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WEBINAR

LIVING WILLS FOR HOUSING GOVERNMENT-SPONSORED ENTERPRISES: IMPLEMENTATION AND IMPACT

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PROCEEDINGS

MR. KLEIN: Good afternoon. It's my pleasure to welcome you here today, at the Brookings Institution Center on Regulation and Markets, in our virtual forum today, discussing the future of government-sponsored enterprises, particularly the new and important information and regulatory rule, put forward by the Federal Housing Finance Agency, or FHFA, establishing so-called living wills for the government sponsored enterprises Fannie Mae and Freddie Mac.

Before turning to that, and before introducing our distinguished keynote speaker, Dr. Mark Calabria, I just want to set the stage here for a moment. You know, life, liberty, and the pursuit of happiness are the reasons we formed a more perfect union. Nowhere in that clause does it include the ability for families to own a home, particularly that with a 30-year rate mortgage, which you had the one-way option to repay. Nonetheless, it is essential to life, liberty, and the pursuit of happiness, that you and your family have the ability to purchase a home. Homeownership has become integral into the American Dream, and part of that homeownership structure, that underpins it all, are two of the largest companies in America, that consumers rarely directly deal with, but whose decisions directly affect the vast majority of American families lives, in America.

The regulation of Fannie Mae and Freddie Mac, the two government sponsored home enterprises, has been debated and changed many times, over many years, none more recently or more profoundly than the passage of the Housing Economic Recovery Act, or HERA, passed during the financial crisis to set up a new regulatory regime for Fannie and Freddie.

Subsequently, to the financial crisis, the broader Dodd-Frank Wall Street Reforming Consumer Protection Act set up a new regulatory regime for the largest systemically important financial institutions in banks, and in that regime was created a new resolution authority to allow these systemically important financial institutions to plan their own demise and death, in the hopes that in planning for their death, we would solve problems related to being too big to fail.

It is in that vein that the Federal Housing Financing Agency has recently taken up their own ruling to create their own living will process, a rule that Director Calabria, who I am about to introduce, will explain to us. It is my hope that in better understanding how the director is planning for these government-sponsored enterprises' potential death that we will learn far more about their life, and

in some way, we will find out that the resolution planning for the GSEs will not only impact their future lives, but will actually impact the lives of millions of Americans, tens of millions of American families, as they plan for their future, and figure out their housing structure.

With that incredibly important area, we're going to hear from Dr. Calabria and then a distinguished panel, to react. But let me go straight to Dr. Calabria and introduce Mark. Dr. Calabria was confirmed by the United States Senate and sworn in as director of the Federal Housing Finance Agency, FHFA, in April of 2019. Prior to assuming the helm of FHFA, he was the chief economist for Vice President Mike Pence. Prior to serving Vice President Pence, for almost three years, in the administration, he served eight years as director of the Financial Regulatory Studies Department at the Cato Institute, and where he also helped establish Cato Center for Monetary and Financial Alternatives, showing, once again, thinktanks are where the future leaders of America come from. And before coming to think tanks, Dr. Calabria was a senior aid on the U.S. Senate Banking Housing and Urban Affairs Committee, which is where I first met Mark, where he distinguished himself for both Chairman Phil Graham and Richard Shelby. He served as a deputy assistant secretary at the Department of Housing. He's held positions at Harvard University's Joint Housing Center, the National Association of Homebuilders. He has a PhD in economics. Mark, you check all the boxes to be an incredible housing expert and to have the government experience to have the nation's largest role in regulating the world's largest housing finance agencies. So, Mark, why don't you tell us what you're doing, and how you're changing the world for Fannie and Freddie, and how that's going to impact the world for all of us in the future.

MR. CALABRIA: Seriously --

MR. KLEIN: It's been a pleasure to introduce you.

MR. CALABRIA: Thank you, Aaron, for that introduction, and I know I will always look back with a special fondness for our time together on the Banking Committee, particularly when Senator Shelby and Senator Sarbanes were the leaders on that committee. Let me also, of course, thank the Brookings Institute for hosting this important discussion. Really such an honor to speak before these distinguished panelists, and, of course, this distinguished audience.

Now, I was reflecting upon when President Johnson addressed the Institute on its 50th

anniversary and said, "In field after field, reports and studies, that emerge from Brookings, brought about substantial changes in law and in practice." What he, of course, highlighted is especially important, the power to evaluate, the power to say about public policies, our private choices, what works, what does not.

And I think that's as true today, as when President Johnson said those words, in 1966, that the Brookings Institute continues to inform on those consequential policy debates, and I really -- glad to see you airing out the middle of those, in emphasizing the importance of careful analysis and evaluation, which I think is just critical to making sure we get policy right. And I think that's important, particularly as we think ahead for potential financial crises. As we remember in 2008, American families were hardest by the effects of market uncertainty, about how the largest financial institutions might fail or could bail.

I believe that advanced planning allows the government to act predicably and transparently, and in doing so, helps the public and markets make their own informed preparations for such, and, of course, this is the primary reason that we, at FHFA, have just finalized the resolution planning rule for Fannie Mae and Freddie Mac. The rule is built upon the foundation of the resolution plan, established by the Dobb-Frank Act. Under Dodd-Frank, America's biggest banks are required to create resolution plans, or so-called living wills.

And this is in the event that the institution experiences severe financial distress. Each plan clarifies how it could be placed into a receivership overseen by the FDIC, or also in potentially into bankruptcy, and resolve without destructing markets, are relying on extraordinary government support. I'll note that when President Obama signed Dodd-Frank, he said, "Because of this law, the American people will never again be asked to foot the bill for Wall Street's mistakes. There will be no more taxpayer funded bailout, period. If a large financial institution should ever fail, this reform gives us the ability to wind it down, without endangering the broader economy." I remember, perhaps on the anniversary, that then Brookings scholar, Distinguished Fellow Janet Yellen had to say about living wills, "Enhancements and resolvability protect financial stability and help insure that the shareholders and creditors of failing firms have bare losses. These steps promote market discipline, as creditors demand prudent risk taking, thereby limiting the too big to fail problems."

