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"Let the people know the facts . . . and the country will be safe." - A. Lincoln

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We were all snookered.

"THE CASE OF THE CONCRETE LIFE PRESERVER"

Henry Paulson turns a smoldering fire into a worldwide conflagration.

Nine years ago today, the government seized **Fannie Mae** and **Freddie Mac**. Angry shareholders filed lawsuits, but the government's lawyers convinced a federal judge no one should be allowed to see over 11,000 documents relating to its decision. Making them public, it told the court, might set off another financial crisis and affect national security. But now the cat is out of the bag. Judge **Margaret Sweeney** of the **U.S. Court of Federal Claims** has lifted the seal on the first 3,000. As **Richard Bove**, the dean of Wall Street banking analysts, asserts in this 5-minute CNBC interview, the government has been lying to us all along. With each turn of the page, it becomes clear the September 6, 2008 takeover wasn't a bailout, it was a stick-up. A heist. Billed at the time as a 'rescue', it was anything but.

The storyline put out was the two mortgage insurers were undercapitalized. (Yes, even Yours Truly fell for it at the time.) They weren't. It was only after the government took control and ordered their accounting staffs to start booking massive non-cash *paper* losses that they *appeared* to be. But when the housing market turned around four years later and those accounting sleights-of-hand had to be reversed, the 2008 machinations were exposed for the accounting fraud they were. No longer burdened by the concrete-life-preserver of 'cookie jar' accounting gimmicks, Fannie and Freddie became massively profitable in 2012 and were on the verge of rebuilding their capital bases and exiting the Conservatorships into which they had been forced. To ensure that didn't happen, however, the **Treasury Department** stepped in and changed the rules. (As other documents prove, they lied about the reasons for that as well; see *The Cover-Up Unravels* - HINDESight™ July 25, 2017.) Tossing them another 'concrete life preserver' to replace the one which – despite Treasury's best efforts – hadn't lived up to its name, the 10 percent dividend which the government had been collecting for four years was cancelled and replaced with a new 'dividend': *100 percent of the companies' net worths whatever the amount.* No matter how much the companies wind up paying the government in 'dividends' (at this writing, it's already over $100 billion more than it would have otherwise received), *not a penny counts towards principal*. Like the restaurant owner who borrowed from the Mob, Fannie and Freddie have found themselves in an un-severable relationship. Even though they are two of the most profitable companies in the world, as things currently stand, they will continue to owe Uncle Sam $187 billion *in perpetuity*.[1]

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[1] *"They* (aren't going to be allowed to) *repay their debt and escape, as it were."* -- **Jim Parrott**, senior advisor to President Obama in an August 18, 2012 email to **Tim Bowler**, deputy assistant secretary of the Treasury.

Securities fraud?
The government secretly plans to seize the companies – while allowing them to keep selling stock to an unsuspecting public.

Despite the government's line that the takeovers were hastily put together in the 'fog of war', newly-released documents reveal that at least six months earlier, *nationalizing* the companies was under active consideration. On March 8, 2008, a derogatory article about Fannie appeared in *Barron's* Magazine with the front-page headline "Is Fannie Mae the Next Government Bailout?" The article appears to have been written almost verbatim from a confidential memo written by **Jason Thomas**, then a special assistant to President George W. Bush. The memo (and article) described a litany of Fannie's perceived failings; both were riddled with seriously flawed assumptions. Proof the White House deliberately planted the smear piece is confirmed by an email sent by Mr. Thomas to then-Under Secretary of the Treasury **Robert K. Steel** on the day it was published:

> *"Attached is the document used as the sourcing for today's Barron's article on the potential collapse of Fannie Mae. This is for your eyes only. I send it . . . to help inform . . . discussions about the potential costs and benefits of nationalization. Thank you for your discretion."*

If Treasury's goal was to trash the stock, it worked – but not for long. As investors read through the article and started questioning its assumptions, many realized the emperor had no clothes. It was a "hit job" based on wildly inaccurate premises. In the months to follow, Fannie and Freddie would, at the urging of their regulator, the **Federal Housing Finance Agency** ("FHFA"), raise billions of fresh capital, culminating on May 13, when Fannie sold more than $2 billion of preferred shares bearing an 8¼ percent dividend and a AA- rating. The offering was oversubscribed, an indication that investors (and the rating services) had done their own analysis and concluded the companies were not even remotely close to bankruptcy. Nonetheless, Mr. Thomas' memo would be used just weeks later as the accounting blueprint justifying their seizure. That so many sophisticated investors had read the government's analysis of the situation and not only didn't believe it, but instead purchased more shares means either they were all idiots – or the folks at Treasury were determined to grab Fannie and Freddie, the facts be damned. As Professor **Richard Epstein** later put it, if, instead of the government, it had been private parties involved, *"they all would have gone to jail."*

It wasn't Lehman Brothers.

Conventional wisdom is that then-Secretary of the Treasury **Henry Paulson**'s decision to stand by idly as Lehman teetered on bankruptcy on September 15, 2008 triggered the meltdown of the world financial system. A careful review of the timeline, however, reveals it was the seizure of Fannie and Freddie a week earlier which spooked the markets and plunged the world financial system into the abyss.

