

How to Privatize Fannie Mae and Freddie Mac

A Presentation by

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to the

American Enterprise Institute

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- **Creating a housing finance horse race on a level playing field**

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- **Initiating the privatization of Fannie and Freddie (F&F)**

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- **The structure of the housing finance industry after privatizing F&F**

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- **The impact of privatizing F&F on the total cost of home mortgages**

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- The impact of privatizing F&F on the total cost of home mortgages
- **Issues related to privatizing F&F**

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- Initiating the privatization of Fannie and Freddie (F&F)
- The structure of the housing finance industry after privatizing F&F
- The impact of privatizing F&F on the total cost of home mortgages
- Issues related to privatizing F&F
- **Topics for further research**

Creating a housing finance horse race on a level playing field

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- **The two horses in the race**

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 - Stimulate a competition in housing finance absent today because of the tax and capital tilt towards mortgage securitization and away from holding mortgages in portfolio
 - **This competition will squeeze inefficiencies out of the housing finance marketplace**

Initiating the privatization of Fannie and Freddie

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 - **Key characteristics of MHS**

A Private-Sector alternative to Fannie Mae and Freddie Mac – the Mortgage Holding Subsidiary model

**Commercial bank, thrift,
or other financial firm
subject to capital regulation**

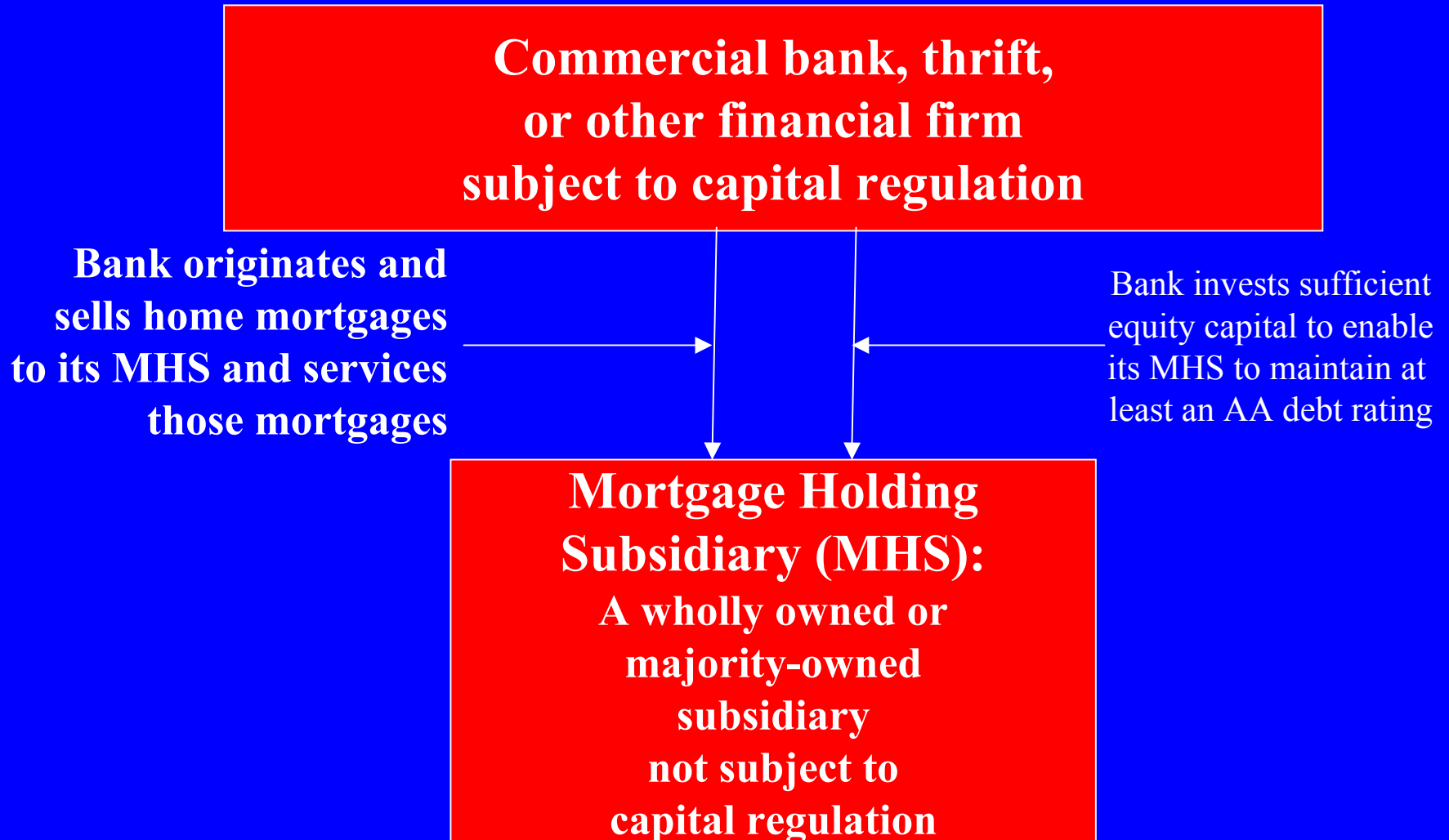
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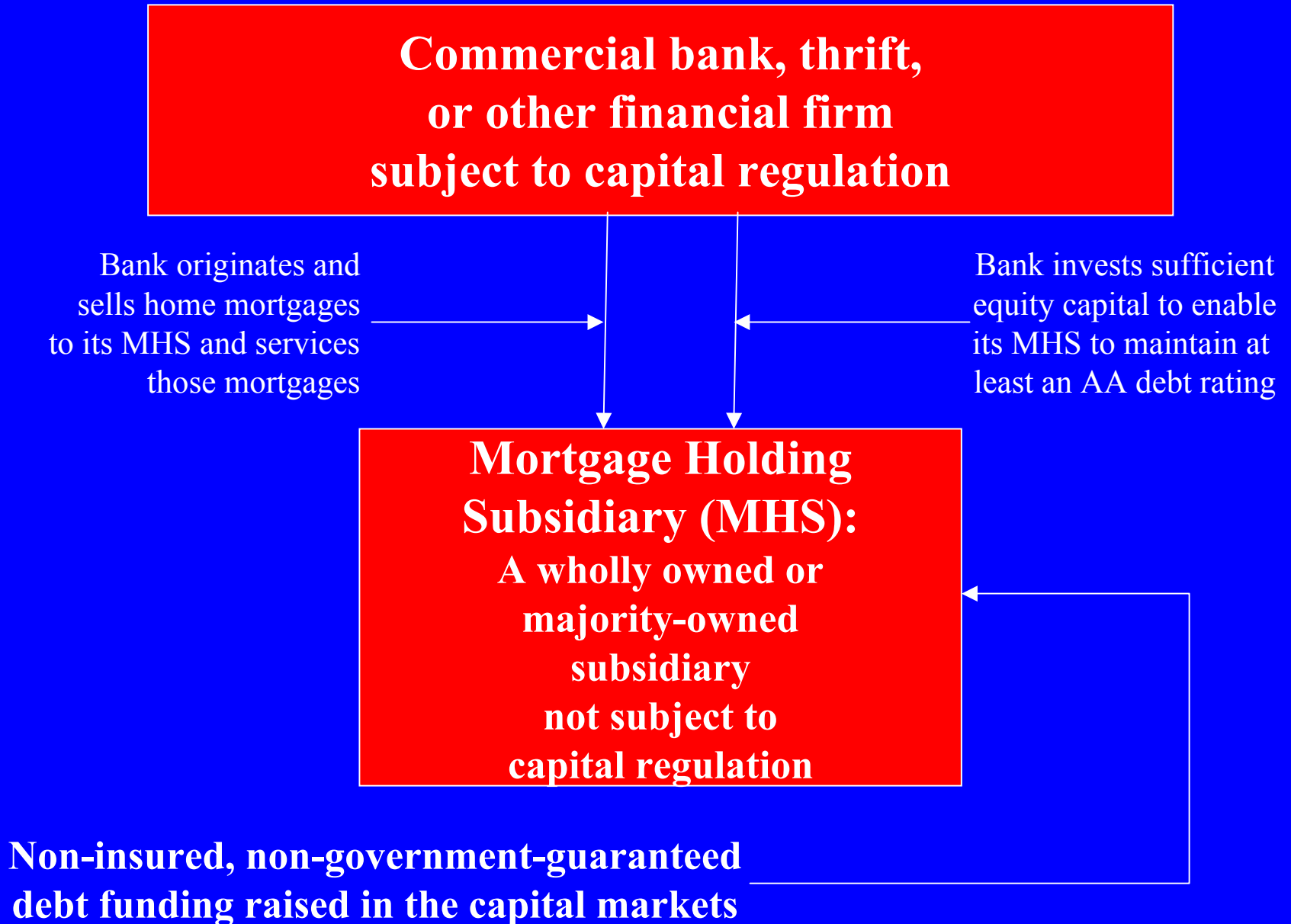
**Bank invests sufficient
equity capital to enable
its MHS to maintain at
least an AA debt rating**

