

House Bill Provides For A More Bank-Like Regulator For Fannie and Freddie
Raymond Natter
Barnett Sivon & Natter, P.C.

On May 25, 2005, the Financial Services Committee of the U.S. House of Representatives overwhelmingly approved a bill, H.R. 1461, to strengthen the supervision and regulation of Fannie Mae and Freddie Mac (the “GSEs” or the “Enterprises”).¹ The bill has engendered some controversy based, in part, on provisions that could be used to enhance the GSE’s competitive position, such as increases in the size of loans that Fannie Mae and Freddie Mac can purchase. Arguments have also been made that the regulatory and safety and soundness provisions in the bill are too weak, and that these areas of the bill are “worse than current law.” This article will address this second point only, and will compare the regulatory and safety and soundness authority of the GSE’s current regulator, the Office of Federal Housing Enterprise Oversight (OFHEO) with the authority that would be granted the new regulator, the Federal Housing Finance Agency (FHFA). This analysis demonstrates that the supervisory authority and regulatory discretion granted the new regulator under this bill is much greater than under current law.

Regulatory Independence

Under current law, OFHEO’s independence is circumscribed. Unlike the Federal banking agencies, OFHEO does not have independent litigating authority, and the agency must ask the Justice Department to argue its cases in court, and even to enforce its subpoenas.² The agency’s budget is subject to the Congressional appropriations process, despite the fact that funds are raised through assessments on the GSEs and not appropriations.³ The agency’s authority over the GSEs does not extend to the housing mission, and thus approval of new programs for the Enterprises rests with the Secretary of HUD, and not OFHEO.⁴

The bill, on the other hand, provides the regulator with much of the independence that the banking agencies currently enjoy. The Director of the FHFA is given a five-year term and may be removed only for cause.⁵ Congressional testimony does not have to be cleared by the Administration,⁶ and funding is independent of Congressional appropriations.⁷ The agency has independent litigating authority and would no longer be dependent upon the Justice Department to enforce safety and soundness related subpoenas.⁸ The regulatory role of the Secretary of

1 House Report No. 109-171, 109th Cong. 1st Sess. (2005).

2 12 U.S.C. § 4641.

3 12 U.S.C. § 4516(f).

4 12 U.S.C. §§ 4541 *et. seq.*

5 H.R. 1461 § 101 (All references to H.R. 1461 are to the committee passed bill).

6 H.R. 1461 § 102(b).

7 H.R. 1461 § 106.

8 H.R. 1461 § 102.

HUD would be eliminated, and the new agency would have responsibilities for all activities of the GSEs.

On the other hand, the bill also contains a provision that goes against independence. This is the section that creates an Oversight Board that includes the Director of FHFA, the Secretaries of the Treasury and HUD, and two Presidentially appointed members. While this Board is not given any regulatory authority, it is authorized to have a permanent staff, and could assume a prominent role in the overall direction of the agency.⁹ However, even with this provision, the new agency would have considerably more independence from political influence than at present.

Activity and Program Approval Authority

Under current law, the GSEs must submit a proposal to engage in a “new program” to the Secretary of HUD, who may take up to 60-days to review the proposal. If the Secretary does not act within this period, the new program is deemed approved.¹⁰ The term “new program” is defined as a significantly different program for dealing in conventional mortgages.¹¹ There is no explicit authority for the Secretary to review other activities of the Enterprises.

The bill requires that both new programs and *new business activities* be submitted to the Director of FHEA for prior approval.¹² The Director must publish “new program” proposals in the Federal Register and solicit public comment. Proposals for new business activities are not published in the Register, but the Director is given 30-days to reject the new activity. The bill also gives the Director authority to declare almost any GSE activity to be a “new activity,” and make it subject to prior review procedures. If the Director determines that any activity the GSE is engaging in “consists of, relates to, or involves” a new business activity, the Director may prohibit the activity until it is submitted for review.¹³ The bill also contains a provision that may allow the Director of FHFA to issue a “conditional approval” at any time.¹⁴ This provides the Director additional discretion to expedite an approval, and perhaps even waive the publication requirements. This provision adds to the Director’s regulatory discretion, it does not in any way diminish his or her authority.

These provisions are important enhancements over the current statutory language, and clearly allows the FHFA to review proposed business activities, and if appropriate, to deny the proposed activity or program based on safety and soundness, the underlying statutory purposes for the GSEs, or the “public interest.”

