GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market

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MBA.ORG/GSEREFORM

The MBA Task Force

In March 2016, MBA convened the Task Force for a Future Secondary Mortgage Market:

- Comprised of 22 individuals representing institutions spanning a wide range of sizes and business models
- Spent over a year considering and debating many potential models in developing its recommendations for a new secondary market system, from the formation of a government-owned corporation to restoration of the GSEs to their pre-crisis forms
- Included two working groups specifically devoted to affordable housing and transition risks—issues that have stalled prior reform efforts
- Released its final recommendations in the form of a detailed white paper, *GSE Reform: Creating a Sustainable, More Vibrant Secondary Mortgage Market*, in April 2017

Why We Need GSE Reform

- Long-term conservatorship is politically and economically unstable
- Ending conservatorship must start with reform first
- Government and private sector roles in the market need to be re-balanced
    - Fix structural flaws in the pre-crisis system (e.g., implied guarantee)
    - Protect taxpayers from future bailouts
- Ensure continued liquidity for mortgage credit through all economic cycles
- Support expanded affordable housing opportunities

GSE Reform: Balancing Multiple Priorities

- Taxpayer Protections
- Investor Returns
- Consumer and Borrower Costs/Access to Credit

Key Principles

- Preserve what works: 30-year, fixed-rate, single-family mortgage; TBA market; and long-term multifamily financing options
- Minimize transition risks to avoid market disruptions
- Leverage competition and existing infrastructure
- Ensure liquidity through all economic cycles
- Explicit guarantee of eligible single-family and multifamily MBS only
- Increased levels of private first-loss capital ahead of taxpayers
- Strong capital supervision and regulation of activities
- Promote competitive primary market for lenders of all sizes/models

Guardrails

- New system must work within certain guardrails and protections
- Guardrails intended to address risks to taxpayers and consumers as well as the stability of the housing finance system:
  - **Structural Requirements** to govern the framework for the new system
  - **Prudential Standards** that protect taxpayers
  - **Market Conduct Regulations** that maintain transparency and ensure a level playing field for market participants

Structural Requirements

- End state to allow for two or more Guarantors
- Regulator authorized to charter new guarantors: single-family, multifamily or both
- Guarantors to be monoline: may not be owned/controlled by lenders
- Guarantors to disperse credit risk to private sector: front- and back-end
- Guarantors to purchase catastrophic risk insurance from Mortgage Insurance Fund
- Guarantors to issue Single Security through CSP for single-family market
- Utility-style regulation: regulated returns balance investor, lender and consumer interests

Prudential Standards

- Regulator to have robust powers over capital requirements and Guarantor risk-taking activities
- Single-family loans eligible for purchase and inclusion into guaranteed MBS must meet QM-like standards
- Multifamily eligibility standards consistent with today's requirements
- Guarantor investment portfolios limited to support cash window operations, delinquent loan repurchases, loss mitigation activities and limited multifamily assets
- Guarantors that reach a certain size could be subject to SIFI-like regulation

