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The Rescue of Fannie Mae and Freddie Mac – Module E: The Housing and Economic Recovery Act of 2008[1]

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Abstract

As the U.S. housing crisis worsened in 2007, and through 2008, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) headed towards insolvency. At the same time, contractions in private securitization resulted in these two government-sponsored enterprises (GSEs) purchasing nearly half of all new mortgages. In July, the government passed the Housing and Economic Recovery Act of 2008 (HERA) to provide a more effective regulator and to address ~~public~~ uncertainty regarding whether the government would back the GSEs' assets and liabilities. HERA provided Treasury and the newly formed Federal Housing Finance Agency (FHFA) with the framework needed to stabilize the distressed firms, which by then collectively held or guaranteed over $5 trillion in mortgages and mortgage-related securities. On September 6, the FHFA placed the GSEs into conservatorships and Treasury took steps to ensure their solvency. The steps taken by the government pursuant to HERA avoided the collapse of the GSEs and the concomitant collapse of the U.S. housing market, but did not address the longer-term issues inherent in the GSEs' structure, which remain unresolved as the firms remain in conservatorship.

[1] This case study is one of seven 2021 Yale Program on Financial Stability (YPFS) case studies that examine in detail the various elements of the government's rescue of the GSEs:

- "The Rescue of Fannie Mae and Freddie Mac – Module A: The Conservatorships" by Daniel Thompson and Rosalind Z. Wiggins.
- "The Rescue of Fannie Mae and Freddie Mac – Module B: The Senior Preferred Stock Purchase Agreements (SPSPAs)" by Daniel Thompson.
- "The Rescue of Fannie Mae and Freddie Mac – Module C: GSE Credit Facility" by Emily Vergara.
- "The Rescue of Fannie Mae and Freddie Mac – Module D: Treasury's GSE MBS Purchase Program" by Michael Zanger-Tishler and Rosalind Z. Wiggins.
- "The Rescue of Fannie Mae and Freddie Mac – Module E: The Housing and Economic Recovery Act of 2008" by Daniel Thompson.
- "The Rescue of Fannie Mae and Freddie Mac – Module F: The Federal Reserve's Large-Scale Asset Purchase (LSAP) Program" by Daniel Thompson and Adam Kulam.
- "The Rescue of Fannie Mae and Freddie Mac – Module Z: Overview" by Rosalind Z. Wiggins, Benjamin Henken, Adam Kulam, Daniel Thompson, and Andrew Metrick.

Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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Keywords: GSEs, HERA, The Housing and Recovery Act of 2008, Fannie Mae, Freddie Mac, FHFA, Treasury, liquidity, housing crisis

The Housing and Economic Recovery Act of 2008: United States Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	$14,681.5 billion in 2007 $14,559.5 billion in 2008 $14,628.0 billion in 2009
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	$47,976 in 2007 $48,383 in 2008 $47,100 in 2009
Sovereign credit rating (5-year senior debt)	As of Q4 2007/2008/2009: Fitch: AAA Moody's: Aaa S&P: AAA
Size of banking system	$9,231.7 billion in total assets in 2007 $9,938.3 billion in total assets in 2008 $9,789.1 billion in total assets in 2009
Size of banking system as a percentage of GDP	62.9% in 2007 68.3% in 2008 66.9% in 2009
Size of banking system assets as a percentage of financial system assets	29.0% in 2007 30.5% in 2008 30.3% in 2009
5-bank concentration of banking system	43.9% of total banking assets in 2007 44.9% of total banking assets in 2008 44.3% of total banking assets in 2009
Foreign involvement in banking system	22% of total banking assets in 2007 18% of total banking assets in 2008 19% of total banking assets in 2009
Government ownership of banking system	0% of banks owned by the state in 2008 0% of banks owned by the state in 2009
Existence of deposit insurance	100% insurance on deposits up to $100,000 in 2007 100% insurance on deposits up to $250,000 in 2008 100% insurance on deposits up to $250,000 in 2009
Sources: Bloomberg, World Bank Global Financial Development Database, Federal Deposit Insurance Corporation.	

