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Why Did Fannie Mae and Freddie Mac Get Away with It for So Long?

A weak regulator

Limits of its authority

Quite simply, there were two reasons for this: the “weakness” of the regulator (the Office of Housing and Enterprise Oversight, or OFHEO), and the lobbying conducted by Fannie Mae and Freddie Mac. The first reason makes it look as though OFHEO was simply asleep on the job or in the grip of the Enterprises, but a brief examination of the powers and resources available to the regulator will show that things were not quite that simple. OFHEO was established as part of the Act which gave Fannie and Freddie their Charters in 1992.¹ It was the GSEs’ “safety and soundness regulator” and an independent agency within the Department of Housing and Urban Development (HUD) until it was abolished in 2008. HUD was the “mission” regulator of Fannie Mae and Freddie Mac, charged with ensuring that the Enterprises enhanced the availability of mortgage credit by creating and maintaining a secondary market for residential mortgages. HUD was also responsible for setting the housing goals.

OFHEO, as the safety and soundness regulator, was authorized to set risk-based capital standards, conduct examinations, and take enforcement actions if unsafe or unsound financial or management practices were identified. Its Director was nominated by the President, and confirmed by the Senate, for a five-year term. Both HUD and OFHEO were however seen as ineffective regulators. One example, as far as OFHEO is concerned, was the length of time it took to develop and finalize its risk-based capital regulation. That was later dismissed by OFHEO Director James Lockhart as a “stress-test”, and both it and the capital surcharge, which OFHEO eventually imposed after the discovery of the “accounting irregularities,” was still inadequate, since their regulatory capital was composed of each other’s bonds were composed of each others’ bonds, deferred tax assets and what Henry Paulson later described as “flimsy” capital.² When the GSEs were finally taken into conservatorship, they were found to have inflated their capital by using deferred tax assets, that is, credits that companies build up over the years to offset future profits. Fannie argued that its worth was increased by \$36bn through such credits, and Freddie claimed \$28bn benefit. Such credits have no

value until the companies generate a profit, which they had not done over the previous four quarters, and which was unlikely to happen in the near future. Even with a rapid increase in profits, the credits would not have been usable, as the Enterprises had large numbers of affordable housing tax credits, which themselves offset profits.³

The weakness overall, as Secretary John Snow observed in his testimony before the House Financial Services Committee, was that “the supervisory system for the housing GSEs neither has the tools, nor the stature, to effectively deal with the current size, complexity and importance of these Enterprises.”⁴ A number of such failings were revealed when OFHEO published its reports on accounting irregularities. The accounting irregularities and the extensive management and system failures had apparently gone unnoticed for many years. The question remains as to why the regulator was so ill-equipped in every way for effective regulation.

By design

That did not come about by accident. James Johnson took up the reins in 1991 as CEO of Fannie Mae, having been a consultant to the company prior to joining it in the same year. He had been campaign manager for Walter Mondale’s failed Presidential bid in 1984, and chairman of the selection committee for the Presidential campaign of John Kerry, which meant that he was well-connected in Washington DC. The GSE had only recently become profitable again, and already had a small but effective lobbying unit. Those who were there at the time recalled that the GSE’s Charter was his overriding concern; he aimed to secure the Enterprises’ hybrid status and above all to ensure that the controls on their activities were as light as possible. To that end, the legislation would give HUD, and OFHEO in particular, severely limited powers. The most efficient way to do that was to restrict the funds available to OFHEO and to make sure that Fannie Mae and Freddie Mac did not suffer for it. This did not go unnoticed at the time. The debate on a new regulator was brief, but Congressman Jim Leach warned at the time that Congress was “hamstringing” this new regulator at the behest of the companies. He pointed out, presciently, that they were changing “from being agencies of the public at large to money machines for the stockholding few.” Barney Frank, on the other hand, argued that the companies served a public purpose, lowering the price of mortgage loans.⁵

The upshot was that OFHEO funded its operations through assessments made on Fannie Mae and Freddie Mac, but could only collect the assessments when approved by the appropriations bill and at a level set by its appropriators (other regulators, such as the banking regulators, are exempt). GAO recognized the severe constraints this placed on OFHEO’s ability to carry out its regulatory tasks and to hire additional resources to carry out its oversight. Furthermore, without the timing constraints of the appropriations process, the regulator

would be able to respond more quickly to budgetary needs created by any crisis at the GSEs. Predictable income would also assist with hiring and retaining the right quality of staff, and building up experienced teams.

