CRS INSIGHT

Freddie Mac Announces Quarterly Loss, Does Not Require Additional Treasury Assistance

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Related Policy Issue

- Housing Finance Reform

Related Author

- Sean M. Hoskins

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Sean M. Hoskins, Analyst in Financial Economics (shoskins@crs.loc.gov, 7-8958)

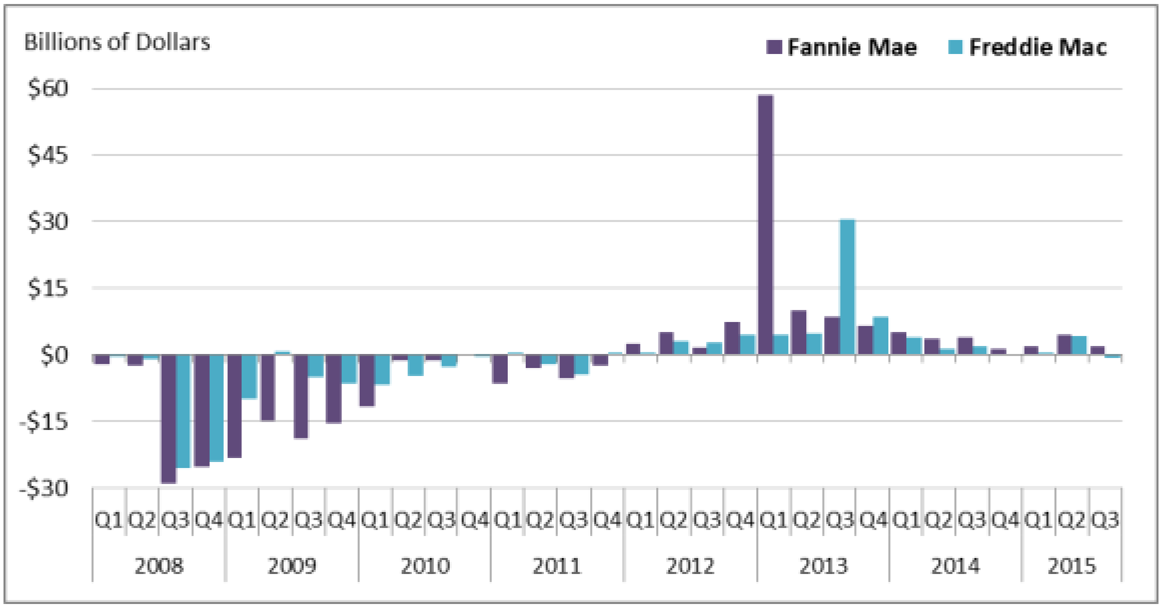
On November 3, Freddie Mac announced a loss of $501 million in comprehensive income for the third quarter of 2015 (and a $475 million loss of net income, which involves a slightly different calculation). This was Freddie Mac's first quarterly loss since the third quarter of 2011. Fannie Mae earned comprehensive income of $2.2 billion (and net income of $2.0 billion) in the third quarter, down from $4.4 billion in comprehensive income in the previous quarter. Because of their prominent position in the housing finance system and their close relationship to the federal government, the two government-sponsored enterprises' (GSEs'), Fannie Mae and Freddie Mac, financial position has been closely followed by Congress.

Third Quarter Financial Status

Freddie Mac reports that its "loss was caused mainly by the accounting associated with our derivatives." Freddie Mac uses derivatives to hedge its risk associated with changes in interest rates. It had $4.2 billion in derivative losses in the third quarter, but derivatives had contributed a $3.1 billion gain in the previous quarter. As seen in the swings in earnings, Freddie Mac's use of derivatives is intended to reduce its interest rate risk exposure but can still lead to a significant amount of variability for income. Fannie Mae also experienced losses on its derivatives in the third quarter, but the losses were not enough to make it unprofitable. **Figure 1** shows the GSEs' net income over time.

Although Freddie Mac experienced losses from derivatives, its single-family guarantee business—the business that has become the GSEs' focus during conservatorship—remained robust with that business line earning $591 million in the third quarter. Fannie Mae reported net income of $2.0 billion from its single-family guarantee business. Part of the strength of the single-family guarantee business is because the seriously delinquent rate for mortgages owned or guaranteed by the GSEs is at the lowest level since the financial crisis.

Figure 1. GSE Quarterly Net Income



Source: Fannie Mae and Freddie Mac Quarterly Earnings Releases.

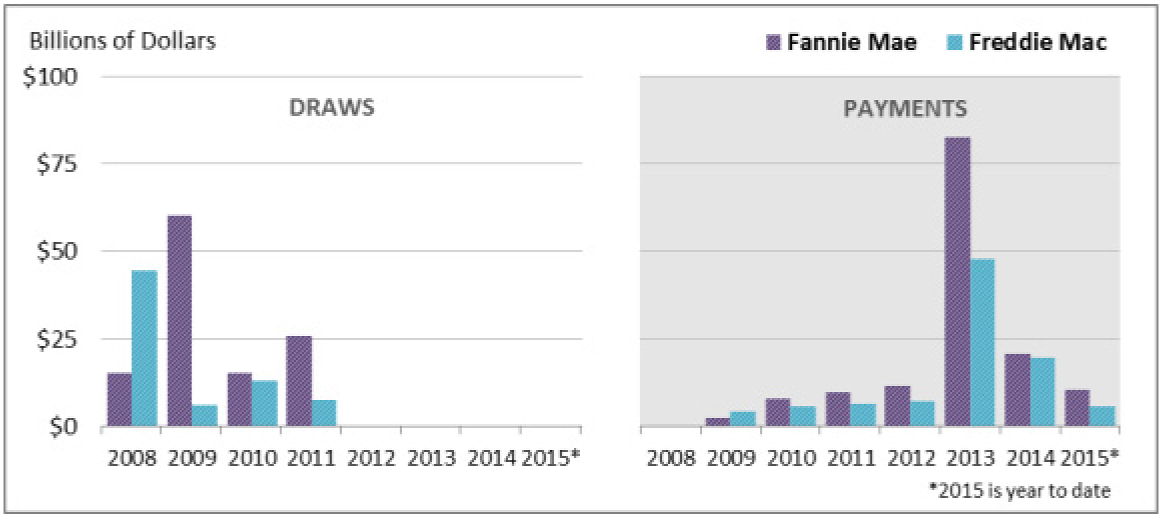
Notes: Income in some years is elevated due to legal settlements and certain tax issues. Net income is shown as reported by each GSE prior to any dividend payment to Treasury.

Draw from Treasury?

Freddie Mac's losses are of particular interest for many reasons, one of which is because of the financial support that the Department of the Treasury provides to the GSEs. Because of extensive financial losses and concerns about their ability to provide support to the housing finance system, the GSEs agreed to be placed into conservatorship in September 2008 by their regulator, the Federal Housing Finance Agency (FHFA). When the GSEs entered into conservatorship, they also entered into an agreement with Treasury in which Treasury would provide financial support to the GSEs through the Senior Preferred Stock Purchase Agreements (PSPA). Under the terms of the PSPA as amended, GSE profits at the end of a quarter are paid to Treasury, but if there are no profits, no dividend is owed to Treasury. (The PSPA is not described in detail in this Insight. See CRS Report R42760, *Fannie Mae's and Freddie Mac's Financial Status: Frequently Asked Questions*, by N. Eric Weiss for more information.)

Since entering into conservatorship, the GSEs have received $187.4 billion in assistance and have paid dividends of $241.3 billion to Treasury. None of these payments count toward paying back the amount injected by Treasury but instead compensate the federal government for its assistance and the risk it has assumed. Under the PSPA, the amount of support Treasury has committed to provide is capped, with Freddie Mac eligible to receive $140.5 billion in further assistance and Fannie Mae eligible for an additional $117.6 billion. See **Figure 2** for the annual amounts drawn from Treasury and paid to Treasury.

