

## Who's Really to Blame for the Banking Meltdown?

By Staff Writer, [National Realty News](#)

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WASHINGTON, DC - Anyone who has picked up a newspaper or turned on the TV over the last few months was led to believe that the current housing crisis was caused by greedy wall street types and unscrupulous mortgage lenders, and reckless real estate agents. As industry insiders we all know that although there were some bad apples, by and large most of our industry was just doing their jobs, getting people into homes using the programs that were readily available.

So then what went wrong and who is really to blame for the meltdown of the country's banking system?

The process of securitizing mortgages in the United States is the most unique in the world. Fannie Mae and Freddie Mac were established by Congress with a mission to provide liquidity and stability to the U.S. housing and mortgage markets. Fannie Mae was established as a federal agency in 1938, and in 1968 was chartered by Congress as a private shareholder-owned company. In 1970 Freddie Mac was established to provide competition for Fannie Mae. Both of these organizations are commonly referred to as a (GSE) Government Sponsored Enterprise.

It was precisely this GSE status, and the belief by investors that securities sold by the GSEs were backed by the federal government, that both gave the GSEs the ability to raise nearly unlimited capital to be eventually used to loan as mortgages, but it also set a series of events into play that was at the heart of the meltdown.

In 1992, the democratically controlled Congress enacted The Federal Housing Enterprises Financial Safety and Soundness Act ("FHEFSSA") which was supposed to modernize the regulatory oversight of Fannie Mae and Freddie Mac in response to the savings and loan crisis. The act created the Office of Federal Housing Enterprise Oversight ("OFHEO") as a new regulatory office within HUD with the responsibility to "ensure that Fannie Mae and Freddie Mac are adequately capitalized and operating safely." However, the act also established HUD-imposed housing goals for financing of affordable housing.

Although the GSEs corporate structures went through several iterations of government then public ownership since their inception in 1938, OFHEO's first initial report to congress stated that even though "the savings and loan crisis was the catalyst for the [FHEFSSA] act," the GSEs were financially sound.

It's important to note that prior to FHEFSSA the GSEs needed to adhere to strict underwriting guidelines that essentially prohibited them from unsound lending. However, now they were mandated by FHEFSSA to make loans that were unsound under the guise of "affordable housing."

Since the formation of HEFO both Democrats and Republicans constantly argued over the effectiveness of the agency. In fact according to the New York Times, "the Clinton administration did not take the agency very seriously and left the top job unfilled for two years after Aida Alvarez, the agency's first director, left to head the Small Business Administration."

In 1999, President Clinton finally appointed Armando Falcon Jr. a little-known Washington lawyer and former Congressional aide to head OFHEO. According to the New York Times, "He and his agency were often the target of political attacks by Fannie Mae and Freddie Mac and were ridiculed by lawmakers who viewed the office as ill-equipped to oversee such large companies."

That same year Franklin Raines took over as CEO of Fannie Mae. In 1991 Raines became Fannie Mae's Vice Chairman, a post he left in 1996 in order to join the Clinton Administration as the Director of the U.S. Office of Management and Budget, where he served until 1998.

During the Clinton administration, Fannie's and Freddie's combined portfolios grew five fold - from about \$200 billion to over \$1 trillion.

In accordance with the mission of Fannie Mae and in compliance with the affordable housing provisions in FHEFSSA, Raines, while Chairman and CEO, began a pilot program in 1999 to issue bank loans to individuals with low to moderate income, and to ease credit requirements on loans that Fannie Mae purchased from banks. The move was intended in part to increase the number of minority and low income home owners. Some observers have noted that the expansion of easy credit to home buyers with a lesser ability to pay them back was one of the major contributing factors to the subprime mortgage crisis.

Although under Raines, Fannie Mae invested in some securities backed by subprime loans, it didn't start buying subprime and Alt-A loans directly (and bundling them into securities) until late 2004 after the accounting scandal. Purchasing of subprime and alt-A mortgages expanded exponentially under the guidance of Raines's successor Daniel H. Mudd.