Successive GAO reports covered the failings of OFHEO over the years of its existence. It was not until 2004–2006 that the regulator's oversight improved; but even then, it was the change of auditor which did more than anything to bring Freddie Mac's manifold failings to light. Indeed, OFHEO's 2001 and 2002 examinations of Freddie Mac gave high marks to the GSEs in such relevant areas as corporate governance and internal controls, despite the widespread deficiencies later identified in these areas. It was then that the Director (in 2004) announced their intentions to strengthen the examinations program, create an office of the Chief Accountant, and include corporate accounting (for the first time) into its oversight process.⁶

Hiring the right level of staff with appropriate experience for such an Office was costly, and indeed, additional funds were made available by the Bush Administration for further examination of Fannie Mae's accounting problems. Even as late as 2007, James Lockhart complained about the lack of tools available to a very small agency to do the job, especially as "Fannie Mae and Freddie Mac lost sight of their mission in the early 2000s and used their GSE status to grow out of control."⁷ He also pointed out that Congress was considering a budget of \$60m for OFHEO, 11% lower than the President's request, leading to cuts in planned supervisory areas.

Limited powers

Apart from insufficient funding, OFHEO simply did not have the powers given to other banking regulators. The minimum capital requirements, and even the so-called risk-based capital requirements, were too restrictive, and other powers were absent, limited or vaguely defined (giving the GSEs scope to mount a legal challenge). OFHEO did not have the authority to remove officers and directors, place an enterprise into receivership, or bring suit on the agency's behalf; it had to rely on the Attorney General for that. The lack of these potential measures, and perhaps the regulator's own timidity, meant that informal means were used, with OFHEO officials pointing out to the GAO that the Enterprises were keen to resolve issues early and expeditiously.⁸ This explains OFHEO's reliance on agreements with Fannie Mae and Freddie Mac, both then and in the years to come. To a weak and underfunded regulator should be added the other concessions afforded to the GSEs, including an exemption from the 1933 and 1934 Securities and Exchange Acts, the ability to borrow more cheaply than their competitors owing to the implicit government guarantee, and the Treasury line of credit. James Johnson had worked assiduously and played the Washington scene to achieve the result he wanted. The money-making machine was underway.

He then laid down the ground rules for running the organization, courting and pleasing the advocacy groups working to expand home ownership among low-income people and minorities. Wall Street appreciated the consistently high returns: “Washington insiders respect him as the most skilled political operator in corporate America, protecting Fannie Mae’s franchise with an influential network that extends from the highest reaches of the Clinton Administration to the ranks of conservative Republicans on Capitol Hill.”⁹ James Johnson, however, would have none of it. “The reason Fannie Mae has broad political support is that we do our job. We effectively promote more homeownership for more people at a lower price.”¹⁰ That would be the theme in the years to come. The nature and extent of the political lobbying has to be understood in order to see why a regulator might be intimidated by it. Lobbying for Fannie Mae and Freddie Mac did not just take the form of gentlemanly discussions, issuing reports and engaging in public debate. In fact, there was very little of that, perhaps because the stakes were high: James Johnson himself earned some \$28m, including a final bonus of \$1.9m, when he left Fannie Mae. Lobbying was just another means of weakening or attempting to control OFHEO, as the regulator revealed.

Lack of market discipline

OFHEO could not look to the markets to assist in the task of regulating Fannie and Freddie; the GSEs had the facility to borrow in the federal agency debt market, and to issue debt obligations and mortgage backed securities with the implicit government guarantee, thus providing them with significant economies of scale. The low capital requirements also worked to their advantage. Banks and thrifts had to hold 4% capital against a residential mortgage, and Fannie and Freddie had to hold much less capital to fund the same mortgage, so clearly, it benefits the bank to sell the mortgage or at least swap it for a GSE-backed MBS. This was the effect of the legal structure and requirements applying to the GSEs. Their expansion came about as a result of the subsidies they received, rather than by them offering clearly more efficient combinations of quality and price; in addition, the implicit government guarantee shielded them from any market discipline. The ever-growing size of the subsidy has been described elsewhere, but as the CBO pointed out in 1996, “one further concern is that Fannie Mae and Freddie Mac rather than public officials substantially control the amount of the subsidy provided to the GSEs.”¹¹ Basically, this meant that Fannie and Freddie were always in a poll position to be ahead of the market: they had the resources for it.

Discrediting OFHEO

As part of its Special Examination, OFHEO reported on four attempts to discredit the organization and its report. Fannie Mae’s Government and Industry

Relations Department had close relationships with selected Congressional staff with whom they co-operated. In the spring and again in the autumn of 2004, Fannie Mae's lobbyists, with the knowledge and support of senior management, used their connections to instigate three investigations to undermine OFHEO in general terms. Two of these concerned OFHEO specifically: compensation levels of OFHEO's public and Congressional relations staff, and whether the regulator was in compliance with a provision of the VA-HUD-Independent Agencies Appropriation Act for the Fiscal Year 2004, which required an agency to allocate at least 60% of its budget to examinations and safety and soundness. Fannie Mae staff had helped to formulate the VA-HUD provision, with a lengthy exchange of correspondence to establish the exact percentage. The HUD Inspector General concluded that OFHEO met the 60% level, but that further testing was necessary. The second conclusion was that OFHEO was comparable to other federal financial regulators in its allocation of resources and staffing.¹²

