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# In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Titans

By **STEPHEN LABATON** and **EDMUND L. ANDREWS**

WASHINGTON — The Bush administration seized control of the nation's two largest mortgage finance companies on Sunday, seeking to shrink drastically their outsize influence on Wall Street and on Capitol Hill while at the same time counting on them to pull the nation out of its worst housing crisis in decades.

The bailout plan for the companies, **Fannie Mae** and **Freddie Mac**, a seismic event in a year of repeated financial crises followed by aggressive federal intervention, places the companies in a government conservatorship, much like a bankruptcy reorganization. The plan also replaces the management of the companies.

The rescue package represents an extraordinary federal intervention in private enterprise. It could become one of the most expensive financial bailouts in American history, though it will not involve any immediate taxpayer loans or investments.

The Treasury secretary, **Henry M. Paulson Jr.**, who engineered the plan, would not say how much capital the government might eventually have to provide, or what the ultimate cost to taxpayers might be. Two months ago, the **Congressional Budget Office** gave a rough estimate of \$25 billion. One senior government official, speaking on the condition of anonymity, signaled on Sunday that even that figure was optimistic.

Mr. Paulson said Sunday that it was important to rescue the mortgage giants because a failure of either company would cause turmoil in financial markets in the United States and around the world.

“This turmoil would directly and negatively impact household wealth: from family budgets, to home values, to savings for college and retirement,” he said. “A failure would affect the ability of Americans to get home loans, auto loans and other consumer credit and business finance. And a failure would be harmful to economic growth and job creation.”

The plan received wide bipartisan support on Sunday, from Congressional lawmakers and both presidential campaigns.

As part of the plan, the chief executives of both companies were replaced. **Herbert M. Allison Jr.**, the former chairman of TIAA-CREF, the huge pension fund for teachers that also offers mutual funds, will take over Fannie Mae and succeed Daniel H. Mudd. At Freddie Mac, David M. Moffett, currently a senior adviser at the **Carlyle Group** private equity firm, succeeds Richard F. Syron. Mr. Mudd and Mr. Syron, however, will stay on during a transition period.

The plan also commits the government to provide as much as \$100 billion to each company to backstop any shortfalls in capital. It enables the Treasury to ultimately buy the companies outright at little cost. It bans them from lobbying the government, putting an end to their ability to use their political machine on Capitol Hill.

It also eliminates dividend payments to current shareholders while protecting the principal and interest payments on the debt, now held by foreign central banks, financial institutions, pensions funds and others.

The Treasury will force both companies to shrink their portfolios over the long term; they now hold or guarantee about half of the country's mortgages. In addition, the government plans to buy significant amounts of their mortgage-backed securities on the open market, beginning with the purchase of \$5 billion worth this month. This step, never before undertaken by the government, could begin to restore some confidence in the credit markets and lead to lower interest rates for home mortgages.

For the companies, the takeover caps an ignominious downfall. Fannie was created during the depths of the Great Depression, and Freddie in 1970, to help make mortgages more affordable for homeowners. The companies buy billions of dollars in mortgages each month from commercial lenders. Some are sold to investors as mortgage-backed securities; others are held by the companies in their own investment portfolios.

The plan represents a cease-fire in a decades-long ideological battle over the proper role of the companies. Free-market conservatives see the companies as extensions of "big government," while Democrats have protected them as the main vehicle to promote affordable housing for middle- and lower-income people.

[Alan Greenspan](#), the former Federal Reserve chairman, and [Lawrence H. Summers](#), a Treasury secretary under President [Bill Clinton](#), along with many other critics, have long maintained that the companies were too powerful politically and financially, and that their huge portfolios posed enormous risks to the financial system.

Moreover, these critics have complained, the companies have used their ability to borrow at low interest rates to dominate the mortgage-finance market, usurping the role of other financial institutions, which do not have the same subsidy.

Free-market adherents have warned of impending disaster as Fannie and Freddie used an implicit government backing to borrow at will, with only a tiny sliver of capital to protect them from nasty surprises like the recent sharp decline in housing prices and rise in foreclosures.

Mr. Paulson has sought to avoid taking sides in the debate, but in recent months came to the conclusion that the companies' conflicting missions of providing federally backed financing for affordable housing while serving shareholders were untenable.

"Market discipline is best served when shareholders bear both the risk and the reward of their investment," Mr. Paulson said on Sunday. "While conservatorship does not eliminate the common stock, it does place common shareholders last in terms of claims on the assets of the enterprise."

