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White House Plans to Revamp Mortgage Market

Administration Proposal to Recommend Eliminating Fannie and Freddie, Curbing Government Role in Housing Finance

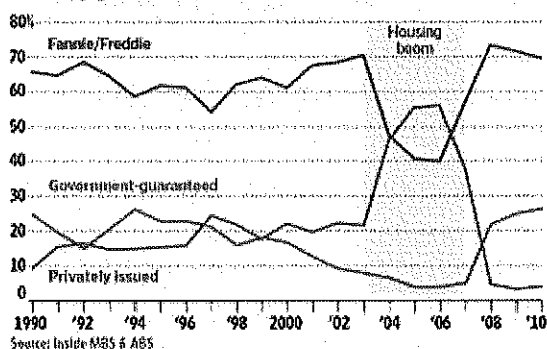
By NICK TIMIRAOS

More than two years after the government seized Fannie Mae and Freddie Mac, the Obama administration will recommend phasing out the housing-finance giants and gradually reducing the government's footprint in the mortgage market, according to people familiar with the matter.

The administration is expected to include three options for a post-Fannie and Freddie world when it releases a long-awaited proposal for the future of the nation's \$10.6 trillion mortgage market, which could come as soon as Friday. Together with federal agencies, Fannie and Freddie have accounted for nine of 10 new loan originations in the past year.

Big Sellers

During the most recent housing boom, private issuers bit off a piece of Fannie Mae and Freddie Mac's share of the loans being bundled into mortgage-backed securities. Share of MBS Issuance:



The White House's "white paper" will begin what promises to be a prolonged and fiery debate about the future of how homes are financed across the U.S. Any wind-down of Fannie and Freddie would happen gradually to avoid roiling markets, and the central, unanswered question is what kind of federal function, if any, the administration and Congress will invent to take their place.

Steps to reduce the government role in the mortgage market likely would raise borrowing costs for home buyers, adding pressure on the still-fragile U.S. housing markets. Consequently, analysts believe any transition could take years and would be driven by the pace of the housing market's recovery.

The fight over how to restructure the housing-finance system has roiled Washington, and yet both parties have been hesitant to propose detailed legislation.

For conservatives, Fannie and Freddie played a starring role in the financial crisis, and any solution that is viewed as replicating their function could face fierce opposition from some Republicans. But more moderate Republicans may resist such an approach and could join Democrats who have said a federal role is necessary to ensure broad access to home ownership.

While advancing one detailed plan risks providing fodder for partisan battles, offering multiple proposals may help the administration force those views into the open, said Michael Barr, a former assistant Treasury secretary in the Obama administration.

"If you focus on the steps everybody agrees on—here are the 10 things you've got to do—that gives people a chance to unite behind a set of steps," he said. A list of options he added, has the benefit of forcing Republicans "to come up with their own plan, and make their own mistakes."

The administration's proposal to Congress is likely to assess the merits and drawbacks of each of the three options. The most conservative would propose no government role in the mortgage market beyond existing federal agencies, such as the Federal Housing Administration.

The two others would create a way for the government to backstop part of the secondary mortgage market, a role long-filled by Fannie and Freddie. Under one, that government backstop would kick in primarily during periods of market stress; under the other, the government would play a role at all times.

For 40 years, the housing-finance system has featured a blend of public and private entities. Fannie and Freddie buy mortgages from banks and other originators, repackage them for sale as securities and make investors whole when borrowers default. Investors long assumed the two shareholder-owned firms had an implied federal guarantee, which let them borrow at below-market rates and facilitate 30-year fixed-rate loans.

As the recent housing bubble inflated, Fannie and Freddie joined private lenders in loosening standards. Mounting defaults wiped out the pair's razor-thin capital reserves, spurring the government to take over both. The White House has committed unlimited amounts of aid to ensure that the firms meet their obligations to debt and securities holders. So far, taxpayers are on the hook for \$134 billion.

Treasury Secretary Timothy Geithner told PBS's Charlie Rose earlier this month that the housing-finance business was a "mess" and that the administration's plan would "crowd private capital" back in. That, he said, would curb the government role and leave "a system that will not be vulnerable to the really tragic colossal failures" of the past.

The administration's paper will focus on three levers to help withdraw the government from the mortgage market, each of which promises to raise costs for borrowers. Officials are likely to call for lower maximum loan limits for mortgages Fannie and Freddie can purchase. Limits are set at \$417,000 nationally but Congress approved emergency measures two years ago raising the limits to as much as \$729,750 in high-cost areas. Unless Congress passes a third extension, they will fall to \$625,500 in October.

Policy makers could also encourage Fannie and Freddie to steadily raise fees they charge banks to guarantee mortgages. As the fees rise, loans offered by private lenders that aren't government-backed will become more competitive. And they could push for gradual increases in the minimum down payments on government-backed loans.

While Fannie and Freddie are already on track to reduce their combined \$1.5 trillion mortgage portfolios by 10% annually, the paper could also recommend accelerating that run-off if market conditions can support it.

Housing and Treasury aides met Tuesday with President Barack Obama to review their report. Top administration officials have publicly discussed the merits of a limited but explicit government guarantee of securities backed by certain types of mortgages. The housing and banking industries have advanced proposals arguing that such a guarantee is needed to maintain a healthy market, particularly for long-term, fixed-rate loans that remain a keystone of U.S. housing.

Others argue that because investors might assume the government will step in during a crisis, it is better to make guarantees explicit and charge up front for them. Industry and academic proposals have called for a new entity to regulate the market and any government guarantees, just as the Federal Deposit Insurance Corp. charges fees to insure deposits and handle bank failures.

But some economists and regulators have warned any new government backstops would put too much risk on taxpayers. In exchange for guaranteeing loans, policy makers could face pressure to under-price guarantees. Any options must also navigate a mortgage market that has grown increasingly consolidated and risks shifting the "too-big-to-fail" risks from Fannie and Freddie to U.S. megabanks.

—Damian Paletta contributed to this article.

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