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## Why the Mortgage Crisis Happened

By [M. Jay Wells](#)

Obama's economic narrative of the mortgage crisis ignores the facts. He has put free-market capitalism at the root of the current mortgage industry debacle, denying the real history of government interference in that market.

On September 15, with banking giant Lehman Brothers filing for bankruptcy protection, Obama was given the opening to begin weaving his anti-capitalist storyline. And that he did. Artfully blurring the mortgage industry crisis with generalized tax policy, Obama declared,

"I certainly don't fault Senator McCain for these problems, but I do fault the economic philosophy he subscribes to. It's a philosophy we've had for the last eight years, one that says we should give more and more to those with the most and hope that prosperity trickles down to everyone else."

The words were carefully chosen. That day in Colorado marked his return to the teleprompter and a strictly refocused campaign message intent on surreptitiously fusing the mortgage industry woes and free-market capitalism in general. Confident the American people are primed for his socialist brand of "change," Obama maintained his anti-capitalist theme, "What we have seen in the last few days is nothing less than the final verdict on an economic philosophy that has completely failed." According to Obama, capitalism has been "rendered . . . a colossal failure."

His chat with a Toledo, Ohio, plumber showcases his socialist, redistributionist ideology:

"It's not that I want to punish your success. I just want to make sure that everybody who is behind you, that they've got a chance for success too. . . . I think when you spread the wealth around, it's good for everybody."

He had already said as much at an April debate where he said his plan was to "look at raising the capital gains tax for purposes of fairness" (after having just admitted that raising the tax would reduce revenues!). For Obama, increased federal revenue be damned, tax increases are nonetheless necessary for redistributionist "fairness."

Contrary to the Obama narrative, however, it is not free-market capitalism at the root of the current mortgage industry crisis, but rather the very socialism Obama hawks. The historical record makes this fact unmistakably clear.

### The Growing Government Hand

#### 1933-1938

President Franklin D. Roosevelt initiated a series of "New Deal" reform programs designed to affect the mortgage market and homeownership. Fannie Mae, the Federal National Mortgage Association, was established to facilitate liquidity among lending institutions.

#### 1968

As part of President Johnson's Great Society reform plan, much of Fannie Mae became a private owned yet government chartered company, a government sponsored enterprise (GSE) providing authority to issue mortgage-backed securities

(MBS). Fannie Mae buys home mortgages in order to preserve liquidity in the secondary mortgage market. Though private, it remained backed by the Federal government.

## 1970

President Nixon chartered Freddie Mac, the Federal Home Loan Mortgage Corporation, as a GSE to compete with Fannie Mae. Designed to help grow the secondary mortgage market, Freddie Mac purchases mortgages from lending institutions to either be securitized as MBS and sold in the secondary market or held by Freddie Mac. At this time the secondary market for conventional mortgages was small.

## 1977

Sen. Proxmire (D-Wisconsin) introduced a "creeping socialism" community reinvestment Senate bill. Opponents argued the bill would allocate credit without regard for merits of loan applications, thereby threatening depository institutions. Proponents countered that it was only to ensure that lenders did not ignore good borrowing prospects in their communities. The bill's sponsor stressed it would neither force high-risk lending nor substitute the views of regulators or those of banks.

President Carter, pressed by grassroots organizations -- though opposed by the banking industry, signed into law the Community Reinvestment Act (CRA). In the years following the Act has undergone several revisions.

To boost community development laws, CRA was a provision designed to stem bank "redlining," the practice of drawing a red line around low-income communities and denying lending in these areas. The original intent of CRA was to encourage banks to foster homeownership opportunities in these underserved communities in which the lending institutions are chartered.

According to Section 801 of title VIII, "regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs [i.e., credit and deposit services] of the communities in which they are chartered to do business." Accordingly, "regulated financial institutions have continuing and affirmative obligation" to meet these needs. Moreover, the title required each "appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions."

## 1980s

With CRA came increased oversight of lending institutions to ensure they were giving credit to low- and moderate-income communities. Regulators expressed that CRA was not designed to compel credit allocation, nor did it require risky lending practices. Moreover, ECOA (Equal Credit Opportunity Act) and FHA, not CRA, were in place to address discrimination in lending. But community organization groups like the radical ACORN began efforts to reshape CRA into government-imposition, in accord with what "affirmative obligation" might suggest. They began pressing the semantic open door and stretching the "discrimination" provision to complain about enforcement of the regulations as lending institutions resisted bad lending practices in poor minority communities.

## August 1989

To deal with the savings & loan fallout of the 1980s, Congress enacted the Financial Institutions Reform Recovery and Enforcement Act. In a move with ominous portent, FIRREA mandated public release of lender evaluations and performance ratings, resulting in added pressure on the banking industry. Such public oversight enabled bullying abuses of community organization groups like ACORN to further influence bank lending practices.

