GSE Activity Report

Friday, June 30, 2017

New Ginnie

Summary

On Wednesday, we laid out how the Ginnie Mae model is influencing Senate Banking consideration of reform legislation. On Thursday, Chairman Crapo made clear just how pertinent the Ginnie option is proving as the panel crafts consensus bipartisan legislation.

Impact

At the surprisingly well-attended session, Crapo laid out principles for bipartisan action:

- preserve TBA;
- protect an "affordable, accessible" 30-year FRM;
- demand layers of private capital ahead of the taxpayer (down payments, loan-level MI, private guarantors with capital comparable to that held by GSIBs). If the GSIB-equivalence test stands, the non-bank guarantors we thought could run rings around banks large and small won't have a capital prayer as first-loss insulators. Competition must also be assured among these guarantors to prevent a new-style duopoly, Crapo said;
- ensure competitive equity for small lenders. This is also a hot button for Sherrod Brown;
- preserve some form of GSE multi-family role; and
- structure an orderly, careful transition, with reliance continuing on current infrastructure where possible.

That said, Crapo has not yet settled on a specific path forward. For example, he is open to lumping FHA into the GSE bill. He isn't, though, open to recap and release – as noted, he and other key senators have made this a dead letter. Brown is largely on track with Crapo's principles, but he emphasized issues such as preventing predatory lending and credit discrimination.

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Based on all this bonhomie, Bob Corker stated that bipartisan agreement is closer than it was in 2014, arguing that a bill this year is possible due to the consensus on the need for an explicit guarantee for catastrophic risk. In contrast to some trade-association testimony, he wants a pre-funded backstop to protect investors, not lenders. On the hot button issue of keeping affordable housing requirements for any new GSE structure, Sen. Warren remained adamant that these goals had to remain and were not replaceable by, for example, an additional 10 bps strip in new RMBS issuances.

Although the hearing focused on the GSEs, servicers got slammed in a good deal of the Q&A. Under fire from Cortez Masto, De Marco agreed that FHFA had dropped the ball on servicing standards and that FHFA now should turn to them. Democrats and Republicans also want more work done on alternative underwriting and credit scores.

Outlook

The analysis above demonstrates that the Fed will remain a dominant player in the agency RMBS market. Unless it uses its roll-off also to shift out of Fannie and Freddie paper solely into Ginnie's – nowhere suggested – then the Fed will also continue to have the huge stake we have previously cited when it comes time to deal with dissolving the GSE conservatorships.

The straight-ahead, five-year liquidation posited in previous legislation would not put the Fed at direct balance-sheet risk because the implicit/effective federal guarantee on existing paper will remain intact even if Fannie and Freddie are no more. However, the market value of GSE paper could rise very sharply if scarcity effects are exacerbated by an end to new issuance. How the Fed handles its portfolio in any such situation is likely to provoke so much market uncertainty that Congress may well move far more slowly to dissolve the GSEs or, as some have proposed, simply convert the conservatorships into new entities to keep the game rolling along.

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