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Open Mind on GSE Reform

Posted on February 5, 2018 by DavidHStevens



The recent release of the draft discussion text from the Corker/Warner Senate team on GSE reform is a strong step forward in the effort towards legislation to resolve the conservatorship of Fannie Mae and Freddie Mac in a productive manner. I encourage all lenders and stakeholders to read the **draft text** and form your own opinions as a lot of misinformation is circulating about what the text actually says.

Here are what I believe are some of the positive key points from the **draft itself**:

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1. The guarantor model remains, but it becomes a multiple guarantor model with Fannie and Freddie essentially spinning off the first two by keeping the core infrastructure and personnel but requiring other new guarantors to join in as well. The primary reason this is in the text is that the authors are trying to eliminate the too-big-to-fail (TBTF) model that exists today. Clearly, because of the systemically important role these two companies serve, in today's world you could not let one fail as it would have a significant adverse impact on the economy. Having multiple (more than two) guarantors would create an environment in which it would be possible to let one guarantor fail, as there will be other guarantors who could fill in the void. We saw this in the mortgage insurance business where MI companies failed during the crisis.

A secondary benefit I can see as a former lender is that real competition, vs the managed market share of the duopoly model, will create far better price transparency and eliminate the "no bid" risk that many lenders fear today when challenging a GSE on an issue. Whether real or imagined, lenders tell us that they often feel like they have to walk on eggshells when challenging a GSE, as they cannot risk being frozen out of a relationship when there are no competitive options to turn to. Eliminating TBTF and the duopoly are the primary reasons why thinking has coalesced around the multiple guarantor model.

2. The draft legislates a permanent level playing field. This is an important win and one the MBA has steadfastly called for. Our task force had 24 multifamily and single family firms represented. Small lenders, non-bank lenders and regional lenders made up the vast majority, and ensuring a level playing field for the long term was a clear priority. The draft legislative text clearly requires that the regulator ensure the same pricing and credit terms for all lenders regardless of business model or size. There is no protection for this level playing field anywhere else in the current system today and we are entirely dependent on the FHFA director to protect this equality. This legislation guarantees the level playing field regardless of who is running FHFA. Further leveling the playing field, the bill preserves the cash window, which is extremely important to the smallest sellers especially community banks, small credit unions, and small IMBs. The legislative draft language dedicates a lot of text to this issue and the

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next.

3. The bright line between the primary and secondary mortgage markets established in the draft eliminates vertical integration by large lenders. The bill would place significant limitations on the extent to which Guarantors could have any direct or indirect affiliation or connection with originators. Additionally a guarantor cannot be a lender. The primary market participant cannot also be a secondary market guarantor in the new regime. This eliminates the vertical integration/bright line risk that MBA and others identified in the previous legislative attempts.
4. All the guarantors' production will flow into a single security issued off the Common Securitization Platform (CSP). This insures parity of execution regardless of size of the guarantor, as all flow assets will be fungible and aggregated together in a single common coupon issue. This is designed as a marketplace leveler for the guarantors allowing the "de-novo"s the ability to better compete with the spinoffs from the legacy GSEs.
5. Affordable housing is actually a big winner in the draft. Estimates of bill's impact suggest that the actual dollars for the aggregate subsidy could increase by about \$1 billion over the subsidy in the goals structure contained in the current system. Furthermore it specifies that the subsidy must be used for first time buyers at or below 100% of area median income (AMI) or other borrowers at or below 80% of AMI. In the current goals regime, most subsidy is used in the LLPA construct which is FICO based, meaning some of the subsidy can go to higher income borrowers who may not need it. While "duty to serve" is a concern, the money is a win and working through this text with other consumer advocates could prove fruitful in a later draft.
6. All data and mortgage underwriting technology becomes the property of the regulator, making access to the markets by a new guarantor far easier. Additionally, FHFA regulates the outer boundaries of the credit box which ensures that loan quality will remain stronger in comparison to what the GSEs did to compete with the PLS markets prior to conservatorship.
7. Loan limits are set at about the exact place they are today. This is written in the bill..

There is much more to the draft text that was leaked but it is important to make clear that the model actually works towards a level playing field for all

lenders and not just those who might be able access the capital markets in a more sophisticated manner to their own benefit.

I realize that there is a lot of anxiety associated with any change, but we are beyond that. In the year ahead we will be faced with a new FHFA director who may have a very different view about the role of the government in housing, and may come with different perspectives about who participates and how they participate. Bank vs non bank, servicing retained or sold, and more could potentially be viewed very differently. In the absence of workable legislation, this administration has made clear that they intend to resolve this conservatorship. Given that a government guaranty can only come through legislation, administrative reforms could be even more disruptive. This is complex stuff, but this draft text has some good framework that could be the best of all options. We will keep an open mind, stay active in the discussions, and hope to find others with a rational view who can align with us in this effort.

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