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Protecting Duties to Serve and Responsible Next Steps for Reforming the Secondary Mortgage Market:

A Case for the Recapitalization and Continued Reform of Fannie Mae and Freddie Mac

ABOUT NCRC

NCRC and its grassroots member organizations create opportunities for people to build wealth. We work with community leaders, policymakers and financial institutions to champion fairness in banking, housing and business development.

Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, and social service providers from across the nation.

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INTRODUCTION:

Duties to Serve Play a Critical Role in Providing Access to Mortgage Credit to Traditionally Underserved Markets

NCRC is committed to the affirmative obligations, *Duties to Serve,*[1] imposed on depository institutions in the primary market and on Fannie Mae and Freddie Mac in the secondary mortgage market. Duties to Serve are designed to ensure that financial institutions reach out and serve *all* creditworthy borrowers, and especially those in low- and moderate-income and traditionally underserved communities. Fannie Mae and Freddie Mac (two government-sponsored enterprises [GSEs]), through their Affordable Housing Goals, the secondary market role they play, and the products they offer, continue to serve a critical role in ensuring mortgage credit flows to creditworthy borrowers in some of the most underserved markets in the country (e.g. low income, rural, minority).

- **Community Reinvestment Act (CRA):** In the primary market, mortgage and business lending by depository institutions are examined under the **Community Reinvestment Act (CRA)**, a law enacted in 1977 to combat "redlining" – the practice of denying credit to individuals and businesses in certain neighborhoods without regard to their creditworthiness. CRA states that "regulated financial institutions have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered".[2] Those obligations are to be met "consistent with the safe and sound operations of such institutions."[3]

- **Affordable Housing Goals/Forthcoming Duty to Serve Rule:** In the secondary mortgage market, Fannie Mae and Freddie Mac have "an affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes, while maintaining a strong financial condition and a reasonable economic return".[4] In 1992, Congress instituted authority for requiring the GSEs to meet numeric housing goals for the purchase of single- and multifamily conventional mortgages that serve traditionally underserved communities.[5] As the secondary market replaced deposits as the primary source of funding for mortgages, the affordable housing goals were a step toward aligning secondary market affirmative obligations with those of CRA-covered lenders in the primary market.[6]

Fair Lending vs. Duties to Serve: Beyond the *entirely different questions* that surround fair lending laws and practices encompassed in the Fair Housing Act, Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act, for example, *broader questions* loom over the current wind-down of the GSEs, the end of the GSEs' conservatorship and, perhaps, an on-going effort to build a new mortgage finance system:

Will the future government-sponsored or -supported secondary mortgage market system continue to have Duties to Serve – affirmative obligations designed to address the disparity in financial opportunity available to creditworthy borrowers in traditionally underserved markets?

Will the Duties to Serve that currently exist in both the primary and secondary market be modernized and strengthened, because they remain essential to ensuring access to credit for traditionally underserved borrowers and markets, including those in low-income, rural and minority communities?

Political and Policy Uncertainty Cloud the Future of Duties to Serve in the Secondary Mortgage Market

Duties to Serve in the nation's secondary mortgage market are at risk:

- Comprehensive housing finance reform continues to languish in Congress, with no legislative consensus on the horizon;

- Various piecemeal legislative and administrative approaches to a new housing finance system are taking shape with no conception of the role affirmative obligations will play or how to serve traditionally underserved markets; and

- The future of Fannie Mae and Freddie Mac hangs in the balance, with political uncertainly about a new Administration and what policy approaches the next President will take on the GSEs' wind-down, their conservatorship, and importantly, the Duties to Serve they are subject to, such as the Affordable Housing Goals.

Because of the important role Fannie Mae and Freddie Mac continue to play in providing access to all creditworthy borrowers including those in low- and moderate-income, minority, rural and other traditionally underserved markets, we believe it is time to recapitalize the GSEs and institute a capital restoration plan, end the conservatorship and build on the reforms of strong supervision, oversight and increased transparency started as part of the Housing and Economic Recovery Act of 2008 (HERA).

I. Today's Safer and Sounder Banking System

The overall U.S. banking system and the housing finance system within it is far more safe and sound today than it was prior to the financial crisis.

Global banking regulators, the U.S. Congress and the nation's new and existing regulators have enacted a series of reforms in response to the 2007 financial crisis that have strengthened the requirements for regulated financial institutions with regard to capital adequacy, liquidity, disclosure, risk retention, and consumer protections.

