



Fannie Mae's and Freddie Mac's Financial Problems

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Summary

The decision to place Fannie Mae and Freddie Mac in conservatorship raises questions about their impact on the housing and finance markets. To a certain extent, the housing, mortgage, and even general financial markets are in an unprecedented situation.

This action by their new regulator, the Federal Housing Finance Agency (FHFA), came after turmoil in the housing, mortgage, and financial markets has raised doubts about the future of Fannie Mae and Freddie Mac, which are chartered by Congress as government-sponsored enterprises (GSEs) and were widely believed to have an implicit guarantee from the federal government.

The Treasury will buy mortgage-backed securities from the GSEs and raise funds for them. Each GSE gave Treasury \$1 billion in senior preferred stock and warrants to acquire, at nominal cost, 80% of each GSE. Treasury pledged to invest up to \$100 billion in each GSE, and committed to invest more if necessary. Now the formerly implicit guarantee is nearly explicit.

The Federal Reserve earlier took actions to allow Fannie and Freddie to borrow directly from the discount window, a privilege normally available only to primary securities dealers and banks that are member of the Federal Reserve System. The Securities and Exchange Commission has issued an emergency order restricting short selling of Fannie and Freddie's stock.

The FHFA replaced the Office of Federal Housing Enterprise Oversight (OFHEO) as the GSEs' safety and soundness regulator. OFHEO repeatedly assured investors that Fannie and Freddie have adequate capital, but as highly leveraged financial intermediaries, Fannie Mae and Freddie Mac had limited capital to cushion them against losses.

This report will be updated as warranted.

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This report presents in question and answer form the issues surrounding the financial conditions of Fannie Mae and Freddie Mac.

Questions About Conservatorship

What Is Conservatorship?

Conservatorship of Fannie Mae and Freddie Mac (which are government-sponsored enterprises or GSEs) involves the Federal Housing Finance Agency (FHFA) taking control of the GSEs. As conservator, the powers of the Board of Directors, officers, and shareholders are transferred to FHFA. A conservator can also cancel certain contracts. This is authorized by the Housing and Economic Recovery Act of 2008 (P.L. 110-289). The goal of conservatorship is to preserve the GSE's assets and to return it to sound financial condition that will allow the conservatorship to be ended.

Why Did the FHFA Place Fannie Mae and Freddie Mac Under Conservatorship?

As regulator of Fannie Mae and Freddie Mac, FHFA announced that it had placed Fannie Mae and Freddie Mac under conservatorship because of their deteriorating financial position and the “critical importance” that each company has to the continued functioning of the residential financial markets.¹

FHFA has said that continuing audits of the GSEs determined that their financial positions were weaker than previously thought and that the GSEs were unlikely to survive without conservatorship. FHFA cited previous public statements that the GSEs needed to increase their capital and needed to strengthen management controls over operations.

Why Did FHFA Act on September 7, 2008, Instead of Earlier or Later?

FHFA, in general, followed the same approach that the Federal Deposit Insurance Corporation uses when it places a bank in conservatorship: a series of requests for changes to the corporation and increased capital followed by the sudden takeover. Providing a deadline could provide the regulated entity with an incentive to take risky gambles in a last attempt to avoid being seized by the government. The FDIC usually seizes a bank by suddenly showing up on a Friday afternoon, closing the bank, and locking the doors. This gives it time to make necessary changes over the weekend and resume business operations on the next business day.

According to media reports, some large foreign investors had been reducing their holdings of GSE debt, mortgage-backed securities (MBS), and stock.² This would have made it more difficult

¹ Federal Housing Finance Agency, *Statement of FHFA Director James B. Lockhart*, September 9, 2008, available at <http://www.ofheo.gov/newsroom.aspx?ID=456&q1=1&q2=None>.

