White House, Senators Back Deal to Do Away with Fannie Mae, Freddie Mac

By Ryan Schuette

Mar 13, 2014

It could be the end for bailed-out mortgage giants Fannie Mae and Freddie Mac as we know them, if recent bipartisan support for their elimination means anything.

U.S. Senator Tim Johnson (D-S.D.), chairman of the Senate Banking Committee, unveiled a proposed agreement with ranking member Sen. Mike Crapo (R-ID) on Tuesday that would wind down the government-sponsored enterprises over the course of 5 years.

The legislation builds on an earlier bill by Sens. Bob Corker (R-TN) and Mark Warner (D-VA) which would replace the two companies — long a linchpin of the U.S. mortgage-finance system and locus of voter anger in recent elections — with a single executive-level agency called the Federal Mortgage Insurance Corporation (FMIC).

"This bipartisan effort will provide the market the certainty it needs, while preserving fair and affordable housing."Tim Johnson, U.S. Senator

In a statement, Johnson hailed "near unanimous agreement" between the two parties in the effort to overhaul a critical piece of the secondary mortgage market.

"This bipartisan effort will provide the market the certainty it needs, while preserving fair and affordable housing throughout the country," he added.

The Bush administration placed the two quasi-private mortgage giants into federal conservatorship at the height of the financial crisis in 2008, bailing out the companies with nearly $200 billion in taxpayer funds that the GSEs continue to repay.

Bloomberg News reports that Fannie Mae and Freddie Mac will have remitted $202.9 billion in dividends back to the federal government by the end of March, with another nearly $180 billion to come over the next 10 years.

However, that was before the Senate Banking Committee and White House came out on Tuesday in overwhelming support of a bill that would mean their elimination.

The Los Angeles Times quoted a White House spokesperson as saying the Obama administration "support[s] this effort and believe[s] it is a workable bipartisan approach to complete the biggest remaining piece of post-recession financial reform" since the financial crisis.

A spokesperson with Fannie Mae was not immediately available for comment. Another for Freddie Mac declined to comment on the story, citing the mortgage giant's decision to generally refrain from speaking about pending legislation.

A History of Influence

Fannie Mae and Freddie Mac have long been at the center of the debate over whether the government should backstop Wall Street securities, however lucrative.

A Depression-era Congress chartered Fannie Mae more than 70 years ago to buy up mortgages insured by the Federal Housing Administration. Freddie Mac came into play later on in order to help bundle and securitize mortgages, creating a financial seesaw with implicit federal backing that made it attractive to domestic and overseas investors.

This helped make U.S. Treasury debt one of the safest and most attractive investments in the world and largely kept it that way during the Cold War — and set up the crisis to come.

Some experts hold that the affordable homeownership legislation passed by Congress over the 1990s and early 2000s put taxpayers on the hook for the federally insured — and highly risky — mortgages that ultimately precipitated the Great Recession 6 years ago.

Others say that the GSEs — quasi-private institutions with enormous influence inside the Beltway, backed by taxpayers and led by board members traditionally appointed by the president — flexed their lobbying muscle with lawmakers for years to assure favorable regulation and, more recently, stall the kind of meaningful reform that made itself an election issue after the recession.

Mark Calabria, director of regulatory studies with the libertarian Cato Institute and a former Senate Banking Committee staffer who used to work for Sen. Richard Shelby (R-AL), one of the bill's sponsors, says Fannie Mae and Freddie Mac lost much of their lobbying power after the crisis.

"They have a tarnished reputation and certainly can't spend on lobbying like they used to, but they have the mortgage industry to lobby for them behind the scenes," he said.

The Devil in the Details

With a draft bill set to follow in coming weeks, the statements released on Tuesday were light on the details of a proposed bipartisan agreement that nevertheless rattled investors on Wall Street.

What details were available revealed that Johnson and Crapo hoped to make the implicit government guarantee an explicit one and relocate the mortgage-securitization functions traditionally held by Fannie and Freddie to the new FMIC.

By making the guarantee explicit, the lawmakers would officially charge the government with the responsibility to reinsure home loans and securities in the event that another financial catastrophe forces lenders and investors to shed nearly all of their capital reserves.

According to the statement, the FMIC would closely resemble the FDIC, the agency currently responsible for insuring bank deposits and safely liquidating financial institutions headed for bankruptcy. Like the latter, this new mortgage-securitization agency would require that lenders and investors withhold enough capital to have 10 percent in reserves on hand in case of a crisis.

Lawrence J. White, a professor of economics at New York University, says the devil is in the details.

What matters “is what regulation the FMIC imposes on these mortgage securitizers,” he said in an interview. “The taxpayer was overexposed to risk with Fannie and Freddie. How much risk will the taxpayer actually be exposed to with this new structure?”

The committee’s statement also outlines a five-year transition plan — a seemingly confident move that suggests officials believe the private market has the liquidity it needs to sop up the more than 60 percent of all residential mortgages that Fannie Mae and Freddie Mac currently insure.

White says he feels comfortable with the timeframe. “If the major uncertainties” about rules and regulation “can be put to rest, then I think we will see a revival of the securitization market. The Johnson-Crapo agreement certainly provides a road map for that revival.”

If the Senate bill passes, supporters would still need to contend with the lower chamber, whose Republican majority remains closely connected to the tea party movement.

U.S. Rep. Jeb Hensarling (R-TX), chairman of the House Financial Services Committee, remains one possible obstacle, with The Dallas Morning News suggesting the conservative congressman was “cool” to the Johnson-Crapo reform package.

The House chairman introduced a bill earlier last year in his own committee that would do away with the companies and completely privatize the market, with language that explicitly prevents the federal government from intervening in another catastrophic emergency.

But Calabria thinks the real challenge will be shepherding the bill out of the Senate in the first place.

“There are a lot of backroom efforts to keep Fannie and Freddie around,” he adds. “But it seems unlikely to pass the Senate in a midterm election year. It’s a long process, and I don’t think it would be surprising if [GSE reform] takes another Congress or two.”