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Fannie Mae and Freddie Mac in Conservatorship: Frequently Asked Questions

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Summary

Fannie Mae and Freddie Mac are chartered by Congress as government-sponsored enterprises (GSEs) to provide liquidity in the mortgage market and promote homeownership for underserved groups and locations. The GSEs purchase mortgages, retain the credit risk (for a fee), and package them into mortgage-backed securities (MBSs) that they either keep as investments or sell to institutional investors. In the years following the housing and mortgage market turmoil that began around 2007, the GSEs experienced financial difficulty. By 2008, the GSEs' financial condition had weakened, generating concerns over their ability to meet their combined obligations on $1.2 trillion in bonds and $3.7 trillion in MBSs that they had guaranteed at the time. In response, the Federal Housing Finance Agency (FHFA), the GSEs' primary regulator, took control of them in a process known as conservatorship.

Subject to the terms of the Senior Preferred Stock Purchase Agreements (PSPAs) between the U.S. Treasury and the GSEs, Treasury provided funds to keep the GSEs solvent. The GSEs initially agreed to pay Treasury a 10% cash dividend on funds received, and dividends were suspended for all other GSE stockholders. If the GSEs had enough profit at the end of the quarter, the dividend came out of the profit. When the GSEs did not have enough cash to pay their dividend to Treasury, they asked for additional cash to make the payment instead of issuing additional stock. After subsequent amendments to the PSPAs, the 10% dividend was replaced with a "profit sweep" dividend. For each GSE, Treasury currently receives all of the net worth in excess of $3 billion capital reserve under the profit sweep.

As of the date of this report, the GSEs have paid dividends totaling $292 billion to Treasury. The majority of this sum—$191 billion—has been paid under the profit sweep. Paying the federal government all profits earned in a quarter prevents the GSEs from accumulating funds to redeem the senior preferred stock, which is held only by Treasury. Since the second quarter of 2012, the GSEs have drawn on their support from Treasury only in the fourth quarter of 2017.

As a result of continuing conservatorship, congressional interest in Fannie Mae and Freddie Mac has increased in recent years. Uncertainty in the housing, mortgage, and financial markets has raised concerns about the potential total costs to Treasury of providing a backstop for the GSEs. Because more than 60% of households are homeowners, a large number of citizens could be affected by the future of the GSEs. Congress exercises oversight of the FHFA and may consider legislation to shape the GSEs' future. As of the date of this report, no such legislation has been introduced in the 116th Congress, but Senate Committee on Banking, Housing, and Urban Affairs Chairman Mike Crapo has released an outline for potential housing finance reform legislation. The committee held hearings on March 26 and March 27, 2019, on the outline. Also on March 27, 2019, President Trump issued a memorandum directing his Administration to develop a plan for legislative and administrative reforms to the housing finance system.

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Introduction

The federal government's role in the mortgage market dates to the Great Depression, when Fannie Mae (officially the Federal National Mortgage Association) and the Federal Housing Administration (FHA, which is part of the Department of Housing and Urban Development, HUD) were created. Many consider the federal role to be substantial: Fannie Mae, Freddie Mac (which Congress created as the Federal Home Loan Mortgage Corporation in 1970), and Ginnie Mae (officially, the Government National Mortgage Association and part of HUD) guarantee virtually all newly issued mortgage-backed securities (MBSs). By the end of 2018, Fannie Mae and Freddie Mac were jointly responsible for approximately $6.64 trillion or 61% of U.S. residential mortgages outstanding.[1] As government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac have special privileges and obligations, although they are corporate entities with shareholders. As discussed in greater detail below, broadly speaking, the GSEs' role is to ensure appropriate availability of mortgages to creditworthy households.

After years of profitability, the financial turmoil of the 2007-2009 Great Recession led to the weakening of the GSEs' financial strength. In September 2008, during extreme financial turmoil and growing concern over financial losses, Fannie Mae and Freddie Mac individually agreed with their regulator, the Federal Housing Finance Agency (FHFA), that unexpected mortgage delinquencies and resulting losses jeopardized their solvency. The GSEs agreed to direct government control, known as conservatorship, which is the equivalent of bankruptcy reorganization for financial companies. As part of the agreement on conservatorship, Treasury agreed to provide financial support to keep the GSEs solvent. To date, Treasury has provided $119.8 billion to keep Fannie Mae solvent and $71.7 billion to keep Freddie Mac solvent.[2]

Since 2008, Congress and the executive branch have been deliberating how and when to unwind federal control of Fannie Mae and Freddie Mac, and the extent of the federal government's proper role (if any) in the nation's mortgage markets. Some proposals have called for reducing the government's support of Fannie Mae and Freddie Mac, selling off their assets, and revoking their congressional charters. Other proposals have concentrated not so much on unwinding Fannie Mae and Freddie Mac as on replacing them with new institutions. In past Congresses, congressional interest included various oversight hearings and bill proposals to reform or replace the GSEs. As of the date of this report, no such legislation has been introduced in the 116th Congress, but Senate Committee on Banking, Housing, and Urban Affairs Chairman Mike Crapo has released an outline for potential housing finance reform legislation.[3] The committee held hearings on March 26 and March 27, 2019, on the outline.[4] In addition, the Trump Administration issued a memorandum on March 27, 2019, directing various federal agencies to develop plans to reform

[1] See Urban Institute, *Housing Finance At A Glance: A Monthly Chartbook*, March 2019, at https://www.urban.org/sites/default/files/publication/100034/march_chartbook_2019.pdf.

[2] See Federal Housing Finance Agency (FHFA0, "Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities," data as of April 30, 2019, at https://www.fhfa.gov/DataTools/Downloads/Pages/Treasury-and-Federal-Reserve-Purchase-Programs-for-GSE-and-Mortgage-Related-Securities.aspx.

[3] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, "Chairman Crapo Releases Outline for Housing Finance Reform," press release, February 1, 2019, at https://www.banking.senate.gov/newsroom/majority/chairman-crapo-releases-outline-for-housing-finance-reform.

[4] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Chairman's Housing Reform Outline: Part 1*, 116th Cong., 1st sess., March 26, 2019; and U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Chairman's Housing Reform Outline: Part 2*, 116th Cong., 1st sess., March 27, 2019.

the housing finance system with the goal of ending the conservatorship of Fannie Mae and Freddie Mac.[5] To date, no such plan has been publicly announced.

This report presents—in analytical question and answer form—background information on the GSEs, specifically their current status in conservatorship, their financial conditions since 2008, the types of risks the GSEs face, and the status of their affordable housing initiatives. The report provides a brief discussion of congressional options for restructuring the GSEs and concludes with recent Administration statements about housing finance reforms.

What Are Fannie Mae and Freddie Mac?

Fannie Mae and Freddie Mac are stockholder-owned, government-sponsored enterprises (as defined above, GSEs) with charters directing them to facilitate liquidity in the mortgage market and promote homeownership, especially for underserved groups and locations. The GSEs do not originate mortgages; rather, the GSEs facilitate liquidity by purchasing existing mortgages and retaining the associated default risks; they subsequently create and issue relatively more liquid MBSs that have the prepayment risk of the underlying mortgages.[6] The GSEs may keep the MBSs as investments or sell them to mortgage originators and other institutional investors such as banks, hedge funds, central banks, and sovereign wealth funds. The GSEs guarantee (for a fee) the MBS investors that timely repayments of principal and interest will occur even if the borrowers default. The GSE guarantee makes the MBSs more easily traded and valuable to investors, increasing investors' demands for GSEs' MBSs. The support GSEs provide in the secondary market[7]—the market for buying and selling mortgages—can translate to lower rates for borrowers in the primary market.[8]

Both Fannie Mae and Freddie Mac are private companies despite having congressional charters with special privileges and certain unique responsibilities to support affordable housing for low- and moderate-income households. As private companies, their employees are not government employees, and their debts are explicitly not backed by the federal government. Despite the explicit disclaimer, MBS investors widely believed prior to 2008 that the federal government was an implicit backstop for the GSEs in light of their congressional charters.[9] When the GSEs' financial condition weakened in 2008, the federal government did provide financial support.

[5] The White House, *Memorandum on Federal Housing Finance Reform*, March 27, 2019, at https://www.whitehouse.gov/presidential-actions/memorandum-federal-housing-finance-reform/.

[6] Prepayment risk is the risk that mortgage loans are repaid ahead of schedule. For more information on loan pricing mechanics and the attached risks, see CRS In Focus IF10993, *Consumer Credit Markets and Loan Pricing: The Basics*, by Darryl E. Getter.

[7] The housing finance system has two major components: a *primary market* and a *secondary market*. Loan originators make loans to borrowers in the primary market. Loan originators may then sell the mortgage originations to other financial institutions, including the GSEs, in the secondary market.

[8] A 2001 report found that although GSE support may result in lower mortgage interest rates, some of the funding advantage of the GSEs goes to investors and company management. See Wayne Passmore, Roger Sparks, and Jamie Ingpen, "GSEs, Mortgage Rates, and the Long-Run Effects of Mortgage Securitization," December 2001, at https://www.federalreserve.gov/pubs/feds/2001/200126/200126pap.pdf.

