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Weiss Op-Ed: Recap and Release Won't Work

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WASHINGTON – In an op-ed to be published in the October 19, 2015 edition of Bloomberg View, Counselor to the Secretary Antonio Weiss explains why the recent push to recapitalize Fannie Mae and Freddie Mac and release them from conservatorship is misguided and why we still need a housing finance system that ensures sustainable, fair and affordable access to housing and limits the risk of a taxpayer-funded bailout.

Read the piece [online](#).

Recap And Release Won't Work

By Antonio Weiss

The recent push to recapitalize Fannie Mae and Freddie Mac and release them from conservatorship is misguided.

Proponents of the proposal known as “recap and release” claim homeowners and taxpayers would benefit if the federal government ceded control of the mortgage finance giants to private shareholders.

Just the opposite is true. Recap and release could raise the cost of mortgages for Americans, and potentially expose taxpayers to another painful bailout.

Seven years ago, Fannie and Freddie were on the brink of insolvency and were placed into conservatorship by the Federal Housing Finance Agency. In what became the largest financial rescue in history, the U.S. Treasury injected \$188 billion in capital and committed to providing another \$258 billion if needed. These measures, along with the administration’s broader rescue efforts, helped stabilize the housing market and lay the groundwork for the recovery. The programs kept millions of Americans in their homes and reduced their mortgage payments.

Fannie and Freddie were created to serve an important public purpose and operated for decades as government-sponsored enterprises, with a perceived federal guarantee. Sadly, pressures to increase shareholder returns drove the GSEs to chase market share with inappropriate and risky products. When the housing bubble burst, Fannie and Freddie were holding trillions of dollars of mortgage risk and their failure would have had devastating consequences for homeowners and the broader economy.

We have learned the hard way that the old business model of privatizing gains while socializing losses doesn't work. The administration of President Barack Obama wants to build a better system, one that provides broad access to housing supported by a sound and robust mortgage market, without exposing taxpayers to another rescue.

There are at least three reasons recap and release wouldn't achieve those goals:

- It would do nothing to increase access to the housing market for creditworthy borrowers who remain shut out or for renters who are struggling to find affordable homes. For the moment, Fannie and Freddie aren't able to meet the needs of many responsible Americans, in particular lower and middle-income households and households of color, despite the GSEs' statutory “duty-to-serve” requirements.

Recap and release would subject Fannie and Freddie to the same investor pressures that got them into trouble in the first place. And there is no evidence the plan would expand access to credit for homeowners or create more affordable rental units.

- Contrary to the claims of some private investors, taxpayers have not been fully “repaid” for the risk they took in the crisis. As Fannie and Freddie verged on collapse, no private investor was willing or able to step in to rescue them. The crisis that followed caused immense harm to American households.

Taxpayers have now received more in total dividends than they injected into Fannie and Freddie. However, those payments alone aren't adequate compensation for the extraordinary risk the public took on and continues to bear.

The “repayment” argument also conveniently ignores that the \$258 billion commitment of support continues to underpin Fannie and Freddie's operations and allows the GSEs to borrow at highly favorable rates.

Without this commitment, confidence in Fannie and Freddie would be severely shaken, impairing the liquidity and depth of the global mortgage-backed security market. Such a scenario would have significant real-world consequences for the cost and

availability of bedrock products such as the 30-year fixed-rate mortgage. No financial institution would provide this kind of insurance for free, but many in favor of recap and release believe the taxpayer should do just that.

- Some have suggested the federal government could stop supporting Fannie and Freddie in the near term by allowing the companies to retain their earnings. This overlooks the high level of capital required to adequately cover the risk of the \$5 trillion in assets on the GSEs' books. A recent analysis from Moody's and the Urban Institute made clear that it could take decades for Fannie and Freddie to build safe and sound levels of capital and that recap and release would ultimately drive up the cost of mortgages.

There should be unanimous agreement on one point: Seven years after the crisis, the housing finance system remains the great unfinished business of financial reform. The U.S. still needs a system that ensures sustainable, fair and affordable access to housing and limits the risk of a taxpayer-funded bailout.

That would mean that private capital would take most of the risk. Taxpayer exposure would be limited to an explicit, appropriately-priced guarantee to ensure against catastrophic risk. And a better structure would create a level playing field that includes a robust role for community banks and credit unions, which know how best to serve their customers. Most importantly, there should be a mandate to serve all communities fairly.

These ambitious goals, and a responsible end to conservatorship, can only be achieved through comprehensive legislation, not a return to a broken model.

Antonio Weiss serves as Counselor to the Secretary at the U.S Department of the Treasury.

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