GSE Activity Report

Monday, December 19, 2022

Nonbanks Get Unwelcome FSOC Attention

Summary

As promised Friday when FSOC's annual report was released, we here go into depth on its implications for residential housing. Most notable to us in the lengthy report was its continuing concern about residential-housing price vulnerability, its new focus on MBS-market volatility, and specific action steps to address longstanding fears about nonbank mortgage originators and servicers.

Impact

The latest report brings FSOC up to date on residential housing as inflation rose and interest-rates spiked. It not only details how this quickly cooled markets, but also notes its concern – new to us among federal entities – that loss-mitigation strategies that have fared well so far will falter under macro stress in a rising-rate environment. Supervisors are thus enjoined to scrutinize resilience expectations and take supervisory action where needed.

No recommendations attend FSOC's prediction of MBS-market risk, but we expect this statement was sparked by the aforesaid BIS report and may prompt FHFA to ensure the GSEs can withstand any short-term shocks in the secondary market.

The most striking section in terms of new content pertains to nonbank mortgage companies. Reflecting the Biden Administration's focus not just on the risks concerns prior FSOC reports have highlighted, the 2022 report now also details nonbank market share as a whole and for the top-ten companies. We doubt this presages an FTC inquiry if only because the FTC is plenty busy, but it does make it clear that competition questions are potent in this sector and could come to haunt any firm contemplating M&A or seeking redress in some way from the CFPB.

The paper also includes a detailed discussion of remaining risks in the nonbanks sector, with FSOC particularly concerned about liquidity risk perhaps because of the second-order effect this would have on MBS. Nonbank originators and servicers are found to be at "significant" risk due to slowing growth, declining origination volumes, and rising rates. The report's details don't provide policy recommendations, but its top-level conclusions urge not just federal and state coordination to address nonbank risk, but also a hard look at stress testing.

Outlook

The only entities that could force stress testing are FHFA – which would have had to sign off on this report – and Ginnie Mae. Each has had its hands full with nonbank-eligibility standards and is likely loathe to press stress-testing unless or until market conditions show that it might have been a good idea. Still, FSOC can press for these through its activity-and-practice standards and the thrust of the

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overall discussion of nonbank companies suggests it might well come to do so once it finalizes its broader systemic framework in the first half of 2023.

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