² Deborah Solomon, Michael Corkery, and Liz Rappaport, “Mortgage Bailout Is Greeted With Relief, Fresh Questions,” *Wall Street Journal*, September 9, 2008, p. A1.

for the GSEs to borrow money to finance their portfolios going forward. For example, Bank of China, Ltd. is reported to have sold or not replaced maturing \$4.6 billion of GSE debt, which reduced its GSE debt holdings to \$17.3 billion as of June 30, 2008. These same media reported that Treasury officials contacted foreign central banks and others to reassure them of the creditworthiness of GSE debt.

FHFA worked with Treasury, the Fed, and the GSEs over the weekend of September 6 and 7, 2008. OFHEO and FHFA continue to take administrative actions to transfer authority and resources to FHFA. For example, on September 4, 2008, FHFA announced that it was publishing a legal notice of its existence in the *Federal Register*.³

What Will Treasury Contribute?

Fannie Mae and Freddie Mac have signed contracts to issue new senior preferred stock to the Treasury, which has agreed to purchase up to \$100 billion of this stock from each of the GSEs.⁴ If necessary, the Treasury has agreed to contribute cash in the amount equal to the difference between each GSE's liabilities and assets. Effective immediately (September 7, 2008), each GSE issued Treasury \$1 billion of senior preferred stock and warrants (options) to purchase common stock. If the warrants are exercised, Treasury would own 79.9% of each company.

As part of the contracts, each GSE has agreed to restrictions on paying dividends, issuing new stock, and disposing of assets. The GSEs can increase their respective retained portfolio of mortgages and MBS to \$850 billion as of December 31, 2009, but have to reduce their respective portfolios by at least 10% annually until each reaches \$250 billion.⁵ If a GSE were to reduce an \$850 billion portfolio by 10% annually, it would take more than 10 years to reduce it to \$250 billion.

Treasury agreed to make open market purchases of GSE MBS.⁶ There are no specific limits to these purchases, but they are subject to the statutory limit on the federal government's debt. Treasury has said that it expects to profit from the spread between the interest rate that it pays to borrow money through bonds and the mortgage payments on the MBS. The GSEs will guarantee payment of the MBS. This program expires December 31, 2009.

Treasury agreed that if the GSEs have difficulty borrowing money, Treasury will create a Government Sponsored Enterprise Credit Facility (GSECF) to provide liquidity to the GSEs, secured by MBS pledged as collateral.⁷ This facility will terminate December 31, 2009.

³ U.S. Federal Housing Finance Agency, "Establishment of a New Independent Agency," 73 *Federal Register* 52356, September 9, 2008.

⁴ U.S. Treasury, *Fact Sheet: Treasury Senior Preferred Stock Purchase Agreement*, September 9, 2008, available at http://www.treas.gov/press/releases/reports/pspa_factsheet_090708%20hp1128.pdf.

⁵ According to Fannie Mae's quarterly report for the quarter ending June 30, 2008, its mortgage portfolio was worth \$754 billion. According to Freddie Mac's quarterly report for the quarter ending June 30, 2008 its mortgage portfolio was worth \$792 billion. Available at <http://www.fanniemae.com/ir/earnings/index.jhtml> and http://ir.10kwizard.com/files.php?source=1372&welc_next=1&XCOMP=0&fg=23, respectively.

⁶ U.S. Treasury, *Fact Sheet: GSE Mortgage Backed Securities Purchase Program*, September 9, 2008, available at http://www.treas.gov/press/releases/reports/mbs_factsheet_090708hp1128.pdf.

⁷ U.S. Treasury, *Fact Sheet: Government Sponsored Enterprise Credit Facility*, September 7, 2008, available at http://www.treas.gov/press/releases/reports/gsecf_factsheet_090708.pdf.

Future

What Are Congress' Options for Restructuring the GSEs?

