

Industry Seeks Fannie, Freddie Overhaul

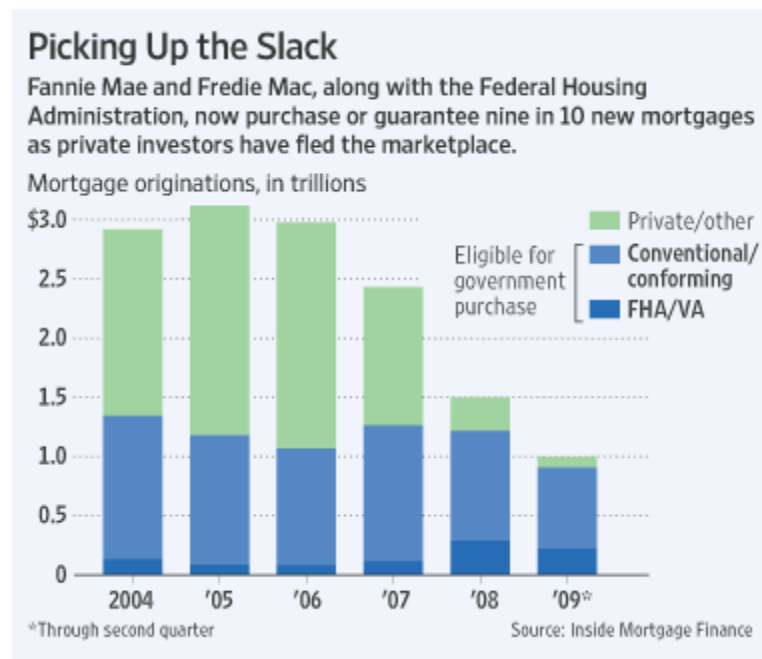
*By Nick Timiraos
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A mortgage-industry trade group is calling for Congress to transform Fannie Mae and Freddie Mac into several smaller privately held companies that would issue mortgage securities carrying an explicit government guarantee.

The proposed framework, to be released Wednesday by the Mortgage Bankers Association, would give successor entities to Fannie and Freddie the authority to create securities backed by certain types of mortgages. The new companies would guarantee the securities against defaults on the underlying mortgages.

The new companies would also pay fees into a federal insurance fund, which would guarantee interest and principal payments to bondholders if the companies were unable to make them.

Such an insurance fund, designed to kick in only if the companies were to suffer catastrophic losses, would provide explicit federal backing. That would replace the current system, in which investors have long assumed that the government would stand behind Fannie and Freddie.



Some foreign investors in China and elsewhere lost confidence in that fuzzy implied guarantee last year and reduced their holdings of the companies' debt, though the U.S. government has propped up Fannie and Freddie with capital infusions.

"If we're going to restore and maintain investor confidence and...consistent liquidity, that is going to require an explicit backstop," said John Courson, chief executive and president of the MBA.

Shares of both Fannie and Freddie fell by more than 17% Tuesday in New York Stock Exchange trading. The price drops followed a Monday

report from FBR Capital Markets that said there is "no fundamental value remaining" in the companies' shares.

The MBA's plan calls for government agencies, rather than the new companies, to assume the "mission" of promoting affordable housing that Congress has long assigned to Fannie and Freddie.

The new companies also wouldn't be allowed to hold large amounts of mortgages and securities under the proposal. Fannie and Freddie hold large investment portfolios in mortgages.

The proposal comes a year after the government seized control of Fannie and Freddie through a legal process known as conservatorship. It is one of several such plans likely to be floated this fall as

debate heats up in Congress over how the government should restructure the \$10 trillion home-mortgage market.

The Obama administration has said it will issue its own recommendations on the future of the housing-finance system early next year.

While the administration has moved quickly to remake sectors from autos to banks, addressing the future of Fannie and Freddie hasn't been a priority. In part that's because the administration is using the government-backed companies to help with foreclosure-prevention efforts and to stabilize the housing market.

Together with the Federal Housing Administration, Fannie and Freddie now purchase or guarantee nearly nine in 10 new mortgages, since private buyers of such loans have been absent amid the housing bust.

Fannie and Freddie have taken nearly \$96 billion of capital infusions from the U.S. Treasury since last November. The companies have received nearly 10 times that amount in additional support through purchases of debt and mortgage-backed securities by the Treasury and the Federal Reserve.

Analysts expect the housing-finance debate to drag on for months, if not years.



John Courson, CEO of the Mortgage Bankers Association, said restoring and maintaining investor confidence requires an explicit guarantee.

Republicans have argued that Fannie and Freddie were brought down as a result of a decade-long affordable-housing push that steered them into loosening their standards. House Republicans have put forward their own plan that would end government conservatorship of the companies within the next 18 months.

Democrats have said that the companies' troubles stemmed from a poorly regulated private-lending market that encouraged Fannie and Freddie to make questionable decisions in an attempt to regain market share they lost to Wall Street firms.

"If we learn the wrong lessons, we'll create a system that doesn't bring capital to underserved communities," said Sarah Rosen Wartell, an executive vice president at the Center for American Progress, a liberal think tank that has close ties to the Obama administration. The center has convened a study group on the future of housing finance that will issue a report this fall.

A report published last month by analysts at Moody's Investors Service said that the likelihood that both companies would be replaced with a new entity "continues to increase as their losses mount." The report predicted that it could take at least a decade of government ownership before Fannie and Freddie become viable stand-alone entities.

While the companies' full losses won't be known until the housing market stabilizes, losses could reach \$175 billion by the end of 2010, according to an estimate by Bose George, an analyst who covers the companies for Keefe, Bruyette & Woods.

The Obama administration appears unlikely to seek an extension from Congress of emergency authority that allows the U.S. Treasury to buy the agencies' debt, which expires Dec. 31. The Treasury is instead expected to take steps to assure the marketplace that the government will continue to keep borrowing costs low for the companies.