

# Let Fannie and Freddie Breathe



By William M. Isaac, Senior Managing Director and Global Head of Financial Institutions

**T**he Inspector General for the Federal Housing Finance Agency (“FHFA”) recently reported that, due to a lack of capital reserves, [Fannie Mae](#) and [Freddie Mac](#) might need more government bailouts if housing markets decline.

This problem is the result of a 2012 decision by the U.S. Department of the Treasury to sweep Fannie’s and Freddie’s profits into the federal government’s coffers. This net worth sweep is illegal and economically dangerous. It needs to end.

It’s not difficult to understand why another bailout of Fannie and Freddie would raise concern. Acting under the Housing and Economic Recovery Act, Treasury rescued the mortgage giants from insolvency in 2008 with \$187 billion of taxpayer money. Nobody wanted taxpayers to assume the \$5 trillion in liabilities on Fanny’s and Freddie’s balance sheets, and the United States needed to reassure bondholders (mostly foreign) that they weren’t about to be wiped out. And so, after being rescued, the two companies were placed into a conservatorship administered by the FHFA, with a mandate to “conserve and preserve” Fannie and Freddie for their sharehold-

ers while the companies rebuilt capital.

Nearly seven years later, Fannie and Freddie remain in conservatorship. As of December 31, 2014, they had repaid the government \$227 billion — roughly \$40 billion more than they were loaned. Yet instead of allowing the companies to build a reserve like any large financial institution, the administration is stripping both companies of 100 percent of their profits. This is based on a 2012 change to the original conservatorship agreement, which required Fannie and Freddie to pay a 10 percent dividend to Treasury each quarter.

The government had every right to impose harsh terms on private investors when it saved the two companies from failure. It did so by taking 79 percent of the company from private stockholders and taking senior preferred stock with a 10 percent dividend.

That’s not a problem so far. But coming back four years later and changing the terms of its deal is troubling — and it will disincline the private sector from helping in a future crisis.

Some of Fannie’s and Freddie’s investors have sued the government. But the public also should be concerned. By

denying Fannie and Freddie the ability to accumulate capital, the government is placing taxpayers on the hook for any future losses that might be incurred.

In Treasury’s view, a dollar going to rebuilding capital is a dollar less for its general fund. But that’s backward thinking. The risk of another massive taxpayer bailout arising from undercapitalization is precisely why Treasury must end the net worth sweep and allow Fannie and Freddie to emerge from conservatorship.

We should let Fanny and Freddie recapitalize, and then, if policymakers develop a better alternative, wind them down in an orderly process.

Policymakers can disagree about Fannie’s and Freddie’s future. But there should be no disagreement about the need to respect the rule of law. ■

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*Mr. Isaac, a former chairman of the Federal Deposit Insurance Corporation, is a Senior Managing Director at FTI Consulting. He advises Investors Unite, a shareholder group opposed to the Treasury’s sweep of Fannie Mae and Freddie Mac profits.*  
[bill.isaac@fticonsulting.com](mailto:bill.isaac@fticonsulting.com)

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