



The Daily Dish

GSE Capital Rule, Finally!

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Eakinomics: GSE Capital Rule, Finally!

In 2008, the Housing and Economic Recovery Act mandated that the Federal Housing Finance Agency (FHFA) establish risk-based capital requirements for Fannie Mae and Freddie Mac (the housing government-sponsored enterprises, or GSEs). FHFA did not propose a rule until 2018, issued a [revised proposed rule](#) earlier this year, took [comments](#) on the proposed rule, and yesterday finally made it over the finish line by publishing the [final rule](#).

By and large, the final rule is quite similar to the proposed rule. There are two ways to evaluate the capital adequacy of the GSEs: a risk-based calculation and a simple leverage ratio. The latter is intended as a backstop, but in the proposed rule it proved to be the binding constraint that determined the GSEs would have to hold \$263 billion in capital. The primary change is that in the final rule the risk-based capital requirement is likely to be more onerous (and therefore binding) than the simple leverage requirement. As a result the GSEs would have to hold \$283 billion in combined capital.

This change strikes me as a step in the right direction because holding more capital further protects the taxpayer from the risk of having to bail out the GSEs in the future. Relying on the risk-based framework also can drive GSE business practice to avoid the riskiest product offerings. There will be complaints that the capital requirements are too high and that they will raise the costs of mortgages and limit availability. Others will grouse that the capital standard will lower returns and make the GSEs less attractive to investors. On the whole, I think the FHFA balanced these competing interests quite well.

The second area of interest is the impact on [credit risk transfers](#) (CRTs). The proposed rule had [reduced the incentive](#) to shift risk out of the GSEs using CRTs largely because the leverage ratio – which was determining the level of capital – does not reflect risk. As noted

above, the risk-based capital calculation is now pre-eminent; that means the GSEs *will* be incentivized to use CRTs. The FHFA, however, did not undertake a wholesale revision of the risk-weights (the amount of capital required) associated with CRTs and instead offered three highly technical changes to provide increased capital relief.

Establishing capital standards is an important milestone for supervision of the GSEs, but it is no panacea. It remains desirable for Congress to pass legislation that enacts wholesale reforms of the GSE charters.