August 25, 2000

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Securities, and
Government Sponsored Enterprises
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Freddie Mac is pleased to respond to your request for written comments from parties desiring to participate in the upcoming Roundtable discussion on the Government Sponsored Enterprises (GSEs).

In May, I appeared before the Subcommittee to provide Freddie Mac's views on H.R. 3703 and to discuss Freddie Mac's success in meeting our mission while meeting the highest standards for safety and soundness. At that time, I provided a detailed written statement. Freddie Mac welcomes this opportunity to submit additional comments.

Executive Summary

Freddie Mac plays a vital role in making America's housing finance system the best in the world. Because of the benefits we bring to the nation's families, it is essential that we operate safely and soundly to sustain this system into the future. This was one of the themes that emerged in the series of hearings held by the Subcommittee, and I would like to use this opportunity to discuss it further.

We want the Congress and the public to have confidence that Freddie Mac meets our vital mission while maintaining world-class risk and capital management standards. Freddie Mac is at the forefront of the financial services industry in disclosing our risk management results, enabling third parties to judge our performance for themselves. We are committed to remaining at the forefront, and believe all financial institutions should be held to the highest standards of public scrutiny. In this regard, we believe the "Three Pillars" framework proposed by the Basel Committee on Bank Supervision provides an excellent framework for the discussion.[1]

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[1] *A New Capital Adequacy Framework*, Consultative Paper on Capital Adequacy No.50, Basel Committee on Banking Supervision (June 1999) (the "1999 Basel Consultative Paper").

Our comment letter has four parts:

I. Freddie Mac's Vital Mission

II. Freddie Mac Is Among the Strongest Financial Institutions

III. Basel Framework for Enhancing Capital Standards, Market Discipline and Transparency

IV. Serving a New Generation of Homebuyers and Renters

Freddie Mac welcomes a dialogue with the Subcommittee. We are committed to meeting our mission by attracting global capital to finance America's housing and leading the way on risk and capital management practices. As a result of the efficiency and excellence provided by Freddie Mac and the secondary market, America enjoys the world's best housing finance system. We are committed to continually improving this system, lowering housing costs and expanding housing opportunities to more families, while operating safely and soundly.

I. Freddie Mac's Vital Mission

Freddie Mac is a shareholder-owned corporation that was chartered by Congress to create a stable flow of funds to mortgage lenders in support of homeownership and rental housing. Since our inception in 1970, Freddie Mac has purchased more than $2 trillion in residential mortgages, financing homes for more than 25 million families.

Because of the high level of support provided by Freddie Mac and the secondary market, America enjoys the world's best housing finance system. Mortgage rates are lower, saving homeowners thousands of dollars in interest payments. Low-downpayment loans are more readily available, enabling people to purchase their first homes. Families can count on the availability of mortgage credit whenever and wherever they need it.

Throughout our history, Freddie Mac has been a pioneer in innovation, exploring new frontiers that create a faster, more efficient and less costly mortgage finance system. We innovate to streamline the mortgage process, which reduces the time and up-front costs of getting a mortgage. Our innovation in financial instruments attracts global investors to finance America's housing, which ensures mortgage money is available at lower cost for homebuyers.

Freddie Mac and the secondary market demonstrably lower mortgage rates and make housing more affordable for low- and moderate-income families. This is the unanimous conclusion of the relevant studies, including a 1996 study commissioned by the General Accounting Office, HUD, the Treasury Department and the Congressional Budget Office.[2]

As a result of the lower mortgage rates Freddie Mac and Fannie Mae provide, homeowners save approximately $12,000 in mortgage interest on a $100,000, 30-year mortgage. Collectively, every year America's homeowners save $15 billion in mortgage interest payments because of the secondary market.

Freddie Mac provides these cost savings while maintaining world-class risk and capital management standards. We remain strongly committed to staying in the forefront of risk and capital management and continuing to provide a reliable source of low-cost mortgage funds to new generations of America's families, of all incomes, in all neighborhoods.