## 1990s

With the mechanisms in place, the community organizing groups began developing directed strategies to exert more and more pressure on the lending industry in the cloak of complicity with CRA. Community organizer Barack Obama worked closely with ACORN activists. Employing the radical Alinsky intimidation tactics Obama had learned and was teaching -- "direct action" -- activists crowded bank lobbies, blocked drive-up teller lanes and demonstrated at the homes of bankers to browbeat risky lending in poor and minority communities. Those who resisted were accused of racism to the media and government officials.

The agitators could now stall or hijack bank mergers by filing complaints of non-compliance against the institutions.

Lawsuits alleging redlining and racism began flooding the court system. With the prospect of expansions and mergers threatened, banks settled cases and, significantly, increasingly made loans they would not have normally made. The net effect, as ACORN litigation increased, was that credit standards lowered.

Initially the GSEs resisted purchasing these risky mortgages but eventually the Clinton Administration instructed them to substantially increase the percentage of these mortgages in their portfolios. The government-backed Fannie Mae and Freddie Mac of the Clinton reforms became "a feeding trough," in the phrase of Peter Ferrara.

The poor communities and their exploitive leaders benefited from the capitalization with a surge of homeownership, at least on the surface. Wall Street benefited from increased sales of Fannie Mae and Freddie Mac and guaranteed mortgage-backed securities, as the housing market benefited from new capital channeled from Fannie and Freddie. And the GSE heads profited, with political support in Washington in the form of campaign contributions.

In the period 1989-2008, topping the list of recipients of contributions from Fannie Mae and Freddie Mac is the chairman of the Senate Banking Committee, Sen. Dodd (D-Connecticut), who received \$165,400. Second on the list is Sen. Obama (D-Illinois), receiving \$126,349 with only three years in the Senate. Rep. Frank (D-Massachusetts), received \$42,350.

### **February 1990**

Madeline Talbott, a well-known radical ACORN leader and banking industry agitator, challenged the merger of a Chicago thrift, Bell Federal Savings and Loan Association, who responded that they were being bullied into irresponsible "affirmative-action lending policy."

### **1991**

ACORN interfered with a House Banking Committee meeting for two days protesting a move to bring CRA reform.

### **1992**

Enforcement of CRA was "sporadic," as the Washington Times notes, until a Federal Reserve Bank of Boston study asserted that there were "substantially higher denial rates for black and Hispanic applicants than for white applicants." Co-author Lynn Browne was approached by co-author Alicia Munnell to do the study because "community activists were complaining that mortgage loans were not being made in minority communities."

According to the Times, however, "the study had mishandled statistics on minority default rates. When the errors were accounted for, the same study showed no evidence that nonwhite mortgage applicants were being discriminated against."

Frank Quaratiello, writing in the Boston Herald, cites Stan Liebowitz, "My guess is that they were interested in finding a particular result." Said Liebowitz, "Richard Syron was head of the Boston Fed at the time. He went on to be the head of Freddie Mac. They were looking for mortgage discrimination and they found it."

According to Quaratiello, Syron became Freddie Mac CEO and chairman in 2003 and "faced increasing pressure to buy up more and more risky mortgages, some of which the Boston Fed's guide had, in effect, served to legitimize." Regarding Syron's total compensation in 2007 of \$18.3 million, Liebowitz reportedly quipped, "Nice reward for presiding over unprofessional research behavior, bankrupting Freddie Mac and crippling our financial system, all in the name of politically correct lending."

### **September 1992**

The Chicago Tribune described the ACORN agenda as "affirmative action lending." And, writes Kurtz, "ACORN was issuing fact sheets bragging about relaxations of credit standards that it had won on behalf of minorities."

### **October 1992**

Congress, enacting the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, allowed legislation to "amend and extend certain laws relating to housing and community development." The Act created the Office of Federal

Housing Enterprise Oversight (OFHEO) within HUD to "ensure that Fannie Mae and Freddie Mac are adequately capitalized and operating safely." It also "established HUD-imposed housing goals for financing of affordable housing and housing in central cities and other rural and underserved areas."

Rep. Jim Leach (R-Iowa) warned about the impending danger non-regulated GSEs posed. As the Washington Post reports, his concern was that Congress was "hamstringing" the regulator. Complaint was that OFHEO was a "weak regulator." Leach worried that Fannie Mae and Freddie Mac were changing "from being agencies of the public at large to money machines for the stockholding few."

Rep. Barney Frank (D-Massachusetts) countered, as the Post reports, "the companies served a public purpose. They were in the business of lowering the price of mortgage loans."

### **September 1993**

The Chicago Sun-Times reports an initiative led by ACORN's Talbott with five area lenders "participating in a \$55 million national pilot program with affordable-housing group ACORN to make mortgages for low- and moderate-income people with troubled credit histories." Kurtz notes that the initiative included two of her former targets, Bell Federal Savings and Avondale Federal Savings, who had apparently capitulated under pressure.