Let me say, I cannot agree, with then, Distinguished Fellow Yellen's remarks, in terms of

living wills. This is what we are trying to accomplish and are looking to accomplish, with our New Resolution Planning Rule. This rule implements FHFA statutory receivership requirements to prioritize protecting housing markets, in the enterprise's admission, ahead of those of interest of their creditors. Fannie Mae and Freddie Mac, I'll remind you, own or guarantee more than six trillion, in single family and multi-family mortgages, so about half the market.

Taken together, these companies are roughly equal in size to the three largest banks combined. Yet, while banks must operate with leverage of around 10 to one, Fannie and Freddie have recently reduced their leverage to 140 to one. It's fair to say that's not enough capital for them to survive a severe housing downturn. While we recognize that Fannie and Freddie are not banks, we do recognize that an orderly system for settling claims is just as critical to any financial institution, as are appropriate capital standards. And as we learned in 2008, inconsistencies in financial regulations, across institutions, can mask and fuel financial instability.

Ensuring Fannie and Freddie have creditable living wills, comparable to the other largest financial institutions, also enhances the integrity of the entire post Dodd-Frank Orderly Resolution System. It also brings important clarity to housing finance about how FHFA's receivership powers would work, in a time of significant financial distress. As remote as those times seem, when housing prices are rising, as they are today, and, of course, as we know, the housing market today, in terms of prices, are booming. The pandemic drove a surge in already tight housing supply. The supply of available homes, for instance, dropped 40% year over year, to almost half pre-pandemic levels.

Mortgage rates, of course, fell to the lowest levels on record. As a result, in 2020, house prices jumped more than 10%, in every census region. This is the biggest year to year increase in the history of our index, at FHFA. All this added on to what was already the normal housing market's longest period of rising housing prices, without a downturn. We are happy to say that Fannie and Freddie supported this market in 2020, ensuring that mortgage credits stayed available, despite the pandemic's disruptions. I remind you that Fannie and Freddie acquired more than 60% of the single-family mortgages originated last year.

But, of course, the cyclical history of the housing market teaches us that strong house price growth is not a guarantee of future stability. In fact, FHFA's data shows that high house prices have

given enterprise borrowers only a slightly greater share of home equity than they had in 2005, on the cusp of the last graphs. We know that, just as prices go up, they also go down. It is prudent to prepare for the downturns during the boom times. This is what our resolution planning will help us accomplish.

Several commentators in the world suggested that planning for a safe and orderly resolution process is a bad ideal because an enterprise going on receivership is an undesirable policy outcome. Others say that we are committed to doing everything in our legal power to avoid an unnecessary receivership. This is why FHFA has been working to strengthen the enterprise's financial conditions and build their capital. The surest path to avoiding receivership runs their capital race, so that we can secure enough equity to keep Fannie and Freddie solvent during a downturn.

But we also recognize that we have to be ready. I believe the job of any credential regulator is to hope for the best, but to prepare for the worst. The Safety and Soundness Act sets out 12 conditions that could initiate an enterprise receivership. The act also sets out two conditions that trigger a mandatory receivership, that is, we have no choice, in FHFA, but to walk down that road. This rule implements the receivership authorities that Congress gave to FHFA in 2008, so that we can make clear what would work in this process.

I believe it will help enable an orderly resolution process that protects Fannie and Freddie and allows them to perform their mission in a stressed environment. Of course, this new rule requires each company to develop plans to facilitate their rapid and orderly resolution, without disrupting housing finance markets, and, of course, that the objective. I should also note that resolution does not mean the solution. By law, Fannie and Freddie would not be going away. FHFA is required to set up a new company that succeeds to the congressional charters, for Fannie or Freddie. This new claimed Fannie or Freddie would continue operating and fulfilling its mission.

These plans will be designed to protect the mission of the companies, throughout the restructuring process. Therefore, Fannie and Freddie's resolution rule requires the enterprises to develop their plans under the assumption of stressed economic conditions, and without the expectations of extraordinary government support. I'll note these are customary assumptions in the resolution, you know, planning process, established under Dodd-Frank. The planning process starts with each enterprise identifying its core business lines. These are lines that are critical to the stability of the housing finance

system or filling the enterprise's statutory mission. The enterprises must describe how these core business lines can be transferred and operated without interruption.

The enterprise must also identify potential obstacles to rapid and orderly resolution and take steps to overcome those obstacles. These plans will be essential in helping FHFA make key decisions, in the event an enterprise is replaced in receivership. Those decisions involve transferring the core business lines into the new operating entity, in a manner that creates franchise value and positive net worth, making it more likely to attract private capital liquidity. Once the new entity builds enough capital, it will exit to permanent independent status. But charters do not change. The new company will continue to be responsible for all the duties and mission obligations of the previous company.

The assets remaining under the failed company will then be used to pay creditors. FHFA will minimize losses to the extent possible and pay creditors according to the prioritization set out in the Safety and Soundness Act. The law is very clear, that creditors should expect to bear losses. The government's priority is protecting the housing market, as a whole, while continuing the mission of the enterprises. And as important as these plans are, they must be backed up, the capacity with capacity to execute an orderly resolution processes.

Last year, for instance, we hired Jason Cave, from the FDIC, to run our Division of Resolutions. We're also delighted that we recently hired FDIC veteran Mark Steckel, as associate director for the Office of Receivership Management and Governance and Operations. Jason and Mark were both key figures in FDIC's implementation of Dodd-Frank's orderly liquidation authority. And we hope to learn from their experience. They helped over -- they helped oversee the creation of credible living wills, for America's largest banks.

And we are continuing to strengthen and grow FHFA, as a world class regulator. We also continue to strengthen the enterprises. In fact, today, I think we will see the -- we have -- we are seeing the strongest boards, and strongest management teams, in the history of these companies. At FHFA's direction, these teams are working on risk management and other supervisory concerns to ensure their business is conducted responsibly. They are currently building capital by retaining their earnings. Of course, capital was essential for Fannie and Freddie to fulfil their mission to promote mortgage access across the country and across the business cycle. When housing prices are stable or

rising, more capital in the enterprises means more resources to support affordable housing and provide relief to families in relief.