However, a potentially more damaging attempt to discredit the regulator was made in April 2004, when the HUD Inspector General received a Congressional request to conduct a fourth investigation. This time the subject was OFHEO's conduct of its Special Examination of Fannie Mae, in particular that the agency had improperly leaked confidential information obtained during the investigation into the GSE. The attempt was not very intelligently carried out, as it happened; OFHEO found a draft of the Congressional request letter on Fannie Mae's computer system, which was nearly identical to the request letter that was finally sent to the HUD Inspector General. It was dated almost two weeks before the actual request letter was sent.

Duane Duncan, Head of Fannie Mae's Government and Industrial Relations Department, admitted as much under oath in his interview with OFHEO. They also knew about the contents of the OIG report before it was published, and wanted it published even though it was a legally restricted document. A sustained campaign to get it published succeeded, and it was put on a Congressional website for one hour, which was long enough to distribute it to their board of directors, analysts and Congressional staff. Mr Duncan made it quite clear that Franklin Raines, the Executive Vice President for Law and Policy, Thomas Donilon, and the General Counsel, Ann Kappler, were all involved. (The allegations in the fourth OIG report, that OFHEO overstated Fannie Mae's accounting problems were, of course, thoroughly discredited.¹³)

The last push was an attempt to use the Appropriations Process to force a change in OFHEO leadership. There were repeated discussions with Fannie Mae's lobbyists to insert into the Independent Agencies' Appropriations Act for the fiscal year, 2005 a provision to withhold \$10m until a new director was found.

Despite these may distractions, OFHEO published its Report of the Findings to Date on September 17, 2004, which, of course, brought about

the “resignation” of Franklin Raines amongst others. All that scheming did nothing to obscure the report’s findings. But that report was published a few weeks after Freddie Mac paid a record \$3.8m fine in settlement with the Federal Election Commission and restated lobbying disclosure reports from 2004 to 2005.

At every turn, Fannie Mae and Freddie Mac sought to defeat any restrictions on their Charters or their activities. This was essential for them, as they lived or died by their Charters. “A federal charter means the politics rather than the market determines its major issues ... such as whether the government will charter other firms on the same terms, the financial services that the GSE may provide, how much capital the GSE should hold, the extent that the government will restrain risk-taking by the GSE, and whether it will go out of business if its net worth drops to zero.”¹⁴

The Enterprises employed various approaches to achieve these ends: spending on lobbying; involving Congressmen and Senators in local housing projects; partnership schemes; and donations from their charitable foundations. Partly owing to the millions spent on lobbying and shrewd appointments to the Board and to senior positions, and partly through the use of their “affordable housing mission,” which politicians dared not disavow, Fannie, in particular, and Freddie were extremely powerful and well-connected companies in Washington DC. As far as lobbying expenditure was concerned, they spent a combined \$174m between 1998 and 2008, positioning them amongst the USA’s top twenty spenders, rather less than the American Medical Association and just ahead of General Electric.

“They have always understood the political risk was huge for them, and they put millions of dollars into using contributions, jobs and consulting contracts to stay in the good graces of people in power. They had both parties, and particularly the Democrats, under incredible control,” according to Wright Andrews, a “veteran banking lobbyist.”¹⁵ Their main aim was to ensure that the government did not change anything about their special status, and that OFHEO continued to lack the resources to carry out effective supervision. In 1999, Franklin Raines stated, “We manage our political risk with the same intensity as we manage our credit and interest risks.”¹⁶

When the GSEs faced all the problems arising from the accounting irregularities, they campaigned even more vociferously against the proposed legislation to impose stronger regulation and controls on their activities. Freddie Mac spent \$12.6m on lobbying in 2005, down from \$15.44m in 2004 but still enough to place it 11th among corporations which had filed at that time. Fannie Mae’s spending rose from \$8.78m to \$10.1m. Fannie did reduce spending on outside lobbyists by about 24%, but in-house lobbying costs increased by 67%.

In 2005, Freddie Mac secretly paid a Republican consulting firm about \$2m to put a stop to Senator Hagel’s bill. At the time at which he introduced the bill,

most Republicans supported it, but DCI, the consulting firm, undermined his efforts by targeting and convincing various Republican supporters to withdraw support. Senator Hagel and his supporters wrote to the Senate majority leader, Bill Frist, telling him that “If effective regulatory reform legislation ... is not enacted this year, American taxpayers will continue to be exposed to the enormous risk that Fannie Mae and Freddie Mac pose to the ... financial system and the economy as a whole.”¹⁷ Of course the legislation did not pass. And a year later, Freddie Mac was caught again: it had used corporate resources to stage 85 fundraising dinners that raised \$1.7m for candidates for federal office. In internal documents, Freddie Mac described the events as an exercise in “political risk management.” The fine of \$3.8m civil penalty to the Federal Election Commission still stands as the largest in the FEC’s 35-year history.¹⁸