Freddie Mac finances mortgages in two ways: with mortgage-backed securities and debt. We securitize mortgages, that is, we purchase mortgages from lenders and package them into mortgage-backed securities, resulting in a liquid security that enjoys our guarantee of timely payment. Lenders may hold these securities in their portfolios or sell them. We also purchase mortgages and mortgage-backed securities to hold in our own portfolio, financing these purchases with a variety of debt securities. Both of these activities fulfill our statutory purposes as articulated by Congress.[3]

Freddie Mac's mission requires us to provide a continuous supply of mortgage credit for U.S. homebuyers in all economic environments. Freddie Mac employs both mortgage security and debt financing to accomplish this objective. Investors value the high quality and liquidity of Freddie Mac's mortgage and debt securities. By using both of these financing methods, Freddie Mac assures mortgage lenders and America's

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[2] Cotterman, Robert F. and James E. Pearce, "The Effects of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation on Conventional Fixed-Rate Mortgage Yields," in *Studies on Privatizing Fannie Mae and Freddie Mac*, ed. by U.S. Department of Housing and Urban Development, 97-168 (1996) (finding that conforming fixed-rate mortgage rates (*i.e.*, rates on mortgages of a size eligible for purchase by Freddie Mac, currently those up to $252,700 for one-unit properties) are approximately 25 to 40 basis points, or more, lower than rates on loans exceeding the conforming loan limit).

[3] *See* H.R. Rep. No. 54, 101st Cong, 1st Sess., pt. 3 at 2 (1989):

> A primary purpose [of Freddie Mac and Fannie Mae] is to provide stability in the secondary market for home mortgages including mortgages securing housing for low and moderate income families. This can be accomplished through both portfolio purchasing and selling activities, as well as through the securitization of home mortgages. The continuous presence of the FHLMC and FNMA in the secondary market in bad as well as good economic times provides assurances of a dependable and substantial funding source for home mortgages.

families a stable supply of mortgage money at the lowest rates the capital markets have to offer.

Beginning in the 1970s, we pioneered the development of the market for mortgage-backed securities, which broadened the investor base and brought more liquidity to the mortgage market. In recent years, our use of debt has enabled Freddie Mac to expand the investor base for America's housing worldwide. For a number of reasons, international investors prefer debt to mortgage-backed securities. They may not be familiar with 30-year, fixed-rate mortgages, which are not readily available in many countries. They also prefer the fixed payment schedule that debt provides. Issuing debt has allowed us to tap a more global capital market for America's mortgages than would have been feasible with mortgage-backed securities alone. The issuance of both mortgage and debt securities enables us to diversify and broaden our funding sources, thereby lowering costs and meeting America's growing need for mortgage funds.

The importance of our purchases of mortgage securities using debt financing became quite apparent during the credit crunch in the fall of 1998, when international capital markets were in turmoil. Freddie Mac provided liquidity and stability to the mortgage market by purchasing billions of dollars of mortgage securities that the market otherwise would have had difficulty absorbing. As a result, while other markets experienced credit shortages, there was no disruption in the mortgage market we serve. This conclusion was confirmed in a report by Capital Economics, which found that Freddie Mac and Fannie Mae stabilized residential mortgage rates during the international financial crisis of 1998 by providing liquidity to the secondary mortgage market. They emphasized: "For consumers in the home loan market during the financial crisis of 1998, mortgage credit remained available *and* affordable."[4]

With Freddie Mac as a strong investor in mortgages, America's families can obtain a mortgage when they need it, at the lowest possible cost. When we invest in mortgage securities we keep demand for mortgage securities high, and lower their yields. This translates directly to lower mortgage rates for homebuyers, because the rates lenders charge when they originate mortgages are determined by the yields on mortgage securities trading in the marketplace at that time, whether the securities are new or existing. Lower mortgage rates make housing more affordable for America's families and increase homeownership.

Freddie Mac is a tremendous Congressional success story. America now has a record 67 percent homeownership rate, and the needs of America's homebuyers and renters continue to grow. We fulfill our mission without government funding, and we do so

[4] "An Economic Analysis of Freddie Mac's (and Fannie Mae's) Contribution to Liquidity in the Residential Mortgage-Backed Securities Market During the Credit Crunch of 1998," Capital Economics, May 2000 (emphasis in original).

while maintaining world-class risk and capital management standards that ensure our safe and sound operations. Freddie Mac's continuing success results from our commitment to provide access to mortgage credit at all times, our ability to tap worldwide capital markets to meet the housing finance needs of America's families at the lowest possible cost, our state-of-the-art risk and capital management, and our continued efforts to reduce costs and improve the mortgage finance system.

II. Freddie Mac Is Among the Strongest Financial Institutions

Because of Freddie Mac's vital role in the housing finance system and the benefits we bring to the nation's families, it is essential that we operate safely and soundly to sustain this system into the future. Freddie Mac is among the strongest financial institutions. The conclusions of our safety and soundness regulator and other independent parties confirm our financial strength.