For instance, when COVID hit last year, Fannie and Freddie used their recently authorized retained earnings to help millions stay safe in their homes. And most recently, FHFA announced a new refinancing option that will help low-income families save thousands of dollars on their mortgage. And all of this was possible because the retention of capital. Capital becomes an even more important consideration in the downturn, when housing prices decline, capital absorbs losses, and allows Fannie and Freddie to continue fulfilling their missions, providing stability and liquidity in the housing market, when it's needed the most.

In a crisis, capital with the enterprises offers borrowers protection from foreclosure, the story credit, and displacement. This is especially important for low-income minority communities, who are often the first to lose their jobs and savings. This is why FHFA is making sure that enterprise risk is matched to capital, and it is why I spent the last two years, making every effort to build capital at Fannie and Freddie. I'll note that, when I came into the office, Fannie and Freddie were allowed to hold only $6 billion in loss absorbing capital to back their $6 trillion balance sheets. That's a thousand to one. In September of 2019, Treasury and FHFA agreed to raise their combined capital caps to $45 billion. This change saved Fannie and Freddie from bailing, due to COVID. But it does not mean that they're safe today.

In their current environment, Fannie and Freddie will fail, in a housing downturn. The DSPA amendments that Fannie and Freddie, that we recently agree to, with Treasury, announced earlier this year, was aimed at preventing this, and it makes important changes in progress towards the goal of building capital. The changes to the preferred share agreements in January, effectively ended the net worth sweep. And so, whilst Fannie and Freddie, to build capital, to meet the requirement set out in the capital rule, that FHFA finalized last year. But most of the work, that put Fannie and Freddie in the safe and sound condition, remains ahead. Allowing the enterprises to retain capital is not the same as enterprises having capital.

And building capital is not the only necessary stout. To responsibly exit their conservatorships, Fannie and Freddie must be both well capitalized and well regulated. The resolution

planning rule is the next critical component in FHFA's commitment to protecting the mission of the enterprises and the millions of families who depend on this stable mortgage market. Credible living wills will provide the clear rules of the road needed in times of stress, when large institutions can fail. As President Johnson closed his Brookings 50th anniversary remarks, he said, "When governments are faced with great public dilemmas, they must shape their programs with the greatest wisdom that they possess, but governments must act."

I believe credible living wills with Fannie and Freddie will ensure that. In a great public they'd want to involve these housing (inaudible). FHFA will be able to act quickly, without exposing the financial system or taxpayers to additional risk. This will help FHFA act to protecting Fannie and Freddie's mission, even on the worst conditions. We have built upon the foundation laid by Dodd-Frank to end too big to fail and to protect taxpayers from Wall Street's losses.

With this living will rule, FHFA has prepared an important tool for a world class regulatory regime. But the surest path to avoiding Fannie and Freddie receivership runs through, again, raising enough capital to keep Fannie and Freddie strong, during a downtime. And FHFA will continue preparing the enterprises to fulfill their mission throughout the cycle. Thank you, Aaron, and thank you, everyone, for listening.

MR. KLEIN: Mark, thank you very much. Those are some fascinating insights, particularly the fact that, had you not acted in September 2019, when I'm going to assume you didn't see COVID coming?

MR. CALABRIA: I did not, that's a fact.

MR. KLEIN: That Fannie and Freddie would've gone into insolvency, and I think your broader points about having the courage to stand firm against bailouts, regardless of what the legal structure is, you know, a lot of that is choice. I'd note, you know, other choices were made to support money market mutual funds, despite, by Secretary Mnuchin, despite, you know, ample statements by regulators, over years, that investors would bear losses. And in this concept, there's some similarities to what you're saying here and how the living wills for the biggest banks were created.

We had a question that came in from the audience, from another FDIC veteran, Jim Wigand, and I really applaud hiring Jason Cave and developing that expertise and hiring experts like

Jason and Mark is really a testament to thinking through, but it is -- it -- you are kind of paralleling this on the bank. So, I just wanted to ask you, is it your intent that something different for the GSEs than the big banks, who under the existing living will plan is largely assumed to be sold off in pieces to competitors. There's a single point of entry phenomenon. How does this structure, in your mind, going to be similar or different from what -- from what is planned for big banks?

MR. CALABRIA: Great question. Thank you, Aaron. So, of course, there are statutory differences between our resolution regime, even though the receivership provisions, in HERA, that predate Dodd-Frank, are very similar to the Title 2 provisions. And there are obviously business differences between them. So, for instance, you know, the usual way of dealing with the bank failures, through a purchase and assumption transaction, are, of course, as you've noted, selling parts off.

And so, Congress certainly made a decision, that the GSEs, were they to fail and go into receivership, would be essentially resolved through a good bank bad bank model. So, this -- essentially what would happen, will be all of the good assets, the operational and the core -- the core facilities, the core business facilities would go to a new entity, a limited life entity, that would become the new GSE, whereas the creditors would stay behind, depending on how much need to stay behind. But all of facilities would move over. So, there would not necessarily be an intention, even though we do have a authorities to sell off pieces of the GSEs, that would not necessarily be the first reaction. The first reaction would, again, essentially be a remake of the capital stock.

And that would be the primary difference between the GSEs, and, of course, there are some differences. Dodd-Frank does provide some essential liquidity funding, if you will, from the deposit insurance fund, which is not necessarily intended to rescue creditors, but it is ascended to essentially divide, you know, the equivalent veteran possession financing, whereas a resolution of the GSEs, there is no external funding provided. There's no backup fund, and so, the GSEs would be expected, in a receivership, to fund themselves from their own liquidity, which, of course, is a very important question about how we setup a regime where that can happen.

So, we are, on one hand, absolutely trying to learn the lessons of, you know, what's been done in the last decade, in the bank framework, but starting from the premise of there are important differences between Fannie and Freddie and the banks, and, of course, Title 2 resolutions, outright,

because they're not just meant for banks, but can be also used for designated insurance companies or any large non-bank financial companies. So, again, all of these things are taken into consideration.

MR. KLEIN: It would be amazing if we designated things beyond just non-federally regulated insurance companies. On the living -- I won't ask about your job as an FSOC member.