**Mortgage Holding
Subsidiary (MHS):
A wholly owned or
majority-owned
subsidiary
not subject to
capital regulation**

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Balance sheet composition of an MHS

(not to scale)

Assets

=

Liabilities +
equity capital

Cash + short-term investments
Mortgages held for sale or securitization (optional)
Residential Mortgages (1-4 family and multi-family)
Other assets

Secured debt (optional)
Unsecured preferential debt raised in the capital markets
Other unsecured liabilities
Subordinated debt (optional)
Equity capital

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 - **The market would determine the appropriate level of capital an MHS needed, based on its risk characteristics**

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- **Since it is not a deposit-taking institution, an MHS would not be subject to the CRA**

Initiating the privatization of Fannie and Freddie

- One, authorize banks and thrifts to own MHS
 - Key characteristics of MHS
- **Two, mandate a timetable for fully privatizing F&F**

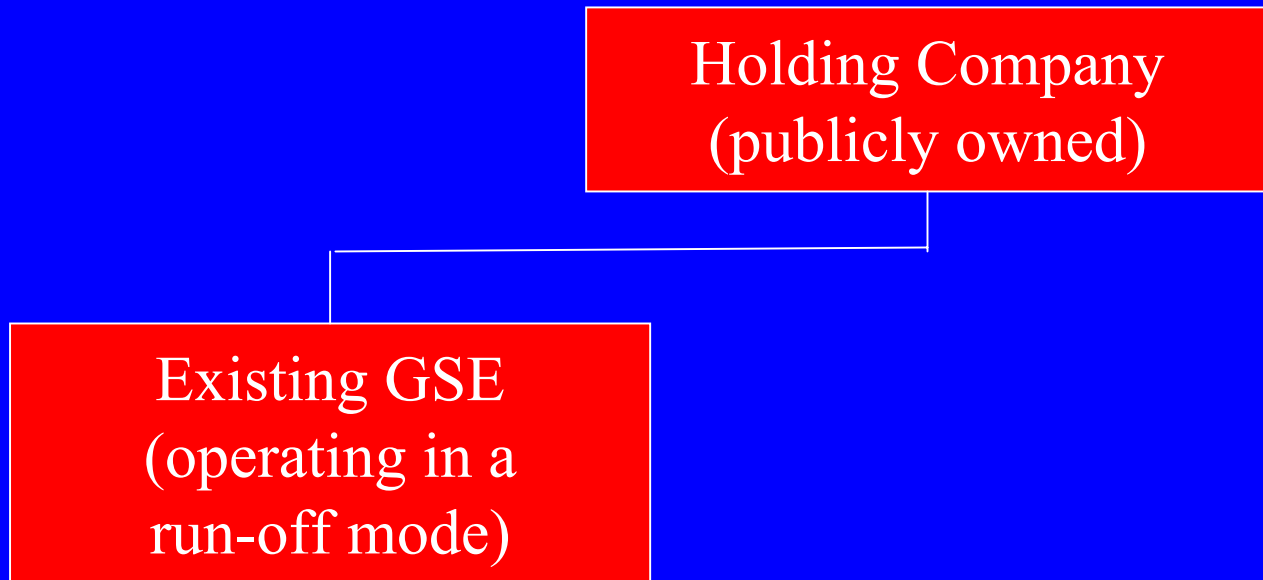
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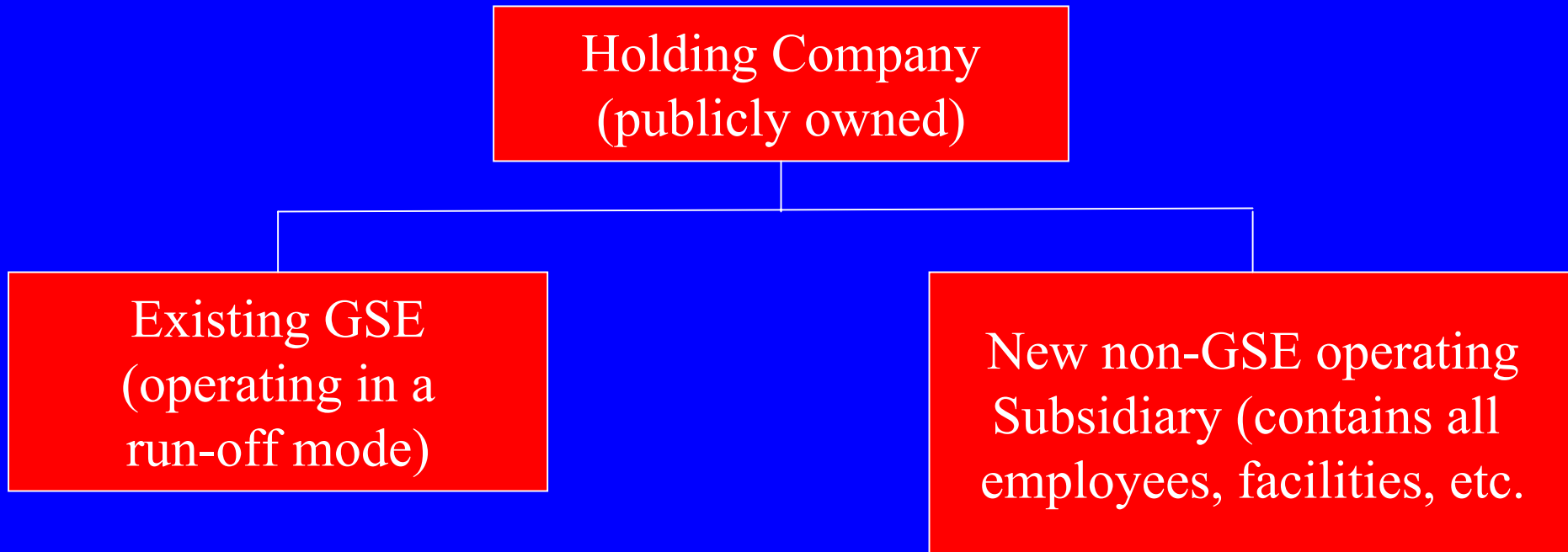
Transition structure for fully privatizing Fannie Mae or Freddie Mac (highly simplified)

