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REPUBLICAN SPENDING REDUCTION PROPOSAL

REFORM, BRING TRANSPARENCY TO FANNIE MAE AND FREDDIE MAC

(saves at least $30 billion)

PURPOSE

- While most of the focus from the financial crisis has been on Wall Street and the Troubled Asset Relief Program [TARP], the taxpayers' largest costs will come from two longstanding government-backed agencies: the Federal National Mortgage Association [Fannie Mae] and the Federal Home Loan Mortgage Corporation [Freddie Mac]. According to the Congressional Budget Office [CBO], the one-time cost of just bailing out Fannie and Freddie is $248 billion (see explanation below). This, combined with new business, will cost taxpayers an estimated $373 billion if Fannie and Freddie remain under conservatorship.

- Fannie and Freddie are clear illustrations of the risk of "crony capitalism." They are private companies that enjoy the special status of government-sponsored enterprises [GSEs]; they have exercised their clout in Washington to protect that status and prevent any effort to reform them; they have enriched their executives and benefactors; and in the end they presented a bill to the taxpayers in the hundreds of billions.

- Representatives Hensarling and Garrett have introduced their own bills to reform Fannie Mae and Freddie Mac to avoid future bailouts and to bring transparency and accountability to these agencies.

SUMMARY

- The first part of this proposal, based on the Hensarling bill – the GSE Bailout Elimination and Taxpayer Protection Act (H.R. 4889) – would provide a clear pathway to phasing out Federal support for these private companies. It would eventually lead to downsizing and then dissolving Fannie's and Freddie's operations.

  - It would repeal the government charter after conservatorship ends.

  - It would also gradually withdraw other special protections afforded to the GSEs, increasing minimum capital requirements, shrinking portfolio size, reducing conforming loan limits to pre-"stimulus" levels, and establishing certain minimum requirements for securitized loans.

- It would require the FHFA Director to assess a fee on Fannie and Freddie to reimburse taxpayers for the value of the benefit provided by the Federal guarantee.

- If H.R. 4889 were enacted, the savings to taxpayers would be at least $30 billion. (This assumes savings begin in 2014 and uses credit reform estimates from CBO's January 2010 baseline.)

- The second part of the proposal, based on the Garrett bill (The Accurate Accounting of Fannie Mae and Freddie Mac Act, H.R. 4653) – would bring greater transparency and accountability to Fannie's and Freddie's obligations by fully reflecting them, and recognizing their debt and Federal debt.

  - Representative Garrett's legislation would make Fannie's and Freddie's debt subject to the Federal debt limit if the agencies are not reformed in a fashion that moves them into the private sector and severs their links to the Federal Government.

  - While CBO has recognized that Fannie's and Freddie's transactions should be included in the Federal budget, the administration's Office of Management and Budget continues to leave them off-budget, recognizing only the cash value of transactions from Treasury and not the full exposure to taxpayers.

BACKGROUND

- Fannie Mae and Freddie Mac have operated as private companies while enjoying government charters for decades.

  - Their public mission is to provide liquidity to the secondary market for residential mortgages. Currently, the mortgages they own or guarantee represent about $5.3 trillion of the U.S. housing market and, in the virtual absence of a private market, they account for almost 75 percent of new mortgage origination.

  - For years, their charters have allowed them to borrow at much lower interest rates than competing institutions and have provided an implicit guarantee that they have been backed by the full faith and credit of the U.S. government.

- After housing values began to nosedive in 2007, Fannie and Freddie experienced record losses on their books, first coming from the risky, private label securities purchased for their portfolios and then spreading to broader types of mortgages and mortgage-backed securities [MBS]. According to CBO, by early 2008, Fannie and Freddie held about $200 billion in risky, private label subprime and Alt-A MBS, and another $500 billion in comparable, high-risk mortgages.

- In September 2008 – after statutory authority had been provided for Treasury to inject capital into Fannie and Freddie earlier that year – the FHFA placed them under conservatorship. This agreement initially gave the Treasury warrants for 79.9 percent in common equity and $1 billion in preferred equity. Since then, the Treasury has injected more than $145 billion in capital into the two GSEs in exchange for additional preferred shares and annual dividends of 10 percent (which are financed by government funds).

- In December 2009, Treasury Secretary Geithner agreed to an unlimited commitment for the next 3 years to provide capital to Fannie and Freddie through its preferred share purchase program.

- According to CBO, the one-time cost to taxpayers of putting Fannie and Freddie under conservatorship – therefore assuming their liabilities – is $248 billion (as reported in *The Budget and Economic Outlook: An Update*," August 2009). Of that amount, $248 billion represents the subsidies associated with the net present value of the cash flows of the GSEs' mortgage commitments, discounted using fair value under Generally Accepted Accounting Principles. Combined with new business, CBO has estimated the credit reform cost of Fannie and Freddie to be $291 billion through 2009, which will grow to a total of $373 billion over the next 10 years absent reform.