The Daily Dish

What Lies Ahead for Fannie Mae and Freddie Mac?

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Eakinomics: What Lies Ahead for Fannie Mae and Freddie Mac?

New Federal Housing Finance Agency (FHFA) Director Mark Calabria has had numerous public speeches recently, from which a simple theme has emerged: Fannie Mae and Freddie Mac — the housing government sponsored enterprises (GSEs) — will be exiting conservatorship. He didn't actually say "come hell or high water," but one could easily infer that.

At one level, ending conservatorship makes perfect sense. After all, the housing bubble peaked nearly 15 years ago, the crisis ended in 2009, and it is long overdue that the GSEs stop being wards of the state (or, as the Congressional Budget Office treats them, government agencies). Moreover, the FHFA Director has the authority to release them from conservatorship, just as the Director used his authority to put them into conservatorship. So the real issue is on what terms the conservatorship ends.

It is relatively straightforward to see the FHFA making the GSEs much safer than they were prior to the crisis. The FHFA can finalize a capital rule this year that would make the GSEs dramatically better capitalized than in the past. It is not obvious exactly how that recapitalization would happen — simply retaining all earnings will not do the trick in any reasonable time period — and it is not obvious if this will be "enough" capital. If not, there is always the possibility that the Financial Stability Oversight Council (FSOC) will designate them as non-bank systemically important financial institutions (SIFIs) and impose even higher standards.

And the FHFA could restrict the size of the GSEs' investment portfolios (a real source of trouble in the crisis) and the range of their business activities, which would steer the GSEs away from riskier cash-out mortgages and other loans, and would incentivize the private mortgage insurance business to take on more risk.

But the FHFA can't do everything, including some important things. It cannot, for example, create new guarantors for mortgages and, thus, create genuine competition for the GSE duopoly. Just as troubling, it cannot set the fees so that the government backstop on mortgages is actuarially priced. And it cannot change the underlying charters that come with all sorts of preferential treatment like tax-exempt status, a line of credit with Treasury, exemptions from securities registrations, and a variety of other bells and whistles. And the FHFA cannot effectively constrain the affordable housing goals that drove the GSEs into some of their risky activities.

All of this means that, even with these changes, there remains the potential to undercapitalize the occupants of a government-sheltered sinecure and let the implicit guarantee permit them to borrow at below-market rates. That's bad, and especially because there is no guarantee (no pun intended) that any Trump-era rulemaking would survive for a second in the next administration. An end to conservatorship in this case doesn't mean it can't happen again in the future.

For these reasons, the best long-term solution is for Congress to pursue legislation that would make these necessary long-term changes. In the meantime, however, stay tuned as the FHFA makes some long-awaited waves with the GSEs’ conservatorship status.