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Freddie, Fannie debt may pose risk to economy

The housing slump has compelled the two entities to buy up mortgages on the secondary market that banks are backing away from. But that could end badly, charges one regulator.

By Les Christie, CNNMoney.com staff writer
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NEW YORK (CNNMoney.com) -- The increased share of housing debt taken on by Freddie Mac and Fannie Mae during the housing slump has put the two government sponsored enterprises at risk, it was charged Thursday.

The two outfits are "reducing risks in the market, but concentrating mortgage risks on themselves. These risks are beginning to take their toll," said James Lockhart, director of the Office of Federal Housing Enterprise Oversight (OFHEO), which regulates Fannie and Freddie. He was speaking Thursday at a Senate Banking committee on regulatory reform.

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Freddie will report its first ever annual loss for 2007 at the end of February, while Fannie, is expected to report its first loss in 22 years for the year.

As the subprime crisis has grown, banks have backed away from buying mortgages in the secondary market. This has left Fannie and Freddie, which do the same thing, to pick up the slack.

As a result, the two government sponsored entities (GSEs) saw the housing debt they and the Federal Home Loan Banks carry grow by 16 percent to \$6.3 trillion, more than the total public debt of the United States, according to Lockhart.

Some experts worry that if Fannie or Freddie take on too much debt and fail, that the government would have to bail them out using taxpayer money.

"The conforming market supported by Freddie Mac ([FRE](#), [Fortune 500](#)) and Fannie Mae ([FNM](#)) is the only well-functioning segment of the mortgage market," said Richard Syron, CEO of Freddie Mac. "We're experiencing greater losses as house prices decline, but that is not surprising since this is the market we were created to support it."

And Daniel Mudd, Fannie's CEO agreed. "Our business is meeting the increased demand for liquidity and our overall credit book has held up relatively well," he said. "Yes, these are tough times, but that is when you want a Fannie Mae."

But Lockhart argues that the GSEs require more regulatory oversight as their market share grows, in order for them to maintain the confidence of both the public and investors.

"[GSEs] have become *the system* for secondary mortgages," said Senator Richard Shelby (R-AL), and that creates a risk to the general economy.

If Fannie or Freddie run into trouble, that could lead to severe disruption in the mortgage market, which could then ripple through the entire financial system. Because they maintain capital that is a very small fraction of their debt obligations, the GSEs particularly vulnerable.



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Lockhart said, "It's critical that their capital grow as their risk grows and that's going to take a lot of work." ■

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