Holding Company
(publicly owned)

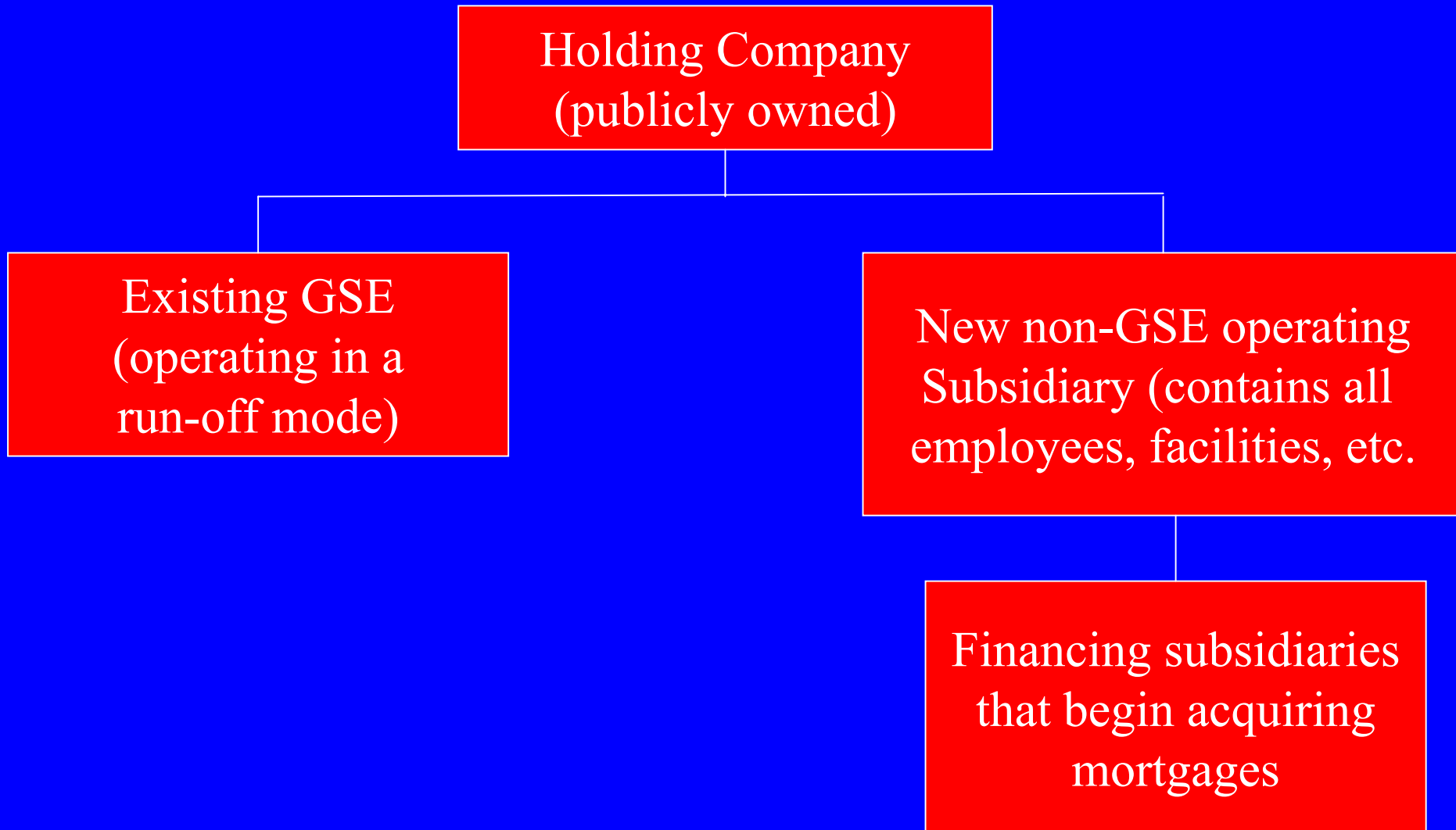
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 - **After 6 months, F&F begin a two-year phase out of their mortgage securitization activities**

Privatizing Fannie and Freddie: the guarantee transition schedule

Transition month	GSE guarantees	Non-GSE guarantees	Transition month	GSE guarantees	Non-GSE guarantees
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3	96%	4%			

