

Reproduced with permission from BNA's Banking Report, 104 BBR 76, 1/13/15, 01/13/2015. Copyright © 2015 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

REGULATORY REFORM

Four Key Voices in Washington's Housing Finance Reform Debate



BY MICAH GREEN, MATTHEW KULKIN,
AND BRANDON ROMÁN

The 113th Congress adjourned on Dec. 16, 2014. Among its legislative shortcomings, including the last-minute failure to extend the Terrorism Risk Insurance Act ("TRIA"), was the inability to produce any meaningful reform to the regulatory regime governing the government-sponsored enterprises ("GSEs"), Fannie Mae and Freddie Mac.

With the opening of the 114th Congress on Jan. 6, the Republican-led House and Senate will be forced to address ways to improve the mortgage finance market, including, but not limited to, addressing the conservatorship of the GSEs, refining the government-sponsored refinancing program, streamlining mortgage regulation, cracking down on consumer fraud and abuse, promoting rental housing, and establishing a revamped common securitization platform.

Congress will not have to start from scratch. There have been dozens of proposals circulating in Washington for years from all sides of the debate, including nu-

merous housing and mortgage-related proposals debated during the 113th Congress. In addition to congressional proposals, the Consumer Financial Protection Bureau ("CFPB") and other federal regulators have issued rules related to "qualified mortgages" ("QM") and "qualified residential mortgages" ("QRM"). Moreover, the Federal Housing Finance Agency ("FHFA") has taken definitive steps related to Fannie Mae and Freddie Mac mortgage limits.

At the same time, local governments are more seriously considering eminent domain programs (which have been restricted by provisions in the congressional spending measure adopted just before adjourning in December) or buying underwater loans with funding from private investors. Members of Congress have faced tough questions at town hall forums from struggling homeowners and borrowers who are unable to navigate the bureaucratic maze to obtain relief through Federal programs like the Home Affordable Refinance Program ("HARP") or the Home Affordable Modification Program ("HAMP"), as well as constituents who are having a more difficult time accessing credit due to increased regulatory lending standards.

As the 2016 presidential election approaches, constituents will press candidates, many of whom will be sitting Members of Congress, for more action, while partisan disputes will make compromise and bipartisanship more difficult to achieve. Despite the political climate, Washington is uniquely positioned to impact the future of the housing and mortgage market, ad-

Micah Green is Chair of the Squire Patton Boggs Financial Services Policy Practice Group; Matthew Kulkin is Senior Associate and Brandon Román is an Associate in the D.C. office.

dressings mortgage origination and servicing, GSE regulation, securitization, mortgage insurance, and other important aspects of the debate.

The debate, however, does not take place in a vacuum. There are many moving pieces, each of which is driven by its own missions, goals, and ambitions. This article identifies four of the most important Washington stakeholders in the housing reform debate, highlighting their roles, their interests, and predicting any likely short-term outcomes.

I. Congress

Although Republicans maintain a majority in the House and Senate, GSE reform will still require bipartisan support and compromise in order to proceed. At this time, it is not anticipated that comprehensive GSE reform can achieve such a consensus, despite it being a “holdover” from the 113th Congress. Therefore, given the split between Democrats and Republicans on the issue, much of the initial discussion on housing finance reform during the 114th Congress is likely to focus more on transitioning the GSEs out of conservatorship and less on significant reforms to the market. While Republicans are likely to raise objections to ending conservatorship of the GSEs, the fact that various reforms have been passed to decrease the risk Fannie and Freddie pose to taxpayers (*i.e.*, QRM Rule¹), coupled with the GSEs’ return to profitability², may support Democrats’ argument that ending the conservatorship would be appropriate and that the urgent need for substantial reform has subsided.

... [G]iven the split between Democrats and Republicans on the issue, much of the initial discussion on housing finance reform during the 114th Congress is likely to focus more on transitioning the GSEs out of conservatorship and less on significant reforms to the market.

After the midterm election, Senator Richard Shelby (R-Ala.) assumed the Senate Banking Committee chairmanship. Given his wariness of large banks and his populist message, there is likely to be a continued push for wholesale reform of the GSEs. However, as was the case during the 113th Congress, Chairman Shelby will

¹ The QRM Rule generally requires securitizers in both public and private securitization transactions to retain not less than 5 percent of the credit risk of the assets collateralizing any asset-backed security issuance, subject to certain exceptions.

² According to a recent financial filing, Freddie Mac reported \$2.1 billion in profit for the third quarter, down from \$6.5 billion during the same period last year; however, profits were up from the previous quarter. With regard to Fannie Mae, the GSE reported \$3.9 billion in profit for the third quarter, down from \$8.7 billion during the same period last year. In total, the GSEs will now have returned more than \$225.5 billion to taxpayers, surpassing the \$187.5 billion they received in bailouts.

be challenged in putting forth a proposal that appeases both Senate moderates and conservative House Republicans and, at the same time, would avoid a presidential veto.

