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GSE and Housing Reform:  
Evaluating the Various Policy Proposals

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# Decision Economics: *Has the Time for GSE Reform Come at Last?*

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- ❑ **Congress finally focusing on GSE reform.** Five years after the GSE melt-down Congress is focusing on GSE reform, with attention centering on two proposals, one from each house.
- ❑ **Senate (Corker-Warner) is a (bipartisan) hybrid plan, diminishing the role of govt. in housing.** The Senate plan would maintain government involvement but at a reduced scale from the old pre-2008 system. The GSEs would be scaled down but not completely eliminated. There would be limited govt. guarantees, first losses would come from private investors, but there would be an explicit govt. backstop paid for by the industry, like the FDIC.
- ❑ **House (Hensraling) plan would completely privatize the industry, eliminating GSEs.** The House plan would set up a private securitization platform with no govt. guarantee and a limited role of FHA in affordable housing. There would be no planned bailout during a crisis but does anyone believe that the govt would let the new mortgage giants fail? While it passed through the committee, the plan has little Democratic support and may not even be brought up for a vote in the House since it would fail in the Senate.
- ❑ **Obama approach follows the Senate plan.** Obama recently outlined an approach similar to the Senate plan, with a significant role for the federal govt.—both to provide a cyclical backstop and support for affordable housing. The GSE's would be “wound down, with the private sector becoming the “backbone” of the mortgage business and the 30-year loan prevalent. Obama's approach follows up on the 2011 Treasury white paper in 2011 which covered a range of policy options. Treasury I option was a fully private system that shares the goals of the house plan. Treasury II and III options were versions of the Senate plan, depending on the size of the final govt. involvement. These last two options were implicitly endorsed by the White House this month.
- ❑ **Where's the Fed?** Bernanke allocated a special section to regulatory reform in his Humphrey-Hawkins presentations and got a ton of questions from Congress. Fed economists embraced a “lender cooperative utility” which has features similar to the Senate plan – a role for govt. guarantees, a first loss provision for the private sector, and an explicit understanding that the mortgage industry would be bailed out in a crisis.
- ❑ **What's next?** Immigration, the farm bill, the budget, and the debt ceiling come first so that Congress may deal with this issue in a big way in late 2013 or more likely in 2014. The eventual compromise plan will involve some form of government guarantee and an explicit backstop paid for by the industry along the lines of the FDIC. The House plan's goal of a completely private system is more of a “marker” to make sure the final solution is as “private” as possible. Operationally, there will be transition period in which the industry and the government figures what the right size for government involvement is on a daily basis. Many think that a 10% first loss will kill private issuance, since that is in excess of the worst default experience.
- ❑ **GSEs will be gone but a major govt. role in housing is permanent.** The new system will not eliminate government involvement in housing, but rationalize it and make it explicit with a smaller chance for a taxpayer bailout the next time.

## Decision Economics: *Key Features of the GSE Reform Proposals*

Characteristics	Current system	Senate (Corker-Warner)	House (Hensarling)	Comments
General summary	No private capital Govt. insures all conforming loans	Private capital to cover 10% of first losses Higher fees and borrowing costs. Govt. still insures “some” conforming loans In crisis, govt. guarantee explicit.	Set up fully private securitization platform “utility” for private lenders. Reduced FHA affordable housing role Implicit guarantee in crisis not acknowledged.	Corker Warner could embrace Treasury options 2 and 3 which envision a hybrid system with varying degrees of govt. support. Treasury 3 is fully private, which is Hensarling’s goal.
Federal guarantees	Implicit Extensive	Explicit Moderate to extensive	None but hidden?	Would the govt. really let housing finance fail in a crisis?
Role of GSEs	Extensive	Eliminated. Replaced with specialized insurers	Eliminated Replaced with private securitization utility.	Role of smaller players unclear is all reform proposals. Banks could get very big in House plan.
Private capital role	Virtually none.	Eventual goal of absorbing first 10% of losses.	Complete.	Would TBTF GSEs be replaced with TBTF banks in Hensarling plan. Germany does not have GSEs but would they let even a landbank fail? Would 10% loss in “full” Senate plan kill private issuance?
Support for affordable housing	Extensive. Expensive. Costs hidden.	Unclear	Restricted to 20% of market via revamped FHA.	Laid out clearly in House plan, with role focused and explicit.
What happens in crisis?	We already found out in 2008.	Intervention financed by new industry insurance fund not taxpayer	Who knows?	Biggest weakness of House plan.

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