Raines was the subject of controversy and investigation during his reign at Fannie Mae. He took an "early retirement" in 2004 as the SEC was investigating "irregularities" and OFHEO, led by Falcon who accused him of accounting errors that shifted losses so that executives could reach their lucrative bonuses.

OFHEO had enough evidence to take Raines to court in 2006 in an attempt to recover the \$90 million Raines pocketed by "adjusting" the company's earnings by over three billion dollars. In 2008, Raines agreed to a settlement that allowed him to walk away after paying fines of \$3 million retaining \$87 million.

Additionally the OFHEO investigation found that James A. Johnson who served as Fannie Mae's chairman and chief executive officer from 1991 to 1998 had improperly deferred \$200 million in expenses. This enabled top executives, including Johnson and his successor, Franklin Raines, to receive substantial bonuses in 1998. A 2006 OFHEO report found that Fannie Mae had substantially under-reported Johnson's compensation. Originally reported as \$6-7 million, Johnson actually received approximately \$21 million.

Mudd, the son of TV anchor Roger Mudd took over as CEO of Fannie Mae in 2004. According to the Washington Post, "Raines recruited Mudd from General Electric Co., where he had risen quickly from a line management job to chief executive of GE Capital in Japan." Prior to his appointment as CEO, Mudd was Fannie's chief operating officer, he oversaw systems technology, back-office operations and customer relations. He was dismissed as CEO of Fannie Mae when Federal Housing Finance Agency stepped in as conservator on September 7, 2008. The government has advised him that his severance package will not be paid.

In 2005 the Democrats came under fire as they fought Republican's efforts to implement a regulatory overhaul in regard to Fannie Mae and Freddie Mac, sparked in part by the Raines accounting scandal, with a plan called the Federal Housing Enterprise Regulatory Reform Act of 2005. The New York Times reported the following quotes in a published story.

"The Bush administration today recommended the most significant regulatory overhaul in the housing finance industry since the savings and loan crisis a decade ago. Under the plan, disclosed at a Congressional hearing today, a new agency would be created within the Treasury Department to assume supervision of Fannie Mae and Freddie Mac, the government-sponsored companies that are the two largest players in the mortgage lending industry. The new agency would have the authority, which now rests with Congress, to set one of the two capital-reserve requirements for the companies. It would exercise authority over any new lines of business. And it would determine whether the two are adequately managing the risks of their ballooning portfolios.

“Democrats pushed back. Among the groups denouncing the proposal today were the National Association of Home Builders and Congressional Democrats who fear that tighter regulation of the companies could sharply reduce their commitment to financing low-income and affordable housing.”

“These two entities, Fannie Mae and Freddie Mac, are not facing any kind of financial crisis”, said Barney Frank of Massachusetts, the ranking Democrat on the Financial Services Committee. “The more people exaggerate these problems, the more pressure there is on these companies, the less we will see in terms of affordable housing.” He obviously did not know what he was talking about but used his political clout to move forward in his political and financial career.

Representative Melvin L. Watt, Democrat of North Carolina, agreed. “I don’t see much other than a shell game going on here, moving something from one agency to another and in the process weakening the bargaining power of poorer families and their ability to get affordable housing,” Mr. Watt said.

Senator and presidential candidate John McCain strongly supported the Federal Housing Enterprise Regulatory Reform Act of 2005.

In McCain’s record text he stated, “Fannie Mae’s regulator reported that the company’s quarterly reports of profit growth over the past few years were “illusions deliberately and systematically created” by the company’s senior management, which resulted in a \$10.6 billion accounting scandal.

“For years I have been concerned about the regulatory structure that governs Fannie Mae and Freddie Mac and the sheer magnitude of these companies and the role they play in the housing market. OFHEO’s report solidifies my view that the GSEs need to be reformed without delay.

“I join as a cosponsor of the Federal Housing Enterprise Regulatory Reform Act of 2005 to underscore my support for quick passage of GSE regulatory reform legislation. If Congress does not act, American taxpayers will continue to be exposed to the enormous risk that Fannie Mae and Freddie Mac pose to the housing market, the overall financial system, and the economy as a whole.”