- Basel III and related requirements adopted by global banking regulators have strengthened capital requirements and liquidity rules for banks, including requiring that large banks maintain a level of high-quality liquid assets.[7]
- The Dodd-Frank Wall Street Reform and Consumer Protection Act[8] (Dodd-Frank Act) enacted a number of key systemic reforms and created the Financial Stability and Oversight Council (FSOC), a body charged with identifying risks to U.S. financial stability that may arise from the ongoing activities of large, interconnected financial companies as well as from outside the financial services market.
- The Securities and Exchange Commission (SEC),[9] the Commodity Futures Trading Commission (CFTC)[10] and other federal regulators have implemented new rules around the registration, disclosure and reporting requirements for asset-backed securities, proprietary trading, credit rating agencies, and various financial instruments.
- The Consumer Financial Protection Bureau (CFPB) has implemented new protections for consumers and the financial services system, including strong Ability to Repay and Qualified Mortgage (QM) standards.[11]

Fannie Mae and Freddie Mac would emerge from conservatorship to a vastly different U.S. banking and housing finance system that has stronger regulations and greater oversight over virtually every aspect of the financial markets.

II. Today's Housing Finance System is Better Regulated

The GSEs' losses, which began in late 2006, were of note because previously the GSEs had been consistently profitable.[12] *The Financial Crisis Inquiry Report* found that although the GSEs participated in the expansion of subprime and other risky mortgages, *they followed rather than led* Wall Street and other lenders – they were not the primary cause.[13] They purchased the highest-rated non-GSE mortgage-backed securities (MBS), but their purchases never represented a majority of the market.[14] In the midst of an overall housing bubble and housing market meltdown, the loans purchased or guaranteed by the GSEs generated substantial losses, but delinquency rates for GSE loans were substantially lower than loans securitized by other financial firms.[15] *GSE mortgage securities essentially maintained their value throughout the crisis and did not contribute to the significant financial firm losses that were central to the financial crisis*.[16]

A. The Housing and Economic Recovery Act of 2008: *The Culmination of Years of Work*

With the enactment of the Housing and Economic Recovery Act of 2008 (HERA),[17] the U.S. Department of the Treasury's subsequent Senior Preferred Stock Purchase Agreement (PSPA) and other steps, Fannie Mae and Freddie Mac, as well as the Federal Home Loan Banks, have undergone significant reforms, have restored profitability, and are serving a critical countercyclical role in the housing recovery – ensuring access to credit for middle-class families.
Under HERA, Congress vested the Federal Housing Finance Agency (FHFA) with sweeping powers as conservator and as a regulator of the GSEs.

- **FHFA as Conservator:** These powers position FHFA to potentially control every aspect of the GSEs. Director Mel Watt recently testified that FHFA is involved in "virtually every decision" that Fannie Mae and Freddie Mac make. In 2014, for example, FHFA completed over 750 conservatorship actions.[18]

- **FHFA as Regulator:** The Federal Reserve Board noted that when it was enacted, HERA significantly reformed the supervisory and regulatory framework for the GSEs, representing the culminations of almost a decade of work by Congress, the Federal Reserve Board and other stakeholders.[19]

    - **On Capital:** HERA "grants the FHFA director broad new authority to set and adjust the capital requirements for the GSEs," including minimum and risk-based capital.[20]

- **On Portfolio Limits**: "HERA requires that the FHFA director establish, by regulation, criteria governing the portfolio holdings of Fannie Mae and Freddie Mac to ensure that the holdings are backed by sufficient capital and consistent with the mission and the safe and sound operations of the enterprises."[21]

- **On Prudential Management and Operations: "**HERA also requires that the FHFA director establish standards for the GSEs related to, among other things, the management of interest rate risk exposure; management of market risk; adequacy and maintenance of liquidity and reserves; management of asset and investment portfolio growth; investments and acquisitions of assets; overall risk-management processes; and such other operational and management standards as the director deems appropriate."[22]

HERA provides the tools that the GSEs' regulator, FHFA, can use to ensure that the GSEs do not return to their pre-2008 activities. And the conservatorship has added a new tool to the arsenal – the PSPA – which could be further modified prior to the GSEs emerging from conservatorship to give the federal government additional tools to ensure continued reform of Fannie Mae and Freddie Mac.