Fannie Mae and Freddie Mac did not use a scatter-gun approach in lobbying expenditure. They have strategically given more contributions to members of the committees which primarily regulate their industry. Fifteen of the 25 lawmakers who have received most from the two companies combined since the 1990 election have either been members of the House Financial Services Committee, the Senate Banking, Housing & Urban Affairs Committee, or the Senate Finance Committee. The others sit on the powerful Appropriations or Ways & Means Committees, are members of the Congressional leadership, or have run for President. A full list of contributions to members’ campaigns from Fannie Mae and Freddie Mac directly, and via their Political Action Committees, is given in the Appendix. It should also be noted that expenditure did not only involve campaign contributions, but may be donated to caucuses of members. In 2007, for example, Fannie and Freddie each gave \$100,000 to the Black Causus Foundation, Inc.

Expenditure on lobbying did not end when the companies were running into serious difficulties in 2007, nor in the months up to the takeover in 2008. Fannie Mae managed to spend \$3.8bn lobbying the federal government in that year, and Freddie Mac spent \$5.78m; in 2007 they spent \$2.9m and \$4.28 m respectively. One of the first actions Lockhart took when Fannie and Freddie were taken into conservatorship was to end all lobbying activities. “There’s no doubt that the legislation was delayed for many years because of the strength of their lobbying power,” he said, after issuing the order. At the time, the companies employed 20 in-house lobbyists, who lost their jobs, and 48 outside firms, who looked for their fees elsewhere.¹⁹

Partnership Offices

It was James Johnson who first established the Partnership Offices in 1994: regional offices, which Fannie Mae regards as catalysts for housing projects in their local communities. He had announced the “Trillion Dollar Commitment”

in 1994, enabling it to help 10 million families nationwide, along with the Partnership Office Initiative; the latter was to create partnerships with housing advocacy groups, community development organizations, lenders, house builders, real estate agents, and local government, all designed to work towards expanding affordable home ownership and affordable renting in their areas. The *New York Times* described one such office opening in Phoenix, with four members of Congress from the area (one Democrat and three Republicans) in the front row, whilst the TV cameras were running. One of the Republicans, Representative J. Hayworth, explained his support, despite philosophical differences, saying that “in many cases, like here, there is broad unanimity in wishing to empower people to achieve the American dream.”²⁰ This was just one of the offices. In 1998, for example, another Partnership Office was opened in Oklahoma, with Governor Keating and Senator Nickles present as James Johnson announced that this was another example of the intention to expand affordable home ownership by working with housing partners state-wide to develop a comprehensive investment plan addressing Oklahoma’s specific housing needs. Senator Nickles added that they looked forward to having Fannie Mae as their new neighbor, and that Fannie’s presence on the ground would help their local mortgage lenders, community groups and housing advocates who are waiting to make the mortgage finance industry more accessible and user-friendly to Oklahoma’s families.²¹ What should also be noted is that in both cases, help would take the form of “promoting products like mortgages requiring as little as 2% down, and to introduce low down-payment loans to Oklahomans who can afford a monthly down payment but have not accumulated enough savings for a down payment.”²²

Johnson achieved his goal of opening 25 Partnership Offices by 1998, when he retired. He described his achievement and his purpose to the Capital Markets, Securities and Government-Sponsored Enterprises Subcommittee of the US Banking Committee in 1996, in these words: “When we announced our Trillion Dollar Commitment two years ago, we realized that we couldn’t do it all from Washington and our five regional offices. One solution was to have people on the ground in 25 communities. In these Partnership Offices, as we call them, small numbers of professionals are in place to custom-tailor our mortgage products to meet the needs of the specific city or state ... So far 20 ... are open and working with local and state governments, local mortgage lenders, and nonprofit and neighborhood groups. Together with three additional cities, they have put together a total of more than \$57bn in comprehensive investment plans. As we make and carry out these investment plans around the country, we tell local communities that, above all, we will be accountable to them ... It is one of the most visible and successful of the 11 initiatives that comprise our Trillion Dollar Commitment, and we are extremely gratified by its success to date.”²³

Franklin Raines was quick to realize the value of the Partnership Offices and over the years more than doubled their numbers, to 44 by 2000.

