Ginnie Mae or CSP? Why it Matters for GSE Reform

MBA's GSE Reform Plan Fosters a Level Playing Field and Preserves Critical Market Infrastructure

Key points:

1. Maintain a bright line between the primary and secondary markets, and promote a strong, diverse primary market to ensure a level playing field for lenders
2. Preserve the existing infrastructure to minimize market disruption.
3. These key principles ultimately benefit borrowers, while alternative choices with respect to system design may result in less competitive mortgage markets.

MBA's proposal for legislative GSE reform was developed by practitioners – mortgage industry executives with hundreds of years of experience in the primary and secondary mortgage markets from companies that represent the great diversity of our mortgage markets. It is based on a set of principles that lenders believed are critical to the success and stability of the mortgage market.

Importantly, a consensus has emerged regarding the benefits of moving to an explicit federal guarantee on mortgage-backed securities (MBS). However, differences remain on how that guarantee should be delivered. A key question is whether the "plumbing" of the system should be composed of federally chartered competitive guarantors, who are solely involved in secondary market activities including securitization through a common securitization platform (CSP), or whether instead the system should be composed of a larger set of lender-issuers who would issue Ginnie Mae securities. It is useful to examine this choice, and its impact on other key principles enunciated in MBA's proposal and on which there is also broad alignment:

1. Ensure that there is a bright line separating the primary and secondary mortgage markets.

For decades, MBA has advocated for a bright line separating primary and secondary segments of the conventional, conforming mortgage market. By maintaining the bright line, lenders operating in the primary market can compete for business, to the ultimate benefit of homeowners, without being faced with a federally-backed competitor who operates on both sides of the market, and can thereby utilize market power in one segment to control market share in another. MBA believes that the market would function better over time and would enable a more competitive primary market with the bright line intact, thus MBA's proposal calls for multiple, competitive guarantors -- secondary market entities who are prohibited from originating mortgages or engaging in other primary market functions.

By contrast, a Ginnie Mae model intentionally crosses the bright line by having primary market lenders also be the issuers of securities, with Ginnie Mae providing the government full faith and credit guarantee. This approach would ultimately result in a market dominated by larger lender-aggregators who could successfully operate in both the primary and second markets.

2. Promote a strong, diverse primary market through a level playing field for lenders of all sizes and business models.

In addition to the bright line, it is imperative that lenders of all sizes and business models can access the secondary market on equal terms. In MBA's model, this would be achieved by requiring guarantors to price at the loan level for mortgage credit risk, rather than volume-based pricing which inherently benefits larger lenders. Moreover, guarantors could not provide special credit variances or other unequal access to their favored customers. Finally – and perhaps most importantly – guarantors would be required to provide a cash window and allow lenders to sell loans on a servicing released or retained basis. This allows small community banks, credit unions and independent mortgage bankers to retain direct access to the federally supported secondary market rather than selling through aggregators who are also competitors.

A Ginnie Mae model would have challenges meeting this principle. While larger lenders with the access to ongoing liquidity would have the ability to become issuers, smaller lenders would not. Evidence of this is that while Fannie Mae and Freddie Mac each have over 1000 lenders selling directly to them, there are only about 320 Ginnie Mae issuers, and even fewer active issuers. Lenders with direct access to the secondary market would have a competitive advantage relative to those who would be forced to sell into aggregators.

One response to this concern would be to have Fannie Mae and Freddie Mac act as aggregators for lenders who cannot or do not wish to become direct issuers. However, this is not a sufficient response, as it would permit larger lenders to arbitrage between two alternative executions, direct issuance and selling to Fannie and Freddie, while smaller lenders would be stuck with a single channel. In effect, this would allow those lenders large enough to become issuers to breach the bright line and operate on both sides of the market, while those without sufficient scale would be severely disadvantaged.

3. Minimize transition risk by preserving the existing infrastructure

The conventional conforming segment of the mortgage market is one of the largest and most liquid markets in the world totaling about five trillion dollars in outstanding MBS. Maintaining the unparalleled liquidity in this market is an essential requirement of any reform plan. Thus, MBA's proposal advocates limiting changes to those necessary to remedy flaws in the prior system, while preserving key infrastructure to minimize any potential disruption in this critical marketplace.

One crucial piece of infrastructure, the CSP, has been built over the past several years while the GSEs have been in conservatorship. Rather than rebuild both GSEs' antiquated back office securitization systems, FHFA directed them to work together to build the CSP on a modern, scalable platform. Freddie Mac has been issuing their PCs off of this platform for a year now, and Fannie Mae is scheduled to begin issuing off of the platform by the second quarter of 2019. This infrastructure is now ready, operational, and in the midst of final testing while market participants ready themselves for the switch to the single security. This multi-year build has been costly and complex, but the end result should be a stable platform which could accept additional guarantors in the future.

By contrast, moving to a Ginnie Mae model at this point would require an entirely new build, as Ginnie Mae's systems are not designed for the conventional market, either in terms of scale or with respect to the structure of the securities. And from an operational standpoint, it's not clear what benefits would be created from forcing the market to an entirely new securitization infrastructure.

Moreover, Ginnie Mae as an entity is not currently configured to take on such a role. Ginnie Mae relies upon FHA, VA, and USDA to cover credit losses, and relies upon its issuers to manage the cash flows of the securities. Ginnie Mae acts only in the event that an issuer fails. Fannie Mae and Freddie Mac have a much larger role in terms of counterparty risk management in the conventional space.

MBA's GSE reform proposal, informed by lenders of varying size and business model, was designed to maintain a bright line between the primary and secondary market, to ensure a competitive and dynamic primary market, and to minimize any potential market disruption as we move forward with reform. It is important for policymakers to understand that these key principles ultimately benefit borrowers, and that alternative choices with respect to system design may result in less competitive mortgage markets dominated by larger lenders.