Going forward, Congress has many options for reorganizing Fannie Mae and Freddie Mac, including (but not limited to) the following:

- It could decide not to change their structure. However, since the Treasury has pledged financial support to the GSEs, the claim that the federal government does not support Fannie Mae and Freddie Mac might not be believed. In this case, some might argue that it is inappropriate to provide financial support of two mortgage companies, but not to others. It should be noted that Treasury has not announced a direct guarantee of outstanding GSE debt. Treasury has said that it will lend to the GSEs whatever funds are necessary so that the GSEs can pay their debt. This arguably allows the statement that the federal government does not guarantee GSE debt to remain technically accurate.
- Congress could make Fannie Mae and Freddie Mac part of the government. Both GSEs were originally government corporations and this would be a return to that environment.
- Fannie Mae and Freddie Mac could become Federal Home Loan Banks. The 12 regional banks are a collective GSE that is owned by their member institutions, and their stock is not publicly traded.
- Fannie Mae and Freddie Mac could be split up into a large number of GSEs. Instead of two GSEs that are “too big to fail,” there would be ten or some other number of smaller GSEs that would each be small enough to fail. Congress might wish to explicitly state what the risks to stockholders, bondholders, and business partners would be.
- Fannie Mae and Freddie Mac (and possibly additional new GSEs) could be converted into “utilities.” Each could issue MBS possibly guaranteed by the federal government, which would charge a fee for the guarantee. There are a number of options for how the fees could be set. The government could establish a standard fee or it could auction off the right to issue a specific amount of MBS.
- The government could sell new GSE charters to the highest bidders.
- Treasury Secretary Henry M. Paulson, Jr. has proposed using bonds backed not only by the issuing corporation's legal obligation of repayment, but also by the pledge of specific collateral as a way to allow banks to supplement, or even replace, the GSEs' role in mortgage markets.⁸

⁸ Henry M. Paulson, Jr., Secretary of the Treasury, “Remarks by Secretary Henry M. Paulson, Jr. on Recommendations from the President's Working Group on Financial Markets,” press release, March 13, 2008, available at <http://www.ustreas.gov/press/releases/hp872.htm>.

What Will Happen to Fannie Mae's and Freddie Mac's Affordable Housing Initiatives?

There have been no official announcements concerning the GSEs' affordable housing initiatives. Both the housing mortgage goals set previously set by the Department of Housing and Urban Development and the new national housing trust contained in the Housing and Economic Recovery Act of 2008 can be suspended if a GSE requests this and presents sufficient justification. Section 1128 of the act allows FHFA to revise the housing goals and Section 1131 of the act allows FHFA to suspend contributions.

What Will Happen to Stockholders and Other Stakeholders?

The powers of common stockholders, who formerly elected the boards of directors and approved certain enterprise actions, are suspended. The conservator has assumed all of their authority. Previously, the common stockholders owned 100% of the GSEs. As a result of the warrants issued to the Treasury, they could own only 20% of the enterprises. In the long run, 20% of a healthy enterprise could be more than 100% of GSEs' whose liabilities exceed their assets. In the short run, the price of the GSEs' common stock has declined, but if the GSEs recover, stockholders be better off compared to their situation at the time that conservatorship was undertaken.

To the extent that current and former employees have invested in common stock, in the short run they are likely to see a decline in the value of their financial assets; the long run outcome is not clear. Both GSEs had employee stock and option plans. The GSEs' agreements with Treasury prohibits issuing new stock. Consequently those programs cannot continue until the GSEs emerge from conservatorship.

GSE employees, except for the chief executive officer (CEO) of each enterprise, are being urged by FHFA to continue working as before. The CEOs are replaced, but have agreed to assist in the transition. Employees may decide to look for other employment, but the decision is theirs.

While the conservator is authorized by federal law to cancel certain contracts, FHFA has said that current contracts continue in force.

Who Invests in the GSEs?

There is little information available about who holds GSE stock, bonds, and MBS. The Fed reports statistics for combined ownership of government agency and GSE debt and GSE MBS. At the end of 2007, non-United States investors held \$1.479 trillion of \$7.397 trillion. Other large investors were U.S. commercial banks (\$929 billion), life insurance companies (\$388 billion), state and local government retirement funds (\$317 billion), mutual funds (\$566 billion), asset-backed securities issuers (\$378 billion), and the GSEs themselves (\$710 billion).