### **July 1994**

Represented by Obama and others, Plaintiffs filed a class action lawsuit alleging that Citibank had "intentionally discriminated against the Plaintiffs on the basis of race with respect to a credit transaction," calling their action "racial discrimination and discriminatory redlining practices."

### **November 1994**

President Clinton addresses homeownership: "I think we all agree that more Americans should own their own homes, for reasons that are economic and tangible and reasons that are emotional and intangible but go to the heart of what it means to harbor, to nourish, to expand the American dream. . . . I am determined to see that you have the opportunity and together we can make that opportunity for the young families of our country. I am committed to a new and unprecedented partnership between industry leaders and community leaders and Government to recommit our Nation to the idea of homeownership and to create more homeowners than ever before."

### **June 1995**

Republicans had won control of Congress and planned CRA reforms. The Clinton Administration, however, allied with Rep. Frank, Sen. Kennedy (D-Massachusetts) and Rep. Waters (D-California), did an end-around by directing HUD Secretary Andrew Cuomo to inject GSEs into the subprime mortgage market.

As Kurtz notes, "ACORN had come to Congress not only to protect the CRA from GOP reforms but also to expand the reach of quota-based lending to Fannie, Freddie and beyond." What resulted was the broadening of the "acceptability of risky subprime loans throughout the financial system, thus precipitating our current crisis."

The administration announced the bold new homeownership strategy which included monumental loosening of credit standards and imposition of subprime lending quotas. HUD reported that President Clinton had committed "to increasing the homeownership rate to 67.5 percent by the year 2000." The plan was "to reduce the financial, information, and systemic barriers to homeownership" which was "amplified by local partnerships at work in over 100 cities."

Kurtz concludes, "Urged on by ACORN, congressional Democrats and the Clinton administration helped push tolerance for high-risk loans through every sector of the banking system -- far beyond the sort of banks originally subject to the CRA. So it was the efforts of ACORN and its Democratic allies that first spread the subprime virus from the CRA to Fannie and Freddie and thence to the entire financial system. Soon, Democratic politicians and regulators actually began to take pride in lowered credit standards as a sign of 'fairness' -- and the contagion spread."

Attorney General Janet Reno, with a number of bank lending discrimination settlements already, sternly announces, "We will tackle lending discrimination wherever it appears." With the new policy in full force, "No loan is exempt; no bank is immune." "For those who thumb their nose at us, I promise vigorous enforcement," reiterated Reno.

## 1997

HUD Secretary Cuomo said "GSE presence in the subprime market could be of significant benefit to lower-income families, minorities, and families living in underserved areas . . ."

## 1998

By falsifying signatures on Fannie Mae accounting transactions, \$200 million in expenses was shifted from 1998 to later periods, thereby triggering \$27.1 million in bonuses for top executives. James A. Johnson received \$1.932 million; Franklin D. Raines received \$1.11 million; Lawrence M. Small received \$1.108 million; Jamie S. Gorelick received \$779,625; Timothy Howard received \$493,750; Robert J. Levin received \$493,750.

## April 1998

HUD announced a \$2.1 billion settlement with AccuBanc Mortgage Corp. for alleged discrimination against minority loan applicants. The funds would provide poor families with down payments and low interest mortgages. Announcing the Accubanc settlement, Secretary Cuomo said, "discrimination isn't always that obvious. Sometimes more subtle but in many ways more insidious, an institutionalized discrimination that's hidden behind a smiling face."

Before the camera, Cuomo admitted the mandate amounted to "affirmative action" lending that would result in a "higher default rate." The institution would "take a greater risk on these mortgages, yes; to give families mortgages who they would not have given otherwise, yes; they would not have qualified but for this affirmative action on the part of the bank, yes. It is by income, and is it also by minorities? Yes. . . . With the 2.1 billion, lending that amount in mortgages which will be a higher risk, and I'm sure there will be a higher default rate on those mortgages than on the rest of the portfolio."

## May 1999

The LA Times reports that African Americans homeownership is increasing three times as fast as that of whites, with Latino homeowners is growing five times as fast, attributing the growth to breathing "the first real life into enforcement of the Community Reinvestment Act." This breath of "life" mandated that Fannie Mae and Freddie Mac buy mortgages with deviant down-payments and debt-to-income ratios which allowed lenders to approve mortgages for lower-income families that would have been denied otherwise.

By now all pretense had disappeared, lending practices were based upon concerns of discrimination in the banking system regardless the consequences. The administration threatened to veto a bill passed by the Senate which had "shortsightedly voted to retrench" CRA, as the advocative Times put it.

Under pressure, Fannie Mae was resisting increased targeting, arguing that the result would be more loan defaults. Barry Zigas, heading Fannie Mae's low-income efforts, argued, "There is obviously a limit beyond which [we] can't push [the banks] to produce," the Times reported.

