

Fannie Mae and Freddie Mac

QUESTIONS FOR THE NOMINEE

What is the reasoning for keeping them in conservatorship?

The case for Occam's razor.

Bush's final words were "we have to make clear that (conservatorship) is transitory, because otherwise it looks like nationalization."

-- President Bush to Treasury Secretary Henry Paulson, Thursday, September 4, 2008, in the Oval Office.

On Thursday, the **Senate Banking Committee** will hold a hearing to consider **President Biden's** nominee to be permanent director of the **Federal Housing Finance Agency** ("FHFA"). **Sandra Thompson** has been serving in an acting capacity since June 2021, when Biden fired then-director **Mark Calabria**.

In October of last year, I questioned why **Fannie Mae** and **Freddie Mac** were continuing to be held in conservatorship, opining that there was "[no legitimate reason](#)" for doing so. Since that time, no one has come forward with an explanation. In addition to the basic "why?", Ms. Thompson's confirmation hearing will offer an opportunity to ask a number of questions which need to be answered. Among them:

- *Why are Fannie and Freddie being forced to maintain, as your predecessor put it, "bank-like" capital even though they are not like banks at all? They are monoline insurers with only a credit risk profile; they take no interest rate risk and do not fund their liabilities with short-term deposits (which, as we have seen, can and do 'run')? The most recent stress tests have shown the GSEs would survive a major housing crisis with a fraction of the current capital standard – well under 50 basis*

points (or one-half of one percent) – instead of what FHFA currently requires (over 400 basis points or four percent). Four percent will force them to charge more for their business and will keep them in perpetual conservatorship. (And it will help the Big Banks, who covet their business.)

- *Do you agree that the proposed four percent-plus capital requirement will drive up the cost of housing for the people who can least afford it? The insurance fees Fannie and Freddie will have to charge will rise significantly from the current 45bps, increasing mortgage rates across the board. And asking higher-end customers to significantly subsidize lower-end customers by having them pay much more for their mortgages will simply drive those customers away from the GSEs into the private label market, reducing the GSEs' ability to subsidize affordable housing.*
- *Why not regulate Fannie/Freddie like public utilities? Less than a year ago, Messrs. [Ranieri and Calhoun](#) laid out a blueprint to do just that.*

- With the currently pending capital rule at four-percent-plus, the GSEs will be on a hamster wheel of needing more capital on the balance sheet for every dollar increase in their assets. Without significantly increasing their fees, the companies will not be making enough to keep up with the asset growth and will be stuck in a perpetual conservatorship. The net result is homeownership will decline because the GSEs will be forced to significantly raise their insurance fees. *Why not lower the capital rule to 2.5% - which still maintains a 5x safety cushion over what is called for under the most "severe adverse consequences" scenario envisioned by the most recent stress tests?*
- Finally, at a cost of \$33 for every \$1 they get back, **Credit Risk Transfers** ("CRTs") are absurdly uneconomic. In reality, they don't transfer risk at all because the prepayment rate of the underlying mortgages (and the GSE first-loss positions) ensure that CRT buyers are never on the hook. *Do you agree that the program is diluting the capital build at the GSEs?* The cost of this 'reinsurance' is excessively high, and the economic wealth transferred by Fannie and Freddie is a one-way financial benefit giveaway to the CRT buyers.

July 11: a day of reckoning approaches.

So far, Fannie and Freddie shareholders have come up with zero in their fight to obtain something, anything, for what turns out to be the effective nationalization of their property. That's because up until now, everything has been what the lawyers call "*motion practice*", i.e., procedural decisions made by judges in response to "motions" filed by the various parties. But that is about to change. On July 11, an actual jury trial is set to begin. In other words, for the first time in nearly 14 years, the facts are going to be on the table. Preceding the trial, summary judgement motions will be filed on March 21, at which time we will get a pretty good look at what those facts are. Based on what is already in the public record, they look directly contrary to what the government has

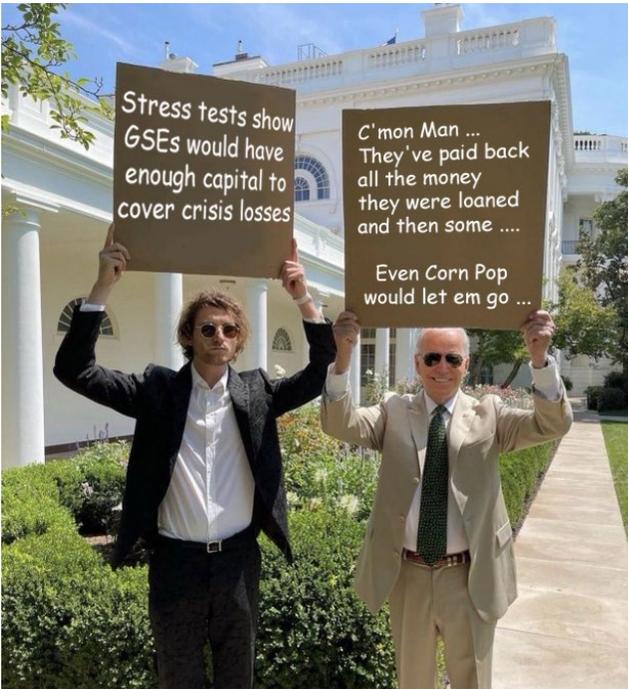
been asserting for all these years. Indeed, it is clear the **Obama Administration's** implementation of the Net Worth Sweep in the summer of 2012 was designed not to avoid a "death spiral" of continuing to pay dividends with draws from Treasury, but instead to deliberately ensure that shareholders would receive nothing for the expropriation of their property.

If **President Biden** wants to nationalize Fannie and Freddie, he should man up and say so. There are, however, reasons why he may find such a course of action to be unpalatable. First, it would require congressional action (not likely). Second, it will instantly add \$6 trillion to the national debt. Finally, the Constitution requires that when private property is taken by the government for public use (think running an interstate highway through the family farm), the owner must be compensated. The alternative, of course, is to regulate Fannie and Freddie like the utilities they are (see [Ranieri and Calhoun, supra](#)), allow them to raise fresh capital, and release them back to their shareholders. And since **Uncle Sam** is the largest shareholder (through warrants, he currently owns 79.9 percent of the common shares), this would actually result in a windfall for the government.

When you think about it, the solution is pretty simple. And as [Occam's razor](#) teaches us, usually the simplest solution is the best one.

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