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# Commentary

## GSE Reform: The Path Forward

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DECEMBER 2020



Having parachuted into housing finance as CEO of Freddie Mac in 2012, I have since followed the writings, speeches and testimony of the policy community. While many were insightful and interesting, I do think they often suffered from not having the knowledge base that comes from being an actual practitioner. I have tried to bring just that to the debate on housing finance issues, including the key question that I have been asked to address here: what is the way forward for these companies.

The GSE reform question, i.e. how should the two companies end their conservatorships and become recapitalized, has proven to be one of the most vexing in Washington in the past decade. The two companies have been under government control for over twelve years now with no likely end in sight, even though conservatorship was meant to be a temporary arrangement. The question is renowned for its complexity, the intense politics surrounding it, and how it involves an immense amount of money (about \$6 trillion, i.e. approximately half of all the residential mortgage assets in America).

The Biden transition team, and other centers of Democratic power in Washington, already have members of the housing finance policy community selling them various ideas of what to do with the two companies – as did the Obama and Trump administrations before them. For many years, these ideas focused on replacing the GSEs with something else, which has ranged from “no GSEs” to a lender cooperative to a government-owned monopoly to many smaller GSEs, among others. However, in a dozen years, almost all such replacement ideas have faded away as, upon further examination, they were found to be unworkable or unduly risky, and so never garnered the support required to pass the needed legislation in Congress. In addition, rarely did such proposals ever address how to transition from what exists today to what was being proposed while successfully avoiding an unacceptable, years-long disruption to the country’s financing of homeownership.

In more recent years, ideas for GSE reform have shifted towards proposals that would instead reform the two existing companies rather than replace them. The most prominent such idea has been the “utility model”, whereby the two current GSEs - after being reformed and recapitalized - would be released from conservatorship but with their regulator, the Federal Housing Finance Agency, empowered to set their guarantee fees, much as a state-level public service commission sets electric power rates. The utility model in recent years has become widely supported throughout the industry and among other stakeholders. I am highly supportive of it as well, since I see it being the only way forward that keeps the best of what we have - especially the 30-year-fixed rate mortgage available at affordable rates to the broad working and middle class - while also strongly protecting taxpayers. In many ways, it just locks in how Freddie Mac and Fannie Mae, with many operating reforms implemented during conservatorship, are currently running - which is generally regarded quite highly in the industry.

Against this background, my view is that the Biden administration, if it is to successfully address the GSE reform question rather than repeat the frustrating and ultimately unproductive attempts of its predecessors, should follow one of two possible paths in the next 12 to 24 months. Neither path involves the more radical approach of winding down the current GSEs and replacing them with something unproven; instead, both work with the two reformed GSEs.

The first possible path is to leave the companies in long-term conservatorship, which has worked, and continues to work, unexpectedly well (including during the pandemic), and then possibly revisit the question of conservatorship exit in a few years. This additional time in conservatorship, however, should not be one of stagnation; more operating reforms and improvements can be implemented, building on the many that have already occurred while the two companies have been under government control.

The second possible path, which can successfully navigate all the complexities and risks of conservatorship exit, is to additionally implement, via administrative means, the early years of a long-term transition to the utility model, as is also proposed in the article herein. Interestingly, I arrived at the conclusion that the utility model



would be a viable option in a very different way than do the authors of this article. Specifically, my view is that possible implicit collusion between the two GSEs post-conservatorship could easily occur and so produce too-high guarantee fees, which in turn necessitates utility-style price regulation, i.e. it's an anti-trust argument. Nevertheless, the end point is the same: the utility model is the way to go, starting either now (the second option, which I personally would prefer) or later (the first option).