THE BLAME GAME ISN'T A GAME
– The Housing and Mortgage Crisis Revisited

Stephen L. Bakke – June 27, 2010

My goal in this report is to help redirect the discussion, by using facts and historic events to more accurately assign blame for the housing and mortgage crisis.

Revisionist History

The "housing and mortgage crisis" decended on us approximately three years ago – and the rest is history. Or is it? The accounts I hear and read aren't what I vividly recall happening. Blaming the "greedy Wall Street bankers" began early on, but at least for a while there was some balanced reporting with examples of how "there's plenty of blame to go around."

But now, the familiar liberal harangue blaming only the "bankers," has become institutionalized. As an example, in a recent StarTribune article the following gratuitous accusation was presented:

> *After all, it was bankers who created the economic crisis that begot the recession …… credit default swaps, collateralized debt obligations and other complicated instruments that wreaked so much havoc …*

The Finger

We no longer hear anything about the many important reasons for the housing and mortgage crisis and ultimately the many economic problems we now face. My frustration with hearing this has led me to breathe life into a commentary I wrote just prior to the 2008 election. Some of the ideas and information herein were born in that report.

As I wrote the 2008 report we were in the midst of ridiculous political maneuvering to gain the most advantage out of supporting, opposing, passing, defeating, delaying, spinning, posturing, blaming, …………. regarding appropriate government intervention into the crisis, and about what actually happened, when and why. So I would like, once again, to raise my "totally" objective hand and point a LARGE (index) finger of my own.

The Crisis – Congressional Legislation "Started the Ball Rolling"

Let's go back in time. In spite of protests and assurances to the contrary, the housing bubble and excesses in mortgage lending has its roots in the 1970s with the passage of the now mostly ignored "Community Reinvestment Act of 1977" (CRA). The CRA, which was subsequently strengthened in the Clinton and Bush administrations, is a federal law that, in effect, mandated lenders to offer credit throughout their entire market to borrowers they would not otherwise lend to, and discouraged them from restricting their credit services to higher income markets.

The application of CRA legislation really hit its stride in the early 1990s in reaction to moral outrage which was ringing throughout the media because lenders had shown reluctance to provide mortgages on properties located in certain neighborhoods. The restricted practices are referred to as "redlining" – or limiting lending into higher risk areas and to higher risk borrowers.

Be Careful What You Wish For – You Just Might Get It!

Creating a crisis was certainly not intended, and it's an "easy out" to state that creating bad loans was never the intent. But be careful what you wish for; you may get it. Be careful what you give people incentive to do; they will do it in spades. **While well intentioned, this legislation led to many unintended consequences.** It led to rampant lending foolishness and many abuses. Lenders were pressured to be creative finding ways to put home ownership into the hands of lower income citizens**. I was personally present at a meeting which included discussion of the pressure we were receiving to be more creative in finding ways to put homes into the hands of more Americans.**

CRA encouraged banks and thrifts to make simplified "desktop" loans, "100% of equity" loans, and the so called "low dock" and "no doc" loans to customers who (as it turns out) had no realistic ability to repay the loan. The expansion of issuing adjustable rate mortgages (ARMs) also exacerbated the problem. Of course, the new and growing artificial demand further expanded the "housing bubble" and encouraged these "loosy goosy" lending practices by giving false comfort as to housing (collateral) values.

That's really how the crisis began! Ultimately, and inevitably, values dramatically softened, and the crisis began. The problem started with Congress foolishly intervening into the mortgage markets, and that role is now denied or forgotten – at least by some. And then they REALLY greased the skids. Fannie and Freddie ("F&F") were unleashed.

It Doesn't Take a Wizard

"Lions and Tigers and Bears! Oh My!" as Dorothy exclaimed long ago, then became: "Fannie and Freddie and Bear Stearns! Oh S___!" exclaimed by all modern day "Dorothys." Fannie Mae and Freddie Mac ("F&F") exploded and many bystanders were injured in the blast – some "fatally." After the events described above regarding CRA, the housing crisis, and the credit crisis, it is clear F&F had become a key enabler of the mortgage disaster. They fueled Wall Street's efforts to securitize sub-prime loans by becoming the primary customer of sub-prime-mortgage pools. Many legislators wanted that – they encouraged it. In addition, F&F held an enormous portfolio of mortgages – purchased from banks and other originators.

When F&F couldn't "make the market," they **became** the market. They provided the wild market liquidity within which even mortgage-backed securities assembled by others could find a ready home. Take away congress's "darling children" F&F, or regulate them! It's hard to imagine how these over-charged markets would ever have emerged and the whole mess would never have happened – at least not this bad. But it did happen!

