



GSE Activity Report

Tuesday, October 21, 2014

QRM=QM, RMBS=GSE

Summary

With the decision by FDIC Vice Chairman Hoenig to concede to implacable advocates of QRM=QM, the final risk-retention rule announced this morning includes no minimum-LTV requirement. Combined with new GSE rep-and-warrant relief and all the tough rules governing private-label securitization, we see a flood of loans – including those with LTVs up to 97% -- heading to Fannie and Freddie. How they can be liquidated after taking on this still more vital role remains, at least to us, a mystery.

Impact

Hoenig as noted dropped his push for a “QM-plus” standard because he could get no support for even a 10% downpayment, we are told. The SEC’s compromise two-year review is also broadened into a four-year one to give the market the certainty it demanded and the Administration wants in hopes of getting mortgage securitization up and running without reliance forever more on the GSEs.

The big winner in the final rule is, we think, private MIs. The combination of a QRM without a downpayment requirement and the continued exemption for the GSEs gives them years of demand for credit enhancement, demand that will only rise if the GSEs go up to the 97% LTVs in the works with the planned extra layer of coverage. For as long as FHA premiums stay high, the MIs should regain a lot of share.

But, can PLS go forth now throughout the QM space? As noted, we see this as problematic. Rep-and warrant relief will presumably open the GSEs spigot wider in concert with higher LTVs, creating strong incentives for securitization through the GSEs. How to price against them given an effective USG guarantee? How to invest in them given high capital requirements? How to count on PLS for liquidity since the U.S. rules don’t allow this, giving indeed only grudging credit to securitizations through the GSEs? How to handle all the new SEC registration and disclosure standards, other than through private placements and even then under standards far more onerous to issuers than a simple sale to the GSEs?

The only crimp in the QRM=QM rule is the possibility that the FDIC will not be as

generous in applying its safe harbor to HLTV mortgages. Clients will recall that successful securitization by an insured depository requires a safe harbor from potential FDIC collateral claims in the event of a receivership. The safe harbor now includes an exemption for GSEs' sales and a maximum LTV of 80%, but the FDIC rule also auto-conforms to the QRM once it is finalized. FDIC directors Hoenig and Norton may now want to revisit the safe harbor (indeed, Norton strongly objected to today's rule), but they need Chairman Gruenberg to agree to do so and we very much doubt he will.

Outlook

As we've noted repeatedly, FHFA Director Watt is taking the conservatorships in a very different direction than Ed DeMarco demanded. Under this authority, the GSEs will take on whatever role he thinks necessary to support the still-struggling residential-mortgage market. Given the risk-retention rules, it's possible that QM-focused PLS could increase, but the formidable competitive edge held by the GSEs will keep almost all of these outside the conventional, conforming box.

It will thus take Congress to settle the secondary-market question. Rumors are rife that it may take up Johnson-Crapo after the mid-term election, but even then action on the Senate floor or in any conference is at best uncertain. By the time the next Congress gets around to thinking through the future of the GSEs, they may well be an even more difficult mountain to move.