- Last month, the Director of the Office of Federal Housing Enterprise Oversight (OFHEO) reported to Congress "that both Fannie Mae and Freddie Mac are currently in excellent financial condition, are well-managed, and have exceeded minimum capital requirements every quarter that the requirement has been in place."[5]

- A recent report from Moody's Investors Service stated that Freddie Mac and Fannie Mae "are well-run, world-class financial institutions with sound business profiles and substantial franchise values."[6]

- Standard & Poor's Corporation (S&P) rated Freddie Mac AA- on a stand-alone basis in 1996. Only six bank holding companies and no thrifts enjoy an S&P rating as high.

Freddie Mac's financial strength stems from our world-class credit risk management, interest-rate risk management and capital management practices.

Credit Risk Management. Freddie Mac's credit risk management begins with the high-quality assets we finance – mortgages backed by the equity in people's homes. Home mortgages are much safer investments than the broad array of commercial loans

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[5] Testimony of the Honorable Armando Falcon, Jr., Director, Office of Federal Housing Enterprise Oversight (OFHEO) before the House Budget Committee Task Force on Housing and Infrastructure, July 25, 2000.

[6] Special Comment, "Moody's Talks with Investors about GSE Credit" (July 2000) ("Moody's Report").

that most financial institutions hold.[7] Moreover, we benefit from the nationwide geographic diversity of our mortgage purchases. By serving communities across the nation, we greatly reduce our credit risk from regional economic downturns.

Our mortgage loans benefit from extensive layers of credit protection. In addition to around $500 billion in homeowner equity, we have significant third-party credit enhancements on these mortgages in the form of mortgage insurance and lender recourse.

These extensive loss protections support mortgages that are underwritten and managed using state-of-the-art statistical tools. Loan Prospector®, Freddie Mac's automated underwriting service, is used by thousands of lenders to originate mortgages that Freddie Mac purchases. The sophisticated evaluation of risks that occurs in automated underwriting allows us to purchase even mortgages with low downpayments in a very safe and sound manner.

We further mitigate credit losses by actively seeking alternatives to foreclosure. Our loss mitigation techniques reduce credit costs and in many cases enable struggling borrowers to keep their homes.

The quality of Freddie Mac's underwriting and loss mitigation tools have resulted in mortgage delinquency and default rates that are significantly lower than the overall market's. Of Freddie Mac's 7 million mortgages, only 30,000 – less than one-half of 1 percent – are more than 90 days late in payment, and we will get a significant number of those homeowners back on track through our loss mitigation efforts.

Interest-Rate Risk Management. Freddie Mac also is a leader in managing interest-rate risk. Because 30-year, fixed-rate mortgages can be prepaid by the borrower at any time, Freddie Mac needs to manage interest-rate risk on a continuous basis.

Due to our size and access to the debt markets, Freddie Mac has a variety of risk management and funding options. We employ sophisticated investment, funding and hedging strategies to manage and mitigate interest-rate risk.[8] To mitigate interest-rate risk, Freddie Mac uses a mix of short-term debt, long-term callable and non-callable debt, and derivative financial instruments that provide flexibility whether mortgages prepayments rise or fall.

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[7] See e.g., Moody's Report at 4 ("The underlying risk asset of the GSEs is primarily single-family residential mortgages that have a very low risk profile and predictable risk characteristics.")

[8] *See* Moody's Report, *supra*, at 4, "These two GSEs also manage very well the prepayment risk associated with mortgages through sophisticated use of callable debt and derivatives."

Our interest-rate risk management practices are among the best in financial markets today. As a result, borrowers enjoy the benefits of long-term, fixed-rate mortgages with the option to refinance, and Freddie Mac is protected from both rising and falling interest-rate environments.

Freddie Mac's interest-rate risk management discipline has proven quite effective. In 1999, for example, despite rising interest rates the market value of our portfolio increased, while portfolio market values fell for many other mortgage investors. We maintain our risk management discipline in all environments, including the global market turbulence in 1998.

Capital Management. As discussed above, the mortgage assets Freddie Mac holds pose relatively low risk compared to other types of assets (such as commercial loans). We manage both credit and interest-rate risks extremely well, and we ensure that we maintain ample capital for the risks we do take.

Freddie Mac is subject to regulatory minimum capital standards, and we have met these standards every quarter since they were implemented by OFHEO. In addition to minimum capital standards, OFHEO is finalizing a dynamic, state-of-the-art risk-based capital standard for Freddie Mac and Fannie Mae. For many years, Freddie Mac has held ourselves to an internal stress test that is similar to the risk-based capital stress test mandated by Congress in the 1992 Act that will be contained in OFHEO's final rule.[9] This stress test requires us to hold enough capital to withstand 10 years of severe, adverse economic conditions – conditions much like those of the Great Depression.

