## The Daily Dish

# GSE Reform Kicks Off

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**Eakinomics: GSE Reform Kicks Off**

On September 6, 2008, the Federal Housing Finance Agency (FHFA) placed the housing government-sponsored enterprises (GSEs) — Fannie Mae and Freddie Mac — into conservatorship. It was the culmination of the steady unwinding of the U.S. housing bubble and mortgage finance meltdown. It was also widely perceived as the beginning of the end for the GSEs. Surely housing finance reform was imminent, and even more surely these privileged, thinly capitalized, risky, systemically important behemoths would not be permitted to survive.

As nicely detailed by AAF's Thomas Wade, this past Thursday the administration released its blueprint for housing finance reform in the shape of twin reports from the Departments of the Treasury and Housing and Urban Development (HUD). After more than a decade, there appears to be an imminent reform effort. What does the proposed reform look like? There are lots and lots of details, but here are three important takeaways.

The first and most important point is that Fannie Mae and Freddie Mac will survive. There is no call to turn them from *de facto* to literal agencies of the federal government or, at the other end of the spectrum, to liquidate the GSEs and start afresh with a level playing field in the secondary mortgage market. Instead, the administration calls on Congress to pass legislation that permits FHFA to charter new competitors to the GSEs. But GSE reform legislation appears very, very, very (did I say very?) unlikely, so the plan is to go ahead and restore Fannie Mae and Freddie Mac as private entities.

The second is the nature of the envisioned competition. The only option the administration has is to attempt to restart the competition between the GSEs and the financial private sector in securitizing mortgages. At the GSE end this means making the GSEs look as much as possible like a private sector entity. The administration says the right things about having

the correct capital standards and prudential regulation — including calling on the Financial Stability Oversight Council (FSOC) to be involved — as well as lines of business and lending standards. But it also hints at loosening regulatory standards on banks to incentivize private label securities. Unless there is simply something badly wrong with the current regulatory framework, that seems like a mistake.

The third is how the taxpayer gets protected in the event of future financial duress. The "right" solution (requiring legislation) is to have any guarantor (Fannie, Freddie, a new entity, or a newly empowered Ginnie Mae) pay a fee to the Treasury in exchange for a catastrophic guarantee of the mortgage-backed security (MBS). Notice that it is the security and not the entity, so the threat of bankruptcy would discipline firms in the future. The FHFA and Treasury do not have the authority to do this, so they are forced to settle for advocating that the current Treasury support be turned into a fixed payment by the GSEs in exchange for support of the entities in future tough times. There is just no way to feel really good about this.

Finally, the administration advocates for keeping mortgages as affordable and plentiful as they are today. If the GSEs have more capital, are more tightly regulated to stick to the mortgage business, and are paying fees for their guarantee then it is hard to see how this happens. When push comes to shove, there will have to be some tradeoffs decided between limiting subsidies to the GSEs and the cost of mortgage finance.

One thing the administration is silent about is the timetable for reforms to take place. All we really know is that that this year FHFA is planning to finalize a capital rule and Treasury is to rework the terms of its financial support. Those initial moves will not say everything about the nature of the outcome, but they will set the tone for the remainder of the effort.