Importantly, Congressional reforms of Fannie Mae and Freddie Mac can and should continue as they are recapitalized and exit conservatorship. While prior legislative reforms have instituted a strong regulator in FHFA, Congress can still address issues around the corporate governance structure of the GSEs, the nature and scope of the federal guarantee, and limits on their returns.

B. While Fannie Mac and Freddie Mac Have Regained Profitability, the Indefinite Conservatorship is Undermining it

By 2012, the GSEs were again profitable and by the second quarter of 2013, Fannie Mae reported record profits of $59 billion and Freddie Mac reported near-record profits of $5 billion.[23] Even with the very aggressive wind-down actions imposed by Treasury's PSPA, the GSEs have remained largely profitable:[24] Fannie Mae recorded a 27 percent rise in second quarter profits in 2015,[25] and Freddie Mac also posted a sharp increase in the second quarter.[26]

- Fannie Mae reported a positive net worth of $6.2 billion as of June 30, 2015, resulting in a dividend obligation to the U.S. Treasury of $4.4 billion. With this payment, Fannie Mae will have returned $142.5 billion to taxpayers, following draws on the U.S Treasury made during the financial crisis totaling $116.1 billion since 2008.[27]

- Freddie Mac reported a positive net worth of $5.7 billion as of June 30, 2015, resulting in a dividend obligation to the U.S. Treasury of $3.9 billion. With this payment, the company will have returned $96.5 billion to taxpayers, following draws on the U.S. Treasury during the financial crisis totaling $71.3 billion since 2008.[28]

Given the conservatorship, however, the FHFA's Office of Inspector General has observed that the GSEs' ability to sustain profitability in the future is not knowable for a number of reasons: the winding down of their investment portfolios and loss of interest income; the level of guarantee fees they will be able to charge; the future performance of their business segments; the elimination of a capital cushion to buffer against losses; and the significant uncertainties involving key market drivers, such as mortgage rates, home prices, credit standard, and short- and long-term interest rates.[29]

Fannie Mae and Freddie Mac remain in conservatorship, but by comparison, several large U.S financial institutions and other companies that also received significant federal relief from the U.S. Treasury during the financial and economic crisis under the Troubled Asset Relief Program (TARP) and other federal programs have now, unlike Fannie Mae and Freddie Mac, exited those programs and the oversight related to those programs after having refunded those monies with dividends, interest and other payments.[30]

III. The State of Housing Finance: *Homeownership, Tight Credit and Duties to Serve*

As FHFA has noted, the housing finance system is in the midst of a period of significant uncertainty, and those uncertainties are having an impact on key market drivers such as home mortgage rates, home prices, credit standards, and other rates.[31] Many have attributed tight conditions in mortgage markets to a combination of factors, including **the political deadlock regarding the conservatorship of the GSEs**.[32]

A. The Importance of Homeownership

Whether through guaranteeing lending institutions, mortgages, or secondary market entities, the government has ultimately taken the credit risk on most mortgages made in the U.S. since the 1930s.[33] The major exception occurred during the mid-2000s when private label securitization briefly and disastrously became the dominant source of mortgage capital.[34]

For decades, government policy has encouraged homeownership through a set of incentives, assistance programs, and mandates. These policies were put in place and promoted by several administrations and Congresses—indeed, both Presidents Bill Clinton and George W. Bush set aggressive goals to increase homeownership.[35]

Home Equity and Household Wealth: Homeownership has long been the keystone for the economic vitality of America's broad middle class, conferring financial and social benefits to families and communities.[36] Today, housing equity is by far the largest source of net wealth for U.S. households.[37]

- Home equity accounted for $80,000 of the $195,000 median net wealth of homeowners in 2013.[38] By comparison, the median net wealth of renters was just $5,400.[39] The difference in net wealth between owners and renters is particularly stark among low-income and minority households.[40] Affordable rental housing also plays an important role and it is also facilitated by the GSEs' multifamily affordable housing goals.

The Quest to Own: Despite the current challenges facing borrowers, most households – regardless of race/ethnicity, age and lifestyle — still consider homeownership a positive goal.[41] According to Fannie Mae's National Housing Survey for the fourth quarter of 2014, 82 percent of respondents thought that owning made more financial sense than renting. Even among renters, 67 percent agreed with this statement.[42] However, homeownership is declining.

