GSE REFORM

Following the financial crisis of 2008, a consensus formed among lawmakers that government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac played a significant, if not the major, role in the mortgage meltdown. There also emerged a consensus that the GSEs needed to be curbed, if not phased out. Yet six years after the crisis, Fannie and Freddie are bigger than ever, and unsubsidized private capital still constitutes a minuscule share of the mortgage market. Nine out of 10 home mortgages are securitized or insured by federal government housing entities, putting taxpayers at risk and limiting choice and competition for homeowners.

Congress should:

- Pass legislation implementing a wind-down of Fannie and Freddie along the lines of the Protecting American Taxpayers and Homeowners Act, which passed the House Financial Services Committee in 2013. The GSEs would sell off part of their portfolios every year until they are completely liquidated.
- In the legislation, include a provision to ensure that GSE shareholders are fairly compensated in such a wind-down. Create a commission to determine fair market value of shares and to resolve claims. The legislation should not interfere with pending or future shareholder lawsuits, but set up the commission as an alternative mechanism that shareholders can use to settle claims.
- Repeal the "qualified mortgage" and "qualified residential mortgage" provisions of Dodd-Frank.

In the first few years after the housing crisis, the Obama administration called for, in the words of Treasury official Michael Stegman, "shrinking the government's footprint in housing finance." Yet because of government backing and crippling regulations facing competitors, Fannie and Freddie are once again making money hand over fist, and the government's role in the mortgage market continues to expand. Should anything go wrong, taxpayers will be left on the hook for an even bigger bailout.

Private capital has been scared off by Dodd-Frank's stringent underwriting rules, such as the regulations for "qualified mortgages" and "qualified residential mortgages" (two separate interlinking provisions of the law), from which loans bought by Fannie and Freddie are largely exempt. It has also been frightened by arbitrary actions against Fannie and Freddie shareholders. In 2012, the Obama administration implemented the "Third Amendment" in governing Fannie and Freddie, which allows the Treasury Department to take 100 percent of all the GSEs' profits in perpetuity, even after the GSEs paid back taxpayers for the cost of the 2008 government bailout.

Experts: John Berlau, Iain Murray, Fred Smith

For Further Reading

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OPERATION CHOKE POINT

Operation Choke Point is a Department of Justice-led initiative based on guidance from the Federal Deposit Insurance Corporation aimed at "choking off" the financial oxygen to certain industries designated as "high risk" for fraud. It is an example of executive overreach, as it abuses existing powers for purposes never intended by Congress. As a result, it has turned into both an extensive fishing expedition that has caused many legal businesses to lose banking services and a vehicle for bypassing the legislative process to shut down politically disfavored industries.

Congress should:

- Amend the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) to prevent its abuse by politically motivated prosecutors.
- Reform the Bank Secrecy Act to provide less room for regulatory overreach.
- Remove all funding for Operation Choke Point.
- Amend Dodd-Frank to provide specific guidance on what constitutes, and does not constitute, fraud in payday lending to prevent regulatory abuse.

Operation Choke Point is ostensibly a joint effort by various regulatory entities—the Department of Justice, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation most prominent among them—to reduce the chances of Americans falling victim to fraud in a variety of "high-risk" industries, predominantly payday lending. It uses existing regulatory powers to provide heightened supervision of banks that do business with the third-party payment processors that provide payment services to those industries. CEI's *Issue Analysis* "Operation Choke Point: What It Is and Why It Matters" provides detailed background on how Operation Choke Point began and what it has turned into.

However, that seemingly laudable aim conceals a worrying reality. There is nothing illegal about most of those industries (at least not yet). However, because they have been designated high risk, banks are cutting off dealings with many processors and companies preemptively, before Choke Point's heightened supervision comes into play. As a result, many companies and individuals that have done nothing wrong have been frozen out of banking services. Without the links to banks, their financial lifeblood is choked off indeed.

Policy makers should weigh Operation Choke Point's few successes in stopping genuine fraudsters against that significant chilling effect, of which the primary victims are the customers of legal businesses that become unable to access financial services. In some cases, that chilling effect will push customers of the now-unobtainable service toward illegal providers, with subsequent risks to their health, liberty, or both.

The Department of Justice's main tool for its overzealous investigation has been subpoenas issued under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989—a statute that was not designed to prosecute consumer fraud, but rather fraud against banks. As a result, it allows for much greater damage awards than other more appropriate statutes for investigation and penalties, such as the Federal Deposit Insurance Act and the Federal Trade Commission Act. That higher level of potential damages for which banks might be found liable is a likely reason for banks to sever ties with potential "high-risk" customers. Congress should amend FIRREA to clarify that it is not intended for use in cases of consumer fraud.

The Department of Justice and its allies have used the Bank Secrecy Act's reporting provisions to compel banks to provide information on their customer activities that go well beyond anything authorized by normal legislative or regulatory authority. The Bank Secrecy Act should ideally be repealed, or at the very least amended, to place strict bounds on what regulators may require of banks—preferably requiring evidence of wrongdoing in order to be allowed to begin a criminal investigation.

Operation Choke Point began with executive branch agencies acting on their own, without authorization from Congress. Therefore, Congress should use the power of the purse to curtail this rogue operation. The House of Representatives has already passed a motion defunding the operation, and that should be a priority in the new Congress.