

INTERNATIONAL
Herald Tribune

U.S. takes control of Fannie Mae and Freddie Mac

By Edmund L. Andrews

Sunday, September 7, 2008

WASHINGTON: The Treasury Department seized control of Fannie Mae and Freddie Mac, the giant quasi-public mortgage finance companies, Sunday and announced a four-part rescue plan that included an open-ended guarantee to provide as much capital as they needed to stave off insolvency.

At a news conference Sunday morning, the Treasury secretary, Henry Paulson Jr., announced that he had dismissed the chief executives of the companies and had replaced them with two longtime financial executives. Herbert Allison, the former chairman of TIAA-CREF, the pension fund for teachers, will take over Fannie Mae and succeed the chief executive, Daniel Mudd.

At Freddie Mac, David Moffett, a senior adviser at the Carlyle Group, one of the biggest U.S. private equity firms, will succeed Richard Syron as chief executive. Mudd and Syron, however, will stay on temporarily to help with the transition.

"Fannie Mae and Freddie Mac are so large and so interwoven in our financial system that a failure of either of them would cause great turmoil in our financial markets here at home and around the globe," Paulson said.

The move, aimed at helping stabilize financial markets, was announced in advance of the opening of trading Monday in Asia.

Paulson added that "this turmoil would directly and negatively impact household wealth: from family budgets, to home values, to savings for college and retirement. A failure would affect the ability of Americans to get home loans, auto loans and other consumer credit and business finance. And a failure would be harmful to economic growth and job creation."

Paulson refused to say how much capital the government might have to provide or what the cost to taxpayers might ultimately be. The companies are likely to need tens of billions of dollars over the next year, but the cost to taxpayers will largely depend on how fast the housing and mortgage markets recover.

Paulson's plan begins with a pledge to provide additional cash by buying a new series of preferred shares that would offer dividends and be senior to both the existing preferred shares and the common stock that investors around the world already hold.

The two companies will be allowed to "modestly increase" the size of their existing investment portfolios until the end of 2009, which means they will be allowed to use some of their new taxpayer-supplied capital to buy and hold new mortgages in investment portfolios.

But in a strong indication of Paulson's long-term intention to wind down the companies' portfolios, drastically shrink the role of Fannie and Freddie and perhaps eliminate their unique status altogether, the plan calls for the companies to start reducing their investment portfolios 10 percent a year, beginning in 2010.

The investment portfolios are now slightly more than \$1.4 trillion, and the plan calls for that to eventually shrink to \$250 billion each, or \$500 billion total.

"Government support needs to be either explicit or nonexistent, and structured to resolve the conflict

between public and private purposes," Paulson said. "We will make a grave error if we don't use this time out to permanently address the structural issues presented by the GSE's," he added, a reference to the companies as government-sponsored enterprises.

Critics have long argued that Fannie and Freddie were taking advantage of the widespread assumption by investors that the federal government would bail them out if they got into trouble. Administration officials as well as the Federal Reserve have argued that the two companies used those implicit guarantees to borrow money at below-market rates and lend money at above-market returns, and that they had become what amounted to gigantic hedge funds operating with only a tiny sliver of capital to protect them from unexpected surprises.

Treasury officials had little choice. With the credit markets still in a tailspin and investors deeply reluctant to buy mortgages with even a hint of risk, **Fannie Mae and Freddie Mac now guarantee about 70 percent of all new home loans**, the director of the Federal Housing Finance Agency, James Lockhart, said.

Paulson said the Treasury Department would provide as much money as needed to keep the companies' capital reserves from falling below the levels that would trigger rules that automatically put them into receivership.

In addition, the Treasury Department will create a "Secured Lending Credit Facility," a backup source of borrowing for the companies in the event they cannot borrow enough money on the open market to finance their main business of buying mortgages and reselling them as pools of mortgage-backed securities.

In a possibly unprecedented move into the private markets, the Treasury Department will also buy billions of dollars in Fannie and Freddie mortgage securities on the open market. This move is likely to make it much easier for the companies to finance somewhat riskier loans. The crisis surrounding the mortgage-finance giants seeped into the presidential campaigns over the weekend, with Senator John McCain, the Republican nominee, saying Sunday that he supported the Treasury move.

"The fact that they'll be able to buy mortgage backed securities from other banks is really important," William de Vijlder, chief investment officer at Fortis Investment Management in Brussels, said, "because it means the U.S. is serious about fixing the problems in the market." The "doomsday scenario," in which write-downs of those securities results in a continuing cycle of bank write-downs and losses, is over, he added.

"I expect a positive reaction in the market in the near term," he said. "The problems have not gone away, but along with the decline in the oil price, this helps to put the machinery into place by which things will eventually return to normal."

McCain added that the two companies need "more regulation, more oversight, more transparency, more of everything, and frankly, a dramatic reduction in what they do."

The Democratic presidential candidate, Barack Obama, said in a statement Sunday that "given the substantial role that Fannie Mae and Freddie Mac play in our housing system, I believe that some form of intervention is necessary to prevent a larger and deeper crisis throughout our entire economy."

David Jolly contributed reporting from Paris.

Correction:

Notes: