United States Senator Richard Shelby, Alabama

May 15 2014

Shelby Opposes Massive New Regulator and Taxpayer Exposure in Housing Regulation Bill

U.S. Senator Richard Shelby (R-Ala.), senior member of the Senate Committee on Banking, Housing and Urban Affairs, today stressed the need for housing finance reform but detailed his opposition to related legislation under consideration by the committee. Shelby pointed out that the proposed bill would greatly expand and further complicate the role of government in housing markets, empowering a new super-regulator with the same authorities used to bail out Wall Street and putting taxpayers on the hook for trillions of dollars of liability. In doing so, Shelby strongly challenged the assertion that the legislation is the best way to move beyond the unacceptable status quo. Excerpts of Shelby's statement are below in bold, followed by the full text of his prepared remarks.

Massive Expansion of Government

"There is no doubt that housing finance reform is long overdue. And, the legislation before us is in many ways commendable. It winds down Fannie and Freddie and aims to do so without disrupting market liquidity and the flow of credit to households and businesses. The question remains, however: Is it a better mousetrap? I fear that while this legislation is well intended, it may further complicate an already complex problem by expanding the role of the federal government in our private housing finance market and creating, yet again, another massive regulator…

"Is it the proper role of government to be the micro-manager of a complex architecture for housing finance? Do we really need a new super-regulator? All too often, we create new and bigger regulators instead of holding our current regulators accountable for their failures. That was the entire premise of Dodd/Frank. The centerpiece of this bill, the Federal Mortgage Insurance Corporation, would have a broad swath of regulatory authorities rivaled only by the Federal Reserve. Not only would it provide mortgage insurance for trillions of dollars of new mortgages, it would also be responsible for maintaining a liquid housing market, regulating financial entities big and small and facilitating credit availability across the spectrum, including during economic downturns. It is fair to say that it would have an unprecedented role in housing markets, even by Dodd/Frank standards."

Trillions in Taxpayer Exposure

"While it is clear that there are many concessions in this bill for the so-called

stakeholders in the process, it is less clear that the most important stakeholder, the American taxpayer, even had a seat at the table. If Congress is to provide a backstop in housing, it should be clear, explicit and accounted for on-budget without gimmicks. Even former Congressman Barney Frank came to that realization.

"Although this new architecture appears to further insulate taxpayers from losses, it may only serve to mask the potential costs. There is also no assurance that Congress will resist double-dipping into the Mortgage Insurance Fund, as it has done with the Deposit Insurance Fund, counting its receipts as savings on-budget on one hand, while spending them on the other. In addition, the quality of capital that private investors would be required to put up remains a moving target. While many in the industry have expressed concerns over 10 percent being too high, I am concerned that this bill does not require real capital in the first place…

"Finally, and most concerning, is the Federal Mortgage Insurance Corporation's authority to 'protect taxpayers in unusual and exigent market conditions.' Ironically, this authority does the exact opposite of protecting taxpayers. It instead allows the Federal Reserve and Treasury, after consultation with HUD, to give the federal mortgage insurer the power to waive all standards established for risk-sharing with the government, and to provide a full guarantee of mortgage-backed securities, including the portion of any security that is supposed to be held by private guarantors in a 'first-loss' position. If the term 'unusual and exigent' gives one pause, it is because we have heard it before. During the financial crisis, the Federal Reserve invoked its authority to lend under 'unusual and exigent circumstances.' Ultimately, it was responsible for the billions needed to bail out Bear Stearns and AIG. It is not surprising that many are concerned about giving similar authority to a government entity that will guarantee trillions, yes trillions in mortgage assets.

The full text of Shelby's opening remarks, as prepared, are as follows:

Thank you, Mr. Chairman.

The seeds of the financial crisis were sown in the mortgage markets and they were fed by misguided housing policies that encouraged homeownership at just about any cost.

It was a perfect storm of interested parties and complicit financial regulators. Everybody was for more homeownership. Mortgage lenders, banks, home builders, home suppliers, realtors, and, of course, potential home owners. Everyone had a piece of the action and no one wanted the party to end, including Congress.

Our financial regulators had the authority to slow the train, but they turned a blind eye and the result was an economic calamity from which we are still trying to recover.

In the wake of the near collapse of the entire worldwide financial system, I believe, this

committee engaged in a “cart before the horse” exercise that ultimately produced a massive piece of legislation known as Dodd/Frank, a so-called reform of our financial regulatory system which excluded the single most important element . . . housing. I commend the Chairman and Ranking Member for finally focusing our attention on housing finance reform.

Few would disagree that Fannie Mae and Freddie Mac are in an untenable position. While they continue to provide the lion’s share of housing guarantees, they possess virtually no capital and remain wards of the state.

Also, their renewed profitability remains vulnerable to future Congressional spending sprees.

There is no doubt that housing finance reform is long overdue. And, the legislation before us is in many ways commendable. It winds down Fannie and Freddie and aims to do so without disrupting market liquidity and the flow of credit to households and businesses. The question remains, however: Is it a better mousetrap?

