GSE Activity Report

Monday, November 9, 2020

Nuts to New

Summary

Acting at last on one of its 2019 commitments, FHFA has proposed a new construct sharply curtailing the GSEs' ability to launch new products. The new framework would last through and after conservatorship, bringing the GSEs more closely under the tightly-circumscribed mission outlined in the 2019 plan and thus into a limited guarantee-and-securitization role favored by many mortgage bankers and insurers.

Impact

After HERA demanded more of FHFA in curbing new products, the agency issued a 2009 interim final rule that gave Fannie and Freddie continued, broad discretion to launch new products as "pilots" even if the pilot had considerable market impact. This led to ongoing controversies about GSE products, especially those in the warehouse financing and credit enhancement area, controversies FHFA now seeks to resolve with a more stringent and transparent new-product approval process. Key provisions in the proposal include:

- there is a unified advance-notice process in which Fannie and Freddie need to tell FHFA of any new activity. "Newness" is determined largely as under the IFR, but more objectively and thus expansively to cover not only novel activities, but also refinements to those under way at either the GSE or the GSE in concert with other parties. Newness is also accorded by virtue of increased GSE risk or outreach to new borrowers, investors, counterparties, and collateral or by opening a new division or otherwise dedicating significant resources.
- newness is also accorded if an activity substantially affects the mortgage system, the GSE's soundness, GSE compliance, or the public interest. No matter FHFA's assertions about its new objectivity, this public-interest criterion is not only subjective, but also intensely political. Who heads FHFA and how he or she sees the public interest will thus prove critical to what Fannie and Freddie get to do going forward.
- pilots would be allowed under additional constraints.
- the new rule would be effective when issued, essentially grandfathering existing controversial activities unless FHFA uses its broad, remaining authority to overturn them.
- Existing exclusions for operational or underwriting activities remain but are narrowed (e.g., new technology not directly associated with AU would trigger notice).
- FHFA would keep very tight reins on all activities, forcing the GSEs to gain express authorization for anything triggering the "new" criteria outlined above. If FHFA spots a new activity, then it would invite public notice and comment before authorizing it, with the NPR

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withdrawing confidentiality protections for both the GSEs and commenters allowed under the IFR. If FHFA does not disallow the product, then a GSE could offer it thirty days after the comment deadline, but FHFA's rights to reverse or alter the product under its safety-and-soundness and mission authority does not lapse. The public-interest criterion could not, however, be directly invoked to reverse an approved new product or activity.

FHFA of course asks many questions on this new construct, including:

- Is newness well defined?
- How would the new technology provisions work in practice?
- How best to define the public-interest criteria that also determines permissible activities and products?

Outlook

The NPR is in today's *Federal Register* with a January 8 comment deadline. We would guess FHFA will finalize it quickly to hard-wire this new construct ahead of any change in the agency's corner office. Once issued in final form, new products and activities would come under the rule's big gun; muzzling it would take a formal notice-and-comment process.

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