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4	94%	6%			

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1	99%	1%	13	55%	45%
2	98%	2%	14	50%	50%
3	96%	4%	15	45%	55%
4	94%	6%	16	40%	60%
5	91%	9%	17	35%	65%
6	88%	12%	18	30%	70%
7	84%	16%	19	25%	75%
8	80%	20%	20	20%	80%
9	75%	25%	21	15%	85%
10	70%	30%	22	10%	90%
11	65%	35%	23	5%	95%
12	60%	40%	24	0%	100%

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 - Upon enactment of privatization legislation, F&F immediately begin running off their mortgage portfolios
 - After 6 months, F&F begin a two-year phase out of their mortgage securitization activities
 - **What to do about F&F's intellectual property?**

Circles of Value in the housing finance horse race

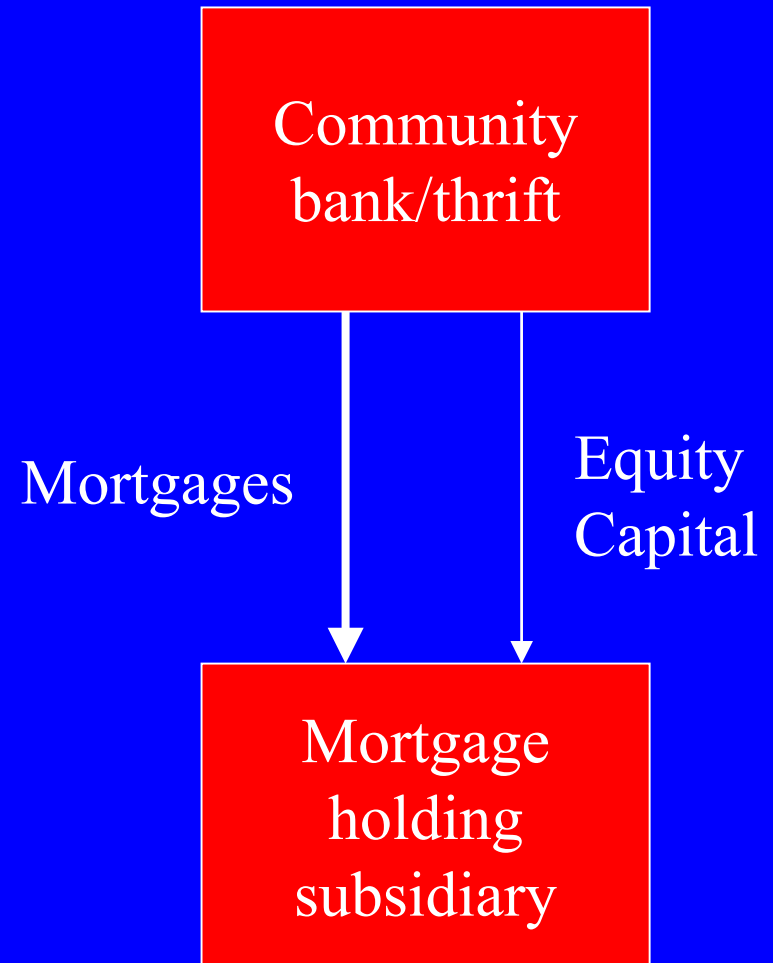
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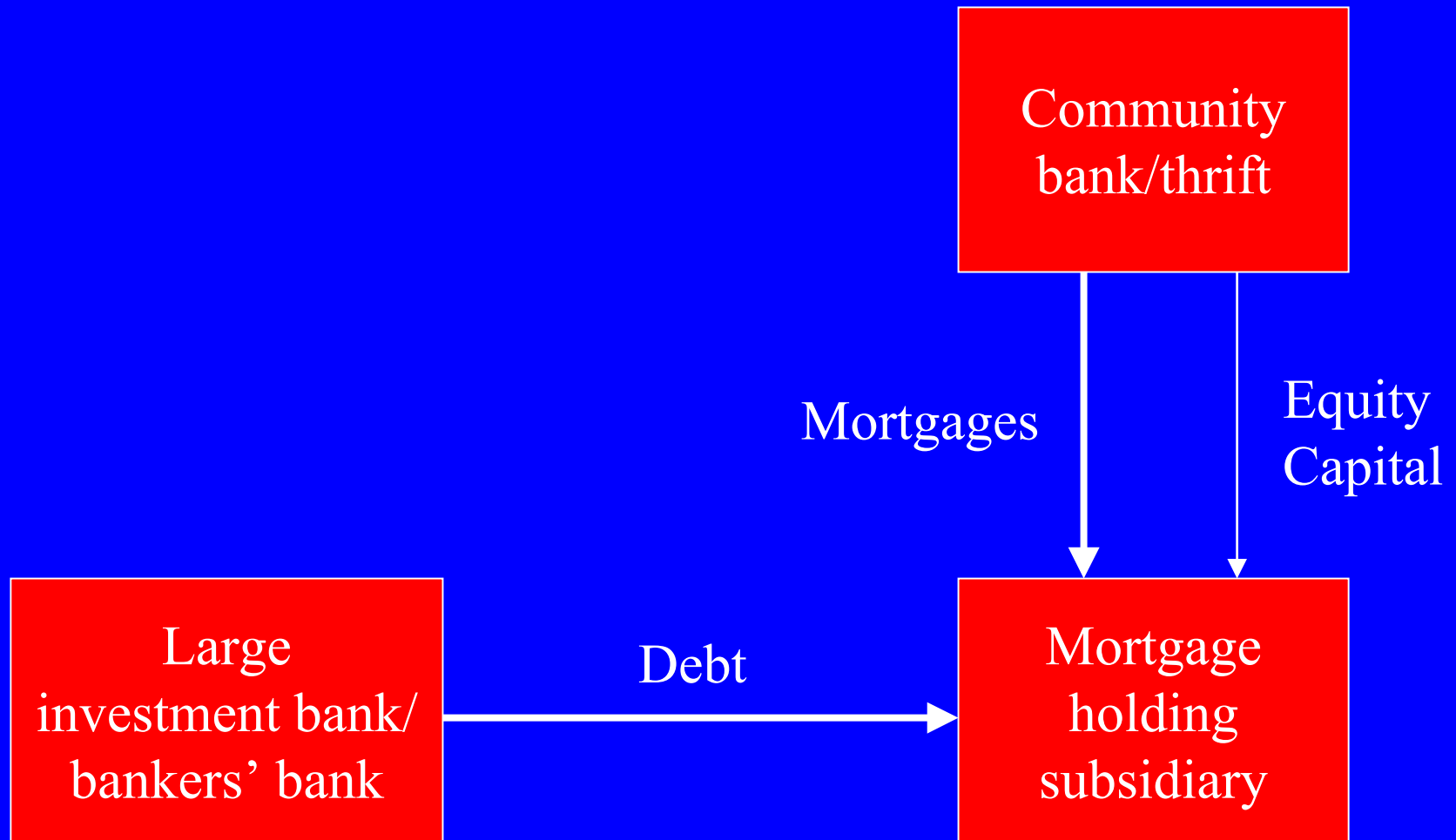
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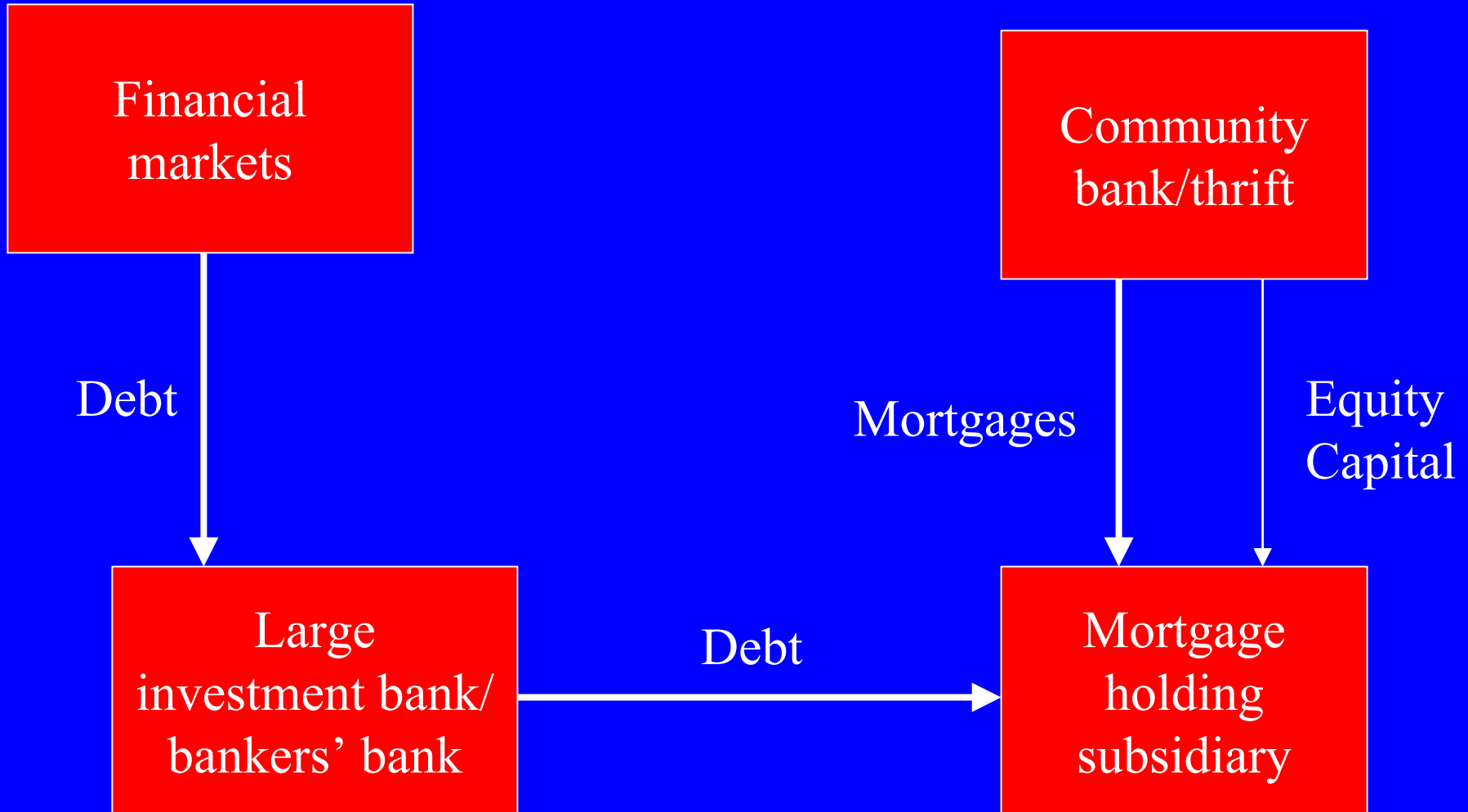
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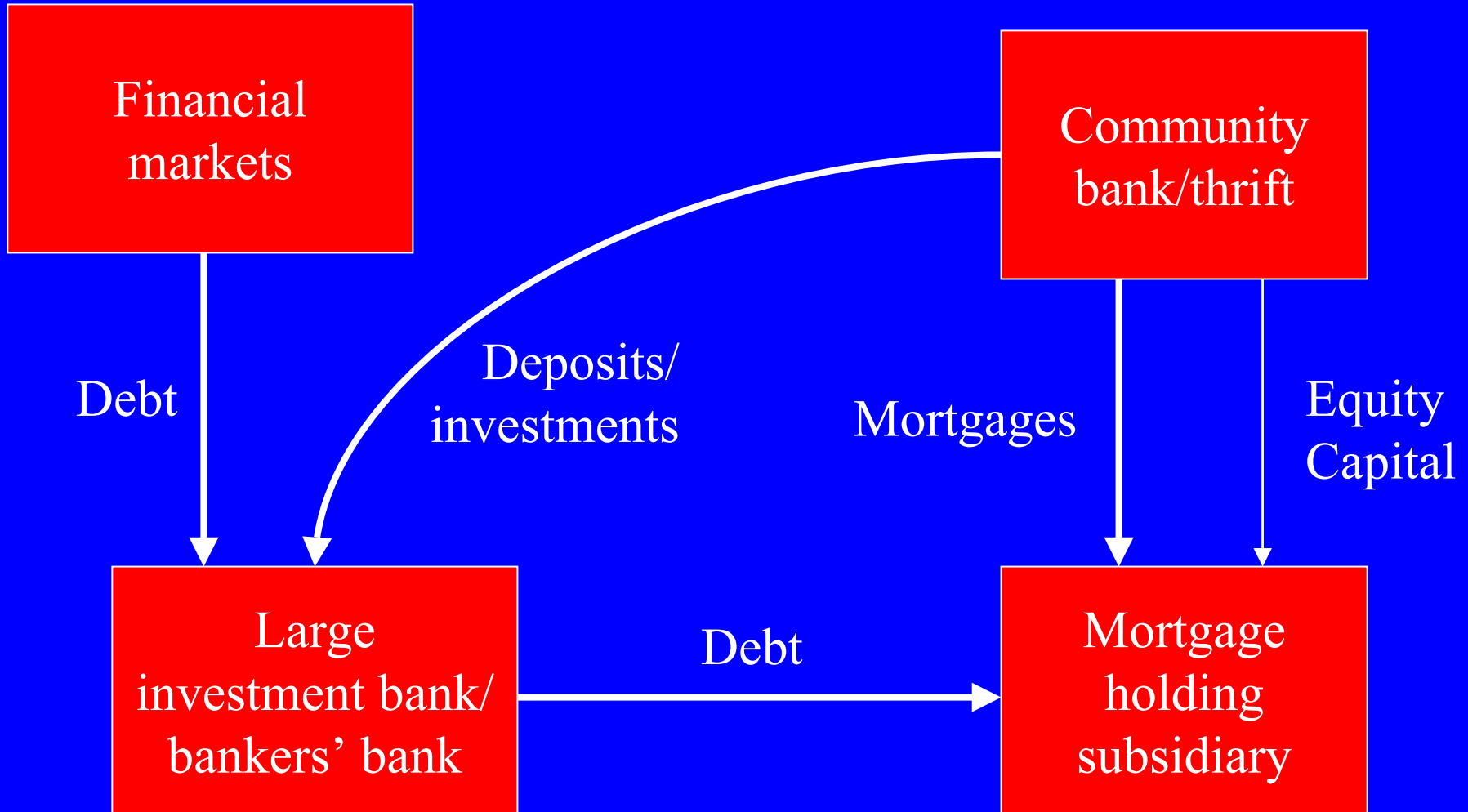


