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Secretary Geithner's Listening Tour on Housing Market Reform Comes to Washington

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Abstract: *Treasury Secretary Timothy Geithner recently held a meeting to discuss what the future housing finance system should do and look like. However, he discouraged discussion of what caused the crisis in the housing market. Regrettably, the consensus view from the panel called for continued and likely expanded federal involvement in the market, even though the entire market is already almost completely federalized. Unless the Obama Administration changes course on the housing financial market, it will simply repeat the mistakes of the past, leaving the taxpayers to pay for the cleanup.*

Talking Points

- America's housing finance market is now almost exclusively in the hands of the federal government.
- The bankrupt and federally controlled Fannie Mae and Freddie Mac, along with the Federal Housing Administration, accounted for 96.5 percent of residential mortgages made in early 2010.
- The private banking system now largely serves as a federal contractor, and mortgage activity is concentrated in a handful of consolidated banks. The top four originated 60 percent of residential mortgages in early 2010.
- Many in the financial community want Fannie Mae and Freddie Mac to continue to play a major role in housing.
- To date, bailing out Freddie and Fannie has cost the taxpayers $145 billion, and the cost is expected to continue rising.
- The promised federal mortgage market reform proposal may very well involve a corporatist partnership between the Obama Administration and a few of the nation's largest financial institutions.

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We worked through Spring and Winter, through Summer and through Fall
But the mortgage worked the hardest and the steadiest of us all
It worked on nights and Sundays, it worked each holiday
Settled down among us and it never went away

—Ry Cooder[1]

On August 17, Treasury Secretary Timothy Geithner and Secretary of Housing and Urban Development Shaun Donovan held a heavily promoted meeting in the Treasury's Cash Room to continue a dialogue on the future of housing finance. Joining them was a carefully selected group of industry and policy insiders, federal dependents, the ubiquitous Mark Zandi, and a few real independents. The members of this eclectic, diverse panel were expected to offer thoughtfully diverse opinions on what the improved and reformed future housing finance system should do and what it should look like. Among the selected members was Ellen Seidman, executive vice president of ShoreBank Corporation, a troubled Chicago financial institution that the Federal Deposit Insurance Corporation (FDIC) seized three days after the meeting.[2]

However, each panelist was given only two minutes to address the four questions on financial reform that Geithner had asked in advance. Furthermore, in his opening remarks, Geithner discouraged any discussion of what caused the crisis in the housing market. Apparently, the current Department of the Treasury does not consider lessons from history relevant. Given the consensus view emerging from the panel, historian George Santayana's oft quoted and oft overused admonition "Those who do not remember the past are condemned to repeat it" seems particularly apt.

The Government Fails…

By discouraging discussion of causes, Secretary Geithner prevented the reform proposals from being informed by the massive failure of the existing federal financial regulatory infrastructure and bureaucracy. Federal regulators failed to detect any problems in the financial system in the days, weeks, months, and years leading up to the cataclysmic collapse that began in 2008.

Where were the Securities and Exchange Commission (3,814 employees); the FDIC (7,421); the Comptroller of the Currency (3,216); the Office of Thrift Supervision (251); the Federal Reserve Board and its 12 regional banks (2,100 employees in Washington, D.C., alone); the Federal Housing Administration (3,204); the Federal Financial Institutions Examination Council (10); and the Federal Housing Finance Agency (466)?[3] In particular, where was the Federal Housing Finance Agency, which was supposed to oversee Fannie Mae and Freddie Mac? Supplementing this massive federal presence were several dozen state bank supervisory authorities responsible for the safety and soundness of state-chartered banks, which also operate with FDIC insurance.

Looking back over the rubble of America's housing finance system, one can see that these federal entities did not lack experience. The FDIC has been attempting to perform these oversight tasks for eight decades, the Federal Reserve System has been doing so for 100 years, and the Comptroller of the Currency has been working at them since 1863. Perhaps practice makes perfect only in music and sports, not in government.

…So More Government Is Needed

The historical record also reveals that the federal regulatory agencies have not been burdened by quaint notions of a bygone era, because every one of these entities underwent a "thorough reform" of their regulatory roles in the late 1980s and early 1990s, when all were found negligent in one way or the other in the collapse of the savings and loan industry, which left both the FDIC and the Federal Savings and Loan Insurance Corporation bankrupt.

Obviously, the massive reform effort and regulatory overhaul in the early 1990s left a few loose ends, which a decade and a half later led to another unraveling of the system and produced a genuine catastrophe. With Secretary Geithner effectively preventing any discussion of the repeated federal financial regulatory failings, it is unsurprising that the day after the meeting the lead sentence of an article in a major newsletter covering Washington policy developments concluded:

> The government must continue to play a fundamental role in the future of housing

1. Ry Cooder, "Taxes on the Farmer Feeds Us All," *Into the Purple Valley*, Audio CD, 1990.
2. ShoreBank's seizure and transfer to new owners and operators is expected to cost the FDIC insurance fund $367.7 million. See Steve Daniels, "ShoreBank Fails; Will Be Reincarnated as Urban Partnership Bank," ChicagoBusiness.com, August 20, 2010, at *http://www.chicagobusiness.com/article/20100820/NEWS01/100829982/shorebank-fails-will-be-reincarnated-as-urban-partnership-bank* (October 1, 2010).
3. U.S. Office of Management and Budget, *Appendix*, *Budget of the United States Government, Fiscal Year 2011* (Washington, D.C.: U.S. Government Printing Office, 2010), at *http://www.whitehouse.gov/omb/budget/fy2010/assets/appendix.pdf* (October 1, 2010).

