

Ethics Matters

Congressional Friends Stopped Reforms of Fannie, Freddie

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***Editor's note:** This article is the second in a four-part series on Fannie Mae and Freddie Mac's financial crisis.*

For years, Fannie Mae and Freddie Mac helped fuel homeownership for low-income borrowers by buying and guaranteeing billions in risky subprime and Alt-A loans. By 2008, both companies were close to filing for bankruptcy. Congress gave them \$200 billion in taxpayers' money to keep them afloat and many people wondered why no one stopped Fannie and Freddie's reckless business practices.

The OFHEO

As early as 1992, some legislators tried to get a strong regulator for Fannie and Freddie. Representative Jim Leach, R-Iowa, contended the companies were changing from being agencies of the public to money machines for the stockholding few. In response, Representative Barney Frank, D-Massachusetts argued the companies served the public purpose of lowering the price of mortgages. Fannie and Freddie's congressional allies contended reforms were unnecessary and would restrict homeownership for low-income families.

Instead of a strong regulator, Congress created the weak and poorly funded Office of Federal Housing Enterprise Oversight (OFHEO) The OFHEO relied on Fannie and Freddie for information about their business practices, which left the companies self-regulated.

Stopping reform attempts

In 2000, Undersecretary of the Treasury, Gary Gensler, testified before Congress in favor of a bill to make Fannie and Freddie more accountable. He warned Congress that risky financial practices prompted Fannie and Freddie's rapid growth curves. A Fannie Mae spokesperson denounced Gensler's testimony and said it stopped 206,000 people from buying new homes because his comments made them fear the companies were not financially secure. Gensler dropped his support for the reform bill.

In 2003, then Federal Reserve Chairperson Alan Greenspan warned Congress to curb Fannie's excessive buying, investing in, and guaranteeing of subprime and Alt-A loans to prevent serious future damage to the U.S. economy.

In 2003 and 2004, bad news came out publicly about Fannie and Freddie's financial problems. Freddie announced it overstated earnings for the previous three years by \$ 6.9 billion. Fannie's executives admitted to inflating Fannie's profits by \$6.3 billion.

Once again, however, Fannie and Freddie's Congressional allies defeated any proposed reforms or proposals for a strong regulator for the companies. Legislator Frank said concerns about the companies' financial soundness were exaggerated. Maxine Waters, D-California praised the leadership of Fannie CEO, Franklin Raines. She declared there was no reason to fix something that was not broken.

Robert Bennett, R-Utah, added an amendment to a proposed reform bill that made the bill unacceptable to the White House. Bennett's amendment gave Congress the power to block any attempts to put the companies into receivership.

Bennett proposed the amendment knowing it would kill the bill. When he proposed the amendment, Fannie was his second largest financial contributor. Also, Bennett's son directed Fannie's regional office in Utah.

Fannie and Freddie also got real estate agents, home builders and mortgage lenders to send letters to members of Congress opposing reform. Before Senate Committee hearings on reforming Fannie and Freddie, advertisements ran featuring couples expressing fear about mortgages going up if reform measures passed.

Senator Chuck Hagel (R-Neb.) in 2005 tried to force Fannie and Freddie to sell part of their portfolios and shrink in size.

Fannie's CEO Daniel Mudd then asked the Congressional Black Caucus for help in stopping Hagel's reform proposal. Mudd told the Caucus, "I am humbled to come here today to reaffirm the friendship and partnership between Fannie Mae and the Congressional Black Caucus....If there are areas we are missing...we'd like to hear it from our friends and, if I be so bold to say, our family first".

Fannie and Freddie also paid \$2 million to the Republican consulting firm DCI to campaign against the bill. Hagel's bill failed. It was the last serious attempt to reform Fannie and Freddie before the full extent of their financial problems became publicly known.

As recently as 2007, with both companies in obvious financial trouble, Representative Frank still supported the companies' risky financial practices. He stated, "I'm not worried about Fannie and Freddie's health. I'm worried they won't do enough to help out the economy."