## Fall of 1999

Treasury Secretary Lawrence Summers warned, "Debates about systemic risk should also now include government-sponsored enterprises, which are large and growing rapidly."

## September 1999

With pressure from the Clinton Administration, Fannie Mae eased credit requirements on loans it would purchase from lenders, making it easier for banks to lend to borrowers unqualified for conventional loans. Raines explained that "there remain too many borrowers whose credit is just a notch below what our underwriting has required who have been relegated to paying significantly higher mortgage rates in the so-called subprime market," reported the New York Times.

With this action, Fannie Mae put itself at substantial risk in the event of an economic downturn. "From the perspective of many people, including me, this is another thrift industry growing up around us," warned Peter Wallison. "If they fail, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry." The danger was known.

## September 1999

A study by Freddie Mac, confirming earlier Federal Reserve and FDIC studies, contradicts race discrimination arguments for CRA. The study found that African-Americans with annual incomes of \$65-\$75,000 have on average worse credit records than whites making under \$25,000, showing that the difficulty in qualifying was not because of race but because of bad credit records. The Federal Reserve Bank of Dallas accordingly entitled a paper "Red Lining or Red Herring?"

## 2000

The National Community Reinvestment Coalition instructed on how to exploit the new CRA regulations, "Timely comments can have a strong influence on a bank's CRA rating." NCRC asserted, "To avoid the possibility of a denied or delayed application, lending institutions have an incentive to make formal agreements with community organizations." That is, the mere threat to intervene in the CRA review process had equipped the ACORN groups for the massive shakedown.

Moreover, ACORN had been given a compelling incentive, as CRA allowed the organizations to collect a fee from the banks for their services in marketing the loans. The Senate Banking Committee had estimated that, as a result of CRA, \$9.5 billion had gone to pay for services and salaries of the organizers.

## Winter 2000

City Journal warned that the Clinton administration had turned CRA into "a vast extortion scheme against the nation's banks," committing \$1 trillion for mortgages and development projects, most of it funneled through the community organizers.

## March 2000

Rep. Richard Baker (R-Louisiana) proposed a bill to reform Fannie and Freddie's oversight in a House Subcommittee on Capital Markets.

Rep. Frank (D-Massachusetts) dismissed the idea, saying concerns about the two were "overblown" and that there was "no federal liability there whatsoever."

Treasury Undersecretary Gary Gensler testified in favor of GSE regulation. He argued that the bill would promote private market discipline, increase transparency and preserve market competition, reducing the potential for subsidized competitors to distort financial markets.

Fannie Mae spokesmen responded by calling the testimony "inept," "irresponsible," and "unprofessional."

Wallison of the American Enterprise Institute testified to the subcommittee that the bill was "a milestone in Congressional efforts to gain control of the Government Sponsored Enterprises." He added that the "political courage and stamina that was required to introduce this bill and to continue to press it forward cannot be overstated." He emphasized that the bill was only an "interim step in the necessary process of dismantling the GSEs and eliminating both their threat to the taxpayers and to the private financial sector of our economy."

Wallison explained why Fannie and Freddie "pose a serious problem for both the public and private sectors." First, they contain an inherent contradiction. "It is a shareholder-owned company, with the fiduciary obligation to maximize profits, and a government-chartered and empowered agency with a public mission. It should be obvious that it cannot achieve both objectives. If it maximizes profits, it will fail to perform its government mission to its full potential. If it performs its government mission fully, it will fail to maximize profits."

He sounded an alarm on a "vicious and dangerous cycle." "Fannie and Freddie must grow in order to maintain their profitability and hence their high stock prices, but there is no countervailing check on their growth - no effective competition, no required government approvals, and no fear in the financial markets that there is any risk associated with financing this growth. Moreover, their fiduciary obligations to their shareholders require them to exploit their subsidy to the fullest extent possible. These are agencies that are - in the fullest sense of the phrase - out of control."

Congressional Democrats and GSE representatives vigorously attacked any such criticism. "We think that the statements

evidence a contempt for the nation's housing and mortgage markets," rebuffed Sharon McHale, Freddie Mac spokeswoman. Congressional Democrats and GSE representatives prevailed.

## June 2000

Fred L. Smith Jr., writing in Investor's Business Daily, recalls testifying before the House Financial Services Committee that GSE "special privileges create a serious hazard to the market, to taxpayers [and] to the economy." He warned that these GSEs were "strange organizations, neither private-sector fish nor political-sector fowl" and that "as a result, no one is quite sure how these entities should be evaluated or held accountable." These new debt portfolios "will certainly increase the likelihood of a Fannie-Freddie default."

Rep. Paul Kanjorski (D-Pennsylvania): "Mr. Smith, that is almost a fallacious argument," adding that rapid growth of GSE debt holdings was nothing to worry about as it simply reflected "inflation and the growth of population. "Everything, proportionately, is that much larger."

Rep. Marge Roukema (R-New Jersey): "very few banks or S&Ls could, even in this day and age, even now, meet the stress-testing requirements which Fannie and Freddie are required to meet."