I. Overview

Note: This article addresses how HERA changed the government's relationship with Fannie Mae and Freddie Mac. It briefly mentions HERA provisions relating to the Federal Home Loan Banks, another GSE, but does not discuss HERA's other functions.

Background

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are large government-sponsored enterprises (GSEs), public-private corporations specially chartered by Congress to enhance the liquidity of the U.S. secondary mortgage market and thereby promote access to mortgage credit, particularly among low- and moderate-income households and neighborhoods (FCIC 2011, 15). The GSEs pursue their mission by buying mortgages conforming to their underwriting standards, guaranteeing payment of the underlying mortgages and packaging the mortgages into mortgage-backed securities (MBS) which they sell to investors (FCIC 2010, 15). They also purchase private-label MBS (PLMBS), which invest in nonconforming mortgages that they hold in their portfolios (FCIC 2010, 23). The GSEs fund their operations by issuing debt and they enjoy a robust market with their debt being widely held.

The firms are publicly traded for-profit companies whose shares are favored by investors large and small. They are governed by their Boards of Directors and shareholders but enjoy numerous advantageous because of their hybrid structure.[4] Although not direct components of the U.S. government, they were often assumed to have the backing of the government due to a number of factors including: their housing mission, their government charter, their favorable statutory treatment, and the $2.25 billion backup credit line that each had from the Treasury Department (CBO 2010; FCIC 2010, 16). Their debt issuances enjoy a favored status among investors, banks, and even the Federal Reserve, similar to debt issued directly by the government (Frame et al. 2015). This "implied government guarantee" of their debt and obligations has been very beneficial to the GSEs in a number of ways including a lower cost of funding in terms of interest paid on debt securities and premiums paid on guarantees of GSE MBS (FCIC 2010, 16; GAO 1996).

GSE Regulation Before July 2008. Several prominent federal officials expressed concerns about the efficacy of GSE regulators at least a decade before the crisis (Bernanke 2012, 8). In 2004, Chairman Alan Greenspan argued that the GSEs' massive balance sheets, dominant role in secondary mortgage, regulatory exemptions, and lack of market discipline created systemic risk in the housing market (Greenspan 2004). During his tenure as Chairman, Ben

[4] The GSEs are publicly traded and privately owned and governed by their Boards of Directors and shareholders but enjoy numerous advantageous because of their hybrid structure. "These statutory benefits include (1) exemption from state and local taxes, (2) a line of credit with the U.S. Treasury up to $2.25 billion, (3) eligibility of their debt to serve as collateral for public deposits, (4) eligibility of their securities for Federal Reserve open-market purchases, (5) eligibility for their corporate securities to be purchased without limit by federally regulated financial institutions, (6) assignment of mortgage-related securities they have issued or guaranteed to the second-lowest credit risk category at depository institutions, and (7) exemption from the registration requirements of the Securities and Exchange Commission" (Jickling 2007).

Bernanke echoed Greenspan's concerns, adding that Fannie Mae and Freddie Mac's low capital limits posed a risk for the housing market and the economy (Paulson 2010, Ch. 1; Bernanke 2015, Ch. 11).

Prior to HERA, Congress had tried and failed to pass legislation to strengthen the GSEs' regulators or create a stronger regulatory agency (Frame and White 2004, 89-93). From the passage of the Federal Housing Enterprises Financial Soundness and Safety Act in 1992[5] until the passage of HERA, Fannie Mae and Freddie Mac were regulated using a two-tiered system: the Department of Housing and Urban Development (HUD) and the Office of Federal Housing Enterprise Oversight (OFHEO), which operated as an independent agency within HUD (Frame and White 2004, 88-89).

