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Senate's Fannie Mae Wind-Down Plan Faces High Hurdles

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A bipartisan U.S. Senate plan to dismantle Fannie Mae (FNMA) and Freddie Mac must clear many political hurdles in a short time if it is to become law, leaving narrow chances of a housing-finance overhaul being enacted this year.

Senate Banking Committee leaders said the proposal, which they plan to release later this week, would replace the two U.S.-owned mortgage financiers with government bond insurance that would kick in only after private capital suffered severe losses.

It will be left to the courts to decide how investors in Fannie Mae and Freddie Mac are treated as the two companies are wound down, Mike Crapo, an Idaho Republican who co-wrote the bill, said today in an interview on Bloomberg Television. Investors including Perry Capital and Fairholme Capital Management are suing the U.S. to challenge an arrangement in which all the companies' profits go to the Treasury.

"They have filed suit right now in order to challenge the way that the current conservatorship is managing the current profitability of Fannie Mae and Freddie Mac and we are not necessarily going to dictate the outcome of that," said Crapo, who co-wrote the measure with Banking Committee Chairman Tim Johnson of South Dakota. "That will be a decision that's made in the courts."

Support Uncertain

It remains unclear whether the bill can gain the support it would need in the next four months, before lawmakers' attention shifts to midterm elections. A Democratic Senate aide said leadership is currently unenthusiastic about legislation that would eliminate the companies.

"It's possible, but it's certainly not probable," said Mark Calabria, a former aide on the Senate banking panel who now directs financial regulation studies at the Cato Institute, a Washington-based research organization that supports free markets. "You're looking at maybe a 10 percent chance of a bill getting to the president's desk."

Pressure from the White House, lawmakers and other advocates who want to eliminate Fannie Mae and Freddie Mac is mounting as the companies return to profitability more than five years after they were bailed out by taxpayers. The bill's fate may determine how soon the nation's system of financing home loans is changed from one in which most of the risk is borne by taxpayers into one where private capital suffers the first losses.

Investors' Take

"I do think we're going to pass this bill out of the Senate," Senator Bob Corker, A Tennessee Republican, said on CNBC today. He said the Senate Banking Committee plans to hold a drafting session in early April. "I'm really pretty upbeat about it," he said, without saying why.

If the measure doesn't pass this year, lawmakers must begin work all over again with the start of the new legislative session in January.

The bill's dim prospects failed to allay fears among investors, triggering a two-day sell-off of stock. Fannie Mae shares plunged 12 percent to \$3.54 at the close of trading yesterday, after tumbling 31 percent March 11. Shares were up more than 10 percent today to \$3.92 at 10:20 a.m. New York time, and the stock is up from \$3.01 on Dec. 31, and 29 cents a year ago.

Freddie Mac (FMCC) fell 17 percent yesterday to \$3.36, a day after after dropping 27 percent. Its shares were up more than 11 percent today to \$3.74.

Obama Support

The Johnson-Crapo bill, based on legislation that gained wide backing from members of both parties on the banking panel last year, was written with input from the administration of President Barack Obama and is the most likely vehicle for an overhaul. Still, it isn't yet clear whether a majority of Democrats on the Banking committee will sign on.

The bill requires 10 percent private capital in advance of any kind of government guarantee, so "it's a big step away from where we are today," Corker said on CNBC.

Democratic senators on the panel including Elizabeth Warren of Massachusetts and Sherrod Brown of Ohio have said they want to ensure any measure guarantees affordable loans for most buyers and provides funds for rental housing for the poor. Others in their party including Chuck Schumer of New York, Robert Menendez of New Jersey, Jeff Merkley of Oregon and Jack Reed of Rhode Island have yet to signal which way they're leaning.

'Bipartisan' Discussion

"My sense is the basic proposal had a lot of merit," Reed said in an interview. "I just want to look at what they're specifically proposing."

Getting approval from the committee will be central to moving forward on an overhaul, said Julia Gordon, director for housing finance and policy at the Center for American Progress, a Washington advocacy group with ties to the Democratic Party.

“It is important that a bill get out of committee so a framework for discussing this in a bipartisan way is established,” she said in a telephone interview. “If you don’t have a framework for discussing this in a bipartisan way, you’re not going to get anywhere.”

Another question is whether Senate Majority Leader Harry Reid, a Nevada Democrat, will expend political capital in an election year to bring the measure to a vote of the full Senate.

Democratic Reservations

Reid has expressed reservations about winding down Fannie Mae and Freddie Mac because the companies ensure that homebuyers are able to get affordable fixed-rate mortgages. The two firms provide liquidity to the housing market by buying loans from lenders and packaging them into guaranteed securities.

The Senate’s Democratic leadership remains lukewarm on the proposal and there is little enthusiasm for taking up the issue this year, said a Senate Democratic aide who spoke on condition of anonymity.

Still, Crapo and Johnson say they are hoping Reid will agree to move forward with their bill. “I have not had a discussion with him about that specifically but I believe Harry would be willing to work with us on this,” Crapo said in an interview.

In the Republican-led House of Representatives, a bill that would almost entirely privatize the mortgage market, written by Financial Services Committee Chairman Jeb Hensarling, hasn’t yet gained enough support for a vote of the full chamber.

House Bill

That could change if the Senate passes the Johnson-Crapo bill, said Corker, who co-wrote the measure that the new legislation is based on.

“If we show we can move a bill over here I think the House is then going to begin to look at what they might do to move closer to what the Senate is going to take action on,” he said in an interview.

Whether or not it’s enacted this year, the bill is likely to be the blueprint for an eventual overhaul, Ed Mills, an analyst at FBR Capital Markets & Co. in Washington, said in a telephone interview.

“It remains a long shot this year, but this is going to be one of those things you can’t count out until the final gavel comes down on this Congress,” he said.

