Privileged Position: *Fannie* Mae Expected To Escape an Attempt At Tighter Regulation --- Lobbying Softens Bill Pushed By Critics Who Assail Implied U.S. Guarantee --- Do Taxpayers Face Exposure?

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WASHINGTON -- When a Capitol Hill softball team needs bases, the Federal National Mortgage Association will quickly provide a set of bags stamped with its logo: "The USA's Housing Partner."

In Congress and on Wall Street, though, Fannie Mae is better known for playing hardball. With assets of $147 billion, Fannie Mae is the nation's fourth largest financial institution. It has muscled into this position by zealously protecting government-granted privileges that enable it to borrow at low interest rates and underprice its private competition in the huge secondary market for mortgages.

Recently, those privileges have come under threat. The Bush administration and many in Congress want to tighten controls on Fannie Mae and its little brother, the Federal Home Loan Mortgage Corp. (Freddie Mac). The reason: The billions in mortgage securities the two companies have issued represent a potential liability to the U.S. taxpayer of more than $800 billion, according to estimates by the Office of Management and Budget. But the profits from the two companies go to private investors.

"They have a sweet deal," says Rep. J.J. Pickle, a Texas Democrat. "The risk is 99% public and the profit is 100% private."

It's a sweet deal that the two institutions fight hard to protect. And so far, their impressive lobbying clout has been highly successful at fending off those who want to curb their freedom.

The Senate yesterday began consideration of a bill designed to increase the regulation of the two companies and to boost the capital they must hold to protect against failure. But the bill itself is testament to their political might. The minimum capital standards in the bill would require only modest increases in capital at either institution. And instead of creating a wholly independent regulatory authority, as recommended by various experts and watchdog agencies, the bill would leave oversight of the two institutions in the Department of Housing and Urban Development, whose regulatory efforts in the past have been lax.

"The bill perpetuates the wafer-thin capital requirements that" Fannie Mae and Freddie Mac now enjoy, says Thomas Stanton, a former Fannie Mae lawyer, whose book "A State of Risk" helped trigger efforts to tighten regulation of the companies.

Fannie Mae and Freddie Mac are two of six government-sponsored enterprises, or GSEs, that Congress chartered to funnel money from Wall Street into three Main Street causes -- housing, agriculture and education. Fannie Mae and Freddie Mac pump money into housing markets in two ways. They either purchase mortgages and hold them in their portfolios, or they "securitize" mortgages by using them as collateral for mortgage-backed securities. These instruments, on which Fannie Mae and Freddie Mac guarantee payment of interest and principal, turn mortgages into securities that can be traded or held by pension funds, banks and other investors. The volume of mortgage-backed securities has grown explosively, from about $100 billion outstanding a decade ago to $1 trillion today.

The special relationships the two institutions have with the Treasury and the Federal Reserve lead most investors to assume that the U.S. government would help them out of any problems, and Congress did bail out the Farm Credit System in 1987. This implied guarantee lowers borrowing costs an estimated third of a percentage point below what the most credit-worthy private corporations pay. (Some of that savings is passed on to the public through lower rates, while some helps ensure investors a profit.)

Fannie Mae and Freddie Mac -- which are publicly held -- also don't have to pay state and local income taxes, and they don't have to register their securities with the Securities and Exchange Commission. The Treasury estimates these exemptions are worth $2 billion to $4 billion annually -- benefits also shared by shareholders and by home buyers.

The benefits have helped the institutions to turn tidy profits. In 1991, Fannie Mae earned $1.36 billion and Freddie Mac $555 million. They have returns on equity two or three times the average for financial firms. Shares of the larger institution, Fannie Mae, have risen from as low as $2.37 1/2 a decade ago to $57.62 1/2 now, adjusted for stock splits.

Their financial strength has enabled Fannie Mae and Freddie Mac to provide a steady stream of mortgage finance during a decade when thousands of banks and thrifts failed. Volatile interest rates and costly new regulations have made banks and thrifts less willing to hold mortgages and more eager to sell them. As a result, the residential mortgage markets are becoming increasingly federalized, with mortgage terms set by Fannie Mae and Freddie Mac. The companies have recycled about one-third of the nearly $3 trillion residential mortgages outstanding, a proportion expected to grow.