I fear that while this legislation is well intended, it may further complicate an already complex problem by expanding the role of the federal government in our private housing finance market and creating, yet again, another massive regulator.

I believe that the threshold question before us is whether we will continue to provide a GSE-like guarantee in any form. I do not think that this debate has been settled, notwithstanding the Committee’s actions today.

If we are to accept the need for a government guarantee in housing, which this legislation would codify, a number of questions remain unanswered.

First, is it the proper role of government to be the micro-manager of a complex architecture for housing finance?

Do we really need a new super-regulator? All too often, we create new and bigger regulators instead of holding our current regulators accountable for their failures. That was the entire premise of Dodd/Frank.

The centerpiece of this bill, the Federal Mortgage Insurance Corporation, would have a broad swath of regulatory authorities rivaled only by the Federal Reserve.

Not only would it provide mortgage insurance for trillions of dollars of new mortgages, it would also be responsible for maintaining a liquid housing market, regulating financial entities big and small and facilitating credit availability across the spectrum, including during economic downturns.

It is fair to say that it would have an unprecedented role in housing markets, even by Dodd/Frank standards.

Unfortunately, we have had decades of government intervention that, ironically, did not even

deliver on its main goal of providing sustainable homeownership for millions.

For far too many, the dream of homeownership became a financial nightmare.

We have seen what happens when government becomes too entrenched in housing and the system becomes too complicated, even for regulators to oversee. For Fannie and Freddie, we saw a slow but steady degradation of underwriting standards that, sanctioned by Congress and ignored by regulators, became the underlying cause of the financial crisis.

Will the new regulatory framework, where government would have a hand in almost every aspect of mortgage finance, be able to resist those who would compel it to make bad loans that are underpriced?

The legislation before us is clearly the product of the give and take necessary to achieve a consensus product, and I applaud the Chairman and Ranking Member for their efforts.

While it is clear that there are many concessions in this bill for the so-called stakeholders in the process, it is less clear that the most important stakeholder, the American taxpayer, even had a seat at the table.

If Congress is to provide a backstop in housing, it should be clear, explicit and accounted for on-budget without gimmicks. Even former Congressman Barney Frank came to that realization.

I am concerned that this bill will be treated fiscally much like the FHA which will produce a windfall for free-spenders in Congress. We must not create any more slush funds.

This bill also establishes a risk-sharing mechanism where guarantors of mortgage-backed securities contribute 10 percent to a “first-loss” position, but even this could be waived under certain conditions. The other 90 percent would be backed by a new Mortgage Insurance Fund that also has a line of credit backed by taxpayers and would take years to capitalize.

Although this new architecture appears to further insulate taxpayers from losses, it may only serve to mask the potential costs.

There is also no assurance that Congress will resist double-dipping into the Mortgage Insurance Fund, as it has done with the Deposit Insurance Fund, counting its receipts as savings on-budget on one hand, while spending them on the other.

In addition, the quality of capital that private investors would be required to put up remains a moving target. While many in the industry have expressed concerns over 10 percent being too high, I am concerned that this bill does not require real capital in the first place.

Would the type of capital permitted under this legislation meet Basel standards, which I would argue are still not strong enough? Would the capital be truly risk-absorbing in the event of an adverse event?

In my view, capital in the “first loss” position should be no riskier than a Treasury security. I am not optimistic that regulators agree with me, given their past propensity to allow watered-down assets to serve as capital.

Finally, and most concerning, is the Federal Mortgage Insurance Corporation’s authority to “protect taxpayers in unusual and exigent market conditions.” Ironically, this authority does the exact opposite of protecting taxpayers.

It instead allows the Federal Reserve and Treasury, after consultation with HUD, to give the federal mortgage insurer the power to waive all standards established for risk-sharing with the government, and to provide a full guarantee of mortgage-backed securities, including the portion of any security that is supposed to be held by private guarantors in a “first-loss” position.

If the term “unusual and exigent” sounds familiar, it is because we have heard it before. During the financial crisis, the Federal Reserve invoked its authority to lend under “unusual and exigent circumstances.”

Ultimately, it was responsible for the billions needed to bail out Bear Stearns and AIG. It is not surprising that many are concerned about giving similar authority to a government entity that will guarantee trillions, yes trillions in mortgage assets.

For these and other reasons, I intend to oppose this bill. My opposition, however, should not be interpreted as opposition to reform of any kind. Rather, it is a vote against a complicated, government-run framework that, I believe, overexposes the American taxpayer and creates more problems than it solves.

Sustainable homeownership and the preservation of a liquid housing finance system are laudable goals and shared by each of us. Our primary goal, however, must remain the protection of the American taxpayer from bailouts. I do not believe that this legislation achieves that goal.

Thank you.

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Permalink: http://www.shelby.senate.gov/public/index.cfm/2014/5/shelby-opposes-massive-new-regulator-and-taxpayer-exposure-in-housing-regulation-bill