GSE Activity Report

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Summary

In this analysis, we assess a new plan to restructure the GSEs sure not only to be considered by the Obama Treasury if it issues the promised RFI on a “utility” approach, but also and far more importantly in any Democratic Administration to come. We confess up-front to a lack of objectivity about this proposal – it favors a government corporation akin to one we have outlined in prior reports not only for the GSEs, but also FHA and agree that its transitional approach may ease the nation into a privatized GSE-style utility without the shock of the new one that has stymied most other plans. One challenge we foresee – rightly raised in the report as a worry – is the procyclicality of the new structure. This protects taxpayers, but undermines the entity’s market liquidity function. We doubt a counter-cyclical capital buffer will cure for this because we’ve yet to see a proposal for one that works, but a counter-cyclical fee structure could solve for this systemic worry if correctly structured and acceptable to the market.

Impact

This plan comes by way of Lewis Ranieri, the font of mortgage-securitization wisdom, and several prominent Democratic advisers along with one active in GOP politics. As noted, the plan is premised on a merger of Fannie and Freddie into a single government corporation called the National Mortgage Reinsurance Corporation (NMRC), guaranteeing RMBS but transferring non-catastrophic risk to the private sector. Key features of the new NMRC would include:

- a guarantee of P&I on purchased loans;
- master servicing for purchased loans;
- continued application of affordable-housing and duty-to-serve requirements. A ten bps fee would be added to support these activities;
- a cash window to satisfy small lenders;
- single-and multi-family purchases;
- transfer of non-catastrophic risk under normal market conditions. A 3.5% capitalization buffer from private investors in the corporation (in the form of preferred or similar equity that does not replicate the GSEs’ incentive problems)

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to offset NMRC risk;
- regulation by FHFA;
- use of explicit g-fees and a reserve fund to insulate taxpayers from risk. Under stress, FHFA would increase g-fees to rebuild the insurance reserve fund akin to the FDIC's premiums, but the fees could also fluctuate based on market perceptions of risk due to the risk transfers. The NMRC insurance reserve is to be set at 2.5% of total insurance in force funded by a cat-risk fee of 10 bps. Because g-fees that rise and fall with risk perceptions could be procyclical, the proposal includes a possible counter-cyclical buffer;
- operation of the common securitization platform;
- acquisition of GSE legacy assets and liabilities (including those to Treasury);
- limits allowing purchase only of QMs below an FHFA-defined conforming dollar threshold, with the ceiling raised or lowered as market conditions warrant;
- no apparent express credit-enhancement requirement for HLTV loans;
- possible imposition of risk-retention requirements; and
- possible inclusion of Ginnie Mae and other USG mortgage operations into NMRC.

Advantages of the NMRC laid out in the paper include:

- insulation from shareholder incentives;
- responsiveness to public-policy needs;
- relatively easy transition from a government corporation to a privately-owned utility;
- protection from Congressional appropriations;
- immunity from the need to raise the huge amounts of private capital required to replace the GSEs;
- lower borrowing costs despite the new g-fees due to the explicit USG guarantee and risk transfers;
- a level playing field for smaller lenders; and
- appropriate budgetary treatment.

On the other hand, the paper readily recognizes possible challenges, including:

- reduced competition in activities conducted by the corporation (e.g., servicing); and
- heightened procyclicality, albeit less so than in other reform options according to the paper.

Outlook

Many details of this proposal will need to be built out – for example, the structure of the government corporation and how it would get its start-up capital (an appropriation or contribution of what's left at the GSEs if this happens fast?). Still, the principal advantage – and it's a big one in our view – of this proposal is that it's a half-way house and thus one that might be easier to build fast as the GSEs approach the January, 2018 drop-dead date when all of their capital is depleted and they operate on fumes and the expectation of Treasury rescue under stress.

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