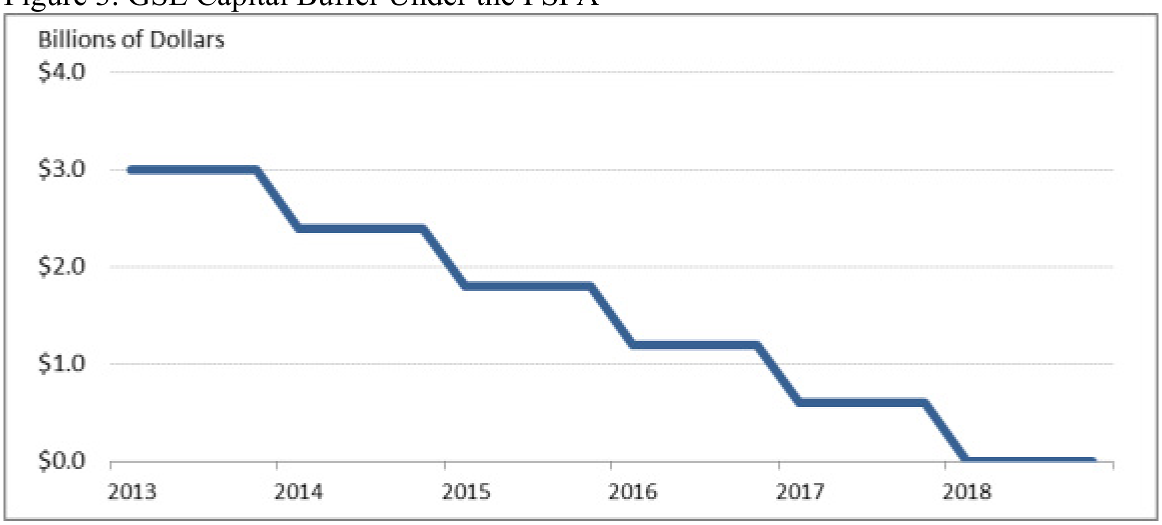
Figure 2. GSE Draws On and Payments To Treasury



Source: Fannie Mae and Freddie Mac Third Quarter 2015 Financial Results.

Although Freddie Mac had a loss in the third quarter, it did not require a transfer of funding from Treasury because it still had a positive net worth at the quarter's end. A GSE receives a transfer when it has a negative net worth (its liabilities are in excess of its assets). Each GSE is allowed under the PSPA to keep a small capital buffer, with the buffer set at $3 billion in 2013 and reduced by $600 million each year until reaching $0 on January 1, 2018, as shown in **Figure 3**. The capital levels set by the PSPA are below what they are required to be by statute if the GSEs were not in conservatorship (FHFA has suspended the requirements while the GSEs are in conservatorship). In 2015, the PSPA allows each GSE a capital buffer of $1.8 billion. With the approximately $0.5 billion loss, Freddie Mac's net worth fell to $1.3 billion but did not fall far enough to need to draw on Treasury. If Freddie Mac's loss had been larger or occurred when its capital level was lower, then it would have been more likely to need a transfer from Treasury.

Figure 3. GSE Capital Buffer Under the PSPA



Source: Senior Preferred Stock Purchase Agreements.

Congressional Considerations

Freddie Mac's loss may bring additional congressional attention to the capital position of the GSEs and the possibility that one or both may need to draw funds from Treasury in the future. The possibility of a draw is something that the GSEs have mentioned in their financial reports and is the subject of an FHFA OIG report.

Some in Congress have advocated allowing the GSEs to retain more of their earnings to rebuild capital and make a draw less likely. H.R. 1673 would establish a secondary reserve fund into which revenues could be deposited and be made available in the event that a GSE experiences losses that depletes its capital.

Others have argued that allowing the GSEs to rebuild capital could be a first step toward returning the GSEs to private shareholders. Critics of this approach would prefer that Congress pass comprehensive housing finance reform rather than allow the GSEs to exit conservatorship, even though many observers believe the prospects do not look bright for housing finance reform in the 114th Congress. S. 2038 would, among other things, prevent the Treasury from disposing of the shares it has received under the PSPA until legislation has been enacted that would instruct Treasury to do so.