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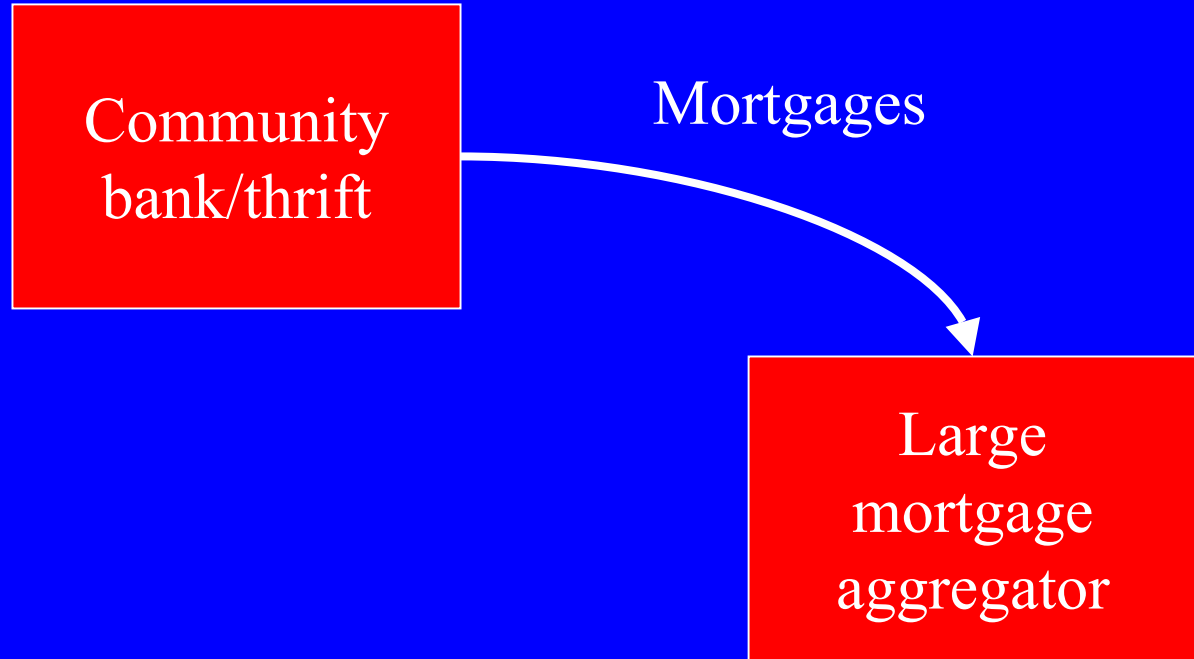
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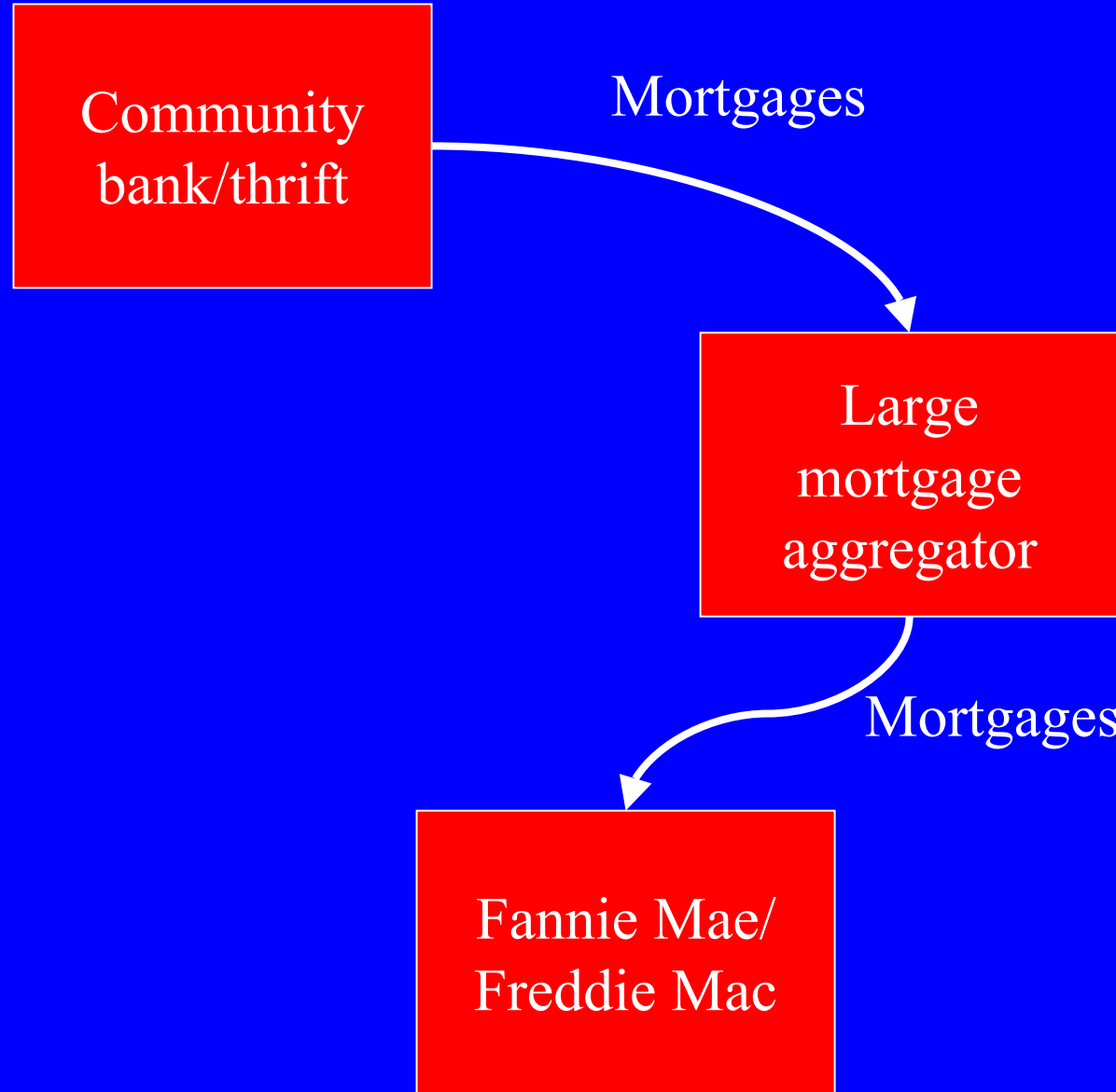


