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## Will 2019 bring long-awaited GSE reform?

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Though the chance for any reform of mortgage giants Fannie Mae and Freddie Mac this year was slim to begin with, a scandal at the Federal Housing Finance Agency and a general lack of political will served to ensure that nascent efforts never really got off the ground.

Some are wondering if that could change in the new year.

The Trump administration will have more room to maneuver when Comptroller Joseph Otting takes the reins of the FHFA in early January on an acting basis while the Senate debates the nomination of Mark Calabria as the permanent agency director. The moves give the White House much more leverage in the reform debate, even with Democrats controlling the House.

How they plan to use it is unclear. Otting and Calabria, currently the chief economist for Vice President Mike Pence and formerly a Cato Institute fellow, have no shortage of proposals to consider if the administration wants to reduce the scope of the government-sponsored enterprises, several of which emerged just in 2018.

In June, the White House proposed a reform plan that would repeal the federal charter of the GSEs and end conservatorship, as part of a larger Office of Management and Budget proposal to reorganize the government. But the plan was widely criticized as being too vague and it is still unclear if the plan had any support elsewhere in the administration.

After the anniversary that marked 10 years of conservatorship in September, House Financial Services Chairman Jeb Hensarling, R-Texas, proposed a surprising — and more politically possible — bipartisan reform plan with Reps. John Delaney, D-Md., and Jim Himes, D-Conn. His proposal built on that of earlier models, which suggested eliminating Fannie and Freddie and instead using Ginnie Mae to provide a government backstop for mortgages.

While Hensarling is retiring at the end of this year, his concessions as part of a larger bipartisan overture may have set the stage for a path forward using some form of middle-ground compromise.

“There is a lot of bipartisan talk going on both on Capitol Hill as well as within the administration and Treasury and others that they’d like to do something,” said Dan Berger, the CEO and president of the National Association of Federally-Insured Credit Unions. “A common

theme around the chatter we're hearing ... is to find a mechanism to make sure that taxpayers aren't on the hook for another bailout."

In fact, a Calabria-led FHFA in line with the administration's beliefs and a divided government that will force Congress to consider bipartisan legislation could align to create somewhat of a perfect storm for housing finance reform.

"There's now a confluence that's been built around the need to really do a deep dive on national housing policy itself, which housing finance is just one important element," said David Jeffers, the executive vice president of policy and public affairs at the Council of Federal Home Loan Banks.

Treasury Secretary Steven Mnuchin said earlier this month that he would like to get the GSEs "out of conservatorship," but also said that his preference for doing so would be with bipartisan legislative support.

The legislative GSE reform Mnuchin wants is extremely improbable, according to most observers, but they do foresee the administration taking steps on its own to limit the reach of Fannie and Freddie, either with Otting in the lead or following Calabria's confirmation.

"Any reform would be administrative with the new FHFA director who's more conservative and focused ostensibly on reducing the GSEs' footprint," said Mark Zandi, the chief economist at Moody's Analytics.

And one of the biggest steps to GSE reform is slated to take place in just a few months, with Fannie and Freddie set to begin using a common securitization platform in June 2019. The FHFA has said combining the two markets into a single market would increase liquidity and encourage market participation, which would ultimately benefit market participants and homeowners.

The single security "is moving the system in the right direction for the future system, so a single security is a precursor to any future system," said Zandi. "In that sense I think it is GSE reform, and that feels like that's on track."

Though the implementation of the platform is likely to be met with a few glitches, the industry is generally prepared for the GSEs to begin issuing a uniform mortgage-backed security, said Ed Wallace, the executive director of the Community Mortgage Lenders of America.

"From an investor standpoint, they're prepared for it because they want it to be a uniform security, making it easier to" participate in the market, he said.

Although the efforts toward a single security have taken place under Director Mel Watt, whose term ends Jan. 6, the move is already in line with the Trump administration's reform goals, said Zandi.

"It feels like the single security would be consistent with any type of reform, even the kinds of administrative reforms that the administration is probably thinking about, so I don't think there's any reason why the new FHFA director would stop that," he said.

The FHFA has already started proposing policy changes to support the implementation of a single security, and issued a proposal in September that would require Fannie and Freddie to align their policies on cash flows for mortgage-backed securities in preparation for the future uniform MBS.

Otting is due to take over when Watt steps down, while Calabria's nomination is pending in the Senate. Some observers said the Trump administration may want the FHFA to focus on rapidly increasing the share of cash-out mortgage refinancings, multifamily lending or finalizing the agency's proposed capital framework released earlier this year, which would take effect if the GSEs were to exit conservatorship.

Although Calabria has pushed previously for placing the GSEs in receivership and eliminating the 30-year fixed-rate mortgage, observers say it's unlikely he would actually follow through with these proposals as FHFA director.

“We fully expect a broader conversation regarding the future of the GSEs during the Trump administration, which will undoubtedly include a consideration of the conservatorship, but we believe exiting conservatorship is likely a bridge too far in the near-term given political considerations and the associated execution risk at this stage in the cycle,” wrote Isaac Boltansky, the director of policy research for Compass Point Research & Trading, in a note.

While the administration is likely facing pressure from shareholders who are “agitating for some solution,” substantial GSE reform will remain just as risky in the coming year, said Zandi.

“It’s going to be difficult to get anything done politically, and changes to the GSEs, whether it's reform or not, are politically charged and make it increasingly more difficult to accomplish any significant change,” he said.

But that doesn’t mean Congress and the White House won’t try to undertake housing finance reform. In fact, the political shake-up could point to progress.

“There’s as strong of a possibility as we’ve had in decades to actually having a debate around what is our national housing policy,” said Jeffers.