History of Fannie Mae

The Federal National Mortgage Association, colloquially known as Fannie Mae, was established in 1938 by amendments to the National Housing Act.[6] after the Great Depression as part of Franklin Delano Roosevelt's New Deal. Fannie Mae was established in order to provide local banks with federal money to finance home mortgages in an attempt to raise levels of home ownership and the availability of affordable housing.[7] Fannie Mae created a liquid secondary mortgage market and thereby made it possible for banks and other loan originators to issue more housing loans, primarily by buying Federal Housing Administration (FHA) insured mortgages.[8] For the first thirty years following its inception, Fannie Mae held a monopoly over the secondary mortgage market.[9] In 1954, an amendment known as the Federal National Mortgage Association Charter Act[10] made Fannie Mae into "mixed-ownership corporation" meaning that federal government held the preferred stock while private investors held the common stock;[6] in 1968 it converted to a publicly held corporation, in order to remove its activity and debt from from the federal budget.[11] In the 1968 change, Fannie Mae's predecessor (also called Fannie Mae) was split into the current Fannie Mae and the Government National Mortgage Association ("Ginnie Mae"). Ginnie Mae, which remained a government organization, supports FHA-insured mortgages as well as Veterans Administration (VA) and Farmers Home Administration (FmHA) insured mortgages, with the full faith and credit of the United States government.[12] In 1970, the federal government authorized Fannie Mae to purchase private mortgages, i.e. those not insured by the FHA, VA, or FmHA, and created the Federal Home Loan Mortgage Corporation (FHLMC), colloquially known as Freddie Mac, to compete with Fannie Mae and thus facilitate a more robust and efficient secondary mortgage market.[12]

In 1981, Fannie Mae issued its first mortgage passthrough and called it a *mortgage-backed security*. The Fannie Mae laws did not require the Banks to hand out subprime loans in any way.[13] Ginnie Mae had guaranteed the first mortgage passthrough security of an approved lender in 1968[14] and in 1971 Freddie Mac issued its first mortgage passthrough, called a *participation certificate*, composed primarily of private mortgages.[14]

In 1992, President George H.W. Bush signed the Housing and Community Development Act of 1992. The Act amended the charter of Fannie Mae and Freddie Mac to reflect Congress' view that the GSEs "have an affirmative obligation to facilitate the financing of affordable housing for low-income and moderate-income families."[15] For the first time, the GSEs were required to meet "affordable housing goals" set annually by the Department of Housing and Urban Development (HUD) and approved by Congress. The initial annual goal for low-income and moderate-income mortgage purchases for each GSE was 30% of the total number of dwelling units financed by mortgage purchases[16] and increased to 55% by 2007.

In 1999, Fannie Mae came under pressure from the Clinton administration to expand mortgage loans to low and moderate income borrowers by increasing the ratios of their loan portfolios in distressed inner city areas designated in the CRA of 1977.[17] Because of the increased ratio requirements, institutions in the primary mortgage market pressed Fannie Mae to ease credit requirements on the mortgages it was willing to purchase, enabling them to make loans to subprime borrowers at interest rates higher than conventional loans. Shareholders also pressured Fannie Mae to maintain its record profits.[17]

In 2000, because of a re-assessment of the housing market by HUD, anti-predatory lending rules were put into place that disallowed risky, high-cost loans from being credited toward affordable housing goals. In 2004, these rules were dropped and high-risk loans were again counted toward affordable housing goals.[18]

The intent was that Fannie Mae's enforcement of the underwriting standards they maintained for standard conforming mortgages would also provide safe and stable means of lending to buyers who did not have prime credit. As Daniel Mudd, then President and CEO of Fannie Mae, testified in 2007, instead the agency's underwriting requirements drove business into the arms of the private mortgage industry who marketed aggressive products without regard to future consequences: "We also set conservative underwriting standards for loans we finance to ensure the homebuyers can afford their loans over the long term. We sought to bring the standards we apply to the prime space to the subprime market with our industry partners primarily to expand our services to underserved families.

