Looting of Fannie and Freddie Demands New Pecora Commission

by John Hoefle

Aug. 7—When the Bush Administration initiated its "rescue" of mortgage-speculation giants Fannie Mae and Freddie Mac last September, we warned that, far from saving the two firms, they were being thrown to the wolves. The Treasury Department effectively took control of both firms, promising to provide as much money as necessary to keep them solvent, and to buy billions of dollars of Fannie- and Freddie-issued mortgage securities on the open market.

The intervention was a crucial part of the scheme to bail out the global financial markets, by pumping up the values of trillions of dollars of mortgages and mortgage-related securities.

There were two major aspects to this plan. The first was to put an explicit government guarantee behind the debt issued by the two quasi-governmental entities, as a way of luring buyers back into badly spooked markets. The second was to get the firms—which were then guaranteeing some 70% of all new home loans—to help bail out the banks by taking over big chunks of their mortgage exposures.

Under this scheme, huge losses have effectively been moved from the books of the banks and other private institutions, to the government and the taxpayer. In that, it has been a wild success, a rip-off of the first order.

While this program was inaugurated under the Bush/Cheney Administration and Treasury Secretary Henry Paulson, it was also explicitly endorsed by then-Democratic Presidential nominee Barack Obama. Obama backed the bailout schemes then, and has continued the swindle as President.

Hemorrhaging Money

Since the September 2008 bailout, the two firms have reported losses of some $150 billion. They have lost over $165 billion since Lyndon LaRouche declared the global monetary system dead, in July 2007. These figures include Fannie Mae's $15 billion loss for the second quarter of this year, but not Freddie Mac's loss, which has yet to be announced.

In what qualifies as one of the understatements of the year, Federal Housing Finance Agency (FHFA) director James Lockhart admitted June 30, that at least some of the $85 billion in capital the government has injected into the two companies to keep them solvent "will never be repaid." Lockhart added that the two firms will continue losing money "for at least the next year or so."

That $85 billion figure does not include the $10.7 billion the government injected into Fannie Mae, after it announced its second-quarter loss. The injection was required to keep Fannie's reported net worth above $0.

Just a few days later, in an Aug. 5 interview with the *Washington Post,* Lockhart announced that he would step down from his post by the end of the month. As head of the FHFA, Lockhart is the primary regulator for Fannie Mae and Freddie Mac. The FHFA was created by the Housing and Economic Recovery Act of 2008, which merged the Federal Housing Finance Board and the Office of Federal Housing Enterprise Oversight, the previous regulator of Fannie Mae and Freddie Mac.

On the day the Housing Act was signed into law (July 30, 2008), Lockhart promised that under the new regulatory structure, Fannie and Freddie would "provide stability and liquidity to the mortgage market, support affordable housing, and operate safely and soundly."

It didn't work out that way. Today, after at least hundreds of billions of dollars of government injections and subsidies, another reorganization of Fannie Mae and Freddie Mac is in the works.

Bad Idea

The Obama Administration is actively considering plans to stop the meltdown of Fannie and Freddie, as part of yet another futile effort to halt the collapse of home values and restart the markets for, and values of, mortgage-related securities.

One of these plans, the *Washington Post* reported Aug. 6, would involve dumping hundreds of billions of dollars of Fannie's and Freddie's toxic assets into a newly created "bad bank." The government would cover the losses of this "bad bank," while Fannie and Freddie would return to financial health, and thus be able to make even more loans to support the bailout.

While the White House was quick to deny that any particular plan has been decided upon, White House spokesman Jennifer Psaki did admit to the *Washington Post* that, since June, Larry Summers' National Economic Council has been looking at plans to reorganize Fannie and Freddie.

The details of any particular plan are less important than the back-door admission that the "rescue" of Fannie and Freddie has been a total disaster, and further proof that Washington has learned nothing from its failure. Two years after the crash, despite failure after failure, these fools are still trying to reanimate a dead system. All they are doing is fueling monetary hyperinflation in a vain effort to halt an unstoppable deflation of financial asset valuations. It is the worst possible move.

Worse To Come

What Washington undoubtedly knows, is that the losses at Fannie and Freddie—losses that were a direct result of using the firms to take over the losses of the banks and other speculators—are about to surface in a big way. Housing values continue to fall, and a report issued this week by Deutsche Bank projects that the percentage of homeowners in the U.S. who owe more on their mortgages than their homes are worth, will nearly double from 26% of mortgage-holders at the end of March, to 48% in 2011. These figures are for prime loans; 69% of subprime loans and 89% of Option-ARM (adjustable rate mortgage) loans will be underwater by 2011, with some areas topping 90%, the bank said.

We view these projections as optimistic, as linear projections of a process which is decidedly non-linear. There is no reason to believe that the delusions of financial viability will survive until 2011, much less the mortgage and home value projections.

Even so, those projections are enough to generate losses at Fannie Mae and Freddie Mac that are almost incalculable in their magnitude. The losses on their mortgage portfolios will be huge, but the losses on their derivatives operations—their mortgage-backed securities and hedging operations—will likely run into the double- or even triple-digit trillions of dollars.

In this connection, we recall the strange death of Freddie Mac chief financial officer David Kellermann, who allegedly committed suicide in April. Kellermann had been involved in heated discussions with officials at the FHFA over whether and how to disclose the losses that the Obama Administration's "foreclosure prevention" schemes would cause Fannie Mae. Kellermann thought the losses should be disclosed. Just two months later, according to the White House, plans were being discussed to reorganize Freddie and Fannie.

At the time of Kellermann's death, Lyndon LaRouche called for a full investigation of the circumstances of the case, noting the recurring frauds in both Freddie Mac's bookkeeping and the way in which the firm was being looted in the bailout. LaRouche noted that not only was Freddie Mac under investigation at the time for accounting and other irregularities by the Justice Department and the SEC, but that Kellermann had also hired private security for his home. Kellermann was clearly on a hot seat, in a position to know a great deal about the company's fiscal condition and its financial practices, and with his death—suicide, or not—that knowledge was lost.

Given the level of criminality which brought the global financial system to its collapse, and the level of criminality which has allowed financial institutions to continue to operate after that collapse, it is imperative that the cases of Fannie and Freddie be thoroughly investigated by a new Pecora Commission—one that, unlike Nancy Pelosi's sham, is worthy of the name.

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