GSE Activity Report

Wednesday, August 17, 2022

Booting Up for 2.0

Summary

FHFA and Ginnie Mae today let loose their long, long delayed standards for eligible seller-servicers. These will require more from almost all large nonbanks but not demand nearly as much as feared from them and from all small servicers. Pain is also postponed, facilitating compliance at a time when it might be particularly challenging for firms to tap markets to meet new capital, liquidity, and stress-test standards.

Impact

This set of final standards comes after tries in 2015 and 2020 at new capital and liquidity criteria, and marks a significant climb-down from the February 2022 outline. More-or-less unified requirements from Ginnie and FHFA also limit the risk of arbitrage that attended prior FHFA-only efforts and, while the new standards do not go as far as bank regulators hoped, they also appease FSOC's concerns about nonbank servicers. Notably, these standards are minimums; Fannie and Freddie can add to them for individual firms or under certain circumstances as each may think best.

The biggest change other than exempting seller-servicers with less than $1 billion of originations a year is the return to a 6% leverage requirement rather than the 9% proposal. The idea behind the 9% ratio was to make bank and nonbank capital ratios roughly comparable using the community-bank leverage ratio as a guide, but this was not to be.

Another back-down is reduction of the 2% hedging add-on which would have been a risk add-on, not a buffer, given the magnitude of this hedging disincentive. Now, it's only 50 bps, providing a buffer against a stress-scenario making risk similar at least in concept if not in construct to the capital requirements large banks hold against hedged positions.

Taking stock of servicer illiquidity under stress, the new standards also recraft the current construct in hopes of making it less procyclical. The new approach eliminates the sharp uptick in liquidity standards as loans go unpaid to varying standards based on remittance type to favor actual-to-actual repayment schedules. Eligible high-quality liquid assets remain unchanged.

Finally, large seller-servicers (i.e., those with master accounts of more than $50 billion in UPB or as designated by a GSE) must file annual capital and liquidity plans with the GSEs along with notice of any material changes to a prior plan. Most notably, the plans must include liquidity stress tests under GSE-prescribed scenarios and contingent capital and funding strategies that are tested and reaffirmed each year. And in what is clearly a significant expression of distrust, large nonbank seller-servicers must also obtain an annual third-party assessment of the firm's performance and creditworthiness. This report is to substantiate assertions about the company's resilience as measured by express and additional ratings and related quality assurances that get tougher as the servicer gets bigger. Also reflecting the agency's worries, the GSEs are to assess each large nonbank servicer each quarter for

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compliance with its plans and look annually at whether the plans still make sense.

Outlook

As is now the case, nothing might happen to a seller-servicer that flunks 2.0, but on the other hand it could lose its seller-servicer status and thus encounter a franchise-busting experience. Effective dates for the GSE standards are September 30 for the tangible net worth eligible liquidity definition change, net worth, base liquidity, and liquidity buffer; December 31 for origination liquidity and third-party ratings; and March 31, 2023 for the capital and liquidity plan.

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