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IPO or IOU? GSE Reform Between Headlines and Hard Truths

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KEY TAKEAWAYS

- A potential privatization of government-sponsored enterprises (GSE) Fannie Mae and Freddie Mac would face significant legal, capital, and market hurdles
- Without an explicit government backstop, mortgage rates could rise and the mortgage-backed securities market could fragment
- Any structural overhaul would be a complicated and lengthy process

Politics vs. Policy

The Trump administration's revived interest in privatizing Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation) has reignited debate over the future of U.S. housing finance. Headlines suggest an initial public offering (IPO) could even come as soon as this year, with proposals ranging from separate offerings to a merger into a new entity that President Trump has called "The Great American Mortgage Corporation."

But behind the headlines lies a far more complicated reality. Given the unprecedented scale of such a transaction, we believe that an overhaul is unlikely before late 2026. Fannie Mae and Freddie Mac together guarantee $6.6 trillion in agency mortgage-backed securities (MBS), representing more than 50% of all outstanding U.S. mortgage debt, according to the Federal Housing Finance Agency (FHFA). Add in Ginnie Mae (Government National Mortgage Association) and that's another $2.5 trillion.

Any plan to transition this infrastructure into private hands during the worst housing affordability crisis in a generation will take time, coordination, and political capital.

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From Capital Shortfalls to Treasury's Stake

Among the many challenges, the GSEs remain significantly undercapitalized. FHFA's Enterprise Regulatory Capital Framework (ERCF) requires Fannie and Freddie to hold $328-350 billion in capital, according to federal documents and a TCW analysis. The two retained just $147 billion as of early 2025, however, creating a shortfall of more than $180 billion. That means an estimated $30 billion IPO, representing just 5-15% of equity, would barely move the needle for capital.

Furthermore, Treasury's $348 billion in senior preferred shares and 79.9% equity warrants complicate the recapitalization path. Treasury shares have generated more than $300 billion in dividends paid to the government to date. Resolving this stake via conversion, sale, or forgiveness raises complex legal and political questions around taxpayer compensation and investor dilution.

It's worth highlighting that several suggestions have been floated to address the capital shortfall:

- **Lowering Capital Requirements:** Some investors have proposed reducing the minimum capital requirements from 4.25% to 2.5% of adjusted assets. This would still be six times higher than pre-crisis levels and enough to cover cumulative losses from 2007–2011.
- **Preferred Share Conversion:** As it did with insurer AIG, Treasury could convert its senior preferred shares into common equity over multiple tranches. This would increase book capital but dilute existing shareholders and raise fairness concerns.
- **Issuing New Preferred Stock:** Some analysts argue that Treasury should repurchase voting common shares and issue new preferred shares to raise hundreds of billions in proceeds.
- **Staged Capital Raises:** A multi-year approach involving retained earnings, private placements, and follow-on offerings could gradually build capital while maintaining market stability.

In our view, the AIG-style unwind – several multi-tranche conversions in which the government gradually reduces its stake to give markets time to absorb dilution – remains the most feasible path to recapitalization. Even that approach, however, would take years to execute. For the GSEs, a similar unwind would face even greater complexity than AIG due to the size of the capital shortfall, the potential for dilution risk to investors as the Treasury's senior preferred shares and warrants are addressed, and a complicated regulatory sequencing between the FHFA, Treasury, and Congress.

As a result, it could take as long as seven years to organically reach FHFA's capital thresholds, assuming current capital retention rates and no major changes to capital rules, according to industry estimates. (See Figure 1.) Multi-tranche conversions would need to be carefully timed to avoid market disruption, and any follow-on offerings would depend on investor appetite and regulatory clarity.

Figure 1. GSE Options

Phase	Action	Estimated Timeline
Phase 1	$30B IPO (5-15% equity)	Early 2026
Phase 2	Retained earnings accumulation	6-7 years at ~$25B/year
Phase 3	Preferred share conversion (multi-tranche)	2026–2030
Phase 4	Follow-on offerings/private placements	Opportunistic, 2026-2029
Phase 5	Capital rule revision	12-18 months regulatory cycle

Source: TCW analysis

The Guarantee – Implicit, Explicit, or Absent?

One of the most consequential and least resolved issues in the GSE IPO debate is the future of the government guarantee. For decades, Fannie Mae and Freddie Mac have operated under an implicit guarantee: a widely held market assumption that the U.S. government would step in to support their obligations in a crisis. This perception has allowed the GSEs to borrow at near-Treasury rates, underpinned the liquidity of the $6.6 trillion agency MBS market, and supported the uniquely American 30-year fixed-rate mortgage.

But implicit guarantees are fragile. They rely on investor confidence, not legal certainty. As the administration explores privatization, the question becomes: will that backstop remain and in what form?

There could be significant consequences if the implicit guarantee is weakened or removed. Any investor demand for higher returns to compensate for a perception of increased credit risk, for example, could drive mortgage rates up by 50 to 100 basis points. The "To Be Announced" (TBA) market, which is the most liquid part of the mortgage-based securities market, sees nearly $290 billion in daily volume, and could fragment as credit risk differentiation and lack of a uniform guarantee reduce standardization and liquidity. Investors may begin pricing securities based on borrower geography, credit quality, and issuer-specific risk, which could undermine market fungibility and liquidity.

In the absence of legislative clarity, the administration may attempt to thread the needle by retaining the implicit guarantee while pushing forward with an IPO. But this approach carries risks. In our view, there's no clear upside for government or market stability unless the guarantee is addressed head-on. Without a credible backstop, investor confidence could erode, and the very structure of the secondary mortgage market could be destabilized.

What Congress Must Approve

While the FHFA and the U.S. Treasury have the administrative authority to release Fannie Mae and Freddie Mac from conservatorship, their powers are limited when it comes to structural reform. Several critical actions require Congressional legislation, not just regulatory discretion:

- **Merging FNMA and FMCC into a new entity:** Consolidating the two GSEs into a single institution would fundamentally alter the housing finance landscape and requires statutory authorization.
- **Creating a new GSE or housing finance institution:** Establishing a replacement or alternative to the current GSE model, such as a public utility or a government-owned corporation, would require new legislation defining its mandate, governance, and capital structure.
- **Replacing the implicit guarantee with an explicit one:** The current system relies on market perception of government backing. Making that guarantee formal and legally binding would require Congressional approval and could have significant budgetary implications.
- **Modifying affordable housing mandates:** The GSEs are subject to statutory obligations to support affordable housing. Any changes to these mandates, such as reducing targets or redefining qualifying criteria, must be legislated.

While administrative actions can influence capital accumulation, risk management, and operational oversight, true transformation of the GSE framework demands bipartisan consensus and legislative action. This makes the path forward inherently complex, as it must navigate not only financial and legal hurdles but also the shifting dynamics of Congressional priorities and housing policy debates.

The Road Ahead

Industry engagement remains active, but recent meetings between SIFMA, Treasury, and FHFA have yielded little concrete guidance. This reflects ongoing uncertainty and the absence of a clear regulatory roadmap. Despite the policy noise, MBS markets have remained stable – likely because the road ahead is long. A balanced approach that safeguards market stability, protects taxpayers, and supports affordable housing is essential. Continued dialogue among policymakers, legal experts, and financial institutions will be critical to shaping the future of U.S. housing finance. ■

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