GSE Activity Report

Thursday, September 16, 2021

Structured Finance Finds a Friend

Summary

As we noted, FHFA wasted no time after the PSPA revision with its proposed changes to GSE capital regulation. Although the changes seemed technical to many observers, the agency's fact sheet makes clear that they are fundamental. Now, the GSE capital construct is predicated on CRT to move the money and thus preserve the capital, not on a capital raise to big-bank equivalents. FHFA says this makes the GSE regime equivalent to that for global systemically-important banks (GSIBs), but it still differs in key and often critical respects from the regime applicable to U.S. GSIBs. No matter, CRT is the new thing and faster GSE recapitalization is the certain result.

Impact

The scope of the changes surprised us given the Fed's allegiance to its own "gold-plated" Basel construct, but the CRT focus is also one long espoused within the Treasury Department due to very effective advocacy by Wall Street structured-finance advocates. Recently, a few big banks have joined in, persuaded now that their own capital rules make it more profitable for them to enable GSE CRT than to originate and securitize mortgages on their own.

FHFA's proposal is essentially ecstatic about CRT as a through-the-cycle risk mitigant that significantly reduces both systemic and taxpayer risk. This rewards Freddie Mac, which continued CRT last year even after Fannie sharply contracted its positions in response to FHFA pressure and the looming capital rule.

Nothing in the proposal limits the types of CRT a GSE could select, with FHFA's new policy opening the door to all sorts of CRT in all sorts of structures for all types of counterparties with or without collateral on the line. The "effectiveness" test in current rules would be retracted on grounds that it's duplicative, with FHFA asserting its approach is analogous to that imposed on U.S. banks even though it appears to differ markedly in the capital credit afforded to monoline insurers such as MI.

The leverage-ratio rewrite is also more than non-trivial. Although there's a bit of a risk-based capital add-on for retained CRT, the new approach drops Fannie's required LR by about two-thirds and trims Freddie's by around 75%. As FHFA says, risk-based capital will now be the GSEs' binding constraint, but the sharp LR discount goes considerably farther in doing so than similar efforts by the Fed to realign U.S. GSIB binding constraints.

Outlook

Comment will be due sixty days after Federal Register publication. If the prose provided at release is any prognostication of the future for a new final rule, the GSEs' capital framework will get considerably more lenient and their CRT role will concomitantly grow far greater.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

We also expect comments not only to praise these changes, but also push for more, many of which may well appear in final form whenever a strong case can be made for the revision's benefit to affordable or equitable housing finance. As a result, the GSEs' capital construct could change still more consequentially, redefining their conservatorship by enhancing considerably capital ratios without the need for costly capital retention. What this turns them into when remains very much to be seen, but the path to a new future could come more quickly upon us.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com