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A real kick in the Fannie

Joe Feuerherd | Oct. 12, 2008

In other words, the kids got something -- 45 minutes of freedom from the rigors of geometry or chemistry, colorful clothing, the camaraderie of friends on a fine fall afternoon, a soothed conscience -- for nothing. The event's patrons took something good, the youthful inclination toward service and the instinct to help the unfortunate, and turned it tawdry and transactional.

The sponsor of this sham? Fannie Mae, the now federally managed mortgage giant whose culture of corruption, both political and economic, is at the root of the current financial crisis. Ultimately, Fannie slimed not just those kids, but most everything it touched: a housing market it was created to stabilize; the Congress members it cajoled, threatened, flattered and influenced; and the bipartisan parade of former government officials who traded the access they could provide for six- and seven-figure salaries.

Initially, as a government entity, Fannie Mae performed a straightforward function, purchasing home mortgages originated by local bankers and then bundling them into securities sold to investors seeking a secure vehicle for their funds. Fannie's role (and subsequently that of its "competitor" Freddie Mac) was positively boring by today's go-go standards. The loans they purchased were underwritten by local bankers and thrifts (think Jimmy Stewart in "It's a Wonderful Life"), hence the requirement that borrowers meet sensible criteria -- essentially that they had enough income to afford the house they were buying. Fannie was as good an example of government working toward the common good, the "general welfare" of its people, as one could cite. So, what happened?

In 1968, Fannie was spun off from the government, its success to be measured by the price of its stock, not the furtherance of its mission. The magic bullet that made all this possible was an implicit federal guarantee that allowed Fannie to operate with fewer reserves than would otherwise be prudent. Still, all was good, as long as the underlying value of its investment -- American homes -- continued to grow.

Then things turned sour. Accounting scandals early in this decade revealed that Fannie overstated earnings by $11 billion. Earnings were tied to stock prices, which in turn fueled Fannie's obscene executive compensation packages. In its quest for returns, Fannie purchased subprime loans -- the type of "innovative financial product" it would have rejected two decades prior. It packaged those mortgages into arcane financial products few actually understood. Eventually, the rapidly declining value of the underlying assets behind those loans -- the foreclosed homes many purchasers discovered they couldn't afford -- became evident.

Through the years there were voices -- Republican and Democrat, conservative and liberal -- urging that Fannie be reined in. But these critics were stifled and quashed, largely through Fannie's bullying. Regional Fannie

offices, for example, functioned as political war rooms, designed to reward well-behaved officeholders with investments in their communities. A stick shaken on Washington's K Street would likely hit a Fannie lobbyist. Housing advocacy groups, meanwhile, found themselves silenced by the beneficence of Fannie's charitable arm, which doled out contributions more to quiet potential critics than to fulfill its federally mandated mission to support the development of affordable rental housing. Regulators looked the other way.

Now the FBI, the SEC, Congress and some other subpoena-powered investigators are looking into both Fannie Mae and Freddie Mac. Were laws broken? Perhaps. But the real scandal could be that this culture of corruption may have been entirely legal.

Still, the idea that the finely coifed grifters who ran this scam might someday have to be sprung from their cells to enjoy a 45-minute stroll around the grounds might convince taxpayers that the government is serious about cleaning up the mess. Maybe the warden will give them matching T-shirts.

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