

H.R. 1859: Housing Finance Reform Act of 2011

Introduced by Rep. John Campbell (R-CA) and Rep. Gary Peters (D-MI)

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On Thursday, Rep. John Campbell (R-CA) and Rep. Gary Peters (D-MI) introduced a bipartisan plan to overhaul the federal mortgage finance system and ensure there will be adequate private sector capital for homebuyers to obtain responsible mortgages at all times, while creating new standards, safeguards, and capital requirements to protect taxpayers.

The *Wall Street Journal* reported on Thursday:

*“Analysts say that the compromise proposed by Rep. John Campbell (R., Calif.) and Rep. Gary Peters (D., Mich.) may be the **only plan likely to attract sufficient support from both parties** on a politically explosive subject, particularly at a time when gridlock looms over issues such as how to curb federal spending.”*

<http://online.wsj.com/article/SB10001424052748704681904576317524068112278.html>

H.R. 1859: Bill Highlights

- *Preserves Access to 30 Year Fixed Rate Mortgage:* Without a secondary mortgage market, loan originators are unlikely to offer long term fixed rate mortgages because they do not want to bear the risk of fluctuating interest rates. The Campbell-Peters bill ensures a strong secondary mortgage market by providing a government guarantee to investors in residential mortgage backed securities.
- *Encourages Private Sector Investment in the Secondary Mortgage Market:* The Fannie Mae and Freddie Mac hybrid model of privatized gains and subsidized losses is eliminated. Instead, privately capitalized associations will be chartered to securitize residential mortgages.
- *Limited Charter:* Associations will receive a narrow charter, limiting these companies from engaging in activity that is inconsistent with preserving the accessibility of traditional mortgage products. Associations cannot originate or service mortgages, and their investment and other activities are limited. They also cannot issue securities backed by anything other than conventional residential mortgage products guaranteed by the government.

- *Limits Taxpayer Liability:* By offering a guarantee on the securities rather than on the entity issuing the securities, and by creating a Reserve Fund to cover any losses, the Campbell-Peters bill ensures that private sector capital is at risk rather than the taxpayer funds. Should the Reserve Fund be depleted and federal dollars expended, taxpayers would be compensated through a special assessment levied on associations issuing securities.
- *Accurately Prices Risk:* The Campbell-Peters bill requires the independent GAO to issue a detailed report assessing what the actual risk associated with the guarantee is, and requires regulators to use this report when adopting a guarantee fee. If the fee is underpriced and the Reserve Fund does not have sufficient funds to cover its obligations a special assessment will ensure that taxpayers are not exposed to losses.
- *Winds down Fannie and Freddie:* The FHFA will be tasked with coming up with a transition plan for fully unwinding the GSEs, and putting in place the new system of private associations. The existing enterprises can be terminated within one year of five associations being chartered, or at the latest no more than 3 years after the first two associations are chartered.

H.R. 1859: Section by Section Summary

Section 1: Short Title

Names the bill the “Housing Finance Reform Act of 2011.”

Section 2: Statement of Purposes

States that the purposes of the bill are to (1) ensure the availability of reasonably priced conventional mortgages, (2) provide incentives for private sector capital to support the secondary mortgage market, (3) limit the role of the government in the secondary mortgage market, and reduce taxpayer exposure, and (4) provide for the gradual wind down of Fannie and Freddie.

Section 3: Establishment, Operation, Supervision, and Regulation of Housing Finance Guaranty Associations

Creates a new subtitle D of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992

Section 1381: Definitions

Defines a number of terms used in the bill.

Section 1382: Establishment of Housing Finance Guaranty Associations

Authorizes the Director of the FHFA to approve applications and issue charters for housing finance guaranty associations. Requires that the application include certain information, including the proposed articles of incorporation or partnership agreement, the capitalization and business plan, information regarding the financial resources and housing finance experience of the organizers and senior management, and other information the Director deems necessary.

Establishes chartering criteria and states that no charter shall be issued if the organizer fails to comply with all formation requirements, provide all information requested, demonstrate competence and experience necessary for safety and soundness, demonstrate sufficient financial resources, and make assurance that the association will make available information the Director deems necessary for operation.

Allows for the creation of special purpose associations that would be limited to serving a particular mortgage market (such as multifamily) or a particular category of mortgage lenders (such as community banks).

Allows banking organizations to acquire an interest in associations.

Section 1383: General Powers of Associations

Gives associations the power to adopt and use a corporate seal, adopt or amend bylaws, sue or be sued, make contracts, borrow money, purchase property, lend money, invest funds (subject to limitations in other sections), elect or appoint directors, officers, employees, and agents, and issue securities and other forms of ownership interest.

Section 1384: Housing Finance Related Powers of Associations

Gives associations the power to deal in conventional mortgages only for the purpose of creating a secondary market for those mortgages, facilitating mortgage securitization, and supporting multifamily housing. Associations can issue securities through the Office of Securitization that are collateralized by conventional mortgages, can establish a trust not subject to the claims of creditors in order to provide for the sale of interests in pools of mortgages, can guarantee the timely payment of interest and principal on mortgage securities and charge a fee for the guarantee, ensure the proper servicing of mortgages, and hedge credit and interest rate risks.

