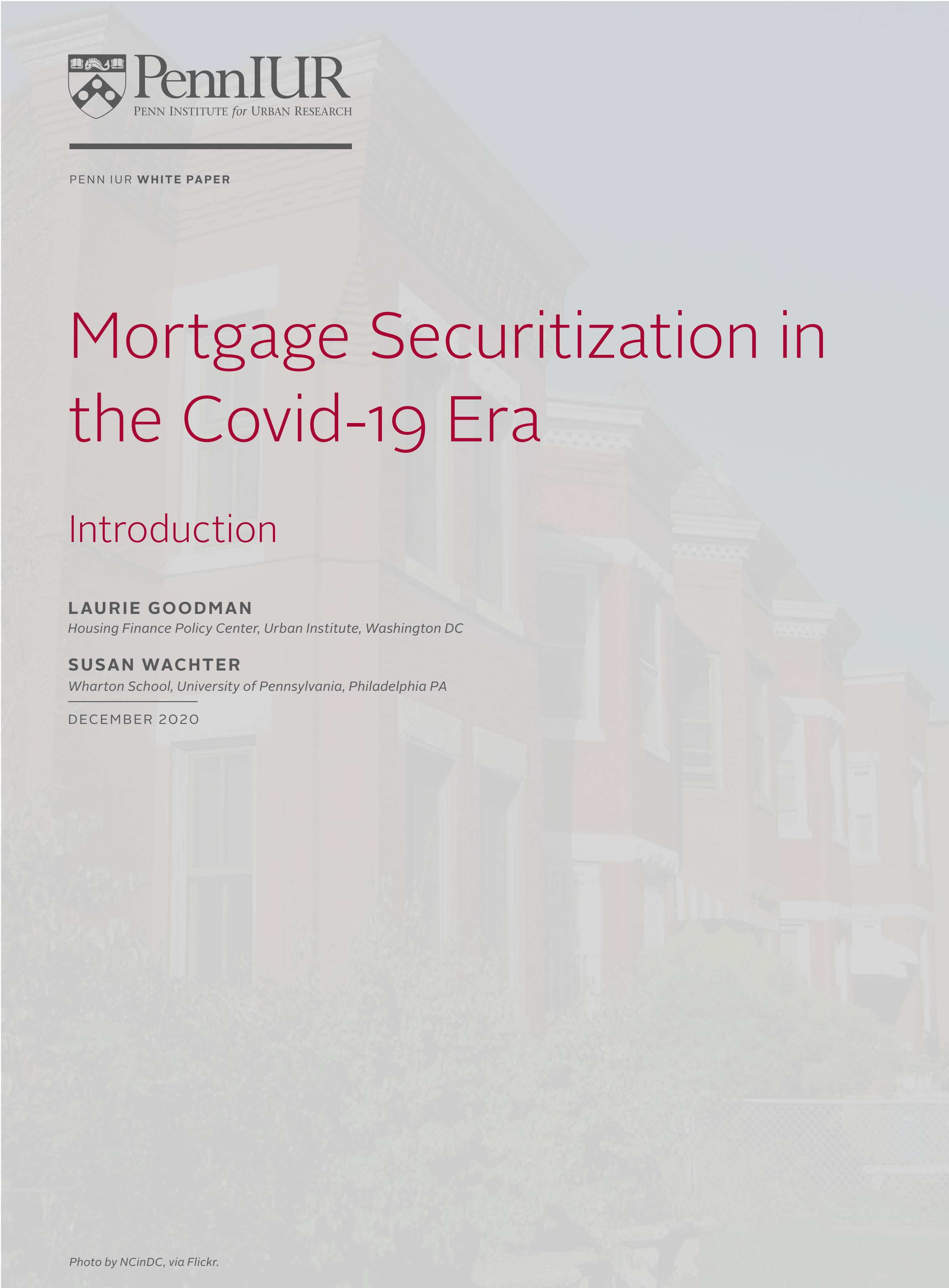

PENN IUR **WHITE PAPER**

Mortgage Securitization in the Covid-19 Era

Introduction

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Fannie Mae and Freddie Mac, collectively known as the Government Sponsored Enterprises (GSEs), have been in conservatorship for over a decade. These organizations continue to dominate the housing finance system, together financing close to half of the $11 trillion market for home mortgages in the United States. In September of 2019, the US Treasury put out a report in which they described the conservatorship of the GSEs as the "last unfinished business of the financial crisis".[1] Although the Treasury made it clear that legislative reform is the preferred solution, it also set out an administrative path to get the GSEs out of conservatorship and re-privatize them. The first step in this process is a set of capital rules for the GSEs post conservatorship. In June 2020, the FHFA released a Notice of Proposed Rulemaking, containing a detailed set of capital rules.[2]

