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Fight Now Looms Over Fannie, Freddie

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The fight over the changes to U.S. financial regulation was bruising.

The coming debate over what to do with Fannie Mae and Freddie Mac promises to be even more contentious.

The revamp of the nation's financial infrastructure, which will be signed into law next week by President Barack Obama, didn't address the fate of the mortgage-finance giants that helped fuel the housing bubble and were taken over by the government in 2008. So far, the U.S. has spent $145 billion to keep the companies afloat.

Administration officials say they will outline a proposal to Congress by early next year and that intense discussions are under way on how the government should restructure its role in housing finance. The administration doesn't appear to have coalesced around an answer, according to the officials, though top advisers have indicated they see some continuing government role.

Lawmakers from both parties have heavily criticized the public-private ownership model that led the once enormously profitable companies to fail spectacularly. However, few in Washington know what to do next.

A Republican amendment to the financial-rules bill that didn't pass spelled out an exit plan for the government but didn't specify what would take the place of Fannie and Freddie, which own or guarantee a little over $5 trillion of the nation's $10 trillion of mortgages.

"The Obama administration is ignoring the issue, and the Congress is ignoring the issue. Even if you look at what the Republicans wanted to do, they were ignoring the issue," said Lawrence White, a professor of economics at New York University.

On Friday, Rep. Barney Frank (D., Mass.) said he would begin drafting a bill in September to address the companies' future that would split their public and private roles. "Yes, there's room for a shareholder-owned corporation," he said on Bloomberg Television. "To the extent that we want subsidy, I think we have to separate it out."

Fannie and Freddie, together with the Federal Housing Administration, are guaranteeing more than nine in 10 new loans, a consequence of the government's propping up of the housing market and the withering of the private securitization market. The government backstop has preserved investors' appetite for mortgages, and rates have fallen in recent weeks to record lows.

The administration has postponed any detailed, public discussion of bold reform of the U.S. housing-finance system, because it says the housing market is too shaky to withstand any change. Critics say the delay only exacerbates the challenge facing the government, by making the market more dependent on its support.

"There will never be a perfect time," said Mark Calabria, a former Senate Republican aide who is now director of financial-regulation studies at the libertarian Cato Institute think tank. "Does anybody think the housing market is going to be in great shape a year from now?"

The administration has indicated it sees a role for the public sector. "There's probably going to be a good economic case, good public-policy case, for some continued provision of a carefully designed guarantee by the public sector going forward," Treasury Secretary Timothy Geithner told lawmakers in March.

At the same time, many in the administration believe the private sector has a large part to play, according to people familiar with the discussions, with some defining success as having the government assume a much smaller, more limited role.

Many academics, industry groups and investors hold that the government should play some part in the mortgage market. Several proposals call for the government to sell an insurance "wrap" on certain issues of mortgage bonds that would carry an explicit guarantee to protect investors.

Conservatives, including Republican lawmakers, have called for a fully private market. With Republicans likely to pick up seats in Congress, and possibly control of both chambers, in the fall, "it increases the prospect of stalemate," said Ann Schnare, a mortgage-industry consultant and former Freddie Mac economist. "The rhetoric is just so charged that it could make it difficult to reach compromise."

Another likely flashpoint is whether any successors to Fannie Mae and Freddie Mac should be mandated to support affordable housing. Many Democrats support that goal, but Republicans have blamed them for the expansion into risky lending.

At a spring hearing, Shaun Donovan, the secretary of Housing and Urban Development, said that the companies' desire for profits, and not to meet government mandates, were to blame for lax standards that fueled big losses.