Holdings of the companies' common stock will not fare well. The plan suspends their dividend payments and holds the potential to make their shares virtually worthless if the government chooses to exercise its right to buy the common stock. The stock of both companies, which traded above \$60 a share last year, had fallen below \$10 a share recently. Their shares will continue to trade and could fall further as a result of the government seizure.

Mr. Paulson made clear that the solution put forward on Sunday would only defer the most important decisions about the mission of the companies for the next president and Congress.

At a news conference on Sunday, Mr. Paulson said: "There is a consensus today that these enterprises pose a systemic risk and they cannot continue in their current form. Government support needs to be either explicit or nonexistent, and structured to resolve the conflict between public and private purposes."

The plan requires the companies to shrink their portfolios long after the administration leaves, officials acknowledged, adding that they hoped to prod Congress into deciding what the role of the companies should be.

Hoping to limit potential taxpayer losses and gain any financial windfall if the companies are restored to profitability, the administration, in exchange for the investment commitment, will receive so-called stock warrants, or purchase rights, for up to 80 percent of the companies' common shares at less than \$1 a share. In after-hours trading on Sunday, Freddie Mac fell \$1.06, or nearly 21 percent while Fannie Mae dropped \$1.54, or 22 percent.

The companies agreed to provide the government with \$1 billion of new preferred senior stock, which will pay the Treasury a dividend of at least 10 percent a year, as well as an unspecified quarterly payment to compensate the Treasury for any taxpayer money injected into the companies.

The companies will be allowed to "modestly increase" the size of their existing investment portfolios until the end of 2009, which means they can use some of their new taxpayer-supplied capital to buy and hold new mortgages in investment portfolios.

But in a strong indication of Mr. Paulson's wish to wind down the companies' portfolios, drastically shrink their role and perhaps eliminate their unique status altogether, the plan calls for the companies to start reducing their investment portfolios 10 percent a year, beginning in 2010.

In addition, the Treasury Department will create a so-called Secured Lending Credit Facility, a backup source of borrowing for the companies in the event that they cannot borrow enough money on the open market to finance their main business of buying mortgages and reselling them as pools of mortgage-backed securities.

While the government takeover seemed to catch some financial experts by surprise, Treasury officials appeared to have little choice, with the credit markets in a tailspin and investors reluctant to buy mortgages with even a hint of risk. Fannie and Freddie now guarantee about 70 percent of all new home loans, said Mr. Lockhart, the chief regulator of the companies.

The initial reaction to the plan was mostly positive. Senator [John McCain](#), the Republican nominee for president, said on [CBS's "Face the Nation"](#) on Sunday that he supported the Treasury move, but he also implicitly criticized the Bush administration's oversight.

"It's an example of cronyism, special interest, lobbyists," he said, adding that the companies needed "more regulation, more oversight, more transparency, more of everything, and frankly, a dramatic reduction in what they do."

Senator [Joseph R. Biden Jr.](#), the Democratic nominee for vice president, said on [NBC's "Meet the Press"](#) Sunday that he had spoken to Mr. Paulson on Saturday night, and that he thought the plan had a good chance of succeeding. "It's not an official reorganization. It will be left to the next administration and the Congress to make those judgments," Mr. Biden said.

After being briefed by Mr. Paulson, the billionaire investor [Warren E. Buffett](#) said: "Secretary Paulson has made exactly the right decision for the country. He is minimizing the problem of moral hazard and maximizing the benefits for the housing market and for the smooth functioning of financial markets."

Democratic and Republican lawmakers also spoke approvingly of the decision. They said that restoring stability to the financial markets was the top priority. But some longtime critics of the companies complained that their warnings had gone unheeded for too long.

"Fannie and Freddie were allowed to grow too quickly and for too long without the strong oversight required of such government chartered firms," said Senator [John E. Sununu](#), Republican of New Hampshire, who is facing a tough campaign for re-election.

Asian stock markets rallied at the opening on Monday after the Treasury's announcement. The Tokyo market rose 2.8 percent and Australia's market jumped 3.2 percent.

Futures contracts on the Standard & Poor's 500-stock index jumped more than 2 percent in early Asian trading as investors concluded that the decision had strengthened the prospects for American businesses, particularly banks, and for the American economy.

The dollar and yen weakened against the euro and the British pound by late Monday morning in Asia as investors began to conclude that European economies might not be in as grave danger as they had seemed last week.

Treasury officials emphasized that the companies would open for business as usual on Monday and that, at least for now, almost nothing would change in their normal course of business.

*Keith Bradsher contributed reporting from Hong Kong.*

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