They were used even more extensively for media events, typically announcing a new partnership with a bank or mortgage company or to welcome a family into their new home; for example, with Representatives Luis Gutierrez and Blagojevich and CitiMortgage to announce a new partnership to finance \$2.7bn in affordable mortgage lending to Chicago families, and with Representatives Larson and Hartford with Hartford Mayor Peters and GMAC Mortgage to welcome a family into their new home made possible by Fannie's Flex 97 mortgage product through GMAC. A statement of support by Rep. Larson was included in Fannie Mae's press release.²⁴

Fannie Mae, of course claimed that these offices were simply created to get away from Washington DC, and that the media events were not directed from Washington. The events were basically product introductions, where a member of Congress asked Fannie Mae to participate in a program; it was all part of the development of relationships in local communities. By 2002, the company had 51 Partnership Offices, which Fannie Mae continued to use for such announcements. For example, Senator Mary Landrieu, Rep. Jefferson and State Treasurer John Kennedy were joined by Fannie Mae to announce a new \$1.25bn lending partnership between the Standard Mortgage Corporation and Fannie on July 15, 2002. Rep. Robert Matsui, Fannie, the Sacramento Realist Association and Countrywide Home Loans sponsored a training seminar for brokers and real estate professionals on new mortgage and technology products. The press release issued by Fannie on July 18, 2002 included a statement of support from the Congressmen. *The Wall Street Journal* commented, "Fannie wins the gratitude of politicians by staging local events with them, often to 'announce its plans to buy local mortgages'."²⁵

A year later, Fannie had 57 Partnership Offices and held at least another 21 press events with Congressmen and some Senators. The process continued, but in 2004 but it attracted some unwelcome attention. This was partly the result of a teleconference with Duane Duncan, Senior Vice President of Fannie Mae's Government and Industrial Relations team, during which he presented a slide listing 70 members of the House Financial Services Committee and the Senate Banking Committee, and pointed out that the Partnership Offices stayed in close contact with each one. "In every one of these offices, we have evidence of what we have done from the business side." The offices tended to be staffed with former aides from Capitol Hill from the banking, financial services and appropriations committees or others who were likely to be politically useful. Even as far back as 1996, a CBO study noted that "although these offices may conduct some mortgage-related business, their principal purpose is to enhance Fannie Mae's political base." Fannie Mae seemed to confirm this when it opened offices in the districts of the new members of Congressional committees overseeing the GSE; for example, it opened its Charlotte office to cover the state of North Carolina in June 1999, after the newly elected Senator John Edwards joined the Banking Committee.

The partnerships at the offices tended to be, as noted above, with a wide range of interest groups, who could serve as lobbying allies to help fend off any Congressional moves to limit their activities or remove their special privileges or status. It meant that they had an army at their disposal, ready to put Fannie's case to lawmakers, often by arguing that changes would increase the cost of mortgages to the poor and underserved or reduce liquidity in the market. Such "partners" were also arguing Fannie's case in their own interests, or as housing advocacy organizations.

The network of offices also provided a grassroots political organization in key legislative districts. Office directors were expected to maintain a list of contacts for generating calls and letters during political crises, encouraged by regional "franchise preservation" awards to those who had helped Fannie defeat an attack (that is, legislative proposals).

The offices were supposedly designed to help Fannie Mae implement its flagship affordable housing program, the American Communities Fund (ACF), a debt and equity investment fund providing financing for underserved communities, where traditional capital is limited or unavailable. The aim was to fund high-impact investments that serve as catalysts for further revitalization. The Fund started off in 1996 at \$100m, by 1999 made almost \$300m in investments, and in 2000 Fannie Mae increased its capitalization and committed it to invest \$3bn over the next ten years. By 2004, the Fund had invested in some 500 housing deals around the country. Fannie Mae made sure that politicians were aware of the ACF investments made in their districts. But there was more to it than that. A *Wall Street Journal* review of 90 ACF press releases since 1998 found that of those which mentioned an individual member of Congress, the Senator or Congressman was either a member of the Senate Banking Committee or the House Financial Services Committee, or the Appropriations Housing Subcommittee, which funds the federal regulator, whereas only 22% of Congress sits on these bodies. Some did much better than others; for example, Senator Bennett was in the top ten by the number of ACF deals.

The review prodded HUD into action. In July 2004, HUD opened a formal inquiry into the political activities of Fannie Mae's regional offices. The report was completed a year later, but HUD refused to publish it in full; instead, the Department released a statement, saying that Fannie's Congressional Charter allowed it to set up regional offices to promote affordable housing. "However, the Department also concluded from its review that the activities of the Partnership Offices were not confined to affordable housing initiatives. Rather, a central purpose of the Partnership Offices was to engage in activities that were primarily designed to obtain access to or influence members of Congress."²⁶ However, HUD did release its August 31 letter from Brian Montgomery to Daniel Mudd, stating that the Partnership Offices were really "assigned to the duty of assisting in outreach efforts to members of Congress ... collectively this information indicates that a central purpose of the Partnership Offices is

to obtain access to or influence members of Congress.” The letter specifically referred to “Rob Bennett, the son of Senator Rob Bennett is the deputy director of Fannie Mae’s Partnership Office in the Senator’s home state. Jeffrey Bennion, Utah’s partnership director, worked for the former Utah Governor, Michael Levitt.” This was an example, based on information provided by Fannie Mae, that many offices were located and staffed based on criteria related to Congressional districts represented by various members of Congress, including party affiliation and the committee assignments of the representatives in those districts.²⁷ The example was apparently greeted with mirth at a closed meeting of Washington lobbyists, when HUD’s statement was announced with an addition: HUD was also shocked to discover that gambling went on at Las Vegas.²⁸