Community
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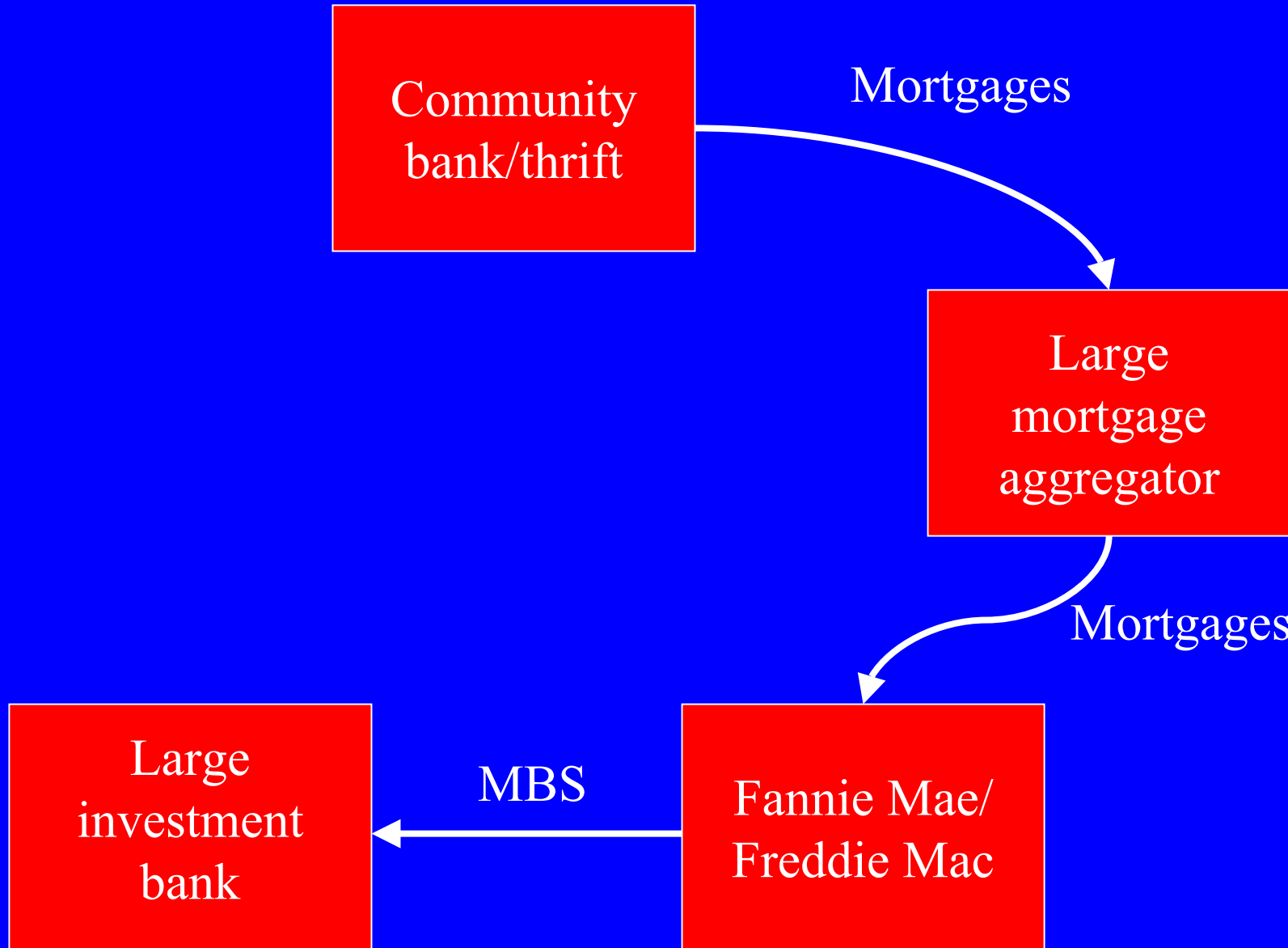
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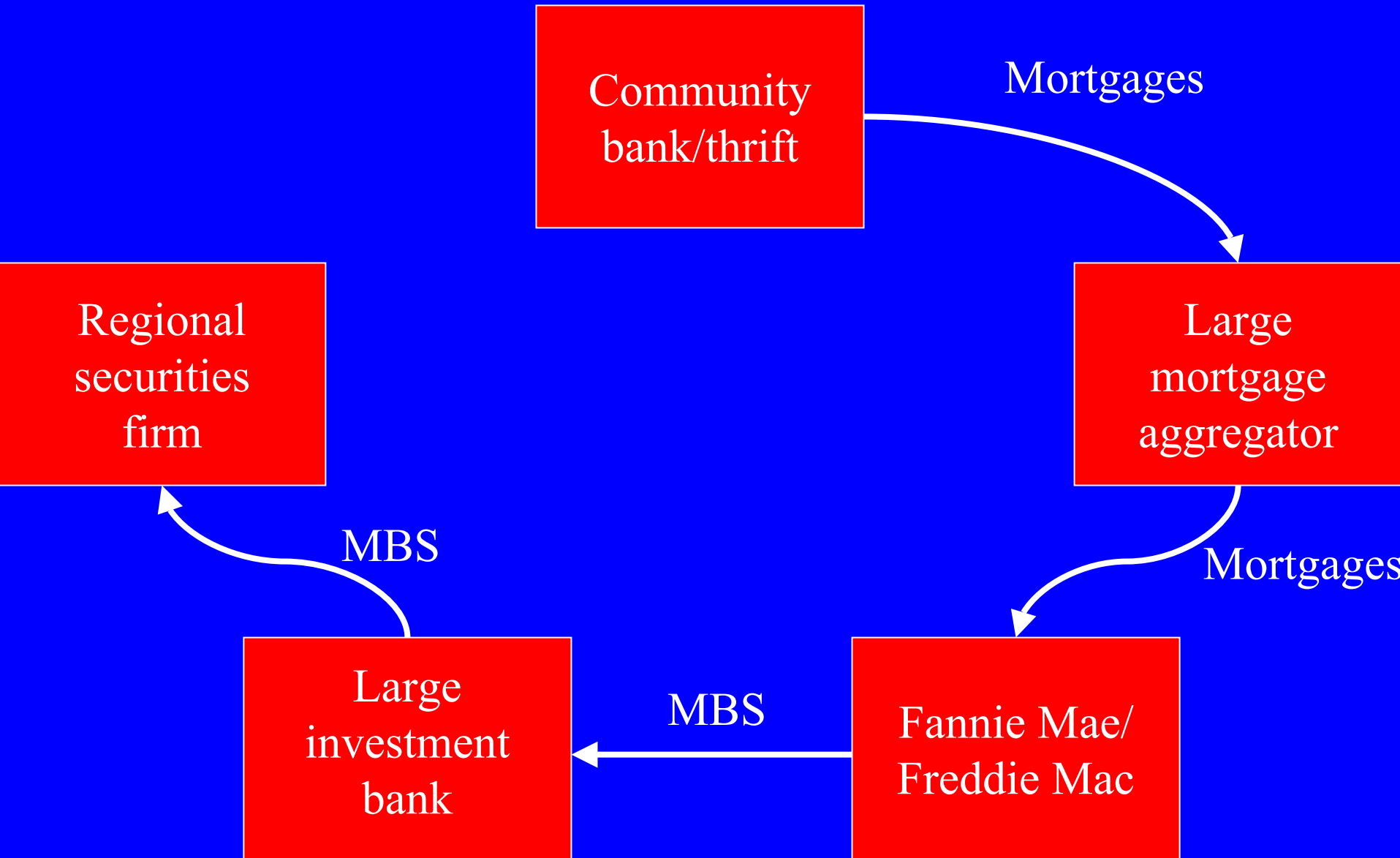
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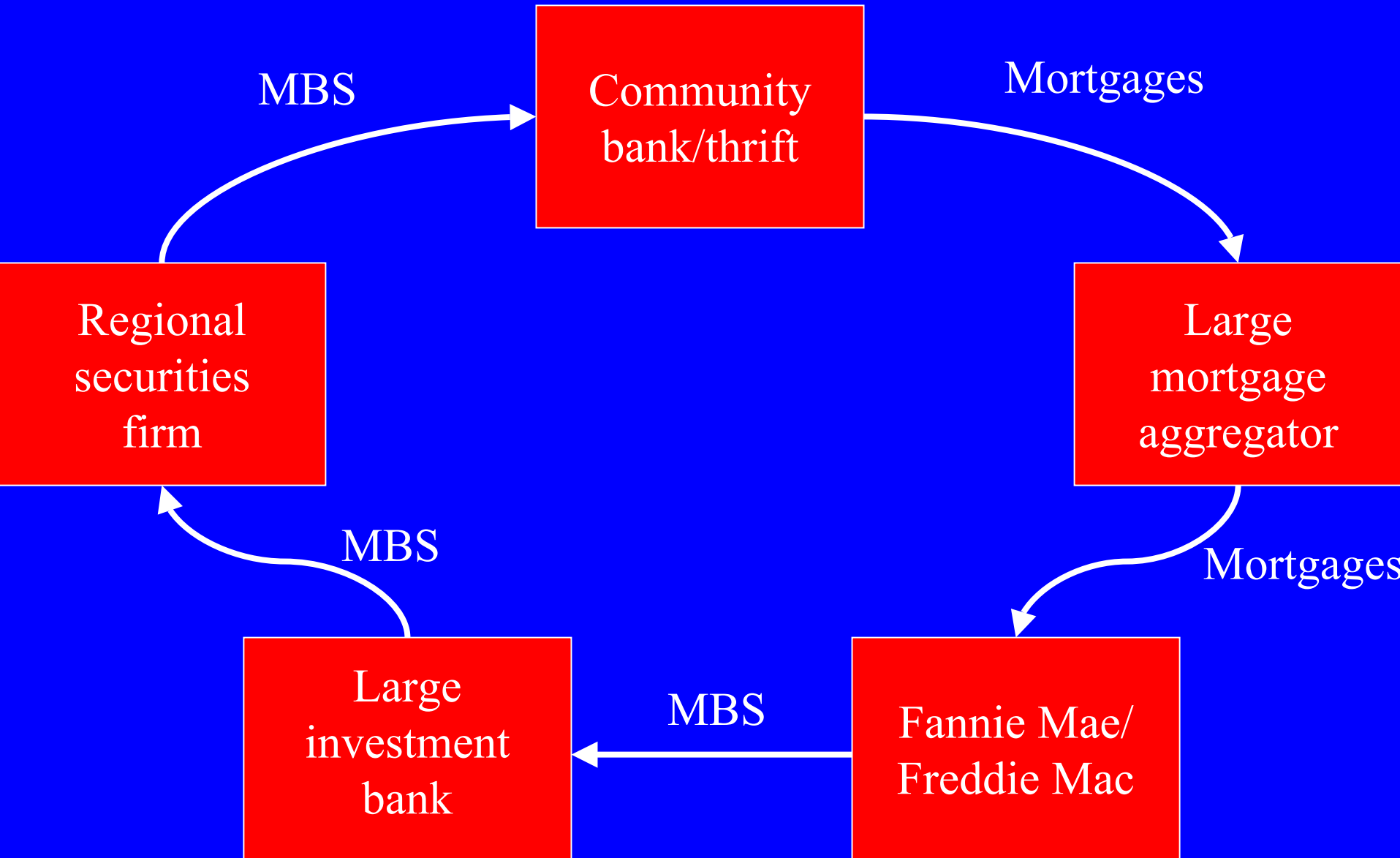
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- **Mortgage product offerings would be more varied**

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 - **Eliminate taxpayers' GSE risk**

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 - **Sources of opposition to privatizing F&F**

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- Refine the privatization transition time frames
- **Explore further how to privatize the FHLBs**

Thank you!

I welcome your questions