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4 Big Mortgage Backers Swim in Ocean of Debt

By MARY WILLIAMS WALSH

Even as the biggest banks repay their government debt in what is being heralded as a successful rescue program, four troubled giants of the financial world remain on government life support.

These companies, the American International Group, Fannie Mae, Freddie Mac and GMAC, are not only unable to repay the government, they are in need of continuing infusions that make them look increasingly like long-term wards of the state.

And the total risk they pose to the taxpayer far exceeds that of the big banks. Fannie and Freddie, in the final days of the year, are even said to be negotiating with the Treasury about greatly expanding the money available to them.

Though the four are not in all the same businesses, they were caught in one of the same traps: They sold mortgage guarantees — in some cases to each other. Now when homeowners default, as they are doing in record numbers, these companies are covering the losses. Essentially, taxpayer money to these companies is being used partly to protect banks and other investors who own the mortgages.

Like the big banks, these four companies would no doubt prefer to be free of government assistance, which comes with pay and other restrictions on their executives. But they appear at risk of getting onto a debt merry-go-round, where they have to draw new money from the government just to keep up with their existing government debts.

Fannie Mae recently warned, for example, that it could not pay the dividends it owes the Treasury, so “future dividend payments will be effectively funded with equity drawn from the Treasury.”

All the companies have recently drawn new government money or are in talks to do so:

¶Fannie Mae and Freddie Mac, which buy and resell mortgages, have used $112 billion — including $15 billion for Fannie in November — of a total $400 billion pledge from the Treasury. Now, according to people close to the talks, officials are discussing the possibility of increasing that commitment, possibly to $400 billion for each company, by year-end, after which the Treasury would need Congressional approval to extend it. Company and government officials declined to comment.

¶GMAC, which finances auto sales, already has $13.4 billion from the Troubled Asset Relief Program, and has been in talks with the Treasury about getting up to $5.6 billion more, because a government "stress test" showed it was still too weak.

¶A.I.G., the insurance conglomerate, recently drew $2 billion from a special $30 billion government facility, which was created in the spring after a $40 billion infusion proved inadequate.

Those capital commitments from the Treasury do not capture the full scale of government assistance to the companies. The government has also bought mortgage-backed securities and guaranteed corporate bonds, while the Federal Reserve Bank of New York has made an emergency loan.

Timothy F. Geithner, the Treasury secretary, welcomed the repayment plans by Citigroup and Wells Fargo this week. Although Citi later ran into difficulty with the share sale to raise money for the repayment, Mr. Geithner said the actions meant that taxpayers were "now on track to reduce TARP bank investments by more than 75 percent." That means that of the $245 billion awarded to banks, more than $185 billion is either recovered or about to be.

But that is just a fraction of the money that the four troubled debtors have received or may still get. Together, they have been offered nearly $600 billion, and that lifeline could climb to nearly $1 trillion if the commitment to Fannie and Freddie is doubled, as some predict. What's more, the companies seem short on persuasive strategies for extricating themselves from the government's embrace.

A spokeswoman for GMAC pointed out that the company had made all its scheduled dividend payments to the Treasury, as had Freddie Mac. While Fannie Mae has said it will have trouble paying its dividends, A.I.G. does

not have to pay dividends.

A spokeswoman for A.I.G. said that the insurance company was committed to repaying taxpayers, but repayment would depend on market conditions. A Freddie Mac spokesman said that the company was dependent on continued support from the Treasury to stay solvent. A.I.G.'s latest request for money offers an example of why it needs more government aid to pay its debts. The company has a big aircraft leasing unit, International Lease Finance Corporation, which is considered a valuable asset but not a core part of its business.

Ever since the company announced in 2008 that it would dismantle itself and sell subsidiaries to pay back the government, analysts have expected International Lease to be sold.

But there is a big catch. A.I.G. does not own International Lease outright. A big block of the unit's stock is actually held by an insurance subsidiary, which uses the shares to secure its promises to pay claims. If A.I.G. sold International Lease and gave the proceeds to the Fed to pay down debt, it would strip too much money out of the insurer, making it insolvent.

So A.I.G. used part of the $2 billion that it recently received from the Treasury to buy back the International Lease shares. That way, when a buyer finally appears, A.I.G. can sell the leasing business and pay the Fed.

"The irony is, for the government to recoup its value, it has to keep its support behind A.I.G.," said a former company executive, who requested anonymity because of the delicacy of the matter. "The thing is a total Catch-22."

A.I.G. said it also recently used some money from the Treasury to restructure its mortgage-guaranty business — something GMAC, Fannie and Freddie are struggling to do as well.

All four of the companies had businesses that provided mortgage guarantees. When defaults began soaring in 2007, they all suffered big losses. In some cases, they have insured each other; in other cases, banks or investors have to be paid.

Although GMAC's main business is financing auto sales, its executives have said its biggest problem is

containing the troubles in its mortgage business, known as Residential Capital. “What we want to do, to the best we’re able to, is draw a box around it and say that it is contained,” Michael Carpenter, the new chief executive, told a trade publication in November.

For its mortgage guarantee unit, A.I.G. used some Treasury money to reinsure $7 billion of obligations through a Vermont subsidiary. The terms call for the unit, United Guaranty of Greensboro, N.C., to pay the claims that it can afford and send the rest to the Vermont affiliate.

Little is known about the Vermont unit because the state does not require that type of company to file annual reports. If the Vermont company needs additional money, it presumably could turn to A.I.G., which can draw more from the Treasury.

Amy Schoenfeld contributed reporting and analysis.

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