Earlier that summer, Mr. Paulson and the Bush Administration pushed Congress to enact the **Housing and Economic Recovery Act** ("HERA"), which, among other things, gave FHFA the authority to place either or both GSEs into Conservatorship if one of 12 conditions were met.[2] The first 11 are what you might expect: being significantly undercapitalized; operating in an unsafe and unsound manner; fraud; money laundering, etc. As it turns out, all were inapplicable; neither company was in danger of insolvency and both had more than sufficient liquidity and billions in high-quality assets which could be pledged as collateral should they need more. Indeed, just two weeks prior to the seizure – on August 22 – **James Lockhart**, the head of FHFA, confirmed in a letter to the CEOs of both companies that they were operating with "adequate" levels of capital ("adequate" being the regulator's highest rating).[3]

With 11 of the 12 conditions being non-starters, Treasury had only one card left to play. As it turns out, the Companies could be placed into Conservatorship if their boards "acquiesced" or "consented". The issue for Treasury thus became:

[2] In July, Mr. Paulson famously told a Congressional panel considering the HERA legislation *"if you've got a squirt gun in your pocket, you may have to take it out. If you've got a bazooka, and people know you've got it...you're not likely to take it out."*

[3] Treasury subsequently demanded that the letter be withdrawn because it was inconsistent with its soon-to-be-announced position the GSEs were in such dire financial straits that placing them into Conservatorships was the only option.

what would it take to obtain that acquiescence or consent?

In hastily-convened, back-to-back meetings on Saturday, September 6, 2008 (with Federal Reserve Chairman **Ben Bernanke** seated alongside him), Mr. Paulson acquainted the directors with *"the awesome powers of the government"* – inferring armed personnel were at the ready.[4,5] But he also offered a consolation prize, a *'get-out-of-jail-free'* card, if you will, directing their attention to a provision of HERA which, were they to cooperate, absolved the directors from liability from shareholder lawsuits. *[Think about that for a moment: the legislation actually included an inducement for the boards to abandon their responsibilities to shareholders who had been paying them hundreds of thousands of dollars each year in director fees to act in their best interest.]* For his part, if we are to believe Mr. Paulson's version of events, Mr. Bernanke basically urged the directors to *'take-one-for-the-team'*.[6]

With two of the most powerful people in the world confronting them across the table, the directors caved.[7]

In the chapter of his memoirs dealing with the Fannie/Freddie situation, Mr. Paulson ends by telling the reader**:** "*. . . that Sunday afternoon in my office, placing calls all around the world, I couldn't help but feel a bit relieved. We had just pulled off perhaps the biggest financial rescue in history. Fannie and Freddie had not been able to stop us, Congress was supportive, and the market looked sure to accept our moves . . . we had, I thought, just saved the country – and the world – from financial catastrophe. The next day, **Lehman Brothers** began to collapse."* (Emphasis added.)

In retrospect, it should have come as no surprise. That Mr. Paulson expected the markets to overlook the fact he'd just incinerated over $80 billion of shareholder equity shows an astonishing level of naivete from someone who had spent his entire career in investment banking and the capital markets – and who was also the former chairman of **Goldman Sachs**. Also of no small import, the affected shareholders included foreign central banks which had purchased shares in the May 13th stock offering.[8] As noted British economist **Anatole Kaletsky** describes in Capitalism 4.0: The Birth of a New Economy in the Aftermath of Crisis (PublicAffairs/Perseus Books Group)[9], by the time the Asian markets opened on Sunday evening, investors around the globe were forced to confront a terrifying new reality: if the U.S. Government could seize two of the world's largest shareholder-owned public companies – *which were in full compliance with their regulatory capital requirements* (and had recently reported the highest capital levels in their histories) – they could do the same to any financial institution: *no one was safe*. As the expression goes, the s—t had hit the fan. Monday morning, U.S. banks immediately stopped lending and trading, fearful of counterparty risk. Loans were called in and lines of credit cancelled. The contagion spread quickly: the bond market froze up and stock markets plunged. From that point forward, any company with even the slightest whiff of financial difficulty could no longer hope to raise

[4] *"We preferred that they voluntarily acquiesce. But if they did not, we would seize them . . . I explained that we had teams of lawyers, bank examiners, computer specialists, and others on standby, ready to roll into* (their) *offices and secure their premises, trading floors, books and records, and so forth."* Henry M. Paulson Jr: *On the Brink* © 2010 Hachette, excerpted at http://abcnews.go.com/GMA/Books/book-excerpt-brink-henry-paulson-jr/story?id=9713451 (Emphasis added).

[5] Mr. Paulson refers to it as an *"ambush"*. *"'Do they know it's coming, Hank?'* President Bush asked me. *'Mr. President,'* I said, *'we're going to move quickly and take them by surprise. The first sound they'll hear is their heads hitting the floor'."* (Ibid.)