"Unfortunately, Fannie Mae-quality, safe loans in the subprime market did not become the standard, and the lending market moved away from us. Borrowers were offered a range of loans that layered teaser rates, interest-only, negative amortization and payment options and low-documentation requirements on top of floating-rate loans. In early 2005 we began sounding our concerns about this "layered-risk" lending. For example, Tom Lund, the head of our single-family mortgage business, publicly stated, "One of the things we don't feel good about right now as we look into this marketplace is more homebuyers being put into programs that have more risk. Those products are for more sophisticated buyers. Does it make sense for borrowers to take on risk they may not be aware of? Are we setting them up for failure? As a result, we gave up significant market share to our competitors."[19]

In 1999, *The New York Times* reported that with the corporation's move towards the subprime market "Fannie Mae is taking on significantly more risk, which may not pose any difficulties during flush economic times. But the government-subsidized corporation may run into trouble in an economic downturn, prompting a government rescue similar to that of the savings and loan industry in the 1980s."[20] Alex Berenson of *The New York Times* reported in 2003 that Fannie Mae's risk is much larger than is commonly held.[21] Nassim Taleb wrote in *The Black Swan*: "The government-sponsored institution Fannie Mae, when I look at its risks, seems to be sitting on a barrel of dynamite, vulnerable to the slightest hiccup. But not to worry: their large staff of scientists deem these events 'unlikely'".[22] Mike Stathis also warned about the risks of Fannie Mae, triggering the financial crisis in America's Financial Apocalypse. "With close to $2 trillion in debt between Freddie Mac and Fannie Mae alone, as well as several trillion held by commercial banks, failure of just one GSE or related entity could create a huge disaster that would easily eclipse the Savings & Loan Crisis of the late 1980s. This would certainly devastate the stock, bond and real estate markets. Most likely, there would also be an even bigger mess in the derivatives market, leading to a global sell-off in the capital markets. Not only would investors get crushed, but taxpayers would have to bail them out since the GSEs are backed by the government. Everyone would feel the effects. At its bottom, I would estimate a 30 to 35 percent correction for the average home. And in 'hot spots' such as Las Vegas, selected areas of Northern and Southern California and Florida, home prices could plummet by 55 to 60 percent from peak values." [23][24]

Congress, controlled by Republicans during this period, did not introduce any legislation aimed at bringing this proposal into law until the *Federal Housing Enterprise Regulatory Reform Act of 2005*, which did not proceed out of committee to the Senate.[25]

On January 26, 2005, the *Federal Housing Enterprise Regulatory Reform Act of 2005* (S.190) was first introduced in the Senate by Sen. Chuck Hagel.[26] The Senate legislation was an effort to reform the existing GSE regulatory structure in light of the recent accounting problems and questionable management actions leading to considerable income restatements by the GSE's. After being reported favorably by the Senate's Committee on Banking, Housing, and Urban Affairs in July 2005, the bill was never considered by the full Senate for a vote.[27] Sen. John McCain's decision to become a cosponsor of S.190 almost a year later in 2006 was the last action taken regarding Sen. Hagel's bill in spite of developments since clearing the Senate Committee. Sen. McCain pointed out that Fannie Mae's regulator reported that profits were "illusions deliberately and systematically created by the company's senior management" in his floor statement giving support to S.190.[28][29]

At the same time, the House also introduced similar legislation, the *Federal Housing Finance Reform Act of 2005* (H.R. 1461), in the Spring of 2005. The House Financial Services Committee had crafted changes and produced a Committee Report by July 2005 to the legislation. It was passed by the House in October in spite of President Bush's statement of policy opposed to the House version.[30] The legislation met with opposition from both Democrats and Republicans at that point and the Senate never took up the House passed version for consideration after that.[31]

Change in ownership structure September 7, 2008

On September 7, 2008, James Lockhart, director of the Federal Housing Finance Agency (FHFA), announced that Fannie Mae and Freddie Mac were being placed into conservatorship of the FHFA. The action is "one of the most sweeping government interventions in private financial markets in decades".[32][33][34] As of 2008, Fannie Mae and the Federal Home Loan Mortgage Corporation (Freddie Mac) owned or guaranteed about half or 56.8% of the U.S.'s $12 trillion mortgage market.[35]