Federal bank regulators in the United States strongly encourage the practice of internal stress testing by large banks to evaluate the effect of high-stress scenarios that could jeopardize the health of a financial institution.[10] Supervisory guidance from these regulators identifies the attributes of a high-quality stress test, including: the use of

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[9] The 1992 Act requires Freddie Mac to meet a state-of-the-art risk-based capital standard that requires us to pass a stringent economic stress test. Under this test, Freddie Mac must hold sufficient capital to withstand a 10-year period during which credit losses equal, on a nationwide basis, the worst actual two-year regional experience. In addition, capital must be sufficient to survive interest-rate fluctuations of up to 600 basis points. Beyond this, Freddie Mac must hold capital of an additional 30 percent capital above the stress test level for any possible management and operations risk.

[10] *Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles,* Division of Banking Supervision and Regulation, Federal Reserve Board, SR 99-18 (SUP) (July 1,1999); Federal Reserve Board, *Bank Holding Company Supervision Manual,* Section 2126.0.5.1.3 (Dec 1998); Speech by Federal Reserve Bank of New York President William McDonough before the Bond Market Association, New York (January 21, 1999).

scenarios of unusual and stressful conditions; consideration of risk interaction; discounting the benefits of diversification; and integrating stress tests into the management process.[11] All of these attributes are embodied in our own internal stress test and in the risk-based capital stress test being finalized by OFHEO.

The stress test required by the 1992 Act is a dynamic one that ties capital to risk better than ratio-based regulatory capital standards under which banks and thrifts currently operate. This stress test is so stringent that very few financial institutions could meet it. For example, in 1999, thrift industry expert IPS-Sendero applied the risk-based capital stress test designed for Freddie Mac and Fannie Mae to the thrift industry and found that the thrift industry could not survive for even five years of the 10-year stress test. The study concluded that the thrift industry would need "more than three times their current capital level" to meet the stress test's capital standard.[12]

Freddie Mac asked former FDIC Chairman Bill Seidman to assess the relative stringency of the 1992 Act's risk-based capital standard. He concluded that "the risk based capital standard set forth in the 1992 GSE Act creates a very stringent capital standard, one that could be devastatingly stringent if applied to most other financial institutions."[13]

III. Basel Framework for Enhancing Capital Standards, Market Discipline and Transparency

Given the continuing and vital role Freddie Mac plays in financing homes for America's families, we welcome a discussion regarding steps that could further enhance understanding and confidence in our capital and risk management standards – standards that already set a best-practices benchmark for financial institutions. As described earlier, our risks are well managed. We are committed to maintaining risk and capital management and disclosure practices that are at the forefront of the best practices of financial institutions, and believe all financial institutions should be held to the highest standards of public scrutiny. We analyze the recommendations of the relevant international and regulatory bodies such as the proposed Basel framework, which we believe provides an appropriate framework for considering enhancements to capital standards, market discipline and transparency.

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[11] *Id.*

[12] "Thrift Industry Analysis: Implications of Risk-Based Capital Stress Test Requirements," IPS-Sendero, August 19, 1999.

[13] L. William Seidman, Jacqueline Pace and David S. Chung, "Analysis of OFHEO Risk-Based Capital Standard," Memorandum to Freddie Mac (March 29, 2000).

The Department of the Treasury has adopted an approach to mitigating systemic risk that was well articulated in Under Secretary Gensler's recent testimony before the Subcommittee.[14] He stated:

> Treasury's general approach to mitigating systemic risk in capital markets emphasizes the role of the private sector. The public sector has three roles: creating an environment in which market discipline can work effectively; promoting the maximum degree of transparency; and maintaining the competitiveness of the system as a whole. For institutions where the public has a special interest – for example, depository institutions carrying federal deposit insurance – further government involvement such as on-site examinations and capital standards is appropriate. Promoting market discipline means crafting government policy so that creditors do not rely on governmental intervention to safeguard them against loss. Transparency is the necessary corollary to market discipline. The government cannot impose market discipline, but it can enhance its effectiveness by promoting transparency. Transparency lessens uncertainty and thereby promotes market stability.[15]

Treasury's approach is entirely consistent with the proposed Three Pillars framework set forth by the Basel Committee on Banking Supervision in its June 1999 report. Basel's First Pillar – Regulatory capital requirements – builds upon existing bank capital standards in an attempt to more closely align capital with risk exposure.[16] The Second Pillar – Supervisory review of capital adequacy – explicitly recognizes the role of supervisory oversight, and in particular regulatory examinations, as an integral and critical component of the capital framework and a complement to both the capital requirement and market discipline pillars.[17] The Third Pillar – Market discipline –

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[14] Prepared Statement of Treasury Under Secretary Gary Gensler before the House Banking Committee Subcommittee on Capital Markets, Securities and Government Sponsored Companies, March 22, 2000.

