



January 2019

HOUSING FINANCE

Prolonged Conservatorships of Fannie Mae and Freddie Mac Prompt Need for Reform

Accessible Version

GAO Highlights

Highlights of [GAO-19-239](#), a report to congressional addressees

Why GAO Did This Study

Since 2008, the federal government has greatly increased its role in financially supporting housing markets. In September 2008, FHFA placed Fannie Mae and Freddie Mac under conservatorship, which created an explicit fiscal exposure for the federal government. As of October 2018, the dollar amounts of their outstanding MBS have grown by more than \$800 billion since the end of 2008.

Since 2013, GAO has designated the federal role in housing finance as a high-risk area. GAO examines (1) recent housing market developments, (2) risks and challenges posed by the current federal role, including ongoing conservatorship, and (3) housing finance reform proposals and their strengths and limitations.

To address these issues, GAO reviewed housing finance data; FHFA and enterprise reports; and 14 housing finance reform proposals introduced in Congress or proposed by industry stakeholders since 2014. GAO also convened panels with housing finance experts and stakeholders (including consumer advocates, mortgage originators, insurers, and investors), who developed reform proposals, testified before Congress, or participated in prior GAO studies.

What GAO Recommends

Congress should consider legislation for the future federal role in housing finance that addresses the structure of the enterprises, establishes clear and prioritized goals, and considers all relevant federal entities, such as FHA and Ginnie Mae.

View [GAO-19-239](#). For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or GarciaDiazD@gao.gov

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What GAO Found

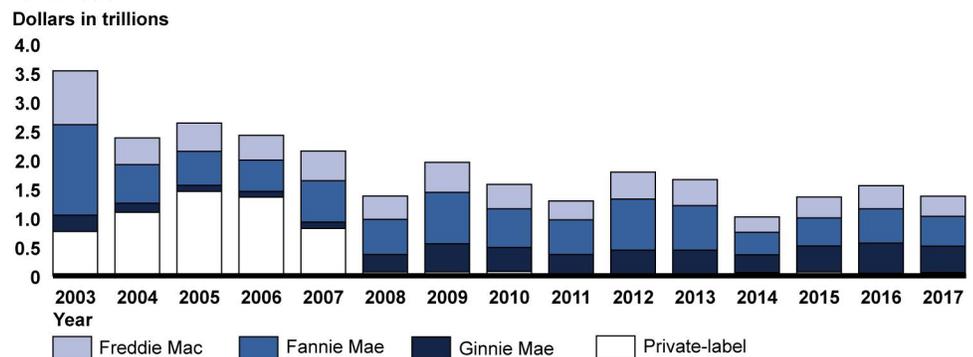
Federal support of the housing finance market remains significant even though the market has largely recovered since the 2007–2009 financial crisis. While down from the peak in 2009, in 2017, the federal government directly or indirectly guaranteed about 70 percent of single-family mortgage originations.

- The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—two government-sponsored enterprises (enterprises) that purchase and securitize mortgages into mortgage-backed securities (MBS)—securitized and guaranteed about 46 percent of mortgage originations in 2017.
- In 2017, federal programs, such as those offered by the Federal Housing Administration (FHA), insured about 25 percent of mortgage originations.

Together, the enterprises and the Government National Mortgage Association (Ginnie Mae)—a federally owned corporation that guarantees MBS backed by federally insured mortgages—have issued or guaranteed 95 percent or more of all MBS issued annually since 2008 (see figure).

However, recent market trends pose risks to these entities and the housing finance system. For example, mortgage lending standards have loosened slightly in recent years, which could increase the risk of borrower default—especially in a recession or downturn in the housing market—and losses to federal entities. Nonbanks have increased their presence in mortgage lending and servicing, which involves collecting monthly mortgage payments, among other duties. For instance, the share of nonbank originations of FHA-insured mortgages increased from 56 percent in fiscal year 2010 to 86 percent in 2017. The share of nonbank servicers of mortgages in enterprise MBS also grew from 25 percent in 2014 to 38 percent as of the third quarter of 2018. While nonbank lenders and servicers have helped provide access to mortgage credit, they are not subject to federal safety and soundness regulations.

Single-Family Mortgage-Backed Security Issuance, Federal and Private, 2003–2017, Adjusted for Inflation



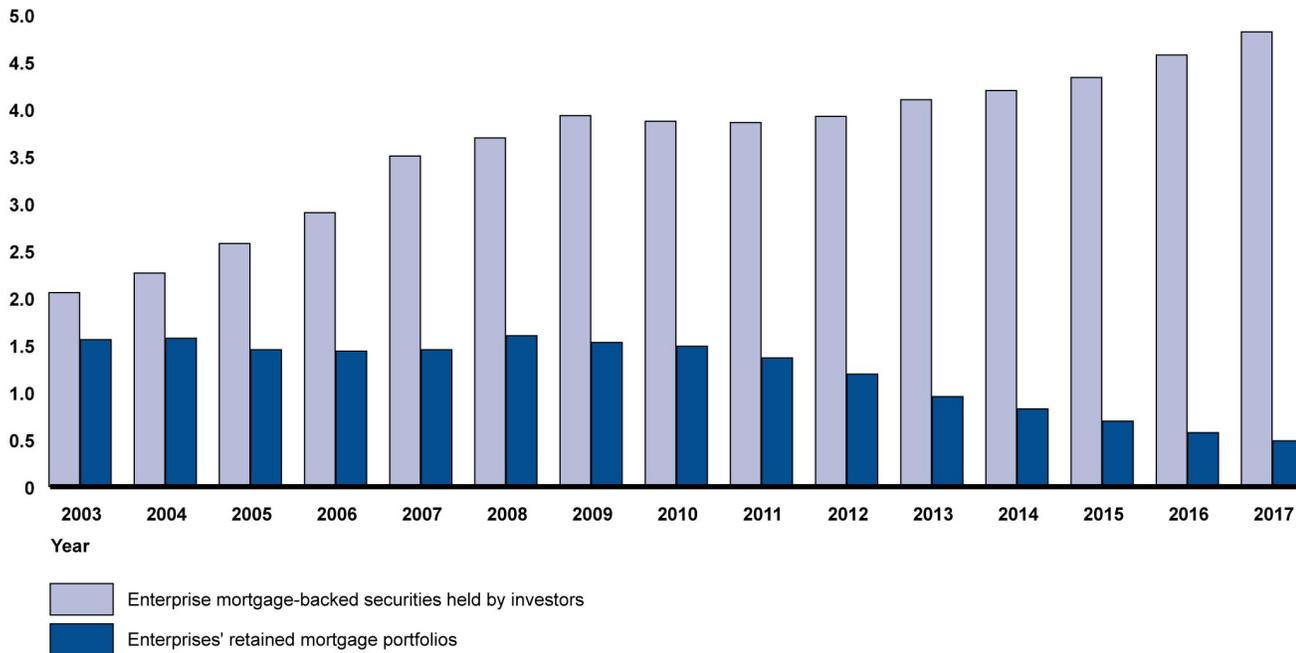
Source: GAO analysis of Inside Mortgage Finance and Bureau of Economic Analysis data. | GAO-19-239

Note: Fannie Mae and Freddie Mac purchase mortgages and issue and guarantee mortgage-backed securities (MBS). Ginnie Mae guarantees MBS backed by federally-insured mortgages. Private-label MBS do not have a government guarantee.

The Federal Housing Finance Agency (FHFA) has taken actions to lessen some of Fannie Mae and Freddie Mac’s risk exposure. For example, under FHFA’s direction, the enterprises have reduced the size of their riskier retained mortgage portfolios which hold assets that expose them to considerable interest rate and other risks from a combined \$1.6 trillion in 2008 to \$484 billion in 2017. Since 2013, the enterprises also have transferred increasing amounts of risk on their guaranteed MBS to private investors and insurers through credit risk transfer programs. However, federal fiscal exposure remains significant. The Department of the Treasury’s remaining funding commitment through the senior preferred stock purchase agreements—which provide financial support to the enterprises—leaves taxpayers exposed to risk, especially in the event of adverse market or other conditions and given the recent growth in the enterprises’ guarantee business. The value of outstanding MBS on which the enterprises guarantee principal and interest payments to investors grew from about \$2.1 trillion in 2003 to about \$4.8 trillion in 2017. The long duration of the conservatorships also raises uncertainty among market participants. Several experts and stakeholders GAO interviewed said that they have hesitated to make longer-term strategic plans and goals due to potential housing finance reforms that could markedly affect their industries. The figure below shows 2003–2017 trends in the enterprises’ guarantee business and retained mortgage portfolios.

Enterprises’ Outstanding Mortgage-Backed Securities and Retained Mortgage Portfolios, 2003–2017

Dollars in trillions



Source: GAO analysis of Federal Housing Finance Agency data. | GAO-19-239

Note: Dollar amounts represent unpaid principal balance at year-end. The enterprises hold some of their mortgage-backed securities in their own and each other’s retained mortgage portfolios.

GAO reviewed 14 housing finance reform proposals from Congress, agencies, industry groups, and think tanks. The proposals generally fit into four different models: reconstituted enterprises, a multiple guarantor system with an explicit federal guarantee, a government corporation, and a completely privatized market without an explicit federal guarantee. The 14 proposals generally meet key elements of GAO’s framework for assessing potential changes to the housing finance system, such as addressing fiscal exposure, protecting investors, and considering the implications of the transition to a new system. However, many proposals lack clearly defined and prioritized goals or do not address the role of other federal entities in the housing finance system, such as FHA and Ginnie Mae—two key elements in GAO’s framework. By incorporating these elements, policymakers could facilitate a more focused and comprehensive transition to a new housing finance system and provide greater certainty to market participants.

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List of Abbreviations

CBO	Congressional Budget Office
CFPB	Consumer Financial Protection Bureau
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
Federal Reserve	Board of Governors of the Federal Reserve System
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
Ginnie Mae	Government National Mortgage Association
HERA	Housing and Economic Recovery Act
HUD	Department of Housing and Urban Development
MBS	mortgage-backed securities
Treasury	Department of the Treasury
VA	Department of Veteran Affairs

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January 18, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
House of Representatives

The Honorable Sean P. Duffy
House of Representatives

In September 2008, the Federal Housing Finance Agency (FHFA) placed two government-sponsored enterprises (enterprises)—the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—into conservatorships out of concern that their deteriorating financial condition threatened the stability of the financial markets. However, this action also created an explicit fiscal exposure for the federal government—that is, the government assumed the responsibility for losses incurred by the enterprises. In the meantime, the enterprises' futures remain uncertain and as of October 2018, the dollar amounts of their outstanding mortgage-backed securities (MBS) had grown by more than \$800 billion since the end of 2008.¹

Since 2013, we have designated the federal role in housing finance as a high-risk issue because of the significant risks the current federal role poses to taxpayers and the stability of U.S. financial system.² In November 2016, we suggested that Congress consider establishing objectives for the federal role in the housing finance system and a transition plan for the enterprises' exit from conservatorship.³ In the last few years, several proposals have emerged that outline potential reforms to the housing finance system intended to address the federal fiscal

¹In the secondary mortgage market, institutions purchase loans from primary market loan originators and then either hold the loans in their own portfolios or pool the loans into MBS that are sold to investors. The secondary market provides liquidity and reduces risk for mortgage originators.

²For our most recent update on high-risk issues, see GAO, *High-Risk Series: An Update*, [GAO-17-317](#) (Washington, D.C.: Feb. 15, 2017).

³See GAO, *Federal Housing Finance Agency: Objectives Needed for the Future of Fannie Mae and Freddie Mac After Conservatorships*, [GAO-17-92](#) (Washington, D.C.: Nov. 17, 2016).

exposure and role in housing finance, conservatorship of the enterprises, and market-related issues. In prior work, we developed a framework to help assess potential changes to the housing finance system.⁴ We also reported that any changes would involve trade-offs and that policymakers should consider priorities in relation to the goals of the housing finance system.

As of early January 2019, Congress had not yet enacted legislation that established objectives for reforming the housing finance system or establishing the future structure of the enterprises. As conservatorship of the enterprises enters its eleventh year, uncertainty remains regarding changes to the housing finance system. We prepared this report under the authority of the Comptroller General to assist Congress with its oversight responsibilities. We examined:

- recent developments in the housing and financial markets and their implications for the safety and soundness of the enterprises;⁵
- the extent to which conservatorship improved the condition of the enterprises, and the risks and challenges the current federal role, including ongoing conservatorship, poses to the enterprises and other aspects of the housing finance system; and
- housing finance reform options that have been proposed and their relative strengths and limitations.

To address our objective on recent developments in the housing and financial markets that could affect the safety and soundness of the enterprises, we reviewed and analyzed house prices and mortgage delinquency rates from FHFA, and mortgage origination and securitization data from Inside Mortgage Finance (a housing market data provider), among other data. To examine trends in the housing market, we reviewed prior GAO work that identified and analyzed key national housing market

⁴See GAO, *Housing Finance System: A Framework for Assessing Potential Changes*, [GAO-15-131](#) (Washington, D.C.: Oct. 7, 2014).

⁵We did not include the Federal Home Loan Bank System (also a government-sponsored enterprise) in our review because we focused on Fannie Mae and Freddie Mac and recent developments affecting their safety and soundness.

indicators, including house prices and loan performance, since the 2007–2009 financial crisis.⁶

To address our objective on risks and challenges that conservatorship poses to the status of Fannie Mae, Freddie Mac, and other aspects of the housing finance system, we reviewed FHFA reports (such as the 2017 Report to Congress), FHFA Office of Inspector General reports, and selected academic literature. We also reviewed Fannie Mae’s and Freddie Mac’s filings with the Securities and Exchange Commission and quarterly financial supplements, and reports from credit rating agencies. We assessed the reliability of the data used for both objectives by reviewing related documentation, corroborating trends across multiple data sources, and interviewing agency officials. We determined the data were sufficiently reliable to report on recent trends in the housing market and developments under the conservatorships of the enterprises.

To address our third objective, we reviewed 14 proposals for reforming various aspects of the single-family housing finance system. We selected proposals introduced in 2014–2018 that were (1) introduced in Congress, either in legislation or released as discussion drafts, and (2) introduced by industry stakeholders or were discussed in Congressional hearings. We used GAO’s framework for assessing potential changes to the housing finance system to analyze the content and assess the potential strengths and limitations of the proposals.⁷ We categorized the proposals under different models and identified potential strengths and limitations based on our review of the proposals, prior GAO reports, Congressional Budget Office (CBO) reports, and industry stakeholder reports.

To address all three objectives, we interviewed officials at FHFA, the Department of Housing and Urban Development (HUD), and the Department of the Treasury (Treasury). We also convened four expert and stakeholder panels representing (1) mortgage originators and insurers, (2) securitizers and investors, (3) consumer and affordable housing advocates, and (4) researchers. We selected the experts and stakeholders because they developed reform proposals, testified before Congress on housing finance reform or participated in prior GAO studies

⁶See [GAO-15-131](#) and GAO, *Mortgage Reforms: Actions Needed to Help Assess Effects of New Regulations*, [GAO-15-185](#) (Washington, D.C.: June 25, 2015).

⁷[GAO-15-131](#).

of housing finance issues. For more information on our scope and methodology, see appendix I.

We conducted this performance audit from March 2018 to January 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Housing Finance System

In the primary market, lenders originate mortgage loans to borrowers to purchase homes. To evaluate the creditworthiness of a potential borrower (called underwriting), the lender considers the borrower's credit scores and history, monthly debts including mortgage payments relative to income (debt-to-income ratio), and the amount of the mortgage loan relative to the home's value (loan-to-value ratio). Borrowers with strong credit histories typically receive prime mortgages with the most competitive interest rates and terms. Lenders generally require borrowers to purchase private mortgage insurance when the loan-to-value ratio is higher than 80 percent. Some borrowers also may qualify for federal mortgage insurance programs (discussed later in this section).

Mortgage lending creates certain risks:

- **Credit risk** is the risk that the borrower will default on the mortgage by failing to make timely payments.
- **Prepayment risk** is the risk that borrowers will pay off the principal of the loan before the mortgage term ends. Prepayment reduces or eliminates future interest payments. The lender must relend or reinvest the prepaid amount and may have only lower-interest options available for lending or investing the funds if interest rates have decreased.
- **Interest rate risk** is the risk that an increase in interest rates will reduce the value of a loan for the lender. For example, a lender might fund mortgage lending through short-term deposits. If interest rates rise and the lender previously made a long-term fixed-rate mortgage

at a lower rate, the difference between the interest payments the lender receives from the mortgage and the interest the lender has to pay to its depositors decreases.

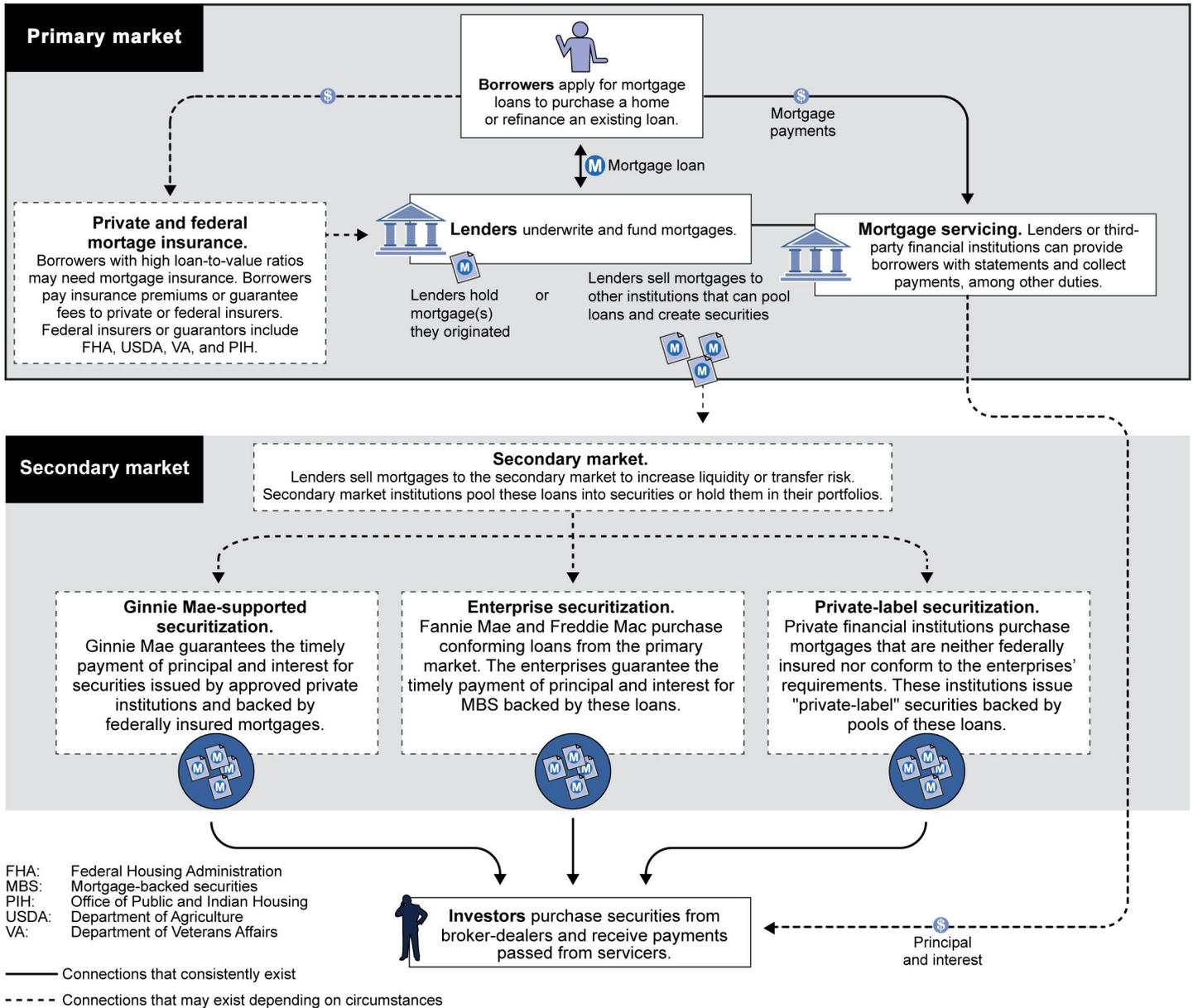
- **Liquidity risk** is the risk that an institution will be unable to meet its financial obligations as they come due without incurring unacceptable losses. For example, firms can be exposed to liquidity risk by funding longer-term asset purchases with shorter-term debt obligations.

After origination, mortgages are serviced until they are paid in full or closed due to nonpayment. Servicers can provide borrowers with account statements, respond to customer service questions, and collect monthly payments, among other duties.⁸ The servicer can be the same institution that originated the loan or the servicer can change as institutions sell servicing rights.

Lenders hold mortgage loans in their portfolios or sell them to institutions in the secondary market (see fig. 1). Lenders sell their loans to transfer risk (such as interest rate risk in the case of fixed-rate mortgages) or to increase liquidity. Secondary market institutions can hold the mortgages in their portfolios or pool them into MBS that are sold to investors. Participants in the secondary market include federal entities, issuers of private-label MBS, and investors. Private institutions, primarily investment banks, may issue MBS (known as private-label securities) which are backed by mortgages that are not federally insured and do not conform to the enterprises' requirements.

⁸For more information about mortgage loan servicing, see [GAO-15-131](#).

Figure 1: Overview of Primary and Secondary Mortgage Markets



Source: GAO. | GAO-19-239

Federal Participation in the Housing Finance System

The federal government participates in the primary and secondary mortgage markets as both an actor and a regulator. In the primary market, the federal government operates mortgage guarantee and insurance programs to promote homeownership for certain types of borrowers. For example, the Federal Housing Administration (FHA), Department of Veterans Affairs (VA), Department of Agriculture's Rural Housing Service, and HUD's Office of Public and Indian Housing offer programs that insure mortgages against default or guarantee lenders payment of principal and interest.

In the secondary market, the federal government facilitates mortgage lending through the enterprises (discussed below) and the Government National Mortgage Association (Ginnie Mae). Ginnie Mae is a federally owned corporation within HUD that guarantees the timely payment of principal and interest to investors in securities issued through its MBS program. Ginnie Mae-guaranteed MBS consist entirely of mortgages insured or guaranteed by federal agencies (such as FHA) and are issued by financial institutions it approves. The federal government also regulates the housing finance system through FHFA, which oversees the enterprises; the Bureau of Consumer Financial Protection, also known as the Consumer Financial Protection Bureau (CFPB); and the federal banking regulators, which enforce regulatory standards for mortgage lending.⁹

Enterprises

Congress chartered Fannie Mae and Freddie Mac as for-profit, shareholder-owned corporations in 1968 and 1989, respectively.¹⁰ They share a primary mission to enhance the liquidity, stability, and affordability of mortgage credit. The enterprises generally purchase mortgages that meet certain criteria for size, features, and underwriting standards (known as conforming loans) and hold the loans in their own portfolios or pool them into MBS that are sold to investors. In exchange for a fee, the

⁹FHFA also oversees the Federal Home Loan Bank System.

