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5 questions for former Obama FHFA director Ed DeMarco
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How to end conservatorship has been a hot-button topic for the government-sponsored enterprises ever since they went into it following the housing crisis. While the Federal Housing Finance Agency now pushes to make it a reality, it remains a complicated issue.

Finding a resolution will require aligning with housing reform and securing bipartisan support, according to Ed DeMarco, a former regulator and conservator for Fannie Mae and Freddie Mac who currently stands as president of the Housing Policy Council. The HPC is a trade organization that advocates for the housing finance system to remain competitive, efficient and accountable. The organization is comprised of industry leaders across mortgage origination, servicing and insurance.

DeMarco was the acting director of the FHFA during the Obama administration from 2009 to 2014 and a senior fellow in residence at the Milken Institute's Center for Financial Markets.

Below are excerpts from a correspondence with DeMarco about the conservatorship, capital framework and housing reform. The questions and responses have been edited for clarity and length.

When do you see Fannie Mae and Freddie Mac coming out of conservatorship?

FHFA Director Calabria is bringing much needed urgency to that question, but the timing remains unclear. He has identified numerous hurdles that must first be cleared, ranging from finalizing a capital rule, to raising capital for Fannie Mae and Freddie Mac, to preparing FHFA to regulate Fannie Mae and Freddie Mac outside of conservatorship.

By itself, ending the conservatorships is not the goal. The goal is ending the conservatorships in concert with structural reforms in our housing finance system, particularly in the secondary market.

In other words, the essential component of reform is replacing the Congressional charters of Fannie Mae and Freddie Mac. Simply ending the conservatorships would take us back to the pre-conservatorship status quo. The failure of Fannie and Freddie in 2008 exposed the undeniable structural flaws with the GSE model.

Only Congress has the authority to address those flaws, by changing the Fannie Mae and Freddie Mac's charters to improve competitive balance in the secondary market and reduce the systemic risk inherent in the GSE duopoly.

What would it take to get them there?

Ending the conservatorships in the context of true reform requires the Administration and Congress to align on a legislative solution. However, FHFA can make great strides in preparing the GSEs and the market for that outcome.

When I was acting FHFA Director, we embarked on a series of reforms designed to both serve the conservatorship mandate and help Congress and the Administration achieve true reform. Those efforts are reflected in all leading proposals today, including credit risk transfer and a common securitization platform.

Director Calabria is driving FHFA to continue building the reform pathway. The more FHFA can accomplish administratively, the easier it will be for Congress to focus on the remaining issues that only it can resolve — which include replacing the GSE charters, providing for an explicit government guarantee on MBS, and crafting a more effective affordable housing mandate.

Administrative reforms provide the means to assess the impact and performance of reform components and build out the needed infrastructure in advance of legislation. Credit risk transfer is a good example of this approach.

What capital framework would you like to see them under?

The Housing Policy Council believes that the FHFA's 2018 proposed capital framework is a good structure. It relied upon capital charges based upon granular risk characteristics of individual mortgages, plus capital set aside to cover other potential losses associated with market risk, operational risk, and model risk. Yet, that proposal needs significant refinement, which is why HPC advocated for a re-proposal back in 2018. So, we are pleased that FHFA intends to do just that.

In our view, four key issues with the earlier proposal need to be addressed:

The first is for FHFA to direct the GSEs to release those portions of their historical loan files that are still not public. These files reflect riskier loans and more adverse outcomes than what has been published to-date. With the release of this data, along with the release of the models and assumptions used by FHFA in the proposed capital framework, market participants can validate, or critique, the credit risk assessments embedded in the proposed capital charges.

Second, FHFA needs to fix the framework's procyclicality by incorporating some reasonable measure of fundamental value that would enable counter-cyclical capital charges.

Third, FHFA should work with other prudential regulators to achieve some reasonable standard of comparability in their capital regulations for mortgage credit risk. Consistent capital standards will enable all lenders to make rational decisions on whether to hold mortgages on their books, to sell and securitize them, or to layoff some or substantially all of the associated credit risk through various other credit risk transfer mechanisms.

Finally, the financial crisis proved the systemic risk to consumers, taxpayers, and market participants from concentrating so much credit risk — and the tools for measuring and managing that risk — in the GSEs. This risk concentration has grown during conservatorship. To protect our financial system from another systemic housing finance crisis requires treating the GSEs as systemically important institutions or introducing enough competition to distribute the risk across the market so that the systemic risk is dissipated — preferably the latter.

How can housing reform help the deficit in affordable housing?

Housing finance reform legislation presents a generational opportunity for Congress to consider the actual home ownership barriers families face today and to develop solutions tailored to those needs.

The Fannie-Freddie system of setting broad percentage goals for secondary market purchases and subsidizing the mortgage rate of higher-credit risk borrowers regardless of income is not working. As a result, we continue to debate both the affordability crisis and the low home ownership rates in certain communities.

Most bipartisan legislative reform proposals envision a 10-basis point fee on all mortgages in securities backed by the federal government. This fee would provide a healthy stream of future revenue that can be targeted to families and situations Congress determines warrant support. Such a funding stream could be targeted at borrower needs like down payment assistance, financial education, and building rainy day reserves to help families withstand bumps in the road.

How will the mortgage industry be impacted during the election year and fallout from the election?

The role of housing finance in the macroeconomy and in the lives of ordinary citizens is too important to leave reform to one political party. A solution that encourages competition, protects taxpayers, and better addresses affordable housing needs is best accomplished, and perhaps only accomplished, with bipartisan support.

There remains broad bipartisan agreement on the principles underpinning reform. Whatever the electoral outcomes, we need leaders that can bridge the remaining partisan divides for the good of the economy, taxpayers, and homebuyers.