Section 1385: Prohibited Activities

Associations may not originate or service mortgages and they may not offer a guarantee for any security by non-conventional mortgages. Associations cannot invest in securities other than conventional mortgage backed securities or those issued by the government, they cannot engage in speculative activity, and cannot underwrite or sell insurance. They are also prohibited from purchasing mortgages from institutions with voting interest in the association. Associations cannot discriminate against any mortgage originator. Special purpose associations are exempted from the non-discrimination provision, so long as the special purpose association would serve all mortgage originators within the market segment for which the charter was granted.

The associations cannot purchase a mortgage with more than 80% loan to value ratio unless either the seller retains a 10% stake in the loan, the seller agrees to repurchase the mortgage on the demand of the association, or private mortgage insurance is used to cover unpaid principal balance in excess of 80%.

Section 1386: Office of Securitization

The bill creates an Office of Securitization within FHFA to issue the federal guarantee, impose and collect the fee, and administer and service the FHFA securities.

Section 1387: Federal Housing Finance Agency Securities

FHFA will establish standard forms and contractual terms for the securities. Standard terms and conditions will include disclosure that the security is a FHFA security and is backed by the full faith and credit of the US, will include details on the payment of interest and principal, will address servicing standards, and other terms as required by the Director.

A GAO study will be required within 12 months of enactment that will determine the market value of the guarantee. The Director will use this study to establish the guarantee fee charged by associations and provides for a reasonable minimum guaranteed return for associations. Regulation of the guarantee fee will be in place until such time as it is no longer needed to ensure sufficient competition between associations and the market is being served.

Associations will be required to disclose within 45 days information about the composition of the pool of mortgages. This information will be used to assess whether there are underserved communities in the secondary mortgage market.

Section 1388: Catastrophic Federal Guarantee

The federal guarantee will only apply to a security issued by an association that has been placed into conservatorship or receivership, and will be used if the Reserve Fund is depleted. A GAO study will be required within 12 months of enactment that will determine the market value of the guarantee. The Director will use this study to set the initial guarantee fee. The guarantee fee will be adjusted quarterly or more often in the event of an emergency. If the government has to make payments because the Reserve Fund is depleted, FHFA will impose a special assessment to recoup all costs associated with the guarantee.

Section 1389: Reserve Fund

The guarantee fee collected will be used to establish a Reserve Fund used to make payments under the guarantee.

Section 1390: Supervision of Associations

FHFA will have supervisory authority over the associations, and will conduct examinations at least once a year. FHFA will establish capital standards that take into account risks associated with conventional mortgages and underwriting standards, and will also issue capital classifications. FHFA will establish standards for the management and operation of associations, including internal controls, independence of audits, management of interest rate exposure, market risk, liquidity reserves, asset management, overall risk management, credit and counterparty risk, maintenance of adequate records, and other issues as determined appropriate. The underwriting standards for conventional mortgages purchased by the associations will be the same as those issued by the CFPB and the Federal Reserve for “qualified mortgages” pursuant to Dodd Frank.

Associations would be limited from purchasing mortgages if the loan amount exceeds the greater of either (1) 150% of the average home price in the US, or (2) 150% of the median home price in the area in which the residence is located.

FHFA will issue public reports using data submitted by the associations that will indicate whether there are geographic areas or market segments that are not being served.

Failure of an association to make timely payments of interest or principal are grounds for placing an association in conservatorship or receivership. If FHFA is appointed receiver, it may create a limited life associations to assume the assets and purchase the liabilities of the association.

Section 1391: Agency Operations

FHFA will create a division to handle the applications for the formation of associations, and establish a division to conduct audits of the associations. The bill creates the position of Deputy Director for Housing Finance Guarantee Associations to carry out the powers given to the Director of the FHFA and the Office of Securitization in the bill. The Deputy Director may not hold any financial interest in any association, hold any office in any association, or have served as an officer or director of an association or regulated entity (Fannie and Freddie) in the previous three years. FHFA will carry out an annual study to determine whether it has the power, systems, personnel, and other resources to carry out its mission. The costs associated with carrying out the actions required in this bill will be covered by a fee charged to associations.

Section 1392: Applicable Law

The actions taken by an association under this bill are governed exclusively by Federal law.

Section 1392: Judicial Review

Associations can only challenge decisions made by the FHFA in federal court. No private right of action is created by the bill.

Section 1394: Budget Neutrality

FHFA is required to implement this bill in a way that does not increase the budget deficit or debt.

Section 4: Transition

FHFA has to submit a transition plan within 6 months that provides for the wind down of Fannie and Freddie, and the creation of the associations. The plan has to provide for continued operation of the GSEs during the transition period and the retention of qualified personnel, the transfer of qualified personnel from the GSEs to the associations, and other matters the Director deems appropriate.

The GSE housing goals are terminated. Fannie and Freddie are required to pay state and local taxes. The GSEs are required to reduce their assets portfolios to not more than \$250 million within 5 years of enactment. The GSEs are required to increase the guarantee fee over a period of three years to more adequately reflect the risk posed by the guarantee. The current conforming loan limits are extended until Fannie and Freddie are no longer in conservatorship.

Rules governing associations, their formation, applications, and auditing must be approved within one year of enactment. One year after at least five associations have been chartered, two

of which are not special purpose associations, FHFA has to determine whether the GSEs can be placed in receivership without causing material disruption to the secondary mortgage markets. No later than three years after two associations have been chartered FHFA has to place them in receivership. The obligations of the GSEs will be backed by the government.

Section 5: Technical and Conforming Amendments

This section makes a number of technical and conforming changes to existing statutes.