Insight

Privatizing the GSEs: More Questions Than Answers

THOMAS KINGSLEY | JUNE 24, 2025

Executive Summary

- Privatizing Government-Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac could restore market discipline and reduce taxpayer risk but would likely require comprehensive legislative action and careful regulatory design.
- An initial public offering of the GSEs is a viable path forward, though it raises unresolved legal questions and complex implications for current shareholders.
- Without appropriate safeguards, privatization risks reduced access to affordable mortgage credit and unintended disruptions to housing market stability.

Introduction

For nearly a decade and a half, Fannie Mae and Freddie Mac, the two Government-Sponsored Enterprises (GSEs) central to the U.S. housing finance system, have operated under the shadow of federal conservatorship. While this arrangement was initially intended to be a temporary measure following the 2008 financial crisis, it has now become the status quo. Despite – or because of – their semi-public nature, the GSEs continue to dominate the mortgage market, accounting for roughly half of all outstanding U.S. mortgage debt.

Calls to privatize the GSEs have grown louder, amplified by comments made by President Trump and Federal Housing Finance Administration (FHFA) officials, driven by concerns about moral hazard, the ever-expanding footprint of government, and the desire for market-driven solutions. Privatizing the GSEs could restore market discipline and reduce taxpayer risk but would likely require comprehensive legislative action and careful regulatory design. Any move toward privatization, however, would be fraught with challenges – including reduced access to affordable mortgage credit and unintended disruptions to housing market stability – and the path forward is uncertain at best.

This insight seeks to make the case for privatizing the GSEs, provide some of the options for doing so, and analyze why any route to privatization is fraught with challenge.

The Case for Privatization

Privatizing the GSEs aligns with broader goals of reducing government intervention in markets, promoting competition, and transferring risk to the private sector. By placing the GSEs on a purely market-driven footing, privatization could reduce taxpayer exposure to future crises. In this ideal scenario, private investors would bear the brunt of mortgage credit risk, and the government's role would be confined to providing oversight rather than implicit guarantees. Privatization alone, however, could not lead to this outcome in the absence of significant GSE reduction and reform – without which the GSEs will remain too big to fail.

Additionally, privatization could bring long-overdue market discipline. With the government no longer standing behind them, the GSEs (or their successors) would need to attract capital in a more competitive market, offering higher returns for higher risk. This may push the GSEs to develop more innovative and efficient business models and pricing structures. The process could also serve as an effective mechanism to reduce the distortions that have arisen from the GSEs' semi-public status. Without taxpayer backing, investors and market participants would demand better returns for assuming risk, thereby improving the efficiency of the mortgage market in general.

Yet the case for privatization is not without its complexities. To navigate these complexities, policymakers must consider not only the methods for privatizing the GSEs but also the necessary safeguards to protect taxpayers, borrowers, and the stability of the broader economy.

Paths to Privatization

There are several potential paths to privatizing the GSEs, each with distinct trade-offs. The two primary options for policymakers are:

1. **Full Privatization Through Liquidation or Sale of Assets**

A straightforward but risky approach is to liquidate the GSEs or auction off their assets and liabilities to private entities. In this scenario, the government would dissolve Fannie Mae and Freddie Mac, allowing private companies to absorb their functions, such as the guarantee of mortgage-backed securities. This would place the secondary mortgage market entirely in private hands, which would lead to increased competition and innovation.

This option is fraught with risk, however. The large-scale sale of the GSEs' mortgage portfolios would require significant market coordination. If not done carefully, it could lead to major disruptions in the housing market. Additionally, the sheer size and complexity of Fannie and Freddie's balance sheets could deter potential buyers, especially if they perceive systemic risks tied to their involvement in the housing sector.

2. **Gradual Privatization with New Chartering Mechanisms**

A more gradual approach might involve transitioning the GSEs to privately chartered entities. Instead of immediately liquidating the enterprises, Congress could establish new regulatory structures that allow these companies to operate with greater market discipline but still retain certain federal oversight, such as capital standards, underwriting guidelines, and affordable housing mandates. The GSEs could then be gradually converted into privately held, profit-driven companies that remain subject to minimal government intervention.

This method would allow for a more measured transition and offer time to address the implications of privatization for access to credit, particularly for lower-income and first-time homebuyers. Yet the challenge here is creating a system that balances private incentives with public policy goals. Overly aggressive market competition could lead to the withdrawal of key services, such as affordable housing financing, from the lower end of the market, where the GSEs' public mission has traditionally been most focused.

Technically, the role of Congress in any privatization effort is assumed but not certain. A third option exists – the unilateral release of the GSEs by the administration to FHFA supervision without congressional involvement at all. It is unclear whether the administration legally has this power but it seems clear that the administration potentially has the opportunity to move where Congress cannot, but that the chaos this would create would likely be significantly greater.

The Role of Congress

The role of Congress in any privatization effort cannot be overstated. Given the size and importance of the GSEs in the U.S. housing market, Congress would likely need to pass legislation to facilitate their privatization – particularly if the move involves altering the structure, oversight, or mandates of the entities. A few key legislative considerations include:

- **New Housing Finance Legislation**: The GSEs were created through legislative acts, and any substantial changes to their structure would likely require new laws. For instance, Congress would need to define the regulatory framework for the newly privatized entities, including their capital standards, housing goals, and market structure. This might also include new mechanisms for providing implicit or explicit support in times of crisis, such as a restructured Federal Housing Finance Agency or new catastrophe reinsurance systems.

