AMERICANS FOR
LIMITED GOVERNMENT

9900 MAIN STREET SUITE 303 • FAIRFAX, VA 22031 • PHONE: 703.383.0880 • FAX: 703.383.5288 • WWW.GETLIBERTY.ORG

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United States Senate
WASHINGTON, D.C. 20510

To the Members of the United States Senate:

As you are well aware, this evening Senate Majority Leader Harry Reid has scheduled a cloture vote on legislation proposed by Senator Chris Dodd, which would be the most sweeping legislation against private property rights in American history. Its provisions, in addition to creating a $50 billion revolving "orderly liquidation fund," will codify an unlimited bailout-takeover authority.

This federal authority will endanger companies across the nation with unlimited government takeovers of their assets, operations, and ownership. No investment would be safe, and once seized, a company's shareholders would have no recourse in federal courts, even if the takeover was unwarranted.

It is your duty as elected Senators to vote against proceeding to this legislation. Its problems, as noted below, are too far-reaching to be fixed without starting over.

According an Americans for Limited Government summary of the legislation, S. 3217 would authorize the Federal Deposit Insurance Corporation, Federal Reserve, and the Treasury Secretary to put into receivership any company that is deemed to be in danger of default that is "substantially engaged in activities… that are financial in nature" and give unlimited power to the Federal Reserve and Treasury Secretary the power to define what constitutes "financial" activities. As a result, the Federal Reserve could declare any company or institution a "non-bank financial company" subject to seizure under the "orderly liquidation fund."

The bill also allows the FDIC to levy assessments on about 60 bank holding and insurance companies totaling $50 billion or more in consolidated assets to finance the revolving $50 billion "orderly liquidation fund" that customers of financial products and savers will pay for with higher costs.

There would be no limit on how much money could flow through the "orderly liquidation fund" in total, nor would it require any Congressional authorization for firms to be seized, the funds to be spent, or new assessments to be levied by the FDIC to replenish the fund. This will create moral hazard of the first order, and institutionalize "too big to fail" for all time.

And, the bill would shield from judicial review any government seizure of a company: "no court shall have jurisdiction over… any claim or action for payment from, or any action seeking a determination of rights with respect to, the assets of any covered financial company for which the Corporation has been appointed receiver."

Despite the serious Fifth Amendment due process property rights concerns raised by the lack of judicial review, almost all of these provisions have completely escaped the scrutiny of elected leaders, media outlets, and the American people alike. More attention needs to be brought to them, and the only way to do that is to vote

against proceeding to it. This is most certainly an instance where the more American people find out about this takeover, the less they will like it.

A vote against proceeding to debate is not "a vote to protect Wall Street," as Majority Leader Reid spokesman Jim Manley stated this morning, it is a vote to protect the American people from a process that has already produced legislation that threatens the entire private sector with perpetual bailouts, takeovers, taxes, spending, and wealth redistribution. This latter point cannot be overemphasized.

When GM and Chrysler were nationalized in 2009, the assets of the companies were redistributed from the bondholders who had kept the companies afloat to the labor unions that had seen to their insolvency. They were not financial companies, but were brought under its authority anyway. There were private sector alternatives to the takeovers, but they were nationalized anyway. The liquidation of their assets under normal bankruptcy proceedings would have resulted in new companies being formed, but it was arbitrarily determined that they posed some form of "systemic" risk.

As currently constructed, there will be nothing to prevent the similar seizure of companies and the redistribution of their assets under the Dodd bill. In fact, the bill contains express authority to do just that: when a firm is seized, the FDIC can convert its assets into securities to be sold to the Treasury. The Treasury can then either keep companies, or sell them to customers of their choosing. This is simply too much power to invest in the federal bureaucracy, which has already proven that it will cater to political constituencies in making these decisions that will be beyond dispute.

Making matters worse, the bill will not address the root causes of the financial crisis. According to research compiled by former Chief Credit Officer of Fannie Mae, Edward Pinto, the government causes of the financial crisis were legion. According to Pinto, "HUD needs to look no further than its own policies and efforts to explain [what HUD in 2010 has described as the causes of the foreclosure crisis to be] the 'rapid growth in loans with a higher risk of default—due both to the terms of these loans and loosening underwriting standards.'"

