GSE Activity Report

Monday, September 26, 2022

One Way Down

Summary

As will be evident in our forthcoming in-depth analysis, the CFPB's fusillade last week on mortgage-finance could have far-reaching implications for the entire market based on how far it takes its new campaign for equitable housing finance and whether the market is willing to come along on at least some of the agency's new ideas. And, of course, the Bureau could well follow up an implicit threat to force new mortgage products if the industry proves unwilling to comply with its social-justice vision. It will take months, if not years, to finalize many of the rules outlined in the RFI, but this schedule is subject to change without notice if the Bureau decides to rewrite mortgage finance by edict, not administrative process. Indeed, new CFPB enforcement actions tackling refi-borrower risks seem imminent. FHFA and/or HUD action to support or even mandate some of the CFPB's ideas would also be radical redesign in one heck of a hurry.

Impact

The rationale behind the CFPB's RFI is that the mortgage market needs a redesign to enhance economic equality, a point echoed in a great deal of research on both refis and forbearance. The Bureau can of course do more than reach conclusions; it could also mandate and/or enforce action to achieve them. This RFI sets the stage for doing just that with far-reaching implications across the industry if the agency wreaks its will and/or FHFA or HUD follow Chopra's lead by opening up new markets, demanding new protocols, or otherwise attaching the CFPB's competitive-mortgage initiatives to their equitable-finance ones.

Key take-aways include:

- **One-Way Risk**: how the CFPB will amend its QM rule to facilitate targeted refis and/or purchase mortgages with automatic rate-driven adjustments that prevent the need for refis is a top-order consideration. A key question is whether these features can be limited to targeted communities or if streamlined actual or de facto refis would become a standard market feature. The secondary market knows how to calculate duration related to refi probability, but factoring interest-rate risk borne only by the investor into new, extremely persistent loans will be challenging. With rates as high as they are, product introduction with all the downward risk it entails could be particularly challenging unless the CFPB finds some way on its own or via other agencies to demand these loan offerings.

- **Refi Terms**: The Bureau is pushing for adjusting terms and/or easing underwriting for the refis and new loans it believes ensure equity by easing lower-rate adjustments. Many of these loans are likely to have high ITVs but pose underwriting concerns for MIs. Would FHFA allow the GSEs to bypass these requirements if alternative forms of credit enhancement are possible or even if they aren't?

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- **The MI Flip-Side**: On the other hand, automatic forbearance at the least delays a claim and if it works as CFPB envisions it did during the pandemic, likely defers many of them.

- **New Consumer-Protection Rules**: The RFI includes a long list of current refi practices the Bureau finds reprehensible – e.g., churning, loans without any net benefit to the borrower, and even cash-outs. Given the agency's broad-scope deployment of the sweeping UDAAP powers it claims, these are exactly the kinds of product features on which the Bureau could slap the UDAAP label via an interpretive opinion, hauling in both banks and nonbanks (now under its broad authority at least according to it).

- **Forever Forbearance**: The Bureau's RFI contemplates automatic forbearance for short and long periods of time under a wide array of circumstances. Some – e.g., natural disasters – are surely non-controversial. Others – e.g., job loss, partner death – may be challenging to administer without putting the burden of proof on the borrowers the Bureau seems unwilling to accept.

Outlook

The RFI asks many questions about all of these options and how they could be executed. Where it and the other agencies come down on them will determine the extent to which the agency's efforts streamline products for borrowers now often frozen out of the refi sector or define a new class of products and loss-mitigation rights across a wide range of borrowers eager to take out loans that protect their interests at considerable cost to lenders, servicers, and investors. The RFI also asks a number of questions about pricing and market viability, but its unilateral focus on ensuring consumer benefit could make it hard to persuade.

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