



# The future of Fannie Mae and Freddie Mac

By Richard Maxstadt, Senior Vice President/Chief Operating Officer, CUC Mortgage

## WHAT IS THE FUTURE OF FANNIE MAE AND FREDDIE MAC?

Put another way, what is the future of mortgage finance? These two government-sponsored enterprises (GSEs) once operated as shareholder-owned corporations that financed home loans with the tacit support of the federal government. Together, they either own or guarantee payment on \$5 trillion in U.S. mortgages and/or mortgage backed securities (MBS). But when the housing market collapsed, so did they.

Fannie and Freddie were formally seized by the Treasury Department in September 2008, with a pledge by the Treasury to provide up to \$400 billion in funding via the purchase of preferred equity shares in both GSEs. The \$400-billion cap has since been removed, enabling the Treasury, if necessary, to provide Fannie and Freddie with an unlimited amount of funding. According to the Congressional Budget Office (CBO), the bailout of Fannie and Freddie added \$291 billion to federal outlays in fiscal year 2009—and another \$99 billion in outlays are predicted from 2010 - 2019, for a total loss of \$380 billion. These totals add up to the largest federal rescue ever.

Without this ongoing commitment from Treasury, Fannie and Freddie would have been unable to continue supporting mortgage originations at a time when mortgage lending outside the arena of government guarantees had virtually collapsed. And without an adequate supply of mortgage finance from Fannie and Freddie, the housing market's decline would likely have been deeper...with even more dire consequences for the overall economy.

### Advocates weigh in

Both industry and consumer advocates have strong opinions about the future of Fannie and Freddie. But setting aside their occasional animosity, these groups share certain core goals for mortgage finance. For example, most recognize

the benefit of having the government continue to promote residential lending by encouraging the practice Fannie and Freddie have implemented for decades: buying mortgages and bundling them into securities for sale to investors. Like it or not, when it functions properly, the mortgage-backed securities market generates fresh cash that can be channeled back into additional affordable loans.

The challenge is figuring out how to do this without the lax practices and open-ended federal commitment that left taxpayers on the hook for catastrophic losses in 2008.

Another issue at the heart of the emerging consensus is the preservation of the 30-year fixed-rate mortgage. Susan Woodward, former chief economist at the Housing and Urban Development Department, was recently quoted by Bloomberg Business Week as saying, "People regard it as a right as Americans to get a 30 year fixed-rate loan."

Advocates also agree that the government's role in any new system should be much clearer than it was in the past. For example, executives with the Mortgage Bankers Association and the National Association of Realtors have said that mortgage-backed securities that meet government standards should receive an explicit guarantee. And the Securities Industry and Financial Markets Association, Wall Street's main lobbying group, has called on the federal government to continue playing a major role in the mortgage market. The group's proposal, submitted to the Administration, states that the government couldn't completely exit the mortgage market without sending costs sharply higher for consumers.

Phillip Swagel, an assistant secretary for economic policy at the Treasury under President George W. Bush, recently made a clear prediction in Bloomberg Business Week: "There will be a government role in the market whether we like it or not."

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**What's next**

One thought for the future is that the successor housing GSE could issue MBS guarantees, and the money would be set aside in an insurance fund. Mortgage lenders that bundle loans into bonds would contribute to the insurance fund, which would be available in case of a calamity. It would function like deposit insurance modeled on the Federal Deposit Insurance Corp., which protects consumers from bank failures with a fund financed by deposit institutions.

In general, the industry-inspired proposals are less radical than some of the ideas emanating from Congress. Proposals are moving forward that retain both a government guarantee and a central role for securitization, and attempt to more clearly separate credit risk and interest rate risk. These proposals also keep some of the credit risk with the originators of mortgages and continue to transfer the interest rate risk to the future replacements for Fannie and Freddie. That may continue to present problems, depending on how the future entities fund themselves and manage their duration risk.

What is the future of Fannie Mae and Freddie Mac? Federal action in the coming months will help answer that question. The Administration's plan for the GSEs, which should include a nod toward creating a housing finance system for the 21st century, is expected within six months. □

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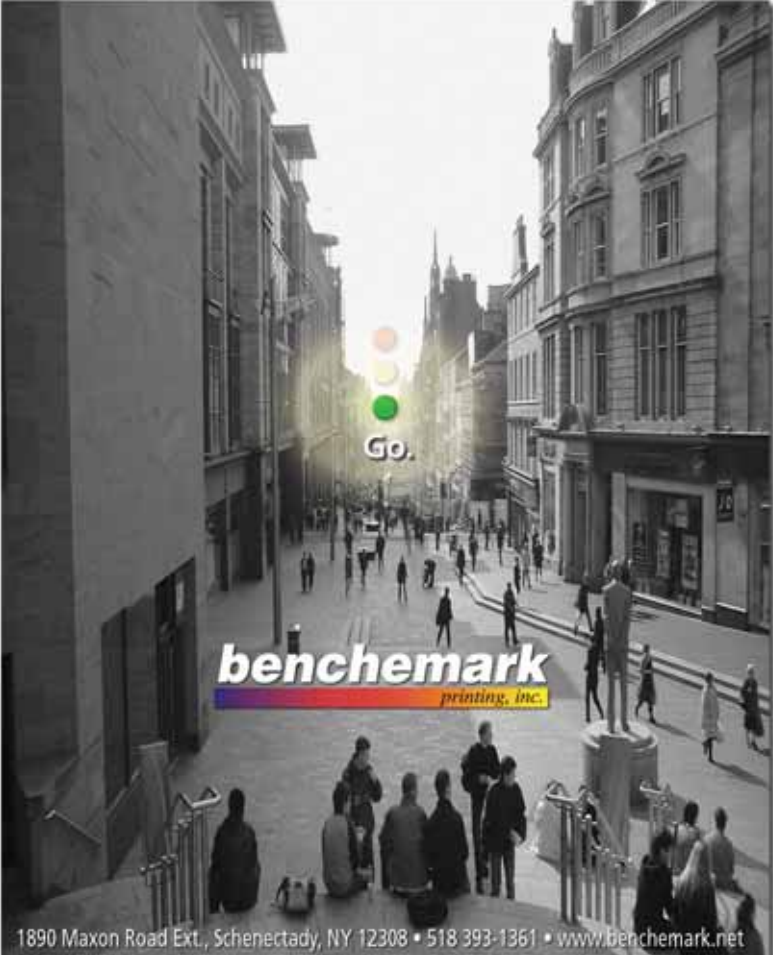
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