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Report to Congressional Addressees

January 2022

HOUSING FINANCE SYSTEM

Future Reforms Should Consider Past Plans and Vulnerabilities Highlighted by Pandemic

GAO-22-104284

GAO Highlights

Highlights of GAO-22-104284, a report to congressional addressees

January 2022

HOUSING FINANCE SYSTEM

Future Reforms Should Consider Past Plans and Vulnerabilities Highlighted by Pandemic

Why GAO Did This Study

Since 2013, GAO has designated the federal role in housing finance as a high-risk area because of the significant risks the current role poses. In September 2019, Treasury and HUD began implementing housing finance reform plans, which included steps to transition the enterprises from federal conservatorship. But pandemic-related strains on the housing finance system and the transition to a new administration have increased uncertainty about the future of reform.

The CARES Act includes a provision for GAO to monitor federal efforts related to COVID-19. Congress also included a provision in statute for GAO to annually review financial services regulations. This report examines (1) vulnerabilities in the housing finance system highlighted by the pandemic, and (2) the nature and status of recommendations in the 2019 reform plans and the extent to which they align with system vulnerabilities and GAO's housing finance reform framework (GAO-15-131).

GAO reviewed housing finance system research and regulations and agency documents on system reforms and pandemic responses. GAO aligned recommendations in the 2019 plans with system vulnerabilities and its 2014 framework elements. GAO also analyzed information on the status of the plan recommendations and interviewed agency and industry representatives.

What GAO Recommends

GAO recommends that as Treasury and HUD develop future plans, they consider recommendations from the 2019 plans that could help address system vulnerabilities and ensure future plans address all GAO framework elements. Treasury and HUD accepted GAO's recommendations.

View GAO-22-104284. For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or garciadiazd@gao.gov.

What GAO Found

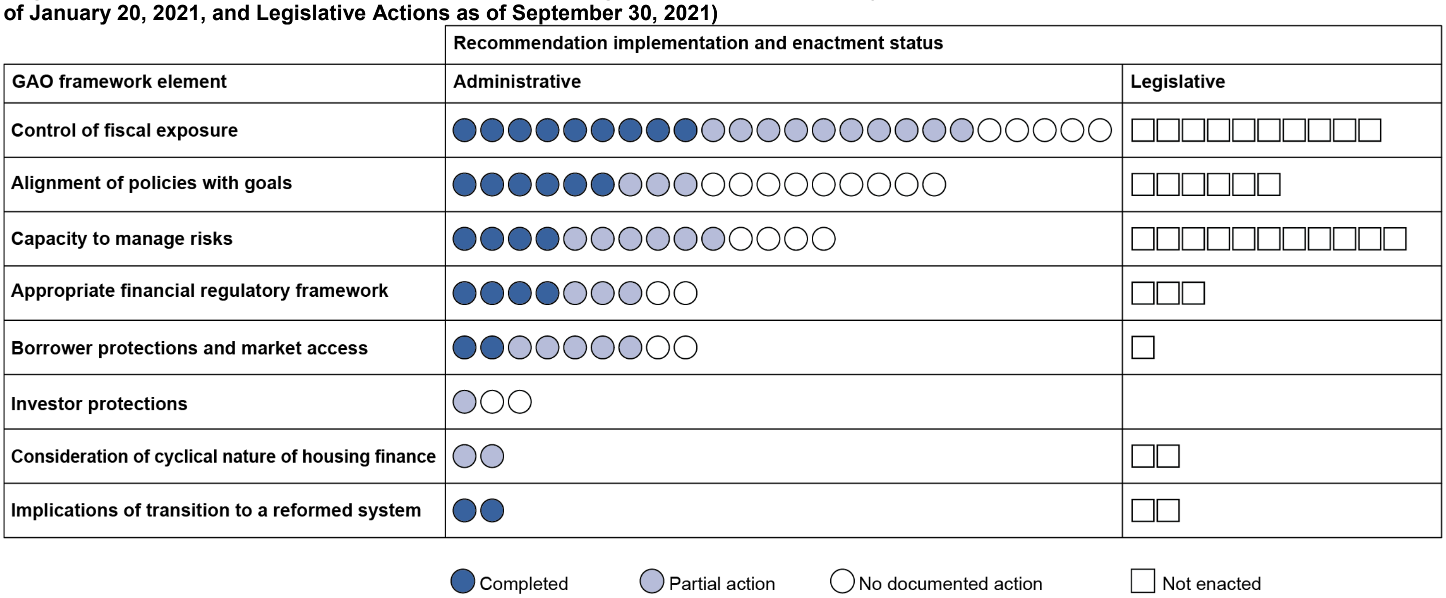
The COVID-19 pandemic highlighted three vulnerabilities in the housing finance system—although thus far mitigated by federal actions and market conditions—that remain relevant to the debate about future system reforms.

- **Federal fiscal exposure**. Exposure to potential mortgage credit losses during an economic crisis is substantial. The government directly or indirectly backs $8 trillion in single-family mortgages, in part due to the ongoing federal conservatorships of Fannie Mae and Freddie Mac (enterprises).
- **Nonbank liquidity risks**. Nonbanks, which service more than 50 percent of federally backed mortgages, faced significant liquidity risk—that they would be unable to meet their financial obligations—at the onset of the pandemic because they were not receiving loan payments but had to continue paying mortgage investors. Failures of nonbanks could constrain mortgage credit.
- **Market instability**. In March 2020, the pandemic's economic shock temporarily disrupted the mortgage-backed securities (MBS) market by causing many investors to sell assets. This overwhelmed market intermediaries and created conditions where MBS could not be sold. Continued market dysfunction could have limited mortgage availability and caused other credit markets to freeze.

GAO analysis of the 2019 housing finance reform plans issued by the Department of the Treasury and Department of Housing and Urban Development (HUD) identified recommendations that align with these vulnerabilities and GAO's 2014 housing finance reform framework. The plans made 81 administrative recommendations to agencies and 35 legislative recommendations to Congress.

- The plans contained 34 recommendations focused on federal fiscal exposure, three related to nonbank liquidity risks, and one related to MBS market stability. Regarding fiscal exposure, the recommendations included steps to help ensure the enterprises and the Federal Housing Administration's (FHA) mortgage insurance programs are financially sound. Some steps, such as strengthening the enterprises' capital framework, were implemented. Others, including certain recommendations to improve the financial viability of FHA's program for reverse mortgages (a loan against home equity), were not.
- Each of the plans' recommendations aligned with an element of GAO's framework, and the recommendations collectively addressed all the elements to some degree (see figure below). The elements include control of fiscal exposure, alignment of policies with goals, capacity to manage risks, and borrower protections and access to mortgages. As of January 2021—the latest point at which Treasury and HUD systematically tracked implementation—agencies implemented or took partial action on 57 of 81 administrative recommendations, focusing primarily on framework elements for control of fiscal exposure and capacity to manage risks. For example, FHA substantially implemented a recommendation to develop and integrate automated tools for managing mortgage origination risks. As of September 2021, Congress had not enacted legislation to implement any of the 35 legislative recommendations.

Alignment and Status of Recommendations in 2019 Housing Finance Reform Plans, by GAO Framework Element (Administrative Actions as of January 20, 2021, and Legislative Actions as of September 30, 2021)



Source: GAO analysis of Department of the Treasury and Department of Housing and Urban Development 2019 Housing Finance Reform plans and plan status. | GAO-22-104284

While the current administration has stated its interest in helping shape future reforms, it has not issued its own plans, or performed an analysis similar to GAO's. GAO's analysis showed that the 2019 reform plans are relevant to future planning efforts.

- Although the plans were issued shortly before the pandemic, they contain implemented and unimplemented recommendations relevant to vulnerabilities the pandemic highlighted. While mitigated by federal actions and market conditions thus far, the vulnerabilities remain relevant for risk assessments that may support future Treasury and HUD planning efforts. Considering recommendations from the 2019 plans could help agencies identify options for mitigating the vulnerabilities and aid assessment of steps already taken.
- The plans also contain recommendations related to each element of GAO's framework. Attention to each framework element is important for establishing an effective housing finance system. While future housing reforms may emphasize different policy goals, considering the prior plans in the context of the framework could help identify actions that would cover all the framework elements.

As Treasury and HUD develop future reform plans, considering the recommendations in the 2019 plans and addressing all GAO framework elements could help ensure the plans address key risks, are comprehensive, and account for prior actions that complement or diverge from current policy priorities.

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Abbreviations

ATR/QM Rule	Ability to Repay/Qualified Mortgage Rule
CFPB	Consumer Financial Protection Bureau
COVID-19	Coronavirus Disease 2019
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
DTI	debt-to-income
enterprises	government-sponsored enterprises (Fannie Mae and Freddie Mac)
Federal Reserve	Board of Governors of the Federal Reserve System
FHA	Federal Housing Administration
FCRA	Federal Credit Reform Act of 1990
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
Ginnie Mae	Government National Mortgage Association
HUD	Department of Housing and Urban Development
MBS	mortgage-backed securities
MMI Fund	Mutual Mortgage Insurance Fund
mREIT	mortgage real estate investment trust
PSPA	preferred stock purchase agreement
RHS	Rural Housing Service
USDA	Department of Agriculture
VA	Department of Veterans Affairs

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
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Congressional Addressees

In September 2019, the Department of the Treasury and Department of Housing and Urban Development (HUD) issued and began implementing housing finance reform plans pursuant to a presidential memorandum that sought to address continuing challenges in the housing finance system.[1] Then, within months, unemployment and business closures due to the Coronavirus Disease 2019 (COVID-19) pandemic disrupted rental and mortgage payments, straining a housing finance system largely supported by the federal government and already on our high-risk list.[2] Housing agencies continued to implement many of the plans' recommendations, while Congress and agencies took actions to address the pandemic's effects.

Other factors also have affected reform efforts. When the current administration took office in early 2021, it did not adopt the prior administration's reform plans. While the current administration has noted it has a key role and interest in housing finance reform, it has not issued plans of its own. No consensus has emerged in Congress about the future federal role in housing finance, including a plan for ending the federal conservatorships of Fannie Mae and Freddie Mac, the

[1]Department of the Treasury, *Housing Finance Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, D.C.: September 2019); and Department of Housing and Urban Development, *Housing Finance Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, D.C.: September 2019). The plans included a mix of administrative and legislative recommendations and involved multiple federal entities.

[2]Since 2013, we have designated resolving the federal role in housing finance as a high-risk area, for reasons including the government's large fiscal exposure. For our most recent report, see GAO, *High Risk Series: Dedicated Leadership Needed to Address Limited Progress in Most High Risk Areas*, GAO-21-119SP (Washington, D.C.: Mar. 2, 2021).

government-sponsored enterprises (enterprises) that play a key role in the housing finance system.[3]

The CARES Act included a provision for GAO to report on efforts to prepare for, respond to, and recover from the COVID-19 pandemic.[4] Additionally, the Department of Defense and Full-Year Continuing Appropriations Act of 2011 includes a provision for GAO to annually review financial services regulations.[5] This report examines (1) vulnerabilities in the housing finance system highlighted by the pandemic and factors that helped mitigate them, and (2) the nature and status of recommendations in the 2019 reform plans and the extent to which they align with system vulnerabilities and GAO's 2014 framework for assessing potential changes to the housing finance system.[6] Both objectives contain analysis pertaining to the regulation of key housing finance system participants, including the enterprises, and the potential implications of such regulation on system stability and credit availability.

To address these objectives, we reviewed relevant legislation (including the CARES Act), regulations, agency documents, and websites related to system reforms and pandemic responses. We also reviewed our prior work on housing finance—including our 2014 housing finance

[3]The enterprises are congressionally chartered, for-profit, shareholder-owned corporations that purchase mortgages meeting certain criteria. They package the mortgages into securities sold to investors and, in exchange for a fee, guarantee the timely payment of interest and principal on the securities they issue. The enterprises have been in federal conservatorships since 2008.

[4]Pub. L. No. 116-136, div. B, § 19010, 134 Stat. 281, 579-81 (2020). We regularly issue government-wide reports on the federal response to COVID-19. For the latest report, see GAO, *COVID-19: Additional Actions Needed to Improve Accountability and Program Effectiveness of Federal Response*, GAO-22-105051 (Washington, D.C.: Oct. 27, 2021). Our next government-wide report will be issued in January 2022 and will be available on GAO's website at https://www.gao.gov/coronavirus.

[5]Pub. L. No. 112-10, § 1573(a), 125 Stat. 38, 138-39 (codified at 12 U.S.C. § 5496b). We are to analyze (1) the impact of regulation on the financial marketplace, including the effects on the safety and soundness of regulated entities, cost and availability of credit, savings realized by consumers, reductions in consumer paperwork burden, changes in personal and small business bankruptcy filings, and costs of compliance with rules, including whether relevant federal agencies are applying sound cost-benefit analysis in promulgating rules; (2) efforts to avoid duplicative or conflicting rulemakings, information requests, and examinations; and (3) other matters related to the operations of financial services regulations deemed appropriate by the Comptroller General.

[6]GAO, Housing Finance System: A Framework for Assessing Potential Changes, GAO-15-131 (Washington, D.C.: Oct. 7, 2014).

framework—and relevant concepts from our 2021 framework for evaluating activities designed to assess and mitigate risks to financial system stability.[7] We performed a literature search for studies on potential vulnerabilities in the housing finance system.

We also analyzed recent federal and industry market data, including data on servicing of single-family mortgages, holdings of and yields for mortgage-backed securities (MBS), and enterprise capital levels. We assessed the reliability of these data by reviewing documentation on data collection and calculation and interviewing company or agency representatives familiar with the data. We concluded the data were sufficiently reliable for describing the market shares of different industry participants for mortgage servicing and MBS holdings and trends in MBS market volatility and enterprise capital reserves.

To determine the extent to which the 2019 reform plans align with system vulnerabilities and our housing finance reform framework, we reviewed and analyzed the recommendations in Treasury's and HUD's plans against the identified vulnerabilities and the elements of our framework. We reviewed the implementation status of the plans' administrative recommendations as of January 20, 2021 (the latest point at which Treasury and HUD systematically tracked plan implementation) and the enactment status of legislative recommendations. Since the January 2021 change in administration, agencies have taken actions relevant to some of the recommendations, but not as part of a broader effort to implement the 2019 plans. Where applicable, we incorporated information on agency actions taken since January 2021. We interviewed officials from Treasury (including the Financial Stability Oversight Council), HUD, the Federal Housing Finance Agency (FHFA), Board of Governors of the Federal Reserve System (Federal Reserve), Consumer Financial Protection Bureau (CFPB), Department of Veterans Affairs (VA), Department of Agriculture (USDA), Fannie Mae and Freddie Mac, and other mortgage industry stakeholders. See appendix I for additional information on our methodology.

[7]GAO, *Macroprudential Oversight: Principles for Evaluating Policies to Assess and Mitigate Risks to Financial System Stability*, GAO-21-230SP (Washington, D.C.: Jan. 28, 2021). We created the macroprudential principles to serve as criteria for assessing financial stability efforts. While designed with the broader financial system in mind, the principles provide useful criteria for assessing housing finance reform efforts because of the housing finance system's large scale and importance to the economy and financial markets.

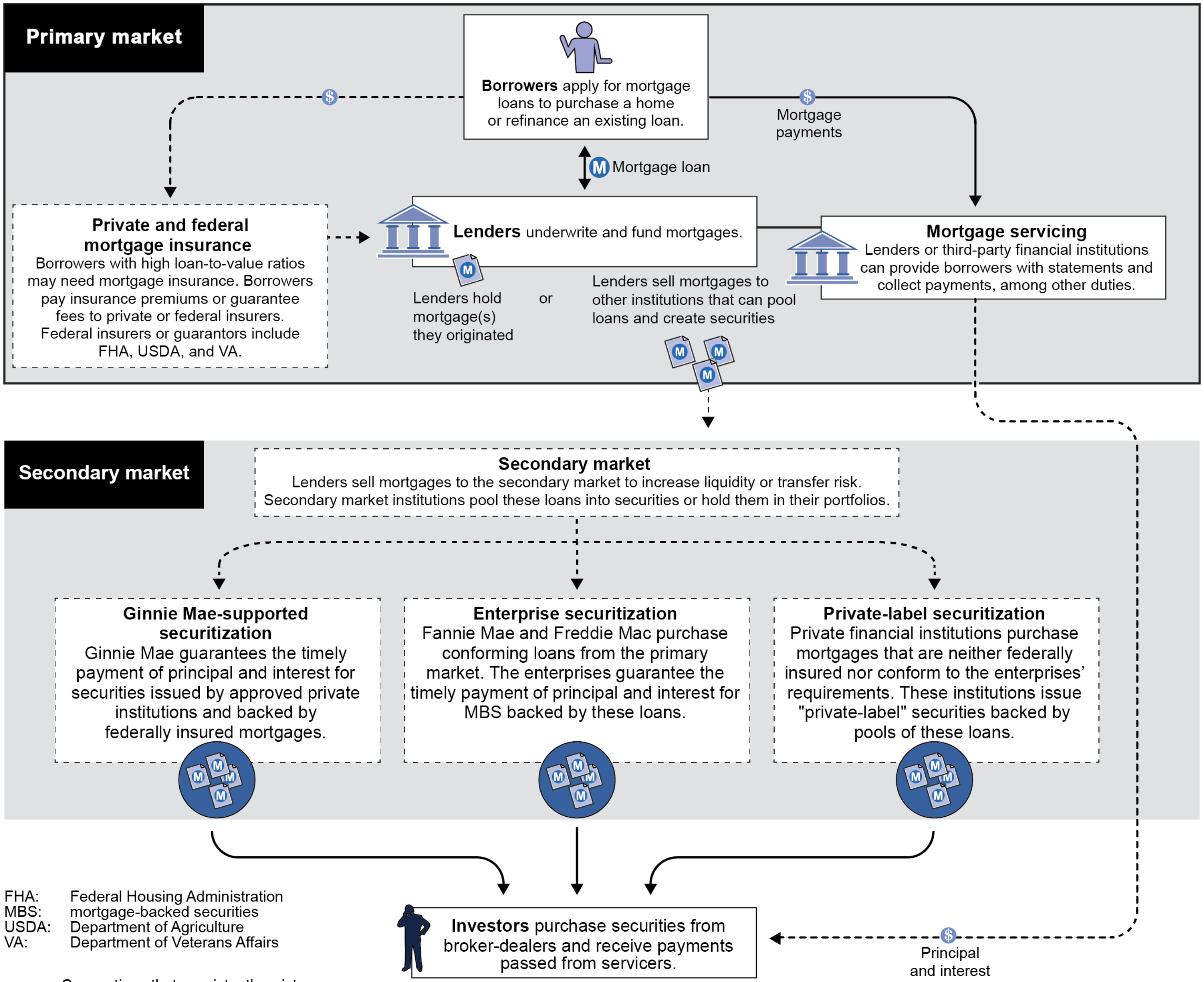
We conducted this performance audit from April 2020 to January 2022, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Key Components of and Federal Role in the Housing Finance System

The housing finance system includes a primary market, in which lenders make loans to borrowers, and a secondary market in which loans are packaged into securities and sold to investors (see fig. 1). The federal government participates in the primary and secondary mortgage markets as both an actor and a regulator.

Figure 1: Overview of Primary and Secondary Mortgage Markets



FHA: Federal Housing Administration
MBS: mortgage-backed securities
USDA: Department of Agriculture
VA: Department of Veterans Affairs

—— Connections that consistently exist

- - - - Connections that may exist depending on circumstances

Source: GAO. | GAO-22-104284

Participants in the **primary market** include borrowers, bank or nonbank lenders, servicers, and private and federal mortgage insurers.[8] Lenders originate mortgage loans to borrowers to purchase single-family or multifamily housing. Lenders hold the mortgages in their portfolios or sell them in the secondary market (discussed later) to transfer risk such as interest rate risk (see text box) or increase liquidity.

Mortgage Lending Risks

Credit risk - The risk that the borrower will default on the mortgage loan by failing to make timely payments.

Prepayment risk - The risk that borrowers will pay off the principal of the loan before the mortgage term ends, reducing or eliminating future interest payments.

Interest rate risk - The risk that an increase in interest rates will reduce the value of a loan for the lender. For example, a lender might fund lending through short-term deposits. If interest rates rise and the lender had made a long-term mortgage at a lower rate, the earning potential of capital used for the mortgage decreases.

Liquidity risk - The risk that an institution will be unable to meet its financial obligations as they come due without incurring unacceptable losses.

Source: GAO. | GAO-22-104284

Mortgage servicers are responsible for sending monthly account statements to borrowers, answering customer service inquiries, collecting monthly mortgage payments, and assisting with mitigation efforts if the borrower defaults.[9] Servicers can be the same institution that originated the loan or may change over the life of a mortgage. Mortgage owners and servicers may sell servicing rights to third-party servicers that service the loan for a fee. Servicers also interact with the mortgage owners or investors in MBS by forwarding principal and interest payments. Servicers

[8]In this report, we use “banks” to refer to bank holding companies, financial holding companies, savings and loan holding companies, insured depository institutions, and credit unions, including their subsidiaries or affiliates. We define nonbanks as lenders or servicers that are not banks.