¹⁰Congress initially chartered Fannie Mae in 1938 but did not establish it as a shareholder-owned corporation until 1968. Congress initially established Freddie Mac in 1970 as an entity within the Federal Home Loan Bank System and reestablished it as a shareholder-owned corporation in 1989.

enterprises guarantee the timely payment of interest and principal on MBS that they issue.

The enterprises also have obligations to support housing for certain groups. Following the enactment of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, the enterprises have been required to meet specific goals for the purchase of mortgages supporting underserved groups (such as low- and moderate-income families) or certain geographic areas. In 2008, the Housing and Economic Recovery Act (HERA) tasked the enterprises to fund new affordable housing programs, including the Housing Trust Fund and the Capital Magnet Fund. The enterprises fund these programs with a dollar amount based on their unpaid balance of new business, purchases, and the funds distribute the money to states and housing organizations to support affordable housing.¹¹

Conservatorship

HERA established authorities for providing capital support to the enterprises and established FHFA as an independent regulatory agency for the enterprises.¹² HERA also authorized the Director of FHFA to appoint FHFA as a conservator or receiver for the enterprises.¹³ FHFA put the enterprises into conservatorship in September 2008.

FHFA has a statutory responsibility to ensure that the enterprises operate in a safe and sound manner and that their operations and actions of each regulated entity foster a liquid, efficient, competitive, and resilient national housing finance market. FHFA sets strategic goals for its conservatorship of the enterprises. According to FHFA, the enterprises' boards of directors oversee day-to-day operations, but certain matters are subject to FHFA review and approval. For example, FHFA officials told us that FHFA

¹¹Pub. L. No. 110-289, § 1131, 122 Stat. 2654, 2711-2727 (2008) (codified at 12 U.S.C. §§ 4567, 4568, 4569).

¹²Pub. L. No. 110-289, §§ 1101-1103, 122 Stat. 2654, 2661-2664 (2008) (codified at 12 U.S.C. §§ 4511-4513). The enterprises were previously regulated by the Office of Federal Housing Enterprise Oversight, an independent office in HUD.

¹³According to FHFA, conservatorship is the legal process in which a person or entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition. In a conservatorship, the powers of the company's directors, officers, and shareholders are transferred to the designated conservator. In contrast, receivership has the goal of liquidating an entity by selling or transferring its remaining assets.

reviews and approves some pilot programs. Fannie Mae and Freddie Mac retain their government charters and continue to operate legally as business corporations.

Using authority provided in HERA, Treasury has committed to providing up to \$445.6 billion in capital support to Fannie Mae and Freddie Mac while they are in conservatorship through the senior preferred stock purchase agreements. If Fannie Mae or Freddie Mac has a net worth deficit at the end of a financial quarter, Treasury will provide funds to eliminate the deficit. Under the most recent agreement in December 2017, the enterprises must pay Treasury a dividend of all their quarterly net income above a \$3 billion capital reserve that each enterprise is allowed to retain.

Reforming the Housing Finance System and Our Framework for Considering Reform Proposals

Since the 2007–2009 financial crisis, Congress has taken steps to improve regulation and consumer protection related to the housing finance system. For example, to address challenges related to limitations on mortgage information, HERA requires FHFA to collect market data. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created CFPB, which has undertaken a number of consumer protection initiatives related to mortgage lending and servicing.¹⁴ The Dodd-Frank Act also updated the Truth in Lending Act to prohibit lenders from making certain mortgage loans without regard to a consumer’s ability to repay the loan (known as the ability-to-pay rule). A lender is presumed to have met the ability-to-repay requirement when it originates a qualified mortgage—a category of loans that have certain more stable features that make it more likely a borrower will repay the loan.

Congress also has considered proposals to make significant changes to the housing finance system. During the 113th Congress (January 2013–January 2015), three proposals—the Housing Finance Reform and Taxpayer Protection Act of 2014, S. 1217; the FHA Solvency Act of 2013, S. 1376; and the Protecting American Taxpayers and Homeowners Act of 2013, H.R. 2767—were reported out of committee but no further action was taken. In September 2018, the Protecting American Taxpayers and

¹⁴Pub. L. No. 111-203, § 1011, 124 Stat. 1376, 1964 (2010) (codified as 12 U.S.C. § 5491).

Homeowners Act of 2018 (H.R. 6746) was reintroduced in the 115th Congress and referred to committee. As of the end of the 115th Congressional session, no further action had been taken. Industry groups and think tanks also have published reform proposals.¹⁵ We discuss reform proposals made since 2014 in more detail later in this report.

Federal agencies also have commented on housing finance reform. In early 2018, the Director of FHFA sent a letter to the Chairman and Ranking Member of the Senate Committee on Banking, Housing, and Urban Affairs stating that conservatorship is not sustainable and needs to end, and provided suggestions on how the enterprises could be reformed. For example, the letter states that the housing finance system should preserve 30-year fixed-rate mortgages, end taxpayer bailouts for failing firms, maintain liquidity, and provide a level playing field for lenders of all sizes. It also states that secondary market activities should be managed by shareholder-owned firms chartered by a regulator and operating as utilities with an explicit paid-for federal guarantee on MBS issued by regulated firms. In June 2018, the Office of Management and Budget released recommendations to reform the federal government in a number of areas, including housing finance.¹⁶ The recommendations propose privatizing the enterprises, allowing new private entities to enter the market, and providing an explicit federal guarantee on MBS that could only be accessed in limited, exigent circumstances.

In a 2014 report, we outlined a framework composed of nine elements we consider to be critically important to help policymakers assess or craft proposals to change the housing finance system (see table 1).¹⁷

¹⁵For example, the Mortgage Bankers Association and Urban Institute have released reform proposals. See Mortgage Bankers Association, *GSE Reform: Creating a Sustainable, More Vibrant Secondary Market* (Washington, D.C.: April 2017); and Jim Parrott et al., *A More Promising Road to GSE Reform* (Washington, D.C.: Urban Institute, March 2016).

¹⁶Office of Management and Budget, *Delivering Government Solutions in the 21st Century: Reform Plan and Reorganization Recommendations* (Washington, D.C.: June 2018).

¹⁷[GAO-15-131](#).

Table 1: Elements of GAO’s Framework for Assessing Potential Changes to the Housing Finance System

Element	Description
Clearly defined and prioritized housing finance system goals	Broad goals for the housing finance system should be clearly articulated and relevant so that government and market participants can effectively conduct activities to implement their missions. Additionally, market and government performance can be assessed against those broad goals. These goals should recognize broader housing policy objectives, as well. Where trade-offs among the broad goals exist, the goals should be prioritized.
Policies and mechanisms that are aligned with goals and other economic policies	Housing finance policies and mechanisms should be aligned with the broader goals of housing finance. Changes in housing finance should consider the full range of options for government actions—such as direct participation in markets through government guarantees, oversight and regulation, data collection and dissemination, and tax or other federal incentives to promote greater private market participation—and show how policies and mechanisms interact to achieve the goals on a comprehensive basis, while minimizing fragmentation, overlap, and duplication. In light of weaknesses exposed during the financial crisis these policies and mechanisms should help to align incentives, provide more information and transparency, and restrain excessive risk-taking. Proposals should also reflect how these mechanisms will interact with broader economic policies.
Adherence to an appropriate financial regulatory framework	In 2009, GAO proposed a framework for a financial regulatory system that included some of the elements listed in this table as well as ensuring that regulation was appropriately comprehensive, consistent, flexible, adaptable, and had a system-wide focus (GAO-09-216). A regulatory system should also ensure that regulators have independence from inappropriate influence; have sufficient resources, clout, and authority to carry out and enforce statutory missions; and are clearly accountable for meeting regulatory goals.
Government entities that have capacity to manage risks	Government entities will need adequate skills and resources to understand, price, and manage risks. These entities would also need the capacity to ensure that their counterparties in the private sector have the capacity to manage the risks inherent in their activities.
Mortgage borrowers are protected and barriers to mortgage market access are addressed	Borrowers need consistent, useful information, as well as legal protections, including disclosures, sales practice standards, and suitability requirements, throughout the mortgage life cycle. Any barriers facing creditworthy borrowers in accessing mortgage markets should be addressed. Key issues will be to encourage innovation to reduce barriers while ensuring that products are easily understood, such as through standardization and developing better tools to assess creditworthiness.
Protection for mortgage securities investors	Investors in the secondary market require adequate, reliable information to assess secondary-market risks. This would include providing clear information on securitizer and trustee responsibilities as they relate to investors. As with borrower protection, some standardization may be useful; however, care must be taken to ensure that certain protections do not discourage beneficial innovation.
Consideration of cyclical nature of housing finance and impact of housing finance on financial stability	Housing finance has been characterized by cycles that have alternated between loose credit standards and those that are tight. Because housing is a significant part of the economy, these cycles may pose risks to financial and economic stability. Government should determine whether actions related to housing finance are procyclical or countercyclical and consider making actions less procyclical. Government may also want to consider the appropriateness of countercyclical measures. Actions also should address the threat housing finance poses for financial stability when there are incentives for excessive risk taking.

Element	Description
Recognition and control of fiscal exposure and mitigation of moral hazard	Choices about policies and mechanisms will result in different levels of fiscal exposure. Wherever possible, exposures should be made explicit and costs recognized. Actions should be taken to minimize unexpected costs and to mitigate any moral hazard created by government policies and support.
Emphasis on implications of the transition.	Because changing the housing finance system may lead to substantial changes in the marketplace, issues related to transitioning from the current system to a new one should be emphasized in any proposal for change. Any action that would severely limit market liquidity during the transition should be of particular concern.

Source: GAO. | GAO-19-239

Government Continues Significant Support of Housing Market but Recent Trends Present Risks to Enterprises and Others

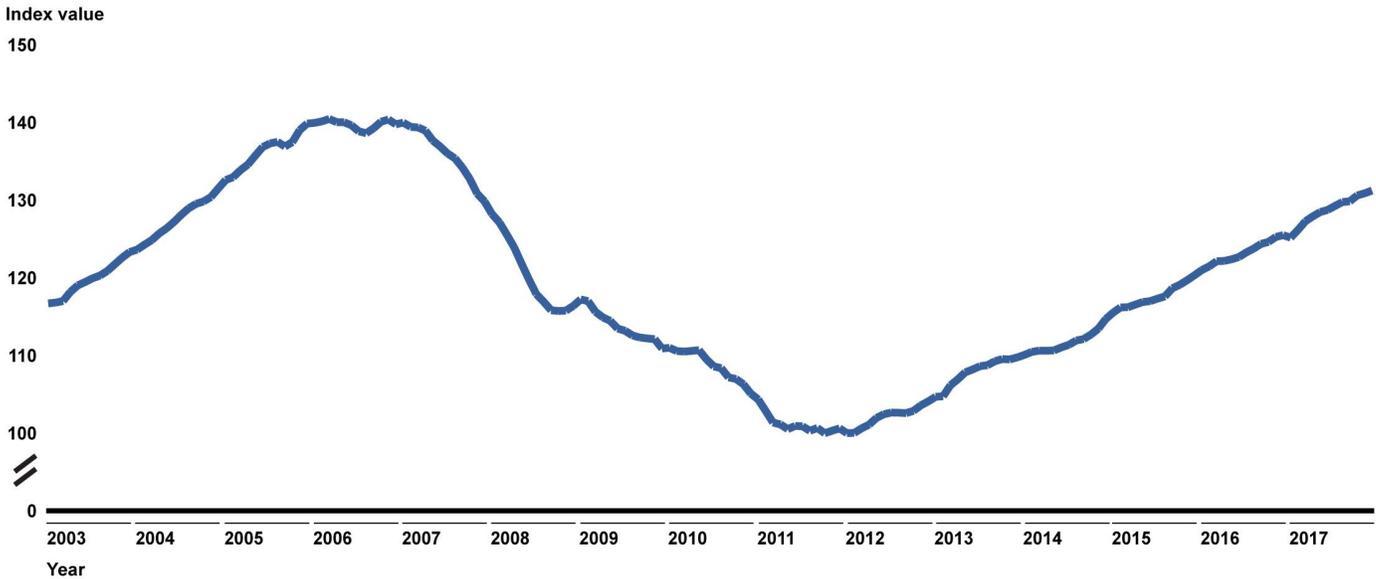
The housing market has recovered since the financial crisis, with significant federal support. Indicators of recovery include rising house prices and declining mortgage delinquency rates. However, the federal government has continued to support the housing market with guarantees on more than two-thirds of new mortgages each year since 2008, either through government-insured originations or by guaranteeing timely payment to investors on mortgage loans purchased and securitized by the enterprises. The government also has continued to play a very substantial role in the secondary market, guaranteeing around 95 percent or more of all MBS issued annually since 2008. But recent trends—some loosening of underwriting standards, the rise of nonbank mortgage lenders and servicers, and less access to affordable housing and homeownership—may pose additional risks and challenges to the housing market and participants, including the enterprises.

Enterprises Have Benefited from Housing Recovery but Government Still Supports a Majority of Mortgages

Several indicators demonstrate that the housing market has recovered since the financial crisis of 2007–2009. For example, real national average house prices have consistently risen each year since 2012 (see fig. 2). The rise in house prices also has been complemented by consistent economic growth, declining unemployment, and low mortgage rates since 2009. Higher house prices have some positive implications for the financial soundness of the enterprises: higher prices can reduce the

enterprises' potential losses due to defaulted loans because the enterprises can recover more value from properties securing the loans.

Figure 2: Federal Housing Finance Agency National House Price Index, 2003–2017



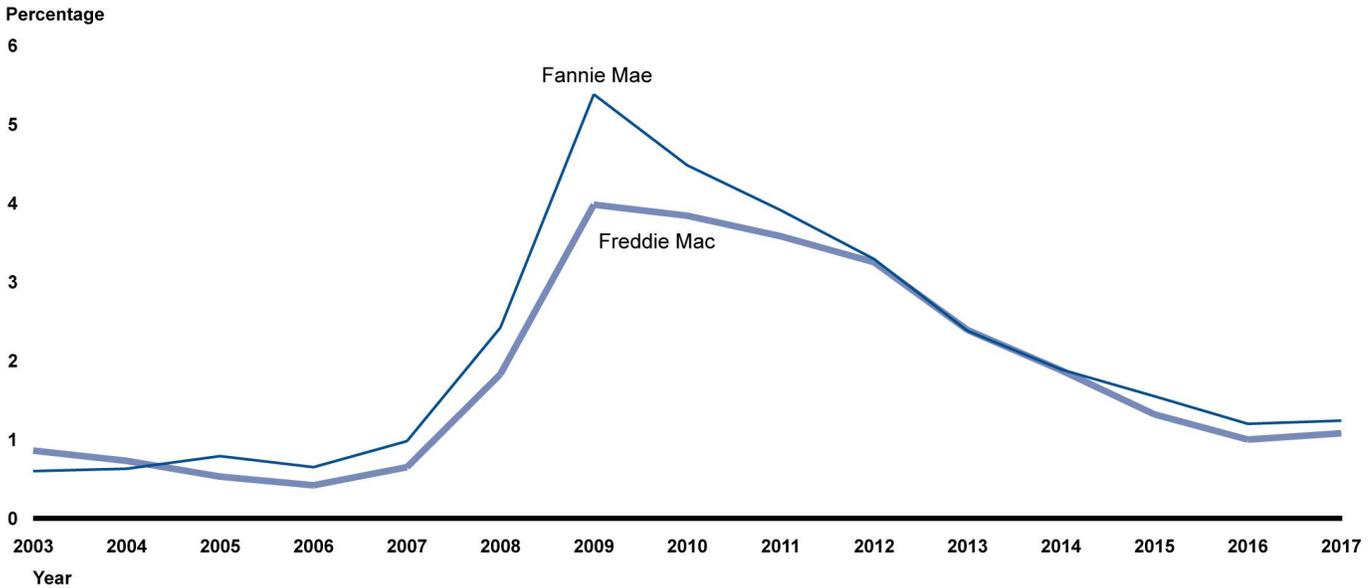
Source: GAO analysis of Federal Housing Finance Agency and Bureau of Labor Statistics data. | GAO-19-239

Note: October 2011 = 100. Index adjusted for inflation using the Consumer Price Index of the Bureau of Labor Statistics.

Serious delinquency rates (90 or more days delinquent) for mortgages purchased by Fannie Mae and Freddie Mac have declined steadily and since 2014 have remained between 1 and 2 percent for both enterprises (see fig. 3). Examining delinquency rates for mortgages by origination year reveals significant differences for mortgages originated before and after the financial crisis. According to Fannie Mae and Freddie Mac reports, mortgages originated since 2009 have had lower delinquency rates than those originated before 2009. For example, in 2017, Fannie Mae’s serious delinquency rate was 6.6 percent for mortgages originated in 2005–2008, compared to 0.5 percent for mortgages originated since 2009. As of October 2018, mortgages originated since 2009 represented more than 90 percent of Fannie Mae’s and 80 percent of Freddie Mac’s outstanding held loans and guaranteed MBS. Serious delinquency rates

for mortgages insured by FHA are higher on average than those purchased by the enterprises but generally have followed similar trends.¹⁸

Figure 3: Percentage of Enterprise-Purchased Mortgages 90 or More Days Delinquent, 2003–2017



Source: GAO analysis of Federal Housing Finance Agency data. | GAO-19-239

Note: Rates are based on the number of loans held and backing enterprise mortgage-backed securities.

Compared to pre-2007 levels, trends in mortgage originations indicate a smaller-volume market largely composed of prime conforming and government-insured mortgages, as shown in figure 4. During 2008–2017, total mortgage origination volume—the dollar value of mortgage loans—remained below pre-crisis levels. Much of the decrease in volume resulted from large declines in prime jumbo and nonprime originations

¹⁸The purpose of FHA’s mortgage insurance is to encourage lenders to make mortgages available to borrowers, including those who may have difficulty qualifying for conventional mortgage credit. Therefore, the loans they insure may tend to be riskier on average than the conventional loans purchased by the enterprises.

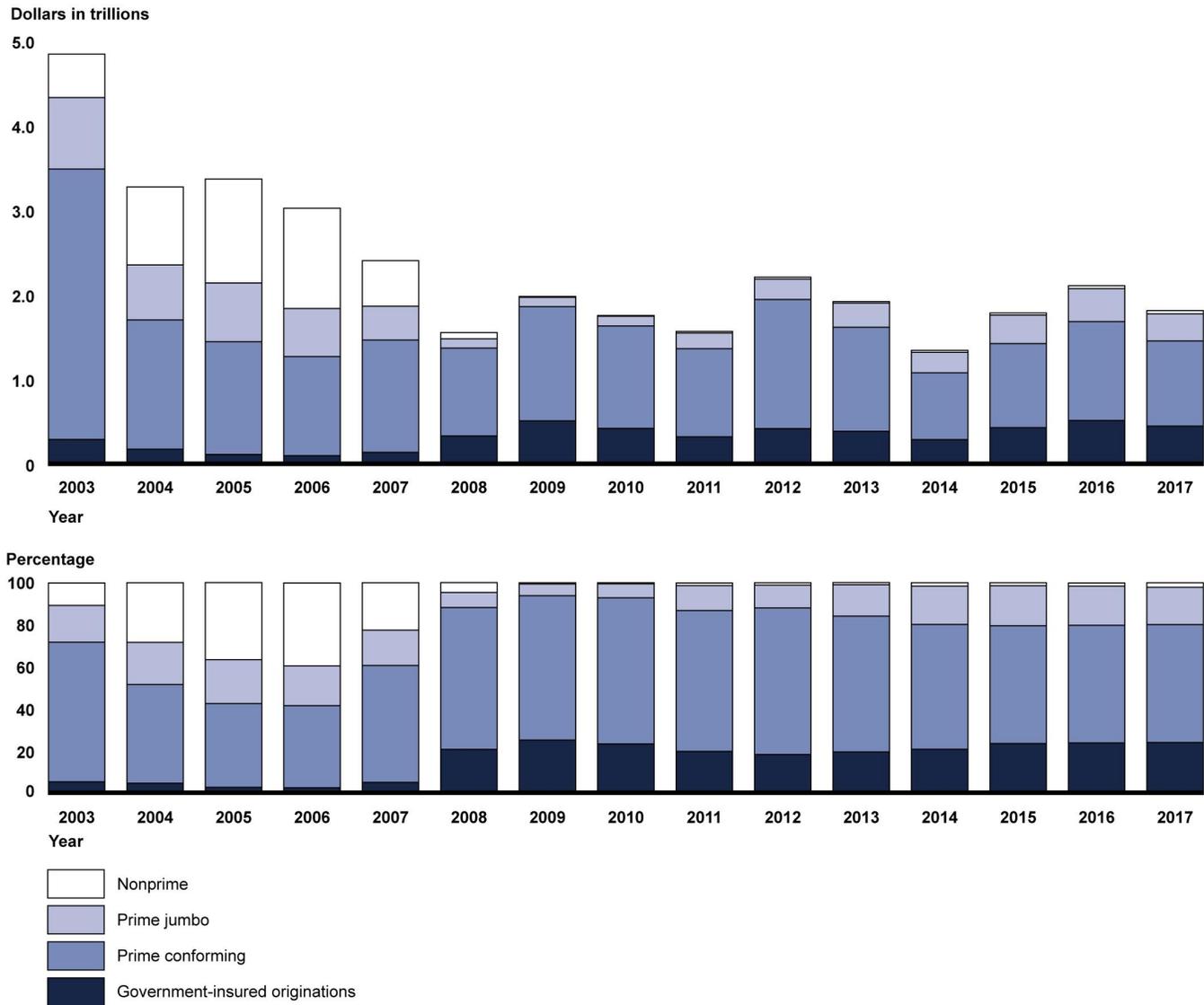
since 2008.¹⁹ Prime jumbo and nonprime originations represented a significant share of originations (market share) before 2007 but declined sharply since 2008. Prime jumbo market share recovered somewhat, increasing from a low of 6 percent in 2009 to approximately 18 percent of originations each year since 2014. Riskier nonprime originations remain very low compared to their pre-crisis levels.²⁰ Meanwhile, federally insured mortgages (such as those insured by FHA or guaranteed by VA) grew significantly in 2008 and retained a market share between 19 and 25 percent in 2008–2017. Finally, prime conforming origination volume varied year-to-year but these mortgages have represented the majority of originations since 2007.²¹ Federally insured and prime conforming mortgages represented 80 percent or more of originations every year since 2008.

¹⁹Nonprime mortgages include subprime, Alt-A, non-qualified mortgage loans, and other non-agency products not sold to the enterprises or federally insured. Subprime mortgages are generally made to borrowers with weaker credit and feature higher interest rates and fees than prime loans, while Alt-A mortgages generally serve borrowers whose credit histories are close to prime, but the loans may have one or more higher-risk characteristics such as limited documentation of income or assets or higher loan-to-value ratios. Jumbo mortgages are prime mortgage loans for amounts larger than the maximum eligible for purchase by the enterprises.