Meanwhile, the COVID-19 pandemic in 2020 has brought additional strain to the financial system, but the housing and mortgage markets have held up very well. Much of the good performance reflects timely, large scale Federal Reserve intervention, quick action from Congress through the CARES Act, as well as reforms and loss mitigation programs that were established in the aftermath of the Great Financial Crisis. The federal government was able to quickly provide this substantial support to the housing and mortgage markets as it currently backstops much of the housing finance system. Even so, one element of the toolkit to deal with the fall-out from the Great Financial Crisis is missing from the COVID-19 policy responses: enabling streamlined refinancing.

The peer reviewed articles in this special volume of Housing Policy Debate focus on both the current performance of the GSEs and the government programs that comprise Ginnie Mae securities in this time of Covid-19, as well as the longer run future structure of the GSEs. Two papers, "FHFA's Capital Rule is a Step Backwards," by Parrott, Ryan and Zandi, and " Analysis of the Proposed 2020 FHFA Rule on Enterprise Capital," by Golding, Goodman and Zhu, critique the proposed 2020 capital rule that has been put forth in contemplation on the GSEs privatization. Parrott, Ryan and Zandi argue that the FHFA's proposal misapplies the Basel-like bank capital regime in a way that would ultimately take the GSEs and the housing finance system in the wrong direction, unnecessarily leading to higher mortgage rates, riskier GSEs, and a less stable housing finance system. In particular, the absolute leverage constraint is binding much of the time, giving no credit to reducing risk, and leading to an increase in risk int eh system. Goodman, Golding and Zhu agree that that Basel-like bank capital regime is the wrong approach to GSE capital, and they urge FHFA to better tailor its proposed risk-based capital requirements to the risk and mission of these monoline entities. The researchers offer a package of specific adjustments that will better align capital with risk, without reducing the overall rigor or stringency of the capital standard.

A third paper "GSEs: Their Viability as Public Utilities," by Cooperstein, Fears, and Wachter, offers an alternative vision of the GSEs future as mortgage utilities. They argue that if the GSEs are simply privatized, it will be difficult for these entities to be profitable enough to pay for sufficient capital to protect the taxpayer while maintaining mortgage rates low enough to maintain broad access to the 30- year fixed-rate mortgage. The mortgage market would be better served with a utility model; allowing the GSEs to carry out their public mission while having sufficient capital in place to protect the taxpayer.

While the combination of Federal Reserve policy, the CARES Act, and enhanced loss mitigation efforts has helped to stabilize mortgage markets and the overall economy, more can be done. One tool that was very effective in the 2008 Financial Crisis was not incorporated into the current policy response: streamlined refinancing. An additional two papers, "The Mortgage Market as a Stimulus Channel in the COVID-19 Crisis," by Golding, Goodman, Green and Wachter, and "Evaluating the Benefits of a Streamlined Refinance Program," by Gerardi, Lowenstein and Willen, discuss the advantages of a streamlined refinancing process, designed to accomplish two goals (1) improve the transmission of monetary policy through the mortgage

1 U.S. Department of the Treasury. 2019. "Housing Reform Plan". September. Washington, DC : U.S. Department of the Treasury.

2 Federal Housing Finance Agency. 2020. ***Enterprise Regulatory Capital Framework: Notice of Proposed Rulemaking***. Washington, DC: Federal Housing Finance Agency.

market, (2) improve the position of borrowers and reduce the long term probability of a mortgage default. An earlier version of this refinancing program was very successful in accomplishing both these goals after the Great Financial Crisis, and both papers argue for a restart of this type of program. Gerardi, Lowenstein and Willen take this one step further, arguing such a program could include a cash out refinancing component.

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