⁹ H.R. 1461 § 103.

¹⁰ 12 U.S.C. § 4542.

¹¹ 12 U.S.C. § 4502(13).

¹² H.R. 1461 § 122.

¹³ *Id.*

¹⁴ *Id.*

On-Going Activity and Program Review

Even if an activity or program is approved, the bill gives the Director of FHFA new authority to determine that the GSE must modify the activity or program, or cease from engaging in the activity, based on safety or soundness concerns, or a finding that the activity is inconsistent with the authorizing Acts.

The Director's authority in this regard is quite broad and specific. The Director *must* conduct a periodic review of all of the assets and liabilities of the GSEs and may order the Enterprise to dispose of any asset or liability.¹⁵ For example, since the purpose of the GSE is to foster liquid and efficient housing finance markets, the Director could determine that a GSE must divest itself of non-housing assets, such as automobile loans. This is an important and significant clarification of the Government's authority to require divestiture of non-mission related assets.

Prudential Management and Operations Standards

Unlike the banking agencies, OFHEO has no explicit statutory authority to issue mandatory prudential management and operations standards. The agency has instead used its general regulatory authority to issue such standards. The legislation provides the explicit statutory basis for such standards, and mandates that the standards include portfolio management, credit and counterparty risk, internal controls, internal audit, market risk, the issuance of subordinated debt, records maintenance, and similar items. Failure to comply with a standard may result in higher capital requirements, limitation on growth, or other remedial actions by the FHFA.¹⁶

Capital and Prompt Corrective Action

Currently, OFHEO has limited ability to set capital levels. Essentially, these levels are dictated by statute.¹⁷ The bill, on the other hand, gives the Director of the FHFA *complete discretion* to set capital levels by regulation, and if necessary, to require additional capital based on the activities or programs of a particular GSE.¹⁸ The Director may also order a GSE to make a temporary adjustment to capital if the GSE is engaging in certain unsafe or unsound practices, is deemed to be in an unsafe or unsound condition, or violates any operational or management standards that must be established by the Director. Finally, the legislation provides the Director essentially the same tools as the Federal banking agencies to take significantly more stringent "prompt corrective actions" as the capital level of a GSE falls below the adequately capitalized level.¹⁹

15 H.R. 1461 § 113.

16 H.R. 1461 § 102.

17 12 U.S.C. §§ 4611 *et. seq.*

18 H.R. 1461 §§ 111, 112.

19 H.R. 1461 § § 4614 *et. seq.*

Enforcement Powers

The current scope of OFHEO's enforcement powers is limited, and for example, the agency lacks explicit authority to take action against many “enterprise affiliated” parties that might be involved in malfeasance at the GSE.²⁰ Also, OFHEO has no specific statutory authority to remove a bad actor from a GSE. The bill addresses these issues, and provides the Director with explicit enforcement powers that are similar to those of the Federal banking agencies. For example, under the bill, a violation of *any law* may serve as a basis for an enforcement order.²¹ Further, the FHFA is given jurisdiction over any party participating in the affairs of the Enterprise.²² Civil money penalties are also increased. The maximum penalty that may be assessed against an Enterprise is set at \$2 million per day, per violation.²³ Even for a GSE, an annualized penalty of \$730 million per violation would certainly motivate the board of directors, if not the executives, to take corrective action.

Conservatorship and Receivership

OFHEO currently has the authority to place an Enterprise into a conservatorship, but does not have the power to place a GSE into receivership. The bill gives the Director of the FHFA the same authority to place a GSE into a conservatorship or receivership as the banking agencies have with respect to banks.²⁴

Conclusion

H.R. 1461, as passed by the House Committee on Financial Services, provides the new GSE regulatory agency, the FHFA, with explicit and enhanced authority in the areas of general regulatory power, safety and soundness tools (including prompt corrective action powers), capital, program and activity review, enforcement and removal powers, independent litigating authority, and receivership. These provisions provide FHFA with considerably more authority to take various remedial actions than currently provided to OFHEO, and considerably more discretion in regulating and supervising the GSEs. Other provisions in the bill, including those that relate to the competitive position of the GSEs or their responsibilities to provide for more affordable housing for low- and moderate-income families are beyond the scope of this brief review.

20 12 U.S.C. §§ 4631 et. seq.

21 H.R. 1461 §§ 161.

22 H.R. 1461 § 2.

23 H.R. 1461 § 165.

24 H.R. 1461 § 144.