I. Streamline

The GSEs activities should be limited to those directly related to their guarantee and securitization functions. Their retained portfolio business should be substantially reduced or eliminated.

Actions:

1. Reduce the Retained MBS portfolios. (Already well underway)
2. GSE would still have portfolio for cash window and repurchase of seriously delinquent loans.
3. Establish a plan to sell off or re-insure non-performing and re-performing assets, recognizing that such sales could produce losses.
4. Continuing development of the common securitization platform and other shared functions is desirable but not required.

II. Share Risk

The GSEs have demonstrated over the last two years that they can "reinsure" a significant portion of their credit risk into the market through a variety of risk sharing approaches thereby reducing taxpayer risk and the concentration of credit risk in the economy.

Actions:

1. Establish reinsurance/credit-risk sharing programs for up to 75% of risk on new GSE loans.
2. Develop risk retention/upfront risk sharing for originators on either a pooled or specific basis.
3. Establish capital rules that encourage the use of risk sharing, but adequately address counterparty risk.
4. Change IRS and SEC rules to establish risk-sharing transactions as REMICs and good assets for REITS.
5. Address bank capital rules that reduce liquidity in secondary market by requiring excessive amount of capital to hold CRT bonds.
6. Address CFTC rules that limit the use of credit-credit linked note structures.

III. Wrap

The GSE MBS should receive an explicit government wrap like GNMA securities and thus should be closely regulated. The use of a vintage based cap on losses will allow the housing finance system to function through catastrophic economic and housing downturns. In exchange for the government guarantee, the GSEs would pay a fee to the government that would be used to defray the potential cost of the guarantee and to fund affordable housing or other national housing goals.

Actions:

1. Establish a GNMA program to wrap GSE MBS or new government wrap.
2. GSE responsible for losses up to a cap by cohort or vintage
3. Government establishes eligible loan criteria, capital and risk-sharing requirements to access wrap; oversight provide by Treasury.
4. Charge an explicit fee plus housing affordability fee.
5. Establish a fund to cushion losses.
6. Wrap would only apply to MBS; GSE would need access to agency market to maintain cash window and repurchases of delinquent loans from MBS pools.

IV. Mutualize

Mutual ownership of the GSEs by mortgage originators offers the opportunity to align incentives and protect taxpayers from future losses, while limiting the incentives to siphon off the benefits of government guarantees to private shareholders.

Each mutual would also be responsible for implementing the national duty-to-serve responsibilities of the secondary market. The regulator of the mutual can track the availability of credit to borrowers throughout the country and can require the mutual to have its members serve those communities. The mutual can decide on what incentives would be necessary to achieve that goal, rather than having a government entity create incentives for private companies.

In the event that a mutual is unable to raise sufficient capital in a stressed environment, Treasury could agree to take on a portion of the risk sharing role at a high, but not stifling required return. This would ensure that the mutual would seek private capital first, and that the government would earn an adequate return if and when it provides support to the market. The combination of a government wrap on the MBS and the vintage-based limit on loss would likely reduce the probability of calling on this backstop.

Actions:

1. Create mutual structure, owned by originators, with activity-based funding.
2. FHFA would remain regulator of the mutuals and the Home Loan Banks.
3. Profits would be paid to members as dividends.
4. Mutual is responsible for implementing national duty-to-serve obligations, subject to regulatory oversight.
5. Treasury to provide a backstop to risk sharing for new vintages

Comparison of Governance Structures

	Mutual	Stock	Utility—stock owned	Government
Profits	Recycled into mortgage business	Profits extracted from mortgage business	Profits extracted from mortgage business	Profits used for other government purposes or allow non-economic decisions
Governance	Issues related to number and heterogeneity of members	Conflict between private profits and public goals	Conflict between shareholders and utility regulator	Political process affects management
Transition	Gradual transition	Need to raise capital in large IPO	Need to raise capital in large IPO	Difficult transition to single entity
Duty to Serve	Implemented by members, oversight by regulator	Difficult to enforce	Enforced by regulator	Varies with political will, imposed on originators
Number of entities	Can maintain two, combine or add additional mutual	Need five or six to insure competition	Could maintain two, most likely reduce to one	Need to combine into a single entity
Innovation	Modest innovation	Aggressive innovation	Modest innovation	Limited innovation
Precedent	Freddie Mac formerly operated as mutual largely funded by thrifts	Sub-Prime originators or Fannie/Freddie pre-crisis	None in the mortgage market, or similar financial institution	FHA/GNMA