Freddie Mac headquarters in McLean, Va., a Washington suburb, in July. CEOs of Fannie Mae and Freddie Mac will be replaced, the government said.

By Pablo Martinez Monsivais, AP file

Taxpayers take on trillions in risk in Fannie, Freddie takeover

By Stephanie Armour and James R. Healey, USA TODAY

WASHINGTON — The unprecedented federal takeover of mortgage giants Freddie Mac and Fannie Mae announced on Sunday is a bold attempt to stabilize financial markets and restore the faltering housing market, but it thrusts trillions of dollars of risk directly onto taxpayers' shoulders.

"You can call it a bailout, you can call it a safety net or you can call it a rescue package, but the bottom line is the American taxpayer is left footing the bill," says Richard Yamarone, director of economic research at Argus Research.

At a Sunday morning news conference, Treasury Secretary Henry Paulson and James Lockhart, director of the newly formed Federal Housing Finance Agency (FHFA), announced that Fannie Mae (FNM), based in Washington, D.C., and Freddie Mac (FRE), based in McLean, Va., will begin operating immediately under a federal government conservatorship. Unlike a receivership, the arrangement leaves hope for shareholders that investments may regain some value. President Bush signed housing legislation in July that gives the government clear authority to intervene as it has.

If the plan settles the bond market as government officials hope, borrowers may find mortgages at slightly lower rates. In taking over the companies, the government ousted their CEOs; otherwise, work continues as normal.

Though the companies haven't been at imminent risk of collapse, deep losses from the housing meltdown have raised concerns from investors around the world about their ability to meet financial commitments.

"I have determined that the companies cannot continue to operate safely and soundly and fulfill their critical public missions without significant action to address our concerns," Lockhart said.

Freddie Mac and Fannie Mae combined own or guarantee $5.4 trillion in outstanding mortgage debt. The government's decision to place both agencies into a conservatorship — in essence, taking on responsibility for that debt by wresting control from the corporations — is an historic move.

It is still uncertain how much capital the companies may need from the government. What that means to taxpayers ultimately depends on what happens with the faltering housing market. To the extent homeowners continue to make timely mortgage payments, pressure on the government is lessened. Continued foreclosures and troubles in the mortgage market could run up an expensive tab.

The Mortgage Bankers Association reported Friday that more than 4 million homeowners, or 9% of those with mortgages, were delinquent by at least one payment or in foreclosure at the end of June. It's the highest rate ever, the MBA says.

Terms of the government takeover call for drastically reducing,

TAKEOVER OF FANNIE, FREDDIE

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- **Sept. 7 announcement:** Government takes over Fannie Mae, Freddie Mac | Events leading to takeover | **Q&A:** How did the trouble start?

Enlarge By Justin Sullivan, Getty Images file

A foreclosure sign in front of a Stockton, Calif., home in April. Fannie Mae and Freddie Mac have both been hit hard by the nation's housing woes.

ABOUT DAVID MOFFETT

New job: CEO of Freddie Mac.
Age: 56
Currently: Senior adviser at The Carlyle Group, a leading private-equity firm. Moffett last year joined the board of MBIA, an insurer of mortgage bonds and other securities that, like Freddie Mac, has also been hurt by the mortgage financing crisis. Moffett also serves on the boards of eBay, Building Materials Holding and E.W. Scripps.
Career history: He's held a series of executive-level jobs in banking. He retired in 2007 as vice chairman and chief financial officer of Minneapolis-based U.S. Bancorp, after its merger with Firstar, where he had also been CFO.
Education: MBA from Southern Methodist University; bachelor's from Oklahoma University.

ABOUT HERB ALLISON

New job: CEO of Fannie Mae
Age: 65
Career: Retired this year after six years as CEO of TIAA-CREF investment fund. Stepped down as vice chairman of Merrill Lynch in 1999 after 28-year career in a variety of positions there. He was president from 2000 to 2002 of the Alliance for Lifelong Learning, a joint venture of Oxford, Stanford and Yale universities that offers online college courses to adults.
Early life: Served as a naval officer in Vietnam.
Other: Served as Sen. John McCain's finance chairman during McCain's unsuccessful run for presidential nomination in 2000. In 2005, Allison received Excellence in Leadership Award from Stanford's business school, where he graduated.

over time, the roles that Freddie Mac and Fannie Mae play in the mortgage market. Government officials say the duration of the conservatorship is indefinite, and Paulson said policymakers need to use the time to decide whether the role of the companies is best played by private corporations, the government, or hybrids such as Fannie Mae or Freddie Mac.

Although Fannie and Freddie are public companies, owned by shareholders, their debt has had an implicit government guarantee.

Paulson and Lockhart unveiled a four-part plan to come to the aid of the companies, which have sustained combined losses of $14 billion in the past four quarters.