More recent reports from the GSEs show more than 40% of certain debt issues being held by foreign central banks.

What Will Happen to Executive Compensation?

The Housing and Economic Recovery Act strengthened FHFA's regulation over executive compensation and golden parachutes. The senior preferred stock agreement signed by each GSE with FHFA requires the GSEs to get approval for new compensation agreements with executives. After accounting irregularities were uncovered in 2003 and 2004, OFHEO sued Fannie Mae's and Freddie Mac's previous CEOs (Franklin D. Raines and Leland C. Brendsel, respectively) to recover part of their compensation; in both cases, out of court settlements were reached which included the payment of fines and donations to charities.

When Will Conservatorship End?

The conservatorship will end when FHFA determines that Fannie Mae and Freddie Mac have adequate capital and have improved their controls and risk management sufficiently. The Housing and Economic Recovery Act charges FHFA with developing new capital standards for the GSEs to replace those established in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (P.L. 102-550). While it is reasonable to expect that conservatorship will end either with the GSEs' recovery, or with their being placed in receivership and liquidated, there is nothing mandating this outcome.

Context

Why Did Fannie Mae's and Freddie Mac's Stock Prices Decline over the Last Year?

Changes in the perception of the risks that Fannie Mae and Freddie Mac face—in terms of future profitability and even continued financial viability—has reduced the price that investors are willing to pay for a share of the enterprises. There was also concern that intervention by the federal government would reduce the value of the common stock.

Between the end of 2007 and August 1, 2008, Fannie's stock lost 72% of its value, while Freddie's fell by 77%. As part of the Treasury's financial aid package of September 7, 2008, the GSEs agreed to issue warrants to the Treasury worth 79.9% of their outstanding stock. If Treasury were to exercise the warrants, current stockholders would own 20% of each enterprise. This is one explanation why the GSEs' stock prices declined further since September 7, 2008.

Fannie Mae and Freddie Mac are GSEs whose charters limit them to buying single family and multifamily home mortgages originated by others. This lack of diversification makes them more exposed to housing and mortgage market problems than other financial institutions such as commercial banks that have other lines of business. The GSEs have a special relationship with the federal government, sometimes called an implicit guarantee, that has allowed them to borrow at interest rates only slightly above those paid by the federal government.

The two GSEs were very highly leveraged versions of banks: they borrow money to lend, and they maximize profits by keeping their capital reserves close to the minimum permitted by their regulators. Like banks, the GSEs are required by law and by their regulators to maintain a certain ratio between their loans and reserves to protect against loan losses. A key component of reserves

is shareholders' equity or the current value of the shareholders' investments. However, unlike banks the GSEs can only purchase home mortgages that others have made.

Has Anything like Placing Fannie Mae and Freddie Mac under Conservatorship Ever Happened Before?

This is the first time that a GSE has been placed under conservatorship. It appears to also be the first time that the federal government has made a continuing commitment to a company (other than government companies). On a more general level, the federal government has intervened in the past to assist many companies.⁹

What Has Congress Done Previously to Improve the Financial Condition of the GSEs?

Congress has previously acted to assist GSEs that were in financial difficulty. When Fannie Mae was losing significant amounts of money in 1982, Congress passed the Miscellaneous Revenue Act of 1982 that provided some tax benefits for Fannie Mae.¹⁰ The Farm Credit System, another GSE, was aided with the Agricultural Credit Act of 1987, which authorized the issuance of \$4 billion in bonds to support system members.¹¹

Section 1117 of the Housing and Economic Recovery Act of 2008 (H.R. 3221, P.L. 110-289) authorizes the Treasury to purchase any amount of GSE securities—debt or equity—if necessary to provide stability to financial markets, prevent disruptions in the availability of mortgage credit, or protect the taxpayer. This means that if either of the two GSEs becomes unable to raise funds in private markets, the federal government could simply purchase the debt securities that the firms were unable to sell elsewhere, or recapitalize either firm by purchasing stock, possibly becoming the majority shareholder. This authority expires on December 31, 2009.