Thus, private-sector competitors question the continuation of their privileges, especially amid the S&L bailout. "I'm surprised that these quasi-public firms have been able to maintain their access to government guarantees for free when there have been hundreds of billions of dollars spent right around them," says Bruce Paradis, an executive of Residential Funding Corp., a mortgage finance unit of General Motors Corp.

Fannie Mae and Freddie Mac both had troubles in the 1980s. Fannie Mae showed heavy losses early in the decade amid surging interest rates, and Freddie Mac bungled a big multifamily housing program. But no bailout was needed, and since then, both have boosted the capital they hold to offset potential losses, tightened underwriting standards and taken other safety steps.

Past moves to abolish the GSEs' federal charters or charge them a fee for the implicit federal guarantees (similar to banks' premiums for deposit insurance) have failed. The legislation under consideration now would require Fannie Mae and Freddie Mac to file more reports, increase their capital cushions slightly and finance more inner-city lending. But with some help from their many friends in Congress, the companies have shaped the bill so it will have little initial impact.'

Freddie Mac Chairman Leland Brendsel says the bill "establishes the toughest, most dynamic capital standards faced by any financial institutions." But he agrees it is "unlikely to cause Freddie Mac or Fannie Mae to have significantly higher capital requirements."

It would require them to hold capital equal to 2.5% of their assets and 0.45% of their guarantees to purchase mortgages and make payments on securities. That compares with a 5%-of-assets minimum for well-capitalized banks. G.E. Capital Corp., which operates without government benefits, maintains 11.5% capital to keep its AAA rating secure, according to public documents.

Fannie Mae Chairman James Johnson says the legislation, which has passed the House, will "remove any cloud that remains about our governmental mandate . . . and allow Fannie Mae to get on with housing Americans and making more money for its shareholders."

One reason Fannie Mae has been so successful in protecting its privileges is that it has done just what Congress created it to do in 1938: aid housing by helping lenders supply credit at the lowest rate. The institutions also say they funnel money to the lower end of the housing market. However, a 1990 Federal Reserve study of mortgage lending found that just 2.5% of the housing loans Fannie Mae bought that year were in predominately minority neighborhoods; for Freddie Mac, the figure was 3.6%.

Another factor is Fannie Mae's unusual dual public-private nature as a government insider that can, for example, dispense political-action committee money. "Their intelligence is so good," says Rep. Gerald Kleczka, a Wisconsin Democrat who sits on the House Banking Committee, "that one time I was drafting an amendment, and Fannie Mae had a rebuttal in the hands of the Republicans before I spoke."

SEC Chairman Richard Breeden saw how quickly Congress moves to protect its favored offspring when he endorsed a Treasury proposal to end GSEs' exemption from SEC registration. House Banking Committee Chairman Henry Gonzalez belittled the proposal as an SEC power grab. The Texas Democrat said he was only trying to protect the public interest. "I'm not lobbying for powerful and rich entities like the GSEs," Mr. Gonzalez said. "They can take care of themselves."

The SEC chairman shot back: "It seems that they have, yes."

Fannie Mae has its own political action committee, called Fannie PAC, which made campaign contributions of $16,300 in the 1992 first quarter. The company also uses hired guns. In 1990, it hired former Fed Chairman Paul Volcker to help defeat a Treasury proposal for new capital standards. Then last year, it faced a House Banking Committee effort to limit executive salaries, a reaction to the $29 million retirement package Fannie granted to its former chairman, David

Maxwell; it brought in Stuart Eizenstat, former President Carter's domestic policy adviser, to help work on Democrats.

"I don't think I've ever been lobbied by such a broad cross-section of influential Democrats -- strategists, businessmen, everybody from the Washington hierarchy," says Rep. Joseph Kennedy, the Massachusetts Democrat who unsuccessfully pushed the pay amendment. As a result, Fannie and Freddie will continue to be able to tout their public purpose even as their chairmen earn over $1 million.