²⁰Nonprime originations increased slightly in 2016 and 2017 but still represented 2 percent or less of originations since 2009. We previously reported that many pre-crisis nonprime mortgages had nontraditional and higher-risk features that may increase the likelihood of borrowers defaulting. Many of these products would not have met the criteria for a qualified mortgage (a category of loans that have certain, more stable features that help make it more likely that a borrower will be able to afford the loan). See GAO, *Nonprime Mortgages: Analysis of Loan Performance, Factors Associated with Defaults, and Data Sources*; [GAO-10-805](#) (Washington, D.C: Aug. 24, 2010), [GAO-15-131](#) and [GAO-15-185](#) for more information on riskier mortgage products.

²¹Yearly variations in prime mortgage origination volume fluctuate based on changes in the volume of new mortgages to refinance an existing mortgage.

Figure 4: Dollar Volume and Percentage of Single-Family Mortgage Loan Originations by Product Type, 2003–2017



Source: GAO analysis of Inside Mortgage Finance and Bureau of Economic Analysis data. | GAO-19-239

Note: Figures include first-lien mortgages only. A first-lien mortgage creates a primary lien against real property and has priority over subsequent mortgages. Prime mortgages are made to borrowers with strong credit histories and provide the most attractive interest rates and loan terms. Conforming loans are those eligible for purchase by Fannie Mae and Freddie Mac. Jumbo loans are larger than the maximum amount eligible for purchase by Fannie Mae and Freddie Mac. Nonprime loans refer to loans with more liberal underwriting standards, without qualifying mortgage protections, or those made to borrowers with nontraditional documentation or weaker credit. Government-insured originations include those insured by the Federal Housing Administration and guaranteed by the Department of Veterans Affairs. Dollar amounts were adjusted for inflation and reflect real 2017 dollars.

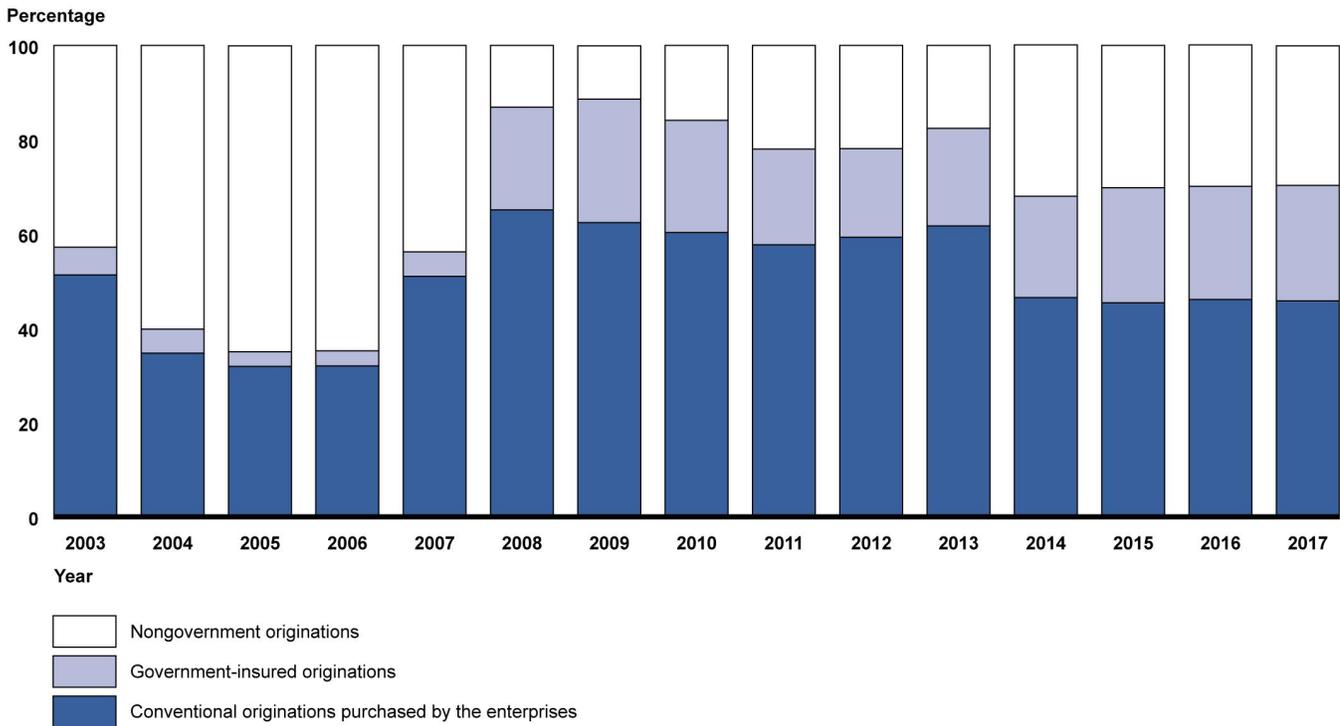
The federal government has continued to support a significant share of the mortgage markets since the financial crisis. For instance, while down from the peak in 2009, the federal government has guaranteed more than two-thirds of new mortgages since 2014, either by insuring mortgages or by guaranteeing timely payment to investors on loans purchased and securitized by the enterprises (see fig. 5).²² Government-insured mortgages declined leading up to the financial crisis, largely due to the availability of nonprime mortgages and securitization by fully private institutions. But when the availability of these products declined sharply, government agencies such as FHA and VA insured or guaranteed significantly higher volumes of mortgages. For instance, the share of mortgages insured or guaranteed by federal agencies grew from 6 percent (\$134 billion) in 2007 to more than 20 percent (\$328 billion) in 2008.²³ As of 2017, federally insured mortgages were 25 percent (\$444 billion) of total originations. Similarly, as the share of conventional mortgages held in banks' portfolios declined during the financial crisis, the enterprises purchased and securitized large volumes of these mortgages.²⁴ The share of mortgage originations purchased by the enterprises peaked at 65 percent in 2008 and still accounted for nearly half of new mortgages in 2017.

²²In this report, we refer to mortgages guaranteed by the federal government as those insured or guaranteed through federal programs such as FHA and VA as well as conventional mortgages securitized or held in portfolio by the enterprises while they have explicit financial backing from Treasury through the senior preferred stock purchase agreements. The enterprises do not guarantee mortgage originations but rather the timely payment of principal and interest to investors on mortgages they securitize.

²³We adjusted dollar amounts of mortgage originations and MBS issuance from Inside Mortgage Finance data for inflation to real 2017 dollars using the Bureau of Economic Analysis's implicit price deflator.

²⁴We estimated originations held in portfolio based on the difference of the value of mortgages originated and the value of mortgages securitized by year as reported by Inside Mortgage Finance.

Figure 5: Percentage of New Single-Family Mortgages with Federal Guarantees, 2003–2017



Source: GAO analysis of Inside Mortgage Finance data. | GAO-19-239

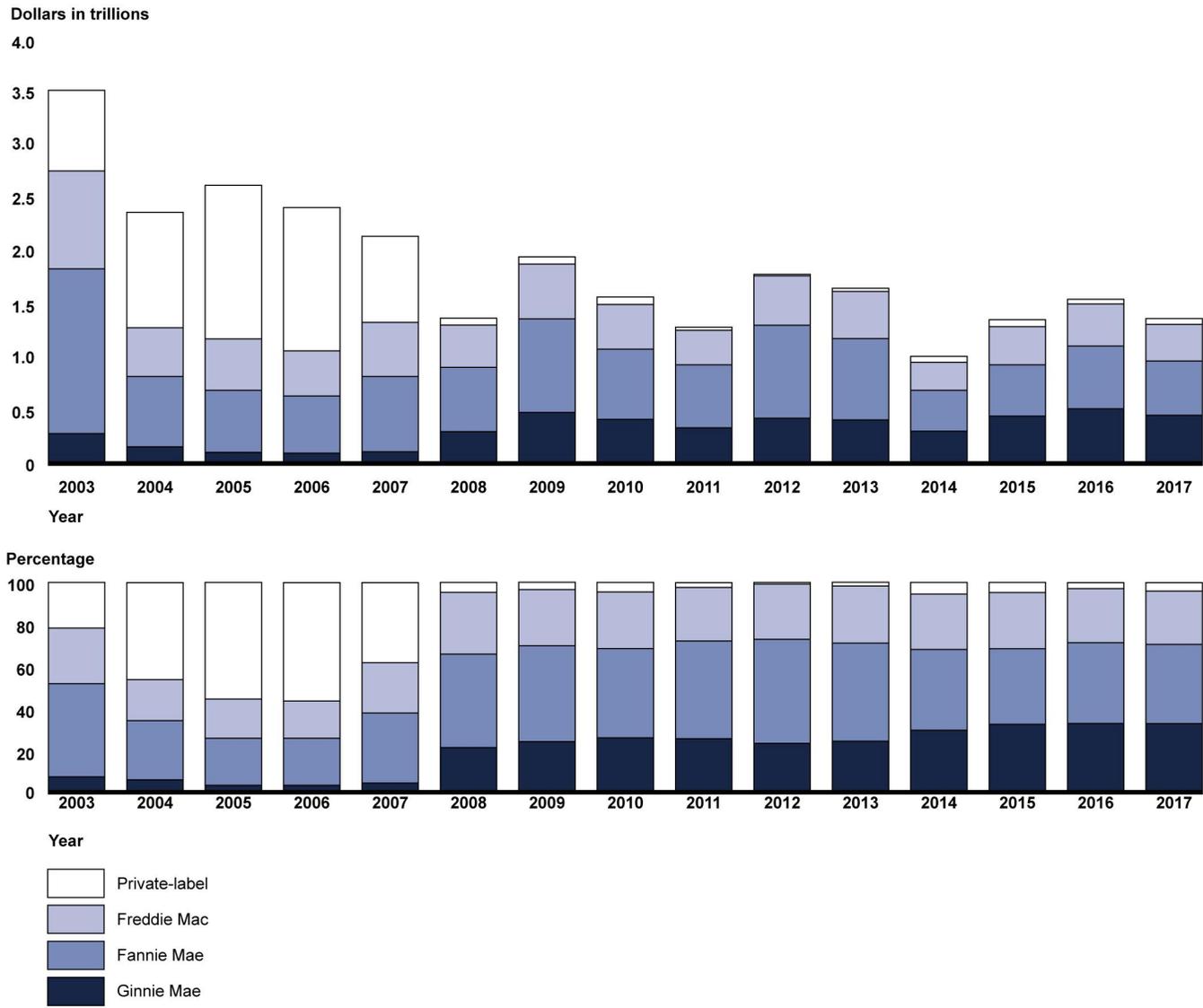
Note: Figures include first-lien mortgages only. A first-lien mortgage creates a primary lien against real property and has priority over subsequent mortgages. Before September 2008, mortgages purchased and securitized by the enterprises did not have an explicit federal guarantee. Conventional originations are mortgages not insured or guaranteed by a federal agency such as the Federal Housing Administration (FHA) or the Department of Veterans Affairs (VA). Government-insured originations include those insured by FHA and guaranteed by VA. We estimated the enterprises' conventional purchases using their volume of mortgage-backed security issuance backed by unseasoned conventional loans, as reported by Inside Mortgage Finance. Estimates of enterprise purchases do not include purchases of seasoned loans, government-insured loans, or those held in Fannie Mae's or Freddie Mac's retained mortgage portfolios. Nongovernment originations are conventional mortgage originations not securitized by the enterprises.

The federal government also has maintained a very substantial role in the secondary mortgage market since the financial crisis. The enterprises and Ginnie Mae guaranteed around 95 percent or more of all MBS issued each year since 2008, despite a nearly decade-long economic expansion. In line with the rise in federally insured originations, Ginnie Mae's market share increased substantially, from 5 percent (\$110 billion) in 2007 to 22 percent (\$301 billion) in 2008, and about 33 percent (\$455 billion) in 2017 (see fig. 6).²⁵ Conversely, private-label MBS issuance since 2008 has been minimal, as many private-label issuers left the market and nonprime originations declined.²⁶

²⁵As previously discussed, Ginnie Mae-guaranteed MBS are composed entirely of federally insured mortgages (such as FHA loans).

²⁶A majority of private-label MBS issuance since the financial crisis has been for nonperforming loans, reperforming loans (those on which borrowers have resumed payments), or resecuritizations of previously issued MBS. Since 2008, less than 1 percent of new mortgage originations have been securitized as private-label MBS. While jumbo origination volume has increased since 2008, only about 3 percent was securitized in 2017.

Figure 6: Dollar Volume and Percentage of Single-Family Mortgage-Backed Security Issuance by Source, 2003–2017



Source: GAO analysis of Inside Mortgage Finance and Bureau of Economic Analysis data. | GAO-19-239

Note: Dollar amounts were adjusted for inflation and reflect real 2017 dollars. Private-label MBS are issued by private institutions and do not have a federal guarantee.

The growth in the market share of Ginnie Mae and the enterprises resulted in part from actions by Congress and the Board of Governors of the Federal Reserve System (Federal Reserve). Congress increased the loan limits for FHA-insured loans and loans eligible for securitization by

the enterprises.²⁷ The federal government also made its backing of securities issued by the enterprises explicit by committing to provide them financial assistance, and Ginnie Mae continued to provide guarantees for securities backed by federally insured mortgages.²⁸ According to several mortgage originators, securitizers, investors, and researchers with whom we spoke, the enterprises will continue to dominate the MBS market because the federal guarantee through conservatorship offers a competitive advantage over other participants without such a guarantee.

In response to the financial crisis, the Federal Reserve provided additional support for the mortgage market, becoming one of the largest purchasers of MBS issued by the enterprises and guaranteed by Ginnie Mae. Among other impacts, this action made these securities somewhat more attractive to secondary market participants. In June 2017, when the Federal Reserve's MBS holdings had peaked at \$1.78 trillion, it announced plans to gradually reduce its MBS holdings as part of its efforts to reduce the size of its balance sheet. As of November 2018, the Federal Reserve had \$1.66 trillion in MBS holdings.

Recent Trends in the Housing Market May Present Risks and Challenges

Recent trends—particularly changes in underwriting standards and borrowers' credit risk profiles, the rise of nonbank mortgage lenders and servicers, and limited access to affordable housing and homeownership—pose risks and challenges to the housing market and participants, including the enterprises.

²⁷While FHA loans still represent the majority of federally insured mortgages, the volume and market share of VA loans have grown more significantly relative to FHA since 2011.

²⁸Fiscal exposures may be explicit in that the federal government is legally required to pay for the commitment; alternatively, it may be implicit in that the exposure arises from expectations based on current policy or past practices. Before 2008, securities issued by the enterprises were explicitly not backed by the U.S. government. However, in response to the financial crisis, the government's agreement to provide temporary assistance to cover their losses up to a set amount created a new explicit exposure. FHFA and the enterprises have made efforts to manage this exposure (for example by transferring some additional risk to the private market). We discuss these efforts later in this report.

Underwriting Standards and Borrower Credit Risk

Indicators of borrower credit risk and surveys of loan officers indicate a loosening of underwriting standards in recent years.²⁹ More specifically, indicators of borrower credit risk for mortgages the enterprises purchased suggest underwriting standards tightened in 2008 but loosened slightly since 2012, which could pose increased risk to the enterprises. Specifically, average combined loan-to-value ratios (for all loans on the property) and debt-to-income ratios have increased, while average borrower credit scores have declined.³⁰ The enterprises and FHA include assessments of these measures in setting their underwriting standards. As discussed earlier in the report, mortgages originated since 2009 have performed much better than those originated before 2008, but remain untested by a large-scale stressful economic event.

Furthermore, mortgages to refinance an existing mortgage (as opposed to mortgages for purchasing a home) declined since 2012. According to FHFA officials, credit scores, loan-to-value ratios, and debt-to-income ratios tend to be stronger for refinance mortgages than purchase mortgages. FHFA and HUD officials also told us that reduced refinancing volume due to rising interest rates may put additional pressure on lenders to maintain volume and profitability by offering more relaxed credit terms to borrowers.

Average combined loan-to-value ratios for mortgages purchased by the enterprises peaked in 2014 and have remained roughly similar to pre-crisis levels (see fig.7). In December 2014, FHFA began allowing the enterprises to purchase mortgages with loan-to-value ratios up to 97 percent.³¹ In the first three quarters of 2018, 22 percent of mortgages Fannie Mae purchased included a loan-to-value ratio over 90 percent,

²⁹Underwriting standards include factors that may influence the capacity of the borrower to repay a loan, such as the level of the borrower's equity invested in the property, indebtedness, and overall creditworthiness of the borrower.

³⁰These figures reference a subset of fully amortizing, full documentation, conventional fixed-rate mortgages purchased by the enterprises. They exclude mortgages with certain features, such as balloon amortization, or other features to be more reflective of current underwriting guidelines.

³¹Due to the riskier nature of these loans, the enterprises require mortgages with loan-to-value ratios over 80 percent to have some form of credit enhancement, most commonly private mortgage insurance. Many of these loans also have been targeted for credit risk transfer, which is discussed later in this report.

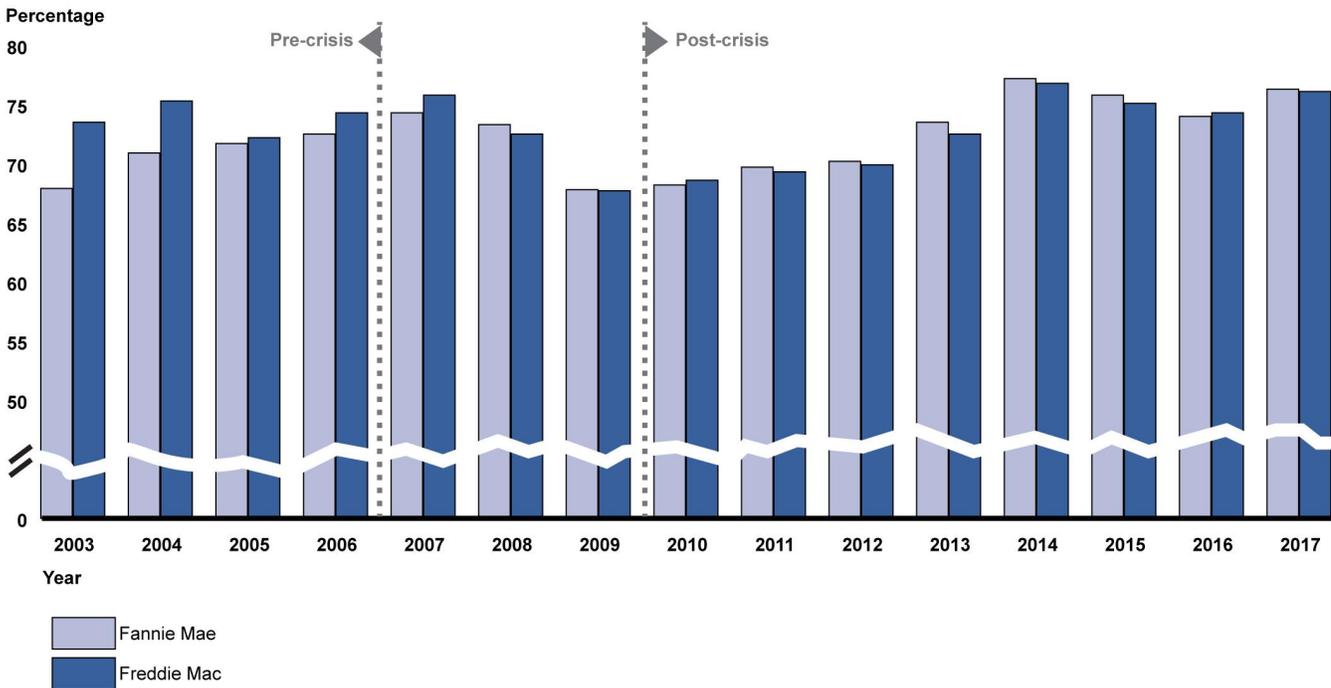
which is higher than shares in 2005–2008. FHA’s loan-to-value ratio is limited to 96.5 percent, and the average among borrowers has remained relatively consistent around 93 percent since 2008.³² The higher the loan-to-value ratio when a loan is originated, the less equity borrowers will have in their homes and the more likely they are to default on mortgage obligations, especially during times of financial stress or falling home values.³³ Additionally, house price valuation—measured by the price-to-rent ratio—has increased substantially since 2012 to levels last seen in 2004.³⁴ Higher valuations could increase the risk of future price decreases—which would reduce collateral values that protect the enterprises against losses in the event of default—or more modest price increases. This could signal increased risk when associated with higher loan-to-value ratios.

³²FHA loans often have additional down-payment assistance features that may change how loan-to-value ratios traditionally would be reported. Depending on these features, the reported loan-to-value of an FHA-insured mortgage could be up to nearly 5 percentage points higher if it were reported using standards outside of FHA’s.

³³[GAO-15-185](#).

³⁴We calculated the price-to-rent ratio using FHFA’s purchase-only house price index and the Bureau of Labor Statistics’ owners’ equivalent rent of primary residence.

Figure 7: Combined Loan-to-Value Ratio for Mortgages Purchased by the Enterprises, 2003–2017



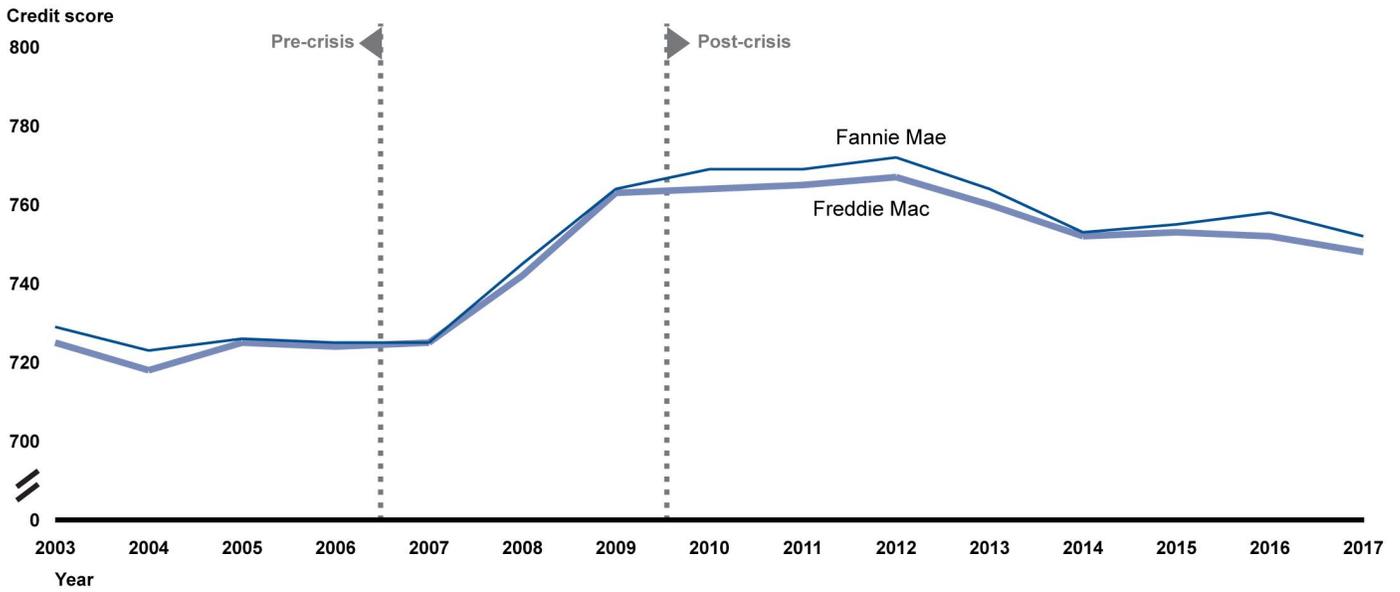
Source: GAO analysis of Fannie Mae and Freddie Mac data. | GAO-19-239

Note: Values represent weighted average based on unpaid principal balance. Data for 2017 are as of September 30, 2017.

Average credit scores for enterprise-purchased loans rose significantly from their pre-crisis lows and remained historically high through 2012 but have since slightly declined (see fig. 8).³⁵ The average credit score of FHA-insured borrowers, while lower than those for loans purchased by the enterprises, followed a trend similar to those of the enterprises. Generally, a higher score indicates a greater credit quality and potentially lower likelihood of default. Lenders continue to use credit scores as a primary means of assessing whether to originate a loan to a borrower.

³⁵A credit score is a numeric value that represents a borrower’s potential credit risk, based on his or her credit history.

Figure 8: Borrower Credit Score for Mortgages Purchased by the Enterprises, 2003–2017



Source: GAO analysis of Fannie Mae and Freddie Mac data. | GAO-19-239

Note: Values represent weighted average based on unpaid principal balance. Data for 2017 are as of September 30, 2017.

Average debt-to-income ratios for mortgages purchased by the enterprises remained below their pre-crisis levels but have deteriorated since 2012, and the share of high debt-to-income mortgages rose.³⁶ Additionally, according to Fannie Mae financial reports, in the first three quarters of 2018, roughly 25 percent of mortgages it purchased included a borrower debt-to-income ratio over 45 percent, up from roughly 7 percent of mortgages in the first three quarters of 2017.

The share of high debt-to-income ratios for FHA-insured borrowers also has risen significantly. For example, nearly half (49 percent) of FHA-insured borrowers in fiscal year 2017 had high debt-to-income ratios, surpassing the previous high of 45 percent of borrowers in 2009.³⁷ According to FHA, as of March 2018, about 24 percent of mortgages included debt-to-income ratios above 50 percent, up from 20 percent of mortgages in March 2017. The Dodd-Frank Act requires mortgage lenders to make “a reasonable, good faith determination” of a borrower’s ability to repay the loan. A lender that originates a “qualified mortgage” is presumed to have met this requirement. All qualified mortgages must meet mandatory requirements including restrictions on points and fees, and loan structure. In addition, the borrower’s debt-to-income ratio must be 43 percent or less; however, loans eligible for purchase by the enterprises or to be insured by the FHA, VA or USDA are not subject to a specific debt-to-income ratio.³⁸

³⁶Lenders use debt-to-income ratio as a key indicator of a borrower’s capacity to repay a loan. The ratio represents the percentage of a borrower’s income that goes toward all recurring debt payments, including the mortgage payment. A higher ratio is generally associated with a higher risk that the borrower will have cash flow problems and may miss mortgage payments. An increase in debt-to-income ratios is consistent with a widening of credit availability for borrowers with higher debt burdens. According to Freddie Mac, debt-to-income reporting standards may vary by lender and may be missing or excluded in some cases.

³⁷In this instance, we define high debt-to-income ratios as 43 percent or greater. Debt-to-income ratios above 43 percent do not meet the criteria for qualified mortgage protections, with some exceptions. A qualified mortgage is a category of loans that have certain, more stable features that help make it more likely that a borrower will be able to afford the loan.

³⁸To implement the ability-to-repay and qualified mortgage provisions of the Dodd-Frank Act, CFPB issued a rule amending Regulation Z, which implements the Truth In Lending Act. CFPB’s rule includes an exemption from the 43 percent debt-to-income cap for mortgages eligible for purchase by the enterprises. This applies only as long as the enterprises remain in federal conservatorship or until January 2021, whichever comes first. The Dodd-Frank Act also required HUD, VA, and USDA to issue rules to implement the qualified mortgage provisions. Mortgages eligible for insurance or guarantee by FHA, VA, or RHS generally are qualified mortgages under these regulations

Additionally, according to results from the October 2018 Senior Loan Officer Opinion Survey on Bank Lending Practices, more loan officers reported loosening than tightening their underwriting standards for enterprise-eligible mortgages every quarter from 2015 through the second quarter of 2018. More officers reported loosening their standards for government-insured mortgages during 12 of the last 16 quarters.³⁹

Nonbank Mortgage Lenders and Servicers

Our review found that the increased role of nonbank mortgage lenders and servicers in recent years has helped provide liquidity and access to mortgage credit but also presented additional liquidity risks. FHFA and HUD officials reported that the share of nonbanks mortgage originators and servicers grew since the financial crisis. According to data from Inside Mortgage Finance, nonbanks originated roughly half of all mortgages sold to the enterprises in 2017 and the first three quarters of 2018. Of the top 10 mortgage sellers to the enterprises in the first three quarters of 2018, six were nonbanks that originated more than 20 percent of all enterprise purchases during that period. Nonbank servicers of loans backing enterprise MBS have grown from 25 percent in 2014 to 38 percent as of the third quarter of 2018. For FHA-insured mortgages, nonbank originations represented 74 percent in 2003, declined to 56 percent in 2010, and then increased to 86 percent in fiscal year 2017.⁴⁰

While FHFA and HUD officials told us nonbanks have helped provide access to mortgage credit, several stakeholders and experts in all four of our panels identified the increased presence of nonbank lenders as a current risk in the housing finance system. A 2018 paper published by the Brookings Institution cited that nonbanks are exposed to significant liquidity risks in their funding of mortgage originations and servicing of mortgages, because nonbank lenders rely more on credit lines provided mostly by banks, securitizations involving multiple players, and more

³⁹The Federal Reserve generally conducts the survey quarterly and includes up to 80 large domestic banks and 24 U.S. branches and agencies of foreign banks. The survey asks about changes in the standards and terms of loans (including residential mortgage loans) and demand for loans.

⁴⁰As described above, the volume of FHA-insured originations was much lower in 2003 than in 2017.

frequent trading of mortgage servicing rights than banks.⁴¹ For instance, during times of financial stress, lenders to nonbanks have the right to quickly pull their lines of credit and seize and sell the underlying collateral if nonbanks do not maintain certain levels of net worth. HUD officials identified similar risks and added that this may reduce borrower access to credit in the event of financial stress or a liquidity crisis.

Additionally, while nonbanks are subject to some federal and state oversight, they are not federally regulated for safety and soundness. State regulators may require nonbanks to be licensed and may examine their financial soundness and compliance with relevant state laws, but there are no such federal regulations, unlike with banks. The Conference of State Bank Supervisors has a series of initiatives with the goal of all state regulators adopting a nationwide nonbank licensing and supervisory system by 2020. CFPB oversees nonbank issuers for compliance with consumer financial protection laws but not for financial safety and soundness. We reported in 2016 that incomplete information on the identity of nonbank servicers may hinder those responsible for their oversight.⁴²

The lack of federal safety and soundness oversight of nonbank lenders and servicers may pose risks for the enterprises and federal housing finance entities. The enterprises conduct financial and operational reviews of their counterparties in accordance with FHFA guidance. But, as we reported in 2016, FHFA does not have the authority to independently evaluate the safety and soundness of entities that conduct

⁴¹Nonbank issuers typically rely on credit lines provided by warehouse lenders, which tend to be commercial and investment banks. Warehouse lending is a process by which lenders extend lines of credit to nonbanks to fund mortgages until the nonbank finds a willing investor. Warehouse lenders can adjust the terms or cancel lines if nonbanks violate any of the covenants of the contract, including maintaining certain levels of net worth and profitability. For more information, see You Suk Kim, Steven M. Laufer, et al., "Liquidity Crises in the Mortgage Market," *Brookings Papers on Economic Activity*, Spring 2018 (Washington, D.C.: 2018).

⁴²To improve CFPB's ability to monitor the consumer effect of nonbank servicers, we recommended that CFPB take action to collect more comprehensive data on the identity and number of nonbank mortgage servicers in the market. To address the recommendation, CFPB analyzed National Mortgage Licensing System data and identified 880 additional servicers, resulting in a list of 1,050 mortgage servicing entities. See GAO, *Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened*, [GAO-16-278](#) (Washington, D.C.: Mar. 10, 2016).

business with the enterprises.⁴³ In 2014, the FHFA Office of Inspector General found that nonbank lenders may have limited financial capacity and are not subject to federal safety and soundness oversight, creating an increased risk that these counterparties could default on their financial obligations.⁴⁴ They also found that rapid business growth among specialty servicers could put stress on their operational capacity or overrun their quality control procedures, potentially increasing representation and warranty claims and credit losses on mortgages they sell to the enterprises. Representation and warranty claims allow the enterprises and other federal entities to recover some losses from lenders in the event of misrepresentation by the seller. From 2009 through 2013, the enterprises received \$98.5 billion through repurchase requests to sellers (that is, they required sellers to repurchase the enterprises' interests in the loans). According to the FHFA Office of Inspector General, due to lower capital levels, nonbanks may be less able to honor these representation and warranty commitments.⁴⁵

FHFA and HUD officials also told us nonbanks have helped increase servicing capacity. We previously reported that nonbank servicers provide benefits to the housing market through increased capacity to service delinquent loans and contribute to liquidity by broadening participation in the market for mortgage servicing rights.⁴⁶ In particular, larger numbers of individual servicers also can reduce market concentration, suggesting that servicers may be more likely to behave competitively and can, for instance, increase innovation. Furthermore, large nonbanks are generally not as interconnected with the financial system as large banks, potentially limiting broader market effects in the event of the failure of a single large nonbank servicer.⁴⁷

⁴³FHFA has indirect oversight of third parties that do business with the enterprises, including nonbanks that service loans on the enterprises' behalf. However, their oversight of third parties is through contractual provisions rather than statutory authority. In 2016, we recommended that Congress consider granting FHFA authority to examine third parties that do business with the enterprises. See [GAO-16-278](#). As of November 2018, Congress had not yet taken action on this issue.

⁴⁴Federal Housing Finance Agency, Office of Inspector General, *Recent Trends in the Enterprises' Purchases of Mortgages from Smaller Lenders and Nonbank Mortgage Companies*, EVL-2014-010 (Washington, D.C.: July 17, 2014).

⁴⁵Federal Housing Finance Agency, Office of Inspector General, EVL-2014-010.

⁴⁶See [GAO-16-278](#).

⁴⁷[GAO-16-278](#).

But the enterprises and Ginnie Mae likely would incur costs in the event of a failure of a large nonbank servicer whose portfolio cannot be easily absorbed by others. Mortgage servicers must continue making payments to investors when borrowers do not make payments. For mortgages backed by the enterprises, servicers can be reimbursed for principal and interest and certain other expenses, but they must finance them in the interim. Servicers of mortgage pools guaranteed by the enterprises must advance payments until the borrower is 120 days delinquent on the loan.⁴⁸ Servicers of Ginnie Mae-guaranteed pools are not limited in how long they must advance principal and interest on delinquent loans, and they additionally may be required to absorb losses not covered by FHA insurance or VA guarantees. In the event of a failure of a large nonbank servicer with a not readily absorbable portfolio, Ginnie Mae and the enterprises likely would bear most of the associated costs, and consumers also likely would see some effects, such as service interruptions.⁴⁹ In 2015, FHFA and Ginnie Mae raised their minimum financial eligibility requirements for sellers and servicers (including for net worth, capital ratio, and liquidity criteria for counterparties), but these requirements may not fully account for the high interest rate and default risks that nonbanks face.

Affordable Housing

Challenges related to affordable housing and access to homeownership also remain. Fannie Mae and Freddie Mac are subject to affordable housing goals for their purchases of single-family and multifamily mortgages that benefit families with lower incomes.⁵⁰ However, a number of factors affect the development of affordable housing and access to homeownership. For example, according to a 2018 study on the state of the nation's housing, competition for the historically low supply of existing homes on the market has pushed up home prices in most metropolitan

⁴⁸According to FHFA officials, servicers of pools guaranteed by Fannie Mae must advance payments of both principal and interest on delinquent loans. For those guaranteed by Freddie Mac, the servicer advances interest payments but Freddie Mac advances principal payments. Servicers are also responsible for advancing additional costs and payments such as property taxes.

⁴⁹[GAO-16-278](#).

⁵⁰The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 created this provision. Pub. L. No. 102-550, § 1331-1334, 106 Stat. 3672, 3956-3961 (1992), which was amended by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, §1128, 122 Stat. 2654, 2696-2703 (2008) (codified as 12 U.S.C. §4561-4564).

areas, raising concerns about affordability.⁵¹ The study also noted that although better housing quality accounts for some of the increase in housing prices, sharply higher costs for building materials and labor, among other factors, have made housing construction considerably more expensive. Land prices also increased as population growth in metropolitan areas increased demand for well-located sites. Along with rising housing costs, the study also reported that weak income growth among low- and moderate-income households contributed to affordability pressures. As homeownership becomes less affordable with house price increases, the enterprises' affordable housing goals become more difficult to achieve. For example, for calendar year 2016, Freddie Mac met all of its affordable housing goals, and Fannie Mae met most of its affordable housing goals, but failed to meet its goal for the single-family home purchase, very-low income category.⁵² For calendar year 2017, based on FHFA's preliminary determinations, Fannie Mae met all of its affordable housing goals, but Freddie Mac missed its single-family home purchase goals for both the very low-income and low-income categories.

Experts and stakeholders we interviewed identified other contributing challenges. For example, a few experts and stakeholders cited lower levels of lending in minority communities and to low- and moderate-income borrowers, which are typically most in need of affordable housing, as contributing challenges. A few other experts and stakeholders stated that borrowers increasingly have been holding other types of debt, such as student loan debt, which makes it more difficult for them to obtain an affordable mortgage. Lastly, the qualified mortgage rule exception, which may have helped some borrowers with a debt-to-income ratio above 43 percent to obtain a mortgage, expires in 2021 or earlier if conservatorship of the enterprises ends before then. When this happens, this could also hinder the ability of certain borrowers with a debt-to-income ratio higher than 43 percent to obtain mortgages.

⁵¹Joint Center for Housing Studies at Harvard University, *The State of the Nation's Housing* (2018), (Cambridge, Mass.: June 19, 2018).

⁵²Fannie Mae also failed to meet its calendar year 2016 single- family, low-income refinance goal.

Enterprises Have Expanded or Plan to Expand Activities That Could Present Challenges for Other Market Participants

Fannie Mae and Freddie Mac have taken actions in recent years that could further increase the scope of their activities and present challenges or barriers to entry for other market participants.

Mortgage Insurance

Both enterprises have recently introduced pilot programs that affect mortgage insurance decisions and terms typically made by lenders. In 2018, Fannie Mae introduced a pilot program to offer an enterprise-paid mortgage insurance option—an alternative to the borrower-paid and lender-paid options currently available. Under the program's structure, Fannie Mae is the entity responsible for purchasing mortgage insurance on loans with high loan-to-value ratios. To do so, Fannie Mae secures an insurance arrangement from a qualified insurer, which in turn transfers the risk to a panel of approved reinsurers. Fannie Mae pays the mortgage insurance premiums, while the lender is responsible for paying an additional, loan-level price adjustment.

Freddie Mac launched a similar pilot program earlier in 2018 known as the Integrated Mortgage Insurance program. Under this program, simultaneous with purchasing single-family mortgages, Freddie Mac purchases mortgage insurance from a panel of pre-approved reinsurance companies that it has allocated risk among. In addition, the reinsurers post collateral to provide further assurance that claims will be paid, and they cannot deny or rescind coverage.

According to Fannie Mae and Freddie Mac documents, these pilot programs allow the enterprises to better manage their counterparty risk and streamline the operational requirements of participating lenders. For example, each participating reinsurer undergoes a thorough counterparty review in order to be approved for participation in the programs. Additionally, under the programs, lenders are not required to purchase mortgage insurance for loans with loan-to-value ratios above 80 percent, which would simplify the process of selling loans to the enterprises. However, according to several experts and stakeholders with whom we spoke, by allowing the enterprises to play a role in selecting the mortgage insurer, these pilot programs widen the scope of activities of the enterprises. They also allow them to become more dominant by

potentially growing their role beyond the secondary market and into the primary market. They explained that these programs promote greater vertical integration of private-sector activities into the enterprises, and create challenges for market participants. For example, they stated that they promote an uneven playing field in the private market by allowing for different terms and standards for enterprise-paid mortgage insurance versus other sources of private capital.

Other Activities

Experts and stakeholders also identified other enterprise pilot programs or activities, such as Freddie Mac's financing of nonbank mortgage servicers and the enterprises' standardization efforts, as potential challenges. Freddie Mac's Mortgage Servicing Rights pilot program provides financing to nonbank servicers, with some limitations, secured by the servicers' mortgage servicing rights. The program is intended to address impediments nonbank mortgage servicers face in obtaining financing and extends credit to nonbank mortgage servicers when they need access to cash. However several experts and stakeholders with whom we spoke stated that this could lead to certain servicers having a competitive advantage. For example, they stated that under this program, Freddie Mac may target its financing at the biggest servicers and charge comparatively low interest rates, putting small lenders and servicers at a disadvantage. The enterprises also have efforts to standardize appraisal data, loan applications, and closing disclosures. While these efforts are intended to streamline and standardize aspects of the mortgage process, several experts and stakeholders explained that the results of these activities can be costly to smaller lenders and servicers who have to bear the costs of adapting their systems to enterprise requirements. They also indicated that participants in the primary market have become reliant on the enterprises for standards and innovation. Several experts and stakeholders also stated that the cost for market participants to adopt new programs or standards set by the enterprises can be high and could inhibit other participants from entering the housing finance market.

In addition, the enterprises are currently developing a common securitization platform to support the issuance of a common single

mortgage-backed security by both enterprises.⁵³ The platform will support the enterprises' single-family mortgage securitization activities, including issuance by both enterprises of a common mortgage-backed security to be known as the uniform mortgage-backed security. FHFA expects the issuance of the uniform mortgage-backed security to improve the overall liquidity of the enterprises' securities and promote liquidity of the nation's housing finance markets. The common securitization platform also would integrate the various securitization infrastructure systems within each enterprise, which is expected to lower costs and increase efficiency.

However, several stakeholders we interviewed explained that the platform presents concerns. For example, mortgage securitizers and investor stakeholders who participated on our panels expressed concern about the platform and its availability to other market participants. Specifically, they stated that the goal of the project has, at times, been unclear and that it has been difficult to tell to what extent or when the platform will be accessible to other secondary market participants. They also stated that if the platform would not be accessible to other secondary market participants, it would take away opportunities from participants willing and able to pool eligible securities. FHFA officials told us the platform currently is intended for use only by Fannie Mae and Freddie Mac, but that the agency is aware that potential reforms to the housing finance system may bring about the inclusion of other guarantors. As such, the platform is being designed to be adaptable for use by other participants in the secondary market in the future.⁵⁴ (We discuss recent proposals to reform the housing finance system in detail later in this report.)

⁵³Common Securitization Solutions, LLC (a joint venture owned by the enterprises) has been developing a common securitization platform under FHFA's direction and guidance. According to FHFA, the platform will perform many office operations for the uniform mortgage-backed security—a joint initiative between Fannie Mae and Freddie Mac, under the direction of FHFA, to develop a single mortgage-backed security that the enterprises will issue to finance fixed-rate mortgage loans backed by one- to four-unit single-family properties—as well as most of the enterprises' current securitization functions for single-family mortgages.

⁵⁴For more discussion on FHFA's strategic goal of building a securitization infrastructure, see [GAO-17-92](#).

FHFA Has Taken Actions to Reduce the Enterprises' Exposure, but Risks, Uncertainty, and Challenges Remain

FHFA Has Taken Actions to Reduce the Enterprises' Risk Exposure

FHFA-directed actions (including retained mortgage portfolio reductions, credit risk transfer, and foreclosure prevention) have improved the condition of the enterprises by mitigating some of the enterprises' exposures to potential losses.

Retained Mortgage Portfolios

Under the direction of FHFA and in accordance with the requirements of the senior preferred stock purchase agreements between Treasury and the enterprises, the enterprises have substantially reduced the size of their retained mortgage portfolios since 2008.⁵⁵ The portfolios invest in mortgages the enterprises purchased but did not securitize, mortgages bought out of securities due to delinquency status or other reasons, MBS they purchased from each other or from private issuers, and their own MBS repurchased from other investors.

