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A Major Lift for Fannie and Freddie

By Annie Lowrey

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WASHINGTON — The federal overseer of Fannie Mae and Freddie Mac on Tuesday announced a shift in policies intended to maintain the mortgage finance giants' role in parts of the housing market, spur more home lending and aid distressed homeowners.

"Our overriding objective is to ensure that there is broad liquidity in the housing finance market and to do so in a way that is safe and sound," Melvin L. Watt, the new head of the Federal Housing Finance Agency, said in a speech at the Brookings Institution in Washington.

But Mr. Watt's announcement raises bigger — and divisive — questions about the role of the now-profitable mortgage institutions, which were fully taken over by the federal government during the financial crisis to avoid their bankruptcies. Should they become broader instruments of government housing policy? Or should they winnow their portfolios and allow the private markets to take over?

Mr. Watt's changes would perpetuate the presence of the two government-sponsored enterprises in mortgage finance, rather than shrinking it.

"Director Watt has signaled that he will turn from focusing on the enterprises as institutions in intentional decline to institutions that should be better prepared to form the core of our system for years to come," said Jim Parrott of the Urban Institute in an analysis of Mr. Watt's remarks. "This shift in focus ripples through the many decisions announced in the speech and signals a watershed moment in the brief history of the agency."

Many Republicans and some Democrats have forcefully argued that Fannie Mae and Freddie Mac, which sustained huge losses when the housing market collapsed and required a costly government bailout, should step back to encourage the private market to assume more of the risk of financing housing.

Mr. Watt laid out several specific measures. For example, rather than reducing current limits on the size of the loans they guarantee, as previously proposed by the former overseer, Fannie and Freddie would keep the current, relatively loose, limits in place. The two enterprises back about two-thirds of all new mortgages.

“This decision,” Mr. Watt said, “is motivated by concerns about how such a reduction could adversely impact the health of the current housing finance market.”

The new director also loosened rules that obligated banks to buy back distressed loans. Mr. Watt said that the mortgage financiers would now allow two delinquent payments in the first 36 months after their acquisition of a loan, and that they would eliminate “automatic repurchases when a loan’s primary mortgage insurance is rescinded.”

Those changes are intended to stimulate mortgage lending at a moment when the housing market has softened in response to higher interest rates. Many banks have tightened credit standards, in part because of the requirement that they take losses if borrowers default.

In addition, Mr. Watt said he was looking into “an independent dispute resolution program when lenders believe a repurchase is unwarranted” and clarifying Fannie and Freddie’s underwriting rules.

Mr. Watt said the housing institutions would do more to communicate with the 750,000 homeowners who might benefit from the Home Affordable Refinance Program, which helps homeowners modify their mortgage loans. He said he would not change the eligibility requirements for that program, though, because the number of additional borrowers who might be helped is “relatively small.”

Housing experts remain sharply divided on the proper role for Fannie and Freddie. Should they be instruments of government housing policy under conservatorship or operate with a reduced, less-risky footprint?

“You’re a conservator,” said Mark A. Calabria, director of financial regulation studies at the Cato Institute, a libertarian Washington research group. “The focus should be on conserving asserts and nursing Fannie and Freddie back to health. For him to bring up balancing those concerns with the soundness of the housing market and with promoting essentially risky lending, it’s contrary to what a conservator is supposed to do."

But others said that Fannie and Freddie could and should do more. “We encourage Director Watt to address two additional issues that are exceedingly important to America’s families,” Julia Gordon, the director of housing finance and policy at the Center for American Progress, a left-of-center research group, said in a statement.

Fannie and Freddie, she said, should “provide struggling borrowers with principal reduction, an approach that has been shown to result in highly sustainable loan modifications.” Such a policy, which the White House has supported, would let banks reduce the amount that homeowners owe on their mortgages if their house is worth less than the value of their loan.

The mortgagors should also contribute to two federal funds that “support affordable rental housing for those at the bottom of the economic ladder.”

Mr. Watt’s remarks come as Fannie and Freddie have returned to profitability and as lawmakers have started to more seriously consider how to remove them from government conservatorship.

The federal government rescued Fannie and Freddie from collapse in 2008, with a bailout that cost about $190 billion. Since then, they have stabilized their loan portfolios and paid about $200 billion in dividends to the federal government.

A bill sponsored by the Democratic chairman of the Senate Banking Committee and its ranking Republican would substantially reduce the role of Fannie and Freddie.

Mr. Watts’s plan won support from the White House. “We applaud the Federal Housing Finance Agency for issuing certainty and clarity on the rules of the road for loans backed by Fannie Mae and Freddie Mac,” said Jay Carney, the White House press secretary, at a press briefing Tuesday. “Today’s announcements represent a meaningful step toward helping more Americans own their home and continued strengthening of the housing market.” A spokeswoman said the White House had not consulted with the Federal Housing Finance Agency on the specifics of Mr. Watt’s plan.

The fragile state of the housing recovery and lingering concerns about lending regulations — along with the fact that Congress has failed to act even on issues with broad bipartisan agreement — has forestalled any legislation.

On Thursday, the Senate Banking Committee is expected to vote on a bill that would wind the agencies down. But Congress is not expected to pass any reform measures in the foreseeable future.

Mr. Watt was confirmed as the head of the Federal Housing Finance Agency at the end of last year. His predecessor, Edward J. DeMarco, frequently clashed with Democrats, refusing to put in place a White House proposal to reduce the principal on so-called underwater mortgages.