

# Timely insights from portfolio managers and industry experts on key financial, economic and political issues.

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## Investment Grade Fixed Income

### Business as usual for agency MBS market after Supreme Court ruling on regulator

**Boston** - On June 23, the U.S. Supreme Court made two important rulings regarding the Federal Housing Finance Agency (FHFA), the regulator of Fannie Mae and Freddie Mac.

While both of the rulings are essentially non-events for the agency mortgage-backed securities (MBS) market, the court's action does solidify two beliefs that we have held for some time. First, Fannie and Freddie will remain under government conservatorship. Second, and more importantly, there will be no change to the government backing of bonds issued by Fannie and Freddie.

Specifically, the court found that the FHFA's structure was in violation of separation of powers. Previously, the director of the FHFA could only be replaced "for cause." Wednesday's ruling opened the door for the president to fire current FHFA Director Mark Calabria and replace him with someone who shares Biden's agenda. (Wasting no time, the White House has already removed Calabria from his post as director.)

In addition, the court rejected claims that the FHFA exceeded its authority in sweeping profits from Fannie and Freddie. Note that the federal government has been retaining the bulk of each company's profits since they went into conservatorship in 2008.

The first ruling ensures the status quo for agency MBS investors, as it relates to Fannie and Freddie remaining under government control. Mark Calabria, who was appointed by the previous administration, was intently focused on removing Fannie Mae and Freddie Mac from government conservatorship and re-privatizing them. This ruling essentially squashes that potential outcome, as the Biden administration is much more focused on affordable housing goals rather than ending government conservatorship.

The second ruling has some major implications, but not for MBS investors. Instead, the news is taking its toll on activist hedge fund investors in Fannie and Freddie common and preferred shares. These investors' hopes of a substantial windfall from recapitalizing Fannie and Freddie have evaporated, sending preferred shares down almost 60% and the common stock down nearly 40%.

**Bottom line:** Although these rulings have certainly grabbed headlines, we expect the impact on agency MBS to be relatively muted. As has been the case since 2008, bonds issued by Fannie Mae and Freddie Mac will continue to be implicitly guaranteed by the U.S. government and carry AAA ratings.



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"These rulings solidify two beliefs that we have held for some time: Fannie and Freddie will remain under government conservatorship and, more importantly, there will be no change to the government backing of the bonds they issue."

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