[9] The government-sponsored enterprises (GSEs), as congressionally chartered institutions, enjoy benefits unavailable to other private financial firms that contributed to the public perception of an implicit federal backstop at the time. For example, federally insured depository institutions may hold unlimited amounts of the GSEs' mortgage-backed security (MBS) issuances, and the Federal Reserve may use them as tools to conduct open market operations.

Why Were Fannie Mae and Freddie Mac Created?

Prior to the development of the modern secondary mortgage market, U.S. mortgage markets were essentially local. Significant differences in mortgage rates as well as large variations in lending activity existed across the nation. Lenders (e.g., banks, credit unions) had to rely heavily on regional deposits to fund loans, leaving them vulnerable to severe credit shortages during economic downturns when depositors rushed to close their accounts.[10] Funding shortages were exacerbated by the concentration of funds in heavily populated areas, such as Chicago and New York, far from many less populated areas in need of home loans. Moving funds from geographical areas with large concentrations of deposits to other areas (such as California) with a comparatively short supply was difficult and relatively expensive due to interstate banking restrictions.[11] The immobility of funding prevented the mortgage market from operating on a national level.[12]

In 1934, Congress passed, and President Franklin D. Roosevelt signed into law, the National Housing Act, not only to encourage improvement in housing standards and conditions, but also to provide a system of mutual mortgage insurance.[13] Title III of the National Housing Act established national mortgage associations, giving rise to the creation of the Federal National Mortgage Association, which now uses the name Fannie Mae. Fannie Mae originally was a federal government agency chartered to support government-backed mortgages and carry out some government subsidy functions. In 1954, Congress rechartered Fannie Mae as a mixed government and private-sector entity with a clearly delineated separation between its market-oriented (i.e., secondary mortgage trading) and governmental (i.e., special assistance and managing and liquidating government-held mortgages) functions.[14] In 1968, Congress split the firm into two distinct organizations; the secondary market arm retained the Fannie Mae name, and the government arm was named the Government National Mortgage Association (Ginnie Mae).[15] By 1970, the partitioning legislation rechartered Fannie Mae as a GSE to become privately owned with no federal funding.

In 1970, Congress passed the Emergency Home Finance Act (EHFA, P.L. 91-351), which authorized Fannie Mae to buy conventional mortgages (those without insurance provided by a federal government agency). Fannie Mae bought most of the mortgages from mortgage bankers. Savings and loans, the other major source of mortgage money, were restricted to holding mortgages and were generally unable to work with Fannie Mae. The EHFA created the Federal Home Loan Mortgage Corporation, which now uses the name Freddie Mac, as a wholly owned subsidiary of the Federal Home Loan Bank System to facilitate the secondary market trading of conventional mortgages for savings and loan associations. Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA, P.L. 101-73), Congress rechartered Freddie Mac so that its shares could trade on the New York Stock Exchange, in the same manner

[10] Michael P. Malloy, *The Regulation of Banking: Cases and Materials on Depository Institutions and Their Regulators*, (Cincinnati: Anderson Publishing Company, 1992), p. 381.

[11] See Gary Richardson et.al., *McFadden Act of 1927*, Board of Governors of the Federal Reserve System, November 22, 2013, at https://www.federalreservehistory.org/essays/mcfadden_act; and Bill Medley, *Riegle-Neal Interstate Banking and Branching Efficiency Act 1994*, Board of Governors of the Federal Reserve System, at https://www.federalreservehistory.org/essays/riegle_neal_act_of_1994.

[12] See Carrie Stradley Lavargna, *Government Sponsored Enterprises Are "Too Big to Fail:" Balancing Public and Private Interests*, 44 Hastings L.J. 991, 998 (1993).

[13] 48 Stat. 1246.

[14] P.L. 83-560, Title II, the National Housing Act of 1954.

[15] P.L. 90-448, the Housing and Urban Development Act of 1968.

as Fannie Mae's. FIRREA also eliminated the separate missions of Fannie Mae and Freddie Mac, thus both enterprises have similar characteristics and missions today. The Housing and Economic Recovery Act of 2008 (HERA, P.L. 110-289), among other things, created the Federal Housing Finance Agency to replace the Office of Federal Housing Enterprise Oversight and HUD as combined GSE regulator.

Today's modern secondary mortgage market essentially combines the many regional mortgage markets into a single national market that draws financing from around the world. Fannie Mae and Freddie Mac purchase homeowners' mortgages that lenders have already originated. These mortgages must meet Fannie Mae's and Freddie Mac's underwriting standards and not exceed the *conforming loan limit*. The conforming loan limit, which is adjusted each year to reflect the changes in the national average home price, is the maximum mortgage size that the GSEs are allowed to purchase.[16] These conforming mortgage purchases are then pooled into MBSs. The GSEs guarantee the default risks associated with the underlying mortgages. MBSs are either sold to investors or kept by the GSE as an investment.[17]

What Risks Do the GSEs Face as Financial Intermediaries?

Fannie Mae and Freddie Mac face a variety of risks similar to those of any financial intermediary. The GSEs are subject to *credit risk*—the risk that borrowers will default on their mortgages. The GSEs assume the credit risk for (1) the mortgages retained in their lending portfolios and (2) the mortgages securitized such that MBS investors are guaranteed timely payments of principal and interest.[18] In 2008, as home prices were falling, many loan defaults were associated with borrowers who made relatively small down payments and with loans that negatively amortized (allowing borrowers to increase their outstanding principal balances).[19] When home values decline far below the amount of outstanding loan balances, mortgages are *underwater*, meaning that borrowers are provided with a financial incentive to default because they owe more than the property's value. Mortgage lenders also incurred losses on loans to borrowers with less than prime credit, credit between prime and subprime, and less than standard documentation (Alt-A).[20]

The GSEs also face *interest rate risk*, which may arise in a variety of ways. Another common risk GSEs face has to do with the flattening or steepening of the Treasury yield curve.[21] The GSEs fund their asset portfolios, which consist primarily of long-term (typically 30-year) mortgages, by borrowing in shorter-term (typically three months to five years) sequences. This financing strategy is profitable because the GSEs' revenues (borrowers' interest payments) exceed their short-term borrowing costs. If, however, short-term interest rates increase, then the costs of

[16] For areas in which the median local house value exceeds the national average house value by 115%, the local loan limit for that high-cost area is set at 115% of the median home value. See Federal Housing Finance Agency, "Conforming Loan Limits: 2019," press release, 2019, at https://www.fhfa.gov/DataTools/Downloads/Pages/Conforming-Loan-Limits.aspx.

[17] Insured depositories such as banks frequently can reduce their capital requirements and increase profits by holding the GSE-guaranteed MBS instead of the underlying mortgages.

[18] The GSEs are also subject to *model risk*, or the risk that their projected credit models are not accurate.

[19] See Fannie Mae, "*2015 Credit Supplement*," February 19, 2016, pp. 10-14, at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2015/q42015_credit_summary.pdf.

[20] Although the words *prime* and *subprime* suggest that a mortgage should be in one category or the other, the industry category of Alt-A is between prime and subprime.

[21] A yield curve plots the interest rates on various short-term, medium-term, and long-term bonds by the same issuer. For more information, see CRS Insight IN11098, *The Yield Curve and Predicting Recessions*, by Mark P. Keightley and Marc Labonte.

funding longer-term assets this way also increase, thus reducing profitability and, in some cases, potentially generating losses.

When interest rates change, the market value of the GSEs' assets and liabilities also changes. For example, suppose the GSEs use derivative contracts to hedge against rising interest rates, thus facilitating their ability to borrow money at fixed costs (short-term interest rates) for longer periods of time. If, however, interest rates decline, then the current market value of the derivative contracts may fall and, for accounting reasons, show a loss rather than a profit.[22]

Another type of interest rate risk, *prepayment risk*, is the risk that borrowers repay their mortgages ahead of the repayment schedule. The lender does not lose the initial principal lent to the borrower; however, the lender does not earn as much yield as initially anticipated when the borrower prepays. Alternatively, the lender's profitability may fall when funding costs (short-rates) increase and existing borrowers do not prepay their mortgages early. The GSEs face prepayment risk on some of the mortgages and any MBS notes that are retained in their lending portfolios; however, the GSEs generally pass prepayment risk to MBS investors.

The GSEs also have *operational risk*—the risk of losses from the failure of internal controls, people, or systems, or external events as defined by the Basel Committee of Bank Supervision.[23] Operational risks may arise specifically from data breaches, insufficient customer data backups, and operating system hijackings. For example, cyber-related disruptions can potentially weaken public trust and confidence in the financial system.

Did Congress Provide Aid to Support GSEs Prior to 2008?

During the 1980s, financial institutions—particularly federally insured savings and loans and Fannie Mae—held large amounts of fixed rate mortgages in their loan portfolios. Although the interest rates on the mortgages (revenues) were fixed, many lenders were funding these mortgages with shorter-term borrowing and experienced losses after short-rates began to rise.[24] In response, Congress passed the Miscellaneous Revenue Act of 1982, providing support for Fannie Mae in the form of tax benefits.[25] During the 1980s, another GSE, the Farm Credit System, experienced losses linked to developments in the agricultural industry.[26] In response, Congress enacted the Agricultural Credit Act of 1987, authorizing the issuance of $4 billion in bonds to support system members.[27]

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[22] During the third quarter of 2015 and the first quarter of 2016, Freddie Mac reported accounting losses from its use of derivatives that affected its profitability. Freddie Mac, *Freddie Mac Reports Third Quarter 2015 Financial Results*, November 3, 2015, at http://www.freddiemac.com/investors/financials/pdf/2015er-3q15_release.pdf; and Freddie Mac, *Freddie Mac Reports First Quarter 2016 Results*, http://www.freddiemac.com/investors/financials/pdf/2016er-1q16_release.pdf. Freddie Mac had sufficient capital reserves such that it did not need to draw additional funds from Treasury.

