GSE Activity Report

Wednesday, June 23, 2021

Now What?

Summary

There is much rejoicing in mortgage-industry land that the Supreme Court decision today means rapid repeal of Mark Calabria's regulatory legacy and still more rejoicing among affordable-housing advocates about GSEs yoked to a new public-welfare and racial-equity mission without any hope of an end to the conservatorship. Much of course remains in flux pending a new acting director and then a confirmed one, but we think the future of Fannie and Freddie will be a more mixed and modulated one that all the celebrants expect. Still, it's going to be different.

Outlook

There are many moving parts in Mark Calabria's legacy that can be roughly grouped as regulatory, charter, and mission. And, in each of these groups, there are many moving parts that not only make a whole, but are also often strategy-decisive on their own. Here, we highlight key issues in each of these arenas and outline the near-term implications of the landmark decision.

The 2021 GSE-prudential framework is of course a lot different than the 2019 one greeting Mark Calabria. Despite lots of talk about new safety-and-soundness rules, there essentially weren't any due to the Treasury backstop. Calabria determined that Fannie and Freddie needed to stand on their own and, while he did this in large part to build the foundation necessary for reprivatization, he also built a foundation long advocated by the Federal Reserve and others across the U.S. regulatory pantheon regardless of the Administration in which they served. No matter who comes to control FHFA, he or she will surely be loath to cross Janet Yellen and Jay Powell as well as those in the White House who remember September 2008 and how the GSEs' collapse played into the November election.

We thus do not expect any near-term changes in the broad structure of the GSEs' capital, liquidity, stress-testing, and resolution framework. This is not to say that all aspects of each of these rules are forever, but changing any of them touches on controversial questions and in most cases also a formal rulemaking process that can't and won't move fast. Over time, we can see a new FHFA director taking a more sympathetic look at credit risk transfer in response to all the industry pressure in this arena, but it's important to remember how little the Fed thinks of credit-risk mitigation without large amounts of regulatory capital at both the enhancer and the enhanced. The pressure to reduce GSE reliance on nonbanks comes as much from the Treasury and banking agencies as from FHFA and also will continue apace.

Things get a lot more interesting a lot more quickly on the charter and mission fronts. Under Calabria, there was little likelihood of a near-term end of the conservatorship and there's still less of one in the Biden Administration, leaving the limbo that has defined Fannie and Freddie and will be the status quo for the continuing future.

But, as with tweaks to the capital rules, revisions to come to the current pre-privatization charter restrictions could well be revisited and rewritten. The most obvious of these is constraints on GSE purchases of investor and second-home loans. To the extent advocates can make a persuasive case that these constraints adversely affect affordable housing, change is going to come and quickly.

Charter considerations of course overlap and even overhang each other. The charter review of eligible purchases outlined above is of course mission driven, but more is sure to come. The most immediate issue is the interplay between forbearance and GSE risk. Calabria stood for GSE risk reduction and thus for a return to requirements for mortgage repayment; a new FHFA head will do what he or she can to protect the GSEs, but still more will be done to accommodate the CFPB servicing standard and political pressure for continuing forbearance and eviction protection for as long as possible and as generously as possible.

We also expect near-term work on new product authorization for refi structures targeted to Black and Hispanic homeowners and a major push to low-balance acquisitions. FHFA's work on climate risk ahead of the Presidential order will move from a holding pattern into a high-priority initiative to lead the way on the housing/flood risks that top the Fed's climate worry list. FHFA action will also give the Administration something concrete to show on climate financial-sector risk after its 180-day study given the slow pace of work at the banking agencies.

We know we've left out key issues to each of our clients. We'll elaborate on additional issues as more is known; in the interim, do not hesitate to let us know if you would like our analysis of any other FHFA decisions.

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