracting substantial amounts of private capital to the market "through both robust equity capital requirements and credit risk transfer… participation;" and (3) providing "for a single government-guaranteed mortgage-backed security that will improve the liquidity of the to-be-announced… market and promote a fair and competitive funding market for [SMEs]." Further, the FHFA proposes continuation of the Common Securitization Platform, which would be modeled on the Depository Trust and Clearing Corporation, to facilitate the SMEs' issuance of a single security.

Notably, Senators Bob Corker (R-TN) and Mark Warner (D-VA) included a MIF in reform legislation that they introduced in a prior term of Congress, and it is also included as part of a recently circulated discussion draft of their new proposal. Although the final legislative text could differ in some respects from the discussion draft, the draft provides a greater sense of the direction that Senators Corker and Warner could take on their much-anticipated bipartisan reform legislation. In particular, the Corker-Warner discussion draft would (1) create a government guarantee on mortgage-backed securities issued by the Common Securitization Platform ("CSP"); (2) provide that private guarantors and a MIF would stand in front of taxpayers; (3) repeal the charters of the GSEs and require them to implement liquidation plans; (4) replace the GSEs with multiple guarantors; (5) require private

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mortgage insurance or an eligible credit risk transfer agreement for loans where borrowers do not have 20 percent of equity in the value of the home; and (6) allow Ginnie Mae to provide the full faith and credit on eligible mortgage-backed securities issued by the CSP.

Following release of the document, Counselor to the Secretary of the Treasury Craig Phillips reportedly signaled that the Trump Administration is broadly supportive of the FHFA's views. The FHFA's perspectives and the Corker-Warner discussion draft will likely bring into sharper focus the ongoing bipartisan efforts in Congress to reform the GSEs and the broader housing finance system. Moreover, the proposals coupled with recent statements by Chairman Crapo and House Financial Services Committee Chairman Jeb Hensarling (R-TX) strongly suggest that legislative activity is imminent. For additional information about the various pending proposals, please see the K&L Gates Alert entitled "Housing Finance Reform: The Stars Are Aligning."

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