[23] See Basel Committee on Banking Supervision (BCBS), *Principles for the Sound Management of Operational Risk*, Bank for International Settlements, June 2011, at https://www.bis.org/publ/bcbs195.pdf. The BCBS is an international committee that sets global prudential regulatory standards for banking firms.

[24] See Congressional Budget Office, *The Economic Effects of the Savings and Loan Crisis* , January 1992, at https://www.cbo.gov/sites/default/files/102nd-congress-1991-1992/reports/1992_01_theeconeffectsofthesavings.pdf; and Federal Deposit Insurance Corporation, *The Savings and Loan Crisis and Its Relationship to Banks*, at https://www.fdic.gov/bank/historical/history/167_188.pdf.

[25] P.L. 97-362, Miscellaneous Revenue Act of 1982.

[26] See Farm Credit System, *About Us*, at https://www.fca.gov/about/history-of-fca; and CRS Report RS21977, *Agricultural Credit: Institutions and Issues*, by Jim Monke.

[27] P.L. 100-233, Agricultural Credit Act of 1987.

What Is Conservatorship?

On September 6, 2008, during extreme financial turmoil and growing concern over financial losses, FHFA, the regulator of Fannie Mae and Freddie Mac, took control of the GSEs from their stockholders and management in a process known as conservatorship. Under conservatorship, the assets and management of a distressed financial firm are placed under the protection of a conservator (guardian) until financial health is restored. (By contrast, a receiver is tasked with liquidating the assets when a firm is placed under receivership.) The GSEs agreed to voluntary conservatorship because of their deteriorating financial positions and the "critical importance" that each company has to the continued functioning of the residential financial markets.[28] HERA (P.L. 110-289) specifies that as conservator, FHFA has the right to operate the GSEs. HERA specifically states the following:[29]

> (D) Powers as Conservator—the [Federal Housing Finance] Agency may, as conservator, take such actions as may be—
>
> (i) necessary to put the regulated entity in a sound and solvent condition; and
>
> (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.

Upon becoming conservator of the GSEs, the FHFA established a set of conservatorship goals, which included preservation of the GSE's assets and a return of each GSE to sound financial condition (ultimately allowing them to exit conservatorship).[30] FHFA reconstituted the boards of each GSE in 2008 with the expectation that they would follow normal corporate governance processes, subject to FHFA review and approval of certain issues.[31] A conservator can cancel certain contracts, but FHFA elected not to do so in 2008.

How Has Conservatorship Affected Stockholders and Other Stakeholders?

Common stockholders own 100% of the GSEs. While under conservatorship, however, the powers of common stockholders, who formerly elected the boards of directors and approved certain enterprise actions, are transferred to the conservator—in this case, FHFA. In addition, Section 1117 of HERA authorizes the U.S. Treasury (Treasury) to purchase any amount of GSE securities—debt or equity—if necessary to provide stability to financial markets, prevent disruptions in the availability of mortgage credit, or protect the taxpayer.[32] In 2008, the FHFA and

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[28] FHFA, "Statement of FHFA Director James B. Lockhart," September 7, 2008, at http://www.fhfa.gov/webfiles/23/FHFAStatement9708final.pdf. See, also, Henry M. Paulson Jr., *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* (New York: Business Plus, 2010).

[29] P.L. 110-289 §1145. In certain circumstances the powers may conflict. For example, if a GSE were placed in conservatorship because of a "violation of any law or regulation ... that is likely to ... weaken the condition of the regulated entity" as specified in the statute, it might be relatively simple to come into compliance and quickly leave conservatorship. In contrast, a more fundamental problem might take longer and lead to conflicts between quickly ending conservatorship by returning a GSE to stockholder control and the GSEs' charters, which require them to support the mortgage market.

[30] Other goals include keeping the GSEs operating to support the mortgage market and homeownership.

[31] FHFA, "History of Fannie Mae and Freddie Mac Conservatorships," press release, at https://www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae—Freddie-Conservatorships.aspx.

[32] The Secretary of the Treasury was given authority to lend or to invest in the GSEs by P.L. 110-289. See the previous question, "What is Conservatorship?"

Treasury, therefore, entered into Senior Preferred Stock Purchase Agreements (PSPAs) with the terms and conditions under which Treasury provides financial support to the GSEs.[33]

The PSPAs are indefinite in duration, each with a funding commitment cap of $100 billion. In exchange for the funding commitment, Treasury immediately received $1 billion of senior preferred stock in each GSE. Treasury also received long-term options (called warrants) for the purchase of 79.9% of the common stock of each GSE at a nominal cost. These agreements have since been amended numerous times.

- In May 2009, the PSPAs were amended to increase the funding commitments to $200 billion each.
- In December 2009, they were amended to replace the fixed-dollar amount funding requirement with a formulaic requirement, which became fixed when it ended on December 31, 2012.[34]
- On August 17, 2012, the PSPAs were amended to establish a positive net worth buffer at $3 billion for each GSE that would be incrementally reduced by $600 million each year until reaching zero by 2018. Any net worth proceeds the GSEs received above the (declining) buffer would be paid to Treasury in the form of dividends. By 2018, the GSEs would have paid all quarterly profits (net worth) as dividends to Treasury, referred to as a profit sweep. (If no profits are earned, then no dividend is paid to Treasury.) Treasury stated that the profit sweep approach reduces taxpayers' exposure to financial risks and prevents the GSEs from rebuilding capital, thus facilitating the option to wind them down.[35]
- The August 2012 PSPA amendments also placed caps of $250 billion on each of the GSE's mortgage portfolios, requiring them to be reduced by 10% per year until they were at or below the caps.
- In 2017, however, Treasury and FHFA agreed to reinstate the capital reserves to $3 billion each.[36] After the 2017 tax revision (P.L. 115-97), the GSEs would have needed further draws from Treasury as a result of not having enough earnings to cover the anticipated reductions in their deferred tax asset values or any other

[33] See Federal Housing Finance Agency, Office of Inspector General (OIG), *Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements*, WPR 2013 002, March 2013, at https://www.fhfaoig.gov/Content/Files/WPR-2013-002_2.pdf. The response by Treasury to the GSEs after they were undercapitalized was similar to its response via the TARP program after the banking system became undercapitalized, in which they purchased preferred shares from the banks. For information about the TARP program, see CRS Report R43413, *Costs of Government Interventions in Response to the Financial Crisis: A Retrospective*, by Baird Webel and Marc Labonte.

[34] At that time, the cumulative funding commitment cap for Fannie Mae was set at $233.7 billion; the cumulative funding commitment cap for Freddie Mac was set at $211.8 billion. See U.S. Government Publishing Office and Office of Management and Budget, *The Budget for Fiscal Year 2016*, February 2, 2015, at https://www.treasury.gov/about/budget-performance/CJ16/19.%20GSE%20FY%202016%20CJ.pdf.

[35] Department of Treasury, "Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac," press release, August 12, 2012, at http://www.treasury.gov/press-center/press-releases/Pages/tg1684.aspx. The FHFA's OIG provides an additional reason for the buffer or profit sweep approach, notably to support the GSEs because Treasury no longer had the statutory authority under HERA to increase the commitment caps. See FHFA, OIG, *Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements*, WPR 2013 002, March 2013, at https://www.fhfaoig.gov/Content/Files/WPR-2013-002_2.pdf.

[36] See letter from Steven T. Mnuchin, Secretary of the Treasury, to Melvin L. Watt, Director, FHFA, December 21, 2017, at https://www.fhfa.gov/Conservatorship/Documents/GSEAgreementLetters_12-21-2017.pdf.

capital losses.[37] Hence, retaining $3 billion in capital reserves allows the GSEs to cover income fluctuations.[38]

If Treasury were to exercise its warrants to purchase 79.9% of the common stock of each GSE, current common stockholders would own 20.1% of the GSEs. However, the GSEs cannot accumulate the capital required by law to return to stockholder control given the profit sweep agreements stemming from the August 2012 PSPA amendments.[39]

What Other Actions Has the Federal Government Taken Since 2008 to Address the GSEs' Financial Conditions?

Prior to the GSEs' conservatorships, the Securities and Exchange Commission (SEC) issued an emergency order on July 15, 2008, to restrict short selling in the stock of 19 financial institutions, including Fannie and Freddie.[40] The SEC acted to prevent the possibility that false rumors would drive down share prices and cause a loss in market confidence, thereby cutting off the firms' access to credit markets. The order restricting short sales of Fannie Mae and Freddie Mac stock was renewed on July 29, 2008 (and expired on August 12, 2008), shortly before they were placed under conservatorship.

