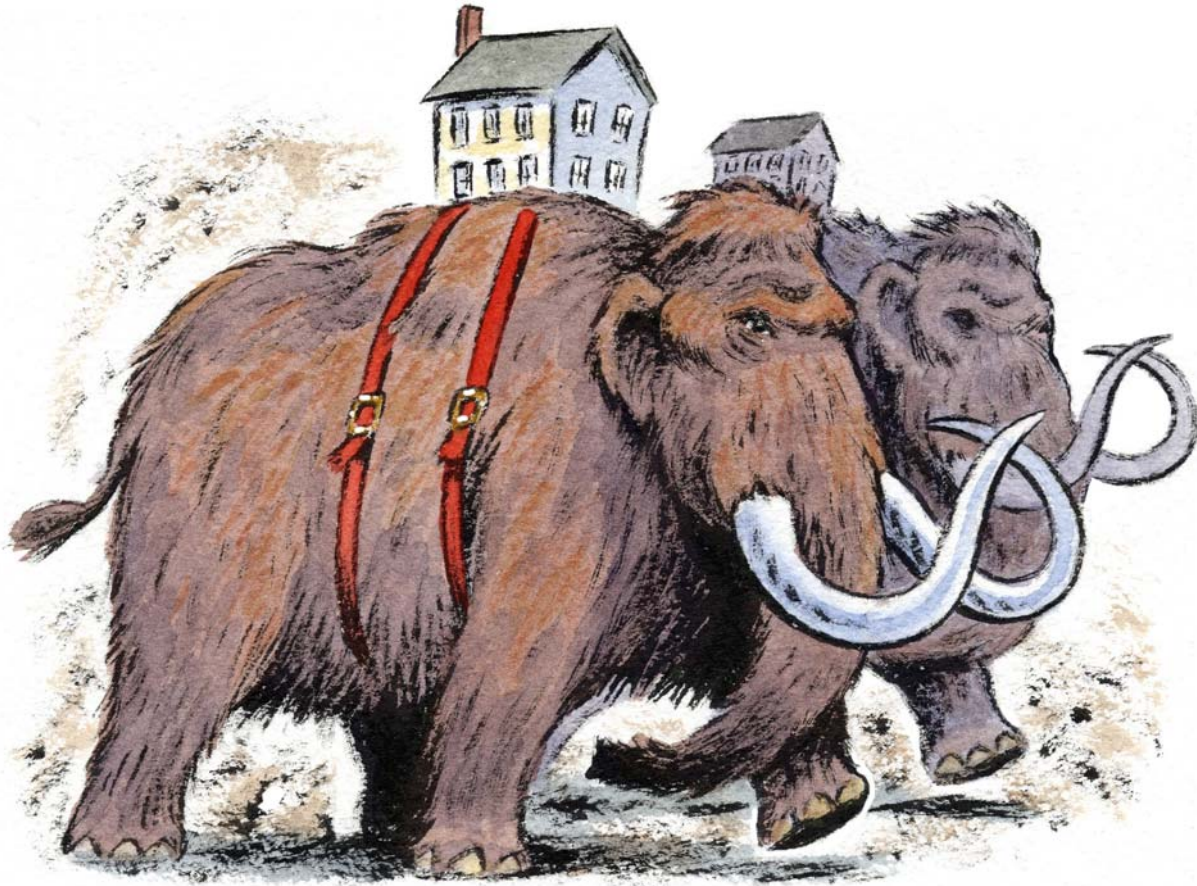


A Fannie and Freddie for the 21st Century

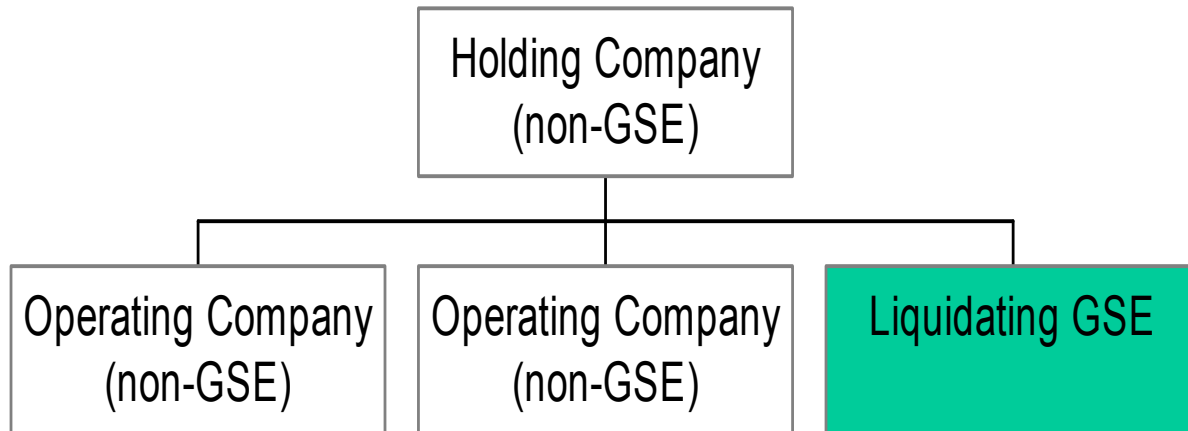


The Mechanics of Removing Government Sponsorship from Fannie Mae, Freddie Mac, and the Federal Home Loan Banks

Core Idea:

1. Terminate authorized GSE activities
2. Allow operations to shift to non-GSE affiliates
3. Holding-company structure (Sallie Mae precedent)
4. Five-year transition period

Restructuring as a Holding Company



The Process for Fannie Mae and Freddie Mac

1. Steps immediately on enactment
 - a. Strengthen regulator
 - b. GSE stops purchasing assets
 - c. Begin 5-year schedule for reducing portfolios to zero
 - d. Set escalating fees on excess portfolio (30 bp up to 60bp?)
 - e. Five year sunset in law

The Process for Fannie Mae and Freddie Mac (cont.)

2. Winding down GSE securitization
 - a. After six months apply 30-month schedule for winding down GSE securitization to zero
 - b. Set escalating fees on excess securitization (10 bp to 30 bp?)

The Process for Fannie Mae and Freddie Mac (cont.)

3. Conditions for operating non-GSE holding company
 - a. GSE “AA” stand-alone rating
 - b. Spin-off AUS and information databases to independent companies with guaranteed access

The Process for Fannie Mae and Freddie Mac (cont.)

4. Operating the holding company
 - a. Regulator certifies preconditions are met
 - b. Holding company operates on non-GSE basis
 - c. Financial services holding company: May engage in all lawful activities
 - d. Subject to to all applicable laws (SEC antitrust, SEC, privacy, etc.)
 - e. May not affiliate with a depository institution until GSE is terminated

The Process for Fannie Mae and Freddie Mac (cont.)

5. Winding up the GSE subsidiary
 - a. Defease outstanding agency-status debt
 - b. Place outstanding agency-status MBS into independent well-capitalized trusts
 - c. Remit excess funds to the holding company as trusts wind up
 - d. Legal authority for GSE terminates/GSE regulator terminates