Rep. Carolyn Maloney (D-New York) regarding the Treasury Department line of credit: "It is really symbolic, it is obsolete, it has never been used." "Would you explain why it would be important to repeal something that seems to be of little use?"

Smith: "as long as the pipeline is there, it is like it is very expandable. . . . It is only \$2 billion today. It could be \$200 billion tomorrow."

Because of Democrat obfuscation, Smith's "tomorrow" arrived in 2008 when Treasury Secretary Henry Paulson put Fannie and Freddie into conservatorship.

## April 2001

Fiscal Year 2002 Budget declares that the size of Fannie Mae and Freddie Mac is "a potential problem," because "financial trouble of a large GSE could cause strong repercussions in financial markets, affecting Federally insured entities and economic activity," says a White House release.

## July 2001

Subcommittee hearing on a bill proposed by Rep. Baker to transfer supervisory and regulatory authority over Fannie Mae and Freddie Mac to the Board of Governors of the Federal Reserve System and abolish the OFHEO.

Rep. Paul Kanjorski (D-Pennsylvania) [responded](#): "This bill would dramatically restructure the current regulatory system for Fannie Mae and Freddie Mac. In my opinion, it also represents a solution in search of a problem. Nearly a decade ago, Congress created a rational, reasonable, and responsive system for supervising GSE activities, and that system with two regulators is operating increasingly effectively. H.R. 1409 would unfortunately interrupt this continual progress."

March 2002

Business Week interview with Fannie Mae Vice-Chairman Jamie Gorelick about the prospects for the coming year:

Gorelick: "we are expecting a very, very strong 2002."

Gorelick: "We believe we are managed safely. . . . Fannie Mae is among the handful of top-quality institutions. . . . And we have consistently exceeded every standard that the examiners have set for us."

## May 2002

In an OMB Prompt Letter to OFHEO, the President calls for the disclosure and corporate governance principles contained in his 10-point plan for corporate responsibility to apply to Fannie Mae and Freddie Mac.

## February 2003

OFHEO reports that "although investors perceive an implicit Federal guarantee of [GSE] obligations . . . the government has provided no explicit legal backing for them," warning that unexpected problems at a GSE could immediately spread into financial sectors beyond the housing market, according to a White House release.

## 2003

Rep. Richard Baker (R-Louisiana), chairman of the House Financial Services subcommittee with GSE oversight over Fannie Mae and Freddie Mac, was informed by OFHEO "on the salaries paid to executives at both companies," according to the Washington Post. Reportedly, "Fannie Mae threatened to sue Baker if he released it, he recalled. Fearing the expense of a court battle, he kept the data secret for a year." "The political arrogance exhibited in their heyday, there has never been before or since a private entity that exerted that kind of political power," he said.

### June 2003

Freddie Mac reported it had understated its profits by \$6.9 billion. OFHEO director Armando Falcon Jr. requested that the White House audit Fannie Mae.

### July 2003

Sens. Chuck Hagel (R-Nebraska), Elizabeth Dole (R-North Carolina) and John Sununu (R-New Hampshire) introduced legislation to address Regulation of Fannie Mae and Freddie Mac. The bill was blocked by Democrats.

### September 2003

In an interview with Ron Insana for CNN Money, Rep. Baker [warned](#), "I have concerns that if appropriate resources aren't allocated for internal risk management, the consequences will be far more severe than just a real estate slowdown. The losses would fall quickly through the capital these companies have and down to shareholders and taxpayers. These companies have some of the lowest capital margins of any financial institution in the nation, yet, at the same time, they are two of the largest. The concern is that if something doesn't work out the way they predict, the American taxpayer could be called on to pay off the debt in some sort of bailout."

The New York Times reports that the Administration recommended "the most significant regulatory overhaul in the housing finance industry since the savings and loan crisis a decade ago," calling for new supervision of Fannie Mae and Freddie Mac by the Treasury Department. Reportedly, Congressional Democrats "fear that tighter regulation of the companies could sharply reduce their commitment to financing low-income and affordable housing."

Treasury Secretary John Snow testifies that Congress enact "legislation to create a new Federal agency to regulate and supervise the financial activities of our housing-related government sponsored enterprises" and set prudent and appropriate minimum capital adequacy requirements, says a White House release.

Rep. Barney Frank (D-Massachusetts): "I do not think we are facing any kind of a crisis. That is, in my view, the two government sponsored enterprises we are talking about here, Fannie Mae and Freddie Mac, are not in a crisis. . . . I do not think at this point there is a problem with a threat to the Treasury. . . . I believe that we, as the Federal Government, have probably done too little rather than too much to push them to meet the goals of affordable housing and to set reasonable goals.

Rep. Barney Frank (D-Massachusetts): "These two entities - Fannie Mae and Freddie Mac - are not facing any kind of financial crisis. . . . The more people exaggerate these problems, the more pressure there is on these companies, the less we will see in terms of affordable housing."

