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Playing Politics with Financial Security

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Fannie Mae and Freddie Mac are dangerously weak. So why are House Democrats delaying critical regulatory reforms?

Legislation that would provide a satisfactory regulatory structure for the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac has finally reached the Senate floor, thanks to an agreement between Banking Committee Chairman Christopher Dodd and ranking Republican Richard Shelby. The GSE provisions have been praised by the Bush administration and are similar to measures passed last year by the House of Representatives. The GSE bill is moving because it is joined at the hip with a housing relief measure that Democrats would like to send to the president before the August recess. The administration has forcefully objected to some of the housing sections; but if White House concerns can be accommodated in conference, there is a real prospect that urgently needed GSE regulatory reforms will be enacted this year.

However, the effective date of the GSE portion of the legislation—not normally a substantive issue—has created a serious obstacle. The House bill was enacted in the more benign financial environment that prevailed during much of 2007, and it provided for a six-month period before the new regulatory agency would begin operations. The Senate bill is being considered at a time when Fannie and Freddie are dangerously weak, and it would make the new regulatory powers effective immediately upon enactment. Recently, House Speaker Nancy Pelosi weighed in to support the six-month waiting period, saying explicitly that this would give the next president the opportunity to name the new GSE regulator. And Barney Frank, chairman of the House Financial Services Committee, recently confirmed that the effective date issue is the biggest sticking point between the House and Senate GSE measures.

Given the dangerous financial condition of Fannie and Freddie, the House position seems needlessly rigid and partisan. The House originally passed this legislation because there was genuine concern that a financial crisis at one or both of the GSEs could have a devastating effect on housing and on the general economy. What else could have been the reason? But now that crisis conditions have actually arrived, with both GSEs reporting large losses in the last two quarters and predictions of even greater declines in housing values in the future, the House leadership is willing to delay implementation of the stronger regulatory controls so that a Democratic president can appoint the head of the new agency.

The Senate legislation provides for a fixed term of five years for the director of the new GSE regulator. However, with the November election just four months away, Senate Democrats will not let President Bush nominate a new director for such an extended period. For this reason, the

Senate bill stipulates that the current director of the Office of Federal Housing Enterprise Oversight (the GSEs' regulator) will serve as an interim director of the new agency—with full power to act—until his successor is nominated and confirmed. The only person who could receive confirmation from the Democratic Senate for a full five-year term would be someone nominated by the new president. Thus, the language of the Senate bill solves the nomination problem, and makes sure that the wider authorities granted to the new GSE regulator are available immediately upon the enactment of the legislation (when they may be needed).

For example, both the House legislation and Senate bill give the new regulator the powers of a receiver—the essential authority to assume control of and continue operating a failing GSE while it can still be saved or after it has become insolvent. The provisions are quite similar to what the Federal Deposit Insurance Corporation can do to take over and resolve failing banks. This is vitally important. Scholars generally agree that the bankruptcy laws do not apply to these federally chartered corporations, so the insolvency of either of them would result in chaos in the financial markets, where thousands of financial intermediaries and central banks throughout the world hold trillions of dollars in GSE debt securities that could fall precipitously in value.

Unfortunately, House leaders seem willing to delay critical regulatory reforms in order to save one more appointment for the next president, regardless of the risks to global financial security. Bipartisanship may be out of fashion in Washington, but partisanship for its own sake is not a responsible course when the health of the financial system is at stake.

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