Residential Mortgage Securitization: Recent Policy Developments

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Private-Label Mortgage Securitization

It is well understood that the recent US housing crisis triggered a global financial crisis and was a driving force behind the Great Recession.

One of the first significant episodes of the financial crisis occurred in August 2007 when the entire non-Agency mortgage securitization sector ground to a virtual halt.

- Massive market value declines and rating agency downgrades.
- Affected the so-called “jumbo”, “subprime”, and “Alt-A” segments.

The dearth of activity continued for five years. But over the past few months some “green shoots” have appeared in the form of executed deals and expectations of more to come. All of these have involved “jumbo” collateral.

There were several reasons for the long-term market freeze, including:

- Continued house price declines.
- Policy uncertainty coming out of the Dodd-Frank Act.

Private-Label Mortgage Securitization

The policy uncertainty centered around new federal regulations required by the Dodd-Frank Act.

"Qualified Mortgages" (QMs). Final rule issued recently by the Consumer Financial Protection Bureau that builds on rules established by the Federal Reserve in 2008 (under the Truth in Lending Act).

QMs meet various standards and hence are covered by a safe harbor (presumption of compliance). Sense that the industry felt that the rule was sensible given the legislative language.

- Certain underwriting/process requirements and debt-to-income thresholds to ensure that a borrower could reasonably be expected to repay a loan;
- Certain loan terms prohibited in the statute (e.g., no negative amortization or "excessive" rates/fees).
- Statute also exempted all "Agency-eligible" loans from QM standards.

Private-Label Mortgage Securitization

The QM rule now makes clear the boundaries for mortgage origination.

- Non-QM loans would seem to attract litigation.
- This is also crucial for private-label mortgage securitization.

"Qualified Residential Mortgages" (QRMs) are not subject to new 5% risk retention requirements for securitizations.

- Ginnie Mae, Fannie Mae, and Freddie Mac issues exempt.
- Does risk retention align incentives better than reps/warrants?
- How does this affect the "economics" of private securitization and what does that mean for market structure and consumers?

QRMs are supposed to carry "lower risk of default", but proposed rules maximum loan-to-value requirements (70-80%) drew the ire of consumer advocates.

- Recent commentary suggests that QRM and QM definitions will be aligned.

QRM Logic: Why a carve-out for the securitizations most associated with the crisis?

Fannie Mae and Freddie Mac

The housing crisis and resulting financial market turbulence brought down several of the nation's largest residential mortgage-focused financial institutions, including Fannie Mae and Freddie Mac.

These two government-sponsored enterprises (GSEs):

- Have been in federal conservatorship since 2008.
- Central to the US housing finance system: Hold the credit risk associated with almost 60% of US mortgage debt outstanding.

Redefining the scope of government involvement in residential mortgage markets has been the subject of much debate, although little legislative progress has been made (or is expected to be made).

Fannie Mae and Freddie Mac

In the meantime, the federal regulator/conservator of Fannie Mae and Freddie Mac (Federal Housing Finance Agency, or FHFA) has been taking steps to improve their operations in a manner that conserves an array of legislative options.

One recent FHFA proposal has been the creation of a new securitization platform that would align the standards and practices of the two GSEs.

This proposal has piqued industry interest as it is intended not simply to update the existing proprietary IT infrastructures at Fannie Mae and Freddie Mac.

Looking to build something that is flexible enough to be used by a wide array of market participants and under different models of government involvement.

Panelists

To discuss these and other related issues today, we have the following distinguished panelists.

1. Adam Ashcraft, Senior Vice President & Head of Credit Risk, Federal Reserve Bank of New York.
2. Mario Ugoletti, Senior Advisor to the Director, Federal Housing Finance Agency.
3. Andrew Davidson, President, Andrew Davidson & Co.
4. Steve Gaenzler, Principal, Five Bridges LLC.