With that in mind, the bipartisan proposal from then-Senate Banking Committee Chairman Tim Johnson (D-S.D.) and then-Ranking Member Mike Crapo (R-Idaho) (“Johnson-Crapo”), represents the likely middle-of-the-road starting point for any debate in the 114th Congress. This proposal was approved along a party line vote by the Senate Banking Committee, though it never received a vote by the full Senate. By contrast, House Financial Services Committee Chairman Jeb Hensarling (R-Texas) likely prefers his legislative proposal, the Protecting American Taxpayers and Homeowners Act (“PATH Act”). The PATH Act, with significant partisan House support, is likely not a viable proposal to clear the 60-vote threshold in the Senate.

Even if Congress succeeds in passing a bill that is signed into law by President Obama, the various legislative proposals all have delayed implementation periods. For example, Johnson-Crapo proposes a five-year period (with extensions, if necessary) to wind-down and eliminate the GSEs and establish a private alternative. Under their bill, the new system would be regulated by the Federal Mortgage Insurance Corporation (“FMIC”), which is modeled in part after the Federal Deposit Insurance Corporation (“FDIC”).

In addition to the transition period for the GSEs, it will likely take lawmakers a significant amount of time to agree upon and move forward with such legislation during the 114th Congress. In reviewing the Senate Banking Committee’s unsuccessful attempt to bring Johnson-Crapo to the Senate floor for a vote, the divergent views of Republicans (focused on systemic risk) and Democrats (concerned about borrower access to credit) precluded the upper chamber from coalescing sufficient support. Lawmakers will face a similar challenge in the 114th Congress, which will likely result in an elongated debate and slow the legislative process until the latter part of the Congressional term.

II. The White House/Obama Administration

In August 2013, President Barack Obama laid out his position on the future of GSE reform. After expressing his support for a proposal from Sens. Bob Corker (R-Tenn.) and Mark Warner (D-Va.), which preceded Johnson-Crapo, President Obama set forth four key principles for housing finance reform. Specifically, these principles include: (1) limiting the government’s role to encourage more private investment in the market; (2) ending bailouts of the GSEs; (3) preserving access to the 30-year fixed mortgage; and (4) strengthening the Federal Housing Administration (“FHA”).

As part of the Administration’s housing finance reform efforts, the White House Jan. 8 announced a plan to lower FHA mortgage insurance premiums by 0.5 percentage points. According to the White House, lowering these premium will provide an average annual savings of \$900 for new borrowers, assist more than 800,000 homeowners reduce their mortgage payments, and help up to 250,000 new borrowers purchase a home. House Financial Services Committee Chairman Hensarling criticized the move, questioning its impact on the FHA’s finances. Chairman Hensarling indicated that the House Financial Services Committee will invite Depart-

ment of Housing and Urban Development Secretary Julian Castro to testify on the plan.

Throughout the course of the debate, the Obama administration has continued to gently encourage lawmakers to take action to reform the GSEs, suggesting that housing finance reform is a key unfinished piece of business from the financial crisis. In particular, the White House's focus has most recently been directed toward ending the conservatorship of the GSEs.

However, while the White House has indicated that it will work with lawmakers on the matter, the Obama administration recently made clear that it will not take steps to unilaterally end Fannie and Freddie's conservatorships. According to the Counselor to the Treasury Secretary for Housing Finance Policy, Michael Stegman, "[t]he critical flaws in the legacy system that allowed private shareholders to reap unlimited profits while leaving taxpayers shouldering enormous losses cannot be fixed by a regulator or conservator. They require congressional action."³ The Obama administration will likely continue its efforts to encourage lawmakers to move forward with GSE reform, while continuing to advocate for those reforms that are aligned with the principles President Obama laid out last year.

III. FHFA

As the 114th Congress begins to deliberate on the future of the GSEs, the FHFA's continued conservatorship of the now-profitable entities will likely remain a headline issue for debate. Director Melvin Watt (formerly a Democratic congressman from North Carolina serving on the House Financial Services Committee) will lead the agency forward and have a significant role on the future of the GSEs and what action, if any, Congress will take on the GSEs and housing finance reform.

The FHFA was established in 2008 under the Housing and Economic Recovery Act ("HERA"). HERA tasks the FHFA to "take such action as may be (i) [n]ecessary to put the regulated entity in a sound and solvent condition; and (ii) [a]ppropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."⁴ HERA grants the FHFA director the discretion to "be appointed conservator or receiver for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity."⁵

Using its authority under HERA, on Sept. 7, 2008, then-FHFA Director James B. Lockhart III placed the GSEs in conservatorship. Conservatorship, together with the Treasury's purchase of senior preferred stock, allowed the FHFA to take control of the GSEs' management and ensured that the GSEs would continue to honor their financial obligations.

