No-Go on Nonbanks

Summary
Following our in-depth analysis of the Fed’s latest financial-stability report, we here focus on mortgage-specific considerations, with the most significant strategic one the Fed’s conclusion that nonbank mortgage servicers and MREITs are far from out of COVID’s Black Forest. If nothing bad happens as forbearance winds down, we think little more will come from the Fed given all its other reform priorities. However, any weakness or worse in these sectors that goes beyond dinged profitability ensures renewed attention to systemic designation and/or regulation in 2021.

Impact
The Fed notes that the pressures on nonbank servicers highlighted in the May stability report abated, but it attributes this largely to Ginnie and FHFA buffers and fiscal stimulus, not servicer liquidity. As a result, forbearance’s end and continuing COVID stress could spell renewed liquidity stress despite all the cash racked up in the refi boom.

MREITs also come in for uncomfortable scrutiny. The November report restates concerns in the May assessment, going on to conclude that continuing MREIT stability is thanks only to Fed facilities, not structural reform that reduced MREIT leverage.

Outlook
What will the Fed do about servicers or MREITs? Nothing for now and, we think, little for later absent renewed crisis. However, this does not mean that the Fed will also do nothing forever. It is watching nonbank servicers and MREITs and warning large banks to continue to buffer exposures to them pending possible action sometime next year on more significant reforms via FSOC, FHFA, and the SEC. The Fed’s top priorities in the very near term are prime MMFs and the Treasury market, with the central bank making a bet that servicers and MREITs, while scary, are not systemic as long as rates stay low, the Fed buys agency paper, and no one calls the forbearance bet.