



# Phony Fannie-Freddie Reform Empowers the Left

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Ever since the phrase appeared in Shakespeare's *Romeo and Juliet*, "A rose by any other name would smell as sweet," and its variations have become familiar expressions. A corollary is that garbage by any other name would stink just as badly, if not worse.

The latter phrase seems applicable to the "reform" of the government-sponsored housing enterprises Fannie Mae and Freddie Mac just introduced by Senate Banking Committee Chairman Tim Johnson, D-S.D., and Ranking Member Mike Crapo, R-Idaho. The media often describe this plan as "ending" Fannie and Freddie.

And yes, it does "end" them in the sense that there will no longer be entities named Fannie and Freddie. But most of their functions would simply be transferred to a new giant government entity called the Federal Mortgage Insurance Corporation.

Not only would the government's role in subsidizing and micromanaging housing not be reduced, in some ways it would substantially be increased.

The legislation would create, for the first time, an explicit taxpayer guarantee of the GSEs' \$5.6 trillion in debt. The "affordable housing trust fund," a slush fund for "housing advocacy" groups such as ACORN with political agendas until it was closed due to Fannie and Freddie's financial woes, would be reopened and parked in the new FMIC.

Worst of all, and sending the worst possible signal to potential private sector investors in the housing market, Fannie and Freddie common and preferred shareholders would be wiped out permanently under the bill's Section 604.

First, let's recap briefly the history of the GSEs and their role as the proximate cause of the financial crisis. Fannie was created as the government agency the Federal National Mortgage Association in 1938 and spun off as a government-sponsored enterprise (GSE) in 1968. Freddie was created as a sister GSE two years later.

But even though they had private shareholders, they always retained government privileges. The

president still appointed some of their board members, they were exempt from state and local taxes, and, importantly, they each had a line of credit with the Treasury.

Though these lines were “only” \$2 billion, Competitive Enterprise Institute Founder and then-President and now Chairman Fred Smith warned presciently at a congressional hearing back in 2000 that “as long as the pipeline is there, it is like it is very expandable. . . . It could be \$200 billion tomorrow.” (The transcript is here. Smith’s statement, in response to questioning by Rep. Carolyn Maloney, D-N.Y., appears on page 193.)

It turns out the only flaw in Smith’s prediction was in fact underestimating the amount taxpayers would spend bailing the entities out when the Bush administration put them under a conservatorship at the height of the financial crisis in 2008.

While the Obama administration estimates the cost at \$188 billion, a figure often used in the media, the Congressional Budget Office puts the figure at \$317 billion, according to a “fair value” accounting.

But the GSE’s real cost to taxpayers and the economy came from Fannie and Freddie’s role in partnering with banks in the creation of destructive new subprime mortgages as early as the 1990s.

As I documented by creating a Fannie-Freddie “Kevin Bacon Game” based on published reports, “the GSEs had co-starring or at least supporting roles providing invaluable assistance to bad actors in the private sector” including Countrywide Financial, Bear Stearns, and Lehman Brothers.”

As Peter Wallison, senior fellow at the American Enterprise Institute and a dissenting commissioner on the Financial Crisis Inquiry Commission created by Congress, put it last fall in the Wall Street Journal, in September 2008, “[H]alf of all mortgages in the U.S. — 28 million loans — were subprime or otherwise risky and low-quality,” and of these, “74 percent were on the books of government agencies, principally the GSEs.”

But the Johnson-Crapo “reform” mostly just shifts these books around. Like an earlier bill drafted by Sens. Bob Corker, R-Tenn., and Mark Warner, D-Va., the plan purports to replace Fannie and Freddie with the FMIC, a government-backed mortgage insurer with political appointees.

Much is made on how, as in Corker-Warner, private investors will take at least 10 percent of the first loss on mortgage-backed securities the FMIC insures.

But that still leaves 90 percent of the loss to be absorbed by the FMIC. As AEI’s Wallison writes, “When the government backs any system — whether through deposit insurance, flood insurance, pension benefits or anything else — the beneficiaries have only limited interest in the risks they are taking.”

And the biggest beneficiaries may be big-government housing “advocates” feeding at the trough

of the “Housing Trust Fund” the Johnson-Crapo plan creates within the FMIC that bears a remarkable similarity to that which used to exist within the GSEs. This “trust fund” was created in another Fannie-Freddie “reform” bill in 2008 by then-House Financial Services Committee Chairman Barney Frank at the urging of a “who’s who” of left-wing lobbying groups.

As I wrote in 2008, “some of the biggest “housing advocates” also have politics in their portfolios. These groups would include the ACORN and the National Council of La Raza, both of which provide housing counseling as well as lobby for liberal causes and politicians.”

Thanks to the late Andrew Breitbart and videographers James O’Keefe and Hannah Giles exposing the group’s underbelly, ACORN is now officially defunct, but like-minded groups have formed to carry on its radicalism.

Fortunately, the “trust fund” lay dormant during the decent financial management of the GSEs Ed DeMarco. But DeMarco’s replacement, former Rep. Mel Watt, D-N.C., who was confirmed in December after Senate Majority Leader Harry Reid went “nuclear” and abolished the filibuster for nominees, has pledged to restart it.

No wonder housing “advocates” applauded so loudly Watt’s confirmation. And now, the fact that a bipartisan “reform” plan gives the “trust fund” its blessing will only strengthen Watt’s hand in bestowing these goodies.

And amazingly, a “reform” plan so generous at giving taxpayers’ money to advocacy groups explicitly codifies the Obama administration’s policy of completely wiping out Fannie and Freddie’s private shareholders, including community banks, pension funds and middle-class investors.

In August 2012, Treasury Secretary Tim Geithner secretly issued the “Third Amendment” to the GSEs conservatorship in which any profit the GSEs make would go to the Treasury Department, even after the GSEs paid back what they owe taxpayers. Section 604 of Johnson-Crapo states that this policy “shall not be amended, restated, or otherwise changed.”

As noted above, there are different estimates of what taxpayers are owed, and I would argue that the CBO’s \$317 billion figure is most accurate. But the government can’t claim GSE profits in perpetuity.

As Ike Brannon and Mark Calabria write in a new paper for the Cato Institute, “If we hope to rebuild our mortgage finance system on a foundation of private capital, then property and contractual rights must be respected.”

CEI has long believed the best option for the government to pursue — the only option to be forever rid of the GSEs’ risk to taxpayers and systemic risk to the economy — is an orderly liquidation of their assets with no government-backed entity to replace them.

Burdens on the housing market, such as that other sham “reform” bill know as Dodd-Frank, must also be repealed to encourage unsubsidized private sector entrepreneurs to fill in the void.

As Fred Smith urged of Congress in 2000 — to mostly deaf ears — policymakers should “develop a divestiture or breakup plan for Fannie and Freddie.” And in such a plan, as in traditional bankruptcies, the rights of both taxpayers and private investors should be sacrosanct.