[9]Defaults are generally due to borrowers becoming delinquent on mortgage payments. When a borrower defaults or is at imminent risk of default, the servicer generally must evaluate the borrower for certain mortgage relief options known as loss mitigation prior to initiating foreclosure.

generally continue to forward payments to MBS investors when a borrower defaults.[10]

HUD's Federal Housing Administration (FHA), VA, and USDA's Rural Housing Service (RHS) have mortgage guarantee and insurance programs that assume some of the risks of certain mortgages (including credit risk) from lenders. FHA operates the largest of these low- or no-downpayment programs, and almost all its single-family mortgages are supported by the Mutual Mortgage Insurance Fund (MMI Fund), which is statutorily required to maintain at least a 2 percent capital ratio (defined as the fund's economic value divided by the insurance-in-force).[11] In contrast, conventional mortgages are not insured or guaranteed by the federal government.

Participants in the **secondary market** include the enterprises, federal entities, private securities issuers, and investors. Private institutions, primarily investment banks, may issue MBS (known as private-label securities) backed by mortgages that are not federally insured or guaranteed and do not conform to the enterprises' requirements. Secondary market institutions can hold the mortgages in their portfolios or pool them into MBS that are sold to investors.

Agency MBS are issued by one of the enterprises or backed by federally insured or guaranteed mortgages and issued by financial institutions approved by the Government National Mortgage Association (Ginnie Mae).

- Fannie Mae and Freddie Mac are congressionally chartered, for-profit, shareholder-owned corporations that have two key housing missions: to provide stability in the secondary market for residential mortgages (including in periods of economic stress) and serve the mortgage credit needs of targeted groups, such as low-income borrowers. The enterprises generally purchase mortgages that meet certain criteria and hold the loans in their portfolios or pool them as collateral for MBS sold to investors. In exchange for a fee, the enterprises guarantee the timely payment of interest and principal on MBS they issue.

[10]The MBS issuer may remove a defaulted loan from the security under specified circumstances, which terminates the advances of principal and interest to investors.

[11]12 U.S.C. § 1711(f)(4). The insurance-in-force is the remaining principal balance on all insured loans in the MMI Fund.

- Ginnie Mae is a federally owned corporation in HUD that guarantees the timely payment of principal and interest to investors in securities issued through its MBS program. Unlike the enterprises, Ginnie Mae does not purchase mortgages, but like the enterprises guarantees the timely payment of interest and principal of MBS. Ginnie Mae MBS consist entirely of federally insured or guaranteed mortgages, such as FHA and VA mortgages.

The Federal Reserve also plays a role in the housing finance system. For example, the Federal Reserve conducts monetary policy, which influences interest rates, including rates on home mortgages. Additionally, in financial crises, the Federal Reserve can implement strategies to help stabilize financial markets, such as by purchasing agency MBS.

Federal Regulation of the Housing Finance System

The federal government regulates the housing finance system through FHFA, which oversees the enterprises and the Federal Home Loan Banks (FHLBank), which provide liquidity for their member institutions to support housing finance and community lending; CFPB; and the federal banking regulators.[12] The Housing and Economic Recovery Act of 2008 established FHFA as an independent regulatory agency for the enterprises and authorized the Director of FHFA to appoint FHFA as a conservator for the enterprises.[13] FHFA put the enterprises into conservatorship in September 2008 due to concern that their deteriorating financial condition threatened economic stability.

Using authority provided in the Housing and Economic Recovery Act, Treasury committed to providing up to $445.5 billion in capital support to the enterprises while they are in conservatorship through senior preferred stock purchase agreements (PSPA).[14] If Fannie Mae or Freddie Mac has a net worth deficit at the end of a financial quarter, Treasury will provide

[12]The FHLBank System consists of 11 regionally based, federally chartered banks that are cooperatively owned by member institutions (such as community banks and credit unions) and of the Office of Finance. Federal banking regulators include the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

[13]Pub. L. No. 110-289, div. A, tit. I, § 1101, 122 Stat. 2654, 2661 (2008); Pub. L. No. 110-289, div. A, tit. I, § 1145, 122 Stat. at 2734.

[14]Pub. L. No. 110-289, div. A, tit. I, §1117, 122 Stat. at 2683. As of the end of the second quarter of 2021, the enterprises combined had received $191.4 billion in capital support from Treasury, leaving $254.1 billion in remaining Treasury commitments. Modifications to the PSPAs have allowed the enterprises to build capital by retaining earnings up to specified thresholds.

funds to eliminate the deficit. In return for the support, Treasury received from each enterprise nonvoting senior preferred shares, rights to purchase 79.9 percent of the enterprise's common stock, and a right to a periodic fee to be determined at a later date.[15]

Since the 2007–2011 housing crisis, Congress has taken steps to improve regulation and consumer protection related to the housing finance system. For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created CFPB and required housing and regulatory agencies to issue "qualified mortgage" and "qualified residential mortgage" regulations designed to prevent a recurrence of risky practices that contributed to the crisis.[16]

However, the future federal role in the housing finance system remains unresolved. In prior work, we recommended that Congress consider establishing objectives for the federal role, including the structure of the enterprises, and a transition plan that enables the enterprises to exit federal conservatorship.[17] As of September 2021, Congress had not enacted legislation addressing these issues.

HUD and Treasury 2019 Housing Reform Plans

In September 2019, Treasury and HUD issued housing finance reform plans pursuant to a presidential memorandum that set out the prior administration's goals in changing the housing finance system.[18] As previously noted, the current administration has not adopted these plans. The plans recommended actions by Congress (legislative recommendations) and by other entities, such as FHFA and CFPB (administrative recommendations). While Treasury and HUD consulted some agencies in developing the plans, the plans did not necessarily reflect other agencies' priorities and preferences. The plans contained

[15]Letters of January 14, 2021, from the Department of the Treasury agreed to and accepted by the Federal Housing Finance Agency (in its capacity of conservator for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation).

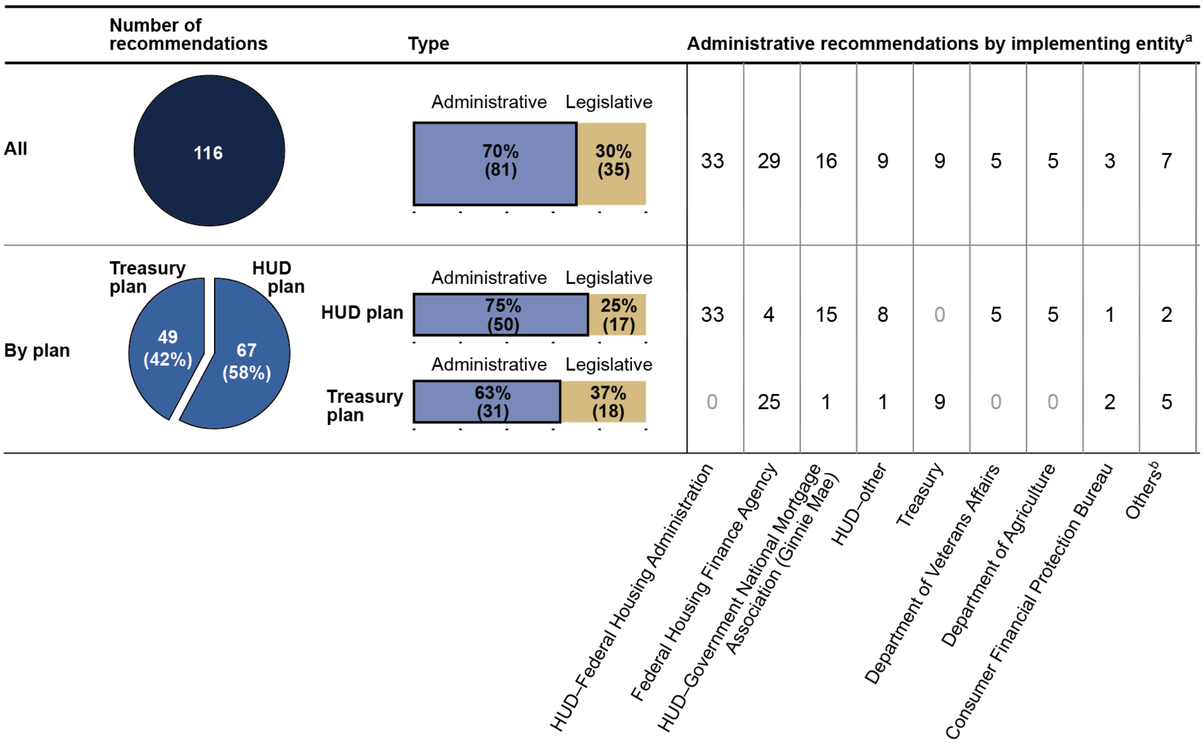
[16]Pub. L. No. 111-203, tit. X, § 1011, 124 Stat. 1376, 1964 (2010); Pub. L. No. 111-203, tit. IX, § 941, 124 Stat. at 1890 (2010).

[17]GAO, *Federal Housing Finance Agency: Objectives Needed for the Future of Fannie Mae and Freddie Mac After Conservatorships*, GAO-17-92 (Washington, D.C.: Nov. 17, 2016); and *Housing Finance: Prolonged Conservatorships of Fannie Mae and Freddie Mac Prompt Need for Reform*, GAO-19-239 (Washington, D.C.: Jan. 18, 2019).

[18]Department of the Treasury, *Housing Finance Reform Plan*; and Department of Housing and Urban Development, *Housing Finance Reform Plan*.

116 recommendations (35 legislative recommendations and 81 administrative recommendations) for a wide range of entities (see fig. 2).

Figure 2: Type and Number of Recommendations in 2019 HUD and Treasury Housing Reform Plans



Source: GAO analysis of Departments of the Treasury and Housing and Urban Development (HUD) 2019 Housing Finance Reform plans. | GAO-22-104284

[a]Some recommendations were to more than one entity.

[b]Other entities include Fannie Mae and Freddie Mac, the Department of Justice, Securities and Exchange Commission, federal financial regulators, and a White House Council on eliminating regulatory barriers to affordable housing.

Housing Finance System Experienced Different Stresses in Pandemic Than in 2007 Crisis

The pandemic's disruption of the housing finance system differed in key respects from the 2007–2011 housing crisis that has served as a reference point for previous housing finance reform efforts. For example, the 2007–2011 crisis featured a steep, multiyear decline in home prices following what has been characterized as a speculative housing bubble. This resulted in many mortgage balances exceeding the underlying home values, which heightened the risk of default and foreclosure. In contrast, home prices have not deteriorated during the pandemic, and have increased in many areas.

Also, in the previous crisis, many mortgages had lower credit quality because they were underwritten with less than full documentation of borrower incomes, among other reasons. For example, mortgages entering the pandemic generally were underwritten to higher standards, partly because of reforms implemented after the previous crisis. Additionally, the pandemic featured a sharper spike in the national unemployment rate than the previous crisis—rising from 3.5 percent in February 2020 to almost 15 percent in April 2020—which abruptly put millions of mortgage borrowers at risk of default from loss of income.

GAO Framework for Assessing Potential Changes to the Housing Finance System

In a 2014 report, we issued a framework comprising nine elements to help policymakers assess or develop proposals to change the housing finance system (see table 1).[19] These elements help ensure a comprehensive plan, and help assess tradeoffs between reform goals.

Table 1: Elements of GAO's Framework for Assessing Potential Changes to the Housing Finance System

Element	Description
Clearly defined and prioritized housing finance system goals	Broad goals for the housing finance system should be clearly articulated and relevant so that government and market participants can effectively conduct activities to implement their missions. Additionally, market and government performance can be assessed against those broad goals. These goals should recognize broader housing policy objectives, as well. Where trade-offs among the broad goals exist, the goals should be prioritized.
Policies and mechanisms that are aligned with goals and other economic policies (**alignment of policies with goals**)	Housing finance policies and mechanisms should be aligned with the broader goals of housing finance. Changes in housing finance should consider the full range of options for government actions—such as direct participation in markets through government guarantees, oversight and regulation, data collection and dissemination, and tax or other federal incentives to promote greater private market participation—and show how policies and mechanisms interact to achieve the goals on a comprehensive basis, while minimizing fragmentation, overlap, and duplication. Additionally, these policies and mechanisms should help to align incentives, provide more information and transparency, and restrain excessive risk-taking.
Adherence to an appropriate financial regulatory framework (**appropriate financial regulatory framework**)	In 2009, GAO proposed a framework for a financial regulatory system that included some of the elements listed in this table as well as ensuring that regulation was appropriately comprehensive, consistent, flexible, adaptable, and had a systemwide focus (GAO-09-216). A regulatory system should also ensure that regulators have independence from inappropriate influence; have sufficient resources, influence, and authority to carry out and enforce statutory missions; and are clearly accountable for meeting regulatory goals.

[19]GAO-15-131.

Element	Description
Government entities that have capacity to manage risks (**capacity to manage risks**)	Government entities will need adequate skills and resources to understand, price, and manage risks. These entities would also need the capacity to ensure that their counterparties in the private sector have the capacity to manage the risks inherent in their activities.
Mortgage borrowers are protected and barriers to mortgage market access are addressed (**borrower protections and market access**)	Borrowers need consistent, useful information, as well as legal protections, including disclosures, sales practice standards, and suitability requirements, throughout the mortgage life cycle. Any barriers facing creditworthy borrowers in accessing mortgage markets should be addressed. Key issues will be to encourage innovation to reduce barriers while ensuring that products are easily understood, such as through standardization and developing better tools to assess creditworthiness.
Protection for mortgage securities investors (**investor protections**)	Investors in the secondary market require adequate, reliable information to assess secondary-market risks. This would include providing clear information on securitizer and trustee responsibilities as they relate to investors. As with borrower protection, some standardization may be useful; however, care must be taken to ensure that certain protections do not discourage beneficial innovation.
Consideration of cyclical nature of housing finance and impact of housing finance on financial stability (**consideration of cyclical nature of housing finance**)	Housing finance has been characterized by cycles that have alternated between loose credit standards and those that are tight. Because housing is a significant part of the economy, these cycles may pose risks to financial and economic stability. Government should determine whether actions related to housing finance are procyclical or countercyclical and consider making actions less procyclical. Government may also want to consider the appropriateness of countercyclical measures. Actions also should address the threat housing finance poses for financial stability when there are incentives for excessive risk taking.
Recognition and control of fiscal exposure and mitigation of moral hazard (**control of fiscal exposure**)	Choices about policies and mechanisms will result in different levels of fiscal exposure. Wherever possible, exposures should be made explicit and costs recognized. Actions should be taken to minimize unexpected costs and to mitigate any moral hazard created by government policies and support.
Emphasis on implications of the transition (**implications of transition**)	Because changing the housing finance system may lead to substantial changes in the marketplace, issues related to transitioning from the current system to a new one should be emphasized in any proposal for change. Any action that would severely limit market liquidity during the transition should be of particular concern.

Source: GAO-15-131. | GAO-22-104284

Federal Actions and Market Conditions Mitigated Risks Highlighted by the Pandemic, but Vulnerabilities Remain

Through literature reviews and interviews with housing finance stakeholders, and consistent with risk-assessment principles, we identified three vulnerabilities to the housing finance system the pandemic has highlighted:[20]

- federal fiscal exposure,[21]
- nonbank liquidity risks, and
- MBS market instability.[22]

Although a combination of federal actions and a strong housing market have mitigated these potential challenges to date, they continue to expose the housing finance system to a range of risks and could reemerge.

Borrower Protections and House Price Growth Mitigated Credit Losses during Pandemic, but Federal Fiscal Exposure Remains Substantial

The pandemic has led to missed mortgage payments that have strained the housing finance system and heightened fiscal risks to the federal government. Because the federal government supports about two-thirds of the $12 trillion single-family mortgage market, exposure to potential mortgage credit losses during an economic crisis is substantial.

Mitigating Factors

However, to date, a combination of federal borrower protections, a fee on some enterprise refinances, and house price appreciation have mitigated credit losses.

Federal borrower protections. Congress, federal agencies, and the enterprises have taken steps to protect the housing and financial stability of mortgage borrowers during the COVID-19 pandemic through expanded

[20]Our prior work on macroprudential oversight (GAO-21-230SP) states that identifying and analyzing potential sources of systemic risk is one of several key principles related to the foundation of financial stability policy. While designed with the broader financial system in mind, the principles are relevant to housing finance reform efforts because of the housing finance system's large scale and importance to the economy and financial markets.

[21]Fiscal exposures are responsibilities, programs, and activities that may legally commit the federal government to future spending or create expectations for future spending based on current policy, past practices, or other factors.

[22]The pandemic also highlighted other challenges in the housing market. For example, if landlords of small rental properties were pressured to sell their properties because of the disruption in rental payments, it could reduce the supply of already scarce affordable rental housing. For more information on this issue, see app. II.

mortgage forbearance options and a foreclosure moratorium. Section 4022 of the CARES Act required mortgage servicers to provide borrowers with federally backed mortgages on single-family homes who experienced a financial hardship due to the COVID-19 emergency the option to suspend or reduce their mortgage payments without charging additional penalties, fees, or interest.[23] Servicers were required to provide borrowers who requested forbearance with an initial 180-day forbearance period and the option to extend it by 180 days.

The agencies and enterprises subsequently extended deadlines and provided borrowers with additional time to use CARES Act forbearance. Borrowers with loans backed by FHA, RHS, and VA can request an initial forbearance through the end of the COVID-19 National Emergency. Borrowers with enterprise-backed loans will continue to have access to 12-month forbearance options that were in place prior to the CARES Act, according to FHFA officials.

Some borrowers nearing the end of forbearance can request an extension beyond the 12 months provided in the CARES Act. Specifically, borrowers with enterprise-backed loans that were in forbearance as of February 28, 2021, and borrowers with FHA-, RHS-, or VA-backed loans who requested an initial forbearance on or before June 30, 2020, may be

[23]Pub. L. No. 116-136, div. A. tit. IV, § 4022(b),(c), 134 Stat. 281, 490-91 (2020).

eligible for an additional 6 months of forbearance (up to 18 months in total).[24]

Section 4022 of the CARES Act also temporarily prohibited most foreclosures of federally backed properties. Specifically, the act prohibited servicers from initiating foreclosure processes, moving for a foreclosure judgment or order of sale, or executing a foreclosure-related eviction or foreclosure sale for not less than 60 days, beginning on March 18, 2020. Thereafter, the agencies and enterprises initiated separate foreclosure moratoriums, which they coordinated to extend through September 30, 2021. In June 2021, FHFA announced that servicers of enterprise-backed mortgages would be prohibited from making most first filings for foreclosure before new CFPB rules establishing safeguards for borrowers affected by COVID-19 took effect on August 31, 2021.

Additionally, Section 3206 of the American Rescue Plan Act of 2021 appropriated nearly $10 billion for a Homeowner Assistance Fund.[25] The act directed Treasury to allocate funds to eligible entities to prevent homeowner mortgage delinquencies, defaults, foreclosures, loss of utilities, and displacements of homeowners experiencing financial hardship. Eligible costs include mortgage payments and other homeowner expenses, such as utilities or insurance. The funds are

[24]FHA provided up to 18 months of forbearance for borrowers who requested their initial forbearance between March 1, 2020, and June 30, 2020; up to 15 months for borrowers who requested their initial forbearance between July 1, 2020, and September 30, 2020; up to 12 months for borrowers who requested it between October 1, 2020, and June 30, 2021; up to 12 months for borrowers who requested it between July 1, 2021, and September 30, 2021; and up to 12 months (if the initial forbearance 6-month period is exhausted and expires during the COVID-19 National Emergency) for borrowers who requested their initial forbearance between October 1, 2021, and the end of the COVID-19 National Emergency. VA provided up to 18 months of forbearance for borrowers who requested their initial forbearance by June 30, 2020. Additionally, it announced that forbearances were to be extended to borrowers who made their first request during the COVID-19 Emergency. VA said it expected all COVID-related forbearances to end not later than September 30, 2022. Under its guaranteed loan program, USDA provided up to 18 months of forbearance for borrowers who requested their initial forbearance between March 1, 2020, and June 30, 2020; up to 15 months for borrowers who requested it between July 1, 2020, and September 30, 2020; and up to 12 months for borrowers who requested forbearance between October 1, 2020, and the end of the COVID-19 National Emergency. Under its direct loan program, USDA provided up to 18 months of forbearance for borrowers who requested their initial forbearance during the COVID-19 emergency.

[25]Pub. L. No. 117-2, § 3206, 135 Stat. 4, 63 (2021).

targeted to certain income groups and to socially disadvantaged individuals.