From 1992 onward, the Department of Housing and Urban Development (HUD) loosened lending standards by imposing "affordable housing goals" on Fannie Mae and Freddie Mac, adopted "Fair Lending Best Practices" requiring low-income lending, and promulgated new Community Reinvestment Act "regulations applicable to all insured banks, in particular a change from a qualitative standard to a quantitative." Pinto describes this weakening as "a direct assault on the 3 C's of lending—collateral, credit, and capacity."

In 1995, according to Pinto's research, the GSE's were allowed to "get affordable-housing credit for buying subprime securities that included loans to low-income borrowers." HUD proceeded to expand the GSE's "affordable housing goals," which rose from 30 percent in 1993 to 56 percent by 2008. Also, loans with down payments of 3 percent or less by the FHA and the GSE's rose from 1991 of just $7 billion (exclusive to the FHA) to $14 billion for the FHA and $160 billion+ for the GSE's in 2007.

Pinto writes that the "impact of highly leveraged lending on other market participants cannot be underestimated." When the GSE's adopted weaker lending requirements, the "market response was: if it's okay with Fannie and Freddie (the de facto standards setters) it must be okay for us." But, because of the GSE's well-capitalized positions in the market, they received "the lower risk end of these high risk [loan] categories for themselves and to garner most of the industry's profits." Competitors got what was left over, which consisted of the riskier mortgages.

Nonetheless, the losses to the GSE's because of this excessive risk-taking pushed them into bankruptcy. By June 2008, Fannie and Freddie had taken on some $1.835 trillion in higher-risk mortgages and mortgage-backed securities just before they were nationalized. This included high risk loans in whole loan form, most of

which, $1.646 trillion, were GSE-issued mortgage-backed securities, and $189 billion of subprime and Alt-A private mortgage-backed securities.

Moreover, because of the implicit backing of taxpayers, Fannie and Freddie securities were automatically given AAA credit ratings, according to Pinto. Because of that shielding from scrutiny, Fannie and Freddie were able to misrepresent the quality of mortgages that underlined those securities.

Because of the implicit backing, Fannie and Freddie crafted a marketing plan that enabled them to sell some $4.7 trillion of mortgage-backed securities, $1.5 trillion of which were sold overseas to investors, as reported by the New York Times. By promising a higher rate of return than treasuries, but with the same risk associated with a taxpayer guarantee, the sales flooded the GSE's throughout the housing bubble. As more securities were sold, Fannie and Freddie bought more mortgages and bundled them into securities. As a direct result, Fannie and Freddie were able to acquire about half of all mortgages as of July 2008.

But the Dodd bill will do nothing about the GSE's. They are not even mentioned in its entire 1,410 pages.

Nor will the Dodd bill rein in existing bailout programs, including the Federal Reserve's purchase of some $1.25 trillion of GSE-issued mortgage-backed securities. It will not sell off the GSE's piece by piece. It will not rein in the inherent moral hazard of taxpayer backing of Fannie Mae and Freddie Mac, with a total of $6.3 trillion in liabilities including $4.7 trillion of mortgage-backed securities. Nor does it repeal the weakened lending standards that Fannie, Freddie, HUD and the Federal Housing Administration helped to foster.

Importantly, the bill will not put an end to the loose dollar, low interest rate policy of the Federal Reserve that accommodated the housing bubble's ascent. Instead, the bill promotes and expands the powers of the Federal Reserve to engage in more bailouts, issue more regulations, and do the same thing all over again by keeping the easy money flowing.

The only solution for Senators to these problems is to vote against proceeding to the current bill, and to demand a completely new bill that actually addresses the root, government causes of the crisis. In this instance, there is much to be said for starting over and getting it done right.

The alternative is to deal with a bill that seeks to micromanage the unintended consequences of the excessive risks taken through government policies, which will not be repealed. The American people will be more than livid with Senators that adopt an approach that expands government powers when the essential cause of the financial crisis was a government that was (and remains) unaccountable to the risks it was (and is) taking.

Sincerely,

William Wilson
President
Americans for Limited Government