HUD monitored the GSEs' commitment to the mission stated in their charter and was charged with determining whether the Enterprises had adequately supplied the secondary mortgage market with loans, particularly for lower-income families and underserved areas (Fishbein 2003, 6-8). HUD, which reviewed new mortgage program proposals from the GSEs, was required to authorize the programs within 45 days of their submission (Fishbein 2003, 6). Under this supervisory process incoming requests were approved by default (unless proven to be unauthorized, not in the public interest, or high-risk) if not rejected by HUD within the 45-day period (Fishbein 2003, 5). Due to its regulatory burden, HUD occasionally chose to not review new GSE programs, such as the GSEs' decision to begin purchasing subprime mortgages for their portfolios (Fishbein 2003, 5).

OFHEO regulated the safety and soundness of Fannie Mae and Freddie Mac (Frame and White 2004, 88). As part of its duties, OFHEO examined the GSEs' financial health, established risk-based capital standards, and ensured the GSEs' compliance with the capital standards (Frame and White 2004, 88). OFHEO used three capital standards to evaluate the GSEs: a risk-based standard, a minimum capital standard, and a critical capital standard (Frame and White 2004, 98). The risk-based standard was intended to consist of enough capital to cover the interest, credit default, and operational risks plus an additional 30% of capital surplus (Frame and White 2004, 98). The established minimum capital standard was 2.5% of assets on the balance sheet and 0.45% of off-balance-sheet assets (Frame and White 2004, 98). The critical capital standard was set to 0.25% of on-balance-sheet and off-balance-sheet assets (Frame and White 2004, 98). OFHEO could seek disciplinary action if the GSEs violated capital standards or the law, which the agency did following the discovery of accounting errors in the early 2000s, but the agency had no authority to change such standards (Frame and White 2004, 90-91, 98-100).

OFHEO's authority and decision to conduct an intervention depended on the GSEs' ability to meet the three capital standards. Based on this capital assessment, Fannie Mae and Freddie Mac fell into four categories of increasing risk: adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized (Frame and White 2004, 99). OFHEO's authority was prescribed by the standard of capitalization of the GSE:

[5] 12 U.S.C. § 4501 *et seq.*

1. If a GSE met all three criteria, it was classified as "adequately capitalized" and required no further action.

2. If the GSE could not meet the risk-based standard, it was considered "undercapitalized," which required the GSE to submit a capital restoration plan to OFHEO and prohibited the GSE from distributing more capital in the short-term.

3. If the GSE failed to meet both the risk-based and minimum capital standards, it was "significantly undercapitalized," which carried the same restrictions as the undercapitalized classification, and additional growth restrictions.

4. If the GSE met none of the three capital standards it was considered "critically undercapitalized," which permitted OFHEO to place the GSE into conservatorship (Frame and White 2004, 99).

Prior to HERA, however, conservatorship was not considered a viable option because OFHEO lacked a mechanism to finance a conservatorship and had no power to delegate losses between debtors and creditors (Frame et al. 2015, 18). In addition, OFHEO was not authorized to initiate a receivership[6] (Frame et al. 2015, 5).

When the mortgage market began to contract during the summer of 2007, OFHEO loosened their portfolio limit and lowered their capital surplus requirements to ensure that the GSEs continued to provide the market with liquidity (FCIC 2011, 310-12). OFHEO raised the GSEs' investment portfolio cap from approximately $728 billion to $735 billion in September 2007 and abolished the cap altogether in March 2008 (FCIC 2011, 312-313). It lowered the capital surplus requirement from 30% to 20% in March 2008 (and from 20% to 15% for Fannie Mae in June 2008), with an understanding that the GSEs would use these loosened restrictions to raise capital (FCIC 2011, 314-315). While Fannie Mae was able to raise $7.4 billion in capital in May, Freddie Mac failed to do so (FCIC 2011, 315).

