

The Fannie-Freddie Takeover: U.S. Poised for Bigger Role; Mortgage Bailout Marks the Return Of Federal Activism

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Abstract: Beyond staging outright rescues, the Federal Reserve is scrutinizing the capital and liquidity positions of investment banks, reconsidering rules for vast but obscure parts of money markets and derivatives markets, and acting as backstop to a huge swath of Wall Street's day-to-day trading. The corporate accounting scandals around the same time, which leveled energy trader Enron Corp. and communications giant WorldCom Inc., led to the Sarbanes-Oxley law in 2002, which tightened regulations on companies and chief executives.

Full text: WASHINGTON -- While the government takeover of Fannie Mae and Freddie Mac represents the most powerful federal intervention in financial markets in decades, there are likely to be further government moves ahead.

Federal officials are looking at how to tighten regulation of the credit-card industry and whether to double prospective loans to bail out the auto industry to \$50 billion. In the coming years, they will examine how to regulate greenhouse-gas emissions from industries across the economy and how to remake the mortgage giants so they no longer can run up enough debt to threaten the economy. The latter could involve creating yet another government entity to carve up Freddie's and Fannie's assets and sell them to investors.

"Freddie and Fannie have been de facto nationalized, at least for awhile," said former Federal Reserve official Ted Truman. "But we don't know what will replace them."

The year-old financial crisis has bolstered the role of the government in markets. Beyond staging outright rescues, the Federal Reserve is scrutinizing the capital and liquidity positions of investment banks, reconsidering rules for vast but obscure parts of money markets and derivatives markets, and acting as backstop to a huge swath of Wall Street's day-to-day trading. Treasury officials are pushing banks to build new markets, such as so-called covered bonds, which are popular as mortgage financing in Europe.

The newfound activism is reflected on the Fed's balance sheet. A year ago, about 90% of the central bank's \$875 billion in assets were Treasury securities. Now, after a year of interventions aimed at mopping Wall Street of its complicated and illiquid assets, the Fed's Treasury holdings have fallen to about 50% of its assets.

The struggle between market forces and government control is as old as the country. Alexander Hamilton and Thomas Jefferson squared off over the role of the government in promoting early industry.

For two decades after Ronald Reagan's election in 1980, markets were clearly in the ascendancy. Even the savings-and-loan collapse of the 1980s, in which the government spent \$125 billion seizing failed S&L's and selling off their loans, didn't shake the widespread conviction that market forces should be lightly restrained, if at all.

The takeover of Freddie and Fannie, coming after a string of other government actions, marks a return to government activism. The 2001 terrorist attacks led to the nationalization of airport workers. The corporate accounting scandals around the same time, which leveled energy trader Enron Corp. and communications giant WorldCom Inc., led to the Sarbanes-Oxley law in 2002, which tightened regulations on companies and chief executives.

The combination of the housing crisis and credit crunch has pushed the Federal Reserve and Treasury to insert themselves deeply into the financial system to try to head off economic disaster. Investors said they need to give far more weight in their decisions to potential government actions.

It is difficult to predict how much deeper the government will insert itself into the economy, especially during a presidential election year. Detroit's auto makers have won Congressional authorization this year for \$25 billion in low-interest loans to rebuild plants to make fuel-efficient vehicles -- and are lobbying to boost the prospective

loans to as much as \$50 billion over three years. If they get the money, the program would, by some measures, dwarf the Chrysler bailout of 1979-1980, which involved \$1.5 billion in government-guaranteed loans, or about \$3.7 billion in today's dollar. Even though no funds have yet been spent, both presidential candidates back steeper financing.

Deborah Solomon and Sudeep Reddy contributed to this article.

Intervention

A history of government bailouts and the ultimate profit or loss sustained

-- 1971, Lockheed Aircraft Corp.: \$250 million federal loan guarantee;

government gets first claim to Lockheed's assets. Profit: \$30 million in payments.

-- 1979, Chrysler Corp.: \$1.2 billion federal loan guarantees; government gets warrants on 14.4 million shares. Profit: Shares sold back at auction for \$311 million.

-- 1984, Continental Illinois: \$4.5 billion emergency line of credit from a 16-bank group, nonperforming loans transfers to the Federal Reserve Bank of Chicago as collateral. Cost: \$800 million after last loans sold.

-- 1988, Farm Credit System: Sale of up to \$4 billion in government-backed bonds. Cost: \$2.5 billion.

-- 1989, Savings and loan funds: Billions poured in to thrifts by government, about \$200 billion recouped. Final bill: \$480.9 billion.

-- 2001, Airlines: \$5 billion in cash infusions, \$1.56 billion in loan guarantees. Profit: \$350 million from fees and stock sales.

-- 2008, Student loans: Private lenders get to sell new loans for this school year to government for full value of loan, accrued interest, rebate on origination fees and a \$75 payment. Cost: unknown

-- 2008, J.P. Morgan Chase & Co.: \$30 billion from Fed to complete acquisition of Bear Stearns, with loans secured by some of Bear's riskier assets. Cost: unknown

-- 2008, Homeowners: \$300 billion of refinanced mortgages to be guaranteed through Federal Housing Administration. Cost estimate: \$2.7 billion through 2013, the Congressional Budget Office says. Cost: unknown

-- 2008, Fannie/Freddie: Government pledges up to \$200 billion in fresh capital as needed. Cost: unknown

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