



Barney Frank: Leadership versus Partisanship

Robert Huebscher

November 18, 2008

Representative Barney Frank (D-MA) may be the most powerful man in Congress. As Chairman of the House Financial Services Committee, he will control key legislation that will determine the scope of regulation in the financial services industry. His remarks at a luncheon for business leaders in Boston on November 10 indicated that he favors an approach that will balance the needs of industry with the protection of consumers.

However, Representative Frank is a sharp-tongued politician, and his record suggests that he may not have the leadership skills to carry forward his agenda. In particular, his legislative record does not indicate a history of practical regulatory oversight, and his remarks during the credit crisis reveal that he did not fully grasp the severity or complexity of dangers posed by the GSEs.

At the luncheon, Frank summarized the current state of the capital markets when he said, "Banks invested in things they shouldn't have, and now they won't invest in things they should." Despite his recognition of the paralyzed credit markets, most of Frank's comments were directed to changes he foresees in the regulatory environment.

Frank placed a high priority on halting foreclosures, and said his principles would be guided "not by compassion, but by practicality." He said the government should not be bailing out lenders or businesses, and that bailouts should not cost the government any money. Frank voiced support for allowing distressed homeowners to rent their homes for a period of five years, after which they would have an option to purchase the remaining balance. He is skeptical of this plan, however, because it implies that taxpayers would ultimately bear the cost of the foreclosed mortgage.

Remarks such as this were certainly directed to appeal to the pro-business crowd at the luncheon, as was Frank's acknowledgement of his role, along with that of other Democrats, in pushing unqualified borrowers into home ownership. But he said "that would not have been a problem by itself." Rather, he pointed to securitization, which Frank called a form of "diversification to spread poison," undertaken by largely unregulated entities, as the underlying catalyst causing the credit crisis.



Subprime loans were analogous to bullets, spread by the “guns” of securitization, according to Frank. He claims the lending practices that led to subprime borrowing has been stopped, but says “we still have to deal with the guns.”

“We need to find regulatory substitutions to constrain the risks that were taken in the era of securitization,” Frank said, calling for regulation that does not “snuff out the benefits” of financial innovation. Activities – like securitization should be regulated, not institutions.

At the luncheon, Frank called securitization a “good thing” and denied that new regulation would be too overreaching, saying that “if you look at our record, you won’t see any overreaching.”

Viewing Frank’s record, overreaching regulation may not be the biggest concern. Frank’s record does not demonstrate a penchant for tight oversight of the GSEs.

Frank’s legislative record indicates he took very little initiative toward regulating the GSEs during his tenure in Congress, and he did not fully grasp the consequences of the credit crisis as it unfolded.

In a remark he surely wishes he could take back, Frank is quoted as saying in the September 11, 2003 *New York Times*, “These two entities Fannie Mae and Freddie Mac are not facing any kind of financial crisis. The more people exaggerate these problems, the more pressure there is on these companies, the less we will see in terms of affordable housing.”

Even through most of this year, Frank’s confidence in the GSEs did not waver. In an [interview](#) on July 14, 2008, he said Fannie Mae and Freddie Mac were “fundamentally sound” and “not in danger of going under” and their “prospects moving forward are very solid.”

A *Wall Street Journal* editorial, “Fannie Mae’s Patron Saint”, on September 9 recounts Frank’s support of the GSEs and how he “abetted their disastrous plunge into Alt-A and subprime loans.”

By directing the brunt his attack to the securitization industry, Frank demonstrates a lack of objectivity that calls into question his leadership skills.

Frank’s position is that he was a leading advocate of housing reform, but that his attempts to pass legislation that would have effectively regulated the GSEs were consistently blocked by Republicans during the 12 years they controlled Congress. Frank cites his support of a bill – HR. 1461 (“Federal Housing Finance Reform Act”) – introduced by Mike Oxley, which Frank called “very tough regulation” that would have reformed the GSEs.



Frank actually voted against this bill, which never became law.

Frank also cites his support of the Home Equity Protection Act of 1994 as evidence of his foresight in instituting the regulatory environment that should have forestalled subprime lending practices. This law forced full disclosure for certain types of loans, but had virtually no effect on stemming the bad lending practices rampant in the subprime era. The bill, much like the Surgeon General's warning on cigarette packages, forced lenders to expose certain risks, but did nothing to curtail the practices of unregulated lending.

Frank's record reveals a highly partisan approach. His press releases uniformly cite the Republican control of Congress from 1994 to 2006, along with the Bush administration, as the principal reasons for the lack of oversight of the GSEs. At the luncheon, Frank said that "partisanship can be a good thing" when it leads to new ideas and informative debate.

What Frank fails to acknowledge is that the lack of GSE oversight was a failure of the political process, and not a partisan issue. In large part, the GSEs failed because the regulatory bodies charged with their oversight were unable to read the situation accurately and heed the advice of experts that warned of the housing bubble. Democrats and Republicans were equally to blame.

Conflicts of interest may play a role in clouding objective judgment – Frank received more than a half million dollars in campaign contributions from the finance, insurance, and real estate industries in the last year.

Frank's committee will confront highly complex issues that will determine the future health of the financial services industry. His leadership skills will be tested. Whether he succeeds will depend on his ability to abandon what has been a highly partisan track record, admit to the failures of the political process, and adopt a framework that truly balances the needs of industry with the goals of consumer protectionism.

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
<http://www.advisorperspectives.com/subscribers/subscribe.php>