Despite OFHEO's efforts to mitigate the GSEs' losses, many critics considered it unable to handle the full extent of the crisis (FCIC 2011, 314-315). Ever since its inception in 1992, and increasing overtime as the firms grew, many observers believed that OFHEO's structure and regulatory practices were inadequate to its assigned task (FCIC 2011, 314-315). The agency could not adjust the GSEs minimum capital requirements, as the 1992 statute mandated that they remain at 2.5% and 0.45% of on-balance-sheet and off-balance-sheet assets, respectively (Frame et al. 2015, 5). OFHEO required annual congressional appropriations to function, which subjected the regulator to political interests, particularly because Fannie Mae and Freddie Mac had substantial congressional lobbying teams (Frame et al. 2015, 5). In 2003, then Treasury Secretary John Snow testified before the House Financial Services Committee that there was "a general recognition that the supervisory system for the housing

[6] The key distinction between a conservatorship and a receivership is that the former process is intended to manage the entity through a reorganization or rehabilitation, preserving its assets, and the latter is intended to manage the wind-down or resolution of the entity (Jester et al. 2018, 7-8).

GSEs neither has the tools, nor the stature, to effectively deal with the current size, complexity, and importance of these enterprises" (Frame and White 2004, 89).

Market Instability in 2007-08. When Fannie Mae and Freddie Mac began to post billion-dollar loses at the end of 2007, it became more apparent to government officials that the firms' decision to purchase (and to continue to purchase) risky loans could destabilize the GSEs and, by extension, the entire financial system (FCIC 2011, 309-312). Fannie Mae and Freddie Mac's worsening health increased public concerns about whether the government would guarantee their assets (FCIC 2011, 314-316). In the words of Tim Geithner (then President of the Federal Reserve Bank of New York [FRBNY]), "just about everyone except their captured regulator [OFHEO] agreed [Fannie Mae and Freddie Mac] were woefully undercapitalized" (Geithner 2014, Ch. 5). Market concerns increased on July 7, 2008, when a Lehman Brothers analyst released a report speculating that Fannie and Freddie would not be able to raise the required capital in light of weak market conditions for their stock and the possible effect of a new accounting standard that would require the firms to bring their off-balance sheet entities onto the balance sheet (Paulson 2010; Wingfield 2008). The GSEs' common share prices dropped by more than 16% as a result (Lockhart 2008).

In July 2008, at Fannie Mae's and Treasury Secretary Paulson's requests, the Federal Reserve Board invoked its emergency authority under Section 13(3) of the Federal Reserve Act, enabling the FRBNY to extend a provisional line of credit to Fannie Mae and Freddie Mac (FCIC 2011, 316-317; FRB 2008). This also allowed the Fed—in cooperation with the Office of the Comptroller of the Currency (OCC)—to conduct its own investigation into the GSEs for the first time (FCIC 2011, 317). The review revealed that the GSEs were more financially unstable than previously suspected and might soon become insolvent (FCIC 2011, 317). Treasury also hired a team from Morgan Stanley to review Fannie Mae and Freddie Mac's business operations; their assessment corroborated the Fed and OCC's conclusions (FCIC 2011, 317).

Secretary Paulson, Chairman Bernanke, and OFHEO director James Lockhart increased their lobbying efforts for legislation to create a new regulator that could rescue the GSEs from insolvency, stabilize them, resolve their regulatory issues, and quell general uncertainty in the market (FCIC 2011, 316-317). On July 13, 2008, Secretary Paulson testified before Congress, requesting "GSE reform legislation . . . to have a strong independent regulator that will inject confidence into those institutions and into the markets" (Paulson 2008). Paulson stressed that the new regulator should have the financial capacity—with the backing of Treasury—to stabilize the GSEs (Paulson 2008). Offering an analogy to support his request, Paulson argued that Treasury required a "bazooka" that it could threaten to use to increase confidence in the stability of the agencies (FCIC 2011, 316-317).

Program Description

On July 30, 2008, the government passed the Housing and Economic Recovery Act (HERA). Among other things, the bill merged OFHEO, the Federal Housing Finance Board, and HUD's GSE Oversight Team into the newly created Federal Housing Finance Agency (FHFA), and enabled the FHFA and its new director, James Lockhart, to exercise significantly increased authority over Fannie Mae and Freddie Mac[7] (FHFA 2008, 15).

