Whitewashing Fannie Mae

Congress begins its self-absolution campaign.

Henry Waxman's House Committee on Oversight and Government Reform met Tuesday to examine "The Role of Fannie Mae and Freddie Mac in the Financial Crisis." Alas, Mr. Waxman didn't come to bury Fan and Fred, but to bury the truth.

The two government-sponsored mortgage giants have long maintained they were merely unwitting victims of a financial act of God. That is, while the rest of the market went crazy over subprime and "liar" loans, Fan and Fred claimed to be the grownups of the mortgage market. There they were, the fable goes, quietly underwriting their 80% fixed-rate 30-year mortgages when—Ka-Pow!—they were blindsided by the greedy excesses of the subprime lenders who lacked their scruples.

But previously undisclosed internal documents that are now in Mr. Waxman's possession and that we've seen tell a different story. Memos and emails at the highest levels of Fannie and Freddie management in 2004 and 2005 paint a picture of two companies that saw their market share eroded by such products as option-ARMs and interest-only mortgages. The two companies were prepared to walk ever further out on the risk curve to maintain their market position.

The companies understood the risks they were running. But squeezed between the need to meet affordable-housing goals set by HUD and the desire to sustain their growth and profits, they took the leap anyway. As a result, by the middle of this year, the two companies were responsible for some $1.6 trillion worth of subprime credit of one form or another. The answer to Mr. Waxman's question about their role in the crisis, in other words, is that they were central players, if not the central players, in the creation of the housing boom and the credit bust. Mr. Waxman released some of these documents Tuesday but kept others under wraps.

In early 2004, Freddie's executive team was engaged in a heated debate over whether to start acquiring "stated income, stated assets" mortgages. And in April of that year, David Andrukonis, the head of risk management, wrote to his colleagues, "This is not an affordable product, as I understand it, but a product necessary to recapture [market] share. . . . In 1990 we called this product 'dangerous' and eliminated it from the marketplace." Freddie went ahead anyway.

At Tuesday's hearing, both Mr. Waxman and former Fannie CEO Franklin Raines argued that Fan and Fred were following the market, not leading it, as if this was exculpatory. The documents plainly show that people at both Fan and Fred clearly understood that these mortgages were risky, thought many homeowners didn't understand them and that they were putting their business at risk by buying up Alt-A and subprime mortgage-backed securities.

One Fannie Mae document from March 2005 notes dryly, "Although we invest almost exclusively in AAA-rated securities, there is a concern that the rating agencies may not be properly assessing the risk in these securities." But they bought them anyway, both to maintain their market share and to show people like Democrat Barney Frank that they were promoting affordable housing.

By April 2008, according to a document prepared for then-Fannie Mae CEO Daniel Mudd and marked "Confidential—Highly Restricted," Fannie's $312 billion in Alt-A mortgages represented "12% of single-family credit exposure." This book of business, the document notes, "was originated to maintain relevance in market with customers—main originators were Countrywide, Lehman, Indymac, Washington Mutual, Amtrust." The first four need no introduction; regulators ordered Ohio-based Amtrust to stop lending two weeks ago.

Remember that one of Fannie's roles was supposed to be to buy up mortgage-backed securities in the secondary market and keep that market "liquid." This was, they always argued, the rationale for their $1 trillion-plus MBS portfolios. By becoming buyers of private-label subprime and Alt-A-backed MBS, they did just that—they liquified and helped legitimize products that they now claim others irresponsibly sold.

Mr. Raines even suggested that Fan and Fred's regulator was to blame for allowing them to get into trouble. "It is remarkable," he told the committee, "that during the period that Fannie Mae substantially increased its exposure to credit risk its regulator made no visible effort to enforce any limits."

What Mr. Raines failed to mention was that, all along, Fannie and Freddie were spending millions on lobbying to ensure that regulators did not get in their way. As the AP reported Sunday night, Freddie spent $11.7 million in lobbying in 2006 alone, with Newt Gingrich, for example, getting $300,000 that year for talking up the benefits of Freddie's business model. (Apologies welcome, Newt.)

Other Republicans on Freddie's payroll included former Senator Al D'Amato and Congressman Vin Weber, and then House Majority Leader Tom DeLay's former chief of staff, Susan Hirschmann. As we know by now, Fan and Fred tried to buy everybody in town from both political parties, and the companies did it well enough to make themselves immune from regulatory scrutiny.

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Mr. Waxman calls it a "myth" that Fannie and Freddie were the originators of the crisis. That's a red herring. Mr. Waxman's documents prove beyond doubt that Fan and Fred turbocharged the housing mania with a taxpayer-backed, Congressionally protected business model that has cost America dearly.