This action sent a signal to the markets that the Treasury was prepared to intervene rather than let either GSE fail. If this had been enough to maintain confidence and to persuade investors to continue to purchase GSE debt, no Treasury purchases would have been necessary.

What Are Other Actions the Federal Government Has Taken to Address the Financial Condition of the GSEs?

Under existing law (including the Housing and Economics Reform Act), Treasury, the Federal Reserve, and FHFA currently have the power to take certain actions. Even prior to the act, the GSEs' charters authorized the Secretary of the Treasury to lend each GSE \$2.25 billion, but this is more a symbolic amount than a total solution. On the basis of Fannie Mae's issuance of \$1.588 trillion in short term debt in 2007, the \$2.25 billion would have lasted less than 12.5 hours. On

⁹ CRS Report RL34423, *Government Interventions in Financial Markets: Economic and Historic Analysis of Subprime Mortgage Options*, by N. Eric Weiss discusses some of these actions.

¹⁰ P.L. 97-362, 96 Stat. 1726 et seq.

¹¹ P.L. 100-233, 101 Stat. 1568 et seq.

the basis of the \$598.6 billion of short term debt that Freddie Mac issued in 2007, the \$2.25 billion would have lasted just under 33 hours.¹²

On July 13, 2008, the Federal Reserve Board of Governors granted the New York Fed the authority to lend directly to the GSEs.¹³ Section 1118 of P.L. 110-289 requires the new GSE regulator to consult with the Fed to ensure financial market stability.

In addition to the Fed's general authority to be a lender of last resort, the GSEs' charters give the GSEs a special relationship to the nation's central bank.¹⁴ The Federal Reserve can use the GSEs' bonds purchased on the secondary market for open market operations.¹⁵ This could indirectly help the GSEs by adding to the demand for their debt and increasing its liquidity.

On July 15, 2008, the Securities and Exchange Commission (SEC) issued an emergency order restricting short selling in the stock of 19 financial institutions, including Fannie and Freddie.¹⁶ The SEC acted to prevent the possibility that false rumors could drive share prices down and cause the market to lose confidence, thereby cutting off the firms' access to credit markets, as happened to Bear Stearns in March 2008. The order restricting short sales of Fannie Mae and Freddie Mac stock was renewed on July 29, 2008 and expired on August 12, 2008 at 11:59 pm.

What Was Fannie Mae's and Freddie Mac's Financial Position?

In placing the GSEs under conservatorship, their new regulator, FHFA, has said that they need assistance to survive. FHFA reported that changes in the economy and the GSEs' slow recovery from their earlier accounting and financial problems reduced their financial strength.¹⁷

The Office of Federal Housing Enterprise Oversight (OFHEO), which was Fannie Mae's and Freddie Mac's safety and soundness regulator before July 30, 2008, repeatedly said that the GSEs had adequate capital.¹⁸ In other words, according to OFHEO, the GSEs had sufficient funds to survive their current financial difficulties.

This statement was difficult to verify independently. Details of the GSEs' portfolios and guarantees contain confidential proprietary information. In broad terms, the GSEs purchased slightly more than \$169 billion of private label subprime MBS in 2006 and 2007; they purchased slightly less than \$58 billion of Alt-A MBS in the same time period out of combined total

¹² Freddie Mac, *Debt Issuance by Trade Date*, available at <http://www.freddiemac.com/debt/data/cgi-bin/debtissuance.cgi?order=TD>.

¹³ Federal Reserve Board of Governors, *Press Release*, July 13, 2008, available at <http://www.federalreserve.gov/newsevents/press/other/20080713a.htm>.