[15] *Id.*

[16] 1999 Basel Consultative Paper, at 12.

[17] *Id.* at 16. Similarly, as Federal Reserve Governor Laurence Meyer recently stated:

> In short, it will, I think, be increasingly the job of the supervisor to evaluate and test systems and to evaluate and criticize the accuracy and helpfulness of the information banks disclose about their own risk profiles. I anticipate that market discipline at the complex banks will play an important role as a supplement to the evolving supervisory paradigm. Internal systems and public disclosure are the real first line of defense in the safety and soundness of our banking system.

consists of greater transparency through public disclosure, imposing strong incentives on institutions to conduct their business in a safe, sound and efficient manner and to maintain a sufficient capital base as a cushion against potential future losses.[18]

Measured against the Basel Three Pillars framework, Freddie Mac's current capital, supervisory and disclosure standards stand up extremely well.

Capital Standards. The risk-based capital stress test mandated under the 1992 Act is a dynamic and rigorous standard that ties capital to risk. Ratio-based capital standards at best loosely tie capital to risk, and are not as accurate in assessing the amount of capital needed to serve as a buffer against potential losses.

As discussed previously, Freddie Mac employs state-of-the-art capital management tools, including self-implementation of an internal stress test that closely resembles the stress test required by the 1992 Act – a test that ensures we maintain ample capital, even under extreme conditions. Moreover, we publicly disclose information about our adherence to our internal stress test on an annual basis – a disclosure standard that meets or exceeds the practices of leading financial institutions. Additionally, Freddie Mac is one of the few financial institutions to merit a AA- rating from S&P.

Regulatory Supervision. Freddie Mac is subject to rigorous supervisory oversight by OFHEO. OFHEO's experienced examination team operates under an examination manual, written standards, and procedures that are comparable to the risk-based examination manuals and guidance used by the Federal Reserve and Comptroller of the Currency in their examination of large, complex banking organizations. OFHEO has an examination staff of approximately 20 full-time examiners that maintains on-site offices at Freddie Mac and Fannie Mae. Moreover, unlike bank regulators, OFHEO must submit the results and conclusions of its annual examinations of Freddie Mac and Fannie Mae to Congress and the public.

Market Discipline through Transparency of Financial Condition. Freddie Mac's financial disclosures regarding the risk of our business activities, including our management of credit risk and interest-rate risk, are among the most transparent in the financial services industry. Freddie Mac takes extensive steps to ensure that investors and market participants have the information necessary to evaluate our business practices and results.

"The Roles of Banks, Supervisors, and the Market in Advancing Risk Management," Remarks by Governor Laurence H. Meyer, at the Risk Management Planning Conference, Chicago, Illinois (June 1, 2000).

[18] *Id.* at 17-18.

Freddie Mac recently retained PricewaterhouseCoopers, LLP, to independently compare our risk management disclosures to a group of large financial institutions whose financial disclosures are considered "best in class," or "best practices." PricewaterhouseCoopers found Freddie Mac's risk management disclosures to be among the best of the disclosures made by this exemplary group.[19]

While Freddie Mac currently maintains state-of-the-art disclosure practices, we are committed to constant review of these standards to remain at the vanguard of developments in best practices standards.

Freddie Mac believes the Basel Pillars and the best practices standards of other federal and international regulatory bodies provide an appropriate framework for a discussion regarding how to enhance transparency, market discipline and early-warning signals. We believe these discussions are most constructive when they include other financial institutions. For example, focus on the frequency and adequacy of disclosures relating to interest-rate risk, credit risk and capital management could lead to adoption of practices that improve market discipline for all financial institutions, providing early-warning signals to the public, Congress and regulators alike.

IV. Serving a New Generation of Homebuyers and Renters

Charter Benefits to Serve Our Mission. Congress created Freddie Mac to ensure America's families have access to low-cost mortgage money whenever and wherever they need it. In creating Freddie Mac, Congress conferred a number of benefits that enable us to access the capital markets to fulfill our mission. At the same time, we have significant limitations on the types of business in which we can engage.

