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Fannie, Freddie should exit government grip, Mnuchin says

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Steven Mnuchin, president-elect Donald Trump's nominee to be treasury secretary, said Fannie Mae and Freddie Mac should leave government control and that the incoming administration "will get it done reasonably fast."

The comments, which came in an interview on Fox Business, sent shares of the mortgage-finance giants soaring Wednesday. Fannie Mae jumped as much as 33 percent by mid-morning trading, the most since April, and Freddie Mac rose almost 33 percent, the most since May 2013.

The fight over the future of the mortgage companies has been raging since they were bailed out in 2008 for an eventual cost of $187.5 billion. There's been competing legislation proposed in Congress and battles with shareholders over the U.S. Treasury taking most of the companies' profits. Since the takeover, the companies have sent the Treasury more than $250 billion.

Mnuchin in the interview said that government ownership of the companies displaces private mortgage lending.

"We will make sure that when they are restructured, they are absolutely safe and don't get taken over again. But we've got to get them out of government control," Mnuchin said.

Mnuchin isn't a stranger to the mortgage market. In 2009, he joined with a group of former Goldman Sachs colleagues and billionaires to buy the remnants of IndyMac, turned it around and sold the bank for a big gain last year.

Fannie Mae and Freddie Mac, which are also referred to as the "government-sponsored enterprises" don't make mortgages. They buy them from lenders, wrap them into securities and provide guarantees to investors in case of default. That process underpins the U.S. mortgage system and is largely responsible for making inexpensive 30-year fixed-rate loans widely available.

The government took Fannie Mae and Freddie Mac over during the 2008 financial crisis, but left private shares of the companies outstanding. Their current bailout agreements require that they send nearly all of their profits to the Treasury, while winding down their capital to zero dollars by 2018.

The Obama administration for the past eight years has said that Congress should pass legislation to reform the housing-finance system. The last big push for legislation was in 2014 and failed to reach the Senate floor.

In the meantime, investment managers who bought shares of the companies have pushed for changes. They've sued the government to challenge the current terms of the bailout while also lobbying lawmakers to allow the companies to survive.

Investment managers whose funds hold common or preferred shares of Fannie Mae and Freddie Mac include Bruce Berkowitz of Fairholme Capital Management and hedge fund managers John Paulson, Bill Ackman and Richard Perry.

Fairholme's Berkowitz, who endorsed Trump, was one of the winners on Wednesday as Fannie Mae and Freddie Mac securities climbed. His two biggest holdings, preferred shares in both companies, added about $220 million in value as of 10:25 a.m., according to data compiled by Bloomberg.

According to Trump's most recent personal financial disclosures, the president-elect owns between $3 million and $15 million worth of funds managed by Paulson, who's served as a political donor and economic adviser to Trump.

Perhaps most important for shareholders, Mnuchin on Wednesday didn't appear to mimic Republicans who have said that Fannie Mae and Freddie Mac should be wound down or eliminated.

That stance could bring him in conflict with Republican lawmakers. Jeb Hensarling, the Texas Republican who chairs the House Financial Services Committee, in a speech earlier this month reiterated his desire to pass his own housing-finance reform plan, which would wind down Fannie Mae and Freddie Mac within five years.

Tennessee Republican Sen. Robert Corker co-sponsored a bipartisan bill that would also have eliminated the mortgage-finance companies.

Lawmakers have been hesitant to release Fannie Mae and Freddie Mac from government control without a broader reform to housing policy. A measure from Corker approved by Congress last year bars Treasury from unwinding its controlling stake for two years unless housing-finance legislation is completed before then.

More recently, Edward DeMarco, who used to helm the companies' regulator the Federal Housing Finance Agency, and former Corker staffer Michael Bright proposed a plan that would turn Fannie Mae and Freddie Mac into lender-owned insurers.

"Fannie and Freddie need to be a lot smaller than they are today, and if they are going to exist they need to operate in a truly competitive marketplace. It sounds like the incoming Treasury Secretary agrees," Bright said in an interview.

Some analysts on Wednesday said that Mnuchin's comments seemed to suggest the Trump administration would be open to allowing Fannie Mae and Freddie Mac to retain profits, which shareholders may see as a step toward allowing the companies to re-enter the private market.

"Any path that leads to the GSEs exiting government control needs to permit the GSEs to rebuild capital," wrote Ed Groshans of Height Securities. Still, Groshans said that it could take a decade or longer for the companies to build enough capital for some profits go to shareholders.

Some small lenders and civil rights groups over the past two years have pushed to allow Fannie Mae and Freddie Mac to recapitalize, arguing that the companies are critical to keeping the mortgage system widely accessible. Some of them believe that the companies should be turned into utilities, with a strong regulator and capped rate of return.

"We are very glad to hear the Treasury Secretary-designate's remarks concerning Fannie and Freddie. The quickest route to getting Fannie and Freddie out of government ownership is to reform those aspects that led to conservatorship," Glen Corso, who heads the Community Mortgage Lenders of America, said in an e-mail. Corso said those aspects included weak capital standards and bad profit incentives.

The Trump administration's proposed direction on Fannie Mae and Freddie Mac is still open to wide interpretation, said Mark Calabria, director of financial regulation studies at the libertarian Cato Institute. The outcome "all depends on what one means by 'privatized'," he said.