The enterprises can earn higher returns from their retained mortgage portfolios than from issuing guaranteed MBS, but the portfolios can expose the enterprises to greater risks. Specifically, the enterprises retain the credit risk on mortgages they securitize because of their guarantee, but transfer the interest rate and liquidity risk to investors. However, holding whole mortgages and MBS in their retained mortgage portfolios entails the enterprises retaining liquidity, and interest rate risk, in addition to credit risk. We previously reported that the enterprises' large retained mortgage portfolios exposed them to considerable interest rate risk and

⁵⁵The senior preferred stock purchase agreements set annual caps on the retained mortgage portfolios that decrease each year. The enterprises have been able to meet these caps each year.

that riskier assets they held represented a disproportionate share of their total credit-related losses in 2007 and 2008.⁵⁶

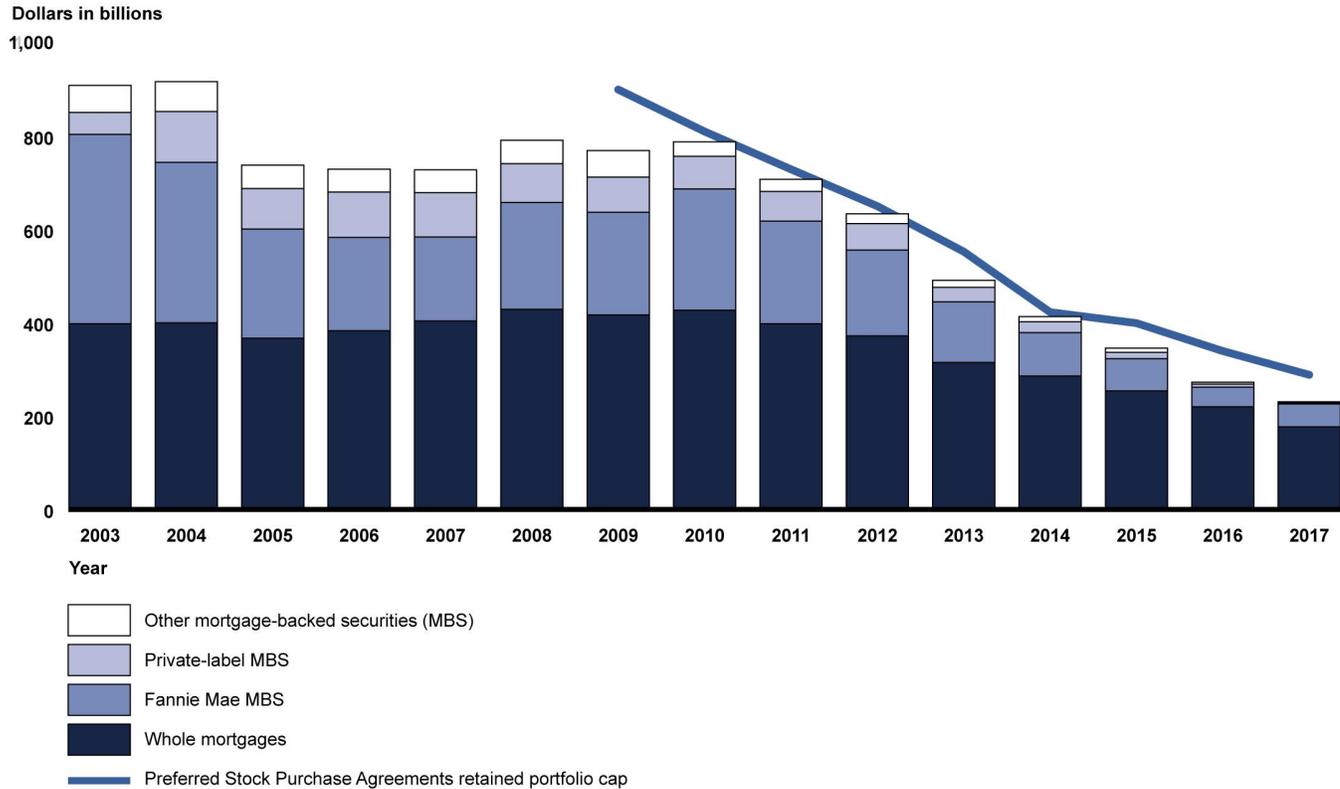
According to FHFA, Fannie Mae reduced its retained mortgage portfolio from \$792 billion in 2008 to \$231 billion in 2017, and Freddie Mac reduced its retained mortgage portfolio from \$804 billion in 2008 to \$253 billion in 2017 (see figs. 9 and 10). Additionally, these reductions have prioritized the sale of less-liquid assets such as private-label MBS and reperforming loans.⁵⁷ For example, Freddie Mac reduced the share of less-liquid assets in its retained mortgage portfolio from 41 percent in 2016 to 34 percent in 2017, in part by selling \$9.2 billion in unpaid principal balance of private-label MBS and \$8.2 billion of reperforming loans.⁵⁸

⁵⁶GAO, *Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, [GAO-09-782](#) (Washington, D.C.: Sept. 10, 2009).

⁵⁷Reperforming loans are mortgages that were previously delinquent but are performing again because payments on the mortgages have become current with or without the use of loan modification.

⁵⁸Most of the annual reductions in their retained mortgage portfolios were the result of voluntary and involuntary prepayments. Much of the reduction in Fannie Mae's own MBS held in its retained mortgage portfolio came by selling the MBS or mortgages in the MBS being paid off or delinquent mortgages being purchased out of MBS.

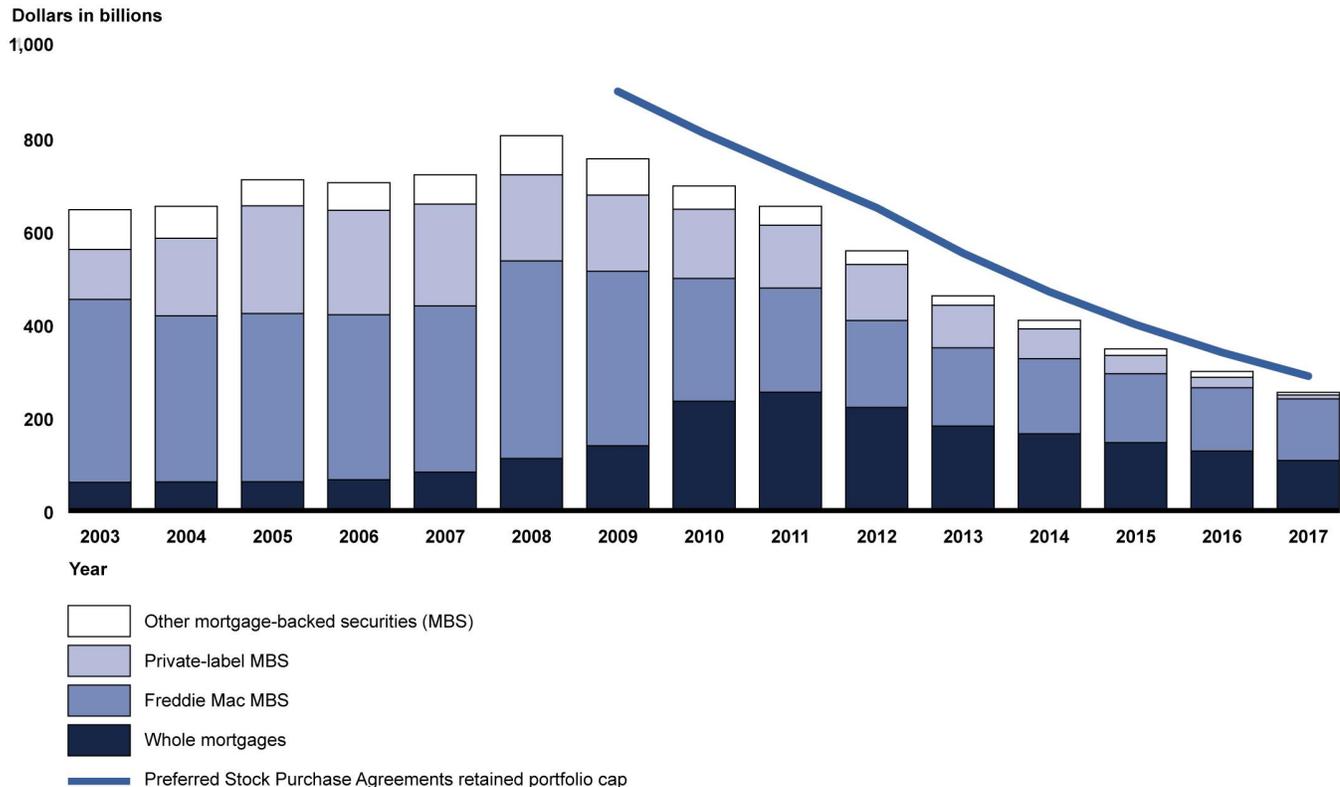
Figure 9: Dollar Volume of Fannie Mae Retained Portfolio Assets and Portfolio Cap, 2003–2017



Source: GAO analysis of Federal Housing Finance Agency data. | GAO-19-239

Note: Other MBS includes mostly Freddie Mac and Ginnie Mae MBS. While under conservatorship, Fannie Mae must reduce the size of its retained mortgage portfolios to levels below an amount agreed upon in the senior preferred stock purchase agreement. Dollar amounts are nominal.

Figure 10: Dollar Volume of Freddie Mac Retained Portfolio Assets and Portfolio Cap, 2003–2017



Source: GAO analysis of Federal Housing Finance Agency data. | GAO-19-239

Note: Other MBS includes mostly Fannie Mae and Ginnie Mae MBS. While under conservatorship, Freddie Mac must reduce the size of its retained mortgage portfolios to levels below an amount agreed upon in the senior preferred stock purchase agreement. Dollar amounts are nominal.

Guarantee Fees

Guarantee fees are the principal source of revenue for the enterprises and are intended to cover administrative expenses, expected costs that result from the failure of some borrowers to make their payments, and the cost of holding the modeled capital amount necessary (if the enterprises held capital) to protect against potentially large, unexpected losses in a severe stress environment. In March 2008, the enterprises modified their guarantee fees to include additional risk-based price adjustments to account for certain risk factors, including corresponding loan-to-value ratio and credit score. FHFA has made modifications to these fees and in 2015, raised fees for factors such as loan purpose (for example, cash-out refinances and investment properties), and jumbo conforming loans. As we noted above, the enterprises are not permitted to retain capital against

losses over a cap of \$3 billion. Nevertheless, FHFA established guarantee fee levels it deemed consistent with the amount of capital the enterprises would need if they were not in conservatorship and could retain capital.

Credit Risk Transfer

Under FHFA's direction, the enterprises have transferred increasing amounts of credit risk on their guaranteed MBS to the private market since 2013. When the enterprises purchase mortgages and issue guaranteed MBS, they retain the credit risk of those mortgages—that is, they are exposed to potential losses if a borrower cannot pay back the mortgage. The enterprises have transferred an increasing amount of credit risk on some of the mortgages they guarantee through a variety of credit risk transfer structures. According to FHFA, from 2013 through June 2018, the enterprises cumulatively transferred a portion of the credit risk on loans with an unpaid principal balance of \$2.5 trillion through these structures.⁵⁹ The amount of risk transferred varies by transaction.

According to a Congressional Research Service report, in these transactions, the enterprises continue to guarantee their MBS, but they transfer some of the credit risk to other private market entities to offset some of the enterprises' risk.⁶⁰ The private entity absorbs this portion of credit risk (and possible losses should they occur) but is compensated for doing so. According to FHFA, from 2013 through the second quarter of 2018, debt issuance structures have accounted for more than 70 percent of the total amount of risk in force transferred through these programs.⁶¹ According to FHFA and Federal Reserve staff reports, use of additional structures has increased since 2013 and has allowed more diverse

⁵⁹In its Credit Risk Transfer Progress Report, FHFA refers to the amount of credit risk transferred by the enterprises as risk in force. FHFA reported that the cumulative risk in force on this amount was \$81 billion, or 3.2 percent of the unpaid principal balance. They also reported that as of mid-2015, actual loss rates for Freddie Mac varied from near 0 to about 3.5 percent, peaking for mortgages originated in 2006 and 2007. See Federal Housing Finance Agency, *Credit Risk Transfer Progress Report* (Washington, D.C.: Nov. 1, 2018); and *Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions*, (Washington, D.C.: August 2015).

⁶⁰Sean M. Hoskins, *FHFA's Administrative Reform of Fannie Mae, Freddie Mac, and the Housing Finance System*, (Congressional Research Service, Washington, D.C.: July 7, 2016).

⁶¹Debt issuance structures include Fannie Mae's Connecticut Avenue Securities and Freddie Mac's Structured Agency Credit Risk.

investors to participate in the mortgage credit risk market.⁶² FHFA establishes credit risk transfer objectives for the enterprises, which in 2017 were to transfer credit risk on at least 90 percent of the unpaid principal balance of their single-family loans meeting certain criteria.⁶³ Both enterprises achieved this objective in 2017.

Under the debt issuance structure, the enterprises sell debt to investors and receive the proceeds up front at the time of the sale.⁶⁴ Different portions of debt are often issued for a given deal that corresponds to a different loss position, and this can vary by each deal. The enterprises repay the debt typically over a period of 10 to 12 years based on the performance of a reference pool of mortgages, in which the investor earns a higher return if the mortgages perform well and a lower return

⁶²Other methods for credit risk sharing with private entities include insurance risk transfers (Credit Insurance Risk Transfer and Agency Credit Insurance Structure), where the enterprises pay reinsurance companies to take on some of the credit risk on pools of mortgages the enterprises own; deeper mortgage insurance, where mortgage insurers agree ahead of time to cover more losses than they currently agree to cover; front-end collateralized lender recourse transactions (L Street Securities), where originating lenders or aggregators retain a portion of the credit risk associated with the mortgages they sell to the enterprises in exchange for a reduced guarantee fee charge on the loans from the enterprises; and senior-subordinate securitization (Wisconsin Avenue Securities and Whole Loan Securities), where subordinate tranches of MBS sold to investors are subject to credit losses and senior tranches sold to investors are guaranteed repayment. The enterprises also have multifamily credit risk transfer structures. See David Finkelstein, Andreas Strzodka, and James Vickery, *Credit Risk Transfer and De Facto GSE Reform*, Federal Reserve Bank of New York Staff Reports, No. 838, February 2018) and Federal Housing Finance Agency, *Credit Risk Transfer Progress Report, Fourth Quarter 2017* (Washington, D.C.: Mar. 29, 2017).

⁶³Targeted loan categories in 2017 were single-family fixed-rate mortgages with loan-to-value ratios greater than 60 percent and original term greater than 20 years, with some exclusions.

⁶⁴According to FHFA, these transactions are effectively fully collateralized by these payments, meaning the enterprises essentially have no counterparty or reimbursement risk with this structure.

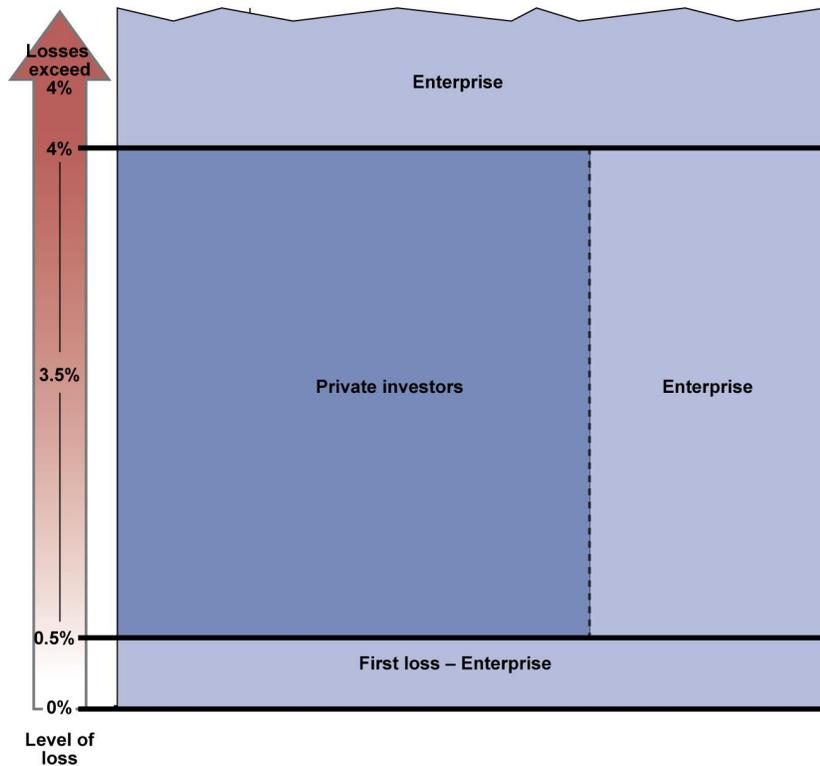
should they perform poorly.⁶⁵ According to FHFA, in 2017, the enterprises moved generally to retaining the first 0.5 percent of losses in most debt issuance transactions.⁶⁶ The enterprises retain all risk above the amount transferred to investors (referred to as the detach point).⁶⁷ They also retain 5 percent of the portions of debt sold to align their incentives with those of investors. Figure 11 is an illustrative example of loss allocation under a hypothetical debt issuance transaction with an attach point of 0.5 percent and a detach point of 4 percent.

⁶⁵The total outstanding balance of the reference pool of mortgages underlying debt issuance transactions is divided into different notes, called tranches, that have differing levels of seniority. Borrowers' scheduled and unscheduled principal payments on mortgages in the reference pool are used to repay the most senior tranche still outstanding at any given point, whereas losses on mortgages in the reference pool are used to reduce the principal balance of the most subordinate tranche outstanding. The amount of loss coverage investors provide is also reduced as borrowers repay their mortgages. After the debt has matured, the enterprises would retain all remaining risk. However, according to a Federal Reserve staff report, after 10 years the remaining mortgages will generally have little remaining credit risk. Additionally, according to FHFA, the average life of a pool of mortgages is less than 10 years. See Finkelstein, Strzodka, and Vickery, *Credit Risk Transfer and De Facto GSE Reform*; and Federal Housing Finance Agency, *Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions*.

⁶⁶According to FHFA, in 2015–2016, the enterprises started to transfer to investors a portion of first losses on mortgage pools in their debt issuance transactions. Feedback from market participants confirmed that selling the first 0.5 percent of losses is expensive because investors know there will be some degree of expected credit losses for any portfolio of mortgages regardless of economic circumstances. Based on this, the enterprises moved generally to retaining the first 0.5 percent of losses in most transactions.

⁶⁷According to FHFA, one way to measure the amount of credit risk transferred can be the difference between the attach and detach points on a transaction. For example, if the attach point is 0.5 percent, the enterprise is responsible for credit losses up to 0.5 percent of the unpaid principal balance of the loan pool. If the detach point is 4 percent, the enterprise is responsible for credit losses above 4 percent of the loan pool. Credit losses between the attach point of 0.5 percent and the detach point of 4 percent are the responsibility of the investors in the credit risk transfer product, with the enterprises also retaining some of this amount.

Figure 11: Illustrative Example of Enterprises' Loss Sharing Under a Debt Issuance Credit Risk Transaction



Source: GAO adaptation of Federal Housing Finance Agency graphic. | GAO-19-239

Note: The level of loss refers to the share of credit losses as a percentage of the outstanding unpaid principal balance of a pool of mortgages. Credit events in the reference pool reduce principal and interest payments to private investors. Amounts and percentages are for illustrative purposes only and can change or vary by transaction. The enterprises retain 5 percent of the portions of debt (and potential associated losses) that are sold.

In the absence of specific capital requirements, these risk transfers can act like capital by helping absorb losses on these pools during a financial downturn. Several reports on credit risk transfer have considered losses above the detach points of debt issuance transactions as those that might occur only in a catastrophic economic event, similar to or exceeding the 2007–2009 financial crisis, especially given the improvement of underwriting standards compared to pre-crisis mortgages.⁶⁸ According to

⁶⁸See Congressional Budget Office, *Transferring Credit Risk on Mortgages Guaranteed by Fannie Mae or Freddie Mac* (Washington, D.C.: Dec. 14, 2017); Laurie Goodman, *Credit Risk Transfer: A Fork in the Road* (Washington, D.C.: Urban Institute, June 2018); and Federal Housing Finance Agency, *Overview of Fannie Mae and Freddie Mac Credit Risk Transfer Transactions*.

a 2018 Federal Reserve staff paper, the enterprises' current guarantee fee revenues should be sufficient to cover their small first-loss position.⁶⁹ While guarantee fee revenues may be adequate to cover the enterprises' first-loss position if they were retaining capital, each enterprise can retain up to a maximum of \$3 billion in capital while they are under conservatorship. According to its quarterly financial statement, as of June 2018, Fannie Mae retained roughly \$7 billion in outstanding first-loss credit risk across debt issuance, insurance risk transfers, and lender-risk sharing transactions.⁷⁰ According to its quarterly financial supplement, as of June 2018, Freddie Mac retained nearly \$6 billion in outstanding first-loss credit risk in debt issuance, insurance risk transfer, and deep mortgage insurance transactions.⁷¹ Any losses on these amounts that exceed the enterprises' capital reserves would be borne by the federal government.

The enterprises have transferred portions of the credit risk on higher shares of their newly acquired mortgages, but the program remains untested during stressful economic periods and could have limited capacity for further growth. According to FHFA, mortgages targeted for credit risk transfer have increased as a share of the enterprises' total acquisitions, from 41 percent in 2013 to 65 percent in 2017. FHFA officials said the enterprises are also experimenting with how much first-loss risk to sell and are beginning to target some loans originated in 2008 or prior for credit risk transfer. However, according to reports from Federal Reserve staff and the Congressional Budget Office, efforts to further expand credit risk transfer through these means may have mixed cost-saving potential to the enterprises depending on economic circumstances.⁷² Additionally, mortgage investors and securitizers, and researchers with whom we spoke told us credit risk transfer has been a popular investment and an important tool for distributing risk. However, they also said the market for credit risk may dry up during stressful

⁶⁹See *Transferring Credit Risk on Mortgages Guaranteed by Fannie Mae or Freddie Mac*.

⁷⁰Insurance risk transfers do not include private mortgage insurance, which is discussed in the following section. See Federal National Mortgage Association Form 10-Q (Washington, D.C.: Aug. 2, 2018).

⁷¹Freddie Mac, *Second Quarter 2018: Financial Results Supplement* (McLean, Va.: July 31, 2018).

⁷²See Finkelstein, Strzodka, and Vickery; and *Transferring Credit Risk on Mortgages Guaranteed by Fannie Mae or Freddie Mac*.

economic periods and leave the enterprises—and potentially taxpayers while Treasury supports the enterprises—holding more risk.

Insurer Counterparty Risk

The enterprises have taken steps to enhance their counterparty monitoring of private mortgage insurers under FHFA's direction. The enterprises' charters require them to obtain some form of credit enhancement, most commonly private mortgage insurance, on acquired mortgages with loan-to-value ratios above 80 percent.⁷³ When losses occur on these mortgages, private mortgage insurers are the first to take losses, before credit risk transfer investors (if applicable) and the enterprises. From 2013 through the first half of 2018, private mortgage insurers provided \$278 billion of insurance coverage on about \$1.1 trillion in unpaid principal balance on mortgages with high loan-to-value ratios. The enterprises are responsible for any losses that might arise from the default of a private mortgage insurer, making these insurers the enterprises' largest sources of counterparty risk.

FHFA and the enterprises updated eligibility requirements for private mortgage insurers that do business with the enterprises by establishing financial standards to demonstrate adequate resources to pay claims and operational standards relating to quality control processes and performance metrics. The changes, effective December 31, 2015, were intended to help ensure stability of mortgage insurance companies that are counterparties of the enterprises, reducing risk to the enterprises and the federal government.⁷⁴ However, in 2018 the FHFA Office of Inspector General identified the increasing insured volume and the concentration of a few insurers—a total of six insurers as of 2017—with monoline business models in a cyclical housing market as risks to the enterprises' private

⁷³Private mortgage insurance coverage is separate from credit risk transfer structures that may involve insurance or reinsurance companies. Other forms of credit enhancement include the seller agreeing to repurchase or replace the mortgage, or the seller retaining participation in the loan.

⁷⁴The enterprises also updated eligibility requirements for private mortgage insurers in September 2018. The revised eligibility requirements reflect changes to the financial and operational requirements for the enterprises' mortgage insurance counterparties and become effective on March 31, 2019.

mortgage insurance coverage.⁷⁵ The Office of Inspector General also found that the credit ratings for these insurers were lower than the historical standards of the enterprises.

