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United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

April 18, 2016

The Honorable Gene L. Dodaro
Comptroller General of the United States
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Comptroller Dodaro:

Congress established Fannie Mae and Freddie Mac (the enterprises) as government entities in 1968 and 1989, respectively, chartering them as for-profit, shareholder-owned corporations. The Housing and Economic Recovery Act of 2008 (HERA), inter alia, provided authority to the Director of the newly-formed Federal Housing Finance Agency (FHFA), in consultation with the Chairman of the Board of Governors of the Federal Reserve System, to place the enterprises into conservatorship or receivership. In September 2008, after determining that the enterprises could not continue to operate safely and soundly and fulfill their critical public mission, the FHFA Director used the authority granted in HERA to place the enterprises into conservatorship. A separate agreement between each of the enterprises and the Department of the Treasury provided the enterprises with significant taxpayer funds. The enterprises' conservatorship was intended to be temporary, yet nearly eight years later, it remains in place.

Congress has two important roles in this unique arrangement. The first is to provide continuous oversight over the FHFA. The second is to determine how the housing finance market should be structured in the future. To aid Congress in fulfilling these roles, I ask that you undertake the work outlined below.

FHFA Oversight

The FHFA has published strategic plans for the conservatorship that outline three goals. Two of these goals – building a new secondary mortgage market infrastructure, and maintaining foreclosure prevention activities and credit availability for new and refinanced mortgages – are found in the FHFA's 2012 and 2014 strategic plans. The third goal has changed. In 2012, it focused on gradually contracting the enterprises' dominant presence in the marketplace, while in 2014, it focused on reducing taxpayer risk through the increased role of private capital in the mortgage market.

Recently, however, the FHFA has taken steps that appear to encourage a more active, rather than a reduced, role in the mortgage market for the enterprises. These steps include issuing proposed rules regarding the enterprises' duty to serve, creating principle write-down requirements, lowering down-payment requirements, allowing allocation of revenues to the national housing trust fund despite the enterprise having no capital, and other actions. Moreover, the development of the common securitization platform, a joint venture established by the enterprises at the FHFA's direction, raises a number of questions about the FHFA's stated goal to gradually contract the enterprises' dominant presence in the marketplace.

Initially, the purpose of the FHFA's efforts, such as the common securitization platform, was to facilitate greater competition in the secondary mortgage market, but now it appears that the FHFA is no longer taking steps to enable the platform to be used by entities other than the enterprises. Likewise, lowering the down-payment requirement for mortgages guaranteed by the enterprises will make the enterprises more competitive with others in the mortgage market, not less. Overall, these FHFA actions raise questions about the goals of the conservatorship and whether its ultimate purpose has changed.

To better understand the impact of these changes, I ask that the GAO study and report the extent to which the FHFA's actions described above could influence:

- The enterprises' dominance in residential mortgage markets;
- A potential increase in the cost of entry for future competitors to the enterprises;
- Current and future financial demands on the Treasury;
- Possible options for modifying the enterprises' structures; and
- Any other areas GAO deems appropriate to fully evaluate these issues.

Future Structure

At the time when the enterprises were placed into conservatorship, the Treasury Secretary urged policymakers to "view this next period as a 'time out' where we have stabilized the [enterprises] while we decide their future role and structure." Since then, several legislative proposals to reform housing finance have been introduced in Congress. To enable Members of Congress to better understand the effects and consequences of reform in the future, additional research and evidence may be helpful in certain areas. A comprehensive reform of our housing finance system should evaluate and properly address concerns across all federal housing programs, while also maximizing the private sector investment in housing. To that end, I also ask GAO to assess and report on the specific topics discussed below.

Capital Requirements for Originating, Funding and Servicing a Mortgage. Since the 1992 legislation creating the Office of Federal Housing Enterprise Oversight and establishing legislative capital requirements for the enterprises was enacted, there has been a growing disparity in capital requirements based on what regulated entity holds the mortgage and in what form. Over the past several years, bank capital rules have become even more complex, requiring more capital than before. While strong capital requirements are generally good, inconsistences in capital standards among market participants may be fundamentally changing how firms finance and service mortgages.

Please include in your report an explanation of how the capital requirements for a typical mortgage depend upon how the loan is financed (i.e., whole loan, lender recourse, single-class MBS, credit risk transfer, PLS, FHA, REMIC, etc.) and compare these capital requirements to those in place before the financial crisis (including state capital requirements for insurance companies). Finally, where possible and applicable, please solicit and evaluate public comment on regulatory inconsistencies and other challenges market participants face which may inhibit investment (these may focus less on capital and more on uncertainties or market inconsistencies).

Geo-Coding in Loan-level Disclosures. Loan level disclosures will be an important component of developing a liquid trading market in mortgage credit risk. Geography is a key element of credit risk assessment but privacy issues arise with full property address disclosure. As such, some level of zip code disclosure typically serves as a proxy for exact location. Some investors seek 5-digit zip code disclosure, while the FHFA has authorized 3-digit disclosure and the SEC's Regulation AB authorizes 2-digit disclosure. Please include in your report an analysis of applicable law on this topic (including the level of geo-coding that may be needed to efficiently assess credit risk while protecting individual privacy) and the tradeoffs among these choices.

Residual Income Approach to Underwriting Affordable Housing. Some outside research has examined the Veteran's Affairs (VA) loan program's superior credit performance relative to the Federal Housing Administration's (FHA) loan performance, focusing on two features that may explain the difference: the VA program does not offer a 100-percent guarantee but rather requires lenders to retain credit risk while utilizing a residual income test (not just debt-to-income) to asses a borrower's ability to repay. Please include in your report an analysis of whether and how some form or forms of risk-sharing could be brought to the FHA program to introduce private sector skin-in-the-game, as well as whether a residual income test might be valuable in protecting both taxpayers and borrowers within the FHA program.

Equity Building. Currently, most federal housing policies and subsidies are geared toward making housing debt more affordable. While many of these programs are very popular with borrowers, we must periodically assess if they best meet the needs of our citizens while safeguarding their financial security in the future. Please include in your report an assessment of options for federal housing policy and federal housing subsidies that could incentivize and encourage equity building rather than encouraging higher debt burdens for Americans.

To the extent that the requests in this letter are likely to require multiple GAO engagements, I request that you not hold completed work until the finalization of all of these requests. Rather, I ask that you issue your reports as they are completed. It would be most helpful if as much work as possible were completed by November 1, 2016.

Please have your staff contact Chad Davis with any questions you may have on these issues. Thank you for your attention to these requests.

Sincerely,

Richard Shelby

Richard Shelby
Chairman