MR. CALABRIA: The only way --

MR. KLEIN: The living wills, as I read the rule, doesn't really spell out exactly how the enterprise will achieve it. It's just that they have to be credible. How long do you anticipate it will take them to develop a credible will, and do you -- a living will, and do see any big sticking points that may make it not possible?

MR. CALABRIA: It's a great, great question, and I will emphasize this is meant to be an iterate process. No, I'd certainly would be, you know, would love to hear our friend Erin Barry's prospective on the next panel. I lost count, but I -- if I remember correctly, Wells had their living will rejected on, like, three different occasions. So, I am -- and, of course, Wells was not alone in that. I don't need to single out Wells, necessarily, but just as you saw over the last decade, the living will process with the large financial institutions and banks was an iterate process, where there was a back and forth.

We've already spent a tremendous amount of time, the last six months, in the development of the rule, in conversations with Fannie and Freddie. I can already say, the things that we have learned in six months, that would be obstacles that we've already made changes to, you know, we've already a considerable amount of progress. You know, I don't want to put time on it, necessarily, but it's certainly my expectation that it shouldn't take us more than six to 12 months to really come up with credible plans, partly, of course, because Fannie and Freddie, you know, are much simpler. You know, if you think about it, in some ways, compared to our largest banks, you know, there's no holding company. There aren't hundreds of subsidiaries. You know, I don't need to call -- one didn't coordinate because there'd be four in subsidiaries. So, there are a lot of instances for Fannie and Freddie, where their simpler business model, you know, actually makes it a much more straightforward plan.

I wouldn't necessarily put words into the mouth of my staff, but I think I would just -- would feel comfortable saying, when we started looking at this, over six months ago, and, you know, I would -- do want to, you know, thank the FDIC for not only letting us hire Jason and Mark, but, you know,

Chairman McWilliams detailed a core group of people to us, for a few weeks, to help us think through these issues, and I think the immediate reaction, six months ago, was, well, we don't that this is doable. And I think the staff reaction, today, would be, this is doable, that we've spent this time thinking through what are the obstacles. You know, for instance, we've learned that a lot of the processes and facilities, that the FDIC provides during bank resolutions, much of that, there are vendors in the corporate bankruptcy world that you can hire.

So, for instance, and we're going to try to put as much of this information out as possible, but I would say over the last six months, I've become increasingly convinced that, were we, unfortunately, forced to be in a situation where the GSEs need to be resolved, via receivership, that we could do it. You know, we've gone through a lot of scenarios. We've done a lot of tabletop exercise planning. And, of course, we learned new things new things every day, and, again, I want to emphasize iterate processes we try to learn with the GSEs and as we look at different potential outcomes.

MR. KLEIN: Let's hit fast forward and rewind at the same time, for those of you who remember when there were tapes, not just streaming, but, so, 12 months from now, there is credible living will in place. You guys have signed off, it works, and then we're going to rewind. So, we have -- if you -- do you believe that if a credible living had been in place, into the financial crisis in 2008, that FHFA would have been able to place the GSEs into receivership?

MR. CALABRIA: So, the question is would have been able. And I do think that if we had had something in place, that would be possible. Of course, it's certainly fair to say, that, you know, if you're going to pose hypotheticals, and I guess, you know, given your involvement in Dodd-Frank, I would ask the same question, and say, you know, if Title 2, had been in place, in 2008, you know, would we have bailed out their (inaudible). Would we have bailed out AIG? Would we have had to pass the tarp? And, of course, there's a degree to which that (inaudible). I think the fairer thing to say, both in relation to GSE living wills, as well as living wills for largest banks is, you know, if we don't have the tools in place, and we don't do planning ahead of time, that absolutely makes the possibility of bailouts much higher.

So, I think about this as probabilistically, and I think that having the living wills in place and having the planning in place make it much more likely that we can maintain critical facilities. We can support the market, without having to fall back on taxpayer support. And again, this is the same sort of

objectives that Dodd-Frank was trying to achieve, and I believe we're achieving them in the same manner.

MR. KLEIN: So, let's turn the table here --

MR. CALABRIA: Sure.

MR. KLEIN: -- because living wills are about the death of an institution, but many view death not as the end, but rather as a moment in the cycle of life, that turns to rebirth. And without getting to far into Eastern philosophy, we might quite like, right, if you think of death and birth are interrelated concepts. The GSE is somewhere -- somehow are in neither. They're in a state of purgatory, a conservatorship that has gone on for 12 plus years, without having transitioned into either the death, or resolution, or rebirth. Some people would call that recap and release. You know, the cycle of life is great, as long as it keeps going. Hitting pause doesn't seem to work. You know, what does having a living will in place mean for the future of the enterprises? How are we able to take this advance and turn it around, going forward, and what does having a credible living will mean for the future of these GSEs, as they currently are structured, Fannie and Freddie?

MR. CALABRIA: You know, at the risk, again, with the medical critical angle. Let me just -- it is such a great question, Aaron, and it certainly reminds people that, you know, the conservatorship is not meant to go this long. The longest bank conservatorship was 18 months, and that was considered an outlier. It certainly is someone who worked on HERA. You know, there was never any expectation that there would be an endless conservatorship. So, to me, this is not the path that -- that the last 12 plus years, almost 13 years, is not the path that Congress laid out and intended.

And part of that, of course, was because that HERA was passed in July of '08, and then September '08, where the conservatorships were put in place, was there simply wasn't enough time to build out the resolution framework that was in statute and to get comfortable that it could work. So, I -- what we're trying to achieve with the living wills is trying to figure out how to make the resolution framework work. In a way, you see that, fortunately, if Fannie and Freddie become insolvent again, which, again, you know, we want to avoid that, but I think the reality is, as I mentioned in some of my remarks, you know, we're probably more at the top of this housing cycle, than we are at the bottom.

You know, and one can debate the roles of the PSPA, but I would be clear that, you

know, from our scenario planning, you know, were we to see a 2008 situation, even if you use the PSPA, Fannie would burn through all of its PSPA, and we'd be in a receivership. So, my hope is, of course, that we can build capital and strengthen these companies, in the time we have left before we hit a stressed environment in the housing market, which, again, I don't have a crystal ball, but I think that's an evitability at some point, and so, there is a race against the clock.

