Moneynews

Experts Look Again at Fannie and Freddie

By: Robert Feinberg – May 28, 2013

The American Enterprise Institute (AEI) held an event on May 15 called "What should be done with Fannie and Freddie?" Six experts, all with close connections to the housing industry, discussed what policymakers should do next, given that the two government-sponsored enterprises (GSEs) have been in conservatorship for 4 ½ years and Congress has expressed some interest in taking up the issue of so-called housing finance reform "real soon now."

The introduction to the conference asks, "How do we get off the tiger?" From my point of view, it's a little late to ask that question, because the circumstance is more reminiscent of one where the tiger has attacked and devoured its keeper at feeding time.

The purpose of this article is to alert readers once again that the avatars of the Housing Industrial Complex are getting frisky again. In addition to a spate of hearings on Capitol Hill, with more to come, groups like the Mortgage Bankers Association (MBA) and the Bipartisan Policy Council (BPC) have been circulating papers purporting to show how so-called "reform' should proceed, and alert investors in the stock of Fannie Mae (FNMA) have seen it soar from pennies to dollars over the past year, due solely to the backing of the federal government and the company's "too big to fail" status, which seems to stay the hands of so-called regulators who probably should have wiped out those shareholders years ago.

One hesitates to call these "highlights," but this article will present representative comments of the panelists to document their position, which predominantly holds that even after the 2008 episode of the ongoing financial crisis should have taught the public otherwise, the country has just not done enough to support the housing industry.

It's another version of the too big to fail argument and one with a lot of horsepower behind it, because one thing this industry is very good at is lobbying. Most of the presenters accompanied their talks, which tended to be repetitious of their own and their colleagues' arguments, with slides, and readers can look at these by following the link below.

In setting the stage, AEI's Alex Pollock, former president of the Federal Home Loan Bank of Chicago, made some comments with which one almost has to quibble. For example, he said that Fannie Mae and Freddie Mac "went from being the stars and darlings of both Washington and Wall Street to being major perpetrators of the housing bubble, making boodles of bad loans, going humiliatingly broke and foisting enormous losses on the public." Perhaps Pollock overstates the case.

There are what might be called "green shoots" that could be signs that these GSEs could become darlings once again as the Fed and the Ominstration proceed to engineer what

is beginning to look like another housing bubble. Pollock concluded his introduction by asserting, "Virtually everybody agrees that we should not return to the flawed and indeed disastrous old GSE model — nobody that I am aware of is proposing that." I am prompted to respond that whether they own up to it or not, most of the panelists are well aware that now that the GSEs are reporting profits, it is getting safer every day to let the GSEs come back, much like a class of cicadas is about to do, once the temperature is right.

James Parrott, a former administration official, presented himself as a "contrarian" and suggested that the discussion should move from what he called "ideological" discourse to one that is "more practical." The translation of this is that while principle would call for the breakup of these defunct companies, it isn't "practical" to do this, because they are too big to fail, and the industry wants to get back to producing a new generation of problematic mortgage products.

He chided other participants in the debate for arguing too much about where reform will end up rather than taking the first steps to reduce the government's footprint, which he asserts all agree should be done.

However, his key statement is that whatever the "new GSE structure" will be, "you need that broad government presence in order to maintain or ensure broad access to credit, and in particular to long-term, fixed-rate financing." So what he is proposing is merely a strategic retreat.

The true contrarian on the panel, Mark Calabria, director of financial regulation studies at the Cato Institute who served on the staff of the Senate Banking Committee when the conservatorship legislation, the Housing and Economic Recovery Act (HERA), was written, stated explicitly that the best course would be to follow that law and take the GSEs into receivership, because they have no capital and are insolvent.

Calabria contended that to take this step would trigger a five-year time limit for Congress either to legislate or to accept this result. I am totally cynical about the prospect that Congress would respect any such deadline. Rather, now that the GSEs are, as Parrott said, "making money hand over fist," the industry advocates would let them go back to business as usual, this time backed by an explicit, rather than an implicit, federal guarantee.

Calabria then swerved into the mainstream banking industry lane when he contended that banks have enough cash to take over the financing of a good chunk of the mortgage market. I would ask the next question, though, about the overall state of bank balance sheets if their assets were marked to market, which the industry and its compliant so-called regulators refuse to do.

The next two presenters, David Stevens, former commissioner of the Department of Housing and Urban Development in the Oministration who has since passed through the revolving door to head the leading industry lobby, the MBA, and industry lawyer Rob Couch, former president of Ginnie Mae in the George W. Bush administration who is a "commissioner" on the Housing Commission of the BPC, offered the high-test industry position after the appetizer had been served by Parrot.

Stevens characterized his views euphemistically, again, as "more pragmatic." (Notice, I

warn, that to empower an industry to produce mortgage products that can bring down the nation's economy is "pragmatic," whereas trying to contain such risk is overly idealistic, because it jeopardizes the ability of the industry to push product.) Stevens allowed that it would be best to bring private capital into play in order to absorb some of the risk, but the flow of liquidity to the industry must, above all, be "continuous." He informed/assured (one might say "warned") the audience that the MBA is going to be aggressively promoting its views in coming weeks, as though this is normally a pussy-cat lobby.

In a candid moment, Couch observed, "There's a fairly significant portion of people who've looked at this and maybe want it to stay the way it is." I suspect that Couch is one of those people.

Peter Wallison of the AEI concluded by calling for the Federal Housing Finance Agency, the so-called regulator of the GSEs, to issue a ukase providing that the GSEs may invest only in prime mortgages and that the Consumer Financial Products Bureau, which has jurisdiction over mortgage regulations under the Dodd-Frank Act, should rule that such mortgages would comply with the "risk retention" provisions of Dodd-Frank, and then private capital would take a considerable share of the market and reduce the overall risk to the financial system.

I have warned that "Tomorrow's toxic financial products are being created today." Thus, as suggested above, the discussion at AEI and in other forums seems headed toward the reconstitution of Fannie Mae and Freddie Mac, or at least Fannie Mae, along with Wells Fargo and maybe a handful of other players, as a cartel designed, once again, to enable mortgage bankers to receive fees for originating mortgage products for sale in the secondary market with virtually no capital behind them and with the explicit backing of the federal government. This will be called reform.