These borrower protections likely prevented some near-term credit losses for federal housing agencies and the enterprises because they decreased or delayed mortgage defaults and foreclosures. For example, we previously found that only about 15 percent of the foreclosures that would have been expected based on recent historical trends have been processed each month since the start of the moratorium, on average, through February 2021.[26]

Adverse market refinance fee. Over the long term, both Fannie Mae and Freddie Mac anticipate increased credit losses because of the economic disruption caused by the pandemic and the cost of borrower protections they put in place. Specifically, FHFA estimated that implementing the forbearance program and foreclosure moratorium could cost the enterprises $6 billion or more depending on the path of the economic recovery from the pandemic. To offset these anticipated credit losses, both enterprises implemented a 0.5 percent one-time fee on certain mortgage refinances. This fee went into effect in December 2020 and was eliminated on August 1, 2021. FHFA and enterprise COVID-19 policies reduced the effect of the pandemic and were effective enough to warrant an early termination of the fee, according to FHFA.

House price appreciation. House price appreciation has likely helped FHA and the enterprises avoid credit losses by increasing borrower equity and reducing the likelihood of default or foreclosure. According to FHFA's House Price Index, house prices in the United States rose by 17.4 percent on average from the second quarter of 2020 to the second quarter of 2021.[27] As of September 30, 2021, FHA's MMI Fund had a capital ratio of 8.03 percent, an increase from 6.10 percent in fiscal year 2020, and well above the 2 percent statutory minimum. FHA credits the growth in the capital ratio during the pandemic primarily to house price appreciation, which helps mitigate expected foreclosures and associated credit losses. Similarly, Fannie Mae and Freddie Mac reported that house

[26]This figure is based on our analysis of data from Black Knight, a mortgage data provider. See GAO, *COVID-19 Housing Protections: Mortgage Forbearance and Other Federal Efforts Have Reduced Mortgage Default and Foreclosure Risks*, GAO-21-554 (Washington, D.C.: July 12, 2021).

[27]The FHFA House Price Index measures average price changes in sales or refinancings on the same properties.

price appreciation partially offset credit losses anticipated as a result of the pandemic.

Rising house prices help borrowers more quickly build equity in their homes (the difference between any outstanding loans on the property and its current market value). Home equity can help borrowers more easily refinance or modify their loan to lower the monthly payment or sell their property for a profit. Borrowers with no or negative equity in their property—meaning they owe more than the value of their property—generally are at a heightened risk of default and foreclosure because they may not be able to refinance their mortgage or afford to sell their home in the event they fall behind on mortgage payments. As we reported in July 2021, appreciation in home prices may help limit foreclosures after pandemic-related forbearance protections expire.[28]

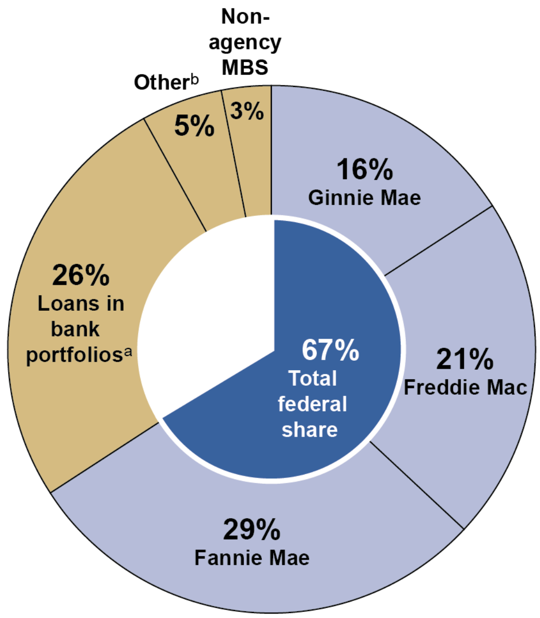
Continuing Federal Fiscal Exposure

But, federal fiscal exposure to the mortgage market—which contributed to our placing the housing finance system on our high-risk list—remains substantial, due partly to the ongoing enterprise conservatorships. The federal government supports $8 trillion, or 67 percent, of the $12 trillion single-family mortgage market through Ginnie Mae and enterprise securitizations (see fig. 3).[29]

[28]GAO-21-554.

[29]Nearly all FHA and VA single-family loans are securitized into Ginnie Mae pools.

Figure 3: Share of Single-Family Mortgage Servicing Outstanding by Market Segment, as of June 30, 2021



Ginnie Mae = Government National Mortgage Association
MBS = mortgage-backed securities

Source: GAO analysis of Inside Mortgage Finance data. | GAO-22-104284

Note: Percentages do not add exactly to the total federal share due to rounding.

[a]We defined banks as bank holding companies, financial holding companies, savings and loan holding companies, insured depository institutions, and credit unions, including any subsidiaries or affiliates.

[b]"Other" includes whole loans held by real estate investment trusts, life insurance companies, and individual investors.

While FHA and the enterprises have not required taxpayer or Treasury assistance during the pandemic, risks remain that could affect their ability to absorb unexpected losses in the event of a severe and extended economic downturn.

Reviews of FHA's Insurance Fund

The Federal Housing Administration's (FHA) Mutual Mortgage Insurance Fund (MMI Fund) is subject to an independent actuarial review and a budgetary review each year. Both reviews involve long-term financial projections that assume no new mortgages enter the fund.

FHA uses actuarial reviews to assess whether the fund's capital ratio meets the statutory 2 percent requirement and how the fund would perform under alternative economic scenarios, including adverse conditions. The reviews do not directly determine if the fund needs additional budget authority; they evaluate the fund's ability to absorb unexpected losses.

FHA's budgetary reviews assess whether the MMI Fund needs more budget authority to cover expected future costs. The Federal Credit Reform Act of 1990 (FCRA) provides permanent and indefinite budget authority for federal credit programs that need supplemental funds for these costs. The fund has drawn on this authority once (fiscal year 2013) since the implementation of FCRA. Drawing on this authority means that the fund is not self-sufficient under FCRA requirements. But it does not indicate the fund is unable to pay insurance claims in the near term without supplemental funding. The fund holds balances to cover anticipated net future costs on insurance claims expected in the near term and over the long term for the existing insurance portfolio.

Source: GAO. | GAO-22-104284

FHA. According to agency estimates, the capital ratio for FHA's MMI Fund would remain positive under a severely adverse economic scenario, but would fall below its 2 percent requirement. Specifically, in its fiscal year 2021 annual report to Congress on the results of the actuarial review of the fund (see sidebar), FHA estimated that if the fund faced the same macroeconomic conditions it faced in 2007 (when average house prices began a steep multiyear decline, among other economic stresses), the fund would have a capital ratio of 1.54 percent.[30]

A negative capital ratio would indicate the fund had limited capacity to absorb unexpected losses and was at risk of requiring supplemental

[30]According to FHFA's House Price Index, average house prices declined by 21 percent from the second quarter of 2007 through the second quarter of 2011 at the national level. We previously recommended that Congress consider specifying the economic conditions the MMI Fund would be expected to withstand without substantial risk of drawing on permanent and indefinite budget authority, and require FHA to specify and comply with a capital ratio consistent with these conditions. As of August 2021, Congress had not acted on this recommendation. See GAO, *Federal Housing Administration: Capital Requirements and Stress Testing Practices Need Strengthening*, GAO-18-92 (Washington, D.C.: Nov. 9, 2017).

funds.[31] For example, in the wake of the 2007–2011 housing crisis, the fund's capital ratio fell below zero, and the fund required about $1.7 billion in supplemental funds at the end of fiscal year 2013.[32]

Although the financial condition of the MMI Fund has strengthened considerably in recent years, FHA has noted that estimates of the capital ratio can change materially and quickly. For example, the capital ratio is sensitive to changes in house price appreciation. In 2 years (2007–2009), the capital ratio fell from 6.97 percent to 0.53 percent, due partly to a sharp decline in home prices. Additionally, due to the COVID-19 pandemic, the fund included $110 billion in seriously delinquent loans as of the end of fiscal year 2021, $14 billion higher than the prepandemic peak in fiscal year 2012. According to FHA, the size of the seriously delinquent portfolio increases the sensitivity of the fund to macroeconomic conditions that could diverge from projections used to estimate the fund's financial health.

[31]As discussed in GAO-18-92, the actuarial and budgetary assessments of the MMI Fund are complementary but serve different functions. Under the Federal Credit Reform Act of 1990 (FCRA), federal credit agencies must estimate the net lifetime costs—or subsidy costs—of their direct loan or loan guarantee programs in annual budgets. Generally, agencies also must produce annual updates of these estimates—known as reestimates—for each loan cohort on the basis of actual performance information and estimated changes in future performance. Agencies do not need to request additional appropriations to cover upward reestimates (increases in estimated lifetime costs) because FCRA provides permanent and indefinite budget authority for this purpose. Permanent and indefinite budget authority is available for obligation and expenditure without fiscal year limitation and is not limited to a specified amount or ceiling.

[32]FHA's MMI Fund required supplemental funds because the budgetary review determined the fund's capital reserve account—a budgetary account that holds funds to cover unexpected losses—did not have a sufficient balance to cover upward reestimates. Any upward reestimates for the MMI Fund are first covered by balances in the capital reserve account, and FHA draws on permanent and indefinite budget authority only if that account is depleted. The mortgage guarantee programs administered by VA and RHS are not required to have, and do not have, capital reserves. Therefore, all upward reestimates are covered by permanent and indefinite budget authority.

Evolution of Enterprise Capital Framework

Capital requirements established in the 1990s and early 2000s were insufficient for Fannie Mae and Freddie Mac (enterprises) to withstand the 2007 crisis in financial and mortgage markets. In July 2008, Congress created a new enterprise regulator, the Federal Housing Finance Agency (FHFA), with authority to establish regulatory capital levels higher than the statutory minimum requirements. FHFA placed the enterprises in conservatorships and suspended their capital requirements.

In July 2018, FHFA proposed a regulatory capital framework designed to allow the enterprises to continue operating after a stress event comparable to the 2007 crisis. It included a risk-based capital requirement and options for a minimum leverage (fixed-ratio) requirement to backstop the former.

In June 2020, FHFA altered and reproposed the 2018 rulemaking to emphasize ending the conservatorships and ensuring enterprise safety and soundness and market-stabilizing capacity through the economic cycle. In part, the final rule issued in December 2020 increased the quantity and quality of required capital and sought to address aspects of the 2018 proposal that could exacerbate market swings.

In September 2021, FHFA proposed amendments to the 2020 rule to address concerns it discouraged use of programs that transfer credit risk from the enterprises to private investors and included a leverage capital requirement that could encourage greater enterprise risk-taking. In part, the proposal would provide greater capital relief for credit risk transfers and modify the leverage requirement to make the risk-based capital requirement binding more often.

Source: GAO analysis of FHFA regulations. | GAO-22-104284

Enterprises. The results of stress tests conducted by Fannie Mae and Freddie Mac in 2021 do not suggest that either enterprise would need to draw on remaining Treasury commitments under the severely adverse economic scenario examined. The stress tests projected that both enterprises would continue to report net income under a scenario in which average house prices declined by 23.5 percent and the unemployment rate increased to nearly 11 percent (among other adverse economic developments) during a 9-quarter stress period. However, under certain tax assumptions, both enterprises were projected to report net losses under the severely adverse scenario. If the future earnings in a stress scenario are poor enough, the enterprises must record a write down of their deferred tax assets, increasing the earnings loss in that stress scenario.

Additionally, both enterprises are substantially undercapitalized compared to an FHFA capital framework intended to ensure the safety and soundness of the enterprises through the economic cycle.[33] In December 2020, FHFA finalized a rule establishing a new regulatory capital framework for the enterprises that FHFA views as a critical step toward ending the enterprise conservatorships (see sidebar).[34]

According to the enterprises, had the capital rule been in effect on March 31, 2021, the enterprises would have needed to hold $320 billion in combined capital to satisfy the rule.[35] This 2020 rule is a revision of a 2018 proposed rule, under which FHFA estimated that the enterprises

[33]In general, capital exists to absorb unexpected losses and allow a financial institution to continue operations during economic downturns.

[34]85 Fed. Reg. 82150 (Dec. 17, 2020).

[35]According to the final capital rule, the compliance date for many of the rule's requirements is tied to the termination of the conservatorship of the enterprises.

would have needed to maintain $180.9 billion in combined capital.[36] For much of their time in conservatorship, the enterprises were limited in their ability to build capital due to the terms of the PSPAs, and they sent most of their profits to Treasury in the form of dividends.[37]

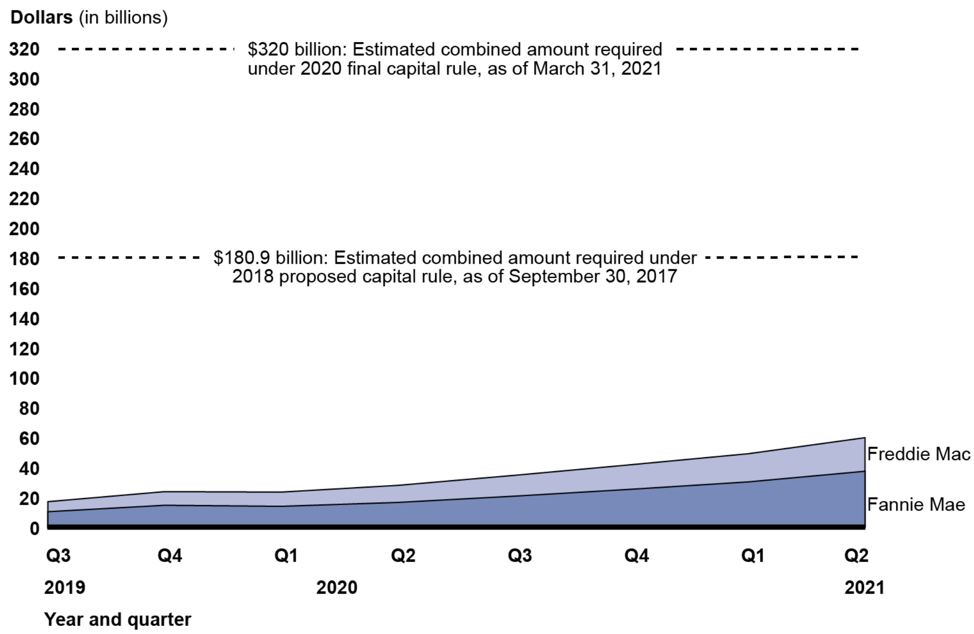
Although the enterprises' combined capital amounts have been increasing, as of June 30, 2021, the enterprises held nearly $60 billion in combined capital, well below the amount contemplated in the 2020 rule or the 2018 proposed rule (see fig. 4).[38]

[36]According to FHFA, the capital amount contemplated by the 2018 rule was insufficient for the enterprises to remain viable going concerns during a severe economic downturn. The 2020 rule sought to enhance the 2018 rule by increasing the quantity and quality of the rule's capital requirement and mitigating its procyclicality (tendency to exacerbate swings in the housing market). To achieve these goals, the 2020 rule modified the method for calculating certain types of capital requirements and introduced a stress capital buffer that would mitigate procyclicality by encouraging each enterprise to retain capital during periods of economic expansion, among other things.

[37]As discussed later in this report, amendments to the PSPAs ultimately increased the amount of capital the enterprises could accumulate. As of June 2021, the enterprises received $191.5 billion in capital support from Treasury and paid $301 billion in dividends to Treasury.

[38]The January 2021 amendments to the PSPAs provide, as compensation to Treasury, that the liquidation preference for each enterprise will increase by the amount of retained capital until the enterprise has achieved its regulatory minimum capital. The liquidation preference, in relation to the senior preferred stock the enterprises issued to Treasury, refers to the amount that must be paid to Treasury before investors in more junior classes of preferred or common stock can receive any payment on their stock in the event of liquidation.

Figure 4: Combined Capital of Fannie Mae and Freddie Mac Compared to Estimated Amount Required under 2018 Proposed Capital Rule and 2020 Final Capital Rule



Source: GAO analysis of Fannie Mae, Freddie Mac, and Federal Housing Finance Agency data. | GAO-22-104284

Note: The most recent information the enterprises reported on the amount of capital they would be expected to hold under the 2020 capital rule is as of March 31, 2021.

In September 2021, FHFA issued a proposed rule to amend the December 2020 capital rule.[39] These amendments would generally decrease the amount of capital each enterprise would be expected to hold under the December 2020 rule.

Market Interventions and Mortgage Refinancing Eased Nonbank Funding Challenges, but Liquidity Concerns Remain

During the outset of the pandemic, nonbank servicers—nondepository financial institutions that perform such activities as collecting borrowers' monthly payments and modifying loan terms—faced stress conditions and

[39]86 Fed. Reg. 53230 (Sept. 27, 2021).

members of Congress, industry groups, and researchers warned that nonbanks may encounter liquidity challenges and possibly fail.[40]

Nonbank Issues Include Liquidity Challenges, Adequacy of Regulation, and Share of MBS Servicing

Nonbanks may face liquidity challenges under stress conditions because they have fewer resources on which to draw and depend on short-term funding that may become unreliable during economic downturns. For instance, nonbanks do not have access to the liquidity facilities that the Federal Reserve System or FHLBank System makes available to banks.

Instead, nonbanks rely on short-term credit facilities, such as lines of credit and advances with borrowing limits. In some cases, nonbank servicers depend on a single investor or a few creditors and are therefore particularly vulnerable to a withdrawal of funds. During difficult economic conditions, these creditors may tighten loan terms or may face strong incentives to cancel loans and seize collateral as permitted.

Although CFPB assesses nonbanks for compliance with federal consumer financial laws, nonbanks generally are not subject to consistently comprehensive federal safety and soundness standards. In contrast, all banks that offer federal deposit insurance have a federal banking (prudential) regulator, whose responsibilities include ensuring the safety and soundness of the banks they oversee, protecting federal deposit insurance funds, promoting stability in financial markets, and enforcing compliance with applicable consumer protection laws.

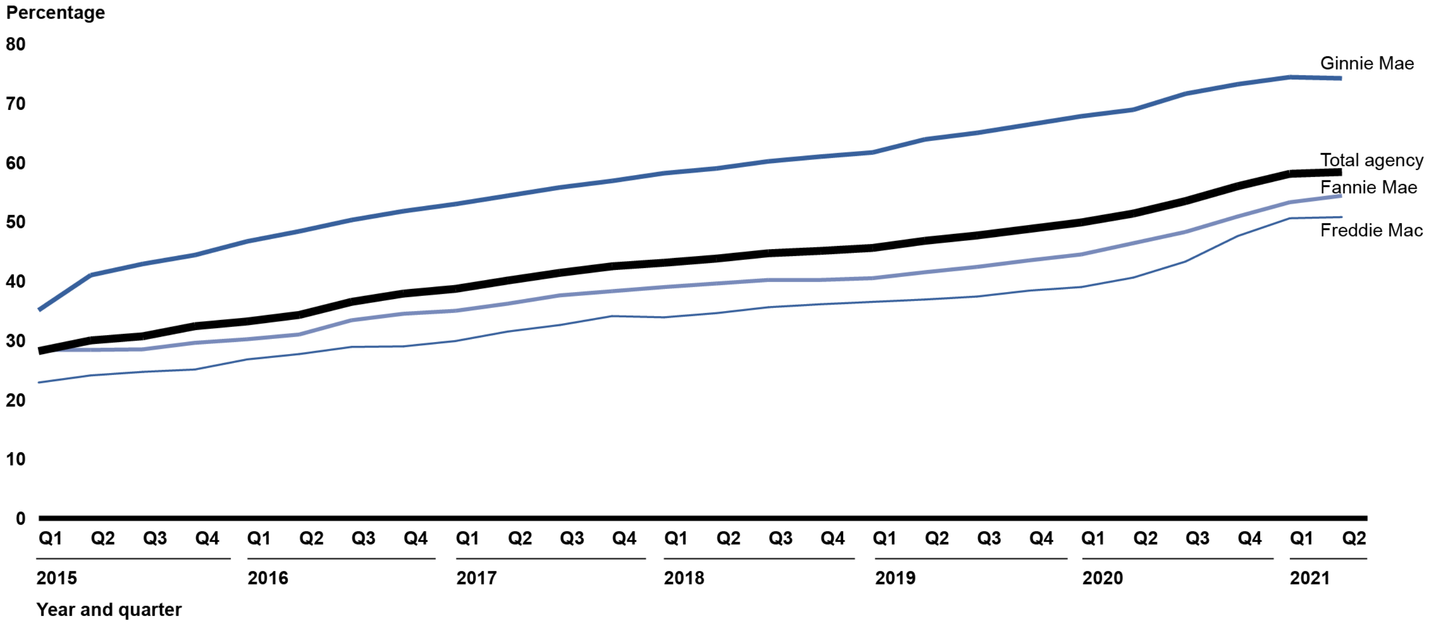
Nonbank entities chartered or licensed in their states to offer mortgage-related products and services are supervised by state regulators. Nonbanks also are subject to monitoring by market participants, such as the enterprises, Ginnie Mae, and FHA. For example, in 2015, FHFA directed the enterprises to issue updated minimum financial eligibility requirements (including net worth, capital ratio, and liquidity criteria) for all their servicers.