But I would go back and say, had we instead -- and let's say that we had passed this resolution regime into place and had a living will in place, 2008, great. For your previous question, then, we could have resolved Fannie and Freddie, losses would have been posed upon creditors. You would have put a clean GSE back out, and, again, we were basically back to normal, in the GSEs would be out of conservatorship. So, again, I believe this living will helps take us down the road to actually having a resolution, no pun intended, of the current situation.

MR. KLEIN: Well, I'm going to take the resolution of the current system, as a brilliant way to use language, as you will often do, Mark, that could have multiple meanings, all of which are internally logically and inconsistent, and using the government role -- give you some optionality and flexibility as you pursue this agenda in the future.

We're at time, and I want to thank you, the willingness of your staff to work together, and the willingness to come forward and present these ideas and concepts here, at Brookings, today. Thank you very much.

MR. CALABRIA: Really, such a pleasure, Aaron, thank you. And thank everybody for listening.

MR. KLEIN: Great, I'm going to now turn to our panel and technology will be wonderful as they magically pop-up in the boxes, as we move forward. It gives me great pleasure to introduce Erin Barry. Erin is a vice president for Housing Policy at Wells Fargo. She's -- previously was the vice president for the Mortgage Bankers Associations and served distinguishably on the committee staff of the Senate Banking Housing and Urban Affairs Committee.

Ed Golding is a professor at MIT, where he's looking at the future of finance and housing. He's served previously, essentially, as the Federal Housing Agency's commissioner, and in addition to his distinguished tenure at HUD, was a chief economist many, many years ago, at Freddie Mac.

And Mike Calhoun. Mike Calhoun is the president for the Center for Responsible Lending. Mike is also the author of a paper with Lou Regnery, talking about the GSEs at crossroads. This is a proactive paper Brookings published, several months ago, proposing a direct plan for Fannie and Freddie that would end this Purgatory and result in an unprecedented availability of $10 -- $50 to $100 million, which he proposes to put forward into a panel for restorative justice.

We've asked all of you to come here, and come back and react to the statements, and react to what Director Calabria just proposed, with living wills. So, with that, let me pause and say, Ed, what's your reaction, and take it away. What do you think of all this?

MR. GOLDING: Well, I think I should have read my Dante before agreeing to this panel, but it's been a while since I've studied Purgatory. So, first of all, you know, let me point out a benefit of the living will, that Director Calabria alluded to, but I actually think is the most important one, is that it really gets the board of directors, the management, to understand what the companies are doing. I think, you know, too many of the boards, get power, you know, feel good PowerPoints, time and time again, and the -- a living will is much sort of disaster planning.

So, it's a very useful exercise to really understand what do you own? What are you responsible for? What are the operations? How could you, you know, basically farm some of that out and the like. So, I think it's a very important exercise to go through. So, I think that's the, you know, the number one. These -- even if we don't talk about receivership and a recasting of 2008, these are useful exercises.

You know, the other thing that I will jump to, though, and Director Calabria knows much more about it than I, is I think the elephant in the room really is how easily you can transfer the charter. What does it mean to be a limited life enterprise? Because I think the secret is these -- the GSEs can't do anything but for their charter and but for the implicit guarantee. So, I do worry a little bit about whether we -- what it means to be a credible living will, given the importance of those charters, because unlike the OCC or the, you know, families charter a new bank or find a new bank with an existing charter to transfer things to, and you can't do that with the GSEs.

There are only two charters, congressional and authorized charters. And you put them into a limited life company, I'm not sure how it works. That's not to say don't do the exercise. You don't

have to make assumptions. And I'm a big believer being, you know, (inaudible) University, putting things back in writing helps you learn from it, but I think that is sort of the elephant in the room.

MR. KLEIN: Jump on in Erin. What do you think?

MS. BARRY: And, you know, I agree with Ed that it is a useful exercise, and, you know, Mark referenced the living wills for some of the large banks. You know, it -- it's going to be a challenge, at first, for the GSEs. It is a challenge to go through it, and -- but it also helps identify where some of those friction points are, so, both for the institutions and for the market, in general. Identifying those things, ultimately and ideally, creates greater stability, both for the institutions and the market, you know, and having -- I think Ed is probably right, that stability is probably the most important thing that the GSEs can provide to the housing market. It helps with affordability. It helps maintain consistency. It helps in situations like we're going through right now with pandemic, where you can move some quick policy changes to help customers stay in their homes, during this unprecedented situation. So, all of those different things, you know, help the GSEs maintain that stability, and making sure that, in a downturn, we know what will happen to them, and where their friction points are will just extend that stability.

MR. CALHOUN: So, these living wills sort of have two different functions. The ostensible one is how to provide for orderly resolution in the event of a crisis, although we -- which is hopefully quite, quite remote for the GSEs, given a whole slew of protective steps that individually each greatly reduce the risk and together remarkably reduce it, will it yield dramatic increase in capital, offloading a risk, an incredibly safer mortgage market, and then, of course, having an explicit government backstop paid for.

So, one thing I would -- I think it's at least equally and maybe more directed to send messages that affect operations in the upcoming years, in normal times. And those messages are to the GSEs and to investors. And really, the key provision in this rule is section 1242.5, and it -- what it says is, and it answers the question, it says, in planning for resolution and planning for your will, the GSEs may not consider or include any support from extraordinary government actions. And included in that are the existing PSPA backup support, the extent agreement with Treasury.

So, first of all, it answers this question or attempts to lock in an answer to the question of is the Treasury backup, if you will, an insurance policy that they've paid for and they could dip into, in a

time of great stress, or is it they are to protect, if you will, the market and their successors. And it tries to answer that to say it's for the market and your successors, which sends two messages, that the GSE management should be more cautious and have an even greater buffer, that that would be a turn out the lights scenario, rather than a get some assistance and keep going. And as Director Calabria eluded to in both the rule and in his comments today, it's also a market signal to investors, that he notes and FHFA noted in the proposed rule, that GSE debt is essentially priced virtually identically with government debt, rather than with commercial debt, even high-quality commercial debt. And that is premised on that there is almost no risk, and part of this, and he indicated this in his comments this morning, is they're very explicit in the rule about -- that the investors will be paid according to their security interests and losses should be expected, so that you should have a greater interest and a greater scrutiny of the GSEs operations and not treat them as de facto full faith and credit government backed up, and then let others jump back in. But for us, one of the big concerns is, particularly in this time but always, a real central focus of the GSEs is their affordable housing mission and something they need to do far more on, particularly in the context of the racial homeownership gap. And it's very unclear, the rule does not provide a template. And so, he wanted it to be an iterative process. There were specific comments of should there be a template. And FHFA explicitly chose not to provide a template for the plans, and so, there's a wide range of outcomes of what a acceptable plan could be. But there's talk about core business loans, essential business loans, and it's unclear, for example, the extent to which affordable housing is treated as a core business line that must be protected through one of these transitions.

