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New Agency Proposed to Oversee Freddie Mac and Fannie Mae

By STEPHEN LABATON

The Bush administration today recommended the most significant regulatory overhaul in the housing finance industry since the savings and loan crisis a decade ago.

Under the plan, disclosed at a Congressional hearing today, a new agency would be created within the Treasury Department to assume supervision of Fannie Mae and Freddie Mac, the government-sponsored companies that are the two largest players in the mortgage lending industry.

The new agency would have the authority, which now rests with Congress, to set one of the two capital-reserve requirements for the companies. It would exercise authority over any new lines of business. And it would determine whether the two are adequately managing the risks of their ballooning portfolios.

The plan is an acknowledgment by the administration that oversight of Fannie Mae and Freddie Mac -- which together have issued more than $1.5 trillion in outstanding debt -- is broken. A report by outside investigators in July concluded that Freddie Mac manipulated its accounting to mislead investors, and critics have said Fannie Mae does not adequately hedge against rising interest rates.

"There is a general recognition that the supervisory system for housing-related government-sponsored enterprises neither has the tools, nor the stature, to deal effectively with the current size, complexity and importance of these enterprises," Treasury Secretary John W. Snow told the House Financial Services Committee in an appearance with Housing Secretary Mel Martinez, who also backed the plan.

Mr. Snow said that Congress should eliminate the power of the president to appoint directors to the companies, a sign that the administration is less concerned about the perks of patronage than it is about the potential political problems associated with any new difficulties arising at the companies.

The administration's proposal, which was endorsed in large part today by Fannie Mae and Freddie Mac, would not repeal the significant government subsidies granted to the two companies. And it does not alter the implicit guarantee that Washington will bail the companies out if they run into financial difficulty; that perception enables them to issue debt at significantly lower rates than their competitors. Nor would it remove the companies' exemptions from taxes and antifraud provisions of federal securities laws.

The proposal is the opening act in one of the biggest and most significant lobbying battles of the Congressional session.

After the hearing, Representative Michael G. Oxley, chairman of the Financial Services Committee, and Senator Richard Shelby, chairman of the Senate Banking Committee, announced their intention to draft legislation based on the administration's proposal. Industry executives said Congress could complete action on legislation before leaving for recess in the fall.

"The current regulator does not have the tools, or the mandate, to adequately regulate these enterprises," Mr. Oxley said at the hearing. "We have seen in recent months that mismanagement and questionable accounting practices went largely unnoticed by the Office of Federal Housing Enterprise Oversight," the independent agency that now regulates the companies.

"These irregularities, which have been going on for several years, should have been detected earlier by the regulator," he added.

The Office of Federal Housing Enterprise Oversight, which is part of the Department of Housing and Urban Development, was created by Congress in 1992 after the bailout of the savings and loan industry and concerns about regulation of Fannie Mae and Freddie Mac, which buy mortgages from lenders and repackage them as securities or hold them in their own portfolios.

At the time, the companies and their allies beat back efforts for tougher oversight by the Treasury Department, the Federal Deposit Insurance Corporation or the Federal Reserve. Supporters of the companies said efforts to regulate the lenders tightly under those agencies might diminish their ability to finance loans for lower-income families. This year, however, the chances of passing legislation to tighten the oversight are better than in the past.

Reflecting the changing political climate, both Fannie Mae and its leading rivals applauded the administration's package. The support from Fannie Mae came after a round of discussions between it and the administration and assurances from the Treasury that it would not seek to change the company's mission.

After those assurances, Franklin D. Raines, Fannie Mae's chief executive, endorsed the shift of regulatory oversight to the Treasury Department, as well as other elements of the plan.

"We welcome the administration's approach outlined today," Mr. Raines said. The company opposes some smaller elements of the package, like one that eliminates the authority of the president to appoint 5 of the company's 18 board members.

Company executives said that the company preferred having the president select some directors. The company is also likely to lobby against the efforts that give regulators too much authority to approve its products.

Freddie Mac, whose accounting is under investigation by the Securities and Exchange Commission and a United States attorney in Virginia, issued a statement calling the administration plan a "responsible proposal."

The stocks of Freddie Mac and Fannie Mae fell while the prices of their bonds generally rose. Shares of Freddie Mac fell $2.04, or 3.7 percent, to $53.40, while Fannie Mae was down $1.62, or 2.4 percent, to $66.74. The price of a Fannie Mae bond due in March 2013 rose to 97.337 from 96.525.Its yield fell to 4.726 percent from 4.835 percent on Tuesday.

Fannie Mae, which was previously known as the Federal National Mortgage Association, and Freddie Mac, which was the Federal Home Loan Mortgage Corporation, have been criticized by rivals for exerting too much influence over their regulators.

"The regulator has not only been outmanned, it has been outlobbied," said Representative Richard H. Baker, the Louisiana Republican who has proposed legislation similar to the administration proposal and who leads a subcommittee that oversees the companies. "Being underfunded does not explain how a glowing report of Freddie's operations was released only hours before the managerial upheaval that followed. This is not world-class regulatory work."

Significant details must still be worked out before Congress can approve a bill. Among the groups denouncing the proposal today were the National Association of Home Builders and Congressional Democrats who fear that tighter regulation of the companies could sharply reduce their commitment to financing low-income and affordable housing.

"These two entities -- Fannie Mae and Freddie Mac -- are not facing any kind of financial crisis," said Representative Barney Frank of Massachusetts, the ranking Democrat on the Financial Services Committee. "The more people exaggerate these problems, the more pressure there is on these companies, the less we will see in terms of affordable housing."

Representative Melvin L. Watt, Democrat of North Carolina, agreed.

"I don't see much other than a shell game going on here, moving something from one agency to another and in the process weakening the bargaining power of poorer families and their ability to get affordable housing," Mr. Watt said.

Photos: Treasury Secretary John W. Snow, left, and Housing Secretary Mel Martinez, appeared before the House Financial Services Committee yesterday. (Photo by Doug Mills/The New York Times)(pg. C1); Franklin D. Raines, Fannie Mae's chief executive, endorsed the proposed transfer of regulatory oversight to the Treasury Department. (Photo by Associated Press)(pg. C6)