- **Affordable Housing Commitments**: One of the most contentious issues surrounding privatization is the role of the GSEs in promoting affordable housing. Policymakers would need to ensure that privatization doesn't result in an abrupt retreat from financing for low-income and moderate-income borrowers. Any plan to privatize the GSEs would need to carefully address their obligations to support affordable housing goals, potentially through new federal subsidies or regulatory requirements for private investors.

- **Fiscal and Budgetary Implications**: The financial ramifications of privatization must also be considered. The GSEs have long been part of the U.S. government's balance sheet, and any sale or transfer of assets would likely generate significant fiscal implications, both in terms of revenue and budget deficits. Given the potential for large-scale market disruptions, Congress would have to weigh the trade-offs between long-term benefits and short-term fiscal consequences. One particular point of concern is the likelihood that any sale proposal would be "scored" differently by the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB), potentially leading to very different budgetary implications.

An Initial Public Offering

An IPO (initial public offering) for Fannie Mae and Freddie Mac could be one of the most likely routes toward privatization, given the size and potential market value of the two enterprises. The idea of turning the GSEs into publicly traded companies listed on a major exchange, however, would have profound implications for shareholders, as well as for the housing market at large.

1. **Legal and Financial Issues Surrounding the IPO**

The GSEs' shares have been in a peculiar state since the 2008 conservatorship. Although the U.S. Treasury took control and has profited from the companies' profits through a controversial "net worth sweep," private shareholders have been left in legal limbo. The question of whether shareholders are entitled to compensation for their losses during conservatorship remains unresolved, and any move toward an IPO would likely reignite litigation. Given the political and legal uncertainties, the road to an IPO could be bumpy, requiring congressional action to settle the shareholder claims.

2. **How the IPO Would Impact Current Shareholders**

For current shareholders, the IPO could present a chance for a financial windfall, but it depends on the terms of privatization. There are a few possible scenarios:

- **Full Compensation for Pre-conservatorship Shareholders**: If Congress or the courts decide to fully compensate current shareholders, they could receive dividends or payments based on the GSEs' book value. This could be a major financial boon, but it would add considerable political and fiscal pressure on policymakers. Taxpayers could bear some of the cost, depending on how the shares are handled.

- **Dilution of Current Shareholder Interests**: On the other hand, an IPO could involve the issuance of new shares, which would dilute the value of current shareholders' holdings. If new private investors are invited to purchase shares during the IPO, existing shareholders could face significant losses, especially if the market value of the GSEs is deemed to be lower than expected due to regulatory changes or other risks tied to the privatization.

- **Potential Impact on Market Behavior**: A successful IPO could result in a surge in market capitalization, benefiting private investors and signaling a return to normalcy in the housing market. Yet this influx of new capital could also result in more speculative behavior, and the "new" GSEs would likely be more focused on short-term returns to satisfy market expectations. This shift could affect long-term housing finance stability.

3. **Impact on Housing Policy**

An IPO could mark a pivotal moment in the evolution of U.S. housing finance. The prospect of publicly traded GSEs would open the door for more private capital to enter the mortgage market, reducing the government's footprint. But the shift toward market-driven policies could lead to increased interest rates and less favorable lending terms for lower-income buyers unless strong regulatory protections are in place.

The challenge would be to balance the need for private investment with the broader goals of affordability and stability in housing markets. Congress would need to ensure that privatized GSEs retain some form of public mandate to ensure that affordable lending continues, even if it is driven by private capital.

Challenges to Privatization

While privatization could increase market efficiency, the path forward is laden with significant challenges.

1. **Moral Hazard and Taxpayer Risk**

One of the chief criticisms of the GSEs' current model is the moral hazard created by their implicit federal guarantee. Although Fannie Mae and Freddie Mac have been in conservatorship since 2008, the perception of a government "bailout" remains embedded in market expectations. A complete privatization would require a clear commitment to removing any perceived safety net from the GSEs. If investors believe that the government will backstop a failing privatized GSE, privatization could simply shift risk around without solving the underlying issue.

2. **Maintaining Access to Credit**

The key concern surrounding privatization is the potential for reduced access to mortgage credit for lower- and middle-income borrowers. The GSEs have long been the primary mechanism for ensuring that mortgage financing remains widely available, even during periods of market stress. Without government involvement, private companies may not have the incentives to extend affordable loans to higher-risk borrowers. The risk of exclusion from the housing market would disproportionately impact first-time homebuyers, minorities, and lower-income households.

3. **Regulatory and Capital Requirements**

In the absence of conservatorship, privatized GSEs would need to meet higher capital requirements to ensure that they could absorb any losses in times of economic stress. This could make it more expensive for GSEs to issue mortgage-backed securities, potentially raising costs for homebuyers. Furthermore, the regulatory framework for these entities must be carefully calibrated to prevent excessive risk-taking without stifling innovation in the housing finance market.

Conclusions

Privatizing the GSEs is a noble policy goal that aims to reintroduce market discipline and reduce taxpayer risk. The path to privatization is fraught with obstacles, however, including potential disruptions to the housing market, concerns about credit access, and the challenge of eliminating government backing. While Congress will be crucial in enacting any reforms, the real test will lie in crafting a privatization framework that strikes the right balance between market efficiency and public policy goals, ensuring that the new system can deliver housing finance stability without reverting to the excesses of the pre-crisis years.

For shareholders, the prospect of an IPO presents both an opportunity and a risk, depending on how privatization is structured. Without careful attention to both legal and market realities, the privatization of Fannie Mae and Freddie Mac could either result in a financial boon or a market setback. In the end, it will be the details – and the political will – that determine whether privatization is a prudent move or a policy misfire.