And then, finally, I would note, wait, you know, we've been talking about, well, how do you get one of the GSEs through resolution and rebirth without disrupting the market, when the odds are high, that if one is going under, they probably both are going under, given the similarity of their risk and similarity of their markets and protections. And it is an order of magnitude greater challenge to replace a whole central function of the housing market versus one troubled entity.

MR. GOLDING: Can I jump in?

MR. KLEIN: Yes, please.

MR. GOLDING: You know, in some ways, I think we're all sort of talking about sort of the -- how well receivership would work, given HERA, and given you don't have an FDIC, and you don't have

a chartering authority, so that we borrow something from the banks that just ain't going to work in this environment. And I think a lot of us, I will agree with Mike, it's probably a really credible living will, it's probably the null sect. That doesn't mean that it's not a useful exercise. It doesn't mean that the regulator, at the end of the day, gives you a passing grade and says good to know. But a very -- a really truly credible living will may be the null set.

The other thing that Mike points out, and I sort of worry about this and sort of don't, is could this exercise break the implied guarantee. And having lived through 500 "reforms", SEC registration of the equity, getting rid of the two and a quarter billion-dollar Treasury this, this and that, I don't think you can break the implied guarantee. Now, if this does it, we're in trouble. So, I think Mike's point, be careful what you wish for, is always useful. But, so far, we've never broken that implied guarantee, as much as people want to.

The last thing where this does -- the bank -- you know, pulling in from the bank analogy, and we tried this with subordinated debt, last time, and it didn't work, when Treasury bailed out the sub debt. This might be another time to get convertible sub debt back into the system, as a sort of belt and suspenders, the loss absorbing capacity. So, you really can't put the losses onto the MBS or the, you know, the straight debt and still have a GSE system. In theory, you could do it on a sub debt that's convertible. We tried something last time, it didn't work. But I very much agree with Mike. If you break -- if this breaks the implied guarantee, it's a terrible idea. I'm just having -- as much as people want to break that implied guarantee, no one's figured out how to do it.

MR. CALHOUN: Just to be clear, you know, the PSPAs provide that the Treasury guaranteed to the investors and MBS is irrevocable, and so, even in the case of a resolution, you would still have the 200 plus billion standing behind the MBS. So, for all intents and purposes, they have, and I think they recognize today, they have is effectively full of faith and credit on the MBS, but it would not -- it would say that that backup is not available to creditors and to management of the GSEs.

MR. KLEIN: Let me just parse a little bit for everybody's who's not playing the acronym game at home. The MBS are the mortgage-backed securities issued by Fannie and Freddie, recycling the mortgages, right? Your mortgage is likely in one of these Fannie or Freddie MBSs floating out there with investors, right, issued by Fannie and Freddie, not issued by the bank. Fannie and Freddie

separately issue their own corporate debt, under their name, which is not backed necessarily by a specific mortgage or mortgage payment. And so, there's a distinguish about how creditors are treated between people that own the mortgage-backed security and people that own the Fannie and Freddie debt, itself. Erin, I don't know if you want to jump in here and --

MS. BARRY: And I think, you know, the talk about breaking the guarantee and does this lead to either breaking the implicit guarantee or the need for some sort of legislative explicit guarantee. You know, I think that's a conversation we've been having for, you know, decades maybe, at least a decade, you know? Ed, and Mike, and I, and Aaron, you, too, we've all been on a number of those different calls and panels about establishing that explicit guarantee. And I think that is, you know, the question about resolution for the GSEs. If you think they can be resolved, what does that do to market stability? And I think that's where this idea of the implicit and explicit guarantee come in. How do you make the market work, if investors don't know what their risk is going to be on any individual, whether it's a security, an MBS, or if it's the debt of the companies? So, making sure that that is clear, so that it doesn't, then, float down to the homebuyer, and that's where all this gets back to is who's buying the home and what does it cost them? And that's ultimately the purpose of the GSEs, is to make sure that you can buy a home, get a 30-year fixed rate mortgage at a reasonable interest rate, across the country, you know, with full underwriting.

MR. KLEIN: So, let's get back to that optimism or pessimism, as Erin, and Mike, and Ed have talked about. And, Mike, I take your point about one failure versus both. I worked on the auto bailouts and the auto failures. And it was very clear that GM and Chrysler were in a very different position than Ford. And it was also equally clear that without GM and Chrysler there is no Ford. Their common supply chain was structured so that even if the companies had made different decisions, the world didn't exist. There was no one while the other lets you die, right? One could have debated whether Chrysler could or couldn't have. But GM and Ford kind of can't, at the time, at least.

And I think that was true in prior auto bailouts in the '70s, right? We talk about this problem with the GSEs, now, as if it happened in 2008 and it had never happened before, but those of us with longer institutional memories know there had been trouble. In fact, there had been trouble at various iterations, the even creation of Freddie Mac, itself, is birthed in the story of the savings and loan crisis of

the ’80s.

You know, the living wills had the biggest bipartisan support of any provision in Dodd-Frank. Over 90 senators voted on behalf of Title 2. They’ve been, you know, roundly supported. In fact, even the Trump administration kind of doubled down on the living will idea and this idea that you could create very specific amounts of debt of different duration, that would or wouldn’t work as the bank company -- holding company goes through receivership. As Director Calabria points out, banks have these different corporate structures with holding companies at tops, and then banks and subsidiaries beneath, which is very different from how Fannie and Freddie are. But they’re modeling this on the FDIC. They hire the FDIC staff, they -- et cetera, and so forth.