When Fannie Mae needs help with Republicans, it uses the Duberstein Group, a lobbying firm headed by President Bush's former chief lobbyist. And to deal with politicians in general, it calls on powerful trade groups, most notably the Mortgage Bankers Association, the National Association of Home Builders and the National Association of Realtors. "They have amassed an army of people to descend upon us any time they think their welfare is in jeopardy," says Rep. Kleczka of Wisconsin. Leaders of the three trade groups and Fannie and Freddie are called the "Gang of Five" in the Senate, where they have lobbied as a team.

Real-estate interests rely on the steady flow of mortgage funds Fannie Mae and Freddie Mac provide and go out of their way to protect them. Edward Kane, a professor of finance at Boston College, told a friend in a letter last year that a research project on the implications of the S&L crisis -- financed by the National Association of Home Builders -- was "aborted in midstream because of my unwillingness to adjust my views on Fannie Mae." He declined to be interviewed, but David Seiders, chief economist for the National Association of Home Builders, says some of the trade group's leaders were upset when they learned that Mr. Kane planned to write that Fannie Mae and Freddie Mac's subsidized dominance of the mortgage market weakened the S&L industry.

In the last year or so, Fannie Mae has hired the top housing staffer from the House Banking Committee and a former top aide to the secretary of the Housing and Urban Development Department, which regulates it. Herb Moses, a Fannie Mae expert on rural housing programs, is the companion of Rep. Barney Frank, the Massachusetts Democrat (who declines to vote on matters affecting the compensation of Fannie Mae officials). Both men say they go out of their way to avoid any conflicts of interest.

But the influence starts at the top. Fannie Mae Chairman Johnson has strong Democratic connections from his days as Walter Mondale's presidential campaign director. He also has close ties to Richard Darman, President Bush's budget director, with whom he worked in 1987-88 at Shearson Lehman Brothers.

In 1990, Mr. Darman used his budget message to warn of the "risk of substantial future claims against the government" from the obligations of GSEs, particularly Fannie Mae and Freddie Mac. Since then his worries have subsided. "The trend in his views has been consistent with the trend in Fannie Mae performance," Mr. Johnson explains, noting that after a series of losses in the early 1980s, Fannie Mae got financially stronger.

Now, it isn't losses but the rapid growth of the GSEs that generates concern. Herbert Sandler, chairman of World Savings & Loan Association in Oakland, Calif., argues that "by exploiting their highly privileged position, Fannie Mae and Freddie Mac have rendered the business of funding home mortgages with consumer deposits and other borrowings uneconomic for many insured institutions."

Bank and thrift executives still shudder at how Fannie cut Salomon Brothers out of underwriting and other business in 1987 for opposing Fannie's bid to move into a new line of business in competition with Wall Street. The fight involved a mortgage-backed security called Remics (Real Estate Mortgage Investment Conduits). Salomon helped create Remics and unsuccessfully fought Fannie's bid to get into the market. Now Fannie and Freddie dominate the Remic market, leaving investment banking firms with less than 10% of the business. When Fannie reduced its business with Salomon, an official said it wasn't doing this to penalize Salomon for its opposition but because "they do not give us any indication that they value our business very highly."

A group of thrifts has tried, and so far failed, to place in the emerging legislation tougher limits on expansion into new financing fields by Fannie Mae and Freddie Mac. The institutions help deflect such efforts by cultivating their image for financing part of the American dream. Says Mr. Johnson: "If you look at the other major domestic initiatives in the postWorld War II period, whether it be in health care, transportation, education or other areas of domestic policy, housing really is a dramatic success story."

Every year Fannie sends every member of Congress a report showing the amount of mortgages it purchases in each state and congressional district. In May Fannie Mae invited congressional housing experts to a Capitol Hill reception to honor innovative projects by six low-income housing groups. Four of the winners of its annual excellence awards came from states represented by members of the Senate Banking Committee. "It's their type of payoff to members," says Rep. Kleczka. "The next time legislation comes up, they'll remember Fannie."

Paulette Thomas contributed to this article.