The Daily Dish

Don’t Forget about the GSEs

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Eakinomics: Don’t Forget about the GSEs

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It’s been ten years since Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs) went into government conservatorship following the height of the financial crisis. After that much time and a number of new policy challenges in the interim, it might be easy to forget about the GSEs and the financial risks they still pose. This would be a mistake. Fannie and Freddie remain actively dangerous systemically important financial institutions (SIFIs), and their policies have started to slip back to where they were before the crisis.

Recall that after the financial crisis and the GSEs’ ensuing conservatorship, new laws and regulations were written to ensure that Fannie and Freddie were abiding by the highest lending standards and were operating with as little risk as possible. For example, for mortgages being financed by Fannie Mae, the borrower’s debt-to-income (DTI) ratio could not be above 43 percent. In other words, a borrower’s monthly payments could only consume 43 percent of their monthly income. Unfortunately, as we’ve gotten further away from the financial crisis, DTI ratios are on the rise, with some borrowers having DTI ratios of 60 percent or higher.

And it’s not just the underwriting standards that are regressing. In the past several years, the GSEs have created billions of dollars of new programs – all without any notice and comment period. Their conservator, the Federal Housing Finance Agency (FHFA), under the guidance of Mel Watt, has done nothing to stop or slow them down. For example, Fannie Mae’s Connecticut Avenue Securities program, created in 2013, has already issued $22.5 billion in debt. On the flip side, Freddie Mac’s Structured Agency Credit Risk program has issued $23.9 billion in debt note transactions in the same period.

Perhaps even more troubling are the GSE programs for which no data is publicly available. For example, Freddie Mac recently announced that it would be offering lines of credit to non-bank lenders. That announcement raises a few red flags (non-bank lenders have no capital reserves, little to no oversight, etc.), but the real concern is that in offering these lines of credit, Freddie Mac is putting taxpayer dollars at risk without following proper administrative procedures.

The GSEs have, in a sense, become their own policymakers, and the lack of any real oversight from Congress or their regulators is allowing them to continue to do so. As Congress heads into a midterm election with no consensus on what comprehensive GSE reform should look like, Congress and the GSEs’ regulators should exercise their oversight power to rein in Fannie and Freddie to ensure that the policies and practices do not return to a place that could send us into another financial crisis. With so much taxpayer money on the line, and a massive bailout in the not-so-distant past, it is important that the real policymakers and overseers do not forget about the GSEs. Luckily, AAF is hosting an event today at 12pm to discuss the future of the GSEs.