HUD ordered Fannie Mae to carry out an internal review of the political activities of its regional offices. As a result, Fannie Mae sacked 20 lobbyists and publicists at its Partnership Offices outside Washington and decided to dismantle its grassroots lobbying network. But the offices were only another part of Fannie’s array of weapons; it had others in its armory. These included the Fannie Mae Foundation, which was used, sometimes to support other political groups such as the Black Caucus, but also to pump \$500m into “highly visible and heavily promoted projects and grants in an effort to sway public opinion and to shape federal regulations.” The author of a paper on the need to reform Fannie Mae and Freddie Mac, Ronald Utt, was honest enough to admit to another aspect of the GSE’s attempt to control the environment in which it operated, when he pointed out that “even America’s college professors became objects of Fannie Mae’s affection.” This was when it created and financed two academic journals, *Housing Policy Debate* and *Journal of Housing Research*, focusing on a wide range of housing issues. “The exception is that both journals generally avoid discussing the GSEs’ role in the mortgage market and whether they make much of a difference. With many professors still confronting a publish-or-perish environment in pursuit of tenure and promotion, common sense argues against irritating a wealthy and influential publisher. As a result, academia has not been a reliable source of dispassionate inquiry into the GSEs’ role in the American housing market.”²⁹

The Fannie Foundation

The Fannie Mae Foundation also donated funds to various housing advocacy and community-based organizations; it is not clear whether or not any money was actually given to the Association of Community Organizations for Reform Now (ACORN), or whether that association with ACORN was only an indirect one through Countrywide, with whom Fannie had a long-standing partnership.

The funding of various community organizations did, however, provide Fannie Mae with yet more voices to be used in opposition to any legislative proposals which threatened its status and which would then be presented as restrictions on GSE lending to low-income families and minorities. The Foundation was closed in February 2007, a “longtime lightning rod for criticism that the company was using tax-exempt contributions to advance corporate interests.”³⁰ Not all of these were directly connected with housing: recipients included Harvard University and Arena Stage, a District theatre where Franklin Raines’ wife was Chairman of the Board, and to the John F. Kennedy Center for Performing Arts. Millions of dollars were also spent on advertising to educate home buyers, and the construction of housing in depressed neighborhoods. For example, The Foundation spent \$44m on television “outreach” advertising so that consumers could request brochures about obtaining a mortgage in 2001. The Foundation was replaced by charitable giving by the company itself, but some sceptical observers noted that the company would not be under a legal obligation to identify the recipients of the gifts to the public as the Foundation was obliged to do.

Fannie Mae and Freddie Mac used all their allies to intimidate those who tried to restrict their activities. Congressmen and women in particular would suddenly receive floods of emails and telephone calls from anxious voters, saying that the costs of their mortgages would increase or that they would be unable to afford to buy a home. Congressman Shay’s experience of a telephone call from Duane Duncan, Fannie’s chief lobbyist, when he had only just mentioned ensuring greater disclosure of the state of the GSEs’ finances to a couple of staffers the previous evening, was typical. Congressional sources also said that the company tried to get critical Hill staffers sacked, and that after Richard Baker proposed a stronger regulator for the GSEs in 2000 (his first attempt), Fannie Mae hired a phone bank to call constituents on behalf of the Coalition to Preserve Home Ownership, a front for Fannie and Freddie, real estate agents and homebuilders. Some members of the House Subcommittee on the bill were “enraged after they received anonymous boxes filled with thousands of letters from constituents protesting a so-called Congressional proposal to raise mortgage costs.”³¹

Other means

Campaign contributions

Harassment was not the only method used. Campaign contributions helped to ensure that many Representatives and Senators remained onside. Other sweeteners were available as well, not directly from Fannie Mae, but from Countrywide, with whom Fannie Mae had a longstanding partnership.

The relationship was such that Angelo Mozilo, Countrywide CEO said, “They have given us a liquid, organized market. If you took them away, it would be a disaster.” Angelo Mozilo had driven Countrywide to a dominant position in the mortgage market, beyond the Citigroups and Wells Fargos, but he knew on whom he depended. “If it wasn’t for them,” he said of Fannie and Freddie, “Wells knows they’d have us.”³² His dependence on Fannie and Freddie led him to ensure their status, as well as giving him the connections and status he craved.