Beginning in August 2008 and continuing during the first three months of the conservatorship, the FHFA absorbed employees from OFHEO, HUD, and the Federal Housing Finance Board (FHFB); the move interfered with FHFA's ability to act as conservator (FHFA 2008, 15). Under HERA, OFHEO and the FHFB had a year to wind down their operations and integrate into the FHFA (HUD's non-GSE-related duties would remain operational) (FHFA 2008, 15). However, the FHFA's decision to enact a GSE conservatorship seems to have accelerated this process to less than three months; the FHFA absorbed all OFHEO and FHFB employees and operations by October 27, 2008 (FHFA 2008, 15). The FHFA later reported that overseeing the GSEs as conservator while simultaneously managing a major reorganization integrating new employees and operations had created "administrative and cultural challenges in merging information technologies and systems, financial and human resources functions, and operational differences" (FHFA 2009, 30). In effect, the FHFA was stressed with creating itself at the same time that it was charged with managing the GSEs and stabilizing the U.S. mortgage market.

Enhanced Safety and Soundness Regulation

Like OFHEO, the FHFA could restrict asset growth if it found a GSE to be undercapitalized (Frame and White 2004, 99; HUD 2008; HERA 2008). However, the FHFA could also adjust minimum and risk-based capital standards (Frame 2009, 10; HERA 2008, 111-12). The FHFA could use cease-and-desist authority and remove company officers (HUD 2008). It was also given power to review and approve the GSEs' new products (previously the authority of HUD) (HERA 2008, §1121-23; HUD 2008). The FHFA no longer needed congressional approval for its budget, providing it increased latitude (Frame 2009, 10).

Based on the severity of the GSEs' undercapitalization, the FHFA could restrict their capital distributions, force them to change their leadership, or—in the most severe cases of undercapitalization—place them in a conservatorship or a receivership (HERA 2008, §1145; HUD 2008). After enacting a conservatorship, the FHFA could stabilize Fannie Mae and Freddie Mac by any means necessary and could access funds from the Treasury if needed (Jickling 2008, 2-3). The conservatorship provision in HERA was intended to be similar to the power of the FDIC over insolvent depository institutions, but unlike bank regulators, the FHFA did not need to resolve the insolvency at the lowest possible cost (Jickling 2008, 2).

[7] HERA also designated the FHFA director to serve as director of the Federal Home Loan Banks (FHLBs), which are a collection of 11 banks that lend to institutions, mainly commercial banks and thrifts, for purposes related to housing (FHFA 2008, 23-26; HERA 2008, Title II). The FHLBs experienced financial difficulties as the result of contractions in the housing markets, but not to the same severity as Fannie Mae and Freddie Mac (FHFA 2008, 3-6). HERA provided Treasury with the same emergency capability to stabilize the FHLBs that it allowed for the GSEs (HERA 2008, Title II; HUD 2008). Treasury never exercised its emergency authority related to the FHLBs (Frame et al. 2015, 17).

After passage of HERA, FHFA continued to use statutory capital requirements to analyze the health of Fannie Mae and Freddie Mac, which gave the impression that Fannie and Freddie were more financially sound than they actually were (FCIC 2011, 318). Secretary Paulson claims that this approach left the FHFA unable to access the capital needs of the market (Paulson 2010, Ch. 1). Bernanke concurred with Paulson, adding that Federal Reserve officials had warned the regulator that the GSEs' capital limits were too low (Bernanke 2015, Ch. 11). During this time, the GSEs capital levels were less than 2% (FCIC 2011, 309).

Consultation with the Federal Reserve

HERA recognized the role that the Federal Reserve played in regulating banks and financial stability by requiring the FHFA director to "consult with the Fed chairman" regarding:

> The risks posed by the regulated entities to the financial system, prior to issuing any proposed or final regulations, orders, and guidelines with respect to the exercise of the additional authority provided in this Act regarding prudential management and operations standards, safe and sound operations of, and capital requirements and portfolio standards applicable to the regulated entities (HERA 2008, §1118).

