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Takeover of Fannie And Freddie Aims To Revive Housing, Financial Markets

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The government seized control of Fannie Mae and Freddie Mac yesterday in a dramatic bid to restore faith in the embattled mortgage giants and arrest a vicious cycle that has driven the nation's economy into a steep downturn.

Following weeks of round-the-clock planning, Treasury Secretary Henry M. Paulson Jr. announced the takeover to try to stabilize the deeply troubled housing and financial markets. Fannie Mae and Freddie Mac, with a combined 11,000 employees, have funded more than two-thirds of U.S. home loans in recent months, and doubts over their ability to continue doing so had threatened to immerse the economy into even more turmoil.

With home loans harder to come by, buyers have recently been unable to make purchases, causing the housing market to tank further, leaving banks and other lenders with huge losses. Those losses, in turn, have made loans even harder to get.

"Our economy will not recover until the bulk of this housing correction is behind us," Paulson said yesterday. "Fannie Mae and Freddie Mac are critical to turning the corner on housing."

There is no guarantee that the takeover will work, and it comes at a potentially massive cost to taxpayers. The government has pledged to inject money in the companies in any quarter in which they would otherwise be insolvent -- up to $100 billion in total for each company.

"This is a shareholder bailout financed by the U.S. taxpayers," said Armando Falcon Jr., formerly the chief regulator of Fannie Mae and Freddie Mac.

Paulson also announced a separate program in which the government will start buying securities backed by mortgages -- $5 billion worth, initially. That will, in effect, subsidize the purchase of homes by lowering the interest rate that buyers must pay for a mortgage.

Paulson said yesterday that both the potential investment in Fannie Mae and Freddie Mac and the planned purchase of mortgage-backed securities are designed to protect taxpayers. The government has received $1 billion worth of preferred stock in each company upfront in exchange for the guarantees, for example, and government officials said taxpayers have a good chance of profiting from the purchase of mortgage bonds.

The Treasury secretary also named new executives at Fannie and Freddie. Herbert M. Allison Jr., who most recently served as chairman and chief executive of TIAA-CREF -- the pension fund giant serving employees in the academic, medical, cultural and research fields -- will take over at Fannie. David M. Moffett, previously vice chairman and chief financial officer of U.S. Bancorp, will lead Freddie.

These are the latest -- and so far, most expensive -- efforts by the government to contain a financial crisis that began in the subprime mortgage market and has metastasized to encompass all types of debt markets. The International Monetary Fund has estimated the global losses will total nearly $1 trillion before the crisis ends.

Previously, the Federal Reserve created exotic new lending programs and rescued investment bank Bear Stearns. But that action, in which $29 billion of taxpayer money was used to back the acquisition, could pale in comparison with the rescue of Fannie and Freddie, in which the funds at risk are in the hundreds of billions of dollars.

"All of the things over the past year that the Fed and the Treasury have undertaken have been intended to stabilize the mortgage and the housing markets," said Howard Shapiro, an analyst at Fox-Pitt Kelton. "What's happened over time is that a lot of things they've done really aren't working."

"If this doesn't work, there aren't too many more arrows in the quiver," he said.

The seizure of the two companies has broad implications for Washington, Wall Street and international markets.

The biggest winners are holders of Fannie and Freddie debt, including investors as varied as Asian central banks and municipal pension funds in the United States. These bonds, which have been perceived as somewhat more risky in recent months, now in effect have an explicit U.S. government guarantee behind them.

Investors in Asia responded enthusiastically to the Treasury announcement. In early trading today, they drove the MSCI Asia-Pacific Finance up 6.8 percent, the biggest jump since October 1998.

"We think it's a very positive action by the U.S. It has come from being an invisible regulator and to coming to the front lines to save the market," said Wang Zhaowen, a spokesman for Bank of China, which in recent months had trimmed its debt holdings by about 29 percent to $7.5 billion.