GSE Activity Report

Wednesday, September 20, 2017

PATH to Where?

Summary

On Tuesday, a senior House Republican told *Inside Mortgage Finance* that House FinServ will soon turn to GSE reform, a prediction backed by hearings planned shortly to kick this off. Here's what we think Hensarling's opening bid will be and what might then befall it.

Impact

We are told that the House bill will take Hensarling's 2013 PATH Act, update it to reflect the almost five years since it failed to reach the House floor, and again position the House with a controversial bill poised for the due-course deliberations to which the Senate eventually will turn. Looking back at PATH and forward to PATH II, here's what the earlier bill did and what we expect to see now:

Privatization?

Press usually characterizes the PATH Act as a privatization bill. This is only partly true – although the GSEs would be put down, FHA would be taken up into a new government corporation. Hensarling is of course no fan of government corporations (see his position on the EXIM Bank), but his version of the FHA would not only be extracted from HUD – and thus likely better governed – but also meet his concerns by backing only HLTV loans for income-targeted and first-time buyers with a partial guarantee. Interestingly, the 2013 language did not require the new government corporation to defer to private-sector pricing, arguably allowing it to take MI head-on as well as co-opt any other lower-income HLTV programs. However, FHA's guarantee would be rolled back from 100% to 50%.

A very important provision in the PATH Act often overlooked during the 2014 debate over Corker-Warner is that the Hensarling bill also included an emergency-liquidity facility for the mortgage market: this new government corporation.

Ginnie was kept largely as is. However, it would still have been subject to mandatory risk-sharing and a tougher capital requirement. During mark-up, Ginnie's itsy-bitsy

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servicing fee was also hiked to ensure that Ginnie would not be the new USG mortgage monopoly. Combined FHA and Ginnie provisions "privatized" housing finance to the extent that they targeted it to underserved borrowers and cut what we would call subsidy pricing for the industry, but the government would nonetheless have remained a huge market presence.

Fannie and Freddie

As noted, their secondary-market role would have been privatized, with the legislation liquidating both the single- and multi-family guarantees over five years. In 2014, the GSEs still had capital resources with which to withstand stress during this wind-down – now, of course, they don't, likely forcing Hensarling to make the GSEs the official full-faith-and-credit agencies Paul Ryan had sought over a limited period before liquidation.

In 2013, the legislation would have turned the CSP into a largely private-sector platform (with the FHLBs interestingly allowed to send loans its way). But by 2017, a billion or so has been spent on this still "in-construction" operation, making transformation into a private enterprise far more complex unless one simply hands over these costly keys to private securitizers. However, the 2013 bill used CSP eligibility as a *de facto* regulator; to keep this in place – which Congress will still want – and transform the CSP will prove both operationally and politically complex.

Unsurprisingly, the PATH Act terminated all of the GSEs' affordable-housing obligations. Hensarling defended this on grounds that his new-style FHA would take care of lower-income borrowers, but Democrats nonetheless very steadfastly opposed it. This battle of course will continue. We expect the House bill to retain this hard line and any Senate legislation to try for the trust fund included in the original Corker-Warner bill.

PLS Please

The center of PATH was its boost to PLS. These would have come under FHFA regardless of issuer, thus for the first time bringing non-bank issuers under federal regulation. FHFA would set some key terms for PLS and CSP eligibility is intended to dictate the rest, combining to form a new fee, disclosure, and transaction structure that would not revisit the sins of pre-crisis securitization.

All of these standards are, though, aimed at investor protection, not safety and soundness except to the extent FHFA uses its pricing power to stipulate them. As we noted in 2013, nothing would limit the ability of PLS issuers to structure transactions other than – importantly – all the rules on banks which now and presumably still will keep them out of new-style CRT structures. Given Hensarling's predilection against both the QM and QRM, both would terminate in concert with the GSEs.

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Covered Bonds

The PATH Act included extensive provisions to resurrect U.S. covered bonds. These were included at Scott Garrett's behest and he is of course no longer in the Congress. However, covered bonds surprisingly remained a FinServ priority in its 2017 agenda and we expect to see a revised version of this language in the new reform bill.

Outlook

As we have noted before, the new approach to GSE reform in the Senate is what we have called "New Ginnie." Given what's likely to be in PATH II, one could also call the Senate's idea "New, New Ginnie." There is considerable middle ground between the old Hensarling approach for both FHA and Ginnie Mae. Key to the politics is, of course, the money. Hensarling's bill engendered enormous opposition because it ripped away much of the profit derived from FHA and Ginnie not just to lenders and servicers, but also realtors and home builders. If a middle path can be found, a new RMBS utility is possible; if not, we'll have the conservatorship unless or until it craters.

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