Nonbanks are significant to the agency MBS market because they service an increasing share of these mortgages. That share (in terms of dollar volume) increased from 28 percent in the first quarter of 2015 to more than 50 percent in the second quarter of 2021 (see fig. 5). Specifically, in the second quarter of 2021, nonbanks serviced 74 percent of mortgages

[40]Funding liquidity risk is the risk that a firm will not be able to meet its current and future cash flow and collateral needs, both expected and unexpected, without materially affecting its daily operations or overall financial condition.

in Ginnie Mae MBS, and 54 and 51 percent of mortgages in Fannie Mae and Freddie Mac MBS, respectively.

Figure 5: Share of Agency Mortgages Serviced by Nonbanks, 2015–2021 by Quarter (Q)



Ginnie Mae = Government National Mortgage Association

Source: GAO analysis of Inside Mortgage Finance data. | GAO-22-104284

Note: In this report, we use "banks" to refer to bank holding companies, financial holding companies, savings and loan holding companies, insured depository institutions, and credit unions, including their subsidiaries or affiliates. We define nonbanks as lenders or servicers that are not banks.

At the outset of the pandemic, mortgage industry stakeholders questioned whether nonbanks would have sufficient liquidity to manage servicing advances, a decline in the value of mortgage servicing rights,[41] or hedge-related margin calls.[42] If these conditions had led to nonbank failures,

[41]Servicing is inherent in all mortgage loans, but the right to service a mortgage becomes a distinct asset—a mortgage servicing right—when contractually separated from the loan at the time the loan is sold or securitized.

[42]Investors use hedging—taking the opposite position in a related asset—to reduce the risk of adverse price movements (losses in value). When purchasing on margin, investors borrow money to purchase assets. Investors must keep a minimum equity in their margin accounts and are subject to margin calls if their equity decreases to a specified level. In response to a margin call, an investor must either deposit more funds or liquidate positions.

mortgage credit to underserved borrowers could have been constrained and consumer protection risks related to mortgage servicing could have increased (as discussed below). Despite concerns about nonbank liquidity, officials from Treasury told us that they were not aware of any nonbank failures, as of September 2021.

Servicing advances. As mortgage servicers, nonbanks are responsible for passing principal and interest payments from borrowers to MBS investors. Generally, servicers must continue advancing these payments to investors even if borrowers do not make them.[43] Servicers also may have to satisfy property tax and insurance obligations for the delinquent borrower. As mentioned previously, agencies and Congress established forbearance options that allow borrowers with certain mortgages to temporarily suspend or reduce their payments without penalty. Therefore, researchers and government officials feared that if enough borrowers entered forbearance, cash flows for nonbank servicers could be disrupted.

Mortgage servicing rights. Mortgage servicing rights are a large asset held by nonbanks. At the outset of the pandemic, the value of the servicing rights declined due to falling interest rates and rising prepayment and delinquency risks. According to one estimate, the value of the rights fell approximately 50–60 percent during March and April 2020.[44] Nonbanks often pledge mortgage servicing rights as collateral to obtain short-term loans from lenders. As the value of the rights declined, lenders began to demand increased collateral from nonbanks. These margin calls from lenders threatened servicer liquidity.

Hedge-related margin calls. Nonbanks also faced margin calls on their hedge positions. Many mortgage lenders hedge the risk that newly originated mortgages could fall in value before their sale on the secondary market by taking short positions (mitigating risk from downward price movement) in the agency MBS market. In March 2020,

[43]Enterprise servicers must advance payments for a limited time, while Ginnie Mae issuers must advance payments until final credit resolution (for example, until the loan performs again or is foreclosed).

[44]Karan Kaul and Laurie Goodman, *Should Nonbank Mortgage Companies Be Permitted to Become Federal Home Loan Bank Members?* (Washington, D.C.: Urban Institute, June 2020); https://www.urban.org/research/publication/should-nonbank-mortgage-companies-be-permitted-become-federal-home-loan-bank-members.

the agency MBS market became illiquid.[45] To restore smooth market functioning, the Federal Reserve purchased agency MBS and MBS valuations rose. As a result of this increase, nonbanks lost money on their short hedge positions, which caused them to experience additional margin calls.

Potential effects of failures. Nonbanks are major originators and servicers of mortgages insured by FHA, which plays a particularly large role among minority, lower-income, and first-time home buyers. According to Ginnie Mae—which guarantees the performance of securities backed by FHA-insured mortgages—nonbanks accounted for over 90 percent of FHA mortgage origination activity as of July 2021. Therefore, failure of nonbanks could limit mortgage credit available to these underserved groups.

Additionally, failure of nonbanks could increase consumer protection risks because the transfer of loan servicing responsibilities from a failed institution to a new servicer could lead to a disruption in servicing for borrowers. Such a disruption could be problematic for delinquent borrowers whose loans generally require more resources to service than performing loans. CFPB told us that servicing transfers have been one of the bureau's areas of interest. The bureau issued guidance in April 2020 that officials said would facilitate the servicing transfer process should nonbanks or other servicers fail in the future.[46]

Nonbank Liquidity Stresses Were Mitigated, but Concerns Remain

According to researchers and government officials, nonbanks weathered these liquidity challenges due partly to earnings on a large volume of mortgage refinancings and government interventions.

A large volume of mortgage refinancing (spurred by low interest rates) has helped ease nonbank liquidity concerns. Many nonbank mortgage servicers are also mortgage originators and when a borrower refinances, it provides the nonbank with funds it can use to offset principal and interest advances to investors. According to HUD officials, the volume of

[45]In an illiquid market, securities cannot be converted into cash easily or without incurring a substantial reduction in the price of the security.

[46]Bureau of Consumer Financial Protection, *Compliance Bulletin and Policy Guidance: Handling of Information and Documents During Mortgage Servicing Transfers*, Bulletin 2020-02 (Washington, D.C.: Apr. 24, 2020).

this refinance market has allowed most servicers to cover missed borrower payments during the pandemic.

FHFA and Ginnie Mae actions also have helped ease liquidity stress on nonbanks. Specifically, FHFA limited to four the number of months that a servicer must continue advancing payments to investors. According to FHFA officials, this decision was designed to mitigate the financial impact of advancing principal and interest payments that borrowers did not make.

Likewise, Ginnie Mae revised and expanded its Pass-Through Assistance Program, which allows servicers to request funds on a monthly basis to help meet principal and interest payment obligations to investors on delinquent loans. Although participation in the program has been low (at the end of July 2021, one issuer had an outstanding balance), Ginnie Mae officials said the program has been beneficial because it has instilled confidence in the market. Additionally, Ginnie Mae said it has used a nonbank stress-testing framework it developed in 2019 to evaluate potential threats to issuers stemming from the COVID-19 pandemic.[47]

According to Mortgage Bankers Association representatives and research, and other market assessments, nonbanks generally remained profitable during the pandemic. However, a series of concerns about nonbanks has underscored their significant role and potential risks. Specifically, in October and November 2020, agency officials told us that nonbanks again could face liquidity stresses if refinancing volume slowed. Agency officials and researchers also noted that nonbanks potentially faced further liquidity challenges if mortgage forbearance or delinquency rates rose. As a result, the Financial Stability Oversight Council in its 2020 annual report encouraged regulators to take additional steps to ensure the largest and most complex nonbank mortgage companies were prepared if refinancings slowed or forbearance rates increased.[48] In December 2021, Federal Reserve officials said declining forbearance rates had helped mitigate concerns about that scenario. But they also noted that a drop in home prices could present a new concern for nonbanks by impeding mortgage refinancing and increasing costs from servicing of defaulted loans.

[47]Stress tests are projections of financial condition under adverse scenarios.

[48]Financial Stability Oversight Council, *2020 Annual Report* (Washington, D.C.: 2020).

Efforts to strengthen oversight of nonbanks are ongoing. In July 2021, the Conference of State Bank Supervisors, a nationwide organization of state financial regulators that helps coordinate state financial regulation, published final model prudential standards for nonbank mortgage servicers. These standards cover several areas of a nonbank's business, including capital and liquidity. The Conference of State Bank Supervisors developed the standards to generally align with FHFA's capital and liquidity requirements for servicers. These standards are intended as a model for voluntary adoption by each state as deemed appropriate and necessary and do not impose any immediate requirement on nonbank mortgage servicers. The Housing Policy Council, a trade association whose members include mortgage originators and servicers, said standards for nonbanks should be consistent with federal requirements and be uniformly applied and enforced by the states.

Additionally in July 2021, Ginnie Mae requested input from stakeholders about changes it anticipates making to the capital and liquidity requirements for single-family MBS issuers. According to Ginnie Mae, these changes are informed by its analysis of stress testing results and observations of systemic stress from the pandemic. These changes are intended to introduce risk-based capital requirements for issuers and to align Ginnie Mae's capital and liquidity requirements to the greatest degree possible with those of other government entities.

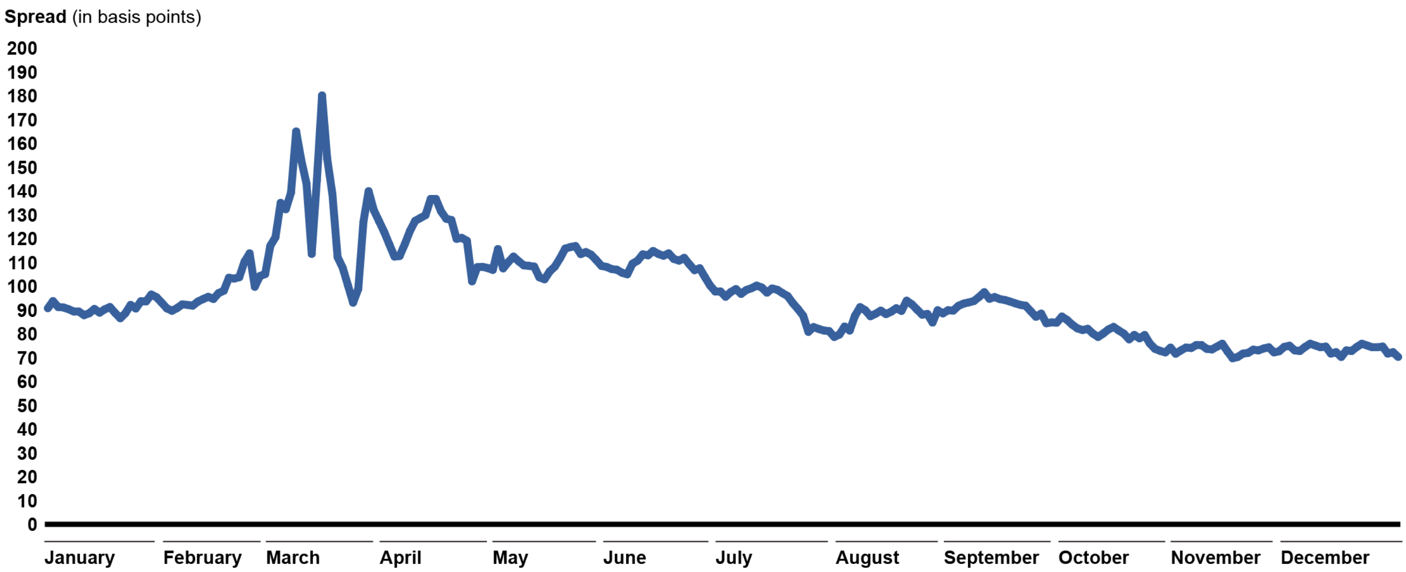
To strengthen regulatory oversight of nonbanks, we previously recommended that Congress consider granting FHFA explicit authority to examine third parties, such as nonbank servicers, that do business with the enterprises.[49] Without such statutory authority, FHFA lacks a supervisory tool to effectively monitor third-parties' operations and the enterprises' actions to manage any associated risks. As of June 2021, Congress had not enacted legislation that would provide FHFA this authority.

[49]GAO, *Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened*, GAO-16-278 (Washington, D.C.: Apr. 14, 2016).

Federal MBS Purchases Calmed the Market, but Amount of Purchase Raises Concerns about Market Resiliency

In March 2020, the MBS market experienced a period of price declines and illiquidity that was later improved by the Federal Reserve's purchase of MBS. During this time, the uncertainty of the COVID-19 economic shock prompted a demand for cash and near-cash investments among investors. In response, investors began selling assets, including agency MBS. The value of MBS fell and spreads against U.S. Treasury securities widened (see fig. 6).[50]

Figure 6: Spread between Agency Mortgage-Backed Securities (MBS) and U.S. Treasury Securities, 2020



Source: GAO analysis of Bloomberg data. | GAO-22-104284

Notes: The graph shows yield spread between the Fannie Mae 30-year current-coupon bond and the 5/10-year U.S. Treasury bond blend. Spreads are the difference in yields between a security (such as MBS) and a safer asset (such as a Treasury security) with similar timing of interest and principal payments. Higher spreads reflect investor perceptions of higher perceived risk for MBS. A basis point is 1/100th of a percentage point.

In March 2020, some market participants responsible for facilitating the sale and purchase of MBS reached capacity and were unable to intermediate further sales. Together, the pressure to sell and the overwhelmed market intermediaries created illiquidity in the agency MBS market. Officials from the Federal Reserve told us that other markets,

[50]Spreads are the difference in yields between a security (such as MBS) and a safer asset (such as a Treasury security) with similar timing of interest and principal payments. Higher spreads reflect investor perceptions of higher perceived risk for MBS.

including the U.S. Treasury securities market, also experienced illiquidity due to asset sales pressures and overwhelmed market intermediaries.

The experience of mortgage real estate investment trusts (mREIT) illustrates the pressures that contributed to MBS market instability early in the pandemic. Among agency MBS investors, mREITs decreased their holdings of these securities the most during this period.[51] These leveraged investment entities rely on short-term funding to purchase long-term mortgage-related assets (such as agency MBS) and obtain short-term funding by pledging MBS as collateral.[52] Because of this business model, funding for mREITs is at risk of disruption should the value of MBS decline.

The decline in MBS prices that occurred in March 2020 prompted demands from mREITs' lenders for more collateral because the collateral mREITs had pledged was no longer sufficient for their loans. In response to margin calls from their lenders, mREITs began selling MBS, which created additional downward pressure on the price of MBS and prompted more margin calls. Asset sales by mREITs potentially contributed to overwhelming the capacity of market intermediaries. Representatives from the National Association of Real Estate Investment Trusts, an industry association representing mREITs and other real estate investment trusts, told us that, although their members faced margin calls during this period, none failed.

On March 15, 2020, the Federal Reserve announced it would purchase at least $200 billion of agency MBS to support the smooth functioning of this market. However, the MBS-Treasury spread continued to widen. On March 23, the Federal Reserve pledged to expand its purchase of agency MBS to amounts necessary to restore market functioning. According to a Federal Reserve Bank of New York executive vice president, credit

[51]According to the Financial Accounts of the United States published by the Federal Reserve, mREIT holdings of securities backed by agencies and government-sponsored enterprises decreased by $124 billion from the fourth quarter of 2019 to the first quarter of 2020. This category of securities includes debt securities issued by budget agencies (those that are part of the federal budget under special financing authorities), government-sponsored enterprises, and agency- and enterprise-backed mortgage pools. According to Federal Reserve officials, almost all mREIT holdings in this category are agency MBS.

[52]To qualify as a REIT, a company must have 75 percent of its assets and gross income connected to real estate investment and must distribute at least 90 percent of its taxable income to shareholders annually in the form of dividends.

markets would have seized up had market dysfunction continued.[53] Continued market dysfunction also could have limited mortgage availability. The Federal Reserve's purchase of agency MBS partially relieved the strain on intermediaries' capacity, gradually improved liquidity conditions, and helped stabilize MBS prices.

In June 2020, the Federal Reserve began increasing its holdings of agency MBS by $40 billion per month, and continued at that pace until November 2021. In November 2021, the Federal Reserve announced that it would begin reducing the amount of agency MBS it purchased per month.

The nature of the Federal Reserve's actions underscores the stability challenges faced by the MBS market. Industry stakeholders have noted that the Federal Reserve's purchases of MBS during this period differed from its previous MBS purchases in that they were both larger and executed more quickly. Additionally, the same Federal Reserve Bank of New York executive vice president noted that the purpose of the recent MBS purchases differed from purchases following the financial crisis of 2007–2009. That official said whereas the past MBS purchases primarily were meant to put downward pressure on longer-term interest rates, the recent purchases were intended to restore market functioning. One researcher noted that the large size of the Federal Reserve intervention needed to restore market functioning raises concerns about the resiliency of the market intermediaries that facilitate the purchase and sale of MBS.[54]

Researchers have identified practices or suggested additional methods for improving MBS market liquidity under stress conditions. One group of researchers theorized that the normal channels of intermediation failed during the outset of the pandemic because the liquidity the market intermediaries provided was insufficient to meet the large volume of

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[53]Lorie K. Logan, The Federal Reserve's Market Functioning Purchases: From Supporting to Sustaining (July 15, 2020); https://www.newyorkfed.org/newsevents/speeches/2020/log200715. The Federal Reserve Bank of New York is authorized to buy and sell agency MBS to execute directives from the Federal Reserve System's Federal Open Market Committee.

[54]Borys Grochulski, "Federal Reserve MBS Purchases in Response to the COVID-19 Pandemic," *Economic Brief*, no. 20-08 (July 2020); https://www.richmondfed.org/publications/research/economic_brief/2020/eb_20-08.

investors' MBS sales.[55] They noted that during March 2020, the Federal Reserve changed how it purchased MBS, allowing intermediaries to quickly reduce their inventories, which lessened short-term selling pressure.[56]

Another group of researchers noted that intermediaries' ability to provide market liquidity relies on having stable access to funding through the repurchase (or repo) market—a short-term market that provides financing for securitization activities and financial institutions.[57] To provide stable access, the researchers proposed creating a standing (as opposed to an emergency) repurchase facility at the Federal Reserve that would offer intermediaries financing in exchange for collateral such as agency MBS through repurchase agreements. However, according to Federal Reserve officials, the availability of reliable funding may not be sufficient in some cases. For example, losses could force some investors to liquidate securities if they are leveraged and have diminished capital. Lastly, one researcher suggested setting maximum leverage and minimum liquidity standards for mREITs as a way to prevent these entities from becoming a potential source of weakness during future economic downturns.[58]

[55]Jiakai Chen, et al., "Did Dealers Fail to Make Markets during the Pandemic?," *Federal Reserve Bank of New York Liberty Street Economics* (Mar. 24, 2021); https://libertystreeteconomics.newyorkfed.org/2021/03/did-dealers-fail-to-make-markets-during-the-pandemic.html.

[56]Most MBS are sold in the forward market, which is known as the to-be-announced market. These trades normally settle once per month according to a schedule set by the Securities Industry and Financial Markets Association. During March 2020, the Federal Reserve contracted with market intermediaries to settle many MBS transactions within 2–3 trading days.

[57]Nellie Liang and Pat Parkinson, "Enhancing Liquidity of the U.S. Treasury Market Under Stress," *Hutchins Center Working Paper*, no. 72 (December 2020); https://www.brookings.edu/research/enhancing-liquidity-of-the-u-s-treasury-market-under-stress/. A repurchase agreement is the transfer of cash for a specified amount of time, typically overnight, in exchange for collateral. When the term of the agreement is over, the transaction unwinds, and the collateral and cash are returned to their original owners, with a premium paid on the cash.

[58]Don Layton, *America's Housing Finance System in the Pandemic, Part 2: Extraordinary Support and Necessary Consequences* (Apr. 3, 2020); https://www.jchs.harvard.edu/blog/americas-housing-finance-system-in-the-pandemic-part-2-extraordinary-support-and-necessary-consequences.

2019 Plan Recommendations That Align with System Vulnerabilities and GAO's Framework Could Inform Future Planning

Our analysis of Treasury and HUD's 2019 housing finance reform plans—the most recent set of plans to date—found they contained recommendations that aligned with system vulnerabilities and our 2014 housing finance reform framework, and that progress on the recommendations varied. The current administration has stated its interest in helping shape future reforms, but has not issued its own plans or performed an analysis similar to ours. Considering the recommendations in the 2019 plans and addressing all GAO framework elements could help ensure that future plans address key risks and are comprehensive.

2019 Plans Include Recommendations Related to Vulnerabilities Highlighted by the Pandemic

As noted earlier, the 2019 housing finance reform plans contained 116 recommendations, some of which were legislative recommendations for Congress and others administrative recommendations to federal agencies. Although these plans were developed before the pandemic, some of their recommendations relate to vulnerabilities the pandemic highlighted (as discussed earlier in this report) and that future reform efforts may seek to address. Because there may be other ways to address these vulnerabilities, our analysis is intended only to identify relevant recommendations, not to endorse their inclusion in future reform plans.

