# “Credit Risk Transfers:
# Stability & Transparency in the U.S. Mortgage System”

Testimony prepared for

“DIVERSIFYING RISK: BENEFITS OF REINSURANCE

AND CREDIT RISK TRANSFERS”

ON

APRIL 22, 2026

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

**WRITTEN TESTIMONY**


**SUSAN M. WACHTER**

Sussman Professor

Professor of Real Estate and Finance

The Wharton School

Co-Director Penn Institute for Urban Research

University of Pennsylvania

422 Dinan Hall

3733 Spruce Street

Philadelphia, PA 19104

Chairman Hill, Ranking Member Waters, and distinguished Members of the Committee:

Thank you for the opportunity to testify at today's hearing, "Diversifying Risk: Benefits of Reinsurance and Credit Risk Transfers." I am the Sussman Professor of Real Estate and Professor of Finance at The Wharton School of the University of Pennsylvania. Together with co-authors, I have researched and written scholarly papers on the efficacy of the Credit Risk Transfer (CRT) market. It is an honor to be here today to discuss the role and importance of the CRT market in strengthening the resilience of the U.S. housing finance system.

Since their introduction by the Federal Housing Finance Agency in 2012, CRTs have become a cornerstone of post-crisis housing finance reform. At their core, CRTs are instruments that allow the government-sponsored enterprises (GSEs) to transfer a portion of mortgage credit risk from their balance sheets to private investors. CRTs trade and thereby price and identify credit risk. Rather than concentrating risk within the GSEs—and ultimately exposing taxpayers—CRTs distribute that risk across a broad base of market participants, including institutional investors and reinsurers. This structure enhances both market discipline and systemic resilience.

The CRT market has grown substantially over time, both in size and sophistication. CRT issuance has transferred hundreds of billions of dollars in mortgage credit risk into private hands, fostering a deeper and more liquid market for mortgage credit exposure. Importantly, this growth has not only reduced taxpayer exposure but has also created a mechanism through which credit risk is continuously priced by market participants. In doing so, CRTs have become a key tool for aligning incentives across the housing finance system.

It is useful to distinguish between the two complementary CRT markets that coexist today. The first is the reinsurance market, in which insurers and reinsurers assume mortgage credit risk through structured agreements. This market operates largely through negotiated contracts. The second is the capital markets CRT segment, in which risk is transferred through tradable securities. These securities are issued to investors and actively traded, providing ongoing price discovery. The CRT market offers continuous pricing signals that reflect evolving credit conditions.

CRTs are effective because they work as intended: they provide accurate, timely signals of mortgage credit risk. In the mortgage market, two primary risks dominate—default risk and interest rate risk. While interest rate risk is widely observed through liquid Treasury and mortgage-backed securities markets, traded in the TBA market, default risk has historically been more opaque. CRTs fill this gap. As a continuously traded market tied directly to mortgage performance, CRT pricing reflects investors' real-time assessment of borrower credit quality and macroeconomic conditions.

Importantly, the CRT market is an "informed market" whose pricing incorporates forward-looking information about credit conditions. Empirical evidence from my research on Hurricanes Harvey and Irma, for example, shows that markets capable of pricing granular credit risk can identify and respond to emerging vulnerabilities. CRTs provide precisely this capability at scale across the national mortgage market.

The availability of such information is critical for financial stability. Accurate pricing of credit risk serves as an early warning system, signaling structural weaknesses before they escalate into systemic crises. By contrast, when risk is mispriced or obscured—as was the case in the lead-up to the 2008 financial crisis—imbalances can build unchecked. CRTs help prevent this outcome by embedding transparency and market discipline directly into the housing finance system.

