

# The GSE "Utility Model" & Why I Am a Supporter

**The Future of the GSEs: Ready Freddie and Fannie for the Next Chapter**

National Association of Realtors Conference

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# Policy background 2008 to 2016: the “wind down” era

- Obama Administration Policy: wind down...with Congress in charge of “to what”.
- Many unproven alternatives proposed:
  - From “nothing” – the private market will provide
  - To “many smaller GSEs” (e.g. Corker Warner)
  - To “industry cooperative”
  - To “government corporation”
  - And many other variations
- All of them “flunked out”
  - Transition too risky/destabilizing
  - Upon examination, would not deliver the promised results
  - Inadequate support...in Congress and the industry
- So, required legislation never came close...to this day

# Policy background 2017 to today: reform, recap and release

- Small lenders in particular: proposed large changes/unproven alternatives risky, existential issue
- “Let’s just fix the 5 or 6 big things wrong and move on.”
- Reform: Those 5 or 6 big things, e.g.:
  - Eliminate excessive investment portfolios
  - No longer undercapitalized – go “SIFI consistent”
  - G-fees level by size of primary market lender
  - No longer use “implied guarantee” – keep PSPA (amended) or full-faith-and-credit guarantee
    - Taxpayer compensated for support
  - Keep proper Credit Risk Transfer
  - ?? Utility regulation ??
- Recap and release: Many such issues – mainly for Treasury



*Hidden subsidies  
eliminated*

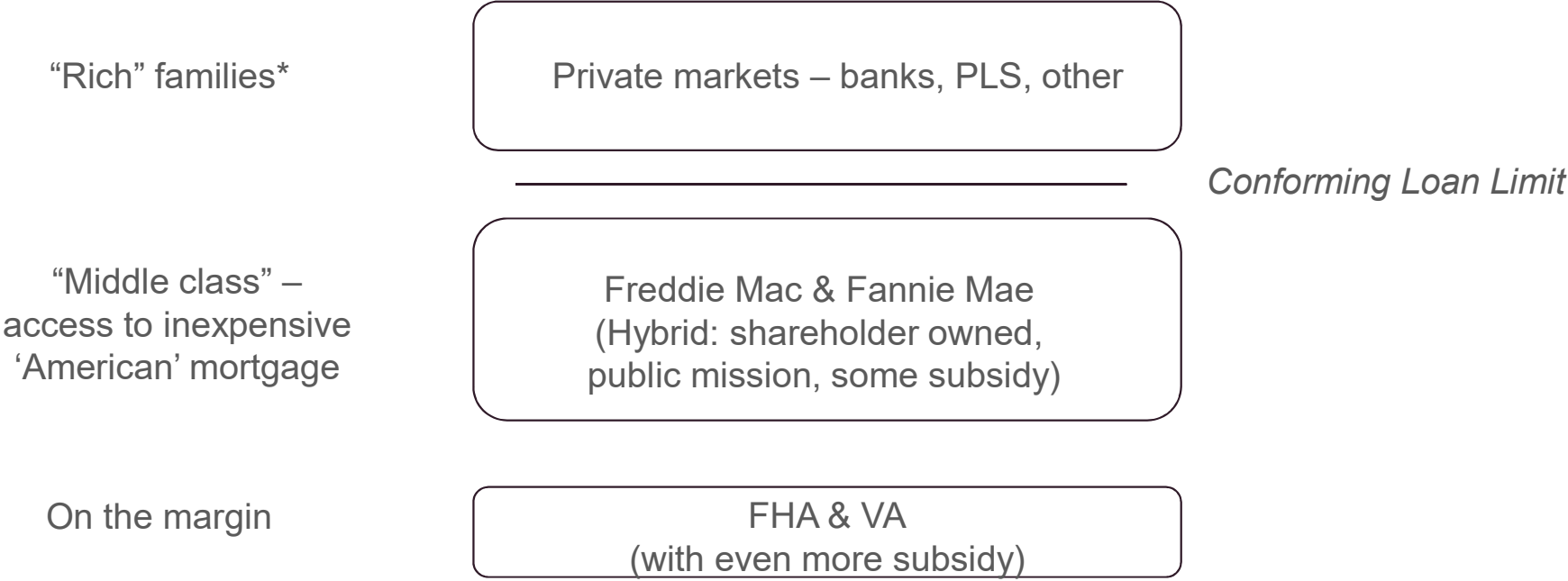
## Meanwhile, in conservatorship...the utility model is ~ built!