[6] *"**Ben Bernanke** followed and made a very strong speech. He said he was very supportive of the proposed actions. Because of the capital deficiency, the safety and soundness of Fannie Mae was at risk, and that in turn imperiled the stability of the financial system. It was in the best interests of the country to do this, he concluded."* (Emphasis added.) (Ibid.)

[7] To this day it is unclear whether the boards "acquiesced" or "consented". Attempts by shareholders to obtain minutes of the meetings have been stonewalled by the government and the courts. The (former) directors have refused to comment. However, I spoke with a person who was in the room during the Fannie Mae meeting. He also clammed up, but walking away and shaking his head bitterly, told me *"it was done at the point of a gun with six bullets in the chambers"*.

[8] Treasury had snookered some of the most sophisticated investors and research analysts in the world – along with a *"Who's Who"* of Wall Street investment banks which had underwritten the issue: **Merrill Lynch**; **Citibank**; **Morgan Stanley**; **UBS**; **Bank of America**; **Barclays**; **Wells Fargo**, and **Wachovia**.

[9] Available at Amazon.com; I draw the reader's attention to Chapter 10: The Economic Consequences of Mr. Paulson.

capital. (Even **GE** was having trouble rolling over its commercial paper.) As Dr. Kaletsky puts it, *"the* (seizure of Fannie and Freddie) *thus raised a Sword of Damocles over every U.S. financial institution that might conceivably need to raise any new capital in the foreseeable future . . . the almost inevitable result was a run on every major bank and financial institution, first in America and then around the world."* (Emphasis added.)

Within the week, Lehman filed for bankruptcy. The day after, **Merrill Lynch**, **AIG**, **Morgan Stanley**, **Citigroup, Washington Mutual, Wachovia,** and **Bank of America** (all highly leveraged) were under attack by short sellers, for – as Dr. Kaletsky puts it – Mr. Paulson had created a financial *"doomsday machine . . . whose mechanism began its inexorable grind within 24 hours of the . . . seizure* (of Fannie and Freddie)*."* **Lloyd Blankfein**, chairman of **Goldman Sachs**, predicted his firm would be bankrupt *"in 15 minutes"* were its then-teetering major competitor, **Morgan Stanley**, to succumb to the rapidly-escalating panic. As Dr. Kaletsky concludes, Secretary Paulson's *"punitive treatment of the Fannie and Freddie shareholders had started a chain reaction that was going to blow up the entire U.S. financial system . . ."*

At the risk of sounding inflammatory (no pun intended), pouring gasoline on a fire is not an inapt analogy here. Had Treasury truly wanted to help Fannie and Freddie get through the crisis (even though, as has been demonstrated, neither needed it),[10] both it and the **Federal Reserve** had programs available that would have allowed either to make repayable loans, fully collateralized by their ample holdings of Mortgage Backed Securities, *at absolutely no risk to the taxpayer*. After all, that's what they did for **AIG**, **Goldman Sachs**, and all the banks to which it gave **TARP** money. But as the unsealed court documents now make clear, Treasury's goal wasn't to help Fannie and Freddie; it was to put an end to them for once and for all and turn their lucrative businesses over to the Big Banks which had long coveted them. In their zeal to accomplish that end, Mr. Paulson and his colleagues had run up against the 'law of unintended consequences'. Instead of *"saving the country – and the world – from financial catastrophe"*, their weekend exploits had plunged the world into an abyss from which many investors were never able to recover.[11, 12]

Nine years and counting.

In August 2012, when Treasury decided to change the terms of the 2008 'bailout', a battle in Congress to extend the debt ceiling limit and avoid a government shutdown was fast approaching. It was utilizing what it called *"extraordinary measures"* to manage the government's cash flow. Whether by happenstance or design, the extra money from the GSEs came in very handy: it extended the runway.

The longest Conservatorship of an FDIC-insured commercial bank reportedly lasted 18 months. However, despite their being two of the most profitable companies in the world (or perhaps because of it) – and the fact they also happen to be the government's most lucrative venture since the **Louisiana Purchase** – Fannie and Freddie are about to enter their 10th year as wards of the state. With the current Treasury secretary, **Stephen Mnuchin**, projecting **September 29** as the latest deadline for extending the debt-ceiling limit, Treasury is again using their profits to keep the lights on (with another $5 billion 'dividend' payment expected to be paid shortly). Enough is enough. The looting has gone on for far too long. The only countries which seize private property without compensating their owners are **Cuba**, **Iran**, **North Korea**, **Russia**, **Venezuela** and **Zimbabwe**. It is time to stop using Fannie and Freddie as piggy banks and return them to their rightful owners.

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[10] With FHFA's prior approval, they were still paying dividends on their common stock!

[11] To this day, the anti-GSE crowd claims Fannie and Freddie needed a bailout because they were running out of liquidity and were unable to tap the capital markets. Nonsense. *"Fannie Mae, Freddie Mac Debt Funding Smooth . . . drew solid demand for $5 billion of new securities today"*, *Reuters* reported on September 3. That was Wednesday. On Saturday, Mr. Paulson showed up with his bazooka.

[12] Among other victims, 15 FDIC-insured banks failed after being forced to write off their Fannie and Freddie holdings. (Their shareholders were wiped out.)