The reason the CRT market is so valuable is that it provides an early and credible indicator of risk in a system where traditional signals arrive too late. Default and foreclosure are lagging indicators—they emerge only after a downturn is already underway. As my research demonstrates, in incomplete markets, where there is limited ability to short housing risk, prices alone can be deeply misleading. Rising home prices are often interpreted as evidence of strength, attracting additional capital and reinforcing the expansion of credit, even as underlying risk deteriorates. Critically, leverage tends to increase in both strong and weak markets: in booms, rising collateral values support greater borrowing, encouraging isk-taking and delaying loss recognition. This dynamic allows bubbles to self-inflate, as there is no reliable, forward-looking mechanism to distinguish sustainable growth from the buildup of systemic risk. The CRT market helps fill this gap by creating a venue where investors actively put capital at risk based on their assessment of mortgage credit quality. In doing so, it generates continuous, market-based pricing of default risk that reflects informed analysis rather than backward-looking outcomes. This forward-looking signal is essential for identifying vulnerabilities early, before they manifest in rising delinquencies or foreclosures, and therefore plays a critical role in mitigating the formation and severity of housing-driven financial crises.

It is also important to contrast CRTs with the credit default swap (CDS) market, which played a prominent role in the Global Financial Crisis. Unlike CRTs, the CDS market was characterized by limited transparency and significant counterparty risk. Pricing in CDS markets was disconnected from underlying credit fundamentals due to opacity and the complex web of bilateral exposures.

CRTs, by comparison, are structured to minimize these weaknesses. The capital markets CRT segment is transparent, with standardized disclosures and observable pricing. Investors bear actual credit risk tied to underlying mortgage pools, ensuring a direct link between pricing and fundamentals. In a CDS scenario where insurers fail to meet their obligations, the burden could revert and did ultimately revert to taxpayers. In the pre-crisis environment, concentrated and opaque exposures amplified systemic risk.

It is worth emphasizing that while Fannie Mae and Freddie Mac were not the primary source of the last financial crisis, they were nonetheless vulnerable to its systemic effects. CRTs represent a key reform that strengthens their resilience and reduces the likelihood that they—and by extension taxpayers—will again be placed at risk due to broader market failures.

CRTs, however, are not the *only* mechanism to distribute risk. Building and retaining capital is another efficient—and in many market conditions, less costly—way to manage risk through the direct absorption of losses. CRTs, by contrast, redistribute risk from taxpayers to private investors and provide valuable, observable market pricing for credit risk that can be difficult to assess otherwise, offering a useful market-based check on the quality and economic soundness of GSE activities. In this way, CRTs complement capital by helping shape the availability and structure of mortgage credit, while the GSEs continue to bear catastrophic or backstop risk.

In conclusion, the CRT market is a vital component of a modern, resilient housing finance system. By transferring risk to the private sector, providing transparent and continuous pricing of credit risk, and complementing traditional reinsurance mechanisms, CRTs enhance both market efficiency and financial stability. Preserving and expanding this market should remain a priority to prevent future crises and support sustainable access to mortgage credit.

It should be noted, however, that this is not a substitute for managing risk and preparing the Government Sponsored Enterprises for privatization as mandated by the Housing and Economic Recovery Act of 2008. A recent convening by the Penn Institute for Urban Research brought together leading public and private sector stakeholders to affirm key principles for the reform of Fannie Mae and Freddie Mac, foremost among which are: (1) preserving the public mission of the GSEs; and (2) ensuring market stability. Embracing these principles must be a foremost priority in ensuring a resilient housing market to safeguard taxpayers, promote long-term financial stability, and support broad access to sustainable homeownership.

Thank you. I look forward to your questions.

**References**

Gete, Pedro, Athena Tsouderou, and Susan M. Wachter. "Climate Risk in Mortgage Markets: Evidence from Hurricanes Harvey and Irma." *Real Estate Economics*, Vol. 52, No. 3, 2024, 660-686, available at: https://onlinelibrary.wiley.com/doi/full/10.1111/1540-6229.12477

Golding, Edward, and Susan M. Wachter. "Resolving the Contested Future of the GSEs: The Stakes Are High." *Housing Policy Debate* (2025): 1-14.

"Bubbles in Real Estate markets," co-author Richard Herring, Asset Price Bubbles: Implications for Monetary, Regulatory, and International Policies, ed. George Kaufman, MIT Press, January 3, 2003, 217-230.

Wachter, Susan M. "Credit Risk, Informed Markets, and Securitization." *Economic Policy Review*, Vol. 24, No. 3, March 2019, 5-62, available at: https://www.newyorkfed.org/research/epr/2018/epr_2018_crt-informed-markets_wachter.html