On July 13, 2008, the Board of Governors of the Federal Reserve System authorized the Federal Reserve Bank of New York to lend directly to the GSEs.[41] The GSEs' charters allow for a special relationship to the nation's central bank,[42] the Federal Reserve, which may purchase (in the secondary market) the GSEs' debentures (debt issuances) and MBS issuances for open market operations.[43] The Federal Reserve, therefore, purchased more than $1 trillion of debentures and MBSs issued by the GSEs during calendar year 2009 and the first quarter of 2010.[44] As of March 27, 2019, the Fed held $1.2 trillion of Fannie Mae's and Freddie Mac's MBSs.[45]

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[37] For more information about the GSEs' deferred tax assets and how their profitability may be affected, see question "How Profitable Are Fannie Mae and Freddie Mac?"

[38] See FHFA, "Statement from FHFA Director Melvin L. Watt on Capital Reserve for Fannie Mae and Freddie Mac," press release, December 21, 2017, at https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-from-FHFA-Director-Melvin-L-Watt-on-Capital-Reserve-for-Fannie-Mae-and-Freddie-Mac.aspx.

[39] For more information about how the profit sweep agreements would prevent the GSEs from exiting conservatorship, see question "Can Fannie Mae and Freddie Mac Leave Conservatorship?" Stockholders seeking to regain control of the GSEs sued the federal government over these amendments. For more information, see CRS Legal Sidebar LSB10101, *UPDATE: Fannie & Freddie Investors Turn to Congress After S. Ct. Declines to Resurrect Their Legal Claims*, by David H. Carpenter.

[40] Selling stock "short" allows investors to profit if the price of the stock declines. See, Securities and Exchange Commission, "Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments," at http://www.sec.gov/rules/other/2008/34-58166.pdf.

[41] Federal Reserve Board of Governors, "Authority to Lend to Fannie Mae and Freddie Mac," press release, July 13, 2008, at http://www.federalreserve.gov/newsevents/press/other/20080713a.htm.

[42] The Fed's lender-of-last-resort authority is delineated at 12 U.S.C. §343. Fannie Mae's charter is at 12 U.S.C. §1716b et seq., and Freddie Mac's charter is at 12 U.S.C. §1401.

[43] 12 U.S.C. § 347c.

[44] Section 1118 of HERA requires FHFA to consult with the Federal Reserve to ensure financial market stability. For more information, see Federal Reserve Bank of New York, "FAQs: MBS Purchase Program," August 20, 2010, at http://www.ny.frb.org/markets/mbs_faq.html.

[45] Federal Reserve Bank of New York, "System Open Market Account Holdings: Securities Holdings as of July 31, 2013," at http://www.newyorkfed.org/markets/soma/sysopen_accholdings.html.

What Recent Legislation Has Affected the GSEs?

Since the 110th Congress, two continuing resolutions and seven other bills have been signed into law that have had significant impacts on Fannie Mae and Freddie Mac (see **Table 1**).

Table 1. Public Laws Specifically Affecting GSEs

(110th-116th Congresses)

P.L. Number	Date Enacted	Title	Summary
110th Congress			
P.L. 110-185	February 13, 2008	Economic Stimulus Act of 2008 (ESA) §201	Increased conforming loan limits in high-cost areas for mortgages originated between July 1, 2007, and December 31, 2008.
P.L. 110-289	July 30, 2008	Housing and Economic Recovery Act of 2008 (HERA)	Created Federal Housing Finance Agency to replace Office of Federal Housing Enterprise Oversight and the Department of Housing and Urban Development as combined GSE regulator. Made high-cost area conforming loan limits permanent but at lower amounts.
111th Congress			
P.L. 111-5	February 7, 2009	American Recovery and Reinvestment Act of 2009 (ARRA) §1203	Extended 2008 high-cost conforming loan limits to 2009 mortgages.
P.L. 111-88	October 30, 2009	Department of the Interior Appropriations Act, 2010 §104	Extended 2008 high-cost conforming loan limits for FY2010.
P.L. 111-242	September 30, 2010	Continuing Appropriations Act, 2011 §146	Extended 2008 high-cost conforming loan limits for FY2011.
112th Congress			
P.L. 112-78	December 23, 2011	Temporary Payroll Tax Cut Continuation Act of 2011 §401	Requires Fannie Mae and Freddie Mac to increase their guarantee fees by 10 basis points. The funds raised are to be deposited in the Treasury.
P.L. 112-105	April 4, 2012	Stop Trading on Congressional Knowledge Act of 2012 §16	Prohibition on bonuses to executives of Fannie Mae and Freddie Mac while they are in conservatorship.
114th Congress			
P.L. 114-93	November 25, 2015	Equity in Government Compensation Act of 2015, §3	Limits salaries of chief executive officers of Fannie Mae and Freddie Mac.
P.L. 114-113	December 18, 2015	Consolidated Appropriations Act, 2016 §702	Restricts Treasury's ability to sell Fannie Mae and Freddie Mac senior preferred stock.

Source: Congressional Research Service.

As of the date of this report, no housing finance reform legislation has been introduced the 116th Congress. However, Senator Mike Crapo, chairman of the Senate Committee on Banking,

Housing, and Urban Affairs, has released an outline of what he views as the key issues in housing finance reform.[46] The committee held hearings on March 26 and March 27, 2019, on the outline.

What Has Happened to the GSEs' Financial Conditions Since Conservatorship?

The GSEs' losses, which began in late 2006, were notable because the GSEs had previously been consistently profitable. Prior to 2007, Fannie Mae had not reported a full-year loss since 1985, and Freddie Mac had never reported a full-year loss since it became publicly traded in 1989. From 2007 through 2011, both Fannie Mae and Freddie Mac reported losses, but starting in 2012, both GSEs began to report profits. In 2018, Fannie Mae showed a $16.0 billion annual profit, and Freddie Mac showed a $9.2 billion annual profit.

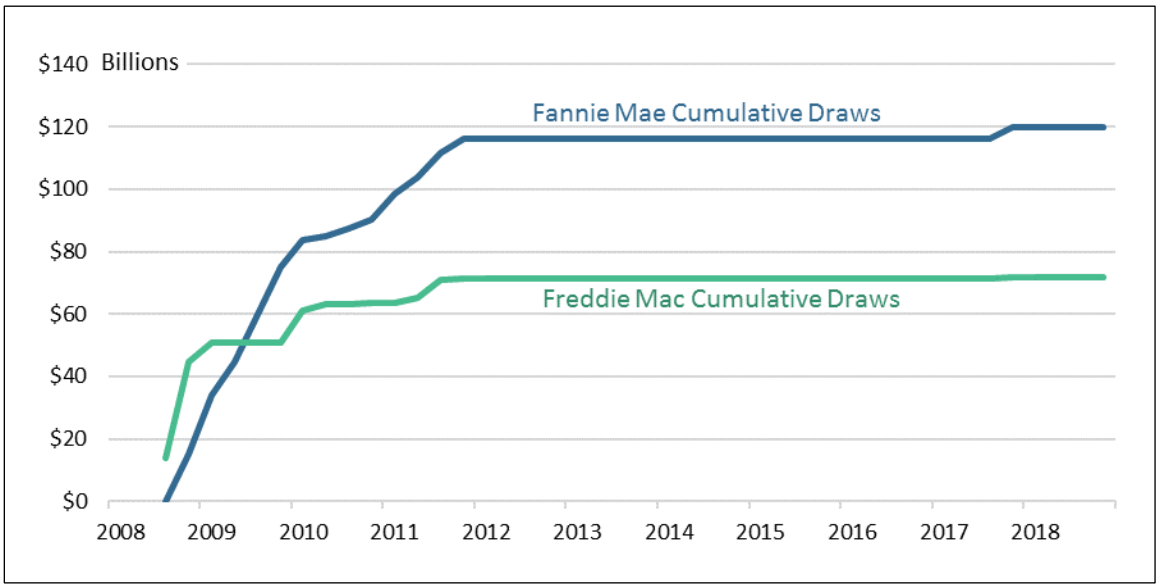
How Much Support Has Treasury Extended?

Figure 1 shows that, since the third quarter of 2008, the FHFA has asked Treasury for a total of $119.8 billion to increase Fannie Mae's assets to offset its liabilities, and a total of $71.7 billion for Freddie Mac.[47] Treasury supports the GSEs by purchasing new senior preferred stock, which is senior to (has priority over) all other common and preferred stock.

[46] Sen. Mike Crapo, "Chairman Crapo Releases Outline for Housing Finance Reform," press release, February 1, 2019, at https://www.banking.senate.gov/newsroom/majority/chairman-crapo-releases-outline-for-housing-finance-reform.

[47] FHFA, "Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities," data as of April 30, 2019, at https://www.fhfa.gov/DataTools/Downloads/Pages/Treasury-and-Federal-Reserve-Purchase-Programs-for-GSE-and-Mortgage-Related-Securities.aspx.

Figure 1. Treasury Support for Fannie Mae and Freddie Mac
2008-2018



Source: Federal Housing Finance Agency, Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities: Data as of March 29, 2019, at https://www.fhfa.gov/DataTools/Downloads/Documents/Market-Data/Table_1.pdf.

Notes: Treasury holds senior preferred stock in each GSE valued at the amount of support provided—plus $1 billion each paid Treasury for its support agreements.

