

September 10, 2008

The Old GSE Model Has Failed

It's Time to Transition Fannie and Freddie to Private Sector Companies

Dear Colleague:

As you know, this past weekend the Treasury Department and the newly created Federal Housing Financing Agency (FHFA) announced a series of sweeping actions to take over the troubled government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. These actions included placing both GSEs into a legal conservatorship where the FHFA will run each company and attempt to restore their financial health. Along with the conservatorship decision, Treasury announced three other actions to bail them out:

- Agreements to provide up to \$100 billion in capital assistance to *each* GSE in exchange for \$1 billion worth of preferred stock and warrants for the future purchase of up to 80 percent of stock in each company;
- Creation of a new Credit Facility to make unlimited short term loans to the GSEs subject only to the confines of the debt limit; and
- A new Mortgage Backed Securities (MBS) Purchase Program that will allow the government to directly buy and hold mortgages from the secondary market in its own portfolio subject to the confines of the debt limit.

In announcing these actions, Treasury and FHFA stated that their goals were to provide stability to financial markets, support the availability of mortgage finance, and protect taxpayers. Those are goals which we all support, and hopefully can achieve. Yet the trade off for these goals is that taxpayers now find themselves exposed to tens of billions of dollars of new *risk* that could far exceed the CBO-estimated \$25 billion *cost* of the enacting bill, which the New York Times has reported is now seen as 'optimistic' by some government officials.

Only time will tell if Treasury and FHFA will be successful in meeting these goals. However, while these actions might help prop up Fannie and Freddie as companies, they have also shown that the privatized profits, socialized risks GSE model is fundamentally flawed and must be ended once and for all. For far too long we have ignored this problem and allowed Fannie and Freddie to swell to such stratospheric proportions that their impending failure threatens our entire economy. In a matter of mere weeks, Fannie and Freddie have gone from *too big to fail* to *too dangerous to repeat*. This hybrid illusion cannot be allowed to continue.

As I said back in July, if we are going use taxpayer dollars to bail Fannie and Freddie out today, we must take all the necessary steps to make sure we never, ever force taxpayers to do it again. That is why I will soon be introducing legislation that would transition Fannie and Freddie over a reasonable time period to truly private companies without special government privileges and open them up to real free market competition. In the time that they are still GSEs, my legislation would:

- establish commonsense limits for their capital requirements and portfolio holdings relative their size,

- focus their mission on affordable housing only, not profit making,
- require them to pay an appropriate risk-based amount for the government guarantee they enjoy,
- subject them to state and local taxes and accurate SEC filings like every other private for-profit corporation, and
- ultimately provide for the phase out their GSE charters once their conservatorship has ended.

Such changes may be uncomfortable to implement, but they will provide the certainty that markets need while protecting taxpayers and affirming the principle that the federal government should not be in the business of picking winners and losers in a marketplace.

Fannie and Freddie own or guarantee a combined for \$5.4 trillion of mortgages – an amount larger than the economy of every single country in the world except the U.S. or China. In an albeit unlikely total collapse, that amount could end up increasing our total national debt by 50 percent. The time has come to decide if they are going to be private sector competitors or government sponsored proxies. We owe it to ourselves and to our children to decide now before we put any more taxpayer dollars at risk.

Sincerely,

JEB HENSARLING

Member of Congress