



## **GSE developments: FHFA may have acted illegally**

Michelle Jones

July 7<sup>th</sup>, 2020

Three major GSE developments over the last 10 days will greatly impact the future of Fannie Mae and Freddie Mac. Dick Bove of Odeon Capital outlined the three GSE developments in a recent note.

Seila Law case is the biggest GSE development

The biggest GSE development is the Seila Law case, although the ruling was directly aimed at the Consumer Finance Protection Bureau. The Supreme Court ruled that although the CFPB might be legal, the position of its director is not.

Bove explained that the Supreme Court justices believe the Constitution should be interpreted as it is written and amended and that the laws of Congress should be followed as written. He also said that they fear bureaucrats aren't following the Constitution and the laws passed by Congress.

The Supreme Court believes Congress' job is to write laws, while the president's job is to execute them. The court recognizes that the president's job is so massive that he needs help performing his functions. Thus, there is a need for departments and agencies to help carry out these laws, and the CFPB and the Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, are two such agencies. The Supreme Court believes these agencies can study and advise but not create or enforce.

However, the CFPB's structure obviously violates these principles. The agency is structured in such a way that it creates its own rules and enforces them without asking the president, congress or even an oversight committee about them. It also doesn't have to go to Congress to obtain funding and can take a percentage of the costs of running the Federal Reserve for itself.

The reason the CFPB's structure was ruled to be unconstitutional is because it allowed one person to make all final judgments about what it could do. The director could make rules and regulations impacting the private sector without any oversight committee looking over the decisions.

The Supreme Court could not accept the fact that one person had so much power and that the director of the agency could usurp the powers of the president. Thus, the court ruled that the president's power to execute the will of Congress is to mandate that they control all the entities set up to do it. To control the agencies, the president must have the power to remove their directors at will. As a result, the Supreme Court ruled that the position of the CFPB director is unconstitutional.

Why this development matters for the GSEs

Bove explained that this development matters for the GSEs because the FHFA's structure basically mirrors that of the CFPB. FHFA Director Mark Calabria doesn't have any oversight either. The Fifth Circuit Federal Court already ruled that his position was unconstitutional, although the Supreme Court did not make any such official ruling.

This development is important for the GSEs because if the FHFA director's position has always been unconstitutional, then presumably, all the rules he put in place in invalid. That includes the net worth sweep, under which the Treasury sweeps all of the GSEs' profits into its own coffers.

The Fifth Circuit Court claimed that since the presidents and the FHFA directors always seem to agree on the actions taken by the FHFA, the actions were lawful, meaning that the agency was merely carrying out the president's wishes.

Bove said it's widely hoped that the Supreme Court will take up the issue by deciding to review the Collins case. If it does, then he expects Fannie Mae and Freddie Mac shares to jump in value.

Calabria speaks

The other GSE development came in the form of a speech given by Calabria to the Cato Institute. The remarks he made suggest that he agrees with shareholders who dispute the net worth sweep.

He said at the Cato Institute that he believes the FHFA's actions have not followed the will of Congress as set out in the Housing and Economic Act of 2008, which would mean they are illegal. Calabria intends to see that the agency only takes actions it is allowed to take under the law, which are to ensure the safety and soundness of Fannie Mae and Freddie Mac.

He also backed up something he has said previously, which is that the net worth sweep is illegal. He also said it isn't the FHFA's job to raise capital for Fannie Mae and Freddie Mac. The GSEs are supposed to do it themselves.

Another GSE development: presentation by former Freddie Mac CEO

Finally, Bove noted that former Freddie Mac CEO Don Layton is now at Harvard University's Joint Center for Housing. He recently made a presentation arguing that the new capital rule proposed for Fannie Mae and Freddie Mac is invalid for two reasons.

One reason is because it requires the GSEs to raise so much capital that they become uninvestable. The other is that the true nature of the risk in these companies is misunderstood. He argued that this suggests their real capital needs are well below what was suggested.

Bove said the importance of Layton's presentation is that it suggests Fannie and Freddie can be viable independent companies with far less capital than what the FHFA requires.