

GSE Reform: A Credit Union Viewpoint



GSE BACKGROUND

The GSEs operated for decades as private companies, and have always operated under a congressional charter to provide a liquid secondary market for common types of home loans. They do this primarily by providing a guarantee of the timely payment of interest and principal to investors in mortgage-backed securities (MBS) comprised of loans they purchase from lenders.

The guarantee supports the deep, liquid global market for U.S. MBS, and benefits homeowners through lower mortgage rates and the availability of popular mortgage products, such as the 30-year fixed-rate loan.

The GSEs failed financially during the housing crisis of 2008—partly due to relaxed credit standards, partly due to large investments in subprime mortgage assets. To that point in time, the GSEs' guarantee was viewed by MBS investors to be an implicit assurance of the U.S. government. Ultimately, this view was proven correct.

When the GSEs failed in 2008, they were placed into conservatorship and the federal government made their guarantees to MBS investors explicit. Whether or not the government should provide such guarantees is one of the two main issues in the current

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The housing finance system is critical to credit unions and their members. Fannie Mae and Freddie Mac (government-sponsored enterprises, or GSEs) enable credit unions to obtain liquidity—beyond their balance sheets—to originate new mortgages for their members. And they provide this liquidity with unique features that benefit credit unions.

For instance, GSEs buy on a loan-by-loan basis while allowing sellers to retain the right to service after the sale, and they do not consider a seller's volume in determining pricing.

Credit unions need to be aware of the fast-moving discussions unfolding in Washington, D.C., on the topic; some proposals may place smaller lenders, like credit unions, at a distinct disadvantage.

debate. The other is the degree to which affordable housing should influence their mandate.

CURRENT DISCUSSIONS

The taxpayer currently stands behind the guarantees issued by the GSEs, but the Treasury also collects the profits they earn (almost \$300 billion while in conservatorship).

Since 2008, their regulator, the Federal Housing Finance Agency (FHFA) has increased oversight, reigned in their riskiest activities, and enabled the GSEs to issue a new kind of security transferring risk of loss to willing investors, thereby mitigating substantial possible losses to taxpayers.

Some argue that with these changes, the current system is working well. And given the risk to housing and the economy from unintended consequences of reform, why drastically change it?

Because the GSEs are critical sources of liquidity for credit unions, some industry advocacy groups have urged congress to enact GSE reform to ensure a lasting government-supported level playing field for small lenders. But given current political dynamics and the complexities involved, this appears unlikely to happen in the near future.

Because legislative action is improbable, the Trump Administration and the newly confirmed FHFA Director are considering actions that do not require congressional approval.

Most notably, the FHFA Director has discussed allowing the GSEs to build (and perhaps raise) capital that would make releasing them from conservatorship possible. Once privately owned again, MBS issued by the GSEs would no longer carry an explicit government guarantee for investors.

Further, the FHFA Director has discussed limiting the types of mortgage loans the GSEs can purchase, possibly eliminating or restricting

cash-out refinances, second home mortgages, and investor-property loans.

Again, the government's role in housing finance is an important public policy issue, and there are many valid considerations and points of view. But there is little doubt that such actions will reduce the competitiveness of the GSEs and probably those smaller lenders that rely on them.

For example:

- Private capital standards being discussed (for example, 4%) will require the GSEs to earn higher returns, which will result in higher mortgage rates for borrowers.
- Limiting the types of loans that the GSEs can purchase will reduce their overall scale and profitability, resulting in higher mortgage rates for borrowers.
- Eliminating the explicit government guarantee for GSE-issued MBS (by returning the GSEs to private ownership) would increase credit risk to investors and decrease overall demand, again leading to higher mortgage rates for borrowers.

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CREDIT UNION PERSPECTIVE

Many secondary market participants believe private capital in the secondary market will step in as a viable alternative should FHFA actions render the GSEs less competitive, and that may well be true. But private secondary market options are very different for smaller lenders, like credit unions, than selling to the GSEs today.

For instance:

- It is unlikely that private secondary market outlets will allow credit unions selling on a loan-by-loan basis to retain the right to service after the sale.
- The volume of loans sold to

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private market participants would almost certainly affect the price credit unions would receive, unlike with the GSEs today. This would place most credit unions at a competitive disadvantage compared with larger lenders.

Of course, credit unions have the ability, like other financial institutions, to hold loans on balance sheet. But that capacity is limited, and they can't raise external capital to grow their balance sheets. So a level playing field in secondary market access will remain critical to their role in servicing their members' mortgage needs.

Reducing the risk to taxpayers from housing finance may be a popular philosophical viewpoint, but it likely will hurt credit unions' ability to compete and serve their members.

In general, what makes GSEs less competitive will make credit unions less competitive. ▲

Greg Spurgeon serves as Senior Vice President of Secondary Marketing at TruHome Solutions, a mortgage CUSO providing a full range of private-label services to credit unions nationwide. In his role, Spurgeon is responsible for providing credit unions with easy, efficient and competitive access to the secondary market so they have the ability to grow their mortgage lending program.



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BECOME AN ADVOCATE

ACUMA encourages discussion on important topics, such as GSE reform. The views expressed in the accompanying article are Mr. Spurgeon's. However, they raise important questions about the future of mortgage lending for credit unions. ACUMA encourages you to consider this important topic and make your voice heard by contacting your congressional representative, the FHFA and the White House.