AMERICAN BANKER

GSE Reform Bill Quietly in Works Under Sen. Corker

By: Donna Borak and Victoria Finkle – May 24, 2013

A bipartisan group of senators led by Sen. Bob Corker, R-Tenn., is drafting legislation designed to reform the housing finance system, including a plan to wind down the government-sponsored enterprises.

The proposal has been deemed by some as an "ambitious solution" to Fannie Mae and Freddie Mac, which were seized by the government in September 2008, and is widely expected to mirror a recent proposal aired by Edward DeMarco, acting director of the Federal Housing Finance Agency.

"Senator Corker is involved in meaningful conversations with his colleagues to develop a sustainable and pragmatic housing finance model that would finally resolve the GSEs, and he is hopeful that we can deal with this issue in the next few months," said Laura Herzog, a spokeswoman for Corker.

Corker hinted at a Senate Banking Committee hearing in April that his office was collaborating with other lawmakers on a GSE bill that could be in place "very, very soon."

"Corker confirmed in April that a number of Senate offices were working together on a bill, and I think Corker and [Sen. Mark] Warner in particular, have given strong hints in their most recent hearing on the subject that they are active on the issue and deep enough into the details to have a bias as to the direction they are favoring," said Jeb Mason, a managing director at the Cypress Group.

Representatives from the offices of Sens. Warner, D-Va., Jon Tester, D-Mont., David Vitter, R-La., confirmed they are working with Corker on GSE reform legislation. "We'll have more to say in a couple of weeks," said Beth Adelson, a spokeswoman for Warner.

Other Senate Banking Committee members are likely to join the effort as well.

Sens. Corker, Warner, Vitter and Elizabeth Warren introduced a bill in March that would prevent the government from using any increase in guarantee fees by Fannie and Freddie to offset government spending. It would also ban the sale of preferred shares of the firms without congressional approval.

The new proposal is expected to build on a suggestion first outlined by DeMarco earlier this month, which called for the creation of a specially-chartered financial institution that would pool capital from shareholders and guarantee principal and interest payments to mortgage-backed securities holders. The model is similar to Fannie and

Freddie's pre-conservatorship model, but would likely swap an implicit guarantee for an explicit one or set up government insurance structures to address certain challenges.

The concept, known as the issuer-guarantor model, could also be supplemented with a structured securities-based model advocated by the Bipartisan Policy Center, according to Karen Shaw Petrou, a managing partner at Federal Financial Analytics.

Ed Mills, a financial policy analyst at FBR Capital Markets and former Hill aide, said there are a lot of lawmakers who are very supportive of DeMarco's approach, which also comes at a time when there is growing consensus on both sides of the need for housing finance reform.

"I would expect if there is something introduced, it would track very similarly to what Ed DeMarco is putting into place," said Mills. "All are coalescing around some of the similar ideas of preserving the government's role, preserving the government's guarantee, but transferring a lot of the credit risk from the entity that is providing that guarantee to a form of private capital, or mortgage insurance, or direct infusement of people being willing to guarantee principal interest rate risk."

DeMarco has already taken some steps toward GSE reform, though there is a limit on what the FHFA can do on its own. He is pushing Fannie and Freddie to create a unified back office that would establish a standardized securitization platform which could be spun off into its own entity. That would maintain the infrastructure of Fannie and Freddie, but pave the way for more substantive reforms by Congress.

"Ed DeMarco is teeing up GSE reform for Congress," said Mills. "It will take a few years, but once he's done the hard work, Congress will absolutely step in and complete the final few steps of this reform process."

For now, it seems senators are keen to find ways to implement DeMarco's vision legislatively.

In a note to clients, Federal Financial Analytics said the draft bill from Corker and other lawmakers would likely impose stricter regulations on any mortgage-backed guarantors that are structured as cooperatives. It would likely provide the issuer guarantors with an explicit government backstop, similar to the Federal Deposit Insurance Corp. and be paid for through premiums to the government. It would also layer in risk tranches ahead of the government's catastrophic-risk guarantee, which means that the government would pay only after all the tranches are played through, rather than serving as an upfront payout to investors.