- The homeownership rate continued to decline in the second quarter of 2015, hitting a 48-year low.[43] The seasonally adjusted homeownership rate declined to 63.5 percent, down from 64.7 percent in the second quarter of 2014.[44]

- Homeownership rates among Gen-Xers – now mostly in the 35-44 and 45-54 year-old age groups – have fallen further than those of any other age groups, and stand four to five percentage points below rates among same-aged households 20 years ago.[45]

- The rate of homeownership among those under the age of 35 has declined to roughly 36 percent over the last few years, from highs of 43 percent in the mid-2000s and close to 41 percent in the early 1980s.[46] However, 84 percent of Millennials surveyed indicated that they already own or intend to purchase a home.[47] Today, a record number of young people under 34 years old are living in the home of their parents.

B. Homeownership and Tight Credit Box

While it was abusive lending and lax standards that created the housing bubble that immediately preceded the housing crisis, mortgage credit today remains tight even when compared to periods well before the run-up to the crisis. The Urban Institute recently estimated that four million more loans would have been made between 2009 and 2013 if credit standards had been similar to those in 2001.[48] And the number of loans missing has grown enormously each year, with over 1.2 million loans missing in 2013 alone.[49]

- **"Boxed Out" By Tight Credit Standards**: The study estimated a 37 percent decline in home-purchase loans among borrowers with scores between 660 and 720, compared to a nine percent drop among borrowers with scores above 720.[50]

- While the number of loans to high-credit borrowers (those with a 720 FICO score or higher) is down only 8.9 percent from 2001, low-credit borrowers (those with a FICO score below 660) have dropped 75.8 percent, and moderate-credit borrowers have dropped 37 percent. As a result of this tightening, high-credit borrowers now make up the majority of new purchase loans, while low-credit borrowers comprise only a tiny share relative to 2001.[51]

The credit scores reflect a mortgage market recovery that is largely limited to households with excellent credit. While high-credit households are now obtaining loans at a slightly lower rate than in 2001, lower-credit borrowers are faring far worse.[52]

Constrained mortgage lending today is disproportionately affecting African American and Hispanic households.[53] As a result, these communities have found it harder to take advantage of the low home prices and interest rates that followed the housing market crash, missing an important opportunity to build wealth through homeownership.[54] When families and communities cannot access credit, the impacts are wide-ranging throughout the economy.[55]

C. The GSEs' Countercyclical Role is Critical to the Housing Recovery

The GSEs back just over half of new mortgages. In the second quarter, the two companies backed a total of more than $230 billion in new mortgages.[56]

In contrast, the private label securities (PLS) market has shrunk over the last seven years,[57] and there are few signs of real rebound. The PLS market has averaged only about $9.6 billion from 2008-2014, after averaging $368.7 billion per year from 2001-07.[58] The swing further demonstrates the cyclical and pro-cyclical nature of the PLS market, and that it cannot reliably undergird the U.S. secondary mortgage market.

Some estimates find that mortgages implicitly or explicitly guaranteed by the government are 90 percent of all loans originated in the mortgage market today, compared to two-thirds before the crisis.[59] Even with the support of the GSEs, the mortgage market continues to limp along more than eight years after the start of the U.S. financial crisis. Were it not for the critical role played by the GSEs, mortgage lending to many middle-class families would be all but non-existent.

D. No Consensus in Congress on Housing Finance Reform; Piecemeal Steps

Congress remains deadlocked over a comprehensive approach to housing finance reform. FHFA and the U.S. Treasury, however, continue major steps towards a new housing finance infrastructure and some in Congress are also advocating piecemeal legislative approaches that construct key pieces of a new housing finance system, and that restrict both the recapitalization of the GSEs and both GSEs' exit from conservatorship.

As policymakers look to the next steps for the housing finance system, we must continue to ask if pursuing piecemeal approaches to a new mortgage finance system and restricting the GSEs' exit from conservatorship will undermine the current affirmative obligations in the secondary mortgage market to reach out to *all creditworthy borrowers* and ensure that traditionally underserved communities continue to have access to mortgage credit.

- **Common Securitization Platform (CSP):** For example, as envisioned by FHFA and Title VII of the Financial Regulatory Improvement Act (S. 1484), will the CSP replace the functions of the GSEs in a post-wind down environment, and if so, would originators seeking access to the CSP be subject to an affirmative obligation to serve *all* creditworthy borrowers, including those in traditionally underserved markets (central cities, rural areas and underserved areas)?