There is no limit on the conservatorship's duration. At the time when the GSEs were placed into conservatorship, then-Treasury Secretary Henry Paulson called it a "time-out" to allow markets to continue to function while policymakers considered and acted on a perma-

nent solution.⁶ The FHFA has stated that the GSEs' conservatorship will be terminated "upon successful completion of [FHFA's] plan to restore the companies to safe and solvent condition."⁷

At the end of the third quarter of 2014, Fannie Mae had paid the U.S. Treasury \$134.5 billion in dividends in comparison to the \$116.1 billion in draw requests. Freddie Mac has paid Treasury \$91 billion in cash dividends. Despite the GSEs' recent profitability, most continue to believe that the GSEs cannot exit their conservatorships and return to their previous corporate forms. When the FHFA released a Strategic Plan for Fiscal Years 2013-2017, then-Acting Director Edward DeMarco noted "that the conservatorships were over three years along and not likely to end soon."⁸

... [T]he CFPB will remain forceful in its oversight of mortgage servicers.

At a recent congressional hearing, Senators expressed concern that FHFA is not doing enough to ensure that GSEs do not dominate the housing market. While Director Watt emphasized that the housing market should not be dominated by the GSEs, he noted that this is ultimately a decision that Congress must address, not solely FHFA. At the same hearing, then-Chairman Johnson encouraged Director Watt to work with Treasury to transition the GSEs out of conservatorship if Congress is unable to come to an agreement.

While Director Watt agreed that the GSEs should be transitioned out of conservatorship, statements made by other administration officials have made clear that the Obama administration will not take steps to unilaterally end Fannie and Freddie's conservatorships. As such, it is clear that transitioning the GSEs out of conservatorship will be an ongoing issue that FHFA, Treasury, and lawmakers will need to address.

IV. CFPB

The CFPB has focused its attention on mortgage servicers and, consistent with its mission, ensuring that markets for consumer financial products work for Americans. In 2015, the CFPB will continue to be the focus of congressional inquiries and political criticism. For example, as a carryover from the 113th Congress, there will likely be additional calls for legislation to change the CFPB's structure from a director-led organization to one governed by a five-person, bipartisan commission.

At the same time, the CFPB will remain forceful in its oversight of mortgage servicers. In fiscal year 2014, the CFPB ordered \$2.6 billion in relief for consumers

⁶ *Sustainable Housing Finance: An Update from the Federal Housing Finance Agency on the GSE Conservatorships: Hearing Before the H. Comm. on Fin. Servs.*, 113th Cong. (2013) [hereinafter *Hearing*] (testimony of Edward J. DeMarco, Acting Director, Federal Housing Finance Agency), at 3, available at <http://financialservices.house.gov/uploadedfiles/hrg-113-ba00-wstate-edemarco-20130319.pdf>.

⁷ Federal Housing Finance Agency Office of the Inspector General, Frequently Asked Questions, available at <http://fhfaog.gov/LearnMore/FAQ>.

⁸ *Hearing*, supra note 5, at 4.

³ Press Release, U.S. Department of the Treasury, Remarks of Counselor Dr. Michael Stegman Before the Women in Housing Finance (Dec. 4, 2014).

⁴ 12 U.S.C. § 4617(d).

⁵ *Id.* § 4617(a)(2).

“harmed by systemic misconduct” by mortgage servicers. In January 2014, the CFPB adopted mortgage servicing rules designed to “protect consumers” and “establish new, strong protections for struggling homeowners, including those facing foreclosure.”

These new regulations have remained the subject of inquiries for policy and compliance purposes. In fact, in December 2014, the CFPB issued a proposal amending these regulations “to ensure that homeowners and struggling borrowers are treated fairly by mortgage servicers” by increasing foreclosure protections, expanding consumer protections, improving transparency surrounding loss mitigation applications, strengthening protections for borrowers during servicing transfers, and providing more information to borrowers in bankruptcy.

With respect to mortgage origination, as one of the federal agencies adopting the QM rulemaking, the CFPB issued a small entity compliance guide to help organizations meet the new federal standards. Additionally, mortgage disclosure forms were streamlined in 2013 to ease the burden on borrowers. The CFPB has also published additional materials with the intent of reducing compliance concerns, including a “Supervisory Highlights” report that identifies specific regulatory

violations related to loan modifications and helps to ensure adequate oversight over third party service providers. As part of its projection for future activity, the CFPB has indicated that it expects to finalize rulemakings promulgating changes to the Home Mortgage Disclosure Act by July 2015, further implementing changes to the mortgage origination process.

V. Conclusion

The next two years are critical to the future of the GSEs and shaping the future of mortgage origination, servicing, and the securitization market. As evidenced by the last two years, even with congressional inaction, Washington can have a significant impact on mortgage finance reform without passing new legislation. With the start of the 114th Congress, it remains to be seen whether future changes will come through law, regulation, enforcement, or other administrative measures.

Regardless, it is clear that Capitol Hill is not the only player in the housing reform debate. Whether it be the White House, Treasury, FHFA, CFPB, or other agencies, each brings its own interests and objectives to the table. The interplay and coordination among these bodies remain as important as each institution’s individual actions.