The director was also to consult with the Fed chairman regarding any decision to place a GSE (including a FHLB bank) into conservatorship or receivership and to periodically share information about with "capital, asset and liabilities, financial condition, and risk management practices" of the GSEs and any information relating to financial stability (HERA 2008, §1118). This consultative relationship expired on December 31, 2009.

Treasury Funding

While the FHFA was the GSEs' regulator, HERA enabled Treasury to serve as a potential financial stopgap for Fannie Mae or Freddie Mac during a conservatorship (HUD 2008). Under Section 1117 of HERA:

> Treasury is authorized to purchase any obligations and other securities issued by the Corporation . . . , on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine. Nothing in this subsection requires the Corporation to issue obligations or securities to the Secretary without mutual agreement between the Secretary and the Corporation. Nothing in this subsection permits or authorizes the Secretary, without the agreement of the Corporation, to engage in open market purchases of the common securities of the Corporation.

Treasury could exercise its broad emergency powers once it determined that its actions were necessary to:

1. provide stability to the financial markets;
2. prevent disruptions in the availability of mortgage finance; and
3. protect the taxpayer (HERA 2008; HUD 2008).

Once it made this "emergency determination" Treasury could inject the GSEs with capital by purchasing an unlimited amount of their securities or debt, provided, however, that such authority was exercised prior to December 31, 2009, as also provided in the HERA (HERA 2008, §1117; Jickling 2008, 2-3).

The December date represents a compromise of design—unlimited authority but limited as to time—which made the bill palatable to legislators who were thought unlikely to grant a total blank check without any limits (Jester et al. 2018, 3-5). While this compromise recognized that it was to be a temporary authority to address the emergency situation at hand, it also acknowledged that the true scope of what might be needed to stabilize the GSEs was unknown (Jester et al 2018, 9-10). Concurrent with the passage of HERA, the federal debt ceiling was also expanded by $800 billion to $10.6 trillion to accommodate any emergency financing (FCIC 2011, 317; Jester et al. 2018, 8-9).

Fannie Mae and Freddie Mac were also subject to additional guidelines, most prominently conforming loan limits, which capped the maximum size of the loans that the GSEs could purchase from originators (Frame et al. 2015, 2-3; HERA 2008, §1124). HERA also established a new formula for calculating the GSEs' conforming loan limit, which provided the conforming loan limit would not exceed $417,000 for single-family units, and could be adjusted annually based on housing prices (HERA 2008, §1124). The conforming loan limit could not be reduced; only increased (HERA 2008, §1124).

The Rescue Plan

On September 7, 2008, with Fannie Mae and Freddie Mac near insolvency and facing liquidity difficulties, Treasury and the FHFA (in consultation with the Fed, as required) announced a four-part rescue plan to stabilize the firms: (1) place the GSEs into conservatorships[8]; (2) enter into senior preferred stock agreements to guarantee the solvency of each GSE; (3) establish a secured credit facility with each GSE; and (4) purchase GSE MBS (FHFA 2008, 9-11).

Figure 1: Programs Developed Using HERA

Name of intervention	Funding limit	Time limit
Conservatorships	Not applicable.	Unlimited
SPSPAs	Initially, $200 billion aggregate. Potentially unlimited.	Unlimited
Credit Facility	No limit stated.	To expire December 31, 2009

[8] The FHFA took Fannie Mae and Freddie Mac under separate conservatorships. We herein discuss the two conservatorships as one due to the similarities between the two structures.

MBS Purchase Program	At the discretion of the Treasury Secretary. No limit stated.	To expire December 31, 2009

Sources: HERA; Treasury 2008a; Treasury 2008b, Treasury 2008c, Jester et al. 2019.

