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Treasury dismisses Fannie Mae comparisons

By Jim Pickard, Kate Allen and Shahien Nasiripour

George Osborne has played down the idea that he is building a British version of Fannie Mae and Freddie Mac, both of which had to be rescued by Washington at the height of the credit crunch.

They play a big role in the US housing market, taking mortgages from lenders and repackaging them as securities to maintain a stream of liquidity to the housing market.

They back more than half of all outstanding US mortgage debt, up from a quarter in 1990.

Their roots lie in the Great Depression, when Franklin D Roosevelt set up the Federal National Mortgage Association (Fannie Mae). In 1968 it was privatised and two years later the government launched a competitor called the Federal Home Loan Mortgage Corporation (Freddie Mac).

The two companies operated with in effect a government guarantee and became the bedrock of the US mortgage market.

But they have also been blamed for helping to fuel the subprime boom, after coming under political pressure in the 1990s and 2000s to allow more low-income borrowers to take out mortgages.

The relaxation of Freddie and Fannie’s lending standards coincided with a rush by private banks to lend to subprime borrowers, creating a time-bomb of bad loans.

In 2008, at the height of the credit crunch, the US government was forced to step in and bail out the pair, which by then had issued $5tn of mortgages, at the cost of some $130bn to date.

The US government inquiry into the crisis concluded that their regulator was more concerned with accounting and operational issues than with their “increasing investments in risky mortgages and securities”.

The Osborne plan may sound superficially similar.

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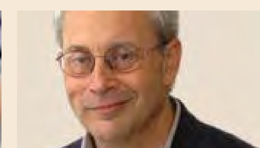

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But there are differences, not least his promise that the “Help to Buy” mortgage guarantee would be temporary – for three years. And while Freddie and Fannie securitised entire mortgages, taking them off banks’ balance sheets, the UK government will underwrite on average 9 per cent of each mortgage.

With plans for about £130bn of mortgages to be underwritten by the scheme, the taxpayers’ cash at risk is about £12bn.

The Treasury says banks will have no incentive to make low-quality loans because they will have to take a share of net losses – but they are only on the hook for 5 per cent. The lion’s share would be born by taxpayers if there was a market crash.

The main lesson from Fannie and Freddie is to be wary of pushing the mortgage guarantor to expand. The US subprime inquiry found that Fannie’s “quest for bigger market share, profits and bonuses led it to ramp up its exposure to risky loans and securities as the housing market was peaking”.

David Min, professor of financial markets regulation at the University of California, said the UK programme could be useful in providing “counter-cyclical mortgage credit”.

”Of course the primary issue with any government guarantee scheme, whether deposit insurance or mortgage insurance or otherwise, is ensuring that taxpayers are sufficiently safeguarded against loss, through restraints on risk-taking by the recipients of those government guarantees,” said Prof Min.

“Moral hazard is of course omnipresent in banking, but it is more pronounced in the presence of government guarantees, as bankers are literally playing with other people’s money.”

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