Foreclosure Prevention

Because mortgage defaults are the enterprises' primary source of risk exposure, one of the strategic goals of the conservatorship is to maintain foreclosure prevention activities (such as permanent loan modifications, modifications with principal forbearance, and short sales). Such activities assist homeowners facing foreclosure and can reduce potential losses on delinquent loans. According to FHFA data, as of the end of June 2018, the enterprises have taken more than 4 million foreclosure prevention actions since the start of the conservatorships in September 2008. Additionally, FHFA and the enterprises extended the Home Affordable Refinance Program (which allowed homeowners who owed as much or more than their home was worth to refinance their home) through the end of 2018. From 2009 through 2017, nearly 3.5 million qualifying homeowners refinanced their mortgages through this program. In December 2016, the enterprises also implemented a permanent loan modification and mortgage assistance program. The program allows more borrowers to qualify for a home retention solution, targets a 20 percent reduction in monthly payments, and may reduce costs to the enterprises associated with foreclosure.

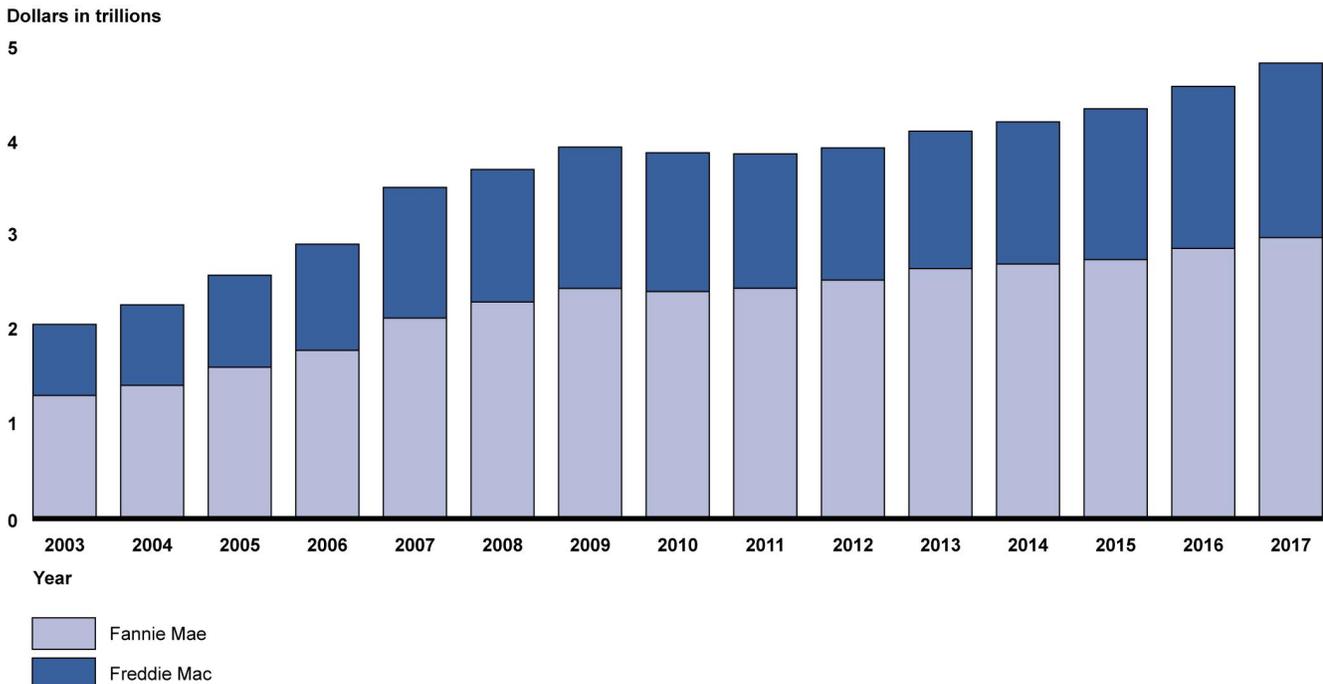
Continued Treasury Support Presents an Ongoing Federal Fiscal Exposure

Treasury's remaining funding commitment through the senior preferred stock purchase agreements leaves taxpayers exposed to risk, especially in the event of adverse market or other external conditions and considering the recent growth in the enterprises' guarantee business. Total MBS outstanding guaranteed by the enterprises and held by external investors has increased each year since 2012. As of the end of

⁷⁵A monoline is a business that focuses on operating in one specific financial area. Private mortgage insurers limit their business activity to writing mortgage insurance and thus cannot diversify to reduce risk. Because housing defaults are cyclical, such insurers may be called upon to make massive insurance payments when defaults spike. See Federal Housing Finance Agency, Office of Inspector General, *Enterprise Counterparties: Mortgage Insurers*, WPR-2018-002 (Washington, D.C.: Feb. 16, 2018).

2017, the enterprises' combined MBS outstanding held by external investors peaked at \$4.8 trillion (see fig. 12).⁷⁶

Figure 12: Dollar Volume of Outstanding Fannie Mae and Freddie Mac Mortgage-Backed Securities Held by External Investors, 2003–2017



Source: GAO analysis of Federal Housing Finance Agency data. | GAO-19-239

Note: The enterprises hold some of their own mortgage-backed securities in their retained mortgage portfolios. These amounts are not included in this figure. Dollar amounts are nominal.

Under the terms of the senior preferred stock purchase agreements with Treasury, Fannie Mae and Freddie Mac do not maintain a capital cushion—as a private financial institution would—to guard against the risk of unexpected losses such as those that might occur during a recession or downturn in the housing market. Instead, Treasury, through taxpayer funds, committed \$445.6 billion of financial support to the enterprises. As of August 2018, Treasury had provided the enterprises with \$191.4 billion of the total amount since they were placed under conservatorship in

⁷⁶The enterprises hold some of their own MBS in their retained mortgage portfolios, which combined for an additional \$181 billion at the end of 2017. Including their own MBS held in their retained portfolios, the enterprises combined had more than \$4.9 trillion in MBS outstanding.

2008, leaving \$254.1 billion in potential taxpayer exposure should Treasury need to provide additional support.⁷⁷ In return, the enterprises must pay to Treasury as dividends all of their quarterly positive net worth amount (if any) over \$3 billion.⁷⁸ Thus, any losses on this amount not recovered through loss-mitigation efforts or covered by private investors or insurers would be borne by taxpayers through additional financial support from Treasury.

While private institutions could absorb a share of losses on mortgages covered by credit risk transfer and private mortgage insurance (discussed earlier in this section), any additional losses would come from Treasury's remaining funding commitment through the senior preferred stock purchase agreements. Because of this arrangement, credit rating agencies have linked the enterprises' strong long-term credit ratings directly to that of the U.S. government and their equity to Treasury's remaining funding commitment.

Since the second quarter of 2012, Fannie Mae and Freddie Mac have not required additional support from Treasury, with the exception of the first quarter of 2018, when both enterprises required Treasury support due to devaluation of their deferred tax assets as a result of changes to the tax code.⁷⁹ As of the end of September 2018, the enterprises had cumulatively returned \$285.8 billion to Treasury through senior preferred

⁷⁷Results of 2018 stress tests (mandated by the Dodd-Frank Act) projected that the enterprises likely would require additional Treasury draws in the event of an economic downturn. Taxpayers could be exposed to some of these risks even absent an explicit federal guarantee if the housing market were structured in such a way that an implicit federal guarantee was expected in order to preserve financial stability.

⁷⁸The enterprises previously were required to reduce their capital bases to \$0 by January 2018, but in December 2017, FHFA raised this amount to \$3 billion each to cover fluctuations in income in the normal course of each enterprise's business. In summer 2018, FHFA issued a proposed rule to establish enterprise risk-based and minimum leverage capital requirements, but as proposed the rule would continue to be suspended while the enterprises are under conservatorship.

⁷⁹The reduction in the U.S. corporate income tax rate resulting from the enactment of the Tax Cuts and Jobs Act on December 22, 2017, required that Fannie Mae and Freddie Mac record a reduction in the value of their deferred tax assets during the fourth quarter of 2017. FHFA submitted a request to Treasury on behalf of Fannie Mae for \$3.7 billion and Freddie Mac for \$312 million.

stock agreement dividend payments.⁸⁰ However, in addition to economic circumstances, changes in market conditions or other external factors—such as changes in interest rates, house prices, accounting standards, or events such as natural disasters—could lead to volatility in the enterprises' quarterly financial results, potentially requiring additional taxpayer support.

Duration of Conservatorships Leaves Future Role of Enterprises Uncertain and Presents Challenges

The extended duration of the conservatorships continues to create uncertainty about the goals and future role of the enterprises. We previously reported that FHFA's priorities can shift, sometimes due to changes in leadership.⁸¹ For example, FHFA initially outlined its understanding of its conservatorship obligations and how it planned to fulfill those obligations in a 2010 letter to Congress. In February 2012, FHFA sent Congress a strategic plan that set three strategic goals for conservatorship and elaborated on how FHFA planned to meet its conservatorship obligations. However, under a new Director in 2014, FHFA issued an updated strategic plan that reformulated its three strategic goals.⁸² This same Director's term expired in early January 2019, and the process is underway for a new, permanent Director to be confirmed. The upcoming change in leadership could shift priorities for the conservatorships again and change enterprise goals. Continuing conservatorship also presents challenges to FHFA, as it has to balance its role as conservator with its role as regulator. FHFA must follow the mandates assigned to it by statute and the missions assigned to the enterprises by their charter. This entails consistently balancing governing of the enterprises, ensuring they employ sound risk-management practices, and ensuring they continue to serve as a reliable source of liquidity and funding for housing finance.

⁸⁰In December 2011, Congress directed FHFA in the Temporary Payroll Tax Cut Continuation Act of 2011 to increase the guarantee fees the enterprises charge lenders by 0.1 percentage points. The proceeds from this fee increase are remitted to Treasury at the end of each quarter and are not a replacement for the reimbursement for the costs or subsidy provided to the enterprises by the federal government. Pub. L. No. 112-78, § 401, 125 Stat.1288 (2011) (codified as 12 U.S.C. § 4547).

⁸¹[GAO-17-92](#).

⁸²[GAO-17-92](#).

In our interviews with experts and stakeholders, at least one expert or stakeholder from each of the groups (mortgage originators, mortgage securitizers and investors, academics and researchers, and consumer advocates) also identified the duration of the conservatorships as a challenge. For example, they said that the duration of the conservatorship has led to a more substantial role for the enterprises than envisioned when they were placed under conservatorship, which could make potential changes to their structure more difficult to implement.

The duration of the conservatorships also has led to uncertainties in the housing finance market. As we previously reported, under conservatorship, the enterprises are subject to agency policy decisions and are insulated from competition and other market forces. As a result, according to several mortgage originators and securitizers, and consumer groups with which we spoke, uncertainty about the future of the enterprises also makes it challenging for them to develop their own strategic plans and goals. They explained that they hesitate to make longer-term strategic plans and goals due to potential housing finance reform changes, particularly to the enterprises, that could markedly affect their industries.

Additionally, the dominant role of the federal government in guaranteeing MBS since the crisis has continued, and private capital generally has not been positioned to absorb losses in the secondary mortgage market during a potential economic downturn. The current structure of the secondary mortgage market will continue to leave taxpayers at risk to potential losses. The significant federal role in the housing market likely will continue if the enterprises remain under conservatorship and without a defined future role.

Reform Proposals We Reviewed Aim to Manage Fiscal Exposure, but Some Do Not Have Clear Goals or a System-Wide Approach

We assessed 14 proposals for housing finance reform against our framework to assess potential changes to the housing finance system. The framework consists of nine elements we determined to be critically important, such as recognition and control of federal fiscal exposure, protections for investors and borrowers, and clear goals (see the Background for more information).⁸³ We found that the proposals generally aim to manage fiscal exposure—the risk the housing finance system poses to the federal government and taxpayers—but only six have clear goals and only seven consider other federal housing finance entities, such as FHA or Ginnie Mae, in addition to the enterprises.

Each Type of Reform Proposal Has Strengths and Limitations

Reform proposals we reviewed generally fit into four different models: (1) reconstituted enterprises, (2) multiple guarantor, (3) government corporation, or (4) privatization (termination of the enterprises). Based on our review of the proposals, relevant literature, and expert interviews, each model has potential strengths and limitations.

Reconstituted Enterprises

Four proposals we reviewed call for the enterprises to be recapitalized and then released from conservatorship, retaining their federal charters. Under these proposals, the enterprises would be regulated by an independent regulator that would oversee their safety and soundness. These proposals also recommend a federal guarantee on MBS under the senior preferred stock purchase agreement or by legislation. To mitigate fiscal exposure from the enterprises, the proposals include the continuation of credit risk transfer programs, and also require the enterprises to have risk-based capital reserves. In its report analyzing

⁸³GAO-15-131. The 14 proposals we reviewed (8 from Congress or federal agencies, 4 from industry groups, and 2 from think tanks) were all released or introduced from 2014 through September 2018. For a list of the proposals we reviewed, see appendix II.

alternative housing finance market structures, CBO reported that under this model, taxpayers would have a higher exposure to risk compared with the multiple-guarantor and privatization models.⁸⁴

According to industry stakeholders, potential strengths of this model include feasibility, minimal market disruption, and the continuation of policies familiar to key stakeholders. For example, one proposal argues that its reforms could be completed under existing legal authority, with no new legislation required.⁸⁵ Five primary market stakeholders in our panels also stated that they would prefer a system similar to the current model with minor reforms because larger changes might disrupt the market and have unforeseen consequences. Industry stakeholders that rely on specific policies of the enterprises also generally support a recapitalization and release model. For example, four associations of small lenders have released statements in support of reconstituting the enterprises to ensure the continuation of the cash window.⁸⁶ In addition, groups that advocate for financial inclusion and civil rights also have expressed support for reconstituting the enterprises to ensure the continuation of the affordable housing goals and other policies to help low-income borrowers.

However, this model may not include sufficient safeguards to mitigate the risk that the enterprises—even in a reconstituted form—could pose to the stability of the mortgage market. As previously discussed, as of 2017, the enterprises issue more than half of new MBS and, in our panels, two participants from industry groups criticized the enterprises for their

⁸⁴Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update* (Washington, D.C.: August 2018). For each alternative market structure, CBO used an illustrative example to estimate the model's impacts. Thus, CBO's estimated impacts may vary based on the specifics of the illustrative example. CBO also estimated that during normal economic times, each model discussed in our report would have little to no impact on mortgage interest rates, house prices, and the availability of 30-year fixed-rate mortgages.

⁸⁵Moelis & Company LLC. *Blueprint for Restoring Safety and Soundness to the GSEs* (June 2017).

⁸⁶Through the cash windows, lenders can sell individual loans directly to the enterprises and retain servicing rights. Community Home Lenders Association, Inc., *CHLA GSE Reform Plan* (Arlington, Va.: Mar. 29, 2017); Community Mortgage Lenders of America, *CMLA Policy on GSE Reform: Time for Reform and Preservation* (Washington, D.C.: 2016); Independent Community Bankers of America, *ICBA Principles for GSE Reform and a Way Forward* (Washington, D.C.: 2017); and National Association of Federally Insured Credit Unions, *Housing Finance Reform Principles* (Arlington, Va.: June 21, 2017).

expansion into other areas of the housing market. In 2018, a former FHFA director stated in Congressional testimony that the enterprises were more entrenched in the market than ever before, the market depended entirely on them, and any weaknesses in their risk management could disrupt the entire housing market.⁸⁷ If the enterprises were recapitalized without sufficient safeguards, shareholders again might have incentive to take on excessive risk.

To mitigate these concerns, two of the four proposals recommend that the reconstituted enterprises operate as utilities. Utilities have a regulated rate of return, which supporters say would limit profit-maximizing motivations and encourage more prudential behavior and underwriting standards.⁸⁸ The utility model is traditionally used in industries that tend to operate as monopolies or near monopolies, such as the electric power industry. Some industry experts believe that the securitization market operates similarly to a monopoly.⁸⁹ Three industry stakeholders, two researchers, and one participant from a consumer protection group we interviewed also supported restructuring the enterprises as utilities. Additionally, three industry groups representing small lenders endorsed turning the enterprises into utilities.⁹⁰

Multiple-Guarantor Model

Six of the proposals we reviewed recommend transitioning to a system with multiple guarantors operating in the secondary market. Under this model, multiple private-sector firms would purchase eligible mortgages and aggregate them into MBS. The MBS would be eligible for an explicit

⁸⁷*A Failure to Act: How a Decade without GSE Reform Has Once Again Put Taxpayers at Risk*, House Financial Services Committee, 115th Cong. (Sept. 6, 2018); statement of Edward J. DeMarco, President, Housing Policy Council.

⁸⁸Another potential way to encourage safer underwriting practices would be to have the reconstituted enterprises transition to cooperatives mutually owned by lenders. For more information about these specific models, see Patricia C. Mosser et al., *The Capital Structure and Governance of a Mortgage Securitization Utility*, Federal Reserve Bank of New York Staff Reports, no. 644, (New York, N.Y.: October 2013) and GAO, *The Cooperative Model as a Potential Component of Structural Reform Options for Fannie Mae and Freddie Mac*, [GAO-11-33R](#) (Washington, D.C.: Nov. 15, 2010).

⁸⁹For example, see Mosser et al., and Andrew Davidson, "Four Steps Forward: Streamline, Share Risk, Wrap, and Mutualize," *Housing Finance Reform Incubator* (Washington, D.C.: Urban Institute, July 2016).

⁹⁰Community Home Lenders Association, Inc., Community Mortgage Lenders of America, and Independent Community Bankers of America.

federal guarantee if the guarantor arranged for private credit enhancements to absorb a certain amount of loss and if it met certain regulatory criteria, such as securitizing mortgages that comply with all qualified mortgage standards. A federal agency—FHFA or a successor—would charge and collect guarantee fees from the guarantors and set capital requirements. The six proposals use the guarantee fees to fund a mortgage insurance fund that would provide the federal guarantee. According to CBO’s analysis, under this model, taxpayers would have less exposure to risk compared with models for reconstituted enterprises or a government corporation, but more than under a fully private market.⁹¹

Proposals within this model vary in a few key ways:

- **Enterprises:** Four of the six proposals call for the enterprises to become guarantors in the new system, while two call for them to be put into receivership and replaced with successor entities. One of the proposals that would keep the enterprises recommends that they and other guarantors operate as utilities and another suggests the enterprises remain in the new system but transition to be mutually owned by lenders instead of shareholders.
- **Securitization:** Three of the six proposals would retain the common securitization platform, while one proposal would rely on Ginnie Mae-approved issuers, allowing them to issue securities including mortgages that obtained credit enhancement from a private guarantor (instead of just federal programs). One proposal that retains the common securitization platform would convert the platform into a government corporation that issues securities from any regulator-approved entity.⁹² The fifth proposal would rely on both Ginnie Mae issuers and the common securitization platform to issue securities. The sixth proposal does not specify an entity to issue securities.
- **Number of guarantors:** Proposals vary in the number of guarantors needed in the new system. For example, the Mortgage Bankers Association’s proposal suggests having more than two guarantors, while Moody’s Chief Economist said in a congressional testimony that

⁹¹Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

⁹²The Congressional Research Service defines a government corporation as “an agency of the federal government, established by Congress to perform a public purpose, which provides a market-oriented product or service and is intended to produce revenue that meets or approximates its expenditures.” Kevin R. Kosar, *Federal Government Corporations: An Overview*, RL30365 (Washington, D.C.: June 8, 2011).

from five to seven would be feasible (using the private mortgage insurance industry as a guide).⁹³

The potential strengths of this model include the benefits arising from competition and replacing reliance on two large firms with multiple smaller guarantors. The Mortgage Bankers Association's proposal stated that, while subject to strong regulations, guarantors can compete on price, products, and service. Multiple guarantors could provide lenders with a variety of options to sell their loans, instead of just the enterprises. More competition also could encourage innovation in the secondary market.⁹⁴ The secondary mortgage market also might reduce its reliance on two "too-big-to-fail" entities with multiple guarantors. Because credit risk would be more dispersed across a number of entities, the failure of one firm would be less likely to disrupt the broader system, thus reducing the likelihood the government would have to rescue a struggling firm.

According to four representatives of investor groups and a former HUD official we interviewed, a potential limitation of the multiple-guarantor model is that it could be difficult for new firms to enter the market and compete with the enterprises. One proposal addresses this concern by terminating the enterprises. However, if there are only a few guarantors, the failure of any one firm could pose a systemic risk and might require federal assistance. In addition, two researchers we interviewed said that because the guarantors would operate in the same market and thus would face the same market trends, having multiple guarantors might not diversify risk. For example, in a financial crisis, it is possible that all the guarantors would struggle and in such a scenario, the government would have to assist many firms.

Some industry experts expressed concern that competition could have negative consequences. We previously reported that leading up to the financial crisis, the enterprises faced new competition from private-label securitizers and, in the absence of strong federal oversight, they relaxed their underwriting standards to regain market share.⁹⁵ Thus, two researchers, four primary market stakeholders, and a former HUD official

⁹³*Sustainable Housing Finance Part III*, House Financial Services Committee, 115th Cong. (Nov. 7, 2017); statement of Mark Zandi, Chief Economist, Moody's Analytics; and Mortgage Bankers Association.

⁹⁴Mortgage Bankers Association.

⁹⁵[GAO-09-782](#) and [GAO-15-131](#).

we interviewed warned that a system dependent on competing entities could face similar risks, particularly if oversight and regulation were not strong. Five of the proposals we reviewed would require all guaranteed securitized mortgages to meet qualified mortgage standards, limiting potential reductions in underwriting standards, and one of the five also would address this concern by regulating the guarantors as utilities.

Government Corporation

Two proposals would replace Fannie Mae and Freddie Mac with a single government corporation that would issue MBS. For example, in one proposal we reviewed, lenders would sell loans meeting certain requirements (such as qualified mortgages) to the corporation, which would operate the common securitization platform to issue MBS with a federal guarantee. The government corporation would manage fiscal exposure by transferring credit risk to the private sector and through capital requirements set by an independent regulator. The two proposals also would use guarantee fees to fund a mortgage insurance fund that would add an additional level of taxpayer protection. Based on its analysis, CBO reported that under this model, taxpayers would have more exposure to financial risk than under the multiple guarantor or privatization models.⁹⁶

The potential benefits of a government corporation include stable lending during financial crises, equitable lender access, and better targeting of underserved groups. According to CBO, a government agency is more likely than private actors to promote stable mortgage lending during financial crises due to federal support.⁹⁷ Additionally, according to a proposal by a think tank, a government corporation could provide lenders of all sizes with equal access to securitization, potentially reducing barriers to entry for new firms in the primary market.⁹⁸ We previously reported that compared with other models, a government corporation would be well-positioned to facilitate lending to targeted groups because it

⁹⁶Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

⁹⁷Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

⁹⁸Parrott et al. Previously, the enterprises offered discounted guarantee fees to lenders that sold large volumes of loans, which favored larger lenders. In 2012, FHFA directed the enterprises to take steps to reduce these disparities in guarantee fees.

does not have potentially conflicting priorities, such as maximizing shareholder value.⁹⁹

Finally, a key benefit of creating a government corporation would be to mitigate the potential challenges posed by relying on private-sector entities (reconstituted enterprises, multiple guarantors, or a fully private market). For example, we previously reported that as for-profit corporations with government sponsorship, the enterprises had an incentive to engage in potentially profitable but risky business practices, in part because of the perception of an implied federal guarantee.¹⁰⁰ In contrast, a government corporation would not be motivated by profit and thus should have less incentive to engage in potentially risky actions. The government corporation also could end reliance on a few large private firms by transferring securitization to a single entity in the public sector.

