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BUSINESS DAY

A Revolving Door Helps Big Banks' Quiet Campaign to Muscle Out Fannie and Freddie

A behind-the-scenes effort of Wall Street banks to take over the mortgage market is driven by advocates who switch between roles in Washington and the private sector.

By GRETCHEN MORGENSON DEC. 7, 2015

Decades ago, Fannie Mae, whose Washington headquarters are seen here, was created to help provide prospective homebuyers with financing in both good times and bad.
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Seven years after their dubious lending practices helped push the United States economy to the brink of disaster, the nation's largest banks are closing in on a long-sought goal: to unseat Fannie Mae and Freddie Mac, the mortgage finance giants, and capture their share of the profits in the country's $5.7 trillion home loan market.

Taking place largely behind the scenes, the movement to take over the mortgage market has been propelled in part by a revolving door between Washington and Wall Street, an investigation by The New York Times has found.

While the big banks' effort to enshrine their vision into law has failed so far, plans to replace Fannie and Freddie — which have long supported the housing market by playing a unique role as so-called government-sponsored enterprises, or G.S.E.s — are still very much alive. The Obama administration has largely embraced the idea, and government regulators are being pushed to put crucial elements into effect.

A review of lobbying records, legal filings, and internal emails and memorandums, as well as housing officials' calendars and White House and Treasury visitor logs, illuminates the banks' effort. Assisting in this work, the documents show, is a group of high-level housing finance specialists who have moved back and forth between public service and private practice in recent years.

The charge began under Michael D. Berman, who has served not only as chairman of the Mortgage Bankers Association, one of the industry's most influential lobbying organizations, but also as a senior adviser to Shaun Donovan, who was the secretary of Housing and Urban Development from 2009 to 2014.

Conversely, Mr. Berman recruited David H. Stevens — who was one of the lead architects of the Obama administration's proposal to phase out Fannie and Freddie — to the mortgage bankers group, where Mr. Stevens is now president and chief executive.

Many in Congress believe Fannie and Freddie contributed to the collapse of the housing bubble, and they still rest on a shaky financial foundation, largely because of actions taken by the Treasury and the companies' regulator.

While they continue to pose a risk to taxpayers, Fannie and Freddie so far have not been replaced by Wall Street behemoths, partly because local banks popular with many lawmakers are resistant. Moreover, some members of Congress are concerned that low-income borrowers would not be well served by private lenders.

For all the problems associated with Fannie and Freddie, some housing experts say, allowing the nation's largest banks to assume greater control of the mortgage market would most likely increase costs for borrowers. It would also reduce participation and competition from smaller lenders, and could imperil taxpayers because of the potential for even greater bailouts for financial institutions that Washington considers too important to be allowed to fail.

Elise J. Bean is among those who are troubled by the quiet advances Wall Street is making toward Fannie and Freddie's turf. A former chief counsel for the Senate Permanent Subcommittee on Investigations, Ms. Bean oversaw a bipartisan investigation into the causes of the financial crisis, playing a central role in the committee's four hearings and helping produce a revealing 650-page report.

"Fannie and Freddie have their flaws, but that doesn't mean the answer is to hand over their business to the banks," Ms. Bean said. "Their role in the mortgage market is too important to put under the thumb of banks with a history of toxic mortgages, structured finance abuse and consumer maltreatment."

Behind the Bailout

Decades ago, Fannie Mae and Freddie Mac were created by the government to provide prospective home buyers with financing in both good times and bad. Fannie was born in 1938 during the Depression, when bank lending dried up. The company didn't make mortgage loans outright; it bought them from other entities. Later, it pooled loans in securities that it sold to investors.

If credit was scarce, the thinking went, banks would be more inclined to lend knowing they could sell a loan to Fannie or to Freddie, a competitor company created in 1970. A bank could then turn around and make another loan, earning fees while keeping the housing finance wheels spinning.

In addition to benefiting borrowers, this system enabled small community lenders to sell their loans to Fannie and Freddie as easily as even the biggest guns in banking. This gave borrowers a choice of lenders, encouraging competition and keeping costs down.

Although government creations, Fannie and Freddie also had public shareholders. Fannie sold shares for the first time in 1968 and Freddie followed suit two decades later. As the nation's economy grew and homeownership expanded, Fannie and Freddie became increasingly powerful and profitable institutions.

The unusual hybrid of shareholder-owned companies carrying the government's imprimatur worked well for a long time. But the combination turned sour in the 1990s when Fannie executives began using the company's lush profits to finance lobbying efforts that enhanced their stature and independence in Washington.

Throughout these years, Fannie and Freddie's mounting profits, generated in part by their special ties to the government, which put them at a financial advantage, also drew resentment from the nation's largest banks.

Fannie's success wound up being a double-edged sword. Its enfeebled overseer, the Office of Federal Housing Enterprise Oversight, allowed its enormous operations to rest on the tiniest sliver of capital, increasing profits during the fat years. But when the financial crisis hit, expected loan losses at both Fannie and Freddie overwhelmed the small amount of capital the companies had on hand.

About a week before Lehman Brothers collapsed in September 2008, the government stepped in. It put Fannie and Freddie into conservatorship under the Federal Housing Finance Agency, a new and stronger regulator created that summer in the Housing and Economic Recovery Act. The companies ultimately drew about $187.5 billion from