Federally insured depository institutions, such as banks and thrifts, enjoy government benefits of their own.[20] For example, the deposit liabilities of federally insured depository institutions provide these institutions with a low-cost source of funding and are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to federal limits. Moreover, most banks and thrifts currently pay no premium for this

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[19] PricewaterhouseCoopers, LLC, "Freddie Mac Risk Disclosure Benchmarking Study" (May 15, 2000). The PricewaterhouseCoopers study was entered into the record as an exhibit to Freddie Mac's testimony for the May 16, 2000 Subcommittee hearing.

[20] See e.g., Written Testimony of Federal Reserve Board Chairman Alan Greenspan before the House Commerce Committee (April 28, 1999) which describes the Government benefits provided to the banking system under the heading of "Subsidies" ("Government guarantees of the banking system— deposit insurance and direct access to the Fed's discount window and payments system guarantees – provide banks with a lower cost of capital than would otherwise be the case. This subsidized capital is achieved through lower market premiums on both insured and uninsured debt and through lower capital than would be required if there were no government guarantees.")

government-backed insurance, which provides access to low-cost deposits to fund their activities. A recent FDIC options paper on deposit insurance points out that risk-based premiums are under-priced, noting that, “a decade that began with a legislative mandate for risk-based insurance premiums ended with the FDIC providing a free guarantee of almost three trillion dollars in bank and thrift liabilities.”[21]

Other government benefits enjoyed by banks include access to the Federal Reserve discount window and access to the Federal Reserve payment mechanism. Many banks and thrifts are members of the Federal Home Loan Bank (FHLB) system. As FHLB members, they have access to low-cost loans (advances) from Federal Home Loan Banks. Many institutions use these funds to make mortgage loans that are not eligible for sale to Freddie Mac – such as jumbo mortgage loans – at rates that are much higher for homebuyers than the rates on the mortgages Freddie Mac purchases.

Government benefits to financial institutions can serve vital public interests. Deposit insurance, for example, has helped achieve a stable financial system. Freddie Mac’s charter benefits help achieve a stable mortgage market and provide tremendous benefits to America’s families. The benefits financial institutions receive from their government charters should be examined in relation to the benefits that in turn accrue to the nation.

The unique aspect of Freddie Mac is not that we have a government charter or public responsibilities, but that we have done an extraordinary job using our charter benefits to serve America’s homebuyers, while maintaining safe and sound operations that put us among the strongest financial institutions.

Freddie Mac requested James C. Miller, III, former Director of the Office of Management and Budget, to study the impact that altering Freddie Mac and Fannie Mae’s charters would have on the efficiency of the housing markets. Dr. Miller found that eliminating our Congressional benefits while maintaining the benefits afforded to other government chartered financial institutions would not result in a more efficient allocation of capital in the marketplace. Dr. Miller further found that eliminating Freddie Mac’s and Fannie Mae’s charters would reduce housing benefits and impose efficiency losses on the nation’s economy.[22]

Serving New Needs in a New Century. More than 70 million families now own their own homes. As homeownership rates increase, so does the amount of mortgage money needed to finance those homes. Indeed, Freddie Mac’s growth is consistent with the growth of the mortgage market.

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[21] FDIC Deposit Insurance Options Paper (August, 2000) at 4.

[22] James C. Miller, III, An Efficiency Analysis of Eliminating Freddie Mac’s & Fannie Mae’s Charters (2000).

We estimate that 50 million American families will need home purchase mortgages in the next decade, and more than 10 million of these families will be first-time homebuyers. At the rate they are growing, bank deposits alone cannot possibly fund the mortgage needs of these families. The public purposes for which Congress chartered Freddie Mac and Fannie Mae remain compelling today. We are fulfilling those purposes in a way that controls risks and expands homeownership.

Freddie Mac is working with lenders and others to extend the reach of low-cost mortgage financing as far as efficient markets can take it. We are purchasing mortgages for borrowers who previously would have no choice but to borrow from a high-cost, subprime portfolio lender. We are working with a new generation of lenders to bring the cost savings potential of the Internet to borrowing families. We are doing this with no government funding, with shareholder accountability and with rigorous risk management practices.

Freddie Mac is committed to making the world's best housing finance system even better for future generations of America's families. We welcome constructive dialogue on ways that we can demonstrate our world-class risk management standards to the public and Congress. We look forward to discussing these vital matters at the Roundtable next month.

Sincerely,

Leland C. Brendsel