FROM THE TREASURY: Secretary Paulson on the move | Senior preferred stock plan | Buying GSE mortgage-backed securitiesWhat is the Government Sponsored Enterprise Credit Facility

FROM THE FHFA: Statement on the move | Q&A

Key elements of the plan:

•Government purchase of mortgage-backed securities. Initially, the government will spend $5 billion to buy the securities, to demonstrate Treasury support for continued mortgage availability.

•Gradual portfolio reduction. Starting in 2010, the companies' mortgage portfolios will be reduced at a rate of 10% per year.

This would dramatically reduce the role that Freddie and Fannie play in the mortgage market. Together, their market share of all new mortgages reached more than 80% earlier this year, but is now falling.

•**A new lending program.** The companies will have access to a new line of government credit if they run into serious trouble borrowing funds on the open market. Treasury officials say they consider it a symbolic step to provide confidence to investors in Fannie and Freddie debt.

•Purchase of preferred shares. The government would be allowed to buy new preferred shares that pay dividends that would be considered senior to the current common and preferred stock. The Treasury may purchase up to $100 billion of this new senior-preferred stock in each company to preserve the companies' positive net worth. Fannie Mae and Freddie Mac must give Treasury $1 billion in senior preferred stock today, as an upfront fee for agreeing to consider doing this in the future.

A closer look

The move to put Freddie and Fannie into conservatorship was triggered in part by closer government scrutiny of the agencies, prompted by the July housing legislation.

The Treasury Department recently signed a contract with Morgan Stanley to investigate the financial position of Fannie and Freddie, with help from the FHFA.

"Based on what we have learned about these institutions over the past four weeks, including what we learned about their capital requirements, and given the financial markets today, I concluded that it would not have been in the best interest of the taxpayers for the Treasury to simply make an equity investment in these enterprises in their current form," Paulson says.

Lack of confidence in the agencies has meant that to build capital, Fannie Mae and Freddie Mac have had to pay more for borrowing in the bond market and have had to tighten credit standards. The takeover is intended to boost confidence in the two companies. They could then find it easier to get funding, which could lead to lower mortgage interest rates. That could spur buyers and help rejuvenate the housing market.

"It'll bring (mortgage rates) down a little bit," says Bert Ely, a banking consultant in Alexandria, Va. "Freddie and Fannie now are piggybacking on the credit of the United Sates government, and that will allow them to borrow more cheaply" and, in turn, lend more cheaply. "It might not happen overnight. But it sure won't drive up interest rates."

"Effectively, this is nationalization," Paul Miller, an analyst at investment firm Friedman Billings Ramsey, said before the announcement. "Freddie and Fannie need help. This is the best way."

But Sung Won Sohn, an economist at California State University, warned that the government's financial standing could get shakier. "The U.S. government has trillions of dollars of debt outstanding. With the takeover of Fannie and Freddie, the government will add trillions more to the burden, because the Treasury will, in fact, guarantee all the Fannie and Freddie debt," he said.

Widespread backing

But many supported the move, since financial problems at Freddie and Fannie risk inflaming problems far beyond the U.S. housing market. Fannie Mae and Freddie Mac shares each are down about 90% from a year ago. Central banks around the world hold their securities.

Bond investors traditionally have believed that the U.S. government would backstop the companies, even in the absence of an explicit guarantee. The action Sunday removes any doubt.

In a statement Sunday, Bush supported Paulson's move, saying, "As we determine the appropriate role for the companies in the future, it is crucial that they not pose similar risks to our economy or the financial system again."

Republican presidential candidate John McCain told CBS television program *Face the Nation* that it was a necessary step. "We've got to keep people in their homes," he said. "There's got to be some confidence that we've stopped this downward spiral."

Democratic candidate Barack Obama told ABC News he's "inclined to support some form of intervention to prevent a long-term, much bigger crisis."

Federal Reserve Chairman Ben Bernanke said in a statement Sunday that "these necessary steps will help to strengthen the U.S. housing market and promote stability in our financial markets."

Spokesmen for Freddie and Fannie had no comment Sunday.

The takeover also means the ouster of current CEOs at Freddie and Fannie. At Fannie Mae, Herbert Allison, former CEO at mutual fund company TIAA-CREF, replaces Daniel Mudd. At Freddie Mac, David Moffett, who was vice chairman of U.S. Bancorp, replaces Richard Syron. Syron and Mudd will remain as consultants for an undetermined time.

Freddie and Fannie were chartered by the government in an effort to help stabilize the mortgage market by buying loans from lenders. Fannie Mae was first established in 1938, during the Great Depression, and Freddie followed in the 1970s.

Contributing: Barbara Hagenbaugh, Sue Kirchhoff, John Waggoner. Healey reported from McLean, Va.

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