

Regulating the GSEs - The Devil is in the Details

By Michael J. Novogradac, CPA

The mark up of the Secondary Mortgage Market Enterprises Regulatory Improvement Act (H.R. 2575) scheduled for October 8 was canceled at the 11th hour because the Bush Administration declared that the bill was not strong enough. The administration has recommended that new program approval authority for Government Sponsored Enterprises (GSE) be shifted from the U.S. Department of Housing and Urban Development (HUD) to a new regulator, perhaps a bureau under the U.S. Department of the Treasury. Currently, the Office of Federal Housing Enterprise Oversight (OFHEO) is the GSEs' regulator, and OFHEO lies within HUD's organizational structure.

According to October 16 testimony by John W. Snow, Secretary of the Treasury, the existing supervisory system for GSEs, which include Fannie Mae, Freddie Mac and the Federal Home Loan Banks, "does not have the tools, stature, authority or resources" to reach President George W. Bush's goal of expanding home ownership to 5.5 million more minority homeowners by the end of the decade. Snow's comments were made before the U.S. Senate Committee of Banking, Housing and Urban Affairs. "We need a strong, world-class regulatory agency to oversee [the GSEs'] prudential operations, including safety and soundness," Snow testified.

On September 10 in testimony before the House Financial Services Committee, Snow called upon Congress to create a new and stronger regulatory system for the GSEs, outlining the administration's recommendations for essential, minimum requirements for a "credible" regulator. At that hearing, Snow outlined the broad parameters of the new agency's powers and presented a list of specific items that should be included. Those can be found at www.ustreas.gov/press/releases/archives/200309.html.

HUD Secretary Mel Martinez also testified on October 16, noting that that administration's proposal was not intended to alter the congressional charter of Fannie Mae or Freddie Mac, nor was there any intent to stifle innovation in the marketplace. In the administration's proposal, HUD seeks to set national subgoals so that Fannie Mae's and Freddie Mac's home purchase efforts are spread fairly among central cities and rural areas, low- and moderate-income families, "special affordable homebuyers" and first-time homebuyers.

This proposal has met with mixed reviews on a number of fronts. The National Association of Home Builders (NAHB) has come out squarely against any move to shift regulatory oversight. "...a new regulator would undercut the mission and erode the effectiveness of what has truly become the best housing finance delivery system in the world," said Jerry Howard, executive vice president and CEO of NAHB, citing Fannie Mae's and Freddie Mac's thorough understanding of and extensive involvement in affordable housing and the financial barriers that may home buyers and renters face. NAHB, on the other hand, does not disagree with those who say that the approval process may need to be improved or strengthened. "Strengthen it - or at least make that attempt - before shifting important responsibility over to another regulator ...," added Howard.

John T. Korsmo, Federal Housing Finance Board chairman in an appearance before members of the Exchequer Club in Washington, D.C., told his audience that the Fannie Mae duration gap problem, the Freddie Mac accounting problems and the recent problems at three Federal Home Loan Banks all have their roots in decisions made by officers and directors of those enterprises. "There is - and always will be - room to improve oversight," he said. "We all understand that housing GSEs are risk-taking businesses ... we all know they need world-class regulation."

But, he added, moving the oversight of some or all housing GSEs to Treasury would be unwise or unrealistic. "[It] will [not] mean that GSE executives will no longer make mistakes, will no longer at times push the reg-

(continued on page 2)

Regulating the GSEs

(continued from page 24)

ulatory or financial envelope, or that GSE shareholders will no longer expect maximum rewards," he said. Rather, he suggested, before again locking into statute a less than world-class system of supervision for some or all housing GSEs, policymakers from Congress, Treasury, HUD and all 14 housing GSEs begin a more comprehensive reform debate. "Once a coherent national policy clearly outlining government and private roles is developed — an informed policy to ensure another seven decades of stability, growth, and innovation in housing finance — only then will all parties to the debate be fully equipped to design a world-class supervisor able to evolve along with the housing GSEs and the markets of tomorrow."

In his October 16 testimony, Snow acknowledged that there may be additional reforms "worthy of consideration."

"I look forward to discussing them, but the reforms that Secretary Martinez and I are presenting today are the foundation for an enduring program of housing finance to help provide an effective regulatory system for Fannie Mae, Freddie Mac and the Federal Home Loan Banks."

It would seem that the devil is in the details of this issue, a concept apparently not lost on the banking, housing and urban affairs committee. The October 16 hearing on the GSEs was scheduled to be continued Oct. 23.

From a syndicator's perspective Raymond James, in its September *Mortgage Finance Industry Brief*, writes that in conversations with both GSEs, Fannie Mae and Freddie Mac indicated no opposition to a change in regulatory structure under the right circumstances and that Snow and Martinez had consulted with Fannie Mae in developing their agenda. "Our take is that investors would likely benefit from a change of regulators, if only because we expect that investors' overall confidence in the Treasury's regulatory oversight competency would be higher than it has been under OFHEO," writes Michael T. Vinciguerra, CFA. "Higher confidence in the oversight would help to ease some of the concerns regarding a potential future crisis situation at either GSE, and we believe that would have to be good for the stocks and their debt securities." ❖