¹⁴ The Fed's lender of last resort authority is delineated at 12 U.S.C. 343. Fannie Mae's charter is at 12 U.S.C. 1716b et seq; Freddie Mac's charter is at 12 U.S.C. 1401.

¹⁵ 12 U.S.C. 347c.

¹⁶ <http://www.sec.gov/rules/other/2008/34-58166.pdf>.

¹⁷ FHFA, *Statement of FHFA Director James B. Lockhart*, September 9, 2008. Available at <http://www.ofheo.gov/newsroom.aspx?ID=456&q1=1&q2=None>

¹⁸ OFHEO, *Statement of OFHEO Director James B. Lockhart*, July 10, 2008, available at <http://www.ofheo.gov/newsroom.aspx?ID=440&q1=1&q2=None>.

mortgage purchases of \$1.677 trillion.¹⁹ At the end of 2007, the subprime and Alt-A MBS represented 13.5% of the GSEs' total assets.

Prior to 2007, the GSEs had not reported a combined loss for a full year since 1982.²⁰ **Table 1** summarizes the losses and profits that Fannie Mae and Freddie Mac have made since 2006. They started 2006 earning quarterly profits, but in the third quarter (July, August, and September) lost money. They were profitable for the entire year of 2006 and in each quarter of 2007 until the third quarter. They have not had a profitable quarter since. For the entire year of 2007, the two GSEs reported combined losses of slightly less than \$5.2 billion. To make certain that the GSEs have adequate funds to cover potential losses, FHFA (like all financial regulators) imposes capital requirements. At the end of 2007, the two GSEs had a \$24.8 billion surplus more than the regulatory capital requirement of \$58.4 billion; they had a surplus of \$50.8 billion more than the risk-based capital requirement of \$38.8 billion.²¹ These amounts can be compared with the combined retained mortgages portfolios of \$1.434 trillion and the \$3.501 trillion in MBS that the GSEs guaranteed for a total of \$4.934 trillion.²²

Table 1. GSE Profitability Since 2006
(\$ millions)

	Fannie Mae	Freddie Mac
1 st Quarter 2006	\$2,026	\$1,942
2 nd Quarter 2006	\$2,058	\$1,336
3 rd Quarter 2006	-\$629	-\$550
4 th Quarter 2006	\$604	\$401
Full Year 2006	\$4,059	\$2,327
1 st Quarter 2007	\$961	-\$133
2 nd Quarter 2007	\$1,947	\$729
3 rd Quarter 2007	-\$1,399	-\$1,238
4 th Quarter 2007	-\$3,559	-\$2,452
Full Year 2007	-\$2,050	-\$3,094
1 st Quarter 2008	-\$2,186	-\$151
2 nd Quarter 2008	-\$2,300	-\$821

Source: Fannie Mae (<http://www.fanniemae.com/ir/>) and Freddie Mac (<http://www.freddie.com/investors/>).

The regulatory capital surplus amounted to 0.50% of the \$4.934 trillion and 1.03% of the risk-based capital surplus. If the GSEs were to face losses in excess of their income by these percentages, they would be forced to either reduce their capital requirements by selling mortgages and MBS from their portfolios or raise new capital from investors. The GSEs hold subprime and

¹⁹ OFHEO, p. 113 and 116. Subprime and Alt-A MBS purchases prior to 2006 are not available.

²⁰ OFHEO, p. 115.

²¹ OFHEO, p. 120.

²² OFHEO, p. 116.

Alt-A MBS that are far in excess of their surplus capital. OFHEO reported that the credit quality of the GSEs mortgage portfolios declined in 2007.²³

Risks

What Risks Do Fannie Mae and Freddie Mac Face in Today's Economic Environment?

