GSE Activity Report

Tuesday, December 1, 2020

Fannie, Freddie, and Janet

Summary

Given the high confirmation odds for Janet Yellen as the nation's next Treasury Secretary, we here assess her impact on the future of U.S. housing finance. We know a good deal about Ms. Yellen's views on this topic, but can only guess at what latitude she will have to express them – the deck of GSE cards she will play has yet to be handed to her by Secretary Mnuchin and Director Calabria. However, even if the Trump Administration closes the conservatorships as it shuts its own door behind itself, Yellen and the FSOC she will head can and will alter what's handed over to them. In key ways, they will thus not just redefine the GSEs, but also and even more importantly U.S. housing finance.

Analysis

Absent a shift in facts on the ground due to COVID, financial-market instability, or other unknowns, we see the following policy shifts as certain under a Yellen Treasury Department:

- Systemic Designation: As we have noted, we expect FSOC to designate the GSEs as they leave conservatorship, making them nonbank SIFIs subject to top-down Fed regulation. Because FHFA's capital rule is satisfactory to the Powell Fed, it will be acceptable to a Yellen Treasury, and FHFA would remain the GSEs' primary regulator. However, systemic designation would first and foremost allow the Fed to force fast action on two critical issues – stress testing and resolution planning. We expect resolution planning to take precedence in order to create the patina of GSEs that, even without an effective or actual federal guarantee, would not fail in any way that undermines the binding nature of the Treasury's implicit backstop to agency debt and MBS.

- Nonbank Mortgage Originators/Servicers: Here, we expect fast action not on designation, but instead on activity-and-practice designation. The Fed's concerns remain unabated and Yellen surely shares them. As we have noted before, activity/practice designation does not solve for the absence of a federal primary regulator for nonbank mortgage firms, but it doesn't have to. Directing FHFA to take certain actions, encouraging FHA to do the same (which it will under Biden), and imposing indirect restrictions on nonbanks via new bank rules in areas such as liquidity facilities will create a binding federal framework no matter the lack of a primary federal regulator.

- Private MI: The role of MI has never risen to that of an issue on which Fed chairs opine, but

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the Fed is institutionally opposed to capital credit for monoline insurers and Yellen either knows or will be told so. This will not undermine FHFA's loan-level treatment in the capital rule, but affect FSOC as well as continuing Fed work on CRT. In general, Yellen, like the Fed, strongly opposes structured credit transfers in which the originator retains direct or even implicit risk. One impact from the overall COVID crisis will be a rewrite of bank "step-in" risk capital rules, and these will come to apply to the GSEs when they come to pass.

- FHLBs: The Fed and Treasury are no FHLB fans and we think they will reconsider designating the FHLBs as nonbank SIFIs once they get through dealing with their top priority – Fannie and Freddie. Under Dodd-Frank, the FHLBs could be designated either as SIFIs or the activity of providing advances to members could be deemed systemic. FSOC and the Fed cannot impose capital rules on the FHLBs following SIFI designation as allowed for Fannie and Freddie, but FHLBs under the Fed would still face significant constraints in areas of longstanding concern such as rollover risk. Activity designation would be less direct, but possibly considerably more potent.

- Affordable Housing: Yellen is a big, big fan of affordable housing and has no fear of setting goals for the GSEs or ramping them up via rulemaking. While she will strongly favor near-term recognition of GSE losses due to COVID's credit costs unless these drive the GSEs into receivership, Yellen will be more than willing to extend forbearance if FHFA concurs – unless some form of PSPA gives Treasury continuing, direct authority over the GSEs, Treasury lacks power to demand this nor could the Fed do so unless or until the GSEs are designated SIFIs.

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