GSE Activity Report

Tuesday, March 6, 2018

MIncemeat?

Summary

Weighing in on tough PMIERs negotiations, FHFA's Inspector General yesterday released a report highly critical of the private mortgage-insurance business and regulatory model. Following days after a similar, critical take on MI from staff at the Federal Reserve Bank of New York, the industry is negotiating with the GSEs with one arm tied behind its collective back. Fannie and especially Freddie have long looked for alternatives to MI. If the GSEs could ever find any willing to take first-loss loan-level positions on HLTV mortgages and price it like the MIs, then the industry would really need to worry.

Impact

FHFA's IG notes that PMIERs are under review following a request from FHFA that the industry reply to the GSEs on a new regulatory framework by the end of last year. The IG doesn't opine on PMIERs *per se*, but takes strong issue with the extent to which the GSEs now have a concentrated counterparty-risk exposure to a small industry with what the IG believes to be little counter-cyclical resilience. The MIs always argued that their risk was neither concentrated nor correlated with the GSEs, but the crisis near-death experience challenged a view – which we shared at the time – that huge holdings of no-risk Treasuries and similar obligations would protect the MIs in even a worst-case risk event.

In its 2017 report on GSE risk, the IG says it noted MI as one of the top four because private MIs are the enterprises' largest counterparties. Concentration risk is a top concern – three companies in this small sector do two-thirds of agency business – but counter-cyclical resilience is also a major worry. The FRB-NY report cited this and recommended a counter-cyclical capital buffer (CCyB) as at least one criterion for MI eligibility as CRT counterparties. But, even if there were a CCyB, the IG appears to distrust MIs in CRTs because the MIs already bear risk the GSEs cannot lay off through these transactions.

The IG also dislikes the run-off model for troubled MIs, noting that Fannie and Freddie still have $13.4 billion in risk outstanding to failed MIs and suggesting that this creates an incentive for faltering MIs simply to call it a night. The monoline model also comes in for a critique, although the IG does recognize that state rules mandate this.

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Outlook

Anticipating a critical review by the IG sure to suit FHFA, at least one MI – MGIC – may have been persuaded to take the unusual step of just saying no. Press reports indicate that this MI has rejected efforts by the GSEs to simply raise DTI thresholds to 50% for AU-authorized loans. MGIC apparently now is willing only to insure these if credit scores meet higher minimum thresholds. In years past, MIs did whatever the GSEs told them to do regardless of risk worries because, as monolines with essentially only two customers on whom franchise value depended, the MIs had no choice.

They still have no choice because their customer base is still more limited by post-crisis jitters from both bank regulators and PL-MBS investors. But the more the MIs just say yes and still see their risk resilience challenged, the more they may be willing to push back and only take the risk a new PMIERs requires them to bear. We shall see.

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