Federal fiscal exposure. We identified 49 plan recommendations related to federal fiscal exposure, which is also an element of our 2014 reform framework. Specifically, fiscal exposure was the primary framework element for 34 of these recommendations and the secondary element for the remaining 15.[59] As previously discussed, federal fiscal exposure is substantial due to the large portion of the mortgage market that is federally backed. Examples of recommendations that address fiscal exposure include the following:

- Several recommendations in Treasury's plan related to increasing the enterprises' capital and liquidity requirements to help them exit federal conservatorship and decrease the likelihood they would require

[59]The appendixes of 2019 plans assign a specific number to each recommendation. Figures 11 (Treasury plan) and 12 (HUD plan) in app. III of this report refer to the numbering for the 49 recommendations (categorized under the "control of fiscal exposure" framework element). Appendix III also includes web links to the 2019 plans.

taxpayer assistance in the future. Agencies acted on a number of these recommendations. For example, in September 2019 Treasury and FHFA amended the PSPAs to allow the enterprises to retain earnings and build capital of up to $45 billion combined.[60] Building capital reduces federal fiscal exposure by increasing the enterprises' ability to absorb unexpected losses during an economic downturn. In January 2021, Treasury and FHFA amended the PSPAs again to allow the enterprises to build capital to the level prescribed by FHFA's 2020 capital framework (discussed earlier). In September 2021, FHFA proposed additional amendments to the capital framework that, among other things, would alter the leverage requirement and change the capital treatment of credit risk transfer transactions.[61] These amendments would result in a decrease to the enterprises' capital requirements below the amounts prescribed in the 2020 capital framework. According to FHFA, these amendments are intended to facilitate an environment in which leverage is not the binding capital constraint for the enterprises and the enterprises have incentives to distribute acquired credit risk to private investors.

- A number of recommendations in HUD's plan concerned the management of FHA's mortgage insurance programs. In July 2020, FHA implemented a recommendation in HUD's plan to more effectively and efficiently use alternatives to property conveyance—the often-lengthy process by which a mortgage servicer transfers ownership of a foreclosed property with an FHA-insured mortgage to FHA.[62] Specifically, FHA announced enhancements to a program that

[60]Specifically, the 2019 agreements allowed capital retention up to $25 billion for Fannie Mae and up to $20 billion for Freddie Mac.

[61]Generally, a leverage capital requirement is the minimum amount—usually expressed as a percentage—of capital that must be held against total assets. In 2012, FHFA began development of a credit risk transfer program intended to reduce the enterprises' overall risk and, therefore, the risk they pose to taxpayers while in conservatorship. The enterprises implemented the programs in 2013 and have transferred a significant amount of credit risk to private investors, mostly though debt and trust issuance structures. Transferring credit risk reduces the amount of capital the enterprises are required to hold.

[62]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 13.

allows servicers to sell foreclosed properties to third parties.[63] The enhancements include steps to improve the accuracy of prices for properties and updated guidance on costs for which servicers may be reimbursed. According to HUD, avoiding conveyance reduces administrative, holding, and servicing costs associated with property disposition. Reducing these costs can positively affect the financial condition of the MMI Fund and thus help control federal fiscal exposure. In contrast, implementation of certain administrative and legislative recommendations aimed at improving the financial viability of FHA's program for reverse mortgages (a type of loan against home equity) was not completed.[64]

- Treasury's plan included recommendations that could limit the federally supported share of the market and reduce fiscal exposure. For example, Treasury's plan recommended that FHFA assess credit and other risks posed by the enterprises' underwriting parameters, including for acquisitions of single-family mortgages with higher-risk characteristics, and use this assessment to guide the underwriting restrictions it prescribed.[65]

  Consistent with this recommendation, in January 2021, Treasury and FHFA amended the PSPAs to limit the enterprises' acquisitions of single-family mortgages with two or more higher-risk characteristics to no more than 6 percent of purchase mortgages and no more than 3 percent of refinance mortgages in any 52-week period.[66] Market analysts have noted that these acquisition restrictions may present

[63]Under the claims without conveyance of title program, the servicer attempts to secure a third-party purchase of an eligible property for an adjusted fair market value that is less than the amount of the servicer's projected insurance claim to FHA. For more information, see GAO, *Federal Housing Administration: Improved Procedures and Assessment Could Increase Efficiency of Foreclosed Property Conveyances*, GAO-19-517 (Washington, D.C.: June 20, 2019).

[64]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation numbers 36, 37, and 39.

[65]Department of the Treasury, *Housing Finance Reform Plan*, recommendation number 33.

[66]The higher-risk characteristics include a loan-to-value ratio over 90 percent, a borrower debt-to-income ratio over 45 percent, and a borrower credit score of less than 680. A credit score is a numeric value (generally ranging from 300 to 850) that indicates a borrower's ability to repay future obligations. According to Treasury, the acquisition percentages reflected current levels at the time of the amendments.

tradeoffs in relation to credit availability.[67] In September 2021, FHFA and Treasury suspended the acquisition restrictions for at least 1 year.[68] During the suspension, FHFA said it would review the extent to which these restrictions are redundant or inconsistent with mandated sustainable lending standards and consult with Treasury on any recommended revisions.

Nonbank liquidity risks. Treasury and HUD's 2019 plans together contained three recommendations relating to nonbank liquidity risks. First, the Treasury plan recommended that Congress consider permitting additional classes of mortgage lenders to become members of the FHLBank System (for example, to give nonbanks access to liquidity support).[69] Representatives from the Mortgage Bankers Association stated that nonbanks align with the mission of the FHLBank System and access to FHLBank advances could ease liquidity challenges among nonbanks in the future. However, including nonbanks could pose risk-management challenges to the system. As one analysis of this issue noted, nonbanks are subject to less regulatory oversight and have weaker capital positions than their bank counterparts.[70] As of September 2021, Congress had not enacted legislation to implement this recommendation.

The HUD plan contained two additional recommendations indirectly relating to nonbank liquidity risks. Both recommendations aimed to address the shift in FHA's lender base from banks to nonbanks by encouraging bank participation in originating and servicing FHA-insured mortgages.[71] According to HUD, banks have cited potential legal liability relating to enforcement actions under the False Claims Act as a leading

[67]For example, see Urban Institute, *The Preferred Stock Purchase Agreements Will Hamper Access to Credit: A Further Modification Is in Order* (Washington, D.C.: February 2021).

[68]The suspensions were agreed to on September 14, 2021, and will terminate on the later of 1 year after this date or 6 months after Treasury notifies the enterprises.

[69]Department of the Treasury, *Housing Finance Reform Plan*, recommendation number 48.

[70]Brookings Institution, *Task Force on Financial Stability* (June 2021): 88. The Brookings Institution and the University of Chicago's Booth School of Business formed the task force in October 2019.

[71]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation numbers 24 and 25.

reason for their limited participation in FHA's programs.[72] For instance, some lenders expressed concern about minor loan errors leading to exposure to severe financial penalties under the act.

In October 2019, HUD took action consistent with a recommendation in its 2019 plan to clarify HUD and Department of Justice consultations on use of the False Claims Act. Specifically, the agencies completed a memorandum of understanding that prescribes standards for when HUD may refer a matter to Justice to pursue a case under the False Claims Act. In September 2020, HUD also implemented a recommendation to revise its method for identifying loan-level underwriting defects; it aligned the severity of the defects with proposed remedies. According to HUD's plan, these actions will provide lenders with transparency and a higher level of certainty and promote a more diverse lender base in FHA's programs. But their ultimate impact is not yet known.

MBS market instability. Treasury's plan included one recommendation related to MBS market instability (such as occurred in March 2020). Previously, some mREITs had access to the FHLBank System through the captive insurance arms of their parent companies, but a 2016 FHFA rule that sought to address circumvention of system membership requirements removed that access.[73] Captive insurers are special-purpose insurance companies set up by commercial businesses to self-insure risks arising from the owners' business activities. FHFA's 2016 rule terminated captive insurers' FHLBank memberships. FHFA explained its decision by stating that most new captive insurers that had been admitted as members were owned by entities not eligible for membership.

Treasury's plan recommended that FHFA revisit its 2016 rule in light of the continued evolution of the housing finance system.[74] FHLBank System membership through captive insurance companies could help

[72]The False Claims Act is one of the government's primary antifraud tools. In investigations that began in 2012, HUD, HUD's Office of Inspector General, and the Department of Justice uncovered evidence that certain lenders were originating mortgage loans insured by FHA that the lenders knew were ineligible for insurance. The lenders submitted false certifications to FHA that those loans were eligible, causing FHA to pay hundreds of millions of dollars in ineligible insurance claims. The Department of Justice used the False Claims Act in a series of settlements and actions against these lenders. The act, as amended, is codified at 31 U.S.C. §§ 3729-33.

[73]81 Fed. Reg. 3246 (Jan. 20, 2016).

[74]Department of the Treasury, *Housing Finance Reform Plan*, recommendation number 49.

entities such as mREITs weather economic disruptions, but also could increase risk to the system or encourage greater risk-taking. In February 2020, FHFA issued a request for input on FHLBank System membership, but as of September 2021, had not taken further action on the recommendation. In September 2021, FHFA officials told us that expanding access to the FHLBank System presents challenges and would not fully address housing finance system vulnerabilities such as MBS market instability.

A 2015 Financial Stability Oversight Council report (issued prior to the 2016 FHFA rule) stated that membership in the FHLBank System—such as through captive insurers—provided some mREITs a more diverse capital base, reducing risks associated with a heavy reliance on short-term borrowing in the repurchase market.[75] However, the report also noted that captive insurance companies may be subject to less regulatory oversight than other entities in the FHLBank System. Representatives from the National Association of Real Estate Investment Trusts told us they support expanding FHLBank membership because they view mREITs as highly aligned with the mission of the FHLBank System, and membership would allow mREITs to expand market share and access additional capital. They added that mREITs can operate without the financial support of the FHLBank System and they did not think implementation of the Treasury recommendation was needed for market stability reasons.

2019 Plans Include Recommendations Related to Each Element of Our Framework, with Emphasis on Controlling Fiscal Exposure

A large majority of the plans' 116 recommendations related to three of the eight relevant elements of our framework: controlling fiscal exposure, aligning policies with goals, and enhancing capacity to manage risks.[76] Some recommendations applied to two framework elements (see fig. 7). Accounting for this overlap,

- 49 recommendations applied to controlling fiscal exposure, including those to help ensure that the enterprises and FHA are sufficiently capitalized;

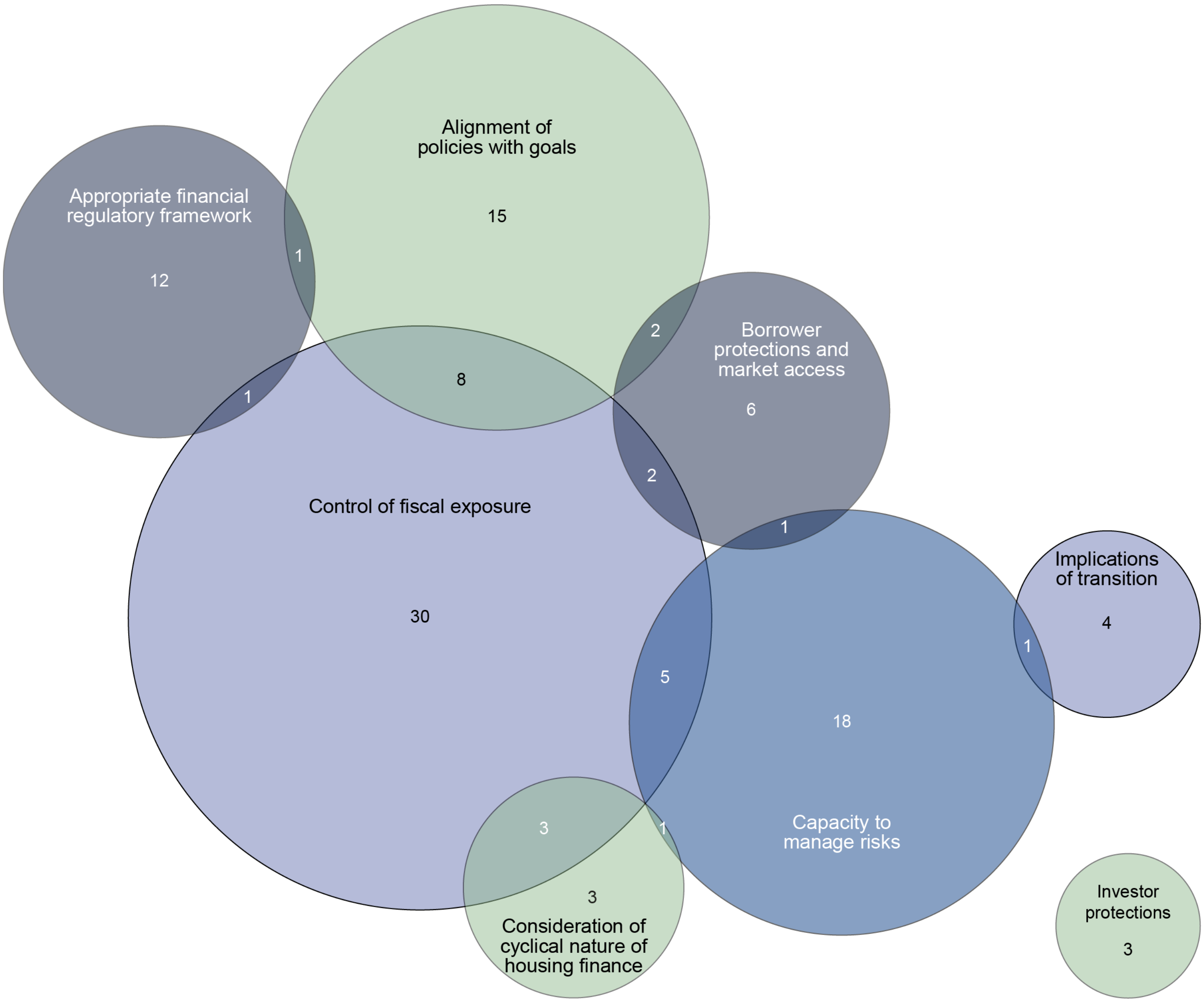
[75]Financial Stability Oversight Council, *2015 Annual Report* (Washington, D.C.: May 19, 2015).

[76]We did not use the framework element related to clearly defined and prioritized housing finance system goals because it applies to a reform plan overall, not to specific reform recommendations.

- 26 recommendations applied to aligning policies with goals, such as those intended to focus FHA's programs on its mission of serving borrowers not served by traditional underwriting;
- 26 recommendations applied to enhancing capacity to manage risks, including recommendations aimed at hiring and retaining FHA staff with specialized skills and modernizing FHA's and Ginnie Mae's information technology; and
- 14 or fewer recommendations applied to each of the remaining five elements (appropriate financial regulatory framework, borrower protections and market access, implications of transition, consideration of the cyclical nature of housing finance, and investor protections), including recommendations to clarify statutory and regulatory requirements.[77]

[77]See figures 11 and 12 in app. III for a more detailed analysis of the plans' recommendations using the relevant eight elements of our framework. That analysis links the eight elements with specific numbered recommendations from the plans. The percentage of recommendations aligned with each framework element is not a comprehensive measure of plan emphasis because it treats each recommendation equally, when in fact some recommendations may be more consequential than others. However, in this case, the percentages are broadly consistent with the plans' overall goals, which stress limiting the role of and risks to the federal government.

Figure 7: Distribution of 2019 Housing Reform Plan Recommendations across Elements of GAO's Framework for Assessing Potential Changes to the Housing Finance System



Source: GAO analysis of Departments of the Treasury and Housing and Urban Development 2019 Housing Finance Reform plans. | GAO-22-104284

While consistent with the overall goals of the plans, the strong emphasis on reducing fiscal exposure presents potential trade-offs in relation to borrower access to mortgage credit. For example, actions that would reduce risks to the federal government by raising the cost of federal guarantees or tightening underwriting standards also might reduce the number of borrowers who could afford or qualify for mortgages. Changes in policy priorities could shift emphasis to other framework elements and therefore present different trade-offs.

Progress on 2019 Plan Implementation Varied by Framework Element

Progress on the recommendations in the 2019 plans was limited to the administrative recommendations and varied by framework element. Future reforms may emphasize different framework elements. Therefore, analysis of the status of the 2019 recommendations by framework element may help agencies decide whether to sustain or modify (or possibly reverse) actions on the administrative recommendations to meet future reform goals.

Recent Changes in Ability to Repay/Qualified Mortgage (ATR/QM) Rule

The ATR/QM Rule requires creditors to make a good faith determination of a borrower's ability to repay a residential mortgage loan and provides certain protections from liability for mortgage loans meeting the definition of a "qualified mortgage," the categories of which include a General QM category.

Under a previous version of the rule, a residential mortgage loan could be a General QM only if it did not have certain features (such as interest-only payments or points and fees above specified limits) and the borrower's monthly debt-to-income (DTI) ratio did not exceed 43 percent. The creditor also had to verify borrower debt and income using prescribed standards.

In December 2020, the Consumer Financial Protection Bureau (CFPB) amended the General QM definition to replace the DTI ratio limit with one based on the mortgage's annual percentage rate. CFPB also made requirements for verifying borrower income and debts less prescriptive. Creditors must comply with the new definition starting October 1, 2022.

A second, temporary category of QMs was residential mortgages eligible to be purchased or guaranteed by Fannie Mae and Freddie Mac (enterprises). To meet the definition for this category, a mortgage had to comply with ATR/QM prohibitions on certain loan features and points and fees limits, but did not have to meet the 43 percent DTI limit.

Due to amendments to the enterprise conservatorship agreements, this temporary QM category effectively expired. Mortgage loans with application dates of July 1, 2021, or later must meet the revised General QM category definition to be eligible for sale to the enterprises.

Source: GAO analysis of CFPB regulations. | GAO-22-104284

The 2019 plans contained legislative and administrative recommendations, but only administrative recommendations have been implemented. As of September 2021, Congress had not enacted any of the 35 legislative recommendations, but, consistent with one recommendation, funded a portion of a multiyear modernization of FHA's single-family IT systems.[78] Additionally, by finalizing amendments to the qualified mortgage rule, CFPB took steps related to a legislative recommendation regarding the Truth in Lending Act and compliance with the required ability-to-repay determination (see sidebar).[79] Fourteen of the 35 legislative recommendations call for, or assume, prior enactment of major changes to the housing finance system—including an explicit, paid-for Ginnie Mae guarantee of qualifying conventional and multifamily MBS, or repeal and replacement of the enterprises' statutory charters and authorization of competitors to the enterprises. The remaining 21 recommendations encompass issues including FHLBank membership and reorganizing HUD. Among the legislative recommendations, seven of 18 in Treasury's plan applied to controlling fiscal exposure, and nine of 17 in HUD's plan applied to the capacity to manage risks.

As of January 20, 2021, housing and regulatory agencies had acted on 57 of the 81 administrative recommendations. Specifically, agencies completed implementation of 27 recommendations and took partial action on 30. There was no documented action for the remaining 24 (see fig. 8).

[78]The recommendation was for Congress to appropriate sufficient funds to complete the IT modernization. As of September 2021, Congress had appropriated $60 million for this effort. See Pub. L. No 116-6, 133 Stat. 13, 454 (2019); Pub. L. No. 116-94, 133 Stat. 2534, 2998 (2019); Pub. L. No. 116-260, 134 Stat. 1182, 1891 (2020). HUD has estimated that the total cost of the modernization will be about $92 million. However, in a September 2021 report, we concluded HUD lacked reliable cost and schedule estimates. See GAO-21-459.

[79]See Fed. Reg. 86308 (Dec. 29, 2020). CFPB extended the mandatory compliance date with the rule from July 1, 2021, to October 1, 2022. 86 Fed. Reg. 22844 (Apr. 30, 2021).

Figure 8: Status of Administrative Recommendations in 2019 Housing Finance Reform Plans, by GAO Framework Element (Agency Actions as of January 20, 2021)

	Implementation status of recommendations			
GAO framework element	**Treasury plan**		**HUD plan**	
Control of fiscal exposure: Recognition and control of fiscal exposure and mitigation of moral hazard	●●●●●●[a]◐◐◐◐◐◐[a]○○[b]	6 of 14 completed	●●●◐◐◐◐○○○	3 of 10 completed
Alignment of policies with goals: Policies and mechanisms that are aligned with goals and other economic policies	●[c]●[c]◐[c]○○○	2 of 6	●●●●[b]◐◐[c]○○○○○○[c]	4 of 12
Capacity to manage risks: Government entities that have capacity to manage risks	○[d]	0 of 1	●●●●◐◐◐◐[a]◐[c]◐[c]○○○	4 of 13
Appropriate financial regulatory framework: Adherence to an appropriate financial regulatory framework	●◐◐○	1 of 4	●●●◐○	3 of 5
Borrower protections and market access: Mortgage borrowers are protected and barriers to mortgage market access are addressed	●	1 of 1	●◐◐◐[c]◐[e]◐[f]○○[e]	1 of 8
Investor protections: Protection for mortgage securities investors	○○	0 of 2	◐	0 of 1
Consideration of cyclical nature of housing finance: Consideration of cyclical nature of housing finance and impact of housing finance on financial stability	◐	0 of 1	◐	0 of 1
Implications of transition: Emphasis on implications of the transition	●●	2 of 2	No recommended actions in plan	
Total		**12 of 31**		**15 of 50**

● Completed
◐ Partial action
○ No documented action

Source: GAO analysis of Departments of the Treasury and Housing and Urban Development (HUD) 2019 Housing Finance Reform plans and plan status. | GAO-22-104284

Note: Several recommendations applied to two of GAO's framework elements. In these cases, we identified a primary and secondary element. We categorized recommendations in this graphic based on the framework element we identified as primary, and indicated the recommendations that also applied to a secondary element using superscript letters.

