# The White House's Latest GSE 'Reforms' Repeat Sins Of The Past

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On September 14, the U.S. Treasury and the Federal Housing Finance Agency (FHFA) announced that they would suspend "certain provisions" added to the Preferred Stock Purchase Agreements (PSPAs) in 2021. The PSPAs, of course, are key to protecting taxpayers against future bailouts and ensuring that Fannie FNMA -3.1% and Freddie, propped up by the federal government, do not further crowd out private capital.

On the following day, the FHFA announced a notice of proposed rulemaking to amend the Enterprise Regulatory Capital Framework enacted in 2020. This framework, along with the 2021 amendments to the PSPAs, were designed to strengthen the GSEs and protect taxpayers, and they were the most meaningful housing finance reforms since Fannie and Freddie were placed into conservatorship.

Rolling back these reforms will weaken the GSEs' capital requirements *and* force taxpayers to back more high-risk loans, thus increasing the risk of future bailouts. These changes make even less sense given where the U.S. housing cycle currently sits.

If things go south, the Biden administration will own the latest implosion of Fannie and Freddie, and it won't help that the president's chief of staff is a former Fannie Mae lobbyist.

Regardless, the core problem here is that the FHFA is supposed to be the housing finance industry's watchdog, not its lapdog.

Here is a quick rundown of how the Biden administration is weakening the GSEs and exposing taxpayers to greater risks.

First, the administration is going to suspend the PSPA provisions that capped the GSEs' purchases of multifamily housing loans, as well as single-family loans "with higher risk characteristics," second homes, and investment properties.

These last two provisions have nothing to do with helping people become homeowners. They don't even pass the laugh test for good public policy – they are a naked give away to the special interests that simply want to make as many loans as possible.

As for helping the multifamily housing corporations, the ones that live off subsidies and pretend they can't borrow money without government help, that really deserves its own column.

Most important, it defies all logic to intentionally funnel higher-risk mortgages through the GSEs right now. Fannie and Freddie remain under government conservatorship because of their weak financial condition, and home prices have risen far beyond the peak that they reached prior to the 2008 crash.

The proposed changes to the capital rules are no better.

The administration wants to lower the prescribed leverage buffer amount (PLBA) and the floor on the risk weight assigned to any retained credit risk transfer (CRT) exposures. Just as with weakening the PSPA provisions, it makes zero sense to *lower* the GSEs' capital requirements right now.

Of course, reducing the capital requirements is precisely what the special interests – including Urban's Jim Parrott, Bob Ryan, and Mark Zandi – have been calling for since the FHFA originally proposed the rule.

Most groups, for instance, called for *no risk weight floor* on CRT exposures. That position was hardly surprising, though, because the cottage CRT industry (Wall Streeters love these structured debt securities) wants to trade as many of these bonds as possible. It does not care about the safety and soundness of the GSEs.

The fact that the new FHFA proposal still includes a risk weight floor (it proposes lowering it from 10 percent to 5 percent) is better than completely removing it, but the change is in the *wrong* direction. The notion that CRTs completely eliminate the GSE's risk is a joke – they *increase* the GSEs' financial obligations and their value to the GSEs (or taxpayers) is virtually nil.

As for the existing leverage buffer, it serves as a part of a backstop to the risk-based capital requirements. In addition to the tier 1 leverage ratio, the GSEs are supposed to maintain a fixed buffer of at least 2.5 percent (tier 1 capital to adjusted total assets).

Given the imperfect nature of *any* risk-weighted system, a backstop is more than prudent.

Lowering it – or any of the risk-based requirements – cannot legitimately be described as improving the GSEs' safety and soundness. It would do the exact opposite. In fact, if anything,

the original rule should have called for even higher capital requirements, so that the GSEs' requirements were more in line with those of the GSIBs.

Nonetheless, the new proposal calls for replacing the fixed buffer with "a dynamic leverage buffer determined annually and tied to the stability capital buffer." Figure 2 of the new proposal estimates that this change will reduce the GSEs' leverage buffers by about two-thirds.

Again, it makes no sense to reduce this cushion.

Worse, though, is that the proposal sets up an even larger reduction in capital. The GSEs' ultimate level of capital partly depends on how the leverage buffer interacts with the risk-based capital requirements, and the proposal is a clear signal that the administration wants to lower the overall capital requirements.

Not only does the new notice call for moving away from the (higher) fixed buffer, it poses several leading questions for comments:

- Question 2: Is the proposed PLBA appropriately formulated? What adjustments, if any, would you recommend?
- Question 3: Is the PLBA necessary for the ERCF's leverage framework to be considered a credible backstop to the risk-based capital requirements and PCCBA?
- Question 4: In light of the proposed changes to the PLBA and the CRT securitization framework, is the prudential risk weight floor of 20 percent on single-family and multifamily mortgage exposures appropriately calibrated? What adjustments, if any, would you recommend?

All of these are a bad sign, but the last one is a real doozie.

Question 4 opens the door for the administration to *further* decrease the GSEs' capital requirements on single-family mortgages, even though the notice purports to be about "refining the prescribed leverage buffer amount (PLBA or leverage buffer) and credit risk transfer (CRT) securitization framework" for the GSEs. There is zero doubt that industry participants will submit comments calling on the FHFA to lower – sorry, to *recalibrate* – these requirements.

The main question now is how many of the progressive senators who regularly criticize Fed Chair Powell for weakening banks' capital requirements will criticize the Biden administration for doing the same thing to the GSEs. After all, Fannie Mae is larger than the largest GSIB banks, with an even less-diversified balance sheet.

Even the Financial Stability Oversight Council (FSOC) officially stated that capital requirements should not be lower than those in the 2020 GSE capital rule. (See page 4.)

It will also be interesting to see if the changes reverse the recent flow of private capital into the securitization market, a long awaited change that the administration should have welcomed.

All the typical American has to show for the GSE system is excessive debt, high housing costs, volatile home prices, overregulation, and a trail of federal bailouts. The homeownership rate is almost exactly where it was prior to the GSE system; home price appreciation has consistently outpaced income growth, and taxpayers have been forced to shell out hundreds of billions of dollars in bailouts.

If the administration wants to help make housing more affordable, it needs to move away from that system.

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