William Michael Cunningham
Registered Investment Adviser

Thursday, August 24, 2000

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets
U.S. House of Representatives
Committee on Banking and Financial Services
2129 Rayburn House Office Building
Washington, DC 20515-6050

Dear Chairman Baker,

Earlier this year, I testified before your subcommittee at a hearing on actions you are considering to improve regulation of the three housing GSE's. The hearing took place on June 15, 2000. I am in receipt of your letter dated August 9, 2000 inviting witnesses to participate in further discussions on this issue. I understand this "roundtable" format meeting will take place at House Banking Committee offices in Washington on September 6, 2000. I would be happy to participate.

In advance of my participation, I am sending these additional comments and suggestions concerning H.R. 3703. Please feel free to contact me at 612-752-4268 with comments or questions.

Let me take this opportunity to personally thank you for your kind words directed to my mother, present at the June hearing and whom I acknowledged before my testimony. She really got a kick out of your comments.

Sincerely,

William Michael Cunningham
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Executive Summary: Comments on H.R. 3703

H.R. 3703 seeks to enact regulatory reforms suggested by the U.S. General Accounting Office. It seeks to protect hundreds of millions of U.S taxpayers from the failure of one or both of two congressionally chartered housing finance agencies, Freddie Mac and Fannie Mae. In addition, the bill seeks to have these agencies refocus attention on the mission they were created to carry out – helping Americans finance the purchase of low and moderately priced housing.

This legislation will strengthen government regulation and encourage market discipline. The legislation is designed to insure that taxpayers are never faced with the trillion-dollar liability they would face if one or both of these institutions failed. In addition, the bill may make it easier for people to purchase homes.

The bill clarifies Freddie and Fannies' relationship with the federal government, and protects taxpayers in case problems arise in the future. According to Federal Reserve Board Chairman Alan Greenspan, Freddie Mac and Fannie Mae "succeeded (in) smoothing out regional imbalances in mortgage supply and integrating regional mortgage markets into the national capital markets..many years ago."

The question for Congress now - what's next for Freddie Mac and Fannie Mae? Mr. Greenspan himself may have answered that question. In a speech given early in his tenure he said:

"The history of financial involvement in increasing home ownership is one of taking risks - of designing new financial instruments and financial products to make financial resources available so that more people can realize the goal of home ownership. Taking prudent risks in lending so that others may attain an objective is the essential role of a financial intermediary..."[1]

Freddie Mac and Fannie Mae can rekindle their involvement in the home ownership process by designing new financial products tailored to the needs of low income, minority and other homebuyers. This legislation will help them do so.

A modernized GSE regulatory policy is necessary if Freddie Mac and Fannie Mae, and the nation's housing markets, are to prosper, to move forward, to endure.

I support all current provisions of H.R. 3703 and would add the following:

<u>Promoting Market Competition</u>
I respectfully suggest that a section be added to H.R. 3703 making the **Federal Reserve Board** the primary GSE regulator.

<u>Increased Role for GSE's in reducing homelessness in the District of Columbia</u>

I suggest the GSE's be required to report on efforts they specifically have undertaken to reduce homelessness in the United States.

I further suggest that language be added to the bill requiring the GSE's to undertake a special effort to virtually eliminate or, in the alternative, significantly reduce homelessness in a five square mile radius of the U.S. Capital within five years.

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[1] These quotes are taken from comments made by Chairman Alan Greenspan at The Social Compact Awards Luncheon, San Francisco, August 1995.

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Comments on H.R. 3703

Promoting Private Market Discipline
I support repealing the GSEs' conditional line of credit with the Treasury. I agree with Treasury Under Secretary Gary Gensler when he stated, in testimony on March 22, 2000 before this Committee, that: "Repeal of the line of credit would be consistent with the congressional requirement that all GSE securities carry a disclaimer that they are not obligations of the U.S. government."

Increasing Transparency
I support provisions in the bill that increase transparency. I support provisions in the bill that require the GSE's to receive an annual credit rating from nationally recognized statistical rating organizations. Such an examination would significantly improve transparency by providing an independent and objective opinion concerning the GSE's financial condition.

I also suggest that the GSE's be subject to a "Social Audit." A Social Audit is an examination of the performance of an enterprise relative to certain social objectives. The GSE's are currently subject to a limited social audit: central city and minority lending goals have been established and progress GSE's make in meeting those goals is reviewed annually. I am suggesting, however, that the GSE's be subject to a more detailed and rigorous social audit covering all aspects of their operations. Congress may want to specify, in detail, which social objectives should be measured.

For the GSE's the major benefits of a social audit are:

- Improved accountability with respect to social and community investment activities
- Increased social efficiency and effectiveness
- Increased ability to effectively monitor and steer social performance
- Social achievements reported in an unbiased manner

Promoting Market Competition

I support provisions in the Bill to further encourage market competition.

Structural issues

I support the creation of a fully independent GSE regulator. I further suggest this regulator not part of the executive branch. As an alternative, Congress may wish to consider designating the Federal Reserve Board the primary GSE financial institution regulator.

I believe the Fed will, one day soon, need to oversee the activities of GSE's, banks, thrifts, pension funds, insurance companies, mutual fund companies, brokerage firms and investment banks. Recent advancements in financial and computer technology require the creation of such a strong central bank.

Role of the Executive Branch in regulating GSE's.

I strongly suggest that the Executive Branch's role in regulating GSE's be limited. Recent incidents suggest that political interference may limit Executive branch regulatory effectiveness and objectivity. I refer the Committee to one such incident:

" A top federal bank regulator, responding to concerns over possible political interference in bank examinations, has ordered his staff to quit fielding a list of friendly bankers to support a controversial fair lending law.

John D. Hawke Jr., acting Comptroller of the Currency, told his staff in a memo issued Friday that bank examinations must be 'kept completely free from even the appearance of being influenced by political considerations.' The comptroller, an arm of the Treasury Department, regulates 2,600 national banks."[2]

We have observed this type of inappropriate behavior before, preceding the S&L Crisis of the 1980's, and more recently, with the Community Development Financial Institution program, a financial institution program administered by the U.S. Treasury. According to the House Banking Committee:

"$37 Million Clinton Inner-City Loan Fund in Disarray and subject to Political Cronyism. 1 in 3 Grants To First Lady's Favorite.

A $37 million Clinton Administration campaign centerpiece designed to overcome perceived inequities in bank lending to poor and inner-city clients appears to be in disarray, is without adequate standards for making grants, and has at least the appearance of conflicts of interest that 'raises questions concerning the fairness of the system,' a senior House Banking Committee member said today."[3]

In this case, critical federal assistance and funding was determined to have been distributed, in part, based on political ties and not on efficiency, market requirements, performance or need. Given this, I believe making an executive branch agency the chief GSE institution regulator may have harmful consequences. The Federal Reserve System, an independent body, is not subject to and has not been shown to engage in this type of politically biased regulatory interference. I therefore respectfully suggest that a section be added to H.R. 3703 to make the Federal Reserve Board the primary GSE regulator.

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[2] *Complaints Prompt U.S. Bank Regulator to Warn Staff on Contacts*. By Robert Wells. Washington, Feb. 8, 1999. (Bloomberg)

[3] Press release from the U.S. House Banking Committee, issued by U.S. Representative Spencer Bachus, (AL - 6th.) Dated May 15, 1997. http://www.house.gov/banking/51597bpr.htm.