

The Predators' Ball

Fannie Mae and Freddie Mac have helped defang laws that might have prevented the subprime mess.

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NEWSWEEK

Updated: 2:55 PM ET Aug 9, 2008

Roy Barnes is a self-described "small-town" lawyer with a mane of silver hair and an Andy Griffith drawl. But like Griffith's Ben Matlock, the TV character he resembles, Barnes is the furthest thing from a rube. He comes from a family of bankers, and back in the '90s Barnes saw, far before many in Washington, what was happening as deregulation took lending further away from the local banks and gave it to mortgage brokers and Wall Street. So when Barnes was elected governor of Georgia in 1998, he decided to push through the toughest antipredatory lending law in the country. The 2002 law made everyone up the line, including investment banks on distant Wall Street and rating agencies like Standard & Poor's, legally liable if the loans they sold, securitized or rated were deemed unfair. "There has to be accountability," Barnes told NEWSWEEK. "In the end you have to be able to say, do I really want to make this loan? Because I may have to eat it." "A victory for Georgia consumers," the Atlanta Journal-Constitution called the new law, which was also hailed by AARP and the NAACP.

It was when Roy Barnes started talking about accountability that the Feds began marching into Georgia. Barnes found himself besieged by lobbyists from major banks and national regulators—as well as Fannie Mae and Freddie Mac, the government-sponsored mortgage issuers whose mandate is to help people obtain affordable homes at fair prices; today, Fannie and Freddie are so financially fragile that the government has agreed to bail them out if necessary.



The major mortgage issuers hinted that they would turn Georgia into a financial pariah if the state made them liable. They let Barnes know in no uncertain terms that he was something of a "country bumpkin" when it came to banking, says his legislative aide, Chris Carpenter. As Barnes recalls, "They would say—and Fannie Mae and Freddie Mac were part of it—'This is a complex global market. If you start interfering with the free flow of money, then Georgia will become an island that has no credit'. I kept telling them, 'You're in for a crash here!'"

Ultimately, the Georgia Legislature, under Barnes's successor, gutted his law in early 2003 after a dramatic eleventh-hour vote in which a Republican senator warned that Freddie Mac was about to cut off most of its business with the state. "It broke my heart," Barnes says. (Fannie and Freddie declined to comment specifically on any efforts against Georgia's liability law, but in general they say they have "always supported efforts to fight predatory lending," says Fannie spokesman Brian Faith.)

The saga of Roy Barnes's failed effort to protect Georgia from the subprime disaster is a reminder that states' rights can still be a good idea. It was state and local officials who saw the oncoming flood of failed loans first—not least because defaults and foreclosures were destroying their neighborhoods years before Wall Street or Washington noticed. But what happened in Georgia is also a warning about what lies ahead—because the kind of federal lobbying Barnes faced six years ago is *still* being directed against state legislation today. Critics say new federal legislation and rules fall short, and that Washington's regulators continue to try to pre-empt states from regulating national banks and thrifts. "In the face of this horrible mess, we still don't have firm, clear regulations to protect consumers, like prohibiting loans the borrower can't repay, or gouging on price," says Margot Saunders of the National Consumer Law Center in Washington.

Nowhere is the sense of state impotence greater than California, which became ground zero for subprime defaults. Last May, David Jones, chair of the California Assembly's Judiciary Committee, tried to resurrect Barnes's idea of liability in California. The result "was major jihad by the lending industry," which killed the bill, says Kevin Baker, the committee's chief counsel. New York state was somewhat more successful—it signed a bill into law this month—but "Freddie Mac was up in Albany working hard to gut the bill's language this past spring," says New York consumer advocate Sarah Ludwig.

Spokesmen for Fannie and Freddie say they've sought to work with states, not override them, and they have often backed consumer-friendly new rules, such as one banning unnecessary credit insurance. Late last month President George W. Bush signed a law that created a new regulator for Fannie and Freddie called the Federal Housing Finance Agency. But that law also offered Fannie and Freddie multibillion-dollar bailouts at taxpayer expense, with no demand for internal reform, critics say. Former Treasury secretary Larry Summers argues that we're missing a "once in a generation opportunity" to reform Fannie and Freddie, which wield enormous lobbying power in Washington and on Wall Street. Summers, a Harvard economist, says the subprime crisis could end up costing taxpayers much more than the 1980s savings and loan bailouts, which left Americans with a \$300 billion bill.

Spokesmen and lobbyists for Fannie, Freddie and the banks say many of the problems that caused the current mess are being addressed. "The new law empowers our regulator to crack down on us in many ways," says Freddie spokesman Doug Duvall. At the Federal Reserve, chairman Ben Bernanke announced a new "Regulation Z," which created some common-sense rules, such as forbidding loans without sufficient documentation to show if a person has the ability to repay. As for now former governor Barnes, he may have turned out to be mostly right in his analysis of the subprime problem, but he says he's staying out of politics. Instead, as a real-life Ben Matlock, he will fight for consumers in the courts. "My law's a toothless tiger now," Barnes says. "We have one of the highest rates of foreclosure in the country." And the states still seem to be fighting a losing battle.

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