So, you know, Mike, you’ve read and understood this rule to the point where you’re quoting very specific sections on it, which is -- I love in a reaction panel. People have actually read the rule. I wish all reaction panels were filled with people who had read the rule across all of thinktank and government land. You know, do you share the director’s optimism that this could work, even in your scenario, which feels the more likely that both of them are trouble? Then, and then I’m going to go around. Everybody’s going to have to answer the same question. Do you share the optimism? Do you think this would work?

MR. CALHOUN: I think that they’re very difficult transition questions that make it unclear. The goal, as I think Dr. Calabria said, is to reduce the probability that you’re forced into this situation by encouraging safer behavior. You know, if I can, just -- I’ll clarify my remark, well, the -- about -- and apologies getting into the weeds. The one real unanswered question here is what is the long-term agreement between the government and the GSEs. So, the current agreement they have says, we back the MBS and the corporate debt, and that’s irrevocable. It can be changed in the future, but for debt that is issued and outstanding, once it’s issued and outstanding, the same with MBS, the guarantee cannot be changed by the government. So, that’s the existing agreement that’s enforced.

But a big question is, you know, we saw a significant PSPA agreement, that essentially the agreement between Treasury and the GSEs, the significant agreement by letter amendment, actually. All it takes is the signature of the Treasury secretary and the director of FHFA, that made significant changes to that agreement in January. One of the $64,000 questions will be in the resolution of the

GSEs coming out of conservatorship. What will be the nature of that contractual backup agreement with Treasury and the Federal government? Because that will profoundly affect all these questions, including what would happen if an actual resolution had to take place?

MR. GOLDING: So, I'm -- you know, would it -- I guess my answer is it won't work as is, that we have the current conservatorship, that's lasted, you know, 13 years because it works. You know, I know it was sold as a temporary time out. I turned -- when I heard that, I turned to the person next to me and said my under over was 20 years. I think I'm still on the money on that. And I -- you know, for whatever sausage was made on that September 6th, it was pretty good sausage. They figured it out. You know, I give a lot of people credit. And it's sort of worked.

This alternative sausage I don't think will work in the current structure, and you need two ingredients, I think. One is that you need a full faithing credit, you know, FDIC paid for insurance, at least on the MBS, so that is sort of, you know, always there and irrevocable. And I think you probably need a way of getting that charter, a new chartering authority, so that it's not in a limited life entity, that for this charter to go forward and do 30-year mortgages, I think you need to be able to somehow either get it out or more -- have a new charter.

And I think you need those two legislative changes, but we'll never -- you know, it's a counterfactual that's hard to know. I will back up and say it's still a good exercise to go through. I just don't think when you rewind that, your tape, Erin, and by the way, if you push both buttons at the same time, you really ruin that tape. So, be careful. But, you know, it's a good exercise. I don't think -- I think we got conservatorship for 13 years for a reason because that is the structure that, you know, has kept a stable mortgage market going. Erin, over to you.

MS. BARRY: Thanks, Ed. You know, I do recall taping things off the radio, as a kid, so. And I think, you know, it is a challenge, I think, when you have two monoline entities that underpin trillions of dollars in the housing market and somewhere between 15% and 17% of GDP. You know, I think that is -- any sort of change to that is going to be difficult and planning out that change is also going to be important, just so you have at least a playbook to work off of. But, you know, I think I kind of am with Ed and Mike, in that getting to the place where you can run them through a receivership, have them come out the other side, in some sort of LLRE situation, which then gets sold off in some other, you know,

financial interaction -- in a financial interaction. And it's going to create a lot of friction and a lot of chaos in the market, for at least a short time, and I think that's the part that hasn't been thought through and that I think makes everyone very nervous in the housing space, when you start talking about receivership or the GSEs and resolution for the GSEs.

MR. CALHOUN: There's one interesting model, I think, to look at here. We haven't talked too much about it today, is people have noted that the GSEs today, you know, in very conservatorship, they have, in many ways, acted and been regulated as de facto utilities and a broad group of organizations, including ours, call for that as the long-term structure for them. There are utility resolutions, the biggest one, one of the biggest in history, being, just in the last two years, with PG&E, in California. I do think it -- and, you know, with a catastrophic event, the wildfires, that caused horrendous damages and liability for PG&E. That was done through Chapter 11 reorganization, and there are some similarities to a utility, where I think it was 16 million Californians, not easy to turn off the lights, literally, build a new company, transfer a few of the -- some of the assets.

Again, it's still -- it's good to think about these exercises, and it certainly is part of Dr. Calabria's general theme of paralleling the bank and GSE regulation. A number of us feel like the GSEs, though, are different, that they -- and they do note this in the proposed and final rule, that they are centrally monoline guarantors who offload a lot of their risk, a much less complex model than you have in the banking world.

MR. KLEIN: Well, I -- let me end this with one final question for the group, and I'm going to kind of riff a little bit on what Ed said about Dante and Purgatory, and your 20 years certainly looks in the money, right now. I'd point out that Jews wandered in the desert for 40 years, between Egypt and Israel, not because God didn't know how to get from Egypt to Israel, but because there was a desire that that generation who had lived in slavery should wander for -- and die out, and the generation that founded the new country should not be encumbered by the legacy of the past. So, I don't know if you picked 20 years, Ed, as a political historian or thinking about the cultural time. There's some theories that we have financial crises every three generations because the children remember the problem from -- the parents remember it, the children remember it, and the grandparents -- the grandkids think we've gone beyond it.

But I want to flip to Eastern philosophies I mentioned earlier and think less about Dante

and more about kind of the Vedic scriptures that, you know, death and life are inherently intertwined. We think of them as being very different in the Western philosophy, but, in certain Eastern philosophy, how you approach death tells you a lot about how you approach life, and it's a cycle, as I mentioned earlier. And so, I want to talk about not, you know, the living wills as the plan for the death, but what the rebirth of the GSE should look for, specifically what new GSEs -- what should we do, going forward, to mean for the mortgage market, for the mortgage finance market, how we should get out of this pathway of conservatorship, in whatever time it takes, to enter into a more stable situation that achieves the goals enumerated by Congress, shared by different folks of a stable mortgage market that gives opportunities for all Americans.

