

Suggestions for the reform of the GSEs are generally based upon assumptions that are not easily tested. Here my key assumptions are that the fixed rate mortgage is a desirable product and that some form of government support is necessary for its continuation. The recommendations below represent an amalgamation of ideas from a variety of sources.

I recommend that the GSEs be reconstituted as securitization-only utilities. The utilities would create MBS with senior and junior bonds. The US government would provide an explicit guarantee on the senior bonds and would receive a wrap fee for providing the guarantee. The junior bonds would be guaranteed by the utility which would receive a guarantee fee. The utility would also reimburse the government for losses on the senior bonds up to pre-specified limits and would be subject to capital regulation from the government guarantor.

Allowing the utilities to sell the junior (non-government guaranteed) bonds into the market will provide more efficient pricing of MBS and if implemented appropriately create market discipline on mortgage credit. The use of junior bonds will allow the government to increase its protection from losses without significantly increasing mortgage rates.

Separately, I recommend that the utilities be structured as cooperatives owned by mortgage originators, based on the assumption that cooperatives tend to reduce risk and increase mutual enforcement of rules. I believe fewer (2-5) such cooperatives would be optimal so as to avoid a race to the bottom and to allow investors to carefully analyze the operations of each cooperative. The utilities could then be called Federal Securitization Cooperatives.