Friends in high places

Until 2004, when President Bush refused to make any more Board appointments, Fannie had another weapon to hand: the five Board appointments in 2002 included Ann McLaughlin Korologos, Labor Secretary under Ronald Reagan; Ken Duberstein, Reagan’s Chief of Staff; William Daley, Commerce Secretary in the Clinton Administration and Al Gore’s spokesman during the 2000 election controversy; and Jack Quinn, Counsel to Bill Clinton. Freddie Mac’s Presidential Board appointments do not seem to have made as much impact, apart from the widely reported appointment of President Clinton’s former senior adviser in the White House, Rahm Emanuel, in February 2000. Emanuel had served in that position from 1993 to 1998, but had joined Wasserstein Perella, an investment bank, in 1998, where he stayed until 2002. His stay on the Board of Freddie Mac was short but lucrative, as he received some \$320,000 in compensation (including Freddie Mac shares, which he sold). At the time of writing, he is currently Mayor of Chicago. Other Board members included Robert Glauber, Undersecretary of the Treasury under President George W. Bush; and Harold Ickes, Adviser to President Clinton and Senator Hillary Clinton, and member of the Democratic National Committee. Former Board members included Dennis Deconcini, former Board member and US Senator from Arizona; and David J. Gribbin, former Board member, aide to Vice President Dick Cheney, Assistant Secretary of Defense under President George W. Bush.³³ These are just some examples of those appointed to the Board, and whatever relevant skills and experience they may have had, their political connections were clearly vital. They could be relied upon to act when Fannie and Freddie considered that they were threatened. It was because the GSEs were hybrid organizations that the Presidential appointments were made, but that practice was ended by President Bush Jr. The Boards were abolished when the GSEs were taken into conservatorship.

Apart from Board membership, others were appointed to senior executive positions. Franklin Raines himself was Director of President Clinton’s Office of Management and Budget; Jamie Gorelick was Deputy Attorney General in the Clinton Administration, and became Vice Chair of Fannie Mae despite having no background in finance, from 1997 to 2003 (with \$26.4m in total

compensation); Robert Zoellick served in both the Reagan and the first Bush Administration in various roles, including Deputy Secretary to the Treasury and Deputy Chief of Staff, before becoming Executive Vice President for Public Affairs and Affordable Housing from 1993 to 1997 at Fannie Mae.

Other connections over the years included John Buckley, who worked at Fannie from 1991 to 2001, but took leave of absence to run Bob Dole's campaign for the Presidency. In 2002, for example, the Enterprise's lobbying team included former Congressmen, such as Tom Downey (Democrat) and Ray McGrath (Republican), as well as Steve Elmendorf, Democrat strategist and Donald Pierce, a GOP operative. McCain's economic adviser, Aquiles Suarez was Fannie Mae's Director of Government and Industry Relations. Arne Christensen, a former Newt Gingrich aide, was Senior Vice President for Regulatory Policy; Tom Donilon was Fannie Mae's Executive for Law and Policy as well as being Secretary to the Board of Directors until 2005, and was in the Clinton state department. William Maloni worked for Congressman W. Moorhead and for the Federal Home Loan Bank and the Federal Reserve before joining Fannie Mae.³⁴

“Friends of Angelo”

Countrywide's Angelo Mozilo adopted a “softly, softly” approach to obtain influence. A report, entitled *Friends of Angelo's*, sets out the way in which the company sought to buy influence.³⁵ The company dispensed favours to those whom it believed might be valuable. They would be known as “Friends of Angelo” who had been given loans on favorable terms. These borrowers included legislators, Congressional staffers, lobbyists, opinion leaders, business partners, local politicians, house builders and law enforcement officials. The VIP Loan Program, as it was called, was designed to build its relationship with members of Congress and Congressional staff and also to protect its relationship with Fannie Mae. Senior Countrywide staff and its lobbyists assessed the value of relationships with potentially influential borrowers, the most important of whom were given preferential treatment as part of an expansive effort by Countrywide to “ingratiate Countrywide with people in Washington who may be able to help the company down the road.”³⁶

The report notes that Countrywide made sure that the “Friends of Angelo” knew they were receiving special pricing and preferential treatment, and that Mozilo had personally priced their loans. They relied on their status as Friends to guarantee such treatment for themselves and others. If they had previously had a loan, then they could expect discounts on subsequent refinancing. A particular loan officer's business card was attached to their loan documents, which clearly indicated that the officer worked in the VIP unit. The loans were

classified into seven categories according to the status of the person concerned, and also to ensure that the “origination and routing of VIP loans is handled flawlessly.”

The report provides some examples of the individuals with prime responsibility for the oversight of Fannie and Freddie, who received (or were offered) such benefits. They were:

Senator Kent Conrad, Chairman of the Budget Committee and a member of the Finance Committee, for whom Mozilo instructed the VIP department to take off 1 point.