In many ways, this approach tracks with a plan laid out by two Federal Reserve Board economists, Wayne Passmore and Diana Hancock, who have suggested a government backstop for all asset-backed securities by creating a catastrophic insurance fund for mortgage-backed securities.

Analysts say the prospects for reform appear to be steadily improving despite concerns that Fannie and Freddie's renewed profitability could weaken Democratic support for an overhaul. The two GSEs have made significant payments to the Treasury Department in recent months, helping to both lower the U.S. budget deficit and serve as an interim buffer on the country's debt ceiling.

"I don't think the payments from the GSEs into the Treasury will have a meaningful impact on slowing reform down, in fact they seem to be speeding it up," said Petrou.

Mark Calabria, director of financial regulation at the Cato Institute, said policymakers can do two things at once: enjoy the economic benefits from the GSEs' recent profitability, while also reforming the two companies.

"Any sort of wind-down implies some number of years, and so you could certainly wind down over the next five years, and during those five years continue to capture the profits that come from them," said Calabria.

That is especially true given the possibility that Fannie and Freddie's earnings could reverse, since the housing market recovery is not robust and both firms are subject to interest rate risk.

"This is not a free lunch with a promise now of five years of X billion to the Treasury; it could go back the other way," said Petrou.

Obama's nomination of Rep. Mel Watt, D-N.C., as director of the FHFA, has also put the spotlight once again on the issue of GSEs.

"There's a lot of activity," said Petrou, who cautioned that passing any reform bill would be difficult. "The president has finally sent the nomination for permanent FHFA director up. That will force a lot of focus on the GSEs. Republicans have said they won't consider Mr. Watt without a plan, and I think that puts the administration on notice to have a plan, which I gather folks are starting to talk about."

Still, given its early stages, the state of play and ability to strike a deal remain murky.

Democrats are hoping to confirm Watt, who will replace DeMarco, while also finalizing a bill by Sens. Barbara Boxer, D-Calif. and Robert Menendez, D-N.J., to help families refinance their mortgages to capture historically low interest rates. Republicans and the industry are strategizing about what they could get in a compromise deal, such as changes to the qualified mortgage rule or even the structure of the Consumer Financial Protection Bureau.

"People are trying to figure if there's a package of all these different issues that can gain enough bipartisan support to get out of the committee, and I think one can see among the things on the table, such a potential if there's truly enough motivation on everyone's part," said Mason.

Thus far, the White House has kept out of the fray and has forgone releasing its own plan beyond three options it outlined several years ago.

"A key driving force, at least politically, for the White House is to not get too specific about a GSE reform plan, because they don't want House Republicans being able to coalesce around being against something, which is the nature of reacting to whatever the

White House would put out," said Mills. "They would rather see congressional Republicans fight among themselves what the best plan forward is and let DeMarco do what he's been doing in his strategic vision."

But the fact that the White House has steered clear of weighing in on any path to GSE reform is seen by some as an invitation to hold Watt's nomination as hostage for other demands.

"The thing to do would be to put out a GSE reform paper," said Mason. "I can't understand why you don't do that. I think they've made a determination that if we're talking about GSEs, we're losing, but in nominating Watt you're going to talk about it whether you want to or not. If getting Watt installed was a huge priority, I think they would release a paper."

Others suspect part of the reason may be the broad consensus, including the administration, on the strategic plan laid out by DeMarco.

"Even the people who criticize DeMarco on principal writedown don't criticize him on his strategic plan, and that's what's striking," said Philip Swagel, a former Treasury official during the Bush administration, who is now a professor at the University of Maryland's School of Public Policy. "The administration is so quick to criticize him, but they aren't criticizing him on this so implicitly they must agree with him on the substance."