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Corker-Warner's Bill May Break Logjam on GSE Reform

By: Donna Borak and Victoria Finkle – June 10, 2013

After years of housing finance reform efforts languishing in Congress, a draft bill by Sens. Bob Corker, R-Tenn. and Mark Warner, D-Va., appears poised to become the catalyst for finally moving ahead on a way to overhaul Fannie Mae and Freddie Mac.

Building off of themes that have circulated in Washington since the government's takeover of the two government-sponsored enterprises in September 2008, the two senators have attempted to put those concepts into legislation, offering an opportunity for what some are calling an "honest conversation" about GSE reform.

Observers and many in the industry are already hailing the draft bill, which was initially leaked online last week, as one of the first serious attempts at GSE reform.

"The fact that this is likely the first bipartisan legislative initiative that's fairly robust, you have to pay attention to it," said David Stevens, chief executive of the Mortgage Bankers Association and former head of the Federal Housing Administration. "Whether this is the final solution or the beginning blueprint for what could be a solution after a long debate, it is a step in the right direction."

He was echoed by Jim Tobin, senior vice president of government affairs for the National Association of Home Builders, one of the key groups in the debate.

"Any time you can get bipartisan support, it shows that's a serious effort to reform the GSEs and we look forward to working with everyone involved and adding more to the details as they roll it out," he said.

In drafting their proposal, both senators "tried to shoot for the middle, where they could draw broad bipartisan agreement" even if there were areas - like a government guarantee - where some lawmakers might be skeptical, said Mark Calabria, director of financial regulation at the Cato Institute.

"You could argue that this falls pretty much in line with what the insiders in Washington -- the advocacy groups and the mortgage banking industry - kind of want," said Calabria, citing the Mortgage Bankers Association, Center for Bipartisan Policy, Center for American Progress and others. "It's very consistent."

Although it is unlikely that Congress will pass any reform bill this year, the fact that a discussion is now occurring offers some hope for 2014.

"If there were an absence of an effort like this come August, I think we could conclude GSE reform is not happening this Congress," said Jeb Mason, a managing director with the Cypress Group. "If you don't start getting some decent discussion around some parameters that can attract bipartisan support, there's just not enough calendar left before you get into the silly season of midterm elections."

The plan by Corker and Warner would unwind the government-sponsored enterprises, expand the role of private mortgage insurers and install a government backstop that would offer a common securitization platform and provide catastrophic re-insurance.

Fannie Mae and Freddie Mac would be replaced with a new system under which private market entities would purchase loans from originators, bundle them and provide credit guarantees. The private entities would be in a first loss position, but there would be a government guarantee for catastrophic losses.

The bill also leaves a significant number of questions unanswered that will shape the debate over the coming months, including whether private capital is ready to return to the mortgage market, the value assigned to junior preferred shares and what role the Federal Home Loan Banks will play.

"Is there enough private capital to come back in and take on the credit risk that they contemplate?" said Ed Mills, a financial policy analyst at FBR Capital Markets and former Hill aide. "Is there enough of a portfolio to ensure that smaller lenders have the ability to continue to make mortgages or are only the largest lenders going to be big enough to do their own securitization to take on that first loss provision? At one point does this bill shut off the dividend payments to Treasury and start allowing the paying down principal on the senior preferred?"

Stevens of the MBA raised other questions.

"Who's the regulator and how big is the regulator and how much gets done by private capital?" he asked. "Capital structure and credit enhancement structures are important. Access to lenders of all sizes, large and small is important - who has access to a secondary market system? How is affordable housing protected and does it ensure a pathway for that?"

The 112-page draft bill is also likely to change significantly, especially if Sen. Tim Johnson, D-S.D., the chairman of the Senate Banking Committee and ranking member Sen. Mike Crapo, R-Idaho seek to put their own spin on a broad housing finance reform package.

Representatives from both offices declined to comment on the draft bill.

"Chairman Johnson and Senator Crapo are absolutely going to want to put their own mark on GSE reform," said Mills. "But it's this balance between having the appropriate level of input based on their leadership positions versus the need and desire to get a bipartisan consensus within the committee to have any shot on the floor."

Some said that Johnson and Crapo would be likely to play off many of the ideas in the Corker-Warner bill while also making significant alterations.

"Despite the amount of effort by the staff and members, Corker and Warner, are putting on this, for this to get out of the committee it will be substantially rewritten in many ways," said Calabria.

Speaking at a banking conference on Tuesday, Crapo said discussions were already underway to work with Johnson on a standalone bill to fix the FHA, which would then be followed by a broader reform bill to deal with Fannie and Freddie.

Still, it remains unclear whether Johnson, who plans to retire at the end of next year, will seek to make GSE reform his legacy bill and help drive this process forward.

"Clearly, the previous chairman had Dodd-Frank. He's been a chairman at a time when Congress has been unable to do much of great significance legislatively. Does the opportunity to do something to cement his legacy push him more towards cutting a deal to get this done?" said Mills. "I think that could be a wild card in that discussion."

It's also unclear just how much support there could be for the Corker-Warner approach. Sens. Jon Tester, D-Mont. and David Vitter, R-La. have both previously confirmed they are working with Corker and Warner on their GSE reform legislation.

"They were still in the process of trying to build support," said Calabria, before the draft discussion bill was released. "I don't think they're at the point where they have a number of people signed on. But I certainly think they've gone out of their way to give things the Jack Reeds of the world would want. I could see most of the Democrats being comfortable with where this goes. The question is how many Republicans can you get on board?"

Brandon Barford, a vice president at ACG Analytics, said both lawmakers may have overlooked the political complexities of bridging consensus.

"They are aiming to produce a good bipartisan piece of policy, but I think they underestimate the political dynamics - most of the Republican caucus would prefer not to have any government guarantee and most Democrats are more concerned about how any reforms impact consumers, rather than getting private capital back into the market for the sake of doing so. As of now, they are a caucus of two."

Even so, both senators, who have been described as moderates and savvy businessmen, were able to strike some balance on a variety of critical issues in the hopes of drawing support from the majority of stakeholders.

For example, hoping to avoid debates over a single director, which has delayed Richard Cordray's nomination to head the Consumer Financial Protection Bureau, the senators opted for a similar board structure as the Federal Deposit Insurance Corp.

"Proposing it to be similar to the FDIC avoids some political backlash that might occur if they promoted a more novel governance structure," said Tom Deutsch, executive director of the American Securitization Forum, which published an online version of the bill on their Web site. "Given all the potential controversies around GSE reform, an area like having a governance structure similar to the FDIC, where they can avoid controversy, will serve the development of this bill well."

Adding heft to the bill, they also included a mechanism designed to promote affordable rental housing, which is likely to be a very controversial aspect of the legislation.

"The fact that this draft bill includes provisions on affordable housing is going to agitate many conservative Republicans," said Barford. "But it also shows that it's a serious bill, because if it didn't include that type of provision, it would have no chance of becoming law. It would never even get considered by the Democratic-controlled Senate or the Obama administration."

Barford also noted that certain provisions in the bill that are likely to affect private mortgage insurers, investment banks involved in securitization, as well as traditional banks involved in servicing, will "satisfy consumer activities and investor groups that have complained about poor servicing, problematic pooling and servicing agreements, and the safety risks of monoline insurers."

The bill also includes an exemption for some high-cost areas when it comes to the reducing the conforming loan limit to $417,000 down from $625,000 over a six-year period. Doing so would foster support from lawmakers in high-cost areas like New York and California, said Deutsche.