How Profitable Are Fannie Mae and Freddie Mac?

Figure 2 shows the GSEs' annual profits and losses from 2006 to 2018. From 2007 through 2011, Fannie Mae and Freddie Mac reported losses. In 2012, however, the GSEs began to report profits.[48]

In 2013, Fannie Mae and Freddie Mac reported profits of nearly $84 billion and $49 billion, respectively. Three factors largely created these profits. First, loss reserves (i.e., money previously set aside by each GSE to cover anticipated future losses) were cancelled, which added $14.7 billion in profits to Fannie Mae and $6.2 billion in profits to Freddie Mac.[49] Second, the GSEs determined in 2012 that the probability of their deferred tax assets (e.g., low-income tax credits) being realized had increased, which they discussed in their 2013 form 10-K reports.[50] Third, the GSEs negotiated agreements with certain loan originators to repurchase mortgages that were riskier than initially documented, increasing Fannie Mae's profits by $17.9 billion and

[48] Although the GSEs have been profitable on a yearly basis since 2012, both GSEs reported a loss the last quarter of 2017.

[49] Fannie Mae, *Federal National Mortgage Association Annual report on Form 10-K*, pp. 3, 80, 143, at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2013/10k_2013.pdf; Freddie Mac, *Federal Home Loan Mortgage Corporation Annual Report on Form 10-K*, pp. 135, 138, 231, at http://www.freddiemac.com/investors/er/pdf/10k_022714.pdf.

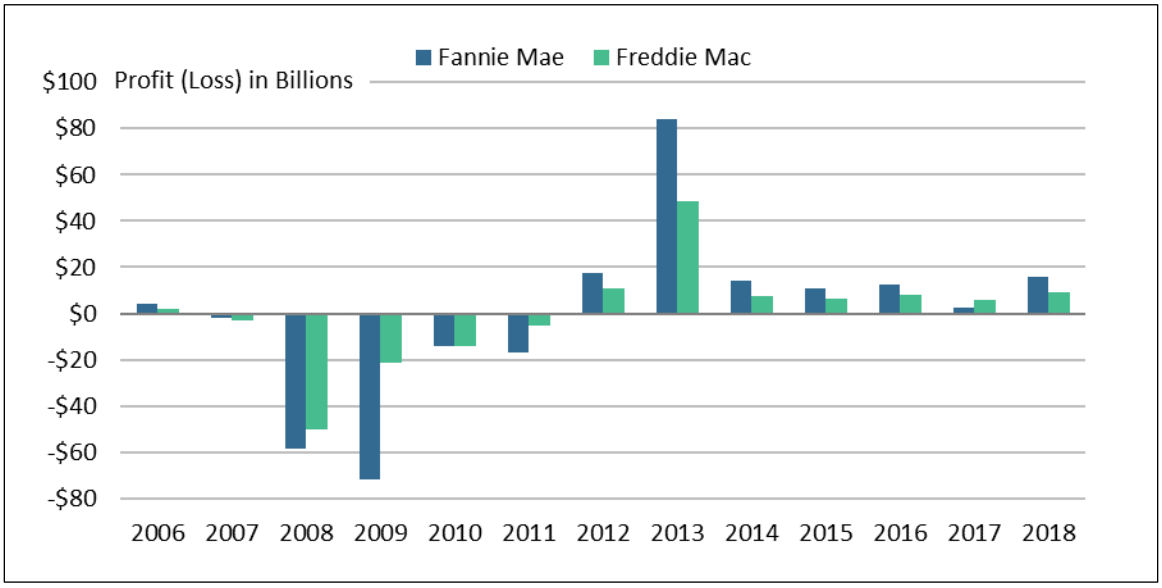
[50] The accounting valuations increased Fannie Mae's profits by $45.4 billion and Freddie Mac's profits by $31.7 billion. For Fannie Mae, see 2013 Annual Report, Note 10: Income Taxes, p. F-51, at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2013/10k_2013.pdf; for Freddie Mac, see 2013 Annual Report, Note 12: Income Taxes, p. 231, at http://www.annualreports.com/HostedData/AnnualReportArchive/f/NYSE_FMCC_2013.pdf.

Freddie Mac's profits by $5.6 billion.[51] In 2013, these three factors combined added $78.0 billion to Fannie Mae's bottom line and $43.5 billion to Freddie Mac's bottom line.[52] By 2014 and 2015, the GSEs had few outstanding mortgage repurchase requests, and neither had deferred tax assets valuation allowance.

Except for the fourth quarter of 2017—when accounting changes required both GSEs to make draws from Treasury—neither GSE has drawn funds from Treasury since the first quarter of 2012.[53] Changes in the 2017 tax law revision reduced the value of the GSEs' deferred tax assets, leading to the losses in the fourth quarter.[54] By 2018, Fannie Mae showed a $16.0 billion annual profit, and Freddie Mac showed a $9.2 billion annual profit.

Figure 2. Fannie Mae and Freddie Mac Annual Profits and Losses

2006-2018



Source: Fannie Mae and Freddie Mac Form 10-K filings with the Securities and Exchange Commission, at http://edgar.sec.gov/.

Figure 3 shows that, since conservatorship in September 2008, Fannie Mae has reported a cumulative profit of $29.0 billion; Freddie Mac has reported a cumulative profit of $31.7 billion.[55]

[51] Companies settling disagreements with the GSEs over mortgage quality included Bank of America, Wells Fargo, CitiGroup, and Morgan Stanley.

[52] Without these three income sources, Fannie Mae would have reported a profit of $6.0 billion; Freddie Mac would have reported a profit of $5.2 billion.

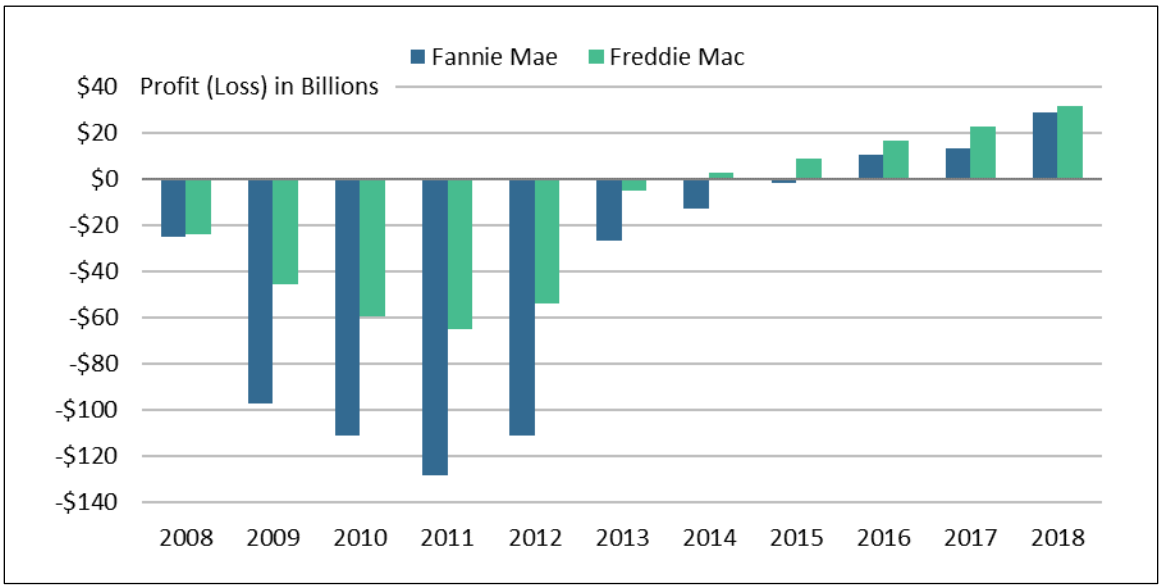
[53] For the fourth quarter of 2017, Fannie Mae drew $3.7 billion from Treasury and Freddie Mac drew $0.3 billion from Treasury. See Federal Housing Finance Agency, *Table 1: Quarterly Draws on Treasury Commitments to Fannie Mae and Freddie Mac per the Senior Preferred Stock Purchase Agreements*, at https://www.fhfa.gov/DataTools/Downloads/Documents/Market-Data/Table_1.pdf.

[54] See, for example, Fannie Mae, "Fannie Mae Fourth Quarter and Full Year 2017 Earnings Media Call Remarks," press release, February 14, 2018, at http://www.fanniemae.com/portal/media/speeches/2018/financial-results-q42017-speech-mayopoulos.html.

[55] This report measures profits and losses as "net profit (loss) attributable" to the GSEs as reported in their quarterly (10-Q) and annual (10-K) filings with the Securities and Exchange Commission. This measure excludes dividends paid to Treasury.

Figure 3. Fannie Mae and Freddie Mac Cumulative Profits/Losses

2008-2018



Source: Fannie Mae and Freddie Mac Form 10-K filings with the Securities and Exchange Commission, available at http://edgar.sec.gov/.

