



Quick Summary of Fannie/Freddie Debacle

History of two “household” names

- “Fannie Mae” (Federal National Mortgage Assn...FNMA) was created by Congress in 1938 as a government agency to create a marketplace for home mortgages, amid Depression-era credit doldrums; in 1968, Fannie issued its first public shares.
- Federal Home Loan Mortgage Corp. (FHLMC, somehow known as “Freddie Mac”) was chartered by Congress in 1970, to be a competitor for Fannie Mae’s monopoly; it was capitalized by issuing publicly traded shares.
- By 2008, Fannie & Freddie owned, or guaranteed about \$5 trillion of the total \$12 trillion US home mortgage market.

Quasi-governmental, or not?

- Both companies have always properly disclaimed any government guarantee for their debt, but the market assumed otherwise; result: they borrowed at near-government interest cost and then purchased mortgage loans at lower-than-market interest rates.
- No real or apparent reason seems to explain why the companies were allowed to enjoy a quasi-government agency role in the market, making their bonds and interest rates into “crème”, compared to other publicly traded debt issues.
- In modern times, Fannie/Freddie executives have been compensated as though their jobs were comparable to those in corporations which have a full range of business risks.
- Moreover, in the past 10 years, Fannie & Freddie “invested” \$170 million into lobbyist fees, plus additional amounts of campaign contributions, presumably in

order to influence would-be regulators, the Congress and even the White House. [Note: As you might expect, US Government departments and agencies are legally barred from hiring lobbyists or making campaign contributions.]

- Though they are essentially now in receivership to the US Government, Fannie and Freddie reportedly continue to hand out political contributions and pay lobbyists, even as their fate is being debated in Congress.

So, now what?

- The apparent legislative “solution” to the 2007/08 mortgage debt crisis will be not only to substitute a US debt-guarantee for Fannie’s and Freddie’s existing guarantees, but also to permit the Treasury to purchase Fannie/Freddie equity. What is yet unclear is whether this will mean a direct bailout of existing shareholders, via open market purchase of shares, or saving them indirectly, via a new issue of, say, preferred stock.
- The new Fannie/Freddie debt guarantees will double the US Treasury’s existing liabilities...this, however, does *not* mean that taxpayers will have to *pay out* \$5 trillion, or anything close to that amount. In fact, only defaulted debt will be taxpayer-paid and even that will be partially offset by any recovery on the underlying homes and other collateral.
- The BIG issue: Though Fannie & Freddie are too big to allow them to belly-up, the instant debate question is: Should they be gradually pushed out of existence? Indeed, we have seen strong cases made by well informed policy-types who say that F&F should fade away (over 5-10 years), letting the risk-taking marketplace do its job.