GSE Activity Report

Monday, June 28, 2021

How to Redesign a Government-Sponsored Enterprise

Summary

After last week's colossal Supreme Court decision, we provided our first assessment of its impact on near-term charter, mission, and regulatory decisions. Now, we turn in detail to what might come to pass for the conservatorship. Nothing soon of course – the status quo will be steady-state at least until a new director is confirmed and likely for at least a year thereafter given all else on FHFA's and the Administration's to-do list. Still, what many have come to consider a good thing can't and won't last forever. Many Biden proposals are new-age versions of Obama ideas and we expect this to prove the case also for the conservatorship. And, of course, even if the conservatorships continue – as surely they will for a while – key aspects of them can and will be redesigned.

Impact

Before we turn to how old Obama could lead to new Biden, a caveat: that which occurs between now and the time at which structural decision-making begins will determine what that decision-making decides. Among just the few things with direct impact defining the GSE-charter paradigm are the new QRM definition, the pending rewrite of bank capital rules, how the biggest banks revive PLS, Ginnie's decision to offer a 40-year MBS, likely drops in FHA premiums, and what FSOC does about mortgage servicing.

Still, much in Obama-era thinking about converting the GSE conservatorships into a merged utility applies to current and future circumstance. The plan most likely to influence Yellen's Treasury emerged in the Obama Administration in October of 2016 intended then to direct what the White House felt sure would prove to be a Hillary Clinton Administration. Never mind all that, but those who waited out the Trump Administration still think well of the plan hatched by Treasury Counselor Antonio Weiss.

As we detailed at the time, the Treasury plan emphasized affordable housing in part by mandating continued pricing cross-subsidies along with up-front equity-and-access sanctions for any private guarantor relying on a GSEs' catastrophic-risk backstop. This backstop was designed very much like that in all the legislation up to that point in time and of late from Republicans such as Pat Toomey. A new-style trust fund for affordable housing would also fund federal efforts along with a tougher duty to serve. All private guarantors riding atop the GSE backstop would also be federally-regulated, with a national loss-mitigation standard demanded of servicers that reads now very much like the CFPB's pending proposal.

Much in the Weiss plan echoed one put out by former Obama officials tightly linked into the Biden team.

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These went on from ideas along Weiss' lines also to lay out how Fannie and Freddie could be converted into a new, merged utility construct, a proposal similar in many respects to the utility proposal favored by FHFA's director at the time, Mel Watt.

As we noted in 2018, the Watt plan presaged Calabria's ideas for multiple secondary-market guarantors ahead of a federal cat-risk backstop. As proposed, this would surely have led to no more than one or two Fannie/Freddie successors unless Congress laid out viable terms for chartering new ones and the banking agencies relaxed key capital rules. No matter how many of these entities there came to be, all would need to use the common-securitization platform to issue uniform MBS, with mortgage rates uniform along all guarantor-entities but varying for the group as a whole by single- or multi-family product type. This rate is designed to give the guarantor entities a guaranteed rate of return satisfactory to private-sector investors and affordable-housing advocates. The cat-risk backstop would be akin to FDIC insurance for eligible-guarantor mortgages backing only the loan, not the guarantor and funded by a premium much like federal deposit insurance. Interestingly, the new guarantors would be able to pay delinquent or defaulted mortgages and issue new MBS including or solely comprised of them backed by the federal backstop, a proposal that might prove particularly palatable now even without more profound structural reform.

Some of these proposals expressly define the future of MI and CRT and some don't. All would, though, have profound impact on third-party credit enhancement based on the extent to which charter requirements continue to apply, pricing, and underlying mortgage risk.

Outlook

Both the Weiss and Watt plans require a lot of brushing up. However, each of them has, like Calabria's long-term ambitions, numerous aspects that can be accomplished without new law to ready the market for the federal backstop that cannot be constructed without the statutory change also needed for new affordable-housing and credit-enhancement requirements. Indeed, aspects of the Obama plans are made more immediately practical by intervening Calabria actions to institute the capital, liquidity, and resolution rules that this Administration will consider as much of a necessary precondition to charter redesign as all those that came before.

However, we reiterate: nothing substantive will happen soon unless something forces federal hands. While we wait, watch for lots of high-profile proposals along old lines recrafted for new circumstances.

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