- **Limitations on the Sale of Preferred Stock:** Will the so-called "Jumpstart" provision in S. 2038 that blocks the sale or conversion of senior preferred stock without Congressional action first also block the GSEs from exiting conservatorship? Will it also allow a wind-down of the GSEs by the next President in ways that will circumvent or undermine the Duties to Serve traditionally underserved markets by participants in any government-sponsored or -supported secondary mortgage market facilities?

E. Changes in the Make-up of the Mortgage Market and the Duties to Serve

Duties to Serve, such as the GSEs' affordable housing goals, are part of the purpose for granting special-purpose charters for financial intermediation, and for the government support of the market, which comes in a variety of forms—economic, regulatory, and infrastructure—that benefit stakeholders directly and indirectly.[60]

- Duties to Serve must include offering the same types of products to all communities, adjusted for the needs of communities (e.g. seasonal income in rural agricultural communities).[61]

- Duties to Serve must be consistent with safety and soundness. They must operate to prevent a two-track, separate and unequal housing (and consumer) credit system in the U.S., with wealthier (and whiter) communities offered traditional, non-predatory products from lenders, such as long-term, fully amortized, fixed rate mortgages, while low- and moderate-income communities go un-served or served only by lenders offering higher cost and non-traditional products that expose borrowers to greater risks.[62]

The role of Duties to Serve is even more consequential post-crisis as the make-up and composition of the lending industry changes. Banks have reduced their market share in residential lending, and non-depository institutions – that are generally not subject to CRA in the primary market – have rapidly assumed a greater role in the mortgage finance system as new technologies and technology-enabled lending platforms proliferate.

- In 2014, non-banks accounted for 42 percent of total mortgage originations in terms of dollar volume compared to 12 percent in 2010.[63]

- By 2014, of the top 20 purchase mortgage originators in terms of dollar volume – whose loans made up 55 percent ($400.4 billion) of the total $725 billion in 2014 purchase mortgage originations – 10 were non-banks, accounting for 28 percent ($111.1 billion) of 2014 purchase mortgages originated by the top 20 lenders.[64]

- Traditionally, the GSEs purchased most of their loans from a small number of the largest commercial banks and mortgage companies. In early 2011, their top five sellers delivered between 65 percent and 70 percent of the mortgages purchased by each GSE.[65] Since then, there has been a pronounced decline in the market share of the GSEs' largest mortgage seller counterparties.[66]

- Data from Fannie Mae and Freddie Mac also indicates sales from a wider variety of lenders representing a growing percentage of their mortgage purchases, including sales from nonbank mortgage companies. According to a Fannie Mae document, 46.6 percent of its mortgages were purchased from non-bank mortgage companies in the first three quarters of 2013, which was up from 33.2 percent in 2011.[67] Freddie Mac data shows that its share of mortgage purchases from non-bank mortgage companies more than doubled from 8.4 percent to 20.5 percent over that same period.[68]

- Non-banks also now dominate the market for home-purchase loans insured by FHA, with their share rising from 29.75 percent in November of 2012 to 62.63 percent in February of 2015.[69]

Even as the lenders from whom they purchase mortgages change, the GSEs' purchases today remain subject to their affirmative obligations to purchase a certain number of mortgages made to low- and moderate-income borrowers and in traditionally underserved communities.

VI. Recapitalizing the GSEs and Ending the Conservatorship

The continuing conservatorship without any plan for resolution is itself injecting a level of uncertainty into the mortgage market that market actors have said is contributing to the tightness of credit and a lack of access for creditworthy borrowers across the country. The political and policy uncertainty is also placing the critical role of the Duties to Serve at risk.

Step 1 - Build A Capital Buffer

FHFA should exercise the authority granted under HERA "to take such action as may be necessary to put the regulated entity in a sound and solvent condition."[70]

- Since 2012, U.S. Treasury has swept, as dividends, the entire positive net worth of the GSEs above an established "buffer" that was set at $3 billion for each GSE for 2013 and is gradually being reduced to zero by 2018. Elimination of the GSEs' capital cushion has created a perverse outcome: Fannie Mae and Freddie Mac currently have less capital than they did prior to the financial crisis.