Senator Christopher Dodd, Member of the Committee on Banking, Housing and Urban Affairs and Chairman in 2007, who saved about \$75,000 by refinancing his home at a reduced rate.

Senator John Edwards, Member of the Judiciary Committee, who was referred to the “Friends of Angelo’s” program when trying to finance the purchase of a \$3.8m home in Georgetown.

Alphonso Jackson, Secretary of Housing and Urban Development, who received two loans through the VIP program and whose daughter was referred to the program by a Countrywide lobbyist in 2003. To make sure she received preferential treatment, when the loan was confirmed in 2004 the loan officer told the Senior Vice President that her father, Alphonso, was expected to be confirmed as Secretary for HUD.

Clinton Jones III, Senior Counsel of the House Financial Services Subcommittee on Housing and Community Opportunity, was referred for “specialized handling” to the “Friends of Angelo” program by a Countrywide lobbyist, resulting in “0.5 off and no garbage fees.”

All of these were confirmed by email correspondence and other documents inspected by Congressional staff, as is clear from the full report and copies of various loan documents. The benefit for Countrywide? The company found that Congress turned to them when the industry-related legislation was being considered to share expertise and to provide insight. Lenz, who was in charge of government relations for the company, said that, “Countrywide had an incredibly good relationship with Congress. It was not unusual for us to get a call, saying, ‘A bill’s being introduced. It’s a little technical, and there are parts we don’t understand. Can you educate us on this?’”³⁷

For the lawmakers concerned, there was surely a reputational risk. Although the existence of “Friends of Angelo” was at least common knowledge, if not public knowledge, through much of the period in question, damaging hints could be dropped, enough to undermine a lawmaker’s reputation, such that his contributions on certain topics would not be taken seriously. It also exposed a

lawmaker to having to take positions on certain issues that he may not wish to take. In the process of getting a loan, the fact that documentary evidence of an explicit sort would exist (the business card of a specific loan officer, who may leave the company and not feel bound by any rules or loyalty to it) did not seem to weigh on the borrower's mind.

Fannie Mae and Freddie Mac were not the only ones to spend millions of dollars on lobbying. At the end of 2007, the *Wall Street Journal* reported that two of the largest mortgage companies had spent vast amounts of money on political donations, campaign contributions, and lobbying activities between 2002 and 2006. Ameriquest and Countrywide fought hard against anti-predatory legislation in Georgia, New Jersey and other states as well as at the federal level.³⁸ The largest suppliers of securities to Fannie and Freddie included New Century Financial Co., and Ameriquest, as well as Countrywide, of course. Their lobbying and the expenditure on it were mutually beneficial, so Fannie and Freddie should always be included in any assessment of the impact of lobbying. A recent study, *A Fistful of Dollars*, examined the relationship between lobbying by financial institutions and mortgage lending, and sets out to show that it contributed to the accumulation of risks leading to the financial crisis. The study argues that "lenders which lobbied more intensively on these specific issues have (i) more lax lending standards measured by loan-to-income ratio (ii) greater tendency to securitize (iii) faster growing mortgage loan portfolios. It can now be seen that delinquency rates are higher in areas in which the lobbying banks; mortgage lending grew faster, and during key events of the crisis, these lenders experienced negative abnormal stock returns. These results are consistent with certain lenders having more to gain from lax regulation. Such risk-taking exposed them to worse outcomes during the crisis ... With the caveat that empirical evidence cannot pin down whether lobbying is for signaling information or is motivated by rent-seeking, our analysis suggests that the political influence of the financial industry can be associated with the accumulation of risks."³⁹ That might be true in general, but it does not fully explain the mortgage market in America between 1995 and 2008.

Fannie Mae and Freddie Mac were not lenders, of course, but buyers of MBSs. The lobbying was mutually beneficial for both the lenders and the buyers. It was clearly rent-seeking behaviour, in that, in effect, *retaining* the kind of legislation which enabled the lenders and Fannie Mae and Freddie Mac wanted for their own purposes required payment. Nor were the lenders, Fannie and Freddie the only rent-seekers involved. The whole context in which the lobbying operated during this period was unusual. It was dominated by the affordable housing ideology, which, *inter alia*, meant that in practice the standards had already been lowered; and it was only at state level (and not with all states) that any serious effort was made to ban predatory lending. Congress had already given the status and benefits to Fannie Mae and Freddie Mac through their Charters, and most lawmakers did not see the need to alter

the Charters. They believed or chose to believe that Fannie Mae and Freddie Mac's underwriting practices imposed the highest standards, and the GSEs maintained that myth. The lawmakers did not see, and were helped not to see, that affordable housing for low-income groups inevitably required lower down payments. If anything, the lobbying was designed to signal disinformation, not information. Clearly lobbying by the banks played a significant role in the crisis, but the context in this case was unusual in that it was dominated by the desire of politicians to see home ownership rates increase, and the desire of all the other interested parties to see that happening.