Rep. Melvin Watt (D-North Carolina): "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."

### October 2003

Fannie Mae discloses \$1.2 billion accounting error.

## November 2003

Council of the Economic Advisers Chairman Greg Mankiw warned, "The enormous size of the mortgage-backed securities market means that any problems at the GSEs matter for the financial system as a whole. This risk is a systemic issue also because the debt obligations of the housing GSEs are widely held by other financial institutions. The importance of GSE debt in the portfolios of other financial entities means that even a small mistake in GSE risk management could have ripple effects throughout the financial system," from a White House release.

Mankiw explains that any "legislation to reform GSE regulation should empower the new regulator with sufficient strength and credibility to reduce systemic risk." To reduce the potential for systemic instability, the regulator would have "broad authority to set both risk-based and minimum capital standards" and "receivership powers necessary to wind down the affairs of a troubled GSE," says a White House release.

## February 2004

Fiscal Year 2005 Budget again highlights the risk posed by the explosive growth of the GSEs and their low levels of required capital, and called for creation of a new, world-class regulator: "The Administration has determined that the safety and soundness regulators of the housing GSEs lack sufficient power and stature to meet their responsibilities, and therefore . . . should be replaced with a new strengthened regulator," reports a White House release.

Mankiw cautions Congress to "not take [the financial market's] strength for granted." Again, the call from the Administration was to reduce this risk by "ensuring that the housing GSEs are overseen by an effective regulator," says a White House release.

## June 2004

Deputy Secretary of Treasury Samuel Bodman spotlights the risk posed by the GSEs and called for reform, saying "We do not have a world-class system of supervision of the housing government sponsored enterprises (GSEs), even though the importance of the housing financial system that the GSEs serve demands the best in supervision to ensure the long-term vitality of that system. Therefore, the Administration has called for a new, first class, regulatory supervisor for the three housing GSEs: Fannie Mae, Freddie Mac, and the Federal Home Loan Banking System," the White House reports.

## September 2004

OFHEO reported that Fannie Mae and CEO Raines had manipulated its accounting to overstate its profits. Congress and the Bush administration sought strong new regulation and authority to put the GSEs under conservatorship if necessary. As the Washington Post reports, Fannie Mae and Freddie Mac responded by orchestrating a major campaign "by traditional allies including real estate agents, home builders and mortgage lenders. Fannie Mae ran radio and television ads ahead of a key Senate committee meeting, depicting a Latino couple who fretted that if the bill passed, mortgage rates would go up." Again, GSE pressure prevailed.

## October 2004

Rep. Baker again warned about the coming crisis in the Wall Street Journal: "Then there's the lesson of a company, Frankenstein-like, seemingly grown so powerful that it can intimidate and arrogantly flout all accountability to the very government that created it."

Baker adds, "Although their bonds bear the disclaimer 'not backed by the full faith and credit of the U.S. government,' the market does not believe it and looks right past the companies' risk strategies to the taxpayers' pockets."

In a subcommittee testimony, Democrats vehemently reject regulation of Fannie Mae in the face of dire warning of a Fannie Mae oversight report. A few of them, Black Caucus members in particular, are very angry at the OFHEO Director as they attempt to defend Fannie Mae and protect their CRA extortion racket.

Chairman Baker (R-Louisiana): "It is indeed a very troubling report, but it is a report of extraordinary importance not only to those who wish to own a home, but as to the taxpayers of this country who would pay the cost of the clean up of an enterprise failure. . . . The analysis makes clear that more resources must be brought to bear to ensure the highest standards

of conduct are not only required, but more importantly, they are actually met."

Rep. Maxine Waters (D-California): "Through nearly a dozen hearings where, frankly, we were trying to fix something that wasn't broke."

Rep. Maxine Waters (D-California): "Mr. Chairman, we do not have a crisis at Freddie Mac, and particularly at Fannie Mae, under the outstanding leadership of Mr. Frank Raines."

Rep. Gregory Meeks (D-New York): "And as well as the fact that I'm just pissed off at OFHEO, because if it wasn't for you I don't think that we'd be here in the first place, and now the problem that we have and that we're faced with is: maybe some individuals who wanted to do away with GSEs in the first place, you've given them an excuse to try to have this forum so that we can talk about it and maybe change the, uh, the direction and the mission of what the GSEs had, which they've done a tremendous job. There's been nothing that was indicated that's wrong, you know, with uh Fannie Mae. Freddie Mac has come up on its own. And the question that then presents is the competence that, that, that, that your agency has, uh, with reference to, uh, uh, deciding and regulating these GSEs. Uh, and so, uh, I wish I could sit here and say that I'm not upset with you, but I am very upset because, you know, what you do is give, you know, maybe giving any reason to, as Mr. Gonzales said, to give someone a heart surgery when they really don't need it."