The Warnings

But we were warned! In "W's" first year in office he **explicitly** called for more oversight and reform of F&F. I found information on several congressional hearings about the problem – in 2003, 2004, and 2005 for sure. And yes, regulators **did** blow the horn! At least to the extent they could. But they have little, if any, authority over F&F.

Remember the scandal surrounding the accounting procedures of the agencies during that time? And the accusations of impropriety about the huge salaries and bonuses paid to the F&F's top officials? The SEC has taken a lot of "flack" for their culpability (probably deservedly), but to be fair, **in 2004, the SEC's chief accountant told Fannie's chief Franklin Raines that Fannie's position on the relevant accounting issue was not even " on the page" of allowable interpretations.**

After that, there was an inclination to create more effective ways to regulate F&F which, until then, had escaped serious scrutiny. **At a 2004 Subcommittee hearing the Republican Chairman Baker predicted the collapse of Fannie if nothing was done.** He called for more regulation, something Democrats claim Republicans never sought.

In 2005 **Alan Greenspan** told Congress how urgent it was for it to act in the clearest possible terms: If F&F "continue to grow, continue to have the low capital that they have, continue to engage in the dynamic hedging of their portfolios, which they need to do for interest rate risk aversion, they potentially create ever-growing potential systemic risk down the road ….. **We are placing the total financial system of the future at a substantial risk"** – so stated the Fed Chairman – in 2005. **Yes, we were warned!**

Most Democrats LOVED What Was Happening – They Were Gathering Votes!

Rep Barney Frank, a man saturated with guilt for this crisis, had spent several years ridiculing Alan Greenspan, John McCain and others who sought more regulation for Fannie's market-distorting schemes. He and his Senate counterpart Chris Dodd claimed that this mess was the result of poor oversight – but wasn't Senator Dodd was in charge of bank oversight? **Democrats actually liked the result of this market distortion** – more constituents (often with lower incomes) purchasing heavily mortgaged homes.

Representative Maxine Waters stated in a 2003 hearing on Financial Services that **"We do not have a crisis at Fannie Mae and in particular Freddie Mac under the outstanding leadership of Frank Raines".** In a 2004 hearing, **Representative William Lacy Clay called the investigation that found illegal activity at Fannie a "lynching."** This was very incendiary language considering both Clay and Raines are African Americans. Yes, the **race card was played** by a very defensive and angry congressman.

There is so much more available from these hearings. Check it out!!

Many People Tried To Do Something About F&F, They Really Did!

What happened next? Would you believe that, for the first time in history, a serious F&F reform bill was passed by the Senate Banking Committee which gave a regulator power to crack down and ultimately improve the quality of the loans being made? **But the bill didn't become law because Democrats opposed it on a party-line vote in committee.** Republicans were "tied up" by the resolute and committed Democratic opposition, and couldn't even get the Senate to vote on the matter!

A reporter wrote at the time:

> *It is a classic case of socializing the risk while privatizing the profit. The Democrats and the few Republicans who oppose portfolio limitations could not possibly do so if their constituents understood what they were doing.*

Bill Clinton, stated in September 2008 on ABC TV, regarding his party's reluctance to place more restrictions on F&F:

> *I think the responsibility that the Democrats have may rest more in resisting any efforts by Republicans in the Congress, or by me when I was president, to put some standards and tighten up a little on Fannie Mae and Freddie Mac.*

WOW! – go gettem' "Slick Willie"! Also in September 2008, the Wall Street Journal stated in an editorial:

> *[Barney Frank's] record is close to perfect as a stalwart opponent of reforming the two companies, going back more than a decade. The first concerted push to rein in [F&F] in Congress came as far back as 1992, and Mr. Frank was right there, standing athwart. But things really picked up this decade, and Barney was there at every turn.*

The roadblock by Senate Democrats was done, I am sure, for what some thought were honorable reasons. But once again, there were unintended consequences. At the time, in another report, I cynically speculated that considering as far as this crisis had gone, perhaps "waste, fraud and abuse" were the only things holding the system together – and that the Democrats' rush to do the bailout bill was partly motivated by doing things to minimize disclosure of their foolish meddling and bungling.

My Goal For This Report?

I don't deny that there were many greedy and foolish things done outside of government and in the financial services industry. But that's only PART of the story. **My goal in this report is simply to help redirect the discussion, by using facts and true historic events, to more accurately assign blame for the housing and mortgage crisis.**