The Process for the Federal Home Loan Banks

1. Steps immediately on enactment
 - a. Strengthen regulator
 - b. GSE limited to advances (collateralized by investment grade loans)
 - c. Begin 5-year schedule for reducing portfolios to zero
 - d. Permit FHLBanks to merge (if “AA” is maintained)
 - e. Limit advances and GSE debt to shorter maturities
 - f. Five year sunset in law

The Process for the Federal Home Loan Banks (cont.)

2. Winding down GSE advances
 - a. After six months apply 30-month schedule for winding down GSE advances to zero
 - b. In three years begin running off advance business

The Process for the Federal Home Loan Banks (cont.)

3. Operating the holding company
 - a. Condition for operating non-GSE holding company: GSE “AA” stand-alone rating
 - b. Regulator certifies precondition is met
 - c. Holding company operates on non-GSE basis
 - d. Financial services holding company: May engage in all lawful activities
 - e. FHLBank members determine governance structure (investor-ownership or co-op)
 - f. Subject to all applicable laws (SEC, antitrust, privacy, etc.)
 - g. May not affiliate with a depository institution until GSE is terminated

The Process for the Federal Home Loan Banks (cont.)

4. Winding up the GSE subsidiary
 - a. Defeasement of outstanding agency-status debt
 - b. Legal authority for GSE terminates/GSE regulator terminates

Completing the Transition

1. The GSE companies are transformed into non-GSE financial services companies
2. Some Federal Home Loan Banks might turn into bankers' banks

Thank you for your comments, which are greatly helping to refine this paper

Issues

1. Shareholder rights (plan approval)
2. Risk during transition
 - a. Imprudent risk-taking
 - b. Imprudent shift of resources from the GSE
3. Market power of companies after transition
4. Distributional questions
 - a. Refcorp obligation (FHLBanks)?
 - b. Affordable Housing Program (FHLBanks)?
 - c. GSE fees during transition?
 - d. Exit fee?
5. Likely pervasive GSE influence