Andrew Davidson
Three Dynamics of Credit Risk Transfer
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One. The value of the methodical and far-sighted approach that Fannie Mae and Freddie Mac have taken with respect to loan origination quality, servicing practices and establishing the risk transfer market. In the wake of the financial crisis, and the central role of the mortgage market in the meltdown, there was widespread disgust with the housing finance system and the lack of integrity in the quality of the loans being created. Under the effective supervision of FHFA since that time, Fannie Mae and Freddie Mac have reasserted their successful role as standard setters of mortgage quality. As a result of these process improvements in origination and servicing, we have seen defect rates and early delinquencies fall to perhaps unprecedented levels. The quality of these processes forms the basis for investor confidence in the risk sharing transactions.

Two. The success of a government-private partnership. At mid-year, Freddie Mac and Fannie Mae were paying out, on an annualized basis, nearly $1.2 billion to investors in STACR and CAS to take mortgage credit risk. Combined with additional monies paid to reinsurers, mortgage insurers and lenders, plus market growth, this could rise above $4 billion in the next few years. This cash flow gives rise to a deep and increasingly liquid market comprised of multiple executions to distribute risk that was previously concentrated in two entities. Given the lack of capital at Fannie Mae and Freddie Mac, this risk is being transferred from taxpayers to private investors. As one participant said to me, this market is exciting because it is not tinged by the same moral ambiguity as the sub-prime market that we knew was based on flawed economics and predatory practices. FHFA deserves significant credit for its oversight role and for recognizing that trading income for risk sharing is a good deal for taxpayers.

Three. Credit Risk Transfer is not just a tool of the Government Sponsored Enterprises. Other firms, including Arch, Penny Mac and JPMorgan Chase, have recognized that the concepts and techniques that underlie the GSE programs are also valuable for the creation of new business models. In the past, we viewed securitization as a method to separate origination from risk taking. In the new paradigm, firms develop origination capabilities and can use credit risk transfer technology to decrease, or increase their risk exposure to the mortgage market. Execution in the capital markets, insurance markets and reinsurance markets along with traditional securitization technology creates additional flexibility for the well-positioned firm.