Rep. Ed Royce (R-California): "In addition to our important oversight role in this committee, I hope that we will move swiftly to create a new regulatory structure for Fannie Mae, for Freddie Mac, and the federal home loan banks."

Rep. Lacy Clay (D-Missouri): "This hearing is about the political lynching of Franklin Raines."

Rep. Ed Royce (R-California): "There is a very simple solution. Congress must create a new regulator with powers at least equal to those of other financial regulators, such as the OCC or Federal Reserve."

Rep. Gregory Meeks (D-New York): "What would make you, why should I have confidence? Why should anyone have confidence, and uh, in, in you as a regulator at this point?"

Armando Falcon, OFHEO Director: "Sir, Congressman, OFHEO did not improperly apply accounting rules. Freddie Mac did. OFHEO did not fail to manage earnings properly. Freddie Mac did. So this isn't about the agency engaging in improper conduct. It's about Freddie Mac."

Rep. Christopher Shays (R-Connecticut): "And we passed Sarbanes-Oxley, which was a very tough response to that, and then I realized that Fannie Mae and Freddie Mac wouldn't even come under it. They weren't under the '34 act, they weren't under the '33 act, they play by their own rules, and I and I'm tempted to ask how many people in this room are on the payroll of Fannie Mae, because what they do is they basically hire every lobbyist they can possibly hire. They hire some people to lobby and they hire some people not to lobby so that the opposition can't hire them."

Rep. Artur Davis (D-Alabama): "So the concern that I have is you're making very specific, what you have correctly acknowledged, broad and categorical judgments about the management of this institution, about the willfulness of practices that may or may not be in controversy. You've imputed various motives to the people running the organization. You went to the board and put a 48-hour ultimatum on them without having any specific regulatory authority to put that kind of ultimatum on 'em. Uh, that sounds like some kind of an invisible line has been crossed."

Rep. Christopher Shays (R-Connecticut): "Fannie Mae has manipulated, in my judgment, OFHEO for years. And for OFHEO to finally come out with a report as strong as it is, tells me that's got to be the minimum not the maximum."

Rep. Barney Frank (D-Massachusetts): "Uh, I, this, you, you, you seem to me saying, 'Well, these are in areas which could raise safety and soundness problems.' I don't see anything in your report that raises safety and soundness problems."

Rep. Maxine Waters (D-California): "Under the outstanding leadership of Mr. Frank Raines, everything in the 1992 Act has worked just fine. In fact, the GSEs have exceeded their housing goals. What we need to do today is to focus on the regulator, and this must be done in a manner so as not to impede their affordable housing mission, a mission that has seen innovation flourish from desktop underwriting to 100% loans."

Rep. Lacy Clay (D-Missouri): "I find this to be inconsistent and a and a rush to judgment. I get the feeling that the markets are not worried about the safety and soundness of Fannie Mae as OFHEO says that it is, but of course the markets are not

political."

Rep. Barney Frank (D-Massachusetts): "But I have seen nothing in here that suggests that the safety and soundness are at issue, and I think it serves us badly to raise safety and soundness as kind of a general shibboleth when it does not seem to me to be an issue."

Rep. Don Manzullo (R-Illinois): "Mr. Raines, 1.1 million bonus and a \$526,000 salary. Jamie Gorelick, \$779,000 bonus on a salary of 567,000. This is, what you state on page eleven is nothing less than staggering."

Rep. Don Manzullo (R-Illinois): "The 1998 earnings per share number turned out to be \$3.23 and 9 mills, a result that Fannie Mae met the EPS maximum payout goal right down to the penny."

Rep. Don Manzullo (R-Illinois): "Fannie Mae understood the rules and simply chose not to follow them that if Fannie Mae had followed the practices, there wouldn't have been a bonus that year."

Rep. Christopher Shays (R-Connecticut): "And you have about 3% of your portfolio set aside. If a bank gets below 4%, they are in deep trouble. So I just want you to explain to me why I shouldn't be satisfied with 3%?"

Franklin Raines, Fannie Mae CEO: "Because banks don't, there aren't any banks who only have multifamily and single-family loans."

Franklin Raines, Fannie Mae CEO: "These assets are so riskless that their capital for holding them should be under 2%."

### **January 2005-July 2006**

Sen. Chuck Hagel (R-Nebraska), co-sponsored by Sens. Sununu and Dole and later Sen. McCain, re-introduced legislation to address GSE regulation.

"The bill prohibited the GSEs from holding portfolios, and gave their regulator prudential authority (such as setting capital requirements) roughly equivalent to a bank regulator. In light of the current financial crisis, this bill was probably the most important piece of financial regulation before Congress in 2005 and 2006," reports the Wall Street Journal.

Greenspan testified that the size of GSE portfolios "poses a risk to the global financial system. It would be difficult, if not impossible, to bail out the lenders [GSEs] . . . should one get into financial trouble." He added, "If we fail to strengthen GSE regulation, we increase the possibility of insolvency and crisis . . . We put at risk our ability to preserve safe and sound financial markets in the United States, a key ingredient of support for homeownership."