- Conservatorship Capital Framework: SIFI-consistent, 2014 to 2017
- Allowed rate of return (i.e. cost of capital): benchmarked versus other large FI's\*
- Single family focus mainly
- Freddie-Fannie revenue/profit calculations made consistent
- CRT "ROE improvement" added as well
- FHFA declared target ROE pre-CRT, range post-CRT

 *Was in place beginning in 2018*

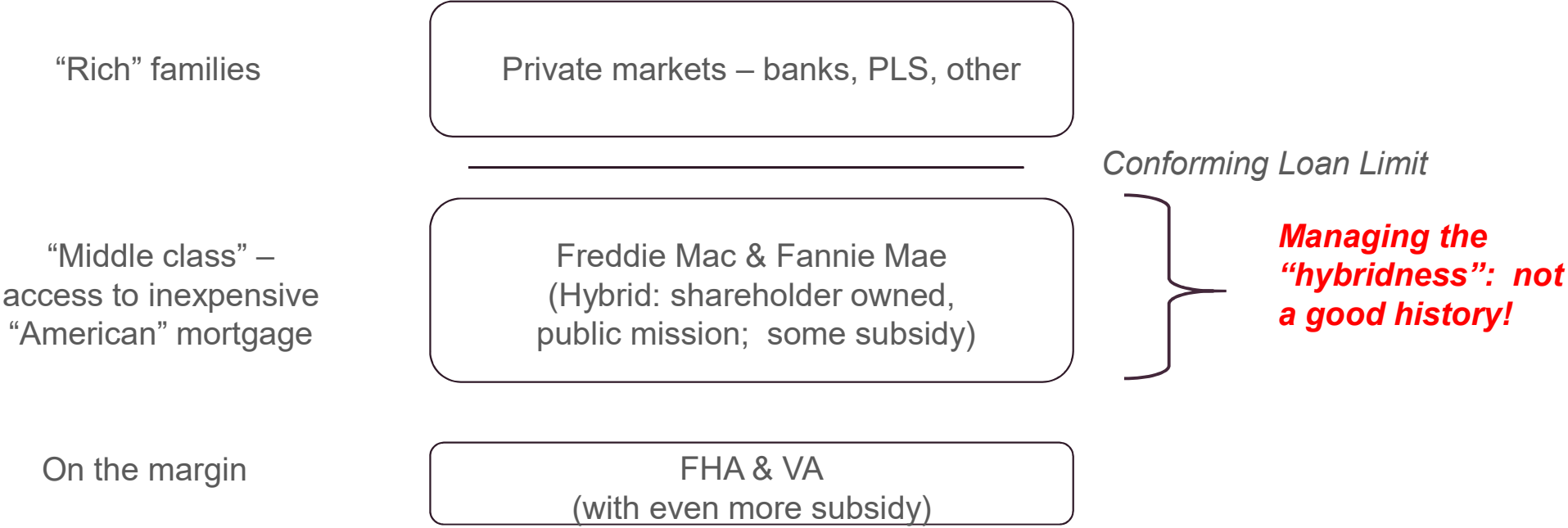
*\* Until GSE shares actually trading post-conservatorship*

# A reminder: the simplified architecture of US housing finance



\*plus, later, non-QM products

# A reminder: the simplified architecture of US housing finance



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# The only viable/proven post-conservatorship solution is... *the utility model*

## What is the “utility model”?

- “Reforms” of reform/recap/release retained – either via PSPA amendment or legislation
  - Necessary to keep the GSEs focused on their proper business, with no loopholes (i.e. all known unintended consequences and loopholes addressed)
  - Note: FHFA does not have OFHEO regulatory weakness
- State PSC-quality pricing/terms regulation to be developed and implemented
  - On one hand: enough to earn credibility with investors (“you won’t steal my money”)
  - On the other hand: utility regulation prevents implicit collusion to keep G-fees too high... *and is an additional source of discipline on GSEs*

***It seems to be the only likely successful path forward  
given the realities of the facts and the politics.***

(If not, what is the better alternative?)

*Note: The addition of SIFMU (Systemically Important Financial Market Utility) status can definitely contribute additional strength and discipline to the utility model.*

# What is “state PSC-quality pricing/terms regulation”?

- Conservatorship utility model is a pale imitation of a full public company utility model
- Public company utility model balances shareholder needs vs. mission objectives
  - Tried and true - in place for over 100 years
  - Track record – very good, not perfect
- Structure:
  - Protection in law of “fair return” to owners
  - Independent commission to make decisions (note: not single FHFA head)
  - Public hearings required on rate of return, other issues.
  - Lots of professional/proper process in law/regulations/precedents
- Implications:
  - Semi-independent commission within FHFA? Separate from FHFA totally?
  - All mechanisms for non-partisanship (SEC style? Fed non-partisan/long tenure style? PCAOB style?)
  - Can probably start via PSPA amendment but legislation eventually needed



## Conclusion: “Boxed in” to the reformed GSE/utility model

1. Workable – actually can deliver the goods
2. Transition risk – minimal
3. Reforms - existing from conservatorship and others - can be locked in via PSPA/legislation, to keep GSEs on the straight and narrow
4. Ensures G-fees set reasonably, and enforced – implicit collusion blocked too
5. Sources of discipline upon GSEs:
  1. FHFA vs. OFHEO
  2. Utility regulation – has various tools: price-setting, approval of “terms”, disallowing costs
  3. SIFMU possibly too

***Best shot at managing the “hybridness” - keeps balance between the “government agency” (to deliver the mission) and “shareholder-owned company” (to attract capital) nature of the GSEs***

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