- While U.S. lawmakers and global and national regulators have enacted capital requirements and tested for capital adequacy at most major financial institutions in the country and many around the world as well as systemically important financial institutions (SIFIs), the GSEs, though currently profitable, are operating seven years after the crisis without an adequate capital cushion to support the entities in the event of an economic downturn.

- Because of the lack of a capital cushion, Fannie Mae and Freddie Mac would require up to $157.3 billion in additional support from the U.S. Treasury in a severe economic downturn, according to their most recent stress test.[71]

Consistent with safety and soundness considerations prevailing throughout today's financial sector and the GSEs' profitability, FHFA and the U.S. Treasury should immediately amend the PSPA to allow the GSEs to rebuild a capital buffer against potential economic shocks and institute a capital restoration plan.

Step 2 - End the Conservatorship

- Given the significant legal and regulatory steps by Congress and the nation's regulators have taken to restore safety and soundness to the overall financial system and the housing finance system;

- Given that the profitability of both Fannie Mae and Freddie Mac is placed at risk with the aggressive wind-down actions being taken;

- Given the continuing critical importance of the GSEs to providing stability and liquidity in the secondary mortgage market and the countercyclical role they are playing now in the housing finance system overall;

- Given the GSEs' Duties to Serve and the important role they play in providing mortgage credit to traditionally underserved markets across the country, including rural communities, low- and moderate-income communities and minority communities;

- Given the changes on the horizon potentially affecting the overall mortgage market, including the recent end of the Federal Reserve Banks' quantitative easing asset purchases,[72] and the much-debated reports of an imminent increase in their benchmark short-term interest rates;

- Given that mortgage rates are also tied to the market for the GSEs' debt and MBS, the future of which is uncertain given the protracted conservatorships, and demand for which may shift significantly in response to changing U.S. monetary policy; and

- Given that several major U.S. financial institutions and other private companies who also received significant federal relief from the U.S. Treasury during the financial and economic crisis under other programs such as TARP have now, unlike Fannie Mae and Freddie Mac, exited those federal programs and the oversight related to those programs, after having similarly refunded those monies with dividends, interest and other payments,

FHFA and the U.S. Treasury should begin the steps to end the aggressive wind-down of the GSEs. They should allow the GSEs to build a capital buffer, institute a capital restoration plan, establish a reasonable investment portfolio, continue reforms of the GSEs to ensure safety and soundness, and end the conservatorship. These steps will enable the GSEs to return to their traditional role of providing stability in and liquidity to the secondary market, to respond appropriately to the private capital market, and to promote access to mortgage credit throughout the nation, including central cities, rural and underserved areas.

Step 3 – Build on the Reforms of Strong Oversight and Supervision in HERA

Continuing GSE Reform – Governance Structure and the Guarantee: The ending of the conservatorship should trigger the next steps in reforming the GSEs and their role in the secondary mortgage market, including legislative action on the governance structure of the GSEs and the nature of the government guarantee received by those investing in MBS issued by the GSEs.

- **Governance Structure**: The GSEs could be privately funded, government-chartered entities, a wholly owned government corporation, or have a mutual or cooperative ownership structure. Overall, Congress should move to reform the GSEs' governance structure, but the affirmative obligations – affordable housing goals and the forthcoming Duty to Serve rule – must remain integral to the charter.

- **Government Guarantee:** Congress should also reform the government guarantee so as to ensure that the secondary market remains liquid and deep, credit remains affordable for low- and moderate-income borrowers and investment remains robust for their MBS.

Importantly, FHFA must exercise its strong authorities under HERA as a regulator to establish prudent capital requirements and take other steps as the GSEs exit conservatorship, and coordinate with other financial regulators to ensure proper oversight. The passage of HERA allows for dramatically increased regulatory power on capital, retained portfolio, product mix, and other areas. HERA prevents a return to the past. Such powers, along with other post-crisis laws and regulations, should allow the GSEs to fulfill their public mission without putting taxpayers at risk of future bailouts.

We urge the Obama Administration to recapitalize Fannie Mae and Freddie Mac, institute a capital restoration plan, and end their conservatorship during their remaining months in office. We also urge Congress to continue building on the reforms of strong supervision, oversight and increased transparency started as part of HERA.

