RSC Republican Study Committee

Financial Services Working Group

Congressman Scott Garrett (R-NJ), Chairman

Congressman Tom Price (R-GA), RSC Chairman

May 5, 2010

"These two entities Fannie Mae and Freddie Mac are not facing any kind of financial crisis"

September 11, 2003

How many red flags does it take to recognize a crisis?

The need for reforming Fannie Mae and Freddie Mac has apparently just recently dawned on the White House.

> "[T]he Treasury Department and the Department of Housing and Urban Development initiated a process a few weeks ago to look not just at reforming the GSEs, but our entire system of housing finance."
>
> - *White House Deputy Communications Director Jen Psaki, April 23, 2010*

So…after putting Fannie Mae and Freddie Mac into conservatorship in 2008 and providing them unlimited access to taxpayer funds in 2009, the White House has just recently begun to look into reforming Fannie and Freddie?

2000

- Freddie Mac offers 100% loan-to-value mortgages.

2001

- Fannie Mae offers 100% loan-to-value mortgages. Fannie's new underwriting guidelines allow the borrower to obtain funds from third parties, including unsecured loans from relatives, employers, etc in order to pay their mortgage.

2003

- Freddie Mac admitted it understated $5 billion of earnings and was fined $125 million.

2004

- Accounting scandal emerged at Fannie Mae, resulting $6.3 billion restated earnings.

2005 – 2007

- Fannie and Freddie buy approximately $1 trillion in subprime and Alt-A loans, 40% of the mortgages bought during this period, making the decline in underwriting standards obvious.

2007

- Fannie Mae and Freddie Mac are required make 55% of mortgages purchases low- and moderate-income loans. Within this goal, 25% of loans must be to low-income and very-low-income borrowers.

2008

- Fannie Mae and Freddie Mac are placed in conservatorship.

2009

- Homeowners can use Fannie Mae and Freddie Mac to refinance their homes, even if their loan-to-value ratio is up to 125 percent. That means they can have up to 25 percent negative equity and still be refinanced.
- Treasury lifts the cap on the amount that can be given to Fannie Mae and Freddie Mac from $400 billion to UNLIMITED.

It's obvious from this brief timeline that the use of Fannie Mae and Freddie Mac to interfere in the housing credit system caused private-label issuers to compete against Fannie Mae and Freddie Mac in order to maintain their market share against companies operating with an implicit government endorsement of loans with lower underwriting standards made to less credit-worthy borrowers. As a result, the gradual decline in lending standards dominated mortgage lending here in the United States.

Republicans want to end bailouts for Wall Street and foreign banks, and they have a plan to protect American taxpayers, H.R. 3310. The Republican plan would phase out taxpayer subsidies of Fannie Mae and Freddie Mac over a number of years and end the current model of privatized profits and socialized losses. It sunsets the current GSE conservatorship by a date certain, placing Fannie and Freddie in receivership if they are not financially viable at that time.

For more information contact Chris Russell at 5-4465 or Brad Watson at 6-9719

THE WALL STREET JOURNAL

What About Fan and Fred Reform?

Congress remains missing in action on two key causes of the financial crisis.

May, 4, 2010

By ROBERT G. WILMERS

Congress may be making progress crafting new regulations for the financial-services industry, but it has yet to begin reforming two institutions that played a key role in the 2008 credit crisis—Fannie Mae and Freddie Mac.

We cannot reform these government-sponsored enterprises unless we fully confront the extent to which their outrageous behavior and reckless business practices have affected the entire commercial banking sector and the U.S. economy as a whole.

At the end of 2009, their total debt outstanding—either held directly on their balance sheets or as guarantees on mortgage securities they'd sold to investors—was $8.1 trillion. That compares to $7.8 trillion in total marketable debt outstanding for the entire U.S. government. The debt has the implicit guarantee of the federal government but is not reflected on the national balance sheet.

The public has focused more on taxpayer bailouts of banks, auto makers and insurance companies. But the scale of the rescue required in September 2008 when Fannie and Freddie were forced into conservatorship—their version of bankruptcy—was staggering. To date, the federal government has been forced to pump $126 billion into Fannie and Freddie. That's far more than AIG, which absorbed $70 billion of government largess, and General Motors and Chrysler, which shared $77 billion. Banks received $205 billion, of which $136 billion has been repaid.

Fannie and Freddie continue to operate deeply in the red, with no end in sight. The Congressional Budget Office estimated that if their operating costs and subsidies were included in our accounting of the overall federal deficit—as properly they should be—the 2009 deficit would be greater by $291 billion.

Worst of all are the tracts of foreclosed homes left behind by households lured into inappropriate mortgages by the lax credit standards made possible by Fannie Mae and Freddie Mac and their promise to purchase and securitize millions of subprime mortgages.

All this happened in the name of the "American Dream" of home ownership. But there's no evidence Fannie and Freddie helped much, if at all, to make this dream come true. Despite all their initiatives since the early 1970s, shortly after they were incorporated as private corporations protected by government charters, the percentage of American households owning homes has increased by merely four percentage points to 67%.

In contrast, between 1991 and 2008, home ownership in Italy and the Netherlands increased by 12 percentage points. It increased by nine points in Portugal and Greece. At least 14 other developed countries have home ownership rates higher than in the U.S. They include Hungary, Iceland, Ireland, Poland and Spain.

Canada doesn't have the equivalent of Fannie and Freddie. Nor does it permit the deduction of mortgage interest from an individual's taxes. Nevertheless, its home ownership rate is 68%. Canadian banks have weathered the financial crisis particularly well and required no government bailouts.

This mediocre U.S. home ownership record developed despite the fact that Fannie and Freddie were allowed to operate as a tax-advantaged duopoly, supposedly to allow them to lower the cost of mortgage finance. But a great deal of their taxpayer subsidy did not actually help make housing less expensive for home buyers.

According to a 2004 Congressional Budget Office study, the two GSEs enjoyed $23 billion in subsidies in 2003—primarily in the form of lower borrowing costs and exemption from state and local taxation. But they passed on only $13 billion to home buyers. Nevertheless, one former Fannie Mae CEO, Franklin Raines, received $91 million in compensation from 1998 through 2003. In 2006, the top five Fannie Mae executives shared $34 million in compensation, while their counterparts at Freddie Mac shared $35 million. In 2009, even after the financial crash and as these two GSEs fell deeper into the red, the top five executives at Fannie Mae received $19 million in compensation and the CEO earned $6 million.

This is not private enterprise—it's crony capitalism, in which public subsidies are turned into private riches. From 2001 through 2006, Fannie and Freddie spent $123 million to lobby Congress—the second-highest lobbying total (after the U.S. Chamber of Commerce) in the country. That lobbying was complemented by sizable direct political contributions to members of Congress.

Changing this terrible situation will not be easy. The mortgage market has come to be structured around Fannie and Freddie and powerful interests are allied with the status quo. I recall a personal conversation with a member of Congress who, despite saying he understood my concerns about the two GSEs, admitted he would never push for significant change because "they've done so much for me, my colleagues and my staff."

Nonetheless, Congress must get to work on the reform of Fannie Mae and Freddie Mac. A healthy housing market, a healthy financial system and even the bond rating of the federal government depend on it.

Mr. Wilmers is chairman and CEO of M&T Bank Corporation, an independent commercial bank holding company. This op-ed was adapted from his speech at the company's annual shareholders meeting last month.

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