

OPINION

Ban mortgage-backed securities?

Frank D. Tinari
and Dominick Mazzagetti

One of the big reasons for the financial meltdown of 2008 and the subsequent undermining of Main Street's economy was the collapse of the value of mortgage-backed securities. So would it help our recovery if they were banned entirely?

Mortgage-backed securities were first developed in the late 1970s and early 1980s. By buying home mortgages from banks and financial institutions and then combining them, new securities were created that could then be sold to investors. They were generally viewed as safe and reasonable investments because the underlying mortgages did not carry a substantial degree of risk. Agencies that monitored the quality of these investments gave them triple-A ratings.

Then, in 1995, Fannie Mae and Freddie Mac, federal government-sponsored enterprises that helped folks finance house purchases, were directed by federal regulators to buy and guarantee more mortgages of low- and moderate-income borrowers, and then borrowers with "very low income." From 2000 to 2006, lenders lowered down payments to 4 percent on riskier home loans. During this same period, average U.S. home prices nearly doubled. A flood of government-subsidized lending for home buyers ensued, with total credit-market debt reaching \$43.3 trillion.

Yet the triple-A ratings did not change.

At the same time, the Federal Reserve Bank gave member banks more credit for owning mortgage-backed securities than many other assets. In 2004, the Securities and Exchange Commission applied the

same standard to investment banks, generating a surge of purchases of the securities by the likes of Merrill Lynch and Lehman Brothers. Mortgage-backed bonds were yielding attractive returns and yet had the "safety" of triple-A ratings. A flood of investors from abroad added to the demand for these instruments.

With the collapse in the housing market, the value of mortgage-backed securities also collapsed, causing financial institutions to lose billions of dollars.

Many securities that went bad were private issues backed by high-

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risk, sub-prime loans. Buyers of these securities had just looked the other way, figuring that rising property values would bail them out from any losses. Negative repercussions spread throughout the economy, hurting jobs and business.

Could this debacle have been prevented by banning mortgage-backed securities?

Well, first consider their benefits to banks. Allowing banks to sell the mortgages they have issued frees up capital for other investments, instead of locking it up for decades in mortgage loans. Banks can also sell long-term mortgages (i.e., 30 years) while investing in securities backed by adjustable mortgages to lower their overall interest rate risk.

Also, if a bank needs cash, a security can be sold in the open market

compared with regular mortgage loans that can take weeks to sell. Moreover, mortgage-backed securities from Fannie and Freddie come with the "full faith and credit" of the U.S. government, making them more secure and thereby not requiring much scrutiny.

So, if such securities were prohibited or severely curtailed, the benefits to banks would also disappear, raising costs, which would be passed along to savers and borrowers.

The bottom line is that real economic growth on Main Street depends on the availability of bank credit. So what can be done?

The following steps would be a good start: Banks and other mortgage lenders must return to traditional lending standards for mortgages. Rules must be put in place that limit government agencies from weakening those standards. Such rules would provide greater assurance that a financial meltdown will not occur again. Information on the amount of leveraged loans in the system should be collected and published regularly to help regulatory agencies keep watch. And rating agencies must apply standards that accurately reflect the riskiness of the underlying types of mortgages.

Ban mortgage-backed securities? No, but get a better handle on them and insure that risky loans are curtailed.

Frank D. Tinari is professor emeritus at Seton Hall University, and principal economist of the Tinari Economics Group in Livingston; Dominick Mazzagetti is president of RomAsia Bank. Have a comment? Post it at njvoices.com.