[a]These recommendations also applied to the consideration of cyclical nature of housing finance element of the framework.

[b]These recommendations also applied to the appropriate financial regulatory framework element of the framework.

[c]These recommendations also applied to the control of fiscal exposure element of the framework.

[d]This recommendation also applied to the implications of transition element of the framework.

[e]These recommendations also applied to the alignment of policies with goals element of the framework.

[f]This recommendation also applied to the capacity to manage risks element of the framework.

Progress on recommendations related to each framework element varied (some recommendations applied to more than one element, as noted in the figure).[80] For example, agencies completed or took partial action on 19 of the 24 recommendations related to fiscal exposure. In contrast, agencies completed or took partial action on nine of 18 recommendations related to aligning policies with goals. Appendix III contains examples of implemented and unimplemented administrative recommendations from the 2019 plans as of January 20, 2021—including descriptions of related agency actions—organized by framework element.

Since the January 2021 change in administration, agencies have taken actions relevant to some recommendations, although not as part of a broader effort to implement the 2019 plans. For example, Ginnie Mae officials stated they continue to pursue administrative recommendations from the 2019 plans as part of their operating plan. Agencies also have taken steps to amend or suspend actions related to recommendations from the 2019 plans. For example, as previously discussed, FHFA issued a proposed rulemaking in September 2021 that would amend the 2020 capital framework, and Treasury and FHFA announced the suspension and review of certain requirements in the January 2021 PSPAs. Where applicable, we discuss actions agencies have taken since January 2021 in appendix III.

Conclusions

The pandemic and the transition to a new administration have increased uncertainty about the future of housing finance reform. Sustained focus on reforming the housing finance system remains critical because of the significant risks of the current system, including the substantial federal fiscal exposure and other vulnerabilities highlighted by the pandemic. While the current administration has not issued its own reform plans, it has stated its interest in helping shape future reforms.

Our analysis, which incorporated principles for identifying and analyzing risks and critical elements of housing finance reform, showed that the 2019 reform plans are relevant to future planning efforts.

- First, although the Treasury and HUD plans were issued shortly before the pandemic, they contain implemented and unimplemented recommendations relevant to vulnerabilities the pandemic highlighted. While mitigated by federal actions and market conditions thus far, the vulnerabilities remain relevant for risk assessments that may support

[80]See figure 13 in app. III for the status of specific numbered recommendations from the plans.

future Treasury and HUD planning efforts. Accordingly, considering the plan recommendations we identified could help identify options for mitigating the vulnerabilities and aid assessment of steps already taken.

- Second, our analysis of the nature and status of the plans identified recommendations related to each element of our framework but in different stages of implementation. While future housing reforms may emphasize different policy goals, considering the prior plans in the context of the framework could (1) help identify actions that would cover all framework elements in future plans and (2) aid decisions about implementing or altering prior recommendations to reflect current policy priorities and the framework elements they emphasize.

As Treasury and HUD develop future reform plans, considering the recommendations in the 2019 plans and addressing all GAO framework elements could help ensure the plans address key risks, are comprehensive, and account for prior actions.

Recommendations for Executive Action

We are making the following two recommendations, one each to Treasury and HUD:

The Secretary of the Treasury, as part of developing future housing finance reform plans, should consider recommendations from the 2019 plans that could help address system vulnerabilities and ensure future plans address all GAO framework elements. (Recommendation 1)

The Secretary of HUD, as part of developing future housing finance reform plans, should consider recommendations from the 2019 plans that could help address system vulnerabilities and ensure future plans address all GAO framework elements. (Recommendation 2)

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury, HUD, VA, CFPB, FHFA, USDA, and the Federal Reserve for review and comment. Treasury and HUD provided written comments, which are reprinted in appendixes IV and V, respectively. Treasury, VA, CFPB, FHFA, and the Federal Reserve provided technical comments, which we incorporated as appropriate.

Treasury accepted our recommendation and said it will consider a range of viewpoints and recommendations as it works with Congress and other agencies on housing finance reform issues.

HUD accepted our recommendation. HUD said it will consider recommendations and input from a range of sources—including the 2019 housing reform plans and GAO's framework—in developing plans to support HUD's objective of a more accessible and inclusive housing finance system. HUD said any future housing finance reform plans it develops will be guided by the policies and priorities of the administration and reflect the President's Executive Order on Advancing Racial Equity and Support for Underserved Communities Through the Federal Government.

HUD also described several FHA and Ginnie Mae actions it said were consistent with the 2019 plan's recommendations. These included steps to streamline FHA's loss mitigation options, modernize FHA's IT systems, and revise Ginnie Mae's financial eligibility standards for issuers. Our draft report considered these actions and cited a number of them specifically. As a result, we did not make changes to the analysis or discussion of FHA and Ginnie Mae actions in the final report.

HUD also cited the results of FHA's actuarial analysis of the MMI Fund for fiscal year 2021. FHA released the results shortly after we sent our draft report to HUD for comment. HUD noted that the MMI Fund's capital increased by $21.5 billion in fiscal year 2021, resulting in a capital ratio of 8.03 percent, an increase of 1.93 percentage points from the prior fiscal year. We updated our final report to reflect the recent actuarial analysis, including the higher capital ratio and the results of fund stress tests.

We are sending copies of this report to the appropriate congressional committees, and other interested parties. In addition, the report is available at no charge on the GAO website at https://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or garciadiazd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix VI.

Daniel Garcia-Diaz
Managing Director, Financial Markets and Community Investment

List of Addressees

The Honorable Charles E. Schumer
Majority Leader
The Honorable Mitch McConnell
Minority Leader
United States Senate

The Honorable Nancy Pelosi
Speaker
The Honorable Kevin McCarthy
Minority Leader
House of Representatives

The Honorable Debbie Stabenow
Chairwoman
The Honorable John Boozman
Ranking Member
Committee on Agriculture, Nutrition, and Forestry
United States Senate

The Honorable Patrick Leahy
Chairman
The Honorable Richard Shelby
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Sherrod Brown
Chairman
The Honorable Patrick J. Toomey
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Maria Cantwell
Chair
The Honorable Roger F. Wicker
Ranking Member
Committee on Commerce, Science, and Transportation
United States Senate

The Honorable Ron Wyden

Chairman
The Honorable Mike Crapo
Ranking Member
Committee on Finance
United States Senate

The Honorable Patty Murray
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The Honorable Richard Burr
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Committee on Health, Education, Labor, and Pensions
United States Senate

The Honorable Gary C. Peters
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The Honorable Rob Portman
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Chris Van Hollen
Chairman
The Honorable Cindy Hyde-Smith
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Committee on Appropriations
Subcommittee on Financial Services and General Government
United States Senate

The Honorable David Scott
Chairman
The Honorable Glenn ‘GT’ Thompson
Republican Leader
Committee on Agriculture
House of Representatives

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The Honorable Kay Granger
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Ranking Member
Committee on Oversight and Reform
House of Representatives

The Honorable Richard Neal
Chairman
The Honorable Kevin Brady
Republican Leader
Committee on Ways and Means
House of Representatives

The Honorable Mike Quigley
Chairman
The Honorable Steve Womack
Ranking Member
Committee on Appropriations
Subcommittee on Financial Services and General Government
House of Representatives

Appendix I: Objectives, Scope, and Methodology

The Department of the Treasury and Department of Housing and Urban Development (HUD) each issued a housing finance reform plan in 2019. This report examines (1) vulnerabilities in the housing finance system highlighted by the pandemic and factors that helped mitigate them, and (2) the nature and status of recommendations in the 2019 reform plans and the extent to which they align with system vulnerabilities and GAO's 2014 framework for assessing potential changes to the housing finance system.

Methodologies Used for Both Objectives

For both objectives, we reviewed relevant documentation (including statures, regulations, agency documents, our previous work, and academic and industry articles) and interviewed representatives from federal entities and the housing finance industry. We reviewed relevant laws—including the CARES Act; Consolidated Appropriations Act, 2021; Housing and Economic Recovery Act of 2008; and the Dodd-Frank Wall Street Reform and Consumer Protection Act—and regulations, including the Federal Housing Finance Agency's (FHFA) regulatory capital framework for Fannie Mae and Freddie Mac (enterprises), and the Consumer Financial Protection Bureau's (CFPB) qualified mortgage definition.[1]

We reviewed the Treasury and HUD 2019 housing finance reform plans, and other agency reports and documents, including Treasury and FHFA's 2019 and 2021 letter agreements amending the enterprises' preferred stock purchase agreements, Financial Stability Oversight Council annual reports, the Federal Housing Administration's (FHA) annual reports to

[1]CARES Act, Pub. L. No. 116-136, 134 Stat. 281 (2020); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, 134 Stat. 1182 (2020); Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008); Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); 85 Fed. Reg. 82150 (Dec. 17. 2020); 86 Fed. Reg. 53230 (Sept. 27, 2021); 85 Fed. Reg. 86308 (Dec. 29. 2020); and 86 Fed. Reg. 22844 (Apr. 30. 2021).

Congress, the Board of Governors of the Federal Reserve System's (Federal Reserve) financial stability reports, and HUD mortgagee letters.[2]

We reviewed prior GAO work on housing finance reform, oversight of nonbanks, high-risk areas, federal actions taken in response to the pandemic, mortgage servicing, and macroprudential oversight.[3] We reviewed relevant articles from academic researchers and industry stakeholders.[4] We also reviewed agency documents and websites related to system reforms and pandemic responses.

We interviewed housing finance system stakeholders, including officials from Treasury (including the Financial Stability Oversight Council staff), HUD, FHFA, the Federal Reserve, CFPB, the Department of Veterans Affairs (VA), the Department of Agriculture, the enterprises, industry groups, and industry experts. In interviews, we asked about federal actions taken in response to the pandemic, vulnerabilities highlighted by the coronavirus pandemic, the federal role in the housing finance system, and the 2019 housing finance reform plans.

[2]Department of the Treasury, *Housing Finance Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, D.C.: September 2019); Department of Housing and Urban Development, *Housing Finance Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, D.C.: September 2019); Financial Stability and Oversight Council, *2020 Annual Report* (Washington, D.C.: 2020); Federal Housing Agency, *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2020* (Washington, D.C.: 2020); and Federal Reserve System Board of Governors, *Financial Stability Report May 2020* (Washington, D.C.: 2020).

[3]Our reports include GAO, *Housing Finance System: A Framework for Assessing Potential Changes*, GAO-15-131 (Washington, D.C: Oct. 7, 2014); *Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened*, GAO-16-278 (Washington, D.C.: Apr. 14, 2016); *Mortgage Servicing: Community Lenders Remain Active under New Rules, but CFPB Needs More Complete Plans for Reviewing Rules*, GAO-16-448 (Washington, D.C.: Jun. 23, 2016); *Macroprudential Oversight: Principles for Evaluating Policies to Assess and Mitigate Risks to Financial System Stability*, GAO-21-230SP (Washington, D.C.: Jan. 28, 2021); *High Risk Series: Dedicated Leadership Needed to Address Limited Progress in Most High Risk Areas*, GAO-21-119SP (Washington, D.C.: Mar. 2, 2021); and *COVID-19 Housing Protections: Moratoriums Have Helped Limit Evictions, but Further Outreach Is Needed*, GAO-21-370 (Washington, D.C.: Mar. 15, 2021).

[4]These articles include W. Scott Frame, Brendan McCartney, and Eva Steiner, "COVID-19 Exposes Mortgage Market Vulnerabilities that Led to Volatility, Fed Intervention" (Feb. 2, 2021); Laurie Goodman, et al., "The Mortgage Market Has Caught the Virus" (May 2020); and You Suk Kim, et al., "Liquidity Crises in the Mortgage Market," *Finance and Economics Discussion Series*, 2018-016 (Washington, D.C.: May 31, 2018).

Housing Finance System Vulnerabilities Highlighted by the Pandemic

To address the first objective, we used relevant concepts from our 2021 framework for evaluating activities designed to assess and mitigate risks to financial system stability.[5] Specifically, identifying and analyzing potential sources of systemic risk is one of the key principles the framework identifies as related to the foundation of financial stability policy. In this context, we reviewed relevant research and interviewed housing finance system stakeholders on risks to and vulnerabilities in the housing finance system.

We reviewed research from several sources, including academic, think tank, news, and government publications. To identify relevant research for review, we performed internet searches and two database searches with the assistance of a research librarian. The first search focused on academic and think tank research on housing finance system vulnerabilities published since 2010. The second search examined a wider variety of sources, including news articles on the pandemic and the housing finance system published since 2020. In total, we reviewed 82 papers and articles to identify vulnerabilities to the housing finance system highlighted by the pandemic. To help illustrate the nature and scale of the vulnerabilities, we analyzed the data described in the next section of this appendix.

We identified housing finance system stakeholders to interview through our literature review and through recommendations from the individuals and organizations with whom we spoke. Specifically, we spoke with officials from the Joint Center for Housing Studies of Harvard University, Falcon Capital Advisors, the Housing Policy Council, the Mortgage Bankers Association, the National Association of Affordable Housing Lenders, the National Association of Real Estate Investment Trusts, and the Securities Industry and Financial Markets Association.

Data Analysis for Housing-Related Vulnerabilities

For the first objective, we analyzed federal and industry market data as follows:

- To determine the federal share of single-family mortgage servicing outstanding as of the second quarter of 2021 and the share of agency mortgages nonbanks serviced from 2015 through the second quarter of 2021, we analyzed mortgage servicing data from Inside Mortgage

[5] GAO-21-230SP. We created these principles to serve as criteria for assessing financial stability efforts. While designed with the broader financial system in mind, the principles provide useful criteria for assessing housing finance reform efforts because of the housing finance system's large scale and importance to the economy and financial markets.

Finance. The data break down the total mortgage servicing portfolio in various ways, including the dollar amount of mortgages in mortgage-backed securities (MBS) from the Government National Mortgage Association (Ginnie Mae), Fannie Mae, and Freddie Mac—which we collectively defined as the federal share—and the dollar amount of mortgages in each of those market segments that nonbanks serviced.

- To determine the amount of capital the enterprises have accumulated since the third quarter of 2019, we reviewed the enterprises' regulatory financial filings (10-Qs and 10-Ks). To determine the amount of combined capital the enterprises would be expected to hold under the 2018 and 2020 capital rules, we reviewed FHFA documents and enterprise regulatory financial filings.
- To calculate the yield spread between the Fannie Mae 30-year current-coupon bond and the 5/10-year U.S. Treasury bond blend from January through December 2020, we analyzed data from Bloomberg. We first calculated the average yield between the 5-year and 10-year Treasury bonds using a 50/50 weighting. We then subtracted the average yield from the Fannie Mae 30-year current-coupon bond yield.
- To determine the amount by which mortgage real estate investment trusts reduced their holdings of agency securities—including MBS issued or guaranteed by the enterprises or Ginnie Mae—between the fourth quarter of 2019 and the first quarter of 2020, we used federal securities holding data from the Financial Accounts of the United States.

We assessed the reliability of these data by reviewing documentation on how the data were collected and calculated and by interviewing company or agency representatives familiar with the data. We concluded that the data were sufficiently reliable for describing federal and nonbank market shares, enterprise capital accumulation, spreads between agency MBS and U.S. Treasury securities, and changes in mortgage real estate investment trust holdings during the specified time periods.

Additionally, for appendix II on the pandemic's effect on small landlords, we reviewed the results of two federal surveys, as follows:

- To describe the percentage of renters who had no to slight confidence that they would be able to fully satisfy their next rental payment, we used data from the U.S. Census Bureau's Week 36 (August 18–August 30, 2021) Household Pulse Survey. This survey provides data to help understand the experiences of American households during the coronavirus pandemic.

- To describe the share of rental units owned by individual landlords and the ownership of units with average rental receipts totaling less than $750, we used rental property data from the 2018 Rental Housing Finance Survey sponsored by HUD and conducted by the U.S. Census Bureau. This survey is conducted every 3 years and provides a measure of financial, mortgage, and property characteristics of rental housing properties in the United States.

To assess the reliability of data from these surveys, we reviewed documentation from the Census Bureau and HUD detailing the survey methodologies. We concluded that the data were sufficiently reliable for describing renters' confidence in making rent payments and the relative size and characteristics of the rental property market owned by individual landlords.

Analysis of Treasury and HUD 2019 Reform Plans

To address our second objective, we analyzed the recommendations in the 2019 Treasury and HUD housing finance reform plans against the vulnerabilities identified in our first objective and the eight applicable element of our 2014 framework for assessing housing finance reforms.[6] (The eight elements are alignment of policies with goals, appropriate financial regulatory framework, capacity to manage risks, borrower protections and market access, investor protections, consideration of the cyclical nature of housing finance, control of fiscal exposure, and implications of transition.) We considered Treasury's and HUD's 2019 housing finance reform plans as a single systemwide reform because both plans responded to the presidential memorandum and issued on the same day.

We assigned each recommendation to a vulnerability (if applicable) and to one or more framework elements using an approach in which three analysts reached consensus after reviewing the text of the recommendation, any associated plan narrative, and descriptions of each vulnerability and framework element. In cases in which a recommendation applied to more than one framework element, the three analysts used a similar process to reach consensus on which element was primary (the most directly relevant) and which element was

[6]We analyzed the 2019 plans using eight of the nine elements of our framework. We did not use the framework element related to clearly defined and prioritized housing finance system goals because it applies to a reform plan overall, not specific reform recommendations. GAO-15-131.

secondary (relevant, but in a less direct or significant way). We then determined the number of recommendations that addressed each vulnerability and how many addressed each framework element. Figures 11 and 12 in appendix III show how we categorized each recommendation by framework element for the Treasury and HUD plans, respectively.

Additionally, we analyzed the status of the plans' recommendations. For each administrative recommendation, we categorized the status (as completed, partial action, or no documented action) as of January 20, 2021.[7] To do so, we reviewed information provided by Treasury and HUD in September 2020 and again near the administration change in January 2021. This information included the recommendation status reported in agency tracking spreadsheets and other supporting documentation that an agency provided. In some cases, we supplemented documentation we obtained through information found on agency websites such as mortgagee letters from FHA and notices from the Securities and Exchange Commission. We also interviewed industry stakeholders.

We incorporated the results of this analysis into our analysis of the recommendations by housing finance system vulnerability and framework element described earlier. Since the January 2021 change in administration, agencies have taken actions relevant to some of the recommendations, although not under the auspices of the 2019 plans. Where applicable, we incorporated information on agency actions taken since January 2021.

For the legislative recommendations, we determined whether legislation had been enacted to implement them as of September 2021. To do so, we conducted legal research and reviewed information from relevant agencies on their authorities and responsibilities. Some recommendations assumed enactment of more foundational recommendations in the plans, such as the authorization of competitors to the enterprises. In those cases, we assessed implementation status as a set (the foundational recommendation plus the recommendations that build upon it) rather than on an individual basis.

We conducted this performance audit from April 2020 to January 2022, in accordance with generally accepted government auditing standards.

[7]We use the end of the administration because agencies said they consider the plans to be of the prior administration and no longer track recommendations status. Figure 13 in Appendix III shows the status of each administrative recommendation.

Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: The Pandemic's Effect on Renters and Small Landlords

This appendix provides information about the effect of the Coronavirus 2019 (COVID-19) pandemic on renters and small "mom and pop" (individual) landlords. While federal support has helped renters stay in their homes and mortgage forbearance assisted individual landlords facing disruption in rental payments, these landlords have experienced financial difficulties and remain at risk as support programs and provisions expire. Renters have experienced greater financial hardship and potential housing instability during the pandemic partly because they have experienced higher rates of unemployment and greater income losses than homeowners. According to the U.S. Census Bureau's Household Pulse Survey (for August 18–30, 2021), 25 percent of renters had no to slight confidence they would be able to pay the next month's rent.

Federal Support Helped Protect Renters

Federal actions have helped renters stay in their homes. Specifically, the expanded unemployment benefits and economic impact payments in the CARES Act and subsequent legislation helped renters to continue to make rental payments.[1] Likewise, the Consolidated Appropriations Act, 2021 and the American Rescue Plan Act of 2021 (enacted in December 2020 and March 2021, respectively) together provided about $46.6 billion for emergency rental assistance.[2] These acts directed the Department of the Treasury to disburse funds to eligible state and local grantees that must use the funds to financially assist households—generally through direct payments to property owners and utility providers. Eligible costs include accrued and future rent, utilities, and other housing expenses. The American Rescue Plan Act of 2021 also appropriated nearly $10 billion for a Homeowner Assistance Fund, which provides funds allocated by Treasury to prevent homeowner mortgage delinquencies, defaults, foreclosures, loss of utilities, and displacement due to financial hardship. This funding may help landlords who own single-family rental properties continue to make mortgage payments.