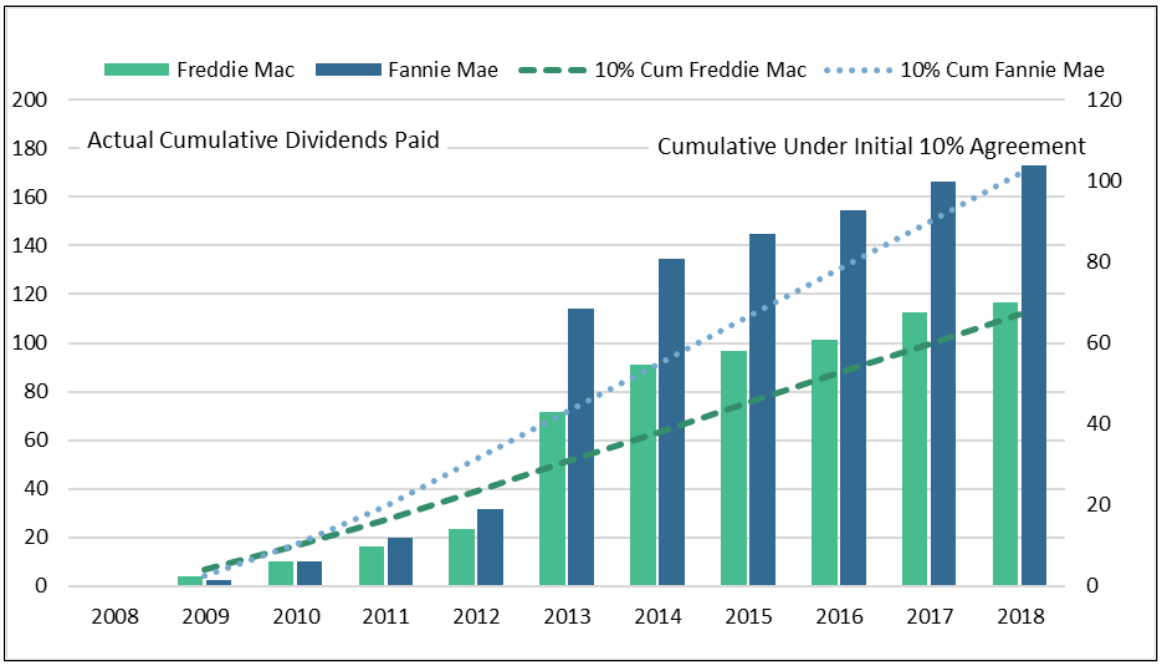
How Much Have the GSEs Paid to Treasury in Dividends?

Since signing the PSPAs in 2008, Fannie Mae and Freddie Mac have only paid dividends to Treasury's senior stock. By the end of calendar year 2018, Fannie Mae had paid $176 billion and Freddie Mac had paid $117 billion in dividends to Treasury.[56] The GSEs initially made quarterly payments on a 10% annual dividend on the senior preferred stock regardless of profits or losses earned in the quarter. On August 17, 2012, the PSPAs were amended to require a profit sweep such that all quarterly profits earned by the GSEs were paid to Treasury. (If there is no profit, there is no payment.) If the profit sweep had not replaced paying dividends to Treasury at a 10% annual rate, Fannie Mae would have paid $102 billion and Freddie Mac would have paid $67 billion to Treasury in dividends. **Figure 4** illustrates both the GSEs' actual dividend payments to Treasury and the payments that would have occurred under the 10% annual fixed dividend. If either Fannie Mae or Freddie Mac were to experience quarterly losses that exceeded their reserves and capital levels, they could remain solvent by selling additional preferred stock to Treasury. By the end of 2017, FHFA reported that Fannie Mae was operating with a $113.9 billion commitment of capital support from Treasury under its PSPA; Freddie Mac was operating with a $140.2 billion commitment of capital support from Treasury under its PSPA.[57]

[56] FHFA, *Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities: Data as of March 29, 2019*, at https://www.fhfa.gov/DataTools/Downloads/Documents/Market-Data/Table_2.pdf.

[57] FHFA, *2017 Report to Congress*, May 23, 2018, p. 57, at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA_2017_Report-to-Congress.pdf.

Figure 4. Cumulative Dividends Paid to Treasury by Fannie Mae and Freddie Mac
2008-2018



Source: Federal Housing Finance Agency, Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities: Data as of March 29, 2019, at https://www.fhfa.gov/DataTools/Downloads/Documents/Market-Data/Table_2.pdf.

How Much Can Fannie Mae and Freddie Mac Pay in Executive Compensation?

In most corporations, executive compensation is set by the board of directors and management. For 2007—the year prior to conservatorship—Fannie Mae reported that it paid its chief executive officer (CEO) $12.2 million;[58] Freddie Mac reported paying its CEO $18 million.[59] HERA strengthened FHFA's regulatory oversight of executive compensation. After conservatorship, the GSEs' senior management was replaced and new managers received significantly reduced compensation. The PSPAs between FHFA and Treasury require the GSEs to obtain Treasury's approval for their executive compensation agreements. Furthermore, the Equity in Government Compensation Act of 2015 places a statutory cap of $600,000 on their CEOs' compensation.[60] In 2019, however, the FHFA Office of Inspector General reported that both GSEs have developed senior executive succession plans that reassign duties in such a way as to circumvent the congressionally imposed salary caps.[61] In the 116th Congress, Senators Warren and Tillis have

[58] Fannie Mae, *Proxy Statement*, April 4, 2008, at http://www.fanniemae.com/resources/file/ir/pdf/proxy-statements/2007proxy.pdf.

[59] Freddie Mac, *Proxy Statement*, April 29, 2008, at http://www.freddiemac.com/investors/pdffiles/proxy_042908.pdf.

[60] P.L. 114-93.

[61] FHFA, OIG, FHFA's Approval of Senior Executive Succession Planning at Fannie Mae Acted to Circumvent the Congressionally Mandated Cap on CEO Compensation, EVL-2019-001, March 26, 2019, at https://www.fhfaoig.gov/Content/Files/EVL-2019-001_0.pdf, and FHFA, OIG, FHFA's Approval of Senior Executive Succession Planning at Freddie Mac Acted to Circumvent the Congressionally Mandated Cap on CEO Compensation, EVL-2019-002, March

introduced S. 1171, the Respect the Caps Act, which would suspend the current compensation packages for all GSE officers.

Can Fannie Mae and Freddie Mac Leave Conservatorship?

Absent congressional or executive action, Fannie Mae and Freddie Mac could exit their conservatorships in two ways. First, if one (or both) of the GSEs were unable to become financially viable—particularly by drawing down all remaining Treasury support—then it could be placed under receivership, in which all of its assets would be liquidated.[62] The usual priority of claims on remaining assets applies in receivership. The GSEs' guaranteed MBS investors would be repaid first, followed by the GSEs' debenture holders, followed by the Treasury's senior preferred stock, and finally private stockholders. The value of the outstanding MBSs would depend on the payments of the underlying mortgages, the rules of receivership, and any action the government might take (or not take) to support the MBSs. Likewise, the value of the debentures would depend on the cause of the receivership and the details of the liquidation process. For example, if mortgage defaults and losses were to increase, the assets available for creditors would decrease. How the mortgage market would function if one or both GSEs were to go into receivership is unclear.

Alternatively, one or both of the GSEs could become financially viable. This outcome, however, is unlikely to happen because the PSPAs limit the GSEs' capital buffers to $3 billion each, preventing them from becoming financially viable to return to stockholder control. The GSEs currently have less capital than what would have been statutorily required prior to conservatorship.[63] Furthermore, when the federal government has previously provided significant financial support to companies, Treasury has auctioned off similar warrants for profit after the companies' financial health was restored; the company that issued the warrants to Treasury typically wins the auction to purchase them.[64] With limited capital reserves, the GSEs would unlikely be able to purchase their warrants from Treasury. Furthermore, private investors would be unlikely to purchase the warrants from Treasury as long as the GSEs' capital reserves are low enough to make them financially vulnerable to returning to conservatorship.

What Are Fannie Mae and Freddie Mac Doing to Reduce Risks?

Since 2008, Fannie Mae and Freddie Mac have tightened their lending standards. For example, Freddie Mac reports that the average FICO score on mortgages purchased in 2007 was 703; in 2008, it was 722; and in the fourth quarter of 2018, it was 747.[65] Fannie Mae reports that the

26, 2019, at https://www.fhfaoig.gov/Content/Files/EVL-2019-002_0.pdf.

[62] Note that it is possible for one GSE to go into receivership while the other one is returned to stockholder control.

[63] In 2007, Fannie Mae needed $25 billion and Freddie Mac needed $14 billion to satisfy their risk-based capital requirements; Fannie Mae had a deficit of $144 billion in minimum capital, and Freddie Mac had a deficit of $91 billion in minimum capital. See FHFA, *2017 Report to Congress*, p. 78, 95, and 107, at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA_2017_Report-to-Congress.pdf.

[64] For example, see U.S. Department of Treasury, "Treasury Completes Auction to Sell Warrant Positions," press release, June 6, 2013, at https://www.treasury.gov/press-center/press-releases/Pages/jl1972.aspx.

[65] Fannie Mae, *2015 Credit Supplement*, February 19, 2016, p. 6, at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2015/q42015_credit_summary.pdf; and Freddie Mac, "Fourth Quarter 2018, Financial Results Supplement," press release, February 13, 2019, at http://www.freddiemac.com/investors/financials/pdf/

average FICO score on mortgages it purchased in 2005-2008 was 695, whereas the average FICO score on mortgages it purchased in 2018 was 742.[66]

Shortly after entering conservatorship in 2008, the GSEs increased their loan loss reserves in anticipation of continuing losses. By contrast, the foreclosure rate and the average loss on a foreclosure have declined in recent years, allowing the GSEs to reduce their loss reserves.