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> finance, a panel of experts agreed at a conference convened by the Obama administration to begin to frame a comprehensive housing finance reform proposal for delivery to Congress by January 2011.[4]

In the current situation, this statement seems wildly detached from reality, not because of its juvenile belief in the magical powers of Washington bureaucracies, but because of its apparent failure to recognize that government's role has gone well beyond the merely "fundamental." At the moment, the federal government *is* the mortgage finance market. Today, what passes for the private-sector mortgage market is little more than a government-fostered concentration of private contractors earning attractive fees for their limited but lucrative role in the new federal mortgage finance system.

Total Federal Control of Housing Finance Market

Secretary Geithner is promising that the Administration will propose an overhaul of the existing housing finance system around January 2011, but there is every reason to expect the Administration's proposal to involve a substantial and unprecedented further expansion of the federal government into the mortgage finance system. Since the early 20th century, the mortgage finance system has been the beneficiary of a variety of federal privileges, big and small. Today, it is nearly wholly federalized, which is unprecedented, even during the Great Depression.

In the first quarter of 2010, Fannie Mae and Freddie Mac, combined with the Federal Housing Administration and the Government National Mortgage Association, funded and/or guaranteed 96.5 percent of residential mortgages to homebuyers or homeowners refinancing an existing home.[5] The cost of this long-term reliance on the government-sponsored enterprises (GSEs) has been staggering. To date, taxpayers have transferred $145 billion to the GSEs,[6] and the Congressional Budget Office estimates that the total cost to the taxpayer will continue to rise.[7]

In turn, these mortgages are being originated by a federally induced concentration of financial institutions that is also unprecedented in America's history. As a consequence of federal subsidies and bank and thrift consolidations and mergers "encouraged" by the FDIC, a staggering 60.26 percent of all residential mortgages in the first quarter of 2010 originated through just four financial institutions: Wells Fargo, Bank of America, JPMorgan Chase, and Ally Bank.[8] Nearly all of these mortgages were sold to the heavily subsidized GSEs, Fannie Mae and Freddie Mac.

The business of servicing outstanding residential mortgages is even more concentrated than the origination process. In the first quarter of 2010, 69.4 percent of residential mortgages were serviced by just four financial institutions: Bank of America, Wells Fargo, JPMorgan Chase, and Citibank.[9]

Banks Become Government Contractors

Notwithstanding the depressed state of the housing finance business, company reports reveal that mortgage origination and servicing, in partnership with the federal GSEs, remains a lucrative business. For example, Wells Fargo reported $4,481 million in mortgage banking income for the first six months of 2010.[10] The other financial institutions selling mortgages to the federal GSEs have posted similar income results.

4. Thecla Fabian and Aaron Lorenzo, "Treasury Gathers GSE Reform Ideas in 'Future of Housing Finance' Conference," Bureau of National Affairs *Daily Report for Executives*, August 18, 2010.
5. "Unfinished Business," *The Economist*, July 24, 2010, p. 71.
6. Nick Timiraos, "Wall Street Group Wants U.S. Involved in Fannie, Freddie," *The Wall Street Journal*, July 21, 2010, at *http://online.wsj.com/article/SB10001424052748703954804575381501771317956.html* (October 6, 2010).
7. Nick Timiraos, "Fannie, Freddie Losses May Hit U.S.," *The Wall Street Journal*, January 22, 2010, p. A6, at *http://online.wsj.com/article/SB10001424052748704381604575005242824023092.html* (October 5, 2010).
8. Ally Bank, formerly GMAC, is 80 percent owned by the federal government.
9. Data from National Mortgage News, "Residential Lenders Ranked by Volume, 2010Q1" and "Residential Servicers Ranked by Total Servicing Volume in 2010Q1," received by e-mail September 4, 2010.

Not surprisingly, the Securities Industry and Financial Markets Association (SIFMA)—these financial institutions are all SIFMA members—issued a press release on July 22, 2010, to accompany their letter to Geithner before his August listening event:

> While we recognize that there is no single right answer to GSE reform, it is critical that, in addressing this complex task, the benefits to consumers and the economy which are created under the current system be preserved. We encourage policymakers to fix what's broken without dismantling the aspects that have provided efficient, cost effective lending and benefits to our economy for the last 30 years.[11]

This press release from America's financial industry is remarkably self-serving given (1) the catastrophic collapse of the GSEs (and the mortgage market in which many SIFMA members were intimately involved); (2) the extraordinary economic hardship this collapse has imposed on the American people, including many employed in the housing market; and (3) the prospective cost of this GSE collapse to taxpayers.

Aftermath of Geithner's Listening Tour

Secretary Geithner has promised that the Obama Administration will be prepared to come forth with its GSE and housing finance reform ideas in early 2011. While the beleaguered taxpayer might hope the Administration would ignore SIFMA's advice on this issue, the indications are not good. Three of the 12 members on the August Treasury panel were from SIFMA member companies, and the Bureau of National Affairs report on the sentiment of the panel was quite similar to SIMFA's recommendation "for some form of continued government support."[12]

However useless the outcome of the Geithner event may be in resolving the profoundly serious problems confronting America's housing finance system, the event was useful in alerting taxpayers and fiscal conservatives that the new federal mortgage market reform proposal may very well involve a corporatist partnership between the Obama Administration and a few of the nation's largest financial institutions.

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10. Press release, "Wells Fargo Reports Net Income of $3.06 Billion: Up 20% from Prior Quarter," Wells Fargo, July 21, 2010, p. 20, at *https://www.wellsfargo.com/downloads/pdf/press/2q10pr.pdf* (October 1, 2010).
11. Press release, "SIFMA Supportive of GSE Reform Which Preserves Benefits to Consumers and the Economy," Securities Industry and Financial Markets Association, July 22, 2010, at *http://www.sifma.org/news/news.aspx?id=17728* (October 1, 2010).
12. *Ibid.*