Conservatorship is "a statutory process designed to stabilize a troubled institution with the objective of returning the entities to normal business operations" (FHFA 2008a). The decision to place the enterprises into conservatorship was based on a finding that they could not independently "continue to operate safely and soundly and fulfill their critical public mission" (FHFA 2008a). As conservator, the FHFA had broad authority to operate the firms until they were stabilized and released form the conservatorships or put into receivership.

The second and third components of the rescue plan permitted the Treasury to inject long-term and short-term funding, respectively, into the GSEs to ensure that they remained solvent (Frame et al. 2015, 16-17). Pursuant to the senior preferred stock purchase agreements (SPSPAs), the Treasury received GSE preferred stock (paying a 10% dividend) and a warrant to acquire 79.9% of the firms' common stock for a nominal price in return for providing draws to maintain a positive net worth for the GSEs[9] (Frame et al. 2015, 16-17). The final part allowed Treasury to purchase GSE MBS, which would help sustain Fannie Mae and Freddie Mac in their key role as issuers (Frame et al. 2015 16-17).

While Fannie Mae and Freddie Mac faced different problems (e.g. Freddie Mac had a larger capital hole), the government decided to adopt the same approach to resolve both GSEs (Paulson 2010, Ch. 1). In defense of treating Fannie Mae and Freddie Mac the same, Paulson argued that the market saw them as the same, as the market believed both had the implicit guarantee of the U.S. government (Paulson 2010, Ch. 1).

Outcomes

Fannie Mae and Freddie Mac continued to sustain significant losses until 2012, and often had to draw funds under the SPSPAs to meet its liquidity requirements including funding the dividend payments it made to Treasury (Frame et al. 2015, 17; Thompson 2021b). Prior to 2012, Treasury invested $187.5 billion in draws pursuant to the SPSPA (Frame et al. 2015, 16). It also purchased $225 billion GSE MBS (Frame et al. 2015, 17). The Fed invested an additional $1,270.4 billion: $134.5 billion in GSE debt and $1,135.9 billion of GSE MBS purchased (FHFA 2019).

In August 2012, the SPSPAs were amended to require that, in lieu of dividend payments, the GSEs would pay all realized profits, after a stated capital buffer, to the Treasury (Thompson

[9] The "keepwell" structure of the SPSPAs enabled the GSEs to continue to draw funding from Treasury even after the December 31, 2009, deadline stated in the HERA (Jester et al. 2018). Generally, a keepwell agreement is a contractual relationship between a parent company and subsidiary in which the parent promises to maintain the subsidiary's minimum regulatory capital (Jester et al. 2018). For details of this structure see Thompson (2021b).

2021b, sec. "Program Description").[10] Beginning in 2012 and continuing through to the date of this case's publication, the GSEs have posted annual profits. As of the fourth quarter of 2018, Fannie Mae and Freddie Mac have paid a combined $292.3 billion to Treasury in dividends and have received $191.5 billion in draws (Frame et al. 2015, 17; Thompson 2021b).

II. Evaluation

HERA provided the tools that the government needed to stabilize Fannie Mae and Freddie Mac in 2008. By doing so, the two GSEs were able to continue to support the U.S. housing market by buying a substantial number of mortgages when private securitization had evaporated.

Over the course of the conservatorship, GSE shareholders have filed several lawsuits challenging the government's sweep of profits pursuant to the 2012 amendment of the SPPSA; lawsuits are still pending as of this case's publication (Frame et al. 2015, 26; Hurley 2020).

Some critics have claimed that the continuing conservatorships have created uncertainty, causing lenders to tighten their underwriting standards (Frame et al. 2015, 27-28). There have been several proposals for reforming the GSEs by various constituencies, but no resolution has emerged (Frame et al. 2015, 30). As of the date of this memo, the firms continue to operate under conservatorship and the amended SPSPAs.

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[10] The payments did not reduce the GSEs' debt to Treasury, which was largely embodied in the liquidation preference of the senior preferred stock. See Thompson (2021b), for further description of the liquidation preference and also of post-2012 amendments to the SPSPAs.

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