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News Release

PRIVATIZING FANNIE MAE, FREDDIE MAC, AND THE FEDERAL HOME LOAN BANKS

Why and How

By Peter J. Wallison, Thomas H. Stanton, and Bert Ely

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The possibility that, at some time in the future, Fannie Mae and Freddie Mac may have to be bailed out puts American taxpayers and the American economy at serious risk. The cost of the S&L bailout was more than $150 billion; the cost of a Fannie or Freddie bailout, if it ever occurs, could be much higher. Although Congress is currently focused on tighter regulation to address this threat, experience has shown that powerful political organizations such as Fannie and Freddie—like the S&L industry in the 1980s—are effective at blocking regulatory efforts until losses have mounted substantially. Tighter regulation, then, is no solution. Privatization, the one alternative that will relieve taxpayers of this risk, has drawn opposition because of concern that the mortgage market will be disrupted, mortgage rates will rise, and Fannie and Freddie will dominate the financial industry even after privatization. Does this mean that we must continue to run the risk of a bailout if Fannie and Freddie encounter financial difficulties?

No, it does not, according to Peter J. Wallison in *Privatizing Fannie Mae, Freddie Mac and the Federal Home Loan Banks: Why and How* (AEI Press, October 4, 2004). Wallison argues that privatization is the only viable solution and can be achieved without market disruption and without market dominance by Fannie and Freddie. And, under a new financing system described in the book, *lower* mortgage rates might be achieved without government backing.

The book presents a privatization program designed by Thomas H. Stanton, one of the nation's authorities on GSEs, and a new mortgage-financing system developed by Bert Ely, a longtime and highly respected student of the residential finance markets. Stanton proposes an innovative privatization plan calling for an immediate end to portfolio investment in mortgages and mortgage-backed securities by Fannie and Freddie and liquidation of their existing portfolios over a five-year period. After a brief period, Fannie and Freddie also must divest their securitization activities to an affiliate that has no government backing and must provide copies of their automated underwriting systems and information databases for use by others in the market.

Ely proposes modifying banking regulations to make it profitable for subsidiaries of banks and bank holding companies—Mortgage Holding Subsidiaries—to hold mortgages as investments rather than selling them to third parties through the secondary mortgage market. This would eliminate or significantly reduce origination costs, such as expenses for appraisal, title insurance, flood certification, termite inspection, and many other costs usually assessed at the closing. These savings should be sufficient to reduce the all-in costs of a home mortgage below the rates now available through Fannie Mae and Freddie Mac.

The findings and proposals in *Privatizing Fannie Mae, Freddie Mac, and the Federal Home Loan Banks* will be presented at an AEI press conference on October 4 at 2:00 p.m. To register, visit www.aei.org/event909.

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