



The Daily Dish

# No Need for GSE Reform?

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## *Eakinomics: No Need for GSE Reform?*

The Wall Street Journal [reported](#) yesterday on the Credit Risk Transfer (CRT) programs of Fannie Mae and Freddie Mac, the so-called housing government-sponsored enterprises (GSEs). Fannie and Freddie do not make loans. Instead, they purchase mortgages from banks and other originators. This puts cash back into the banks, thereby permitting additional loan-making, and moves the risky mortgages off the bank balance sheets. Fine, but the flip side of that transaction is that the risk of non-payment is now on the GSE balance sheets and, ultimately, the taxpayer. The GSEs exacerbated this basic risk during the run up to the financial crisis by issuing mortgage backed securities (MBSs) that guaranteed the purchaser full repayment of mortgage interest, thereby concentrating the so-called credit risk (as opposed to the risk of interest rate changes) in the GSEs. It then accumulated an enormous portfolio of MBSs on its own balance sheet creating an extremely leveraged entity with enormous, undiversified housing market risk.

The result was a calamity. The surprise in the aftermath is that nearly a decade later there has been no reform of Fannie and Freddie. They remain wards of the state and tools of federal housing policy.

The GSEs continue to purchase mortgages, create MBSs, and guarantee against the credit risk. However, under the CRT program, the GSEs create special securities that pass along purely mortgage interest to the purchaser, without a guarantee that the payments will be made. In this way, some credit risk is moved off the taxpayer and onto those in the private sector willing to hold that risk (for a price). The WSJ comments “Fannie and Freddie have sold roughly \$48 billion of the securities since 2013 to a broadening group of buyers including asset managers and insurance companies. Sales are expected to reach a fresh high of \$15 billion this year, up from the previous record \$13 billion last year, according to J.P. Morgan Securities.”

This sounds quite promising; indeed the observation is paired with the quote from prominent housing expert Mark Zandi of Moody’s Analytics “the government’s footprint in the mortgage market is receding quickly and significantly.” Perhaps there is no need for GSE reform after all?

EXCEPT that in 2016, mortgage originations totaled \$1.9 trillion, roughly equally split between refinances and new purchases. With mortgage rates near 3.5 percent, this means another \$60-odd billion in new mortgage interest risk created each year. \$15 billion of CRT means that the same basic dynamics continue to prevail in Fannie and Freddie accumulation of credit risk. Moreover, because their capital holdings are being wound down in conservatorship, there is even less capital backing this risk than previously.

In short, nothing has really changed, and the need for serious reform remains unaddressed.