To reduce risks to U.S. taxpayers, the GSEs have each reduced their portfolios below the PSPA-required $250 billion target.[67] In 2008, Fannie Mae held $729 billion in mortgage assets (MBS and mortgages) compared with $231 billion at the end of 2017; Freddie Mac held mortgage assets valued at $805 billion in 2008 and $253 billion in 2017.[68] Furthermore, approximately 76% of Fannie Mae's current holdings of single-family mortgages were purchased in 2008 or more recently after the tightening of mortgage lending standards; Freddie Mac's purchases over this same period are approximately 71% of its current holdings. By the end of 2017, Fannie Mae held $1.1 billion in private-label MBSs backed by subprime mortgages (down from $24.6 billion at the end of 2008) and held less than $1 billion in private-label MBSs backed by Alt-A mortgages (down from $27.9 billion at the end of 2008).[69] By the end of 2017, Freddie Mac held $3.3 billion in private-label MBSs backed by subprime mortgages (down from $74.9 billion at the end of 2008) and $1.2 billion in private-label MBSs backed by Alt-A mortgages (down from $25.1 billion at the end of 2008).[70]

What Is the Credit Risk Transfer Initiative?

In 2012, FHFA directed Fannie Mae and Freddie Mac to develop ways to share their *credit risk* with the private sector, thereby reducing the risk to the government and taxpayers. After further delineations into *expected*, *unexpected*, and *catastrophic* categories, the GSEs have developed credit risk transfer (CRT) programs. Expected losses occur under normal economic conditions when foreclosures are likely to result from illness, unemployment, and divorce. Unexpected losses occur during stressful times, such as recessions or financial turmoil. Catastrophic losses occur under very extreme economic circumstances. Under recent CRT initiatives, the GSEs are transferring some of their expected and unexpected credit risks to the private sector by issuing bonds, which Fannie Mae calls Connecticut Avenue Securities (CAS) and Freddie Mac calls Structured Agency Credit Risk securities (STACRs).[71] Investors purchase these bonds and are paid based on the performance of a reference pool of mortgages. If the pool performs well, the investors receive a higher return; if the pool performs poorly, the investors receive a lower return. (In cases of extremely poor pool performance, investors could lose their investments.) Furthermore, both GSEs have also entered into some traditional insurance or guarantee

supplement_4q18.pdf. FICO is a company that provides credit scoring services to lenders.

[66] Fannie Mae, "Fannie Mae Financial Supplement," press release, February 14, 2019, http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2018/q42018_financial_supplement.pdf.

[67] The GSEs retained portfolios consist primarily of mortgages in the pipeline to be securitized, nonperforming mortgages that may receive loss mitigation, and those mortgages to support affordable housing mission goals.

[68] FHFA, *2017 Report to Congress*, pp. 70, 87.

[69] FHFA, *2017 Report to Congress*, p. 73.

[70] FHFA, *2017 Report to Congress*, p. 90.

[71] Wanda DeLeo, deputy director, Division of Conservatorship, FHFA, *Prepared Testimony on Housing Finance Reform: Fundamentals of Transferring Credit Risk in a Future Housing Finance System*, December 10, 2013, at http://www.fhfa.gov/Media/PublicAffairs/Pages/Housing-Finance-Reform-Fundamentals-of-Transferring-Credit-Risk-in-a-Future-Housing-Finance-System.aspx; and FHFA, *An Update on the Common Securitization Platform, September 15, 2015*, at http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CSP-Update-Final-9-15-2015.pdf.

agreements with mortgage insurers, reinsurers, or other companies to transfer some unexpected credit risk. The counterparty pays the GSE in the event of a covered loss. Meanwhile, the GSEs have found that sharing catastrophic losses was more expensive given that a catastrophic event rarely occurs to justify paying returns or premiums to the private sector to transfer the risk. Hence, the GSEs are retaining the catastrophic risk.

What Is the Common Securitization Solutions Initiative?

FHFA has directed the GSEs to reduce operational risk by improving their information technology, data quality, and internal controls. Fannie Mae and Freddie Mac created Common Securitization Solutions (CSS), a jointly owned company that will standardize the process of issuing and managing MBSs.[72] FHFA determined that the GSEs' computer operations needed modernizing and that creating one system would be more cost-efficient. Fannie Mae and Freddie Mac are now required to purchase mortgages with similar borrower risk characteristics and pool them into their MBSs.[73]

The CSS's new common securitization platform (CSP) was planned for two releases. Freddie Mac began using the CSP during Release 1 on November 21, 2016, to perform data acceptance, issuance support, and bond administration functions for relatively straightforward types of MBSs.[74] In June 2019, both Fannie Mae and Freddie Mac are scheduled to use Release 2 to perform data acceptance, issuance support, disclosure, and bond administration activities for a wider range of MBSs, which is to be known as the Uniform Mortgage-Backed Security (UMBS).[75] In the longer run, the CSP would be available to other private-sector guarantors.

What Is Happening to Fannie Mae's and Freddie Mac's Affordable Housing Initiatives?

HERA gives the FHFA authority to set housing goals for the GSEs, including a new group of "duty to serve" goals in addition to the affordable housing goals previously established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.[76] The GSEs are required to purchase a specified amount of mortgages that meet particular single-family and multifamily goals to support affordable housing.. The single-family affordable housing benchmarks listed in **Table 2** are measured with reference to numbers of mortgages the GSEs purchase.

[72] For more information, see FHFA, *An Update on the Common Securitization Platform*, September 15, 2015, at http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CSP-Update-Final-9-15-2015.pdf.

[73] See FHFA, "Uniform Mortgage-Backed Security," 84 *Federal Register* 7793-7801, March 5, 2019.

[74] FHFA, *An Update on The Single Security Initiative and the Common Securitization Platform*, November 2018, pp. 2-3, at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Update-on-Implementation-of-the-Single-Security-and-CSP_November-2018.pdf.

[75] See FHFA, "Uniform Mortgage-Backed Security," 84 *Federal Register* 7793-7801, March 5, 2019.

[76] P.L. 102-550, Title XIII; see 12 U.S.C. §§4561-4564.

Table 2. Single-Family Housing Goals, 2015-2020

Benchmark	2015-2017	2018-2020
Low-Income Families Home Purchase Goal	24%	24%
Very Low-Income Home Purchase Goal	6%	6%
Low-Income Areas Home Purchase Subgoal	14%	14%
Low-Income Families Refinance Goal	21%	21%

Source: Federal Housing Finance Agency, "2015-2017 Enterprise Housing Goals Final Rule," 80 *Federal Register* 53392-53433, September 3, 2015.

Note: Low-income families have incomes no greater than 80% of area median income, and very low-income families have incomes no greater than 50% of area median income. Alternatively, Fannie Mae and Freddie Mac can meet their housing goals by purchasing mortgages to equal or exceed the market percentage.

A GSE has two ways to meet its single-family affordable housing goals. First, a GSE can satisfy a goal (e.g., the low-income families home purchase goal) by meeting or exceeding the benchmark percentage (e.g., at least 24% of a GSE's mortgage purchases must have gone to low-income families purchasing homes). Second, a GSE can meet an affordable housing goal if its qualifying purchases meet or exceed the market as measured by data collected under the Home Mortgage Disclosure Act (HMDA).[77] For example, suppose a GSE's purchases of low-income family refinance mortgages were 10% of its purchases, which fails to meet the benchmark goal of 21%. The GSE could meet an alternative goal if less than 10% of the market consisted of these mortgages. The single-family housing goals are the same for each GSE in percentage terms; however, the numbers may differ because Fannie Mae usually purchases more mortgages than Freddie Mac.

FHFA also sets multifamily housing goals, which are listed in **Table 3**. These are defined in terms of rental units that are affordable at the specified income limits. For the purpose of these multifamily goals, small properties have between 5 units and 50 units.

Table 3. Multifamily Housing Goals, 2015-2020

Benchmark	2015-2017	2018-2020
Low-Income Units	300,000	315,000
Very Low-Income Units	60,000	60,000
Small Property: Low Income Units	6,000 (2015) 8,000 (2016) 10,000 (2017)	10,000

Source: Federal Housing Finance Agency, "2015-2017 Enterprise Housing Goals Final Rule," 80 *Federal Register* 53392-53433, September 3, 2015.

Notes: Both Fannie Mae and Freddie Mac have the same multifamily housing goals in terms of units.

[77] P.L. 94-200.

Have the GSEs Made Cash Contributions to the Housing Trust and Capital Magnet Funds?

