THE HILL

On mortgage crisis, Shelby is worthy of praise

By Mark Calabria – January 2nd, 2012

No one saw the financial crisis coming. The real estate industry said — and almost everyone believed — that the housing market would never go down. One senator, however, foresaw the problem and spent the last decade trying to prevent it. From 2003 until the end of this past legislative session, Richard Shelby of Alabama served as the top Republican on the Banking, Housing and Urban Affairs Committee. He made numerous attempts to fix almost every major flaw that eventually lead to the crisis.

Full disclosure: Shelby was once my boss. I now direct financial regulation analysis at the Cato Institute, in which capacity I have pulled no punches toward Republicans for their substantial culpability in causing the mortgage crisis. Shelby, however, is worthy of praise.

Shelby is perhaps best known for his efforts to rein in mortgage giants Fannie Mae and Freddie Mac, which have so far cost taxpayers over $180 billion. He was not the first to challenge their political might or warn of their impending failures; credit also goes to former Reps. Richard Baker and Jim Leach. Shelby did, however, bring a Fannie/Freddie reform bill to a committee vote in both 2004 and 2005. Passing along narrow partisan majorities, both bills failed to secure floor time.

Shelby, along with former Sen. Paul Sarbanes, did more than any legislator to delay the implementation of the Basel II bank standards. these rules would have greatly lowered the level of capital at America's largest banks. Regulators, particularly at the Fed, moved towards eliminating simple leverage ratios in favor of bank-calculated risk ratios. Thanks to Shelby and Sarbanes, our largest commercial banks were still under Basel I standards when the crisis hit. One only need look at Europe's banks, already having adopted Basel II, to see how much worse it could have been.

Unfortunately, the Securities and Exchange Commission did move forward with subjecting U.S. investment banks to Basel II under its consolidated supervised entity (CSE) program. Shelby repeated pressed the SEC to drop CSE. only weeks before the Bear Stearns failure, legislation to codify CSE was presented before the Senate Banking Committee. Shelby led the opposition.

As we know too well, sometimes the Senate works slowly and with much compromise. Under such conditions, Shelby was finally able to pass legislation bringing much-needed competition to the credit rating agencies in 2006. Yes — too little, too late. After delayed SEC implementation, we have witnessed a considerable increase in the number of rating agencies due to the 2006 Act.

Even in opposition, Shelby has had a tremendous impact. While he eventually voted against the Dodd-Frank Act, his efforts to work with Sen. Dodd resulted in a much-improved process for resolving failing banks and protecting the taxpayer. While those changes are insufficient to end “too-big-to-fail,” Dodd-Frank would have been even worse had it not been for Shelby’s efforts. He was ahead of his time as one of the few Republicans to support the Brown-Kaufman amendment to break up the banks.

Unfortunately, the bailouts are not all behind us. The Federal Housing Administration (FHA) teeters on the brink of collapse, headed towards a taxpayer-financed bankruptcy. Shelby warned of such, even in the face of pressure from his own party when President Bush proposed allowing FHA to insure zero-downpayment loans. Despite such a proposal passing both Democrat- and Republican-controlled Houses, it repeatedly died in the Senate. Had it not, FHA’s red ink would have been much worse. Shelby was also instrumental, along with Sen.Dodd, in eliminating seller down payments under FHA, a move which has saved the taxpayer an estimated $14 billion.

FHA was not the last time Shelby bucked the Bush White House. He led the Senate opposition to the TARP, correctly predicting that it would fail to protect us from a deepening recession.

Shelby’s early years as a House member during the 1980s savings and loan crisis left a lasting impression. Congress had failed miserably in both avoiding and addressing the causes of that crisis. Shelby’s later efforts to rein in both Fannie and Freddie and the banks derive from a commitment to not see Congress repeat its earlier mistakes.

I will also look back on my six years as a Banking Committee staffer for Shelby with tremendous pride. Although we lost more than we won, we were never deterred by politics, or the difficulty of implementing good policy in the face of a broadly enjoyed bubble. All too often Washington focuses on what was passed rather than what was tried. The next time a visionary policymaker like Shelby issues a warning, let’s all hope we can muster enough votes to actually do something about it.