There are potential limitations to relying on a government agency to support the secondary market. According to CBO, under this model, the government would still retain most credit risk and thus originators might not have a strong incentive to thoroughly vet borrowers' credit risk, which could lead to potential losses. We also reported in 2009 that because of the limitations on government entities relative to private firms, a government corporation might have more difficulty in attracting and retaining capable staff, responding to market developments, or promoting innovation. If unaddressed, these issues could pose safety and soundness concerns because the agency might not have the skills and capabilities to assess risks and manage a complex industry.¹⁰¹

Privatization

Two proposals we reviewed would terminate the enterprises and completely privatize the housing finance industry, with no federal guarantee on MBS. Under these proposals, the enterprises' charters would be revoked and the enterprises would be wound down over a multiyear transition period during which their guarantee fees would increase and their loan limits decrease until they no longer guaranteed new mortgages. One proposal would keep the common securitization

⁹⁹[GAO-09-782](#).

¹⁰⁰[GAO-09-782](#).

¹⁰¹[GAO-09-782](#) and Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

platform and make it available to all market participants, but it would operate as a nongovernmental entity and would be prohibited from guaranteeing MBS.

The main benefit of this model would be to minimize fiscal exposure by having private firms form the secondary market for mortgages that are not federally insured, similar to the private-label MBS sector before the crisis. CBO noted that private actors should have a stronger incentive to control lending risk without a government backstop. Additionally, if a number of firms replaced the enterprises, then a largely private market likely would reduce the systemic risk of relying on a few large firms.¹⁰²

However, a fully privatized market has some potential limitations related to an implied federal guarantee, and credit availability. CBO reported that although taxpayers' would have less explicit exposure to risk compared to the other models, risk exposure could be very high even without an explicit guarantee. That is, the government likely would assist or prevent the failure of private firms in an economic downturn to ensure financial stability (also known as an implicit federal guarantee). We previously reported that private-sector actors may benefit from an implicit guarantee and this may incentivize firms to engage in potentially risky actions and expose the government to potential losses. Additionally, privatizing the market could increase fiscal exposure through FHA. The CBO report noted that a privatized model could reduce the availability of credit to marginal borrowers, and predicted it would lead to a large increase in FHA-insured loans. A largely private market also might not sustain mortgage lending during periods of economic stress. For example, the private-label market largely disappeared after the 2007–2009 financial crisis and has yet to recover, as previously discussed. Finally, CBO reported that during a financial crisis, there could be large increases in mortgage interest rates, large declines in house prices, and limited availability of 30-year fixed-rate mortgages.

Proposals Generally Meet Some Key Reform Elements

The 14 proposals we reviewed generally meet the following elements of our housing finance reform framework: recognizing and controlling federal fiscal exposure, protecting mortgage investors, adhering to an appropriate

¹⁰²Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

regulatory framework with government entities that have the capacity to manage risks, emphasizing the implications of the transition to a new housing finance system, protecting mortgage borrowers and addressing market barriers, and considering market cyclicity and impacts on financial stability.¹⁰³ Legislative proposals and those from other sources generally address these elements in similar ways.

Fiscal Exposure and Government Guarantee

Every reform proposal we reviewed attempts to recognize and control federal fiscal exposure—the risk that the federal government and taxpayers will have to provide financial support to the housing finance system. Twelve of the 14 proposals we reviewed support an explicit government guarantee on MBS. Some supporters of a federal guarantee maintain that if the government were to support the mortgage industry in a crisis, then such support should be explicit, which will allow it to be priced and reflected in the federal budget. In addition, every expert with whom we spoke—including industry stakeholders, consumer advocates, researchers, and former agency officials—supported an explicit government guarantee on MBS. In 11 proposals, the federal guarantee would be administered through a mortgage insurance fund managed by a federal regulator and funded through guarantee fees.

To manage and limit fiscal exposure, the 12 proposals structure the federal guarantee so that it would only be accessed after a certain amount of private-sector loss. Private capital would be introduced through increased, risk-based capital requirements for the enterprises, successor entities, or new market entrants (such as guarantors). The proposals also would continue to transfer credit risk to the private sector. These proposals vary in how much private capital would be required ahead of the government guarantee. For example, one proposal would require 10 percent but another proposal would require 5 percent. In its proposed rule for enterprise capital requirements, FHFA reported that capital reserves of about 5.5 percent would have covered the enterprises' losses during the

¹⁰³See [GAO-15-131](#) and the Background in this report for more information on the elements of the framework.

financial crisis.¹⁰⁴ However, according to CBO, the initial increases in capital requirements could increase mortgage interest rates.¹⁰⁵

The two proposals without an explicit federal guarantee aim to address fiscal exposure by eliminating the enterprises and relying entirely on the private sector. However, some industry experts have asserted that there likely will always be an implied federal guarantee for the housing finance market (even without the enterprises) as the federal government will not allow the market to fail. These experts stated that they believe that this guarantee should be explicitly recognized and accounted for in the federal budget.

Protections for Mortgage Securities Investors

Thirteen of 14 proposals fully meet the element of providing protections for mortgage securities investors. We previously reported that investors need to receive consistent, useful information to assess risks.¹⁰⁶ We also reported that prior to the crisis, MBS investors may have lacked reliable information to accurately assess the credit risk of their investments. Twelve reform proposals we reviewed attempt to remedy these weaknesses by first providing an explicit federal guarantee on MBS. In a 2017 testimony, a former FHFA Director said that a federal guarantee signaled to MBS investors that they were protected from credit risk and a meaningful segment of investors would not continue to invest in this market without the guarantee.¹⁰⁷

In addition to the federal guarantee, proposals would aim to protect investors in the following ways:

- **Increased transparency:** Proposals recommend providing investors with more information on the mortgages underlying MBS. If investors

¹⁰⁴Enterprise Capital Requirements, 83 Fed. Reg. 33312 (July 17, 2018). Before the 2007–2009 financial crisis, the enterprises were required to hold capital reserves of 2.5 percent for most assets (whole loans) and 0.45 percent for MBS outstanding.

¹⁰⁵Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

¹⁰⁶[GAO-15-131](#).

¹⁰⁷*Principles of Housing Finance Reform*, Senate Committee on Banking, Housing, and Urban Affairs, 115th Cong. (June 29, 2017); statement of Edward J. DeMarco, President of the Housing Policy Council.

had more information about asset quality, it would help them to more accurately price risk.¹⁰⁸ For example, one proposal would require market participants to make available to investors all documents (including servicing reports) related to the mortgage loans collateralizing the security.

- **Standard securitization platform:** Currently, the enterprises each have their own platforms to issue MBS and different rules governing their MBS. To improve investor protections, FHFA and others recommend a standard platform for issuing securities. As previously discussed, FHFA has been developing such a platform, which will result in a both enterprises issuing a uniform security.

Federal Regulators and Regulatory Framework

Twelve of 14 proposals emphasize an appropriate regulatory framework with federal regulators that have the capacity to manage risk.¹⁰⁹

Proposals generally recommend that an independent federal agency, such as FHFA or a successor, regulate housing finance market participants. The regulator also may oversee the securitization platform. Three proposals that would expand Ginnie Mae recommend that Ginnie Mae become an independent agency to strengthen its counterparty oversight capabilities.

The proposals also generally recommend that the regulator have risk-management capabilities to determine market participants' capital requirements. The regulator also would be able to adjust these and other requirements, such as credit risk transfer targets, based on market circumstances. In 11 proposals, the regulator would set and collect guarantee fees and use these fees to create a fund for mortgage insurance that would act as the federal guarantee on MBS. However, we previously noted that federal agencies sometimes have faced challenges in accurately pricing risk in other insurance programs, such as deposit or flood insurance.¹¹⁰

¹⁰⁸[GAO-15-131](#).

¹⁰⁹This section addresses two elements of the framework: adherence to an appropriate financial regulatory framework and government entities that have capacity to manage risks. We address them together because of the similarity in the information we gathered from the proposals for each element.

¹¹⁰[GAO-15-131](#).

Emphasis on the Implications of the Transition

Eleven of the 14 proposals we reviewed fully consider the implications of transitioning to a new system and mitigating potential disruptions. Because transitioning to a new system could disrupt market operations and consumers' access to mortgage credit, we previously noted the importance of a deliberate, well-defined transition.¹¹¹ In our expert panels, participants from investor groups noted that unless there is a clear transition plan (particularly one that addresses any changes to the enterprises), it would be difficult for new market entrants and investors to plan accordingly. The 11 proposals that meet this element include multiyear transitions to help minimize disruption. For example, one proposal that would eliminate the enterprises would allow for a 10-year transition to a new fully privatized system and create a temporary federal entity to oversee the transition.

Five primary market stakeholders and a representative from a consumer advocacy group we interviewed emphasized the importance of minimizing market disruption and maintaining market liquidity. These industry experts noted that some parts of the system currently work well, and these aspects should be maintained and transitioned in reform. The 11 proposals would transition the enterprises to the new market structure or transition their personnel and facilities to successor entities.

One proposal that does not meet this element does not discuss transition plans. Two other proposals do not fully meet this element because they do not address what would happen to the enterprises' current assets, human capital, and intellectual property.

Protecting Mortgage Borrowers and Addressing Barriers to the Mortgage Market

Nine of 14 reform proposals explicitly address protections for mortgage borrowers. The relevant policy mechanisms to protect mortgage borrowers include maintaining CFPB's qualified mortgage and ability-to-repay rules, as well as additional services to support borrowers. For example, one proposal would increase support for programs that help prepare renters to become homeowners. Another proposal recommends modifying servicing guidelines for nonperforming loans to ensure

¹¹¹[GAO-15-131](#).

consumers are treated fairly and would establish consistent procedures for servicers. The five proposals that do not fully meet this element do not address it at all or do not describe specific programs or policies.

Eleven of 14 proposals explicitly address barriers to accessing the mortgage market. For example, eight proposals aim to maintain access to 30-year fixed-rate mortgages, a key instrument for promoting access to homeownership. Eleven proposals would support funds dedicated to affordable housing, such as the Housing Trust Fund and Capital Magnet Fund, through fees on securitized loans.¹¹² Five proposals also would collect fees for a new Market Access Fund dedicated to increasing the number of families able to achieve homeownership and access credit. However, two proposals would eliminate the Housing Trust Fund.

Proposals vary in their support of the enterprises' affordable housing goals. Eight proposals call for the affordable housing goals to be eliminated and eight industry stakeholders we interviewed doubted the effectiveness of such goals, stating that homeownership should not be addressed through the secondary market. In 2009, we reported that there was limited evidence to support the effectiveness of the enterprises' affordable housing goals in supporting homeownership for the targeted groups.¹¹³ However, affordable housing and consumer advocates we interviewed stated that they want to maintain the goals because they believe that the goals improved access to credit for minority and low- to moderate-income borrowers. Regardless of their position on the affordable housing goals, we found that proposals with a federal guarantee generally would require market participants to serve all eligible borrowers in all markets to receive the guarantee.

Thirteen proposals also recommend policies that would promote small lender access to the market, such as maintaining the enterprises' cash windows or creating a similar structure in their successors. Through the cash windows, lenders can sell individual loans directly to the enterprises

¹¹²The Housing Trust Fund—established by HERA, Pub. L. No. 110-289, § 1131, 122 Stat. 2654, 2712—is a program to increase and preserve the supply of affordable housing for extremely low- and very low-income households, including homeless families. The Capital Magnet Fund was established through the same act to provide grants for programs that support affordable housing and economic development activities. Pub. L. No. 110-289 § 1131, 122 Stat. at 2723. The fee generally would be a number of basis points on conforming loans.

¹¹³[GAO-09-782](#).

and retain servicing rights. According to the Center for Responsible Lending, keeping loan servicing within community-based financial institutions often results in better loan performance and customer service outcomes.¹¹⁴ One former HUD official we interviewed stated that minority communities are often served by smaller lenders and these lenders need the cash window as a way to continue making affordable loans. Ten experts in our panels—including housing advocates, primary and secondary market participants, and researchers—said that reform plans should give fair treatment to all lenders, regardless of size.¹¹⁵

Market Cyclicalities and Financial Stability

Nine of 14 reform proposals fully meet the element relating to consideration of the cyclical nature of the housing finance market and its impact on financial stability. We previously reported that the housing finance market is characterized by cyclical fluctuations and its market cycles may pose risks to overall financial and economic stability because housing is a significant part of the economy.¹¹⁶ The five proposals that do not fully meet this element do not address how the reformed system would attempt to mitigate market cycles. We previously reported that financial regulatory action or inaction can exacerbate housing finance cycles, and thus reform proposals should consider the potential impact of new regulations on market cyclicalities.¹¹⁷

To mitigate market cycles, the nine proposals that meet this element generally include policies that would allow the regulator to adjust regulations based on market cycles. In one proposal, the regulator would establish risk-based capital requirements for the enterprises or successor entities and could adjust the requirements temporarily based on market cycles. One proposal that would create a government corporation also would allow the corporation to maintain a small portfolio to manage distressed loans.

¹¹⁴*Principles for Housing Finance Reform*, Senate Committee on Banking, Housing, and Urban Affairs, 115th Cong. (June 29, 2017); statement of Michael D. Calhoun, President, Center for Responsible Lending.

¹¹⁵Before the financial crisis, the enterprises provided lenders that sold large volumes of loans with discounted guarantee fees, but FHFA took steps to reduce these differences under conservatorship.

¹¹⁶[GAO-15-131](#).

¹¹⁷[GAO-15-131](#).

Some Proposals Do Not Have Clearly Defined Goals or a System-Wide Focus

Eight of the proposals we reviewed do not have clearly defined goals and seven do not fully consider other entities in the housing finance system—two key elements in our housing finance reform framework.

Clearly Defined Goals

Eight of 14 proposals we reviewed do not have clearly defined goals for the housing finance system, including four legislative proposals. Additionally, none of the proposals prioritize their goals. Among the six proposals with clearly defined goals, we identified some common goals, such as minimizing the risk of taxpayer-funded bailouts, supporting market liquidity, and maintaining a level playing field for lenders of all sizes. We also identified different goals among the proposals, reflecting differences in reform models. For example, proposals similar to the multiple-guarantor model explicitly include market competition as a goal, while a proposal for reconstituting the enterprises includes stable transition as a goal.

As we reported in 2015, clearly defined and prioritized goals are a key element to consider when assessing changes to the housing finance system. Clear goals help guide agencies' activities and establish accountability.¹¹⁸ Experts with whom we spoke also emphasized the importance of clearly defined goals in housing finance reform proposals. For example, one researcher said it would be difficult to discuss any necessary policy changes until the government clearly articulated goals for its role in the housing finance system.

Furthermore, prioritizing goals can help guide agencies' actions and provide clarity to market participants, particularly if there are conflicting goals.¹¹⁹ For example, three proposals we reviewed include the goals of both minimizing risks to taxpayers and promoting affordable homeownership, but there is a trade-off between these goals—promoting homeownership may mean encouraging lending to riskier borrowers.

¹¹⁸[GAO-15-131](#).

¹¹⁹[GAO-15-131](#) and [GAO-17-92](#).

As of early January 2019, Congress had not enacted legislation that establishes clear and prioritized objectives for the future federal role in housing finance. The lack of such goals in many of the proposals we reviewed raises questions as to whether the proposals that Congress may consider in the future will give adequate attention to these critical elements of housing finance reform.

Without clearly defined and prioritized goals, agencies' housing finance activities may lack focus and consistency. We previously reported that because Congress did not provide clearly defined and prioritized goals to FHFA for conservatorship, each FHFA director has been able to shift agency priorities within statutory requirements.¹²⁰ For instance, the first FHFA director raised guarantee fees to encourage the return of private capital to the MBS market, while the next director stopped the increase out of concern for its effect on credit availability. Additionally, we reported that FHFA's shifting priorities for conservatorship contributed to uncertainty among market participants.¹²¹ Therefore, by identifying a primary objective for housing finance reform, Congress would be better positioned to determine appropriate steps and policies and provide clarity to market participants.

System-Wide Focus

Seven of 14 proposals we reviewed—including proposed legislation—do not consider if and how they would affect other federal entities in the housing finance system, such as FHA and Ginnie Mae.¹²² The proposals that consider other federal entities include policies to help them manage the effects of reform and ensure agencies' policies are consistent with overarching goals. For example, proposals that would expand Ginnie Mae's guarantee to include the enterprises' market also recommend that Ginnie Mae become an independent agency to better manage its expanded role. Another proposal with the broad goal of reducing the federal role in the mortgage market by terminating the enterprises also aims to manage fiscal exposure through FHA by increasing its capital

¹²⁰[GAO-15-131](#).

¹²¹[GAO-17-92](#).

¹²²[GAO-15-131](#). This section addresses our element "Policies and Mechanisms That Are Aligned with Goals and Other Economic Policies." We narrowed the focus of this element to specifically focus on the extent to which proposals had a system-wide approach after observing that a number of proposals focus solely on the enterprises.

reserve ratio from 2 to 4 percent. Finally, one proposal with a goal of promoting market liquidity recommends that FHA should become an independent agency to buttress its countercyclical role (that is, its ability to provide credit availability across market cycles).

We previously reported that aligning policies and mechanisms with goals is a key element of housing finance reform, and that reform should have a comprehensive approach that considers all relevant entities.¹²³ A comprehensive approach would help to promote consistency, transparency, and reduce unnecessary overlap and duplication between the enterprises and other federal entities.

As of early January 2019, Congress had not enacted legislation with a system-wide approach to housing finance reform that considers the enterprises and other federal entities. The lack of a comprehensive approach in half of the proposals we reviewed highlights the need for policymakers to consider these key elements when reforming the housing finance system.

Housing finance reform that does not consider all federal entities or participants may not account for how changes in the enterprises' activities could affect risk exposure of other federal entities.¹²⁴ For example, CBO reported that transitioning to a fully private market likely would lead to large increases in the volumes of loans insured by FHA.¹²⁵ Industry experts with whom we spoke—including stakeholders from the primary and secondary markets, researchers, and former agency officials—also stated that any reforms to the enterprises must consider FHA too. Thus, considering the impacts of potential reforms on other federal entities would help ensure consistency and avoid unintended consequences.

¹²³[GAO-15-131](#).

¹²⁴[GAO-15-131](#).

¹²⁵Congressional Budget Office, *Transitioning to Alternative Structures for Housing Finance: An Update*.

Conclusions

The enterprises have remained in conservatorship since 2008 (over 10 years), perpetuating uncertainty about their future and the federal role in the housing finance market. Determining those future roles and the enterprises' structures has become both more urgent and more challenging as federal fiscal exposures have grown and new risks emerged in the housing finance markets (such as the growing role of nonbank lenders and servicers). Congress and industry stakeholders have introduced a number of proposals to reform the housing finance system, including addressing the prolonged conservatorship of the enterprises, but several proposals lack clearly defined and prioritized goals or do not consider all relevant federal entities in the housing finance system. By incorporating these key elements in future reform efforts, Congress could facilitate a more focused and comprehensive transition to a new housing finance system. Moreover, reform efforts that are both focused and comprehensive could allow market participants to confidently engage in long-term planning and help increase private-sector participation in the markets.

Matter for Congressional Consideration

Congress should consider legislation for the future federal role in housing finance that addresses the structure of the enterprises, establishes clear, specific, and prioritized goals and considers all relevant federal entities, such as FHA and Ginnie Mae. (Matter for Consideration 1)

Agency Comments

We provided a draft of this report to FHFA, Treasury, and HUD for review and comment. FHFA provided a technical comment that we incorporated. We also received technical comments from HUD and Treasury on sections of the draft report, which we incorporated as appropriate. Further comments on the full draft report from HUD and Treasury were not available due to the partial government shutdown.

We are sending copies of this report to the appropriate congressional committees and FHFA, Treasury, and HUD. This report will also be available at no charge on our website at <http://www.gao.gov>.

Should you or your staff have questions concerning this report, please contact me at (202) 512-8678 or garciadiazd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix III.

A handwritten signature in black ink, appearing to read "Daniel Garcia-Diaz", with a long horizontal flourish underneath.

Daniel Garcia-Diaz
Director, Financial Markets and Community Investment

Appendix I: Objectives, Scope, and Methodology

Our objectives in this report were to examine (1) recent developments in the housing and financial markets that could affect the safety and soundness of Fannie Mae and Freddie Mac, two government-sponsored enterprises (enterprises);¹ (2) risks and challenges that the ongoing conservatorships pose to the status and operations of the enterprises and other aspects of the housing finance system, and (3) housing finance reform options that have been proposed and their relative strengths and limitations.

To examine trends in the housing market and assess related risks, we reviewed and analyzed data that we considered relevant to various aspects of risk and developments in the housing market. Specifically, we reviewed and analyzed:

- house prices from the Federal Housing Finance Agency (FHFA) and Standard and Poor's (a financial services company);
- mortgage delinquency rates from FHFA; the Board of Governors of the Federal Reserve System (Federal Reserve); the Bureau of Consumer Financial Protection, also known as the Consumer Financial Protection Bureau (CFPB); and Inside Mortgage Finance (a housing market data provider);
- mortgage origination and securitization data from Inside Mortgage Finance, FHFA, the Mortgage Bankers Association, and the Securities Industry and Financial Markets Association; and
- measures of underwriting standards from Fannie Mae, Freddie Mac, the Department of Housing and Urban Development (HUD), and the Senior Loan Officer Opinion Survey on Bank Lending Practices (conducted by the Federal Reserve).

We adjusted house prices for inflation using the Bureau of Labor Statistics' Consumer Price Index and mortgage origination and

¹We did not include the Federal Home Loan Bank System (also a government-sponsored enterprise) in our review because we specifically focused on Fannie Mae and Freddie Mac, and recent developments affecting their safety and soundness.

securitization volume using the Bureau of Economic Analysis's Implicit Price Deflator for gross domestic product to make dollar amounts reflective of real 2017 dollars.

