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# The return of Freddie and Fannie?

By Paul McMorrow

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WASHINGTON REPUBLICANS have been howling for the demise of Fannie Mae and Freddie Mac

ever since one of their own, George W. Bush, nationalized the two mortgage companies. They got their wish earlier this year, when the Obama administration announced a federal retreat from the housing market. But the GOP seems not to know how to handle victory: It's now helping push a plan that would recreate the same flawed mortgage apparatus that it demanded be put out of business.

Fannie Mae and Freddie Mac will go out of business, but what's up for debate is what will replace the two companies, which helped fuel a massive, decades-long expansion in home ownership by pumping massive amounts of money into the mortgage system.

A bill gaining steam in the Republican-led House would replace Fannie and Freddie with at least five new private companies, each of which would buy and resell prime mortgages. The bill's sponsors, Democrat Gary Peters of Michigan and Republican John Campbell of California, liken the new companies to utilities, although the mortgage-backed bonds these companies would sell would carry an explicit federal guarantee. If the loans in these new bonds soured, taxpayers would be in line to pick up the tab and make bond investors whole.

The new system would look uncomfortably similar to the mortgage regime the bill seeks to replace. In both models, private companies buy mortgages from banks, and then resell them to investors, with guarantees against defaults. The House bill would actually deepen the federal government's involvement in the mortgage market; it would have the government explicitly back mortgage bonds, whereas Fannie and Freddie had long insisted their own guarantees weren't backstopped by Washington.

The issue of the guarantee is key. A federal guarantee would subsidize the profits of the new private mortgage firms the bill would set up. And it would preserve the conflict of interest that led to Fannie and Freddie's implosion in the first place.

Since Fannie and Freddie enjoyed an implicit federal backing, they could borrow money more cheaply than private firms, undercutting competition. Wall Street chafed at the government-sponsored enterprises' built-in advantage. That's one of the reasons the big banks jumped so eagerly into the subprime mortgage game: It was a lucrative pocket of the market that Fannie and Freddie traditionally shunned, leaving the mortgage-bond business, and the buckets of fees that came with it, all to the Street.

Subprime mortgage bonds helped fuel record profits on Wall Street, and those record profits caught the eyes of Fannie and Freddie's management and shareholders. Although the two companies were chartered by Congress and had a direct credit line with the Treasury, they were also money-making institutions. They were companies with split personalities. So when they saw Wall Street getting fat and stupid on subprime profits, their money-hungry halves jumped after the easy money. And when the loans started going bad, the companies' losses wound up being paid out of the Treasury.

The firms' bailout tab now hovers around \$158 billion, and their rescue will be the costliest of the financial crisis. So free marketers rejoiced when it was announced that Fannie and Freddie will soon be put out of business. Fannie and Freddie's Wall Street competitors (those still in business) weren't heartbroken by the news, either.

The Obama administration's mortgage plan, unveiled in February, called for limiting government's role in the mortgage market to robust regulation. The government would still provide some targeted aid to working-class

buyers, and it would pump cash into the system during credit shocks, but by in large, government would leave the mortgage business. The Obama plan essentially wraps the \$11 trillion mortgage market in a bow and hands it to Wall Street. It also says private companies have to earn their profits by shouldering commensurable levels of risk.

It's fashionable to blame affordable housing policy for Fannie and Freddie's downfall, but the real culprit is the same one that caused Wall Street's 2008 meltdown: Unadulterated greed. The mortgage giants chased great private profits, and when those profits didn't materialize, the public suffered. Shareholders took all the upside, and taxpayers got stuck with all the losses. It was a monumental conflict of interest, and one that shouldn't be emulated.

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