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Holding Bankers' Feet to the Fire

By GRETCHEN MORGENSON

KUDOS to the Federal Housing Finance Agency, overseer of Fannie Mae and Freddie Mac, the crippled mortgage finance giants. While some in Washington have continued to coddle the big banks even after they drove our economy into the ditch, this agency seems serious about recovering money for taxpayers by holding bad financial actors to account.

The agency announced last Monday that it had issued 64 subpoenas to a throng of unidentified financial services institutions, seeking documents related to mortgage securities that Fannie and Freddie bought from Wall Street during the boom years.

The subpoenas are designed to tell the agency what many of us want to know: How did Wall Street package and sell private-label mortgage securities to investors, even though the nature and quality of some of the loans crammed inside those tidy little packages were, at best, suspect?

Once that question has been answered, Fannie and Freddie can force the institutions that sold the securities to repurchase the improper loans, allowing taxpayers to recover some of the losses they've swallowed on Fannie's and Freddie's federal bailout.

Investigating this aspect of the mortgage mess seems a pretty logical step for a regulator. But in the topsy-turvy world of Washington, the housing finance agency's move is unusually aggressive. Edward J. DeMarco, its acting director, seems to be that rarity — a regulator who not only talks about looking out for the taxpayer, but actually does something about it.

The subpoenas went to companies that act as trustees for mortgage pools or that service the loans in them. The housing finance agency wants to see loan files and transaction documents related to those pools, including mortgage applications and property appraisals. Recipients of the subpoenas have 30 days to produce the requested documents. Additional subpoenas may follow, it said.

The agency had to resort to subpoenas, it said, because when it asked the institutions for the records it got nowhere for many months. "Difficulty in obtaining the loan documents has presented a challenge to the enterprises' efforts" to ascertain whether losses at the companies are the responsibility of others, its press release said.

Fannie and Freddie bought only the highest-rated pieces of these deals, but they bought buckets of them. During 2006-7, these entities bought $294 billion of so-called private-label securities. Not all of these purchases are under scrutiny, the agency said.

It is clearly turning up the heat on the major players in mortgage servicing and securitization. Among the bigger trustees in the business are Deutsche Bank and the Bank of New York, while loan servicers include Bank of America and many more. None of the banks would confirm if they had received subpoenas.

Fannie and Freddie played pivotal roles in the housing market by buying mortgages from banks that issued them so the banks could turn around and lend even more. After both companies overindulged in the mortgage frenzy they nearly collapsed, prompting the federal rescue. Since then, the government has continued to use the firms to buttress a shaky housing market.

In the immediate aftermath of a government takeover of Fannie and Freddie, the companies were persistent in seeking to recover money from the estates of Lehman Brothers and other defunct lenders related to dubious loans. But more recently, they have ratcheted up their buyback requests of the banks with which they continue to do business. Last March, for example, Freddie said it had submitted $4.8 billion in repurchase requests to such banks, up from $3.8 billion at the end of 2009.

Generating actual money from these requests, however, takes time and effort. While Fannie and Freddie can point to a borrower's misstatements on a loan application as reason for a buyback, the banks often counter these requests with arguments that some borrowers are defaulting because they have lost their jobs or suffered other woes — not because they originally lied on their loan applications about their income and finances. As a result, these can be lengthy and testy negotiations.

But there is a big difference between recovering on loans that were contractually improper versus those that involved fraud. And the subpoenas suggest that officials at the Federal Housing Finance Agency believe that there are large numbers of loans that fall into the latter category.

Mr. DeMarco would not comment further on the subpoenas. But he appears to be taking a fairly literal approach to the agency's role as conservator of Fannie and Freddie — because the taxpayers own these companies, it must conserve their assets and get money back where it is owed.

"Most or all of our conservatorship actions are taken to minimize further taxpayer losses," Mr. DeMarco said last week in an interview. He pointed to the agency's effort on foreclosure prevention, which "minimizes losses on seriously delinquent loans and provides greater stability to neighborhoods."

But Mr. DeMarco has also barred Fannie and Freddie from entering new businesses and, according to people briefed on the discussions, was behind Fannie's new and aggressive approach to combat so-called strategic defaulters — borrowers who can afford to pay their mortgages but stop doing so to get out of their obligations. Last month, Fannie said it would deny access to a government-backed mortgage for seven years to those defaulters.

A CAREER government official, Mr. DeMarco was appointed acting director of the agency in September 2009; he spent 10 years at the Treasury Department, beginning in 1993.

For seven of those years he oversaw public policy analysis involving Fannie, Freddie and other financial institutions. As a result, he had a front-row seat for Fannie's and Freddie's aggressive growth years, when they routinely strong-armed their regulators and bashed their critics.

Those days are over, thankfully, but taxpayers are still on the hook for the mess those practices wrought. At least we now seem to have a strong cop on the Fannie and Freddie beat, someone who genuinely cares about the taxpayers' losses and is working hard to stanch them.