Additionally, Fannie Mae and Freddie Mac offer forbearance as needed to multifamily property owners who are experiencing financial hardship due to COVID-19. Owners agree not to evict tenants solely for the nonpayment of rent while the property is in forbearance. Lastly, the CARES Act contained an eviction moratorium for federally backed or

[1] 15 U.S.C. §§ 9021, 9023, 9027; 26 U.S.C. §§ 6428, 6428A, 6428B.

[2] Pub. L. No. 116-260, div. N, § 501, 134 Stat. 2069 (2020); Pub. L. 117-2, § 3201, 135 Stat. 54 (2021).

supported properties and the Centers for Disease Control and Prevention issued other eviction moratoriums.[3]

But some of these programs and provisions have expired. The CARES Act eviction moratorium expired on July 24, 2020, and a Supreme Court ruling terminated the Centers for Disease Control and Prevention's eviction moratorium in August 2021. The expanded unemployment benefits granted by the American Rescue Plan Act expired in September 2021. Furthermore, the previous federal eviction moratoriums did not forgive or reduce rent. Therefore, renters' ability to make payments could be threatened should they continue to experience financial challenges due to the pandemic. Consequently, cash flow to landlords could be disrupted.

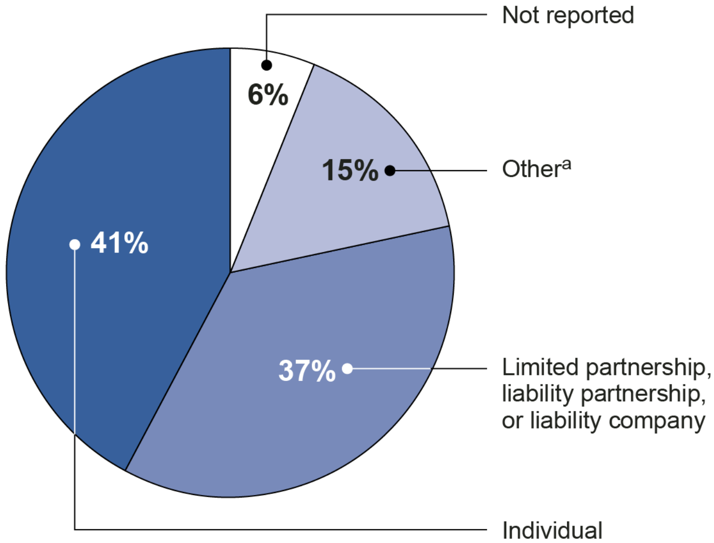
Individual Landlords That Supply Affordable Rental Housing Could Be at Risk

At particular risk are individual landlords. As shown in figure 9, according to the Census Bureau's 2018 Rental Housing Finance Survey, in 2017 (the most recent year for which published data are available) individual landlords owned 41 percent of the 48 million rental housing units in the United States.[4]

[3]The CARES Act and Centers for Disease Control and Prevention moratoriums—in combination with state and local measures—helped limit evictions during the pandemic. GAO, *COVID-19 Housing Protections: Moratoriums Have Helped Limit Evictions, but Further Outreach Is Needed*, GAO-21-370 (Washington, D.C.: Mar. 15, 2021).

[4]The Rental Housing Finance Survey measures financial, mortgage, and property characteristics of rental housing properties in the United States. It is sponsored by the Department of Housing and Urban Development and conducted by the U.S. Census Bureau.

Figure 9: Share of All Rental Units by Ownership Type, 2017



Source: GAO analysis of 2018 Rental Housing Finance Survey data. | GAO-22-104284

Notes: Percentages may not add to 100 due to rounding. Individual landlords also may form limited liability companies for their properties. Therefore, the "limited partnership, liability partnership, or liability company" category may contain some individual landlords.

[a]Other includes entities such as general partnerships, real estate investment trusts, and nonprofit organizations.

According to experts with whom we spoke and researchers, individual landlords are less likely to have access to capital to weather severe disruptions in rental payments. For example, a March 2020 survey by Avail, a rental services firm for individual landlords, found that 58 percent of landlords surveyed did not have access to credit options that might help them in an emergency.[5] Thus, they may be less able to continue to pay mortgages or meet other obligations. While we could not identify a comprehensive source of data detailing the extent to which individual landlords have struggled to make mortgage payments or lost or sold their properties due to the pandemic, some research helps illustrate the financial stress individual landlords have faced during the pandemic. For example, another Avail survey in October 2020 found that nearly 31 percent of landlords surveyed were feeling an increased pressure to sell

[5]Avail, *Avail Report: Landlord and Renter Responses to COVID-19* (March 2020). This study surveyed 2,775 landlords.

their rental property.[6] A survey by Harvard University's Joint Center for Housing Studies of small landlords in Rochester and Albany, New York, found that while 2.6 percent of landlords' rental properties had missed mortgage payments from March to October 2020, 8.2 percent had missed property tax payments, and 30.1 percent had deferred maintenance.[7]

In prior work, we found that property owners relied on temporary mortgage forbearance—in which a lender or mortgage servicer allows a temporary pause or reduction in payments—to offset missed rental payments.[8] Section 4023 of the CARES Act required servicers to provide multifamily properties with federally backed mortgages up to 90 days of forbearance.[9]

Multifamily mortgage forbearance rates have been highest among smaller properties, which suggests that smaller, individual landlords experienced the greatest financial challenges from missed rental payments. In August 2020, about 5.4 percent of properties with 5–9 units with mortgages backed by the Federal Housing Administration, Fannie Mae, or Freddie Mac were under forbearance, as compared to about 1.1 percent of such properties with 50 or more units (see fig. 10).

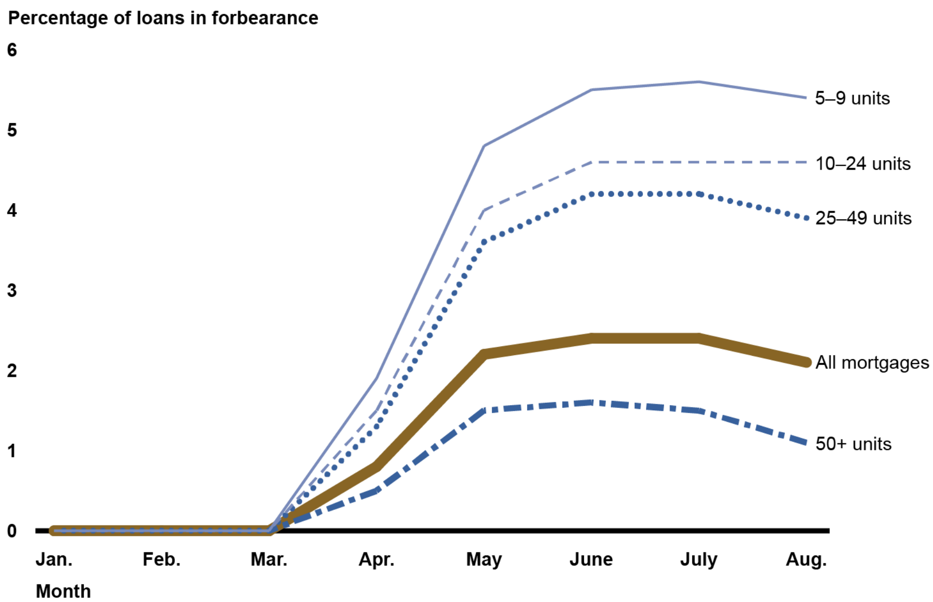
[6] Marin Scott, "Missed Rent, No Government Aid, and the Pressure to Sell: What Renters and Landlords are Facing During COVID-19" (Oct. 30, 2020); https://www.avail.co/blog/missed-rent-no-government-aid-and-the-pressure-to-sell-what-renters-and-landlords-are-facing-during-covid-19. This study surveyed 1,381 landlords.

[7] Elijah de la Campa, "The Impact of COVID-19 on Small Landlords: Survey Evidence from Albany and Rochester, New York," Joint Center for Housing Studies working paper (Cambridge, Mass.: March 2021); https://www.jchs.harvard.edu/research-areas/working-papers/impact-covid-19-small-landlords-survey-evidence-albany-and-rochester. This study surveyed landlords in Albany and Rochester, New York, in June and October 2020. The number of landlords who responded to the surveys ranged from 91 to 165.

[8] GAO-21-370.

[9] Pub. L. No. 116-136, § 4023, 134 Stat. at 491.

Figure 10: Percentage of Federally Backed Multifamily Mortgages in Forbearance, by Property Size (January–August 2020)



Source: GAO analysis of data provided by Fannie Mae, Federal Housing Administration, and Freddie Mac. | GAO-22-104284

Note: We excluded data from the Rural Housing Service because the agency did not provide forbearance data by property size. However, loans backed by the agency used forbearance at a relatively high rate—about 22 percent of multifamily loans backed by the Rural Housing Service were in forbearance in June 2020.

Properties owned by individual landlords are important sources of affordable housing. For example, according to the Census Bureau's 2018 Rental Housing Finance Survey, individual landlords own the majority of units with average rental receipts of less than $750 per month. If individual landlords experience rental payment disruption, they may face pressure to sell their properties and such sales could exacerbate an existing shortage of affordable rental housing units. In a prior report, we found that rental housing affordability had declined.[10] We reported that by 2017, an estimated 48 percent of renter households were rent burdened,

[10]GAO, *Rental Housing: As More Households Rent, the Poorest Face Affordability and Housing Quality Challenges*, GAO-20-427 (Washington, D.C.: May 27, 2020).

6 percentage points higher than in 2001.[11] Severe rent burden also became more common. Of the households that were rent burdened in 2017, about half were severely rent burdened. These households represented 24 percent of all renter households—an increase of 4 percentage points from 2001.

Some experts observed that if individual landlords were forced to sell their properties, the units might not necessarily remain available or affordable to renters once purchased. For example, one expert we interviewed noted that, due to the strong demand for homeownership, once sold, the properties might be converted to owner-occupied properties and therefore no longer available for rental occupancy. Treasury officials noted that the low supply of affordable single-family homes available for purchase may add to this potential challenge. Another expert told us that in local markets where rent demand is strong, new owners may remodel and refurbish an affordable property and then raise rents. Thus, the property is removed from the affordable housing stock even if it remains renter-occupied.

[11]Federal housing policy generally considers rents at or below 30 percent of household income to be affordable, and households that pay more than 30 percent of income in rent are considered to be rent burdened. Households that pay more than 50 percent are considered to be severely rent burdened.

Appendix III: Analysis of Recommendations in 2019 Housing Finance Reform Plans

We analyzed the 2019 housing finance reform plans of the Department of the Treasury and the Department of Housing and Urban Development (HUD) using eight of the nine elements of a framework we previously developed for assessing potential changes to the housing finance system.[1] The eight elements are alignment of policies with goals, appropriate financial regulatory framework, capacity to manage risks, borrower protections and market access, investor protections, consideration of the cyclical nature of housing finance, control of fiscal exposure, and implications of transition.

Treasury and HUD developed the plans pursuant to a March 27, 2019, presidential memorandum that listed overall goals and related objectives for the plans to address.[2] While Treasury and HUD consulted with other agencies in developing the plans, the plans did not necessarily reflect other agencies' priorities and preferences. In addition, the current administration has not adopted these plans. The 2019 plans contained legislative recommendations—actions for Congress to take—and administrative recommendations—actions for other entities such as the Federal Housing Finance Agency (FHFA) and the Consumer Financial Protection Bureau (CFPB) to take.

Below, we provide the results of our analysis of Treasury's and HUD's plans, the status of the administrative recommendations as of January 20, 2021, and examples of implemented and unimplemented administrative recommendations for each of the eight framework elements. Each figure below references the specific numbered recommendations from the plans.

Treasury's Plan

Figure 11 shows our categorization of each Treasury plan recommendation by framework element. Most of the recommendations applied to control of fiscal exposure (29) and alignment of policies with goals (9). The plan had six recommendations related to an appropriate financial regulatory framework, five related to consideration of the cyclical

[1]GAO, *Housing Finance System: A Framework for Assessing Potential Changes*, GAO-15-131 (Washington, D.C.: Oct. 7, 2014). We did not use the framework element related to clearly defined and prioritized housing finance system goals because it applies to a reform plan overall, not to specific reform recommendations.

[2]Department of the Treasury, *Housing Finance Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, D.C.: September 2019); see https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf. Department of Housing and Urban Development, *Housing Finance Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, D.C.: September 2019); see https://archives.hud.gov/news/2019/Housing-Finance-Reform-Plan0919.pdf.

nature of housing finance and implications of transition, and fewer than four recommendations related to each of the other three elements. Some recommendations (those listed in italics in the figure) also applied to a second framework element.

Figure 11: Alignment of Treasury's Housing Finance Plan Recommendations with GAO's Framework for Assessing Changes to the Housing Finance System

Treasury 2019 reform plan sections and subsections (refer to plan appendix for recommendation numbering)		GAO framework elements: Control of fiscal exposure	Alignment of policies with goals	Capacity to manage risks	Appropriate financial regulatory framework	Borrower protections and market access	Investor protections	Consider-ation of cyclical nature of housing finance and impact on financial stability	Implications of transition
Defining a limited role for the federal government	Clarifying existing government support	**1**, **3**, **5**, **6**, *8*, **9**		**7, 8**					**2**, **4**, *7*
	Support of single-family mortgage lending	**10**, *11, 12*	**11, 12**						
	Support of multifamily mortgage lending	*13, 14, 15*	**13, 14, 15**						
	Additional support for affordable housing		**16, 17, 18, 19**						
	Ending the conservatorships	**20, 21, 22**							
Protecting taxpayers against bailouts	Capital and liquidity requirements	**23, 24, 25, 26, 27**						*24*	
	Resolution framework	*28*, **29**		**28**					
	Retained mortgage portfolios	**30, 31**							
	Credit underwriting parameters	*32*, **33**						**32**, *33*	
Promoting competition in the housing finance system	Leveling the playing field	**37, 38**			**34, 35, 36**, *38*, **40, 41**		**39, 42**		
	Competitive secondary market	**43**							**44, 45**
	Competitive primary market					**46, 47**		**48, 49**	

Recommendation number formatting

Bold number = Primary element

Italic number = Secondary element

Source: GAO analysis of the Department of the Treasury's 2019 Housing Finance Reform Plan. | GAO-22-104284

HUD's Plan

Figure 12 shows our categorization of each HUD plan recommendation by framework element. The HUD plan included recommendations relating to seven of the eight relevant elements of our framework, most of which applied to control of fiscal exposure (20), alignment of policies with goals (17), and capacity to manage risks (23). The plan had nine recommendations related to borrower protections, eight related to an appropriate regulatory framework, and two or fewer recommendations each related to investor protections and the cyclical nature of housing finance. We did not identify any recommendations applying to the implications of transition in HUD's plan. Some recommendations (those listed in italics in the figure) also applied to a second framework element.

Figure 12: Alignment of HUD's Housing Finance Plan Recommendations with GAO's Framework for Assessing Changes to the Housing Finance System

HUD 2019 reform plan sections and subsections (refer to appendix A of plan for recommendation numbering)		**GAO framework elements**							
		Control of fiscal exposure	Alignment of policies with goals	Capacity to manage risks	Appropriate financial regulatory framework	Borrower protections and market access	Investor protections	Consider-ation of cyclical nature of housing finance and impact on financial stability	Implications of transition
Refocus FHA on its core mission	Target programs to borrowers not served by traditional underwriting	*2, 5, 6,* **7**	**1, 3, 4, 5, 6**			*2*			
	Define roles for government-supported programs through better coordination	*9*	**8, 9, 10**						
	Strengthen FHA's single-family default servicing processes	*11,* **12, 13, 15, 17**		**11**	**16**	**14,** *15,* **18**			
	Ensure HUD's multifamily programs are appropriately targeted		**19, 20, 21, 22**	**23**					
	Provide regulatory certainty to FHA lenders				**24, 25, 26, 27**				
Protect American taxpayers	Strengthen FHA risk-management systems and governance	**28, 29, 33**	**31**	**30, 32, 34**					
	Improve the financial viability of the Home Equity Conversion Mortgage program	**35, 36, 37, 39**			**38**				
	Implement tiered pricing to protect the MMI Fund	**40**							
	Eliminate regulatory barriers to affordable housing, including manufactured housing		**41,** *42,* **44,** *46*		*44,* **45**	**42, 43, 46**			
Provide FHA and Ginnie Mae the tools to appropriately manage risk	Establish FHA as an autonomous corporation in HUD			**47**					
	Hire and retain the right talent to mitigate risks to taxpayers			**48**					
	Align contracting and procurement processes with business needs			**49**					
	Modernize FHA technology			**50, 51, 52**					
	Realign housing assistance programs into a new Office of Rental Subsidy and Asset Oversight within HUD			**53, 54, 55, 56**					
Provide liquidity to the housing finance system	Advance Ginnie Mae counterparty risk-management and securitization platform transformation	*62*		*57,* **58, 59, 61, 62, 63, 64**		**57**		*58,* **60**	
	Allow flexibility in guaranty fee-setting	*65*		**65**					
	Implement reforms to maintain the integrity of Ginnie Mae securities					**67**	**66**		

Recommendation number formatting

Bold number = Primary element

Italic number = Secondary element

FHA = Federal Housing Administration
HUD = Department of Housing and Urban Development
MMI Fund = Mutual Mortgage Insurance Fund

Source: GAO analysis of HUD 2019 Housing Finance Reform Plan. | GAO-22-104284

Status of Plans' Recommendations

Figure 13 shows the progress made in implementing the administrative recommendations in the 2019 plans as of January 20, 2021 (the start of a new administration).[3] Specifically, agencies completed implementation of 27 recommendations and took partial action on 30. For the remaining 24 recommendations, there was no documented action. In addition, progress on recommendations related to each framework element varied (some recommendations applied to more than one framework element as noted in the figure).

[3]The 2019 plans contained a mix of legislative and administrative recommendations, but only administrative recommendations were implemented. As of September 2021, Congress had not enacted any of the 35 legislative recommendations. Fourteen of the 35 legislative recommendations call for, or assume, prior enactment of changes to the housing finance system—including an explicit, paid-for guarantee of qualifying conventional mortgage-backed securities by the Government National Mortgage Association, repeal and replacement of the enterprises' statutory charters, or authorization of competitors to the enterprises. The remaining 21 recommendations encompass a wide range of issues, including membership in the Federal Home Loan Bank System and reorganizing HUD.

Figure 13: Status of Administrative Recommendations in Treasury and HUD Plans, as of January 20, 2021

	Implementation status of administrative recommendations	
GAO framework element	**Treasury plan**	**HUD plan**
Control of fiscal exposure: Recognition and control of fiscal exposure and mitigation of moral hazard	20 22 24[a] 26 29 37 6 9 21 27 31 33[a] 25 38[b]	13 17 28 12 15 36 37 29 35 40
Alignment of policies with goals: Policies and mechanisms that are aligned with goals and other economic policies	11[c] 15[c] 12[c] 16 18 19	3 4 41 44[b] 1 5[c] 8 9[c] 19 20 21 31
Capacity to manage risks: Government entities that have capacity to manage risks	7[d]	48 50 61 63 11[c] 51 58[a] 59 62[c] 64 30 32 53
Appropriate financial regulatory framework: Adherence to an appropriate financial regulatory framework	36 34 40 41	24 25 26 45 16
Borrower protections and market access: Mortgage borrowers are protected and barriers to mortgage market access are addressed	47	67 2[c] 14 42[e] 43 57[f] 18 46[e]
Investor protections: Protection for mortgage securities investors	39 42	66
Consideration of cyclical nature of housing finance: Consideration of cyclical nature of housing finance and impact of housing finance on financial stability	49	60
Implications of transition: Emphasis on implications of the transition	2 4	No recommended actions in plan

Completed
Partial action
No documented action

Source: GAO analysis of Departments of the Treasury and Housing and Urban Development (HUD) 2019 Housing Finance Reform plans and plan status. | GAO-22-104284

Notes: Several recommendations applied to two framework elements in GAO's framework for assessing potential changes to the housing finance system. In these cases, we identified a primary and secondary element. We categorized recommendations in this graphic based on the framework element we identified as primary, and indicated the recommendations that also applied to a secondary element using superscript letters. Refer to plans' appendixes for recommendation numbering.

[a]These recommendations also applied to the consideration of cyclical nature of housing finance element of the framework.

[b]These recommendations also applied to the appropriate financial regulatory framework element of the framework.

[c]These recommendations also applied to the control of fiscal exposure element of the framework.

[d]This recommendation also applied to the implications of transition element of the framework.

[e]These recommendations also applied to the alignment of policies with goals element of the framework.

[f]This recommendation also applied to the capacity to manage risks element of the framework.

Examples of Implemented and Unimplemented Recommendations

The following examples of implemented and unimplemented administrative recommendations from the 2019 plans are organized by relevant elements of our framework and include any agency actions as of January 20, 2021 (the start of the new administration). Since January 2021, agencies have taken actions relevant to some of the recommendations, although not under the auspices of the 2019 plans. Where applicable in the following examples, we discuss these actions.