SOURCES AND ANNOTATIONS:

1 Duties to Serve in this context is a categorical heading referring to affirmative obligations on lending institutions and the government-sponsored enterprises (GSEs) and does not specifically refer to Sec. 1129 of Housing and Recovery Act of 2008, which imposed on the GSEs a "Duty to Serve" three underserved markets - manufactured housing, affordable housing preservation, and rural areas.

2 *See* 12 U.S.C. 2901.

3 Ibid.

4 *See* 12 U.S.C. 4501(7).

5 *See* 21 U.S.C. 4561-4564. Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, the numeric goals were initially set by the Department of Housing and Urban Development (HUD) on a yearly basis. HERA transferred HUD's authorities and responsibilities for the goals to FHFA (Sec. 1122, 1128). Historically, the legislation that transformed Fannie Mae in 1968 also authorized HUD to prescribe affordable housing goals for Fannie Mae to "require that a reasonable portion of the corporation's mortgage purchases be related to the national goal of providing adequate housing for low and moderate income families, but with reasonable economic return to the corporation." In 1978, HUD tried to implement the law and, after a barrage of criticism from the GSEs and the mortgage and real estate industries, issued a weak regulation encouraging affordable housing. Also, see the *U.S. Financial Crisis Inquiry Report,* National Commission on the Causes of the Financial and Economic Crisis in the United States, pursuant to Public Law 111-21 (February 25, 2011). http://fcic.law.stanford.edu/report

6 *Rethinking Duties to Serve in Housing Finance*, Adam J. Levitan and Janneke H. Ratcliffe, Joint Center for Housing Studies, Harvard University, October 2013. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-12.pdf

7 Basel III is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the global banking sector. http://www.bis.org/bcbs/basel3.htm?m=3%7C14%7C572

8 Among other provisions, the Dodd-Frank Act implements changes that affect the oversight and supervision of financial institutions, introduce more stringent regulatory capital requirements, effect significant changes in the regulation of over-the-counter derivatives, reform the regulation of credit rating agencies, implement changes to corporate governance and executive compensation practices, incorporate the Volcker Rule, require registration of advisers to certain private funds, and effect significant changes in the securitization market.
http://www.banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf

9 The SEC has adopted final rules for 61 mandatory rulemaking provisions of the Dodd-Frank Act designed to shore up safeguards in the nation's financial system. http://www.sec.gov/spotlight/dodd-frank.shtml

10 Pursuant to the Dodd-Frank Act, the CFTC has and is implementing rules around 38 areas in the swaps marketplace where the agency has identified rules are necessary. http://www.cftc.gov/lawregulation/doddfrankact/index.htm

11 The CFPB amended Regulation Z, which implements the Truth in Lending Act (TILA). Regulation Z prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan. http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/

12 *Fannie Mae's and Freddie Mac's Financial Status: Frequently Asked Questions*, Congressional Research Service (August 13, 2013). https://www.fas.org/sgp/crs/misc/R42760.pdf
Prior to 2006, Fannie Mae had not reported a full-year loss since 1985, and Freddie Mac had never reported a full-year loss since it became a stockholder-owned company.

13 *U.S. Financial Crisis Inquiry Report,* National Commission on the Causes of the Financial and Economic Crisis in the United States, pursuant to Public Law 111-21 (February 25, 2011). http://fcic.law.stanford.edu/report

14 Ibid.

15 Ibid. 13.

16 Ibid. 13.

17 *Housing and Economic Recovery Act of 2008*, Congressional Research Service, September 30, 2008. research.policyarchive.org/19905.pdf
HERA created a new, stronger, unified regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks with broader authorities to establish risk-based and minimum capital requirements, to ensure the portfolio holdings are backed by sufficient capital and consistent with the GSEs' mission and safety and soundness. HERA also created a Federal Housing Finance Oversight Board, prudential management (e.g. standards around internal controls, audit and risk management), asset growth and enforcement authorities.

18 *FHFA's Conservatorships of Fannie Mae and Freddie Mac: A Long and Complicated Journey,* FHFA Office of Inspector General (March 25, 2015). https://origin.www.fhfaoig.gov/Content/Files/WPR-2015-002_0.pdf

19 *95th Annual Report 2008*, The Federal Reserve Board. http://www.federalreserve.gov/boarddocs/rptcongress/annual08/sec2/c5.htm

20 Ibid.

21 Ibid. 20.

22 Ibid. 20.

23 Ibid. 12.

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