Fannie Mae and Freddie Mac purchase home mortgages. They package some for sale as MBS and hold others in their investment portfolios. The GSEs guarantee timely payment of principal and interest of the mortgages in their MBS. As mortgage foreclosure rates have climbed since 2006, and as home prices have fallen, the value of the mortgages and MBS that the two firms hold in their portfolio has also fallen. Uncertainty about the duration and severity of the housing slump means that markets cannot now gauge the riskiness of the GSEs with much confidence or precision. The Treasury's support has reduced this risk, but it is not clear if stockholders will benefit.

The GSEs finance their portfolios of long-term (typically 30-year) mortgages with short-term borrowing (typically three months to five years). This increases the GSEs' profits because short-term borrowing is usually less expensive than longer term loans. This creates *interest rate risk*, which is the risk that if short-term interest rates increase, profitability can be reduced or can even turn to losses. To try to reduce these risks, the GSEs use a variety of financial derivatives.

In a worst case scenario, the interest rate on short-term loans to the GSEs could increase enough to cause substantial losses and investors could stop entering into derivative contracts with the GSEs.²⁴ This would leave the GSEs, who anticipated being able to roll over their short term debt, unable to refinance.

Treasury's financial promises of a GSE Credit Facility (GSECF) and to purchase MBS greatly reduces these risks.

What Risks Do Fannie Mae and Freddie Mac Create for the U.S. Government?

There is the risk that one or both GSEs will be unable to repay the loan. This risk that this could result in a loss to the federal government is reduced by requiring collateral in the form of MBS, but the value of such collateral could decline.²⁵ The initial \$1 billion of preferred stock paying a 10% annual dividend (\$100 million annually) reduces the risk to Treasury of loss.

²³ OFHEO, pp. 20-21, 33-34.

²⁴ A derivative is a financial contract whose value is linked to another financial instrument, price, or variable. For example, two companies could trade a derivative whose value was linked to the difference in the interest rates on two-year and ten-year Treasury bonds.

²⁵ The government has received stock in previous market interventions and has sometimes returned a small profit. See CRS Report RL34423, *Government Interventions in Financial Markets: Economic and Historic Analysis of Subprime Mortgage Options*, by N. Eric Weiss.

What Risks Do Fannie Mae's and Freddie Mac's Financial Problems Create for Homeowners and Those Planning to Become Homeowners?

Fannie Mae's and Freddie Mac's financial problems create no risks for homeowners who want to stay in their homes and who do not want to refinance. Homeowners would continue to pay their existing mortgages the same way as they do today.

Treasury's actions of agreeing to lend money to the GSEs and to purchase MBS from the GSEs should stabilize the secondary mortgage market and provide a continuing flow of funds to purchase new homes and to refinance existing mortgages. In 2007, the GSEs financed 91.3% of the conforming mortgage market.²⁶ In the current financial environment, if the GSEs were unable to buy mortgages from originators, it is not clear that other investors are prepared to step into the secondary mortgage market.

The conservator could modify credit requirements for anyone wanting to refinance, take out a second mortgage, or get a home equity line of credit. Presumably, the conservator will balance the goal of returning the GSEs to their own control with the goal of encouraging homeownership.

The Economic Stimulus Act of 2008 raised the loan limit for Federal Housing Administration (FHA) guaranteed loans in most high cost areas of the nation to the same maximum that the GSEs are permitted to purchase.²⁷ As a result, FHA-guaranteed loans can, in theory, replace most conventional loans.

What is The Difference Between 'The Housing and Economic Recovery Act of 2008' and 'The Federal Housing Finance Regulatory Reform Act of 2008?'

The Housing and Economic Recovery Act of 2008 is the title for the entire law, P.L. 110-289. The Federal Housing Finance Regulatory Reform Act of 2008 is the title for Title I-III of P.L. 110-289.

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²⁶ *The 2008 Mortgage Market Statistical Annual*, Volume II (Bethesda, MD: Inside Mortgage Finance Publications, 2008), pp. 3, 9. A conforming mortgage is one that is under the conforming loan limit, which is as high as \$729,750 in high cost areas.

²⁷ P.L. 110-185, 122 Stat. 613 et seq.