GSE Activity Report

Monday, September 25, 2017

The Scary Side of the Shadows

Summary

On Friday, HUD's Office of Inspector General (OIG) ratified former Ginnie head Ted Tozer's fears about Ginnie's growing counterparty exposure to non-bank servicers. Of course, Ginnie's risk is shared by the GSEs, which also have increasing exposures to non-banks and, like Ginnie, little ability to contain this risk without walking away from about half the U.S. mortgage market.

Impact

OIG interestingly states that, when Ginnie's servicing exposures were largely to banks, Ginnie effectively "out-sourced" its risk-management responsibilities to the federal banking agencies. Non-banks are of course not subject to these regulators and, while large ones do come under the CFPB, the Bureau's powers cover consumer protection, not prudential regulation. As a result, Ginnie can no longer out-source risk-management for 73% of its servicer exposures, forcing it to rely on the internal controls for which OIG now calls.

However, OIG's concerns go beyond the simple substitution of federal regulation by no regulation. The new report argues that non-banks are riskier than banks because of their dependence on sub-servicers and on credit lines, not stable funding. Further, while banks have standard corporate ownership and organization structures; non-banks are part of all sorts of companies with all sorts of ownership.

To be sure, OIG doesn't blame Ginnie for the growth of non-banks. The report cites all the capital and market factors we and many others have spotted as transformational. OIG says that, had Ginnie tried to impose risk management, non-banks would still have grown exponentially. We wonder, though, given the general reliance of non-bank servicer models not only on sub-servicers and credit lines, but also on little if any regulatory capital or other balance-sheet cost. Changing the non-bank equity ratio through a Ginnie Mae capital requirement would only have massive structural impact if Ginnie tried to match bank regulatory-capital requirements – unlikely – but even a bit more capital would have made a difference along with better protecting the taxpayer. Further, mortgage borrowers would in our view also have been better protected – it's a lot more fun taking a 50% or more risk share on a high-risk VA loan even if you lose your Ginnie servicing portfolio when don't have capital to back your underwriting bet.

Federal Financial Analytics, Inc.
1140 Nineteenth Street, N.W., Washington, D.C. 20036
Phone (202) 589-0880 Fax: (202) 589-0423
E-mail: info@fedfin.com www.fedfin.com

Outlook

Ginnie's reply: we're doing the best we can. Will it try harder under the new HUD? So far, not so much, but of course new HUD is still in formative stages.

Federal Financial Analytics, Inc.
1140 Nineteenth Street, N.W., Washington, D.C. 20036
Phone (202) 589-0880 Fax: (202) 589-0423
E-mail : info@fedfin.com www.fedfin.com