Greenspan warned that if the GSEs "continue to grow, continue to have the low capital that they have, continue to engage in the dynamic hedging of their portfolios, which they need to do for interest rate risk aversion, they potentially create ever-growing potential systemic risk down the road . . . We are placing the total financial system of the future at a substantial risk."

Bloomberg writes, "If that bill had become law, then the world today would be different. . . . But the bill didn't become law, for a simple reason: Democrats opposed it on a party-line vote in the committee, signaling that this would be a partisan issue. Republicans, tied in knots by the tight Democratic opposition, couldn't even get the Senate to vote on the matter. That such a reckless political stand could have been taken by the Democrats was obscene even then."

### **April 2005**

Treasury Secretary John Snow again calls for GSE reform, "Events that have transpired since I testified before this Committee in 2003 reinforce concerns over the systemic risks posed by the GSEs and further highlight the need for real GSE reform to ensure that our housing finance system remains a strong and vibrant source of funding for expanding homeownership opportunities in America. . . . Half-measures will only exacerbate the risks to our financial system," from a White House release.

### **May 2005**

At AEI Online, Wallison warned that "allowing Fannie and Freddie to continue on their present course is simply to create

risks for the taxpayers, and to the economy generally, in order to improve the profits of their shareholders and the compensation of their managements. It is a classic case of socializing the risk while privatizing the profit."

### **January 2006**

Chairman Greenspan, in a letter to Sens. Sununu, Hagel and Dole, warned that the GSE practice of buying their own MBS "creates substantial systemic risk while yielding negligible additional benefits for homeowners, renters, or mortgage originators." He stated, ". . . the GSEs and their government regulator need specific and unambiguous Congressional guidance about the intended purpose and functions of Fannie's and Freddie's investment portfolios."

### **March 2006**

Sens. Sununu and Hagel introduced an amendment to a Lobbying Reform Bill directing GAO to study GSE lobbying and requiring HUD to audit the GSEs annually.

### **May 2006**

After years of Democrats blocking the legislation, Sens. Hagel, Sununu, Dole and McCain write a letter to Majority Leader William Frist and Chairman Richard Shelby expressing demanding that GSE regulatory reform be "enacted this year" to avoid "the enormous risk that Fannie Mae and Freddie Mac pose to the Housing market, the overall financial system, and the economy as a whole."

### **May 2006**

Sen. McCain (R-Arizona) addressed the Senate, "Mr. President, this week Fannie Mae's regulator reported that the company's quarterly reports of profit growth over the past few years were 'illusions deliberately and systematically created' by the company's senior management. . . . Fannie Mae used its political power to lobby Congress in an effort to interfere with the regulator's examination of the company's accounting problems. . . . OFHEO's report solidifies my view that the GSEs need to be reformed without delay."

McCain stressed, "If Congress does not act, American taxpayers will continue to be exposed to the enormous risk that Fannie Mae and Freddie Mac pose to the housing market, the overall financial system, and the economy as a whole. I urge my colleagues to support swift action on this GSE reform legislation."

### **April 2007**

Sens. Sununu, Hagel, Dole, and Mel Martinez (R-Florida) re-introduced legislation to improve GSE oversight.

### **April 2007**

In "A Nightmare Grows Darker," the New York Times writes that the "democratization of credit" is "turning the American dream of homeownership into a nightmare for many borrowers." The "newfangled mortgage loans" called "affordability loans" "represent 60 percent of foreclosures."

### **September 2007**

President Bush: "These institutions provide liquidity in the mortgage market that benefits millions of homeowners, and it is vital they operate safely and operate soundly. So I've called on Congress to pass legislation that strengthens independent regulation of the GSEs . . . the United States Senate needs to pass this legislation soon."

### **2007-2008**

The housing bubble began to burst, bad mortgages began to default, and finally the Fannie Mae and Freddie Mac portfolios were revealed to be what they were, in collapse. And the testimony is evident as to why. As Wallison noted, "Fannie and Freddie were, I would say, the poster children for corporate welfare."

### **September 2008**

Rep. Arthur Davis, whose testimony is found above in October 2004, now admits Democrats were in error: "Like a lot of my Democratic colleagues I was too slow to appreciate the recklessness of Fannie and Freddie. I defended their efforts to encourage affordable homeownership when in retrospect I should have heeded the concerns raised by their regulator in 2004. Frankly, I wish my Democratic colleagues would admit when it comes to Fannie and Freddie, we were wrong."

### **Today 2008**

The narrative is of another socialist experiment failed, this time a massive federal effort, imperiling the whole US banking industry. Facing this economic disaster, will an informed American people put their trust Obama's socialist ideology to bring remedy? To do so is to trust in an acetylene torch to put out the fire.

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