And, you know, Erin, I think I'm going to start this one with you, and then Ed, and then, Mike, I'm going to let you have the last word because you had a big paper on that, on utilities, that I hope you'll address a little bit and share some of your wisdom from that, a little bit more, but, Erin, why don't you start us off with what does this death plan teach you about life, and where do you see the future of the GSEs, going forward?

MS. BARRY: So, I think the death plan of the GSEs and or the rebirth plan of the GSEs, maybe that's a little more positive spin on it, it does create a lot of potential opportunities for what they are reborn as. And I think that that's a fundamental policy question that, you know, has been part of the GSE, you know, mission, to be -- from the beginning. You know, are they just an entity to expand access to credit and create a national mortgage market, or are they an entity that should, you know, go deeper into our housing space, and as we've all been having these conversations over the last several years, but particularly over the last year, you know, is there a way that the GSEs can use their mission to get deeper into the equity conversation, homeownership equity? And I don't mean the amount of money you have in your home, but I mean the ability for different communities to access homeownership.

You know, I think there are a lot of conversations that can happen at the GSEs about where they target some of that cross subsidy that they have. How do they expand, whether it's working with lending institutions for special purpose credit vehicles, whether it's pulling back the LLPAs a bit to expand lower down payment loans, and some of those items that go into -- you know, it's that rebirth of what -- what is the GSE reason for being? And this creates that opportunity to really expand on that. I

think we're past the point where we need to create a national mortgage market. They already have done that. Now, how do we create a more equitable mortgage market?

MR. GOLDING: That's well said. Let me sort of just build on that. One, and sort of for this rebirth, we have to remember the importance of the liquid security. We've not talked about the common securitization platform. I think it's a subsidiary, but we better plan for a very liquid mortgage market, going forward. And I think you can -- you know, this would be a time to even improve on what the common securitization platform does. And I think one area where if I think of rebirthing is we should also think about how to get new charters in here.

You know, it's somewhat controversial, but I think we've gotten -- we've given too firm sort of monopoly power, that's never good. I think, for a lot of this, especially if you have a liquid security, you, under certain circumstances, you should allow new entry, especially when you think of FinTech and the innovation. These companies are not as innovative as they might be, and even the threat of a birthing, a younger sibling, I think was -- would be very powerful. I know Fannie got better when its younger brother showed up, even though they -- it was a pesty younger brother. So, I think we should think about new siblings in this birthing metaphor. Stop me here, Aaron, if this metaphor goes off the rails.

And I -- then I'm going to pick up and just triple down on what Erin just said. We have to, in the rebirth, we have to put it through a racial lens and, you know, sort of a reckoning. There's a lot of systemic racism still in -- to the current structure. LLPAs, prepayment options all seem to not -- you know, all seem to -- they all stack up against, especially African American and with (inaudible) communities. And if you're going to do a rebirth, we really should dismantle -- I would go much further than just talking about cross subsidies. I would really dismantle a lot of what we've built up, without realizing it. So, that would be my third point, if we were to do a rebirth.

MR. CALHOUN: Well, I strongly agree with the goals, and in particular the focus on racial equity, and that the GSEs today, you know, about four% of their loans go to Black households, which is not helping close and, in fact, maintaining the racial, extreme racial, homeownership gap. I think that the GSEs have moved, and perhaps the greatest push in this direction, to his credit, has been from Dr. Calabria. They've moved to being public purpose utilities, which is very different from being a

commercial bank, which clearly benefits the economic system, but it is not a -- specially chartered with just a public purpose that so much overrides a lot of normal constraints, and two -- just two things.

Director Calabria was among the most proactive when the COVID crisis hit to protect families and took extraordinary steps that a private for-profit company normally would not do. It provided forbearances with modifications at the end that let people skip payments now, for 18 months, and simply have them added to the end of their loan, with no additional interest or fees. That probably costs north of $10 billion for the GSEs to do that. But it was hugely helpful, both for the homeowners and for the overall housing market and the economy. They -- the GSEs picked up the cost of advancing payments for servicers, again, without charging the servicers a fee for doing so. It stabilized the whole mortgage servicing market, which prevented huge disruptions to people. I think, you know, those actions were widely applauded, and implicitly, our endorsement of a public utility, public purpose model for the GSEs, and that's how we should move forward with the racial equity lens.

MR. KLEIN: Well, I'm going to thank you very much, Mike, and note that Director Calabria did everything that you described, without bailing out the servicers, rejecting calls, which were very widespread at the time, to provide additional servicer relief to private entities. But still, you know, the disruptions on the servicer bailout, the servicer bailouts were meant to supposedly save us from -- never materialized, and so, if you're saying you're giving him high marks for providing consumer relief, and the record shows that he held off significant pressure from bailing out private industry, that ultimately survived without it. I had to needle him a little bit earlier about the bailouts given by Treasury Secretary Mnuchin to the money market mutual funds, despite promises to the contrary, as he used to constantly needle me when we were -- when I was at Treasury or on Senate banking and during the financial crisis.

Ed, I'm going to close by pointing out that we have two girls. They both come home from an extremely rare day of in-person learning, which I wish there were far more of, and I wish my beloved Montgomery County, Maryland believed in science at more senior levels. And I may take your arguments as to whether or not my twos would be improved by having a third. I suspect that may not -- that -- we'll see how that goes over at the dinner table. And what's best for my family and what's best for yours is not necessarily the optimal way to structure housing finance.

But the optimal way to structure housing finance is what's best for the children and the

families of America because where children live determines a tremendous amount of their future. And if you have a segregated environment, and Mike's statistic of 4% of GSE loans going to Black families is revolting, to me, indicates that we have a serious problem with the status quo, perpetuates the legacy of segregation, that unfortunately dominates way too many communities and lives way longer than it does, even in my formerly segregated state of Maryland, and we have to do a lot better. And years of Purgatory are not the solution.

Now is the solution, and this conversation, I hope, moves us closer to that solution. So, join me in thanking Erin, Ed, Mike, and Dr. Calabria for joining us here today at Brookings, and let us pledge to work together towards a better future. Thank you all very much. Have a great afternoon.

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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