



Highlights of [GAO-09-782](#), a report to congressional committees

Why GAO Did This Study

Congress established Fannie Mae and Freddie Mac (the enterprises) with two key housing missions: (1) provide stability in the secondary market for residential mortgages (also in periods of economic stress) and (2) serve the mortgage credit needs of targeted groups such as low-income borrowers. To accomplish these goals, the enterprises issued debt and stock, purchased mortgages from lenders with the proceeds, and retained them in portfolio or pooled them into mortgage-backed securities (MBS) sold to investors. On September 6, 2008, the Federal Housing Finance Agency (FHFA) placed the enterprises into conservatorship out of concern that their deteriorating financial condition (\$5.4 trillion in outstanding obligations) would destabilize the financial system. With estimates that the conservatorship will cost taxpayers nearly \$400 billion, GAO initiated this report under the Comptroller General's authority to help inform the forthcoming congressional debate on the enterprises' future structures. It discusses the enterprises' performance in meeting mission requirements, identifies and analyzes options to revise their structures, and discusses key transition issues.

GAO reviewed studies and data, and interviewed housing finance experts and officials from the enterprises, FHFA, Departments of the Treasury (Treasury) and Housing and Urban Development (HUD), the Federal Reserve, lenders, and community groups.

View [GAO-09-782](#) or [key components](#). For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

FANNIE MAE AND FREDDIE MAC

Analysis of Options for Revising the Housing Enterprises' Long-term Structures

What GAO Found

The enterprises have a mixed record in meeting their housing mission objectives, and both capital and risk management deficiencies have compromised their safety and soundness as follows:

- The enterprises' secondary market activities are credited with helping create a liquid national mortgage market, lowering mortgage rates somewhat, and standardizing mortgage underwriting processes. However, their capacity to support housing finance during periods of economic stress has not been established, and they only have been able to do so during the current recession with substantial financial assistance from Treasury and the Federal Reserve.
- There is limited evidence that a program established in 1992 that required the enterprises to meet annual goals for purchasing mortgages serving targeted groups materially benefited such groups.
- The enterprises' structures (for-profit corporations with government sponsorship) undermined market discipline and provided them with incentives to engage in potentially profitable business practices that were risky and not necessarily supportive of their public missions. For example, the enterprises' retained mortgage portfolios are complex to manage and expose them to losses resulting from changes in interest rates. Further, the enterprises' substantial investments in assets collateralized by subprime and other questionable mortgages in recent years generated losses that likely precipitated the conservatorship.

It will be necessary for Congress to reevaluate the roles, structures, and performance of the enterprises, and to consider options to facilitate mortgage finance while mitigating safety and soundness and systemic risk concerns. These options generally fall along a continuum with some overlap in key areas:

- *Reconstitute the enterprises as for-profit corporations with government sponsorship but place additional restrictions on them.* While restoring the enterprises to their previous status, this option would add controls to minimize risk. As examples, it would eliminate or reduce mortgage portfolios, establish executive compensation limits, or convert the enterprises from shareholder-owned corporations to associations owned by lenders.
- *Establish the enterprises as government corporations or agencies.* Under this option, the enterprises would focus on purchasing qualifying mortgages and issuing MBS but eliminate their mortgage portfolios. The Federal Housing Administration (FHA), which insures mortgages for low-income and first-time borrowers, could assume additional responsibilities for promoting homeownership for targeted groups.
- *Privatize or terminate them.* This option would abolish the enterprises in their current form and disperse mortgage lending and risk management throughout the private sector. Some proposals involve the establishment of a federal mortgage insurer to help protect mortgage lenders against catastrophic mortgage losses.

GAO provides a framework for identifying trade-offs associated with the options and identifies potential regulatory and oversight structures, principles, and actions that could help ensure their effective implementation (see table).

Summary of Implications of the Options to Revise the Enterprises' Structures

	Reestablish as government-sponsored enterprises (GSE)	Establish government corporation or agency	Privatize or terminate
Ability to provide liquidity and support to mortgage markets	Reconstituting the enterprises as GSEs may provide liquidity and other benefits to mortgage finance during normal economic times. However, as for-profit entities, their capacity to support housing finance during stressful economic periods is open to question.	A government entity, with access to Treasury-issued debt, may be positioned to provide mortgage liquidity during normal and stressful economic periods. But, without a portfolio to hold mortgages, its capacity to do the latter also may be limited. Treasury or the Federal Reserve may need to step in and purchase mortgage assets under such circumstances.	If other financial institutions assumed key enterprise activities such as mortgage purchases and MBS issuance, liquid mortgage markets could be reestablished in normal economic times. But, private mortgage lending has collapsed in the current recession. A federal mortgage insurer could help ensure that private lenders provide mortgage funding in stressful economic periods.
Support housing opportunities for targeted groups	For-profit status and elimination of mortgage portfolios could limit enterprises' capacity to fulfill this objective. But, permitting smaller mortgage portfolios, expanding FHA programs, or providing direct financial assistance to targeted borrowers could be alternatives.	Might be expected to perform this function as a public entity. But, may face challenges implementing a program to purchase mortgages for such groups if they cannot hold these mortgages in portfolio. FHA insurance programs could be expanded as an alternative.	Would eliminate traditional basis (government sponsorship) for previous programs that required enterprises to serve mortgage credit needs of targeted groups. But, a federal mortgage insurer could be required to establish such programs due to its government sponsorship.
Potential safety and soundness concerns	Although additional regulations could minimize risks, safety and soundness concerns may remain as this option would preserve the enterprises' previous status as for-profit corporations with government sponsorship.	May mitigate risk due to lack of profit motive and the elimination of existing mortgage portfolios. However, managing the enterprises' ongoing MBS business still would be complex and risky, and a government entity may lack the staffing and technology to do so effectively.	In one scenario, risks would decrease as mortgage lending would be dispersed among many institutions. But, large institutions that assumed functions such as MBS issuance may be viewed as too big to fail, which could increase risks. A federal mortgage insurer also may not charge premiums that reflect its risks.
Key elements for potential regulatory and oversight structure	Reduce or perhaps eliminate the enterprises' mortgage portfolios, increase capital standards and impose regulations, such as executive compensation limits, and establish new ownership structures, as appropriate. Require financial disclosures to help ensure transparency and provide congressional oversight of the enterprises' and FHFA's performance.	Provide entity with flexibility to hire staff and obtain necessary technology. Establish risk-sharing arrangements with the private sector, appropriate disclosures of risks and liabilities in the federal budget to help ensure transparency, and robust congressional oversight of operations.	Fragmented U.S. financial regulatory structure would need to be revised, as GAO has identified in previous reports, to help oversee risks of large institutions that may assume enterprise functions or acquire their assets. Oversight structure for a federal mortgage insurer also would need to be established.

Source: GAO analysis of structural reform options.

During the conservatorship, the federal government has tasked the enterprises to implement a variety of programs designed to help respond to the current housing crisis, such as helping borrowers forestall foreclosures. While these efforts may be necessary to help mitigate the effects of the housing crisis, they also might significantly affect the costs of the conservatorship and transition to a new structure. For example, investors might be unwilling to invest capital in reconstituted enterprises unless Treasury assumed responsibility for losses incurred during their conservatorship. Finally, any transition to a new structure would need to consider the enterprises' still-dominant position in housing finance and be implemented carefully (perhaps in phases) to ensure its success.

In written comments, FHFA stated that the report is timely and does a good job summarizing the dominant proposals for restructuring the enterprises and some of their strengths and weaknesses. FHFA also offered key questions and principles for guiding initial decisions that will have to be made about the future of the mortgage market.