Market Conduct Regulations

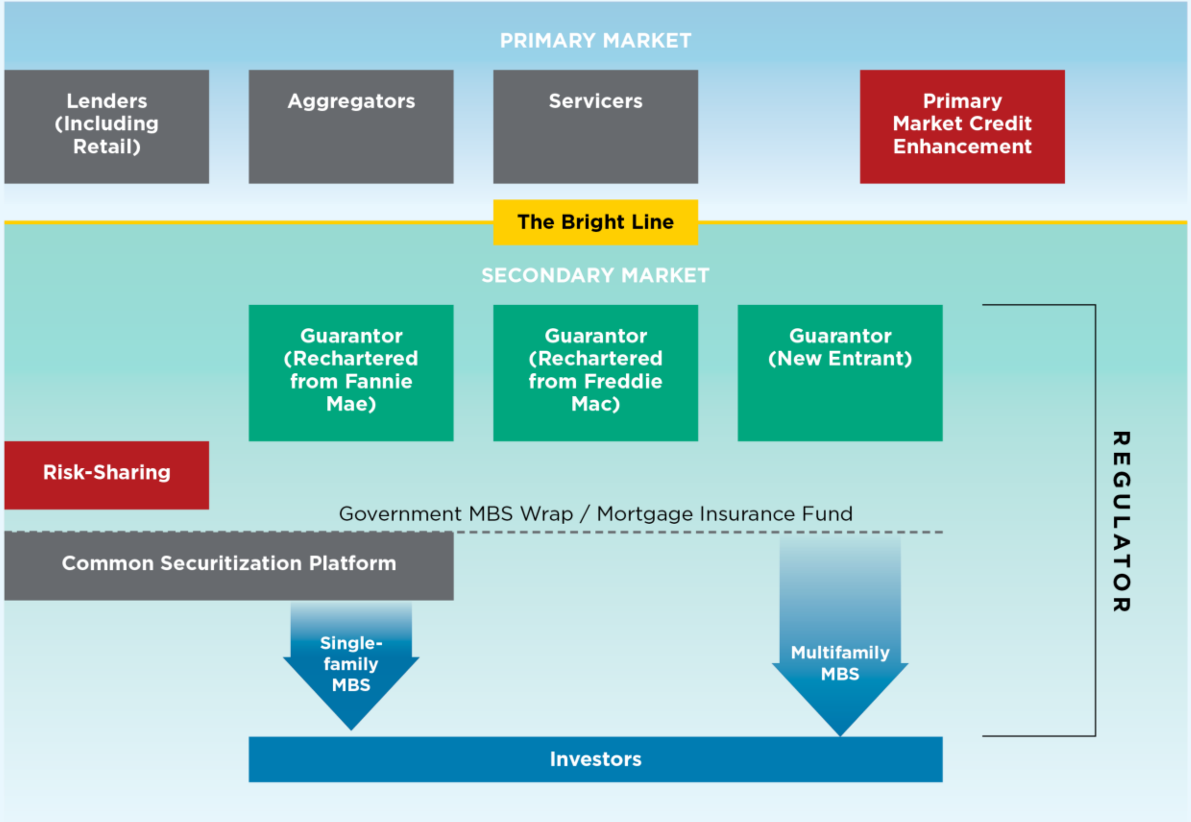
- Utility Regulation: Concept of “regulatory compact” requires market conduct regulations to protect interests of utility customers – e.g. seller/servicers
- Guarantor charters should expressly maintain the “bright line” between primary and secondary markets
- Regulator to ensure Guarantors maintain equitable and transparent single-family guarantee-fee and underwriting standards (e.g., no special deals based on size/volume)
- Guarantors will be required to maintain both cash window and MBS execution options
- Guarantors will be required to maintain an affordable housing strategy based on both single-family and multifamily activities

Small Lender Access: How the MBA Plan Protects it

- Key aspects of the MBA's Principles and Guardrails are specifically designed to ensure that the new system is required to serve smaller lenders in a fair and equitable manner (see page 6 of the Report for a breakout on the importance of small lender access):

  - Require as part of the "regulated utility compact" that the regulator ensure equitable, transparent and direct access to secondary market programs;
  - Prohibit g-fee pricing based on loan volume or asset size of single-family lenders;
  - Preserve cash window and small pool execution options for smaller lenders, with options for selling servicing retained or released;
  - Maintain the "bright line" to ensure that Guarantors do not compete directly with lenders;
  - Prevent vertical integration by prohibiting lenders from owning or controlling a Guarantor; and
  - Establish a transition process designed to maintain key infrastructure of the current system – people, processes and technology – to minimize disruption risks and "switching costs"

End State Model



The Affordable Housing Plan

Overall Affordable Housing Objectives:

- Meet the needs of the full continuum of households, with Guarantors primarily engaged in the markets for affordable rental housing, affordable homeownership and TBA-conforming loans
- Provide responsible, sustainable access to credit for prospective homeowners
- Provide liquidity for the development and preservation of affordable rental housing
- Improve liquidity for segments of the market that are currently underserved

Guiding Principles:

- Preserve what works
- Enhance/improve what doesn’t – support market, don’t distort it
- Harmonize federal housing policy

The Continuum

- Core GSE purchase activities
- GSE can partner as debt buyer; other direct funding required
- Private market

AMI — Area Median Income

Affordable Homeownership | **TBA Conforming** | **Prime Jumbo**

Affordable Rental (with and without subsidies) | **Moderate Income and Market-Rate Rental**

30% AMI — **50% AMI** — **80% AMI** — **120% AMI**

EXISTING PROGRAMS

- LIHTC
- Section 8
- HOME
- National Housing Trust Fund
- CRA

- GSE MF targeted programs
- LIHTC
- CRA

- GSE high LTV SF purchase programs
- GSE MF activities
- FHA/VA/USDA
- CRA

- GSE core SF purchase activities
- GSE MF activities

- Private market
- Outside SF government eligibility

Defining Success

- End the implicit guarantee; replace it with an explicit guarantee on eligible MBS only; pay for it with premiums to the Mortgage Insurance Fund
- Protect taxpayers by putting more private capital at risk
- Establish strong capital requirements and enhanced regulatory powers
- Strengthen affordable housing policy consistent with a holistic national housing policy
- Ensure a level playing field and a strong, diverse primary market
- Heighten competition through new entrants, or the threat of new entrants
- Minimize transition risks – leverage what works
- Maintain the liquidity and stability of primary and secondary mortgage markets, for both single-family and multifamily mortgages

What's Next?

- Senate will move first – has already started what will be an expansive series of hearings
- House will follow…
- Key differences from 2014 (Johnson-Crapo):
  - White House will be fully engaged
    - + Active working group within the Administration on "Housing Finance Reform" (not just GSEs)
    - + Treasury will be involved but White House will drive process
  - MBA/FHFA transition steps – CRT, Single Security, CSP – have "shortened the field" and reduced complexity
  - Other trades and think tanks have begun to align around key elements in the MBA Plan
- An aligned and engaged industry will be critical to success – need to speak with ONE VOICE

GSE Reform: Quick View

	GSEs PRE-Conservatorship	GSEs IN Conservatorship	Guarantors (MBA Model)
Investor purpose	Growth stock returns/risks	Conserve assets	Utility-level returns/risks
Government backing of MBS	Implicit government guarantee	Explicit government guarantee	Mortgage Insurance Fund (MIF) funded by premiums paid, backed by explicit government guarantee
Government backing of corporate debt	Implicit guarantee	Explicit guarantee	No guarantee
Regulatory limitations on pricing	No	Yes	Yes
Retained investment portfolio	Large	Reduced	Minimal
Capital standards	Low capital levels on both retained/guaranteed risk	Reduce capital cushion to zero by 2018	Enhanced Guarantor capital standards
SF risk transfers to private market	Front-end only (MI and lender recourse)	Testing back-end structures in addition to front-end	Deeper front-end and back-end
MF risk transfer to private market	Lender Risk Share	Lender and Capital Markets Risk Share/Transfer	Lender and Capital Markets Risk Share/Transfer
Number of entities	Two	Two	Two or more
New Guarantor entrants permitted	No	No	Yes
SF lender access	Preferential pricing and underwriting by loan volume	Guarantee fee and underwriting variances restricted	Prohibit guarantee fee and underwriting variances based on volume
Support for single-family TBA market	Yes	Yes	Yes
Support for multifamily finance	Yes	Yes	Yes
Preserve operational infrastructure and processes	Yes	Yes	Yes
Affordable housing mission	Yes	Yes	Yes

Contact Information & MBA Resources

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