- **Controlling fiscal exposure**
  - The Federal Housing Administration (FHA) implemented a recommendation in HUD's plan to establish a paperless, data-driven claims process to validate FHA mortgage insurance claims before they are paid and thus better protect taxpayers.[4] Specifically, in December 2020, FHA expanded the functionality of an automated claims system that servicers of FHA-insured mortgages use to submit insurance claims. The expansion increased system use to all types of claims on single-family forward (traditional) mortgages.[5] According to HUD, the automated claims module eliminates redundant work, provides error check processes, and enhances data integrity, leading to more accurate and efficient submissions.
  - HUD's 2019 plan also included a recommendation that FHA develop and implement tiered pricing for its insurance—that is, charge higher-risk borrowers higher premiums than lower-risk borrowers—to protect the Mortgage Mutual Insurance Fund and ensure appropriate pricing for higher-risk loans.[6] Currently, most borrowers pay the same premium rate, which results in lower-risk borrowers subsidizing higher-risk borrowers.[7] FHA did not act on this recommendation. Risk-based pricing could help reduce financial risks to FHA from adverse selection, but it also could

[4]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 17.

[5]Previously, the system did not process some claim types, such as those associated with property conveyances to FHA and property sales.

[6]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 40.

[7]FHA-insured mortgages with certain loan characteristics have different premium rates. For example, mortgages with terms of 15 years or less or loan-to-value ratios less than 95 percent have lower rates. However, these loan characteristics are not typical in FHA's portfolio.

affect the cost and availability of FHA insurance for some borrowers.[8]

- **Aligning policies with goals**
  - FHFA implemented a recommendation in Treasury's plan to assess if the current products and services of Fannie Mae and Freddie Mac (enterprises) were consistent with their statutory mission and should continue to benefit from support under commitments in the preferred stock purchase agreements (PSPA).[9] The recommendation stated that FHFA should solicit information on whether to tailor support for cash-out refinancings, investor loans, vacation home loans, higher principal balance loans, or other subsets of enterprise-acquired mortgages. Consistent with this recommendation, through amendments to the PSPAs in January 2021, FHFA limited the enterprises' acquisition of single-family mortgage loans secured by second homes and investment properties to 7 percent of total single-family acquisitions in any 52-week period. In September 2021, FHFA and Treasury suspended these restrictions for at least 1 year, during which time FHFA plans to review them and consult with Treasury on any recommended revisions.[10]
  - HUD's plan included a recommendation that FHA pursue an interagency agreement on credit policy coordination with other federal mortgage insurance agencies to help ensure efficient targeting, reduce overlap, and achieve the policy goal of having FHA assume primary responsibility for housing finance support to low- and moderate-income families that cannot be fulfilled through

[8]GAO, *Federal Housing Administration: Modernization Proposals Would Have Program and Budget Implications and Require Continued Improvements in Risk Management*, GAO-07-708 (Washington, D.C.: June 29, 2007). In an insurance context, adverse selection occurs when individual insurance buyers may differ in their underlying risk factors in ways that are not fully observed by the insurer. If an insurer offers policy terms and rates designed to cover its costs based on the average risks of a group of potential buyers, the result may be that buyers who are riskier than average purchase the insurance, and impose larger-than-average claims on the insurer, while buyers who are less risky than average do not purchase the insurance.

[9]Department of the Treasury, *Housing Finance Reform Plan,* recommendation number 11.

[10]The suspension will terminate on the later of September 14, 2022, or 6 months after Treasury notifies the enterprises.

traditional underwriting.[11] FHA is not restricted in the types of borrowers it may serve, but it has a statutory operational goal to provide mortgage insurance to traditionally underserved borrowers, such as low-income, minority, and first-time homebuyers. In fiscal year 2020, 83 percent of FHA-insured home purchase mortgages went to first-time buyers, and 33 percent of FHA-insured purchase and refinance transactions served minority borrowers. HUD did not act on this recommendation.

- **Capacity to manage risks**
  - FHA substantially implemented a recommendation in HUD's plan to develop a mortgage origination tool that integrates an automated underwriting system and other components for risk management.[12] Specifically, from April 2019 through January 2021, FHA enhanced the functionality of an information technology platform for modernizing its single-family loan origination system by incorporating components for electronic document delivery, loan applications, property valuations, and credit underwriting (including the automated underwriting system).[13] Additional enhancements are ongoing.
  - HUD's plan recommended pursuing a reorganization that would place the agency's mortgage insurance programs and rental assistance programs in separate offices.[14] Currently, both programs are under the Office of Housing, and the Assistant Secretary for Housing is also the FHA Commissioner. This administrative recommendation echoes legislative recommendations in HUD's plan intended to help FHA better address risk-management functions and allow the FHA Commissioner to focus solely on managing the insurance

[11]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 31.

[12]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 51. FHA's automated underwriting system allows lenders to electronically submit loan application data for single-family mortgages from their loan origination systems and receive mortgage insurance eligibility scoring decisions.

[13]For additional information on the development of the platform (FHA Catalyst), including challenges with cost and schedule estimates, see GAO, *IT Modernization: HUD Needs to Improve Its Estimation and Oversight Practices for Single-Family Housing,* GAO-21-459 (Washington, D.C.: Sept. 29, 2021).

[14]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 53.

programs.[15] The plan suggests that, absent legislation, pursuing a reorganization to create separate mortgage insurance and rental assistance program offices would be a step in the same direction. HUD did not act on this recommendation.

- **Adhering to an appropriate regulatory framework**
  - FHA implemented a recommendation in HUD's plan to prioritize revision of lender certification forms to provide lenders additional certainty and clarity on FHA's requirements.[16] In December 2020, FHA revised a form on which lenders certify compliance with FHA requirements for each loan. According to HUD, the form changes, which became effective March 2021, better reflect regulatory and other legal requirements and help ensure the accuracy of information provided to FHA.
  - Treasury's plan recommended that FHFA, in consultation with the other federal financial regulators, attempt to harmonize requirements applicable to the enterprises and other participants in the housing finance system, including for capital relief provided to the enterprises and banking organizations for their transfers of mortgage credit risk to third parties.[17] According to the Treasury plan, differences in the regulatory frameworks between the enterprises and the private sector are biased in favor of the enterprises and could create opportunities for regulatory arbitrage—the potential for market participants to use a particular market or product instead of a competing market or product to exploit regulatory differences. While not broadly implemented, the recommendation was partially implemented through FHFA's 2020 enterprise capital rule, which adopted some features of the U.S. banking framework.
- **Borrower protections and market access**
  - In January 2021, Treasury and FHFA implemented a recommendation in the Treasury plan to amend the PSPAs to

[15]Specifically, the plan recommends that Congress restructure FHA as an autonomous corporation in HUD and separate the position and responsibilities of the FHA Commissioner from the Assistant Secretary for Housing.

[16]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 26.

[17]Department of the Treasury, *Housing Finance Reform Plan,* recommendation number 34.

require the enterprises to maintain nationwide cash windows for small lenders and prohibit large lenders from receiving volume-based pricing discounts.[18] Through the cash windows, lenders can sell individual loans directly to the enterprises and retain servicing rights. This arrangement facilitates participation of small lenders that do not have large pools of loans to sell to the enterprises. According to the Treasury plan, smaller, community-based lenders play a vital role in serving rural and other historically underserved borrowers, and fostering these lenders' access to the secondary market helps promote access to mortgage credit.

- HUD's plan recommended that FHA create more flexible processes to streamline borrower qualification for loss mitigation options in case of hardship.[19] In July 2020, FHA took partial action on this recommendation by announcing loss mitigation options for hardship caused by the coronavirus pandemic that includes the use of partial claims.[20] FHA's announcement outlines reduced documentation requirements and streamlined processing for borrowers and servicers. According to HUD, these options could be leveraged for more generalized improvements.

  To further streamline its COVID-19 loss mitigation options, FHA issued revisions in February, June, and July 2021. For example, in June 2021, FHA announced that servicers must mail loan modification documents to borrowers who can achieve a 25 percent reduction in their principal and interest payment through a permanent change in one or more terms of their mortgage. Borrowers are not required to contact their servicer to receive these documents.

[18]Department of the Treasury, *Housing Finance Reform Plan,* recommendation number 47. The January 2021 PSPA amendments also required each enterprise to limit the volume purchased through the cash window to $1.5 billion per lender during any period comprising four calendar quarters. In September 2021, FHFA and Treasury suspended this requirement. The suspension was agreed to on September 14, 2021, and will terminate on the later of 1 year after this date or 6 months after Treasury notifies the enterprises. FHFA plans to review the requirement during that period.

[19]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 14.

[20]In a partial claim, servicers may advance funds on behalf of a mortgage borrower to reinstate a loan. FHA reimburses the servicer for the partial claim and executes an interest-free subordinate lien with the borrower for the amount, which is payable when the property is sold or the mortgage is paid off.

- **Protections for mortgage investors**
  - The Government National Mortgage Association (Ginnie Mae) took partial action on a recommendation in HUD's plan to continue to coordinate with appropriate federal mortgage insurance programs, take action where (and when) necessary for the integrity of the Ginnie Mae guaranty of mortgage-backed securities (MBS), and increase data transparency.[21] According to HUD's 2019 plan, in recent years, Ginnie Mae has grown concerned about "loan churning"—repeated mortgage refinancings that may not financially benefit the borrower—in part, because churning increases prepayment risks for MBS investors and threatens the integrity of the MBS. In July 2019, Congress enacted legislation requiring six consecutive monthly payments before certain mortgages guaranteed by the Department of Veterans Affairs can be refinanced.[22] Additionally, Ginnie Mae has taken a number of policy and enforcement actions to address the issue, including its most recent action to implement restrictions on cash-out refinances. For example, beginning in November 2019, Ginnie Mae barred the securitization of cash-out refinance mortgages with loan-to-value ratios over 90 percent into certain Ginnie Mae securities pools.[23]
  - The Treasury plan recommended that FHFA determine how and to what extent the enterprises' historical loan-level data and property valuation data could be publicly disclosed, taking into account any privacy and safety and soundness risks.[24] Treasury's plan stated that, although each enterprise makes some loan-level data available as part of its credit risk transfer program, a considerable amount of data (such as appraisal and other

[21]Department of Housing and Urban Development, *Housing Finance Reform Plan,* recommendation number 66.

[22]Pub. L. No. 116-33, § 2, 133 Stat. 1038 (2019). This legislation revised the loan seasoning requirements first prescribed by the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018. Pub. L. No. 115-174, § 309(b), 132 Stat. 1296, 1350 (2018).

[23]The restrictions were included in a Ginnie Mae memorandum issued in August 2019 and applied to MBS guaranteed on or after November 1, 2019. Government National Mortgage Association, *Revised Pooling Eligibility Requirements for VA Refinance Loans*, All Participant Memorandum 19-05 (Washington, D.C.: Aug. 1, 2019).

[24]Department of the Treasury, *Housing Finance Reform Plan,* recommendation number 42.

collateral data) is not made available to market participants.[25] According to the plan, disclosing more loan-level data could enhance the ability of market participants (such as MBS investors) to analyze and price mortgage credit risk. FHFA did not act on this recommendation.

- **Consideration of cyclical nature of housing finance**
  - Treasury's plan recommended that FHFA revisit its rule excluding captive insurance companies from Federal Home Loan Bank (FHLBank) System membership.[26] Expanding membership to captive insurance companies, and therefore some mortgage real estate investment trusts, might enhance MBS market stability during economic downturns. However, trade-offs include potentially increasing risks to the FHLBank System or encouraging greater investor risk-taking. In February 2020, FHFA issued a request for input on FHLBank System membership, but as of September 2021, had not taken further action on the recommendation.
- **Implications of transition**
  - As discussed above, Treasury's plan contained a number of legislative recommendations that would substantially change the housing finance system, while also noting that any proposal to fundamentally change the system should take careful account of the risks posed by the transition. To avoid market disruption pending legislative action, among other things, Treasury's plan included recommendations to maintain its ongoing commitments to support each enterprise's single-family MBS through the PSPAs.[27] Treasury and FHFA kept these commitments in place when they amended the PSPAs in September 2019 and January 2021.

[25]Through the enterprises' credit risk transfer programs, a portion of the mortgage credit risk from their purchased loans is transferred to third-party investors. As a result of this transfer, the enterprises are allowed to hold less capital.

[26]Department of the Treasury, *Housing Finance Reform Plan*, recommendation number 49.

[27]Department of the Treasury, *Housing Finance Reform Plan,* recommendation numbers 2 and 4.

Appendix IV: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

December 13, 2021

John Pendleton
Director, Financial Markets and Community Investment
Government Accountability Office
441 G St., N.W.
Washington, DC 20548

Dear Mr. Pendleton:

Thank you for the opportunity to review the Government Accountability Office's (GAO) draft report entitled *Housing Finance System: Future Reforms Should Consider Past Plans and Vulnerabilities Highlighted by Pandemic* (the Draft Report). The U.S. Department of the Treasury (Treasury) values GAO's analysis and has provided technical comments under separate cover.

The Draft Report reviews housing finance reform plans issued in response to a Presidential Memorandum in 2019 by Treasury and the Department of Housing and Urban Development (HUD) in the context of GAO's prior work in this area and the vulnerabilities highlighted by the COVID-19 pandemic. As the Draft Report notes, federal action in response to the pandemic has been critical in mitigating these vulnerabilities.

Treasury believes that access to affordable residential housing opportunities and the long-term stability of the U.S. housing market remain of critical importance. The Draft Report recommends that Treasury, as it develops future housing finance reform plans, should consider recommendations from the 2019 plans issued by Treasury and HUD that could help address system vulnerabilities and ensure future plans address all GAO framework elements. Though the 2019 plans were issued under a prior Administration, we accept the recommendation in the Draft Report, and will consider a range of viewpoints and recommendations as we continue to work closely with Congress and our partners in the Administration on these issues.

Treasury appreciates GAO's continued work assessing changes to and vulnerabilities in the U.S. housing finance system. Thank you again for the opportunity to review the Draft Report and for your consideration of our comments.

Sincerely,

Brian Smith
Deputy Assistant Secretary for Federal Finance

Appendix V: Comments from the Department of Housing and Urban Development

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

MEMORANDUM FOR: John H. Pendleton
Director, Financial Markets and Community Investment
Government Accountability Office
441 G Street NW
Washington, DC 20548

lopa kolluri Digitally signed by lopa kolluri
Date: 2021.12.13 18:01:25 -05'00'

FROM: Lopa P. Kolluri
Principal Deputy Assistant Secretary-Housing
Federal Housing Administration

SUBJECT: Response to Draft Report, "Housing Finance System: Future Reforms Should Consider Past Plans and Vulnerabilities Highlighted by Pandemic (GAO-22-104284)

DATE: December 13, 2021

Thank you for providing the Department of Housing and Urban Development (HUD) the opportunity to review and comment on the U.S. Government Accountability Office's (GAO's) Draft Report, Future Reforms Should Consider Past Plans and Vulnerabilities Highlighted by Pandemic GAO-22-104284). We appreciate the GAO's continued acknowledgement of the critical role HUD has in housing finance and the inherent risks associated with that role. HUD has been working with the Biden-Harris Administration and across agencies on housing finance actions specifically related to the implementation of CARES Act provisions, as well as to improve policy and risks that have emerged due to COVID-19 pandemic, including market risk, counterparty risk, liquidity, and mortgage servicing. This work has been done to ensure protection for American taxpayers and homeowners who have suffered significant economic hardships.

We accept the recommendation in the draft GAO report. HUD is in the process of finalizing its FY2022-2026 Strategic Plan, which includes a core objective to create a more accessible and inclusive housing finance system. In developing further plans to support this objective, HUD will consider recommendations and input from a range of relevant sources, including the 2019 housing reform plans issued by the previous administration and GAO framework elements. Any future housing finance reform plans developed by HUD will be guided by the policies and priorities of the Biden Administration and will reflect the President's Executive Order on Advancing Racial Equity and Support for Underserved Communities Through the Federal Government. We aim to build a resilient and more equitable housing finance system for the future.

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Since publication of the 2019 HUD Housing Finance Reform Plan, FHA has undertaken several actions consistent with the plan's recommendations. These include:

- **Policy enhancements to ensure FHA is effectively serving its targeted borrowers.** FHA has executed number of modifications to its origination and underwriting policies to extend access to credit for underserved borrowers. FHA's continued commitment to serving low- and moderate-income homebuyers is evidenced by the fact that FHA achieved record highs in insurance endorsements for first-time homebuyers in fiscal year 2021; 84.61 percent of FHA's insurance endorsements were for loans made to first-time homebuyers and FHA's share of lending to first-time homebuyers in 2021 was almost 40 percentage points higher than that of the rest of the U.S. housing market. In addition, FHA provided access to homeownership for minority homebuyers at a rate twice that of the rest of the mortgage market.
- **Increasing clarity and accessibility of policy.** FHA completed significant updates to its Single Family Policy Handbook 4000.1 in 2021 to incorporate the guidance governing the Home Equity Conversion Mortgage, Title I Manufactured Housing, and Title I Property Improvement programs. The inclusion of these programs offers lenders a consolidated source of guidance for all of FHA's single family lending programs. The addition to the Handbook of FHA's Title I program requirements replaced more than 120 separate policy documents.
- **Streamlining and expansion of loss mitigation options**. Spurred by the needs of homeowners impacted by the pandemic, FHA implemented an array of changes to existing loss mitigation options and introduced new tools that provided greater relief for homeowners while simplifying processes for servicers and borrowers. These changes are important steps in FHA's efforts to decrease the costs of default servicing and improve outcomes for homeowners who encounter difficulties in meeting their mortgage obligations.
- **Modernization of FHA information technology**. FHA has continued efforts to modernize its technology through the FHA Catalyst system. FHA Catalyst has eliminated 75 million sheets of paper annually, reduced average loan origination cycle times by 14 days, and reduced the time to process insurance claims by 99.9 percent. Through additional development underway or planned, FHA Catalyst will provide a modern and comprehensive end-to-end solution for the full FHA lending lifecycle, increasing efficiency for FHA and its stakeholders and reducing risks for FHA.

FHA's programs will continue to focus on programs that expand access to credit for low and moderate income borrowers, including communities of color, protect struggling homeowners impacted by the pandemic while ensuring and the actuarial soundness of its insurance funds. FHA's most recent actuarial analysis of the Mutual Mortgage Insurance Fund (MMIF), which supports its single-family lending programs, found that over the course of fiscal year (FY) 2021 the MMIF's capital increased by $21.5 billion, resulting in an overall capital ratio of 8.03 percent, an increase of 1.93 percentage points from the prior fiscal year and well above the statutorily mandated level of 2 percent.

Ginnie Mae has also taken action on a number of 2019 plan recommendations that address housing finance system challenges noted in GAO's report. These include:

- Full implementation of a comprehensive Issuer Stress Test (IST) model for evaluating the impact of stressed economic scenarios on the compliance and solvency of issuers. The IST informs oversight of individual issuers, and counterparty risk policy formulation.
- Proposed revisions to issuer financial eligibility standards (based in part on IST modeling) for capital and liquidity, including provisions that address the risks posed by margin calls and a risk-based capital standard that addresses the volatility of mortgage servicing rights as a source of capital. These revisions are being considered on the basis of stakeholder input (most notably a Request for Input published in July) and extensive collaboration with the Federal Housing Finance Agency and the Conference of State Banking Supervisors.
- Extensive progress improving liquidity in mortgage servicing by facilitating the ability to pledge mortgage servicing rights as collateral for servicing advances via expanded use of the Ginnie Mae Acknowledgement Agreement.

Current activities that relate to the HUD Plan and topics addressed in the GAO report include:

- Development of issuer requirements in support of the ability to more effectively manage resolution of issuer defaults.
- Development of a pilot program to facilitate investment in mortgage servicing rights by non-traditional entities, as a means of broadening the capital base of the housing finance system.
- Fostering increased digitalization through expansion of the digital collateral (eMortgage) program, and development of a comprehensive blueprint for re-engineering the Ginnie Mae securitization platform to increase its utility, flexibility and security.

HUD continues to be committed to fulfilling its mission of creating strong, sustainable, inclusive communities and quality affordable homes for American families and individuals, while also responding to the impacts of COVID-19 on the housing finance system and proactively managing the recovery. We acknowledge the importance of GAO's review and recommendation and will continue to adapt our housing finance plans to meet the current and future housing needs of all those served by the system.

Appendix VI: GAO Contact and Staff Acknowledgments

GAO Contact

Daniel Garcia-Diaz, (202) 512-8678 or garciadiazd@gao.gov

Staff Acknowledgments

In addition to the contact named above, John H. Pendleton (Director), Steve Westley (Assistant Director), Karen Jarzynka-Hernandez (Analyst in Charge), Stephen Brown, Maxwell Kaufman, Risto Laboski, Christopher Lee, Charlene Lindsay, John McGrail, Marc Molino, Barbara Roesmann, and Andrew Stavisky made key contributions to this report.

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