To further inform our assessment of these developments and risks, we reviewed prior GAO work on these issues. Specifically, we reviewed prior GAO work that identified and analyzed key national housing market indicators, including house prices and loan performance, since the 2007–2009 financial crisis.²

To examine risks and challenges that conservatorship poses to the status of the enterprises and other aspects of the housing finance system, we reviewed FHFA reports and Fannie Mae and Freddie Mac financial statements. Specifically, we reviewed progress reports and program updates from FHFA regarding its credit risk transfer and foreclosure prevention actions, and reviewed FHFA's scorecard progress and other FHFA reports (such as the 2017 Report to Congress), strategic plans, and FHFA Office of Inspector General reports. For financial information on Fannie Mae and Freddie Mac, we reviewed filings with the Securities and Exchange Commission, quarterly financial supplements, and reports from credit rating agencies. We also reviewed selected academic literature that reported on risks and challenges identified in these sources and the potential effectiveness of risk-mitigation efforts. We also reviewed our prior work on the enterprises' instability during the financial crisis.³

We took a number of steps to assess the reliability of the data, including interviewing agency officials; corroborating trends across data from multiple sources that we analyzed for these two objectives; reviewing related documentation; and reviewing relevant, prior GAO work. We used data that had been collected for prior GAO reports and reviewed the data reliability assessments that had been completed for those reports to determine if the data were reliable for our purposes. Based on these actions, we determined the data were sufficiently reliable to report on recent trends in the housing market and developments under the conservatorships of the enterprises.

²See GAO, *Housing Finance System: A Framework for Assessing Potential Changes*, [GAO-15-131](#) (Washington, D.C.: Oct. 7, 2014); and GAO, *Mortgage Reforms: Actions Needed to Help Assess Effects of New Regulations*, [GAO-15-185](#) (Washington, D.C.: June 25, 2015).

³See GAO, *Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, [GAO-09-782](#) (Washington, D.C.: Sept. 10, 2009).

To address our third objective, we reviewed 14 proposals proposed by Congress, federal agencies, industry groups, or think tanks for reforming the single-family housing finance system. We selected proposals for review based on the following criteria:

- **Time frame:** We selected proposals that were released from 2014 through 2018.
- **Source of proposal:** We selected proposals from the following sources: (1) Congress (either proposed legislation or discussion drafts by members), (2) federal agencies, and (3) industry groups or think tanks (limited to those that were discussed in congressional hearings). We excluded some proposed legislation that only would modify certain aspects of the conservatorships of the enterprises and did not contain broader reforms. For example, three proposed legislative acts would have amended the terms of the senior preferred stock purchase agreements but did not address other aspects of housing finance and thus we excluded them from our review. We also excluded documents that outlined principles and objectives for reform but did not include specific policies, such as reform principles documents that some industry and advocacy groups released.

We used elements of GAO's framework for assessing potential changes to the housing finance system to analyze the content and assess the potential strengths and limitations of the reform proposals.⁴ For each element, we defined a series of responses to determine if the proposal fully, partially, or did not meet the element and provided examples of relevant policies for each element. Generally, a proposal fully met an element if it described specific policies and programs relevant to that element, partially met an element if the element was addressed but the proposal did not describe specific policies or programs relevant to it, or did not meet an element if it did not address it at all. We also gathered descriptive information on the policies and programs on which the proposals relied.

We used the information we collected from the proposals to determine the potential strengths and limitations of the proposals. We generally considered a proposal's strengths to be the elements it fully met and its limitations to be elements that were partially met or not met. We did not make an individual, overall determination about each proposal, but

⁴See [GAO-15-131](#).

instead examined whether each proposal fully considered key elements of housing finance reform. For example, a proposal could have useful ideas for reform but had yet to consider some key elements. Using this information, we used the number of proposals that fully met each element to determine which elements were most frequently met. We noted which elements were met least often to determine the gaps in the reform proposals as a whole. We also grouped the individual proposals into the different reform models. We determined the main reform models and their potential strengths and weaknesses based on our review of the proposals, prior GAO reports, Congressional Budget Office reports, industry stakeholder reports, and information we obtained during panels and interviews we conducted.

To address all three objectives, we convened four, 2-hour panels of experts and stakeholders representing (1) mortgage originators and insurers, (2) securitizers and investors, (3) consumer and affordable housing advocates, and (4) researchers. We selected the experts and stakeholders based on the extent to which they developed reform proposals, testified before Congress on housing finance reform, or had participated in prior GAO studies of housing finance issues. Each panel had from three to five participants. In cases in which key experts or stakeholders could not attend our discussion panels, we interviewed them separately. We also interviewed officials at FHFA, HUD, and the Department of the Treasury.

We conducted this performance audit from March 2018 to January 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Housing Finance Reform Proposals Reviewed

For this report, we reviewed the following housing finance reform proposals released between 2014 and September 2018 (see appendix I for more information about how we selected the proposals):

Legislative Proposals

Bipartisan Housing Finance Reform Act of 2018 (discussion draft). Released by House Financial Services Chairman Jeb Hensarling, Representative John Delaney, and Representative Jim Hines on September 6, 2018.

Housing Finance Reform and Taxpayer Protection Act of 2014 (S. 1217). Released by Senate Banking Committee Chairman Tim Johnson and Ranking Member Michael Crapo on March 16, 2014.

Housing Opportunities Move the Economy (HOME) Forward Act of 2014 (discussion draft). Released by House Financial Services Committee Ranking Member Maxine Waters on March 27, 2014.

Mortgage Finance Act of 2015 (S. 495). Introduced by Sen. Johnny Isakson on February 12, 2015.

Partnership to Strengthen Homeownership Act of 2014 (H.R. 5055). Introduced by Representative John Delaney on July 10, 2014.

Protecting American Taxpayers and Homeowners Act of 2018 (H.R. 6746). Introduced by House Financial Services Chairman Jeb Hensarling on September 7, 2018 (originally introduced on July 22, 2013).

Proposals from Other Sources

Bright, Michael, and Ed DeMarco. Toward a New Secondary Mortgage Market. Washington, D.C.: Milken Institute, September 2016.

Federal Housing Finance Agency. Perspectives on Housing Finance Reform. Washington, D.C.: January 2018.

Independent Community Bankers of America. ICBA Principles for GSE Reform and a Way Forward. Washington, D.C.: 2017.

Moelis & Company LLC. Blueprint for Restoring Safety and Soundness to the GSEs. June 2017.

Mortgage Bankers Association. GSE Reform: Creating a Sustainable, More Vibrant Secondary Market. Washington, D.C.: April 2017.

National Association of Home Builders. Why Housing Matters: A Comprehensive Framework for Reforming the Housing Finance System. Washington, D.C.: September 2015.

Office of Management and Budget. Delivering Government Solutions in the 21st Century: Reform Plan and Reorganization Recommendations. Washington, D.C.: June 2018.

Parrott, Jim, Lewis Ranieri, Gene Spalding, Mark Zandi, and Barry Zigas. A More Promising Road to GSE Reform. Washington, D.C.: Urban Institute, March 2016.

Appendix III: GAO Contact and Staff Acknowledgements

GAO Contact

Daniel Garcia-Diaz, 202-512-8678, or GarciaDiazD@gao.gov

Staff Acknowledgements

In addition to the contact named above, Karen Tremba (Assistant Director), Tarek Mahmassani (Analyst in Charge), Miranda Berry, M'Baye Diagne, Michael Hoffman, Risto Laboski, Melanie Magnotto, Marc Molino, Matthew Rabe, Barbara Roesmann, Jessica Sandler, and Andrew Stavisky made significant contributions to this report.

Appendix IV: Accessible Data

Data Tables

Accessible Data for Single-Family Mortgage-Backed Security Issuance, Federal and Private, 2003–2017, Adjusted for Inflation

Year	Ginnie Mae	Fannie Mae	Freddie Mac	Private-Label	Total
2003	283	1,558	928	762	3,530
2004	157	666	461	1,092	2,376
2005	105	587	486	1,454	2,632
2006	97	541	426	1,356	2,420
2007	110	712	512	815	2,149
2008	301	607	401	65	1,374
2009	483	885	519	68	1,955
2010	417	665	422	71	1,575
2011	337	596	326	30	1,289
2012	428	880	466	14	1,789
2013	412	769	447	29	1,657
2014	305	388	265	56	1,013
2015	447	485	361	65	1,359
2016	517	594	398	44	1,553
2017	455	515	346	55	1,371

Accessible Data for Enterprises' Outstanding Mortgage-Backed Securities and Retained Mortgage Portfolios, 2003–2017

Year	Enterprise MBS Held by Investors	Enterprises' Retained Mortgage Portfolios
2003	2,053	1555
2004	2,260	1570
2005	2,573	1448
2006	2,900	1433
2007	3,501	1449
2008	3,692	1597
2009	3,928	1525

Year	Enterprise MBS Held by Investors	Enterprises' Retained Mortgage Portfolios
2010	3,868	1486
2011	3,856	1362
2012	3,920	1191
2013	4,097	952
2014	4,194	822
2015	4,332	692
2016	4,570	571
2017	4,816	484

Accessible Data for Figure 2: Federal Housing Finance Agency National House Price Index, 2003–2017

Month1	Year	Real House Price Index
1	2003	116.713
2	2003	116.8143
3	2003	117.0157
4	2003	118.2014
5	2003	119.0313
6	2003	119.4677
7	2003	119.9517
8	2003	120.2952
9	2003	120.8959
10	2003	121.7448
11	2003	122.6017
12	2003	123.3143
1	2004	123.6332
2	2004	124.2624
3	2004	124.8619
4	2004	125.7147
5	2004	126.3763
6	2004	127.2001
7	2004	128.1288
8	2004	128.9634
9	2004	129.5351
10	2004	129.8371
11	2004	130.4083

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Month1	Year	Real House Price Index
12	2004	131.5232
1	2005	132.595
2	2005	132.9639
3	2005	133.8702
4	2005	134.5915
5	2005	135.7388
6	2005	136.8438
7	2005	137.3119
8	2005	137.5099
9	2005	136.9208
10	2005	137.4704
11	2005	139.0197
12	2005	139.8623
1	2006	139.9529
2	2006	140.1427
3	2006	140.4578
4	2006	140.0478
5	2006	140.0324
6	2006	139.6353
7	2006	138.8658
8	2006	138.6249
9	2006	139.2648
10	2006	140.0985
11	2006	140.3923
12	2006	139.7689
1	2007	139.9849
2	2007	139.4441
3	2007	139.3634
4	2007	138.9526
5	2007	137.6834
6	2007	136.9075
7	2007	136.0124
8	2007	135.3859
9	2007	134.2082
10	2007	132.7499
11	2007	130.8511
12	2007	129.833

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Month1	Year	Real House Price Index
1	2008	128.2188
2	2008	127.1485
3	2008	125.5813
4	2008	123.926
5	2008	121.8337
6	2008	119.7911
7	2008	117.9024
8	2008	116.9159
9	2008	115.8223
10	2008	115.737
11	2008	115.7764
12	2008	116.3906
1	2009	117.2245
2	2009	116.9952
3	2009	115.629
4	2009	114.9122
5	2009	114.4585
6	2009	113.4751
7	2009	113.185
8	2009	112.5842
9	2009	112.3204
10	2009	112.2003
11	2009	112.1111
12	2009	110.9067
1	2010	110.9917
2	2010	110.5737
3	2010	110.5138
4	2010	110.5931
5	2010	110.6913
6	2010	109.515
7	2010	108.5959
8	2010	108.3678
9	2010	107.1792
10	2010	106.9805
11	2010	106.3013
12	2010	105.1017
1	2011	104.3446

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Month1	Year	Real House Price Index
2	2011	102.8819
3	2011	101.3715
4	2011	101.1292
5	2011	100.5272
6	2011	100.9322
7	2011	100.8817
8	2011	100.3072
9	2011	100.6702
10	2011	100
11	2011	100.3166
12	2011	100.6155
1	2012	100.0147
2	2012	100.034
3	2012	100.6319
4	2012	101.1051
5	2012	101.9615
6	2012	102.4388
7	2012	102.6526
8	2012	102.6317
9	2012	102.5822
10	2012	102.8741
11	2012	103.5831
12	2012	104.0933
1	2013	104.6844
2	2013	104.7542
3	2013	106.1711
4	2013	106.9443
5	2013	107.8325
6	2013	108.2075
7	2013	108.6259
8	2013	108.7572
9	2013	109.2577
10	2013	109.5456
11	2013	109.5006
12	2013	109.7452
1	2014	110.081
2	2014	110.4664

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Month1	Year	Real House Price Index
3	2014	110.6276
4	2014	110.615
5	2014	110.6559
6	2014	111.05
7	2014	111.369
8	2014	111.9285
9	2014	112.1194
10	2014	112.697
11	2014	113.4657
12	2014	114.6981
1	2015	115.5278
2	2015	116.1942
3	2015	116.2228
4	2015	116.5536
5	2015	116.887
6	2015	117.0064
7	2015	117.3215
8	2015	117.6157
9	2015	118.6518
10	2015	119.1046
11	2015	119.6941
12	2015	120.3332
1	2016	121.0106
2	2016	121.4835
3	2016	122.1419
4	2016	122.1774
5	2016	122.3856
6	2016	122.6781
7	2016	123.2763
8	2016	123.7661
9	2016	124.3703
10	2016	124.6271
11	2016	125.2602
12	2016	125.4965
1	2017	125.1729
2	2017	126.1762
3	2017	127.2835

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Month1	Year	Real House Price Index
4	2017	127.9195
5	2017	128.4732
6	2017	128.7464
7	2017	129.255
8	2017	129.7609
9	2017	129.8536
10	2017	130.6145
11	2017	130.8828
12	2017	131.2365

Accessible Data for Figure 3: Percentage of Enterprise-Purchased Mortgages 90 or More Days Delinquent, 2003–2017

Year	Fannie	Freddie
2003	0.6	0.86
2004	0.63	0.73
2005	0.79	0.53
2006	0.65	0.42
2007	0.98	0.65
2008	2.42	1.83
2009	5.38	3.98
2010	4.48	3.84
2011	3.91	3.58
2012	3.29	3.25
2013	2.38	2.39
2014	1.89	1.88
2015	1.55	1.32
2016	1.2	1
2017	1.24	1.08

Accessible Data for Figure 4: Dollar Volume and Percentage of Single-Family Mortgage Loan Originations by Product Type, 2003–2017

n/a	Dollars in billions	n/a	n/a	n/a	n/a	Percentage marketshare	n/a	n/a	n/a
Year	Government insured or guaranteed	Prime conforming	Prime jumbo	Nonprime	Year	Government insured or guaranteed	Prime conforming	Prime jumbo	Nonprime

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n/a	Dollars in billions	n/a	n/a	n/a	n/a	Percentage marketshare	n/a	n/a	n/a
Year	Government insured or guaranteed	Prime conforming	Prime jumbo	Nonprime	Year	Government insured or guaranteed	Prime conforming	Prime jumbo	Nonprime
2003	286	3,197	845	513	2003	5.9	66.0	17.4	10.6
2004	171	1,528	651	922	2004	5.2	46.7	19.9	28.2
2005	110	1,331	696	1,227	2005	3.3	39.6	20.7	36.5
2006	95	1,172	568	1,184	2006	3.1	38.8	18.8	39.2
2007	134	1,327	401	537	2007	5.6	55.3	16.7	22.4
2008	328	1,039	110	73	2008	21.2	67.1	7.1	4.7
2009	507	1,350	109	11	2009	25.6	68.3	5.5	0.6
2010	418	1,210	115	9	2010	23.8	69.1	6.6	0.5
2011	318	1,042	184	19	2011	20.3	66.6	11.8	1.2
2012	414	1,528	239	24	2012	18.8	69.3	10.8	1.1
2013	383	1,230	285	19	2013	20.0	64.2	14.9	1.0
2014	285	790	242	22	2014	21.3	59.0	18.1	1.6
2015	427	992	337	25	2015	24.0	55.7	18.9	1.4
2016	511	1,169	390	33	2016	24.3	55.6	18.5	1.5
2017	444	1,008	320	38	2017	24.5	55.7	17.7	2.1

Accessible Data for Figure 5: Percentage of New Single-Family Mortgages with Federal Guarantees, 2003–2017

Year	Government insured or guaranteed originations	Conventional originations purchased by the enterprises	Non-government originations
2003	5.9	51.3	42.8

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Year	Government insured or guaranteed originations	Conventional originations purchased by the enterprises	Non-government originations
2004	5.1	34.7	60.2
2005	3.1	31.9	64.9
2006	3.2	32.0	64.8
2007	5.2	51.0	43.8
2008	21.8	65.1	13.1
2009	26.2	62.4	11.3
2010	23.8	60.3	15.9
2011	20.3	57.7	22.0
2012	18.8	59.3	21.9
2013	20.7	61.7	17.6
2014	21.5	46.5	32.1
2015	24.4	45.4	30.2
2016	24.0	46.1	30.0
2017	24.5	45.8	29.6

Accessible Data for Figure 6: Dollar Volume and Percentage of Single-Family Mortgage-Backed Security Issuance by Source, 2003–2017

n/a	Dollars in trillions	n/a	n/a	n/a	n/a	n/a	Percentage	n/a	n/a	n/a
Year	Implicit Price Deflator	Ginnie Mae	Freddie Mac	Fannie Mae	Private label	Year	GNMA	FHLMC	FNMA	PLS
2003	81.767	282.9	927.6	1557.7	761.9	2003	8.0	26.3	44.1	21.6
2004	84.127	157.1	461.2	665.9	1091.6	2004	6.6	19.4	28.0	45.9
2005	87.050	104.7	485.7	587.5	1454.2	2005	4.0	18.5	22.3	55.2
2006	89.775	97.4	426.2	540.8	1356.0	2006	4.0	17.6	22.3	56.0
2007	92.195	110.1	512.1	712.0	814.9	2007	5.1	23.8	33.1	37.9
2008	94.869	301.4	400.8	607.1	65.0	2008	21.9	29.2	44.2	4.7
2009	94.563	482.7	519.2	885.0	67.8	2009	24.7	26.6	45.3	3.5
2010	95.925	416.7	422.4	664.8	70.7	2010	26.5	26.8	42.2	4.5
2011	98.253	337.1	326.4	595.9	29.8	2011	26.1	25.3	46.2	2.3
2012	100.000	428.3	466.5	879.7	14.0	2012	23.9	26.1	49.2	0.8
2013	101.451	411.9	447.5	768.9	29.1	2013	24.9	27.0	46.4	1.8
2014	103.171	304.8	265.1	387.5	55.7	2014	30.1	26.2	38.2	5.5
2015	103.542	447.3	361.2	485.3	65.3	2015	32.9	26.6	35.7	4.8

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n/a	Dollars in trillions	n/a	n/a	n/a	n/a	n/a	Percentage	n/a	n/a	n/a
Year	Implicit Price Deflator	Ginnie Mae	Freddie Mac	Fannie Mae	Private label	Year	GNMA	FHLMC	FNMA	PLS
2016	104.340	516.8	397.8	593.8	44.1	2016	33.3	25.6	38.2	2.8
2017	106.265	455.0	345.8	514.5	55.5	2017	33.2	25.2	37.5	4.0

Accessible Data for Figure 7: Combined Loan-to-Value Ratio for Mortgages Purchased by the Enterprises, 2003–2017

Year	Fannie Mae (Average combined loan-to-value ratio)	Freddie Mac (Average combined loan-to-value ratio)
2003	67.9	73.5
2004	70.9	75.3
2005	71.7	72.2
2006	72.5	74.3
2007	74.3	75.8
2008	73.3	72.5
2009	67.8	67.7
2010	68.2	68.6
2011	69.7	69.3
2012	70.2	69.9
2013	73.5	72.5
2014	77.2	76.8
2015	75.8	75.1
2016	74	74.3
2017*	76.3	76.1

Accessible Data for Figure 8: Borrower Credit Score for Mortgages Purchased by the Enterprises, 2003–2017

Year	Fannie Mae (Average borrower credit score)	Freddie Mac (Average borrower credit score)
2003	729	725
2004	723	718
2005	726	725
2006	725	724
2007	725	725

Year	Fannie Mae (Average borrower credit score)	Freddie Mac (Average borrower credit score)
2008	745	742
2009	764	763
2010	769	764
2011	769	765
2012	772	767
2013	764	760
2014	753	752
2015	755	753
2016	758	752
2017*	752	748

Accessible Data for Figure 9: Dollar Volume of Fannie Mae Retained Portfolio Assets and Portfolio Cap, 2003–2017

Year	Whole mortgages	Fannie Mae MBS	Private-label MBS	Other MBS	PSPA retained portfolio cap
2003	398	406	46.979	58	n/a
2004	400	344	108.809	64	n/a
2005	367	234	86.915	50	n/a
2006	383	200	97.281	49	n/a
2007	404	180	94.81	49	n/a
2008	429	229	83.406	50	n/a
2009	417	220	75.344	57	900
2010	427	260	69.986	31	810
2011	398	220	63.631	26	729
2012	372	184	56.573	21	650
2013	315	130	30.854	15	552.5
2014	286	93	23.388	11	422.7
2015	254	69	13.729	9	399.2
2016	220	42	6.455	4	339.3
2017	177	49	2.544	2	288.4

Accessible Data for Figure 10: Dollar Volume of Freddie Mac Retained Portfolio Assets and Portfolio Cap, 2003–2017

Year	Whole mortgages	Freddie Mac MBS	Private-label MBS	Other MBS	PSPA retained portfolio cap
2003	60.27	393.135	107.301	85.061	n/a
2004	61.36	356.698	166.411	68.792	n/a
2005	61.481	361.324	231.594	55.947	n/a
2006	65.847	354.262	224.631	59.219	n/a
2007	82.158	356.97	218.914	62.771	n/a
2008	111.476	424.524	185.041	83.721	n/a
2009	138.816	374.615	163.816	78.025	900
2010	234.746	263.603	148.515	50.01	810
2011	253.97	223.667	134.841	40.835	729
2012	221.313	186.763	120.038	29.43	650
2013	181.308	168.034	91.237	20.445	552.5
2014	164.472	161.541	63.879	18.522	469.625
2015	145.664	147.824	39.265	14.158	399.181
2016	127.549	136.184	22.266	12.427	339.304
2017	107.171	132.258	8.45	5.576	288.408

Accessible Data for Figure 12: Dollar Volume of Outstanding Fannie Mae and Freddie Mac Mortgage-Backed Securities Held by External Investors, 2003–2017

Year	Fannie Mae (Total MBS Outstanding)	Freddie Mac (Total MBS Outstanding)
2003	1301	752
2004	1408	852
2005	1599	974
2006	1778	1123
2007	2119	1382
2008	2289	1403
2009	2433	1495
2010	2400	1468
2011	2434	1422
2012	2521	1399

Appendix IV: Accessible Data

Year	Fannie Mae (Total MBS Outstanding)	Freddie Mac (Total MBS Outstanding)
2013	2643	1454
2014	2692	1502
2015	2738	1595
2016	2857	1713
2017	2971	1845

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