HERA requires the GSEs to contribute to the Housing Trust Fund and the Capital Magnet Fund, which are permanent funding streams that do not rely on annual appropriations and are dedicated to affordable housing activities for low-income households.[78] The Housing Trust Fund, which is administered by HUD, provides funds to states and state-designated entities for eligible activities that primarily support affordable rental housing for extremely low- and very low-income families, including homeless families.[79] The Capital Magnet Fund provides competitively awarded grants to financial institutions designated as Community Development Financial Institutions and qualified nonprofit housing organizations for which the development or management of affordable housing is one of their principal purposes.[80]

FHFA suspended the required contributions when the GSEs initially entered conservatorship, but it has since reinstated the requirements effective in 2015.[81] Each GSE must set aside 4.2 basis points (0.042%) of the unpaid principal balance of mortgages purchased in a year to make cash contributions to the various funds. For 2018, Fannie Mae contributed $140 million to the Housing Trust Fund and $75 million to the Capital Magnet Fund.[82] Freddie Mac contributed $105.1 million to the Housing Trust Fund and $56.6 million to the Capital Magnet Fund.[83]

What Is the Duty to Serve Underserved Markets?

HERA created a new duty to serve three underserved markets: manufactured housing, affordable housing preservation, and rural housing. FHFA requires the GSEs to develop their own duty to serve plans to encourage lenders to make more loans in these areas.[84] For manufactured housing, the GSEs have submitted separate plans in four areas:

1. supporting manufactured housing titled as real property,
2. supporting manufactured housing titled as personal property (chattel),
3. supporting manufactured housing communities owned by governments, nonprofits, or residents, and

[78] See CRS Report R40781, *The Housing Trust Fund: Background and Issues*, by Katie Jones; and CRS Report R44304, *Housing Issues in the 114th Congress*, coordinated by Katie Jones. Prior to 2017, the GSEs also made contributions to Treasury's HOPE Reserve Fund, which provided a financial cushion for the HOPE for Homeowners refinance program.

[79] See U.S. Department of Housing and Urban Development: HUD Exchange, "Housing Trust Fund," at https://www.hudexchange.info/programs/htf/.

[80] See U.S. Department of Treasury Community Development Financial Institutions Fund, "Capital Magnet Fund," at https://www.cdfifund.gov/programs-training/Programs/cmf/Pages/default.aspx; and Department of the Treasury: Community Development Financial Institutions Fund, "Funding Opportunities: Capital Magnet Fund; 2018 Funding Round," 83 *Federal Register*, July 20, 2018.

[81] See FHFA, "FHFA Statement on the Housing Trust Fund and Capital Magnet Fund," December 11, 2014, at https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Statement-on-the-Housing-Trust-Fund-and-Capital-Magnet-Fund.aspx.

[82] Fannie Mae, *Form 10-K*, December 31, 2018, p. 178, at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2018/q42018.pdf.

[83] Freddie Mac, *Form -10K*, December 31, 2018, p. 171, at http://www.freddiemac.com/investors/financials/pdf/10k_021419.pdf.

[84] FHFA, "Enterprise Duty to Serve Underserved Markets," 81 *Federal Register* 96242, December 29, 2016.

4. supporting manufactured housing communities with specified minimum tenant pad (ground) lease protections.

For rural housing, the GSEs have submitted separate plans in six areas:

1. supporting high-needs rural regions,
2. supporting high-needs rural populations,
3. supporting small financial institutions that finance rural housing,
4. supporting small multifamily rental properties in rural areas,
5. supporting single-family rentals in rural markets, and
6. investing in low-income housing tax credits (LIHTCs) in rural areas.

For affordable housing preservation, the GSEs have submitted plans that cover nine activities:

1. investing in LIHTCs,
2. supporting housing receiving Section 8 vouchers,
3. supporting housing in HUD's rental assistance demonstration (RAD) program,
4. supporting housing using U.S. Department of Agriculture Section 515 financing,
5. financing small multifamily rental properties,
6. publishing reports on how to improve water and energy efficiency in multifamily rental projects,
7. researching ways to finance energy and water efficiency in single-family properties,
8. developing shared equity programs for affordable housing preservation, and
9. supporting residential economic diversity.

Details of each GSE's activities are in their duty to serve plans.[85]

What Are Some of Congress's Options for Restructuring the GSEs?

Going forward, Congress has many options for reorganizing Fannie Mae and Freddie Mac. If Congress were to decide to keep and reorganize Fannie Mae and Freddie Mac, options include (but are not limited to) the following:

- Congress could take no action.
- Congress could repeal the GSEs' charters and allow the private sector to replace them to the extent that the private sector finds this attractive.
- Congress could make Fannie Mae and Freddie Mac part of the government. Both GSEs were originally government corporations. They could return to being government corporations or become part of an agency such as the Department of Housing and Urban Development.

[85] Fannie Mae, *Introduction of the Duty to Serve Underserved Markets Plan*, December 14, 2018, at https://www.fhfa.gov/PolicyProgramsResearch/Programs/Documents/Fannie-Mae-Revised-Underserved-Markets-Plan-2018.pdf and Freddie Mac, *Freddie Mac Duty to Serve Underserved Markets Plan for 2018-2020*, Revised December 2018, at https://www.fhfa.gov/PolicyProgramsResearch/Programs/Documents/Freddie-Mac_Revised-Underserved-Markets-Plan-2018.pdf.

- Congress could repeal the GSEs' charters and create new entities (perhaps new GSEs) to assume some or all of their role in the mortgage market.

For additional information, see CRS Report R40800, *GSEs and the Government's Role in Housing Finance: Issues for the 113th Congress*, by N. Eric Weiss and CRS Report R41822, *Proposals to Reform Fannie Mae and Freddie Mac in the 112th Congress*, by N. Eric Weiss.

As previously mentioned, congressional interest in potentially restructuring the GSEs has been reflected by various oversight hearings and the introduction of bills to reform or replace the GSEs in past Congresses. As of the date of this report, no such legislation has been introduced in the 116th Congress, but Senate Committee on Banking, Housing, and Urban Affairs Chairman Mike Crapo has released an outline for potential housing finance reform legislation.[86] The committee held hearings on March 26 and March 27, 2019, on the outline.[87]

What Has the Trump Administration Announced Regarding the GSEs?

On March 27, 2019, President Trump signed an executive memorandum[88] directing the heads of various federal agencies and certain advisors[89] who play a role in housing finance to reform the system, stating that "the housing finance system of the United States is in urgent need of reform" and "it is time for the United States to reform its housing finance system to reduce taxpayer risks, expand the private sector's role, modernize government housing programs, and make sustainable home ownership for American families our benchmark of success." That memorandum directed the Secretary of the Treasury to develop and submit to the President "as soon as practicable" a plan for administrative and legislative reforms to achieve the following goals:

- "Ending the conservatorships of the GSEs upon the completion of specified reforms;
- Facilitating competition in the housing finance market;
- Establishing regulation of the GSEs that safeguards their safety and soundness and minimizes the risks they pose to the financial stability of the United States; and
- Providing that the Federal Government is properly compensated for any explicit or implicit support it provides to the GSEs or the secondary housing finance market."

As of the date of this report, no such plan has been publicly announced.

[86] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, "Chairman Crapo Releases Outline for Housing Finance Reform," press release, February 1, 2019, https://www.banking.senate.gov/newsroom/majority/chairman-crapo-releases-outline-for-housing-finance-reform.

[87] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Chairman's Housing Reform Outline: Part 1*, 116th Cong., 1st sess., March 26, 2019; and U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Chairman's Housing Reform Outline: Part 2*, 116th Cong., 1st sess., March 27, 2019.

[88] *Memorandum on Federal Housing Finance Reform*, March 27, 2019, at https://www.whitehouse.gov/presidential-actions/memorandum-federal-housing-finance-reform/.

[89] The agency heads and advisors to whom the memorandum was directed are the Secretary of the Treasury, Secretary of Agriculture, Secretary of Housing and Urban Development, Secretary of Veterans Affairs, Director of the Office of Management and Budget, Director of the Bureau of Consumer Financial Protection, Director of FHFA, Assistant to the President for Economic Policy, and Assistant to the President for Domestic Policy.

Glossary

Alt-A mortgage	Either a mortgage made to a borrower with a credit history between prime and subprime, or a mortgage made to a prime borrower with less than traditional documentation.
ARRA	American Recovery and Reinvestment Act of 2009, P.L. 111-5.
ESA	Economic Stimulus Act of 2008, P.L. 110-185.
FHFA	Federal Housing Finance Agency. Regulator of housing GSEs for mission, safety, and soundness. Created by merger of existing government agencies, including Office of Federal Housing Enterprise Oversight (OFHEO) and the U.S. Department of Housing and Urban Development (HUD) staff (who formerly had mission regulatory authority).
GSE	Government-sponsored enterprise (for the purposes of this report, Fannie Mae and Freddie Mac).
HERA	Housing and Economic Recovery Act of 2008, P.L. 110-289.
MBSs	Mortgage-backed securities. A pool of mortgages sold to institutional investors.
Primary market	Loan originators make new mortgages to borrowers in the primary market.
Prime mortgage	A mortgage made to a borrower with excellent credit history.
Secondary market	After the mortgages have been originated, loan originators may sell the mortgages to the GSEs, which is considered a secondary market transaction.
Senior Preferred Stock Purchase Agreements (PSPAs)	The agreements negotiated with the GSEs, FHFA, and Treasury with the terms and conditions under which Treasury provides financial support to the GSEs.
Senior preferred stock	This stock is senior to (has priority over) all other common and preferred stock; it is the only GSE stock currently receiving dividends.
Subprime mortgage	A mortgage made to a borrower with a blemished credit history.

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