

Fannie Mae and Freddie Mac:

IN DEFENSE OF THE HEDGE FUNDS

Their crime? *They bet on America.*

For every dollar they make, the taxpayer makes four.

They're at it again. Apparently alarmed by reports the **Trump Administration** might finally end the decade-long conservatorship of **Fannie Mae** and **Freddie Mac** (the "GSEs"), their staunchest opponents have taken to the blogs to recycle their shopworn lies: the two mortgage insurance companies caused the 2008 financial crisis; they operated with "*flawed charters*" allowing "*private gains and public losses*"; returning the companies to their rightful owners would be nothing more than a "*payday for greedy hedge funds*".

Time – and the release of documents which the **Obama Administration** kept secret for years – has now thoroughly debunked these falsehoods, but the GSE-haters just can't resist replaying their golden oldies. Indeed, [assertions recently made](#) by **David H. Stevens**, former head of the **Mortgage Bankers Association**, are typical (and typically untrue). Let's unpack them one-by-one:

"These companies are in conservatorship because they failed . . ."

As is clearly spelled out in various lawsuits (which Mr. Stevens apparently hasn't read or has chosen to ignore) Fannie and Freddie never "failed". True, they had been booking losses. But when the

government took them over on September 6, 2008, they were in full compliance with all regulatory capital requirements, had the highest capital ratios in their histories, and were flush with cash. If they truly were on death's door, as Mr. Stevens would have you believe, how does he explain that just three days prior to their being placed into conservatorship, they'd successfully raised \$6 billion in unsecured debt in an over-subscribed offering underwritten by the crème de la crème of Wall Street investment banks? (The bond issues were rated AA+ and AAA-). As I have previously written, "[it wasn't a bailout; it was a stick-up.](#)"

"They made bad decisions that helped spiral the economy near the brink."

The oft-repeated accusation that Fannie and Freddie were the culprits behind the financial crisis is nonsense. From the official report of the **Financial Crisis Inquiry Commission**: "*We conclude that these two entities contributed to the crisis but were not a primary cause. Importantly, GSE mortgage securities essentially maintained their value throughout the crisis and did not contribute to the significant financial firm (i.e., commercial bank) losses that were central to the financial crisis." (Emphasis added.)*

“Only help(s) billionaire hedge funds.”

Really? Tell that to the tens of thousands of Fannie Mae and Freddie Mac shareholders who are not “billionaire hedge funds” – such as **Nicholas Isbell** of Chevy Chase, MD, who invested his daughter’s college tuition fund in what were, until up to the moment the government seized them, blue-chip, dividend-paying stocks. Tell that to the thousands of **Fannie and Freddie employees** who watched, horrified, when the value of their 401(k) plans suddenly plummeted. Tell that to the **thousands of middle-class workers**; policemen, firemen, carpenters, electricians, truck drivers, whose pension funds had invested in the two companies. And how about the hundreds of community banks – which saw the value of their Fannie and Freddie preferred share holdings virtually evaporate between when they left work on Friday afternoon and when they returned on Monday morning – such as **John F. Herbin**, president of the **Jamestown State Bank** in Jamestown (pop. 286), Kansas. Then there are the mutual funds, the insurance companies, and even the **Knights of Columbus** and the **Catholic Order of Foresters**. Are they all just ‘collateral damage’ to Mr. Stevens and his fellow GSE-bashers? Instead of railing against “greedy hedge funds”, perhaps they could do a little homework and make at least a perfunctory effort to learn who the rest of the owners of Fannie Mae and Freddie Mac are.

It’s true that subsequent to the seizures, several large hedge funds were able to acquire blocks of Fannie and Freddie stock and are now significant shareholders. But who sold them the stock? Mom-and-pop investors? Of course not. Ironically, it appears the seller was the government itself. When regulators ordered the banks to write-off their Fannie and Freddie shares, over a dozen suddenly found themselves underwater in terms of meeting minimum regulatory capital requirements. They were seized by the FDIC (with their wiped-out shareholders becoming just more ‘collateral

damage’.) In 2011, the FDIC, as receiver, aggregated their holdings and dumped over 30 million shares on the market. As those of us who lived through those dark days will recall (the Dow had bottomed at 6,443), there weren’t many people with the courage to buy pretty much anything at the time – let alone shares of two companies which had been placed into government conservatorship. There were, however, ‘contrarian’ investors who believed things would get better; markets would stabilize; housing values would rebound. They were willing to step in and buy when most people (including the FDIC) were selling. It was a gutsy call. (And, in retrospect, quite prescient.) But whether the investor pulling the trigger was a hedge fund manager; a mutual fund manager; a pension fund manager – or simply a retail investor trading from a computer in his basement – all had one thing in common: they were betting on America.¹

Over 10 years have now passed since those frightening days. In the interim, the **Dow Jones Industrial Average** has increased just under *20,000* points and Uncle Sam has earned a whopping *\$100 billion* on his Fannie and Freddie ‘investment’. As if that weren’t enough, it’s estimated that were the Treasury to exercise penny warrants on 80 percent of their common shares, it could reap yet another \$150 billion windfall. That would allow **President Trump** to claim credit for making the best deal for the American taxpayer since the **Louisiana Purchase**. Nonetheless, the anti-GSE crowd seems to think Fannie and Freddie shareholders deserve no compensation for the nationalization of their companies.

That may work in banana republics and Communist countries, but not in the United States of America.

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¹ I am told that many of the banks, after being ordered to write off their Fannie and Freddie holdings, never actually disposed of the shares. As a result, were Fannie and Freddie to be

recapitalized (with the shares returning to their par values), the resultant write-ups would substantially increase their regulatory capital which, in turn, would significantly boost their ability to make loans in their communities.

Additional resources:

- HINDESight™ Nov. 26, 2018: [Release the Hostages](#)
- HINDESight™ Sept. 4, 2018: [Ten Years After Henry Paulson's Colossal Blunder](#)
- HINDESight™ Sept. 6, 2017: ["The Case of the Concrete Life Preserver"](#)
- HINDESight™ Aug. 25, 2017: [Fanniegate: The Cover-up Unravels](#)
- HINDESight™ Sept. 6, 2016: [The Myth of Private Gains and Public Losses](#)

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