However, the bill never made it to the floor for a vote. On Jul 28, 2005, the Committee on Banking, Housing, and Urban Affairs “Ordered [the bill] to be reported with an amendment in the nature of a substitute favorably.” This action is commonplace and generally indicates the bill was unable to gather enough votes for cloture, which requires 60 votes. The Republicans at that time controlled 55 seats.

Democrats continue to be implicated in the financial crisis as it was revealed in 2008 that Senator Chris Dodd (D-CT), along with Franklin Raines and several other friends of Angelo’s, (Angelo Mozilo was Countrywide’s CEO at the time) took illegal loans from Countrywide. Dodd’s press secretary said the loans were not given with preferential treatment due to politics but because he was a good customer. Senator Barack Obama also received a Friends of Angelo Cut Rate Loan.

Countrywide was a huge financial supporter of Dodd’s while he proposed a bailout in June that would have rescued troubled companies like Countrywide.

Coincidentally, Bank of America – the company that bought Countrywide – is also a big contributor to Dodd’s campaign. The Heritage Foundation, a conservative think tank in Washington alleged that Bank of America employees were the actual drafters of the bailout bill Dodd proposed, the FHA Housing Stabilization and Homeownership Retention Act of 2008.

Democrats say the allegations are ridiculous and slanderous. They point out that Countrywide is also a financial supporter of McCain’s and has donated nearly triple Dodd’s contribution to McCain’s campaign. McCain would not confirm this allegation.

Countrywide was not the only company that paid off politicians through campaign donations. According to the GSEs they directly contributed to both Democrats and Republicans. Dodd received the most money of any politician a whopping \$133,900 and Dodd is chairman of the Senate committee that has direct oversight of the GSEs.

In fact the GSEs strategically donated to lawmakers that are currently sitting on committees that primarily regulate the industry. Fifteen of the top 25 campaign recipients sit on the House Financial Services Committee, the Senate Banking, Housing & Urban Affairs Committee, or the Senate Finance Committee.

The top three recipients all received over \$100,000. They are Christopher Dodd (D-CT) \$133,900, John Kerry (D-MA) \$111,000, and Barack Obama \$105,849 (D-IL).

### **So where are they now?**

**Franklin Raines (D)** – After adding \$190 million to his bank account, on July 16, 2008, *The Washington Post* reported that Franklin Raines had "taken calls from Barack Obama's presidential campaign seeking his advice on mortgage and housing policy matters." Neither Raines nor the Obama campaign disputed this reporting until the McCain campaign picked the story up.

**James A. Johnson (D)** – Originally reported as \$6-7 million, Johnson actually added approximately \$21 million to his bank account. On May 22, 2007, Democratic Party officials confidentially divulged that Obama had asked Johnson "to lead the process" for selecting Obama's running mate. On June 4, 2008, Obama announced the formation of a three-person committee to vet vice presidential candidates, including Johnson. Johnson announced he would step down from the vice-presidential vetting position on June 11, 2008, in order to avoid being a distraction to Obama's campaign. In addition to personal donations, Johnson is a bundler for the Obama campaign, raising between \$200,000 and \$500,000. He has also participated in Obama campaign efforts to recruit former Clinton supporters.

**Daniel H. Mudd (?)** – After being dismissed from Fannie Mae in September of 2008, little is known of his whereabouts. Although the political party of Mudd is unknown, according to records he did donate money to Bush in 2004 when he was CEO of Fannie Mae.

**Christopher Dodd (D)** – Still serving his term as a US Senator from the state of Connecticut and continues his reign as chairman of the Senate Banking, Housing & Urban Affairs Committee, which has direct oversight of the GSEs. He accepted \$133,900 from the GSEs. He is up for re-election in 2011.

**Barney Frank (D)** – Still serving as a member of the House of Representatives from the 4th Congressional District of Massachusetts and continues to serve as chairman of the House Financial Services Committee, which has direct oversight of the GSEs. As late a July of 2008, Frank still claimed the GSEs were financially stable. He is up for re-election this year.

**This is a reprint from 2009 and tells the true story about the who, the why and the what that pushed the United States into the worst Recession since the Depression.**