

Small Lenders Fear GSE Reform Bill Could Endanger Them

By [Brian Collins](#)
APR 16, 2014 3:40pm ET

A landmark housing finance bill has brought back mortgage bankers' old fears about "mission creep" by secondary market players. Only this time, they fear large banks, not Fannie Mae and Freddie Mac, would be doing the creeping.

Small lenders are concerned the bill to wind down Fannie and Freddie, drafted by Senate Banking Committee Chairman Tim Johnson, D-S.D., and Sen. Mike Crapo, R-Idaho, would allow giant banks to play multiple roles in the new mortgage market—potentially pricing smaller companies out of the business.

Under the bill as drafted, a major bank could operate as an originator, aggregator and guarantor of mortgages. By charter, Fannie and Freddie are prohibited from originating mortgages. The two government-sponsored enterprises serve as secondary market agencies that purchase and guarantee loans from lenders.

"Small lenders never wanted Fannie and Freddie to be in the origination space, and they surely don't want the too big to fail banks to be dominant in both the origination and secondary market spaces," says Rob Zimmer, head of external affairs for the Community Mortgage Lenders of America.

The issue is likely to come up when Senate Banking Committee members mark up the bill, which they are slated to do on April 29 (though the date could be postponed a week or two). It recalls the controversies of the late 1990s, when lenders worried Fannie and Freddie were tiptoeing across the line separating the secondary from the primary market.

So far, there seems to be a consensus that some restrictions are needed in the Senate bill to prevent large institutions from potentially dominating the mortgage market in a post Fannie/Freddie world. Sens. Johnson and Crapo are reportedly considering ways to prevent vertically integrated players from dominating the market. And several trade groups have advanced proposals to protect community-based lenders from being displaced.

The Mortgage Bankers Association says it wants to ensure there is a "bright line" between primary and secondary market players.

Allowing issuers of mortgage-backed securities to originate loans "creates confusion around the bright line," and would make it harder for regulators to oversee their operations, says MBA president and chief executive David Stevens.

"MBA wants to ensure these capital markets aggregators can't originate mortgages," he says.

The trade group has also raised the specter of adverse selection. An aggregator with origination capability could cherry pick the best mortgages for a private securitization. The weakest credits would end up in a securitization that is guaranteed by the new Federal Mortgage Insurance Corp. The FMIC outlined in the Senate GSE reform bill would provide a federal guarantee to protect MBS investors.

The MBA also wants to ensure lenders don't act as guarantors, which under the Johnson-Crapo bill would take a 10% first loss position in mortgages. The FMIC would protect MBS investors from further losses.

The American Bankers Association agrees with MBA that a separation between aggregators and originators is appropriate.

"It is legitimate concern. We just have to have to find the right approach," said ABA vice president and senior counsel Joe Pigg.

But ABA wants to ensure guarantors have access to capital and it may float a proposal to allow originators to take a noncontrolling investment in a guarantor. ABA is not ready to advance this idea yet. "We have to do more work on that," Pigg says.

Under the Senate bill, small banks, credit unions and mortgage banking companies would be able sell their loans to aggregators or to a new mutual mortgage entity or cooperative that would pay cash for mortgage loans.

The Community Mortgage Lenders Association is concerned this co-op and its cash window wouldn't be able to compete with big banks as the Johnson-Crapo bill is currently drafted.

The association doesn't want to see big banks investing in guarantors. And the trade group doesn't want the big banks to have unlimited access to FMIC federal guarantees. There should be "overall limits on those entities accessing FMIC in any form or financial construct," Zimmer

says. "Otherwise small lenders, even in a co-op, can be price-competed over time into irrelevance." The trade group represents community mortgage banking firms.

Another group, the Community Home Lenders Association, is concerned the big banks and other large lenders will "use guarantee and aggregator affiliations to exclusively funnel loans through their internal mortgage origination networks," says its executive director, Scott Olson. "For some time, we have been urging the committee to establish strong protections to avoid the type of mortgage market concentration that could result from this." The association is made up of small and midsize community-based mortgage lenders.

To ensure their members are protected during the transition to a new housing finance system, the two community lender groups want the committee to adopt language that would ensure the mutual co-op is fully operational before Fannie and Freddie are dissolved. The trade groups' jointly proposed amendment would ensure the "co-op is capable of meeting all small lender needs at competitive rates and terms," according to a summary of the measure.