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U.S. seizes Fannie and Freddie

Historic move would place twin mortgage buyers into the hands of new regulator. Top executives are out.

By [David Ellis](#), CNNMoney.com staff writer
September 7, 2008: 11:38 AM EDT

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NEW YORK (CNNMoney.com) -- Federal officials unveiled an extraordinary takeover on Sunday of troubled mortgage giants Fannie Mae and Freddie Mac, signaling the most dramatic move to date aimed at shoring up the nation's housing market.

The plan, which was delivered by Treasury Secretary Henry Paulson and James Lockhart, director of the Office of Federal Housing Enterprise, places the twin mortgage buyers into conservatorship to be overseen by the Federal Housing Finance Agency.

"We examined all options available, and determined that this comprehensive and complementary set of actions best meets our three objectives of market stability, mortgage availability and taxpayer protection," Paulson said.

Both agencies will be open for business Monday morning. Dividends on both common and preferred shares will be eliminated in an effort to preserve capital.

The regulators also ousted Richard Syron and Daniel Mudd, chief executive of Freddie Mac and Fannie Mae, respectively.

In their places, two finance veterans will be charged with restoring the mortgage titans to health. Herb Allison, who has shaken up TIAA-CREF in his eight years as chairman there, will head Fannie Mae. Allison formerly served as vice chairman of Merrill Lynch.

David Moffett, who served as vice chairman and chief financial officer of U.S. Bancorp until early 2007 and then joined the Carlyle Group private-equity firm as a senior advisor, will take over Freddie Mac.

Mudd and Syron, who have shouldered much of the criticism of the companies' failures, will stay on to help with the transition, Paulson said. The executives have also come under fire for collecting multi-million pay packages as investors saw losses mount and share prices plummet.

Freddie (FRE, [Fortune 500](#)) and Fannie (FNM, [Fortune 500](#)), which were created by the U.S. government, own or back \$5 trillion worth of home debt - half the mortgage debt in the country. Since last summer, they have suffered about \$12 billion in losses.

In mid-July, the Treasury Department and Federal Reserve announced steps in to make funds available to the firms if necessary and Congress approved the sweeping proposals later that month.

Fannie and Freddie have become virtually the only source of funding for banks and other home lenders looking to make home loans. Their ability to do so is crucial to the recovery of the battered home market and the broader U.S. economy.

The two firms buy loans, attach a guarantee, then sell securities backed by the loans' income stream. They have been badly hurt in the last year by the sharp decline in home prices and the rise

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in mortgage delinquencies and foreclosures.

Both companies have been losing money for the past few quarters due to the subprime mortgage meltdown and steep declines in housing prices.

Shares of both companies are down more than 80% so far this year.

Unanswered questions

The cost of the government intervention remains unclear. Experts argue that it will depend in large part on the structure of the rescue, the direction of home prices and mortgage default rates. Still it seems almost certain it will run into the billions and will most likely eclipse such other high-profile government bailouts including than the Federal Reserve's \$29 billion backing of Bear Stearns assets when it was taken over by J.P. Morgan Chase.

Another unintended yet unavoidable consequence may be the impact to the nation's banks.

Some of the nation's largest financial institutions including JPMorgan Chase (JPM, Fortune 500) and Sovereign Bancorp (SOV, Fortune 500) own a big chunk of the estimated \$36 billion in preferred shares of Fannie and Freddie, which are at risk of being wiped out should Fannie and Freddie do end up getting a cash infusion from the Treasury Department. ■

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