TREAT FANNIE AND FREDDIE AS UTILITIES

Utility-like regulation would allow the GSEs to continue to operate at low risk and in a way that provides broad access to affordable mortgage credit nationwide.

If Treasury and FHFA release the GSEs from conservatorship, they should continue the return-regulated approach FHFA has used effectively in conservatorship. Utility-like regulation would allow the GSEs to continue to operate at low risk and in a way that provides broad access to affordable mortgage credit nationwide. ***Removing that check on GSE returns on equity would lead to greater risk and less systemic stability, less pooling of risk and access to credit, and higher prices for America's homebuyers.***

Utility-like regulation will promote homeownership by pooling risk and ensuring borrowers are not overcharged

- **If the GSEs exit conservatorship without any constraints on their returns on equity, they will have the incentive, and as a duopoly the means, to increase costs to borrowers across the board** by charging the highest guarantee fees that the market will bear. There would also be a substantial risk that each GSE would pursue low-risk, high-return business at the expense of the existing benefits to low-, moderate-income, and other underserved borrowers, including those served by smaller lenders in rural areas of the country.
- **Continuation of FHFA's de facto utility regulation would ensure that mortgage rates do not rise unnecessarily for American homeowners.** As rate-regulated utilities, the GSEs will continue to promote access to safe, sustainable mortgage credit for borrowers nationally.

Utility-like regulation will continue the GSE low-risk business model

- **In the absence of some regulation of their returns, the GSEs would set more aggressive ROE targets, which would, in turn, drive them to take greater risk to meet those targets.** Given the taxpayer's assumption of stress losses beyond their capital requirements, this would create a dangerous dynamic--***precisely the dynamic that helped lead them into conservatorship in the first place.***
- **Before conservatorship, the GSEs' targeted rates of return were unchecked** and were considerably higher than their implicit ROEs today. ***Predictably, as a result, they took on entirely too much risk.***

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- **In contemplating an exit from the GSEs' conservatorship, FHFA should choose the approach that best supports the continuation of their current low-risk business model and best guards against a return to past risky practices.** The best ways to do so are through establishing strong minimum capital requirements, continuing to transfer the majority of credit risk to private credit protection investors, continuing to limit retained portfolio activities, ***and establishing a utility-like rate of return regulatory process.***

How utility-like regulation will work to ensure that the GSEs do not overcharge borrowers and remain low-risk

- **Although it is not well-understood, FHFA already currently oversees the GSEs as return-regulated utilities.** FHFA compares the GSEs' implicit returns on equity (ROEs) to a target range—if the ROEs fall below that range, FHFA requires the GSEs to raise their guarantee fees; if they exceed the range, guarantee fees are reduced.

- **Utility regulation of the GSEs would function similarly to the monopoly regulation of the electric power industry—which has served the public well for decades.** Because power companies provide an essential service and have high market concentration that prevents competitive pricing, government limits them to a "fair return."

- **Utility regulation of the GSEs would work even more efficiently.** Since FHFA and the GSEs have substantially more market pricing information to guide establishing an appropriate ROE target range, the return-setting process would be simpler than with electric utilities. Investors would likely view the GSEs as value-focused companies with sustainable dividend capacity, which would attract investors seeking long-term, stable returns, such as pension funds and insurance companies.

The full paper can be accessed at http://bit.ly/gse-utilities