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:

Thank you for the opportunity to provide comments in preparation for the upcoming "GSE Roundtable Summit."

As a variety of witnesses have told the Subcommittee, the housing finance system in the United States is the envy of the world. American families enjoy the ready availability of low-cost mortgage credit at relatively stable rates and favorable, fixed-rate terms. This system did not evolve by chance. It was supported by Congressional policies that gave Fannie Mae and Freddie Mac a critical role in creating and maintaining a secondary mortgage market that attracts a broad range of investors and structures mortgage risk to meet a variety of investors' needs. The system also supports greater stability in the financial markets and lowers mortgage rates every day for U.S. consumers. America's housing finance system enjoys strong and broad bipartisan support in every part of the country.

While this system works exceptionally well today for both consumers and investors, Congress bears the responsibility to ensure that the system which it helped create continues to achieve the public purposes it sought to achieve -- and at the highest standard of safety and soundness. Although the Subcommittee did not have the opportunity to hear from a number of participants with valuable insights (including the Independent Community Bankers Association, affordable housing groups, local officials, and others), the hearing process has raised important issues and contributed to a useful dialogue on Fannie Mae's role in expanding access to homeownership and affordable rental housing. We are pleased to participate in the dialogue.

The testimony I submitted to the Subcommittee on May 16 contains a comprehensive discussion of the issues under consideration. In this letter, I would like to address certain issues raised since May 16.

First, the U.S. has the best housing system in the world, but we should not take the system for granted.

Without doubt, U.S. home buyers fare much better than their counterparts in other countries. In the U.S., consumers expect -- and receive -- ready access to long-term, fixed rate mortgages, with down payments as low as three percent. Last year, 66 percent of all conforming mortgages originated in the United States were 30-year, fixed-rate loans. Outside the U.S., this type of mortgage is a rarity. In Canada, consumers buy rollover mortgages, where the rate is fixed during the first one to five years, with a prepayment penalty equal to three months of interest. The fixed-rate term in Spain is usually one year. In France, 80 percent of all mortgages have variable rates. In Germany, consumers can purchase a fixed rate for five to fifteen years, but they cannot refinance during this period without paying a huge penalty. In Germany, the downpayment is typically 30 to 40 percent. In Japan, consumers put down effectively 50 to 60 percent.

In contrast, consumers in the U.S. can choose from among a set of mortgage options that include fixed or variable rates; at terms of 10, 15, 20, 25, or 30 years (with more term options for adjustable rate mortgages); with downpayments as low as 3 percent (and less in some cases); and with options including home improvement, construction to accommodate the needs of people with disabilities, and rate-reduction opportunities for borrowers with impaired credit histories. Borrowers in the conventional market in the U.S. rarely face the prepayment penalties that are common in other countries.

There is a simple reason why the low downpayment, long-term, fixed-rate mortgage is so common in the U.S., and uncommon everywhere else, and why U.S. homebuyers have a variety of housing finance options to meet their needs. Most countries do not have a secondary market to buy or guarantee mortgages that lenders originate. In the place of the secondary market, lenders have to require consumers to pay more up front and more each month if interest rates rise.

But the U.S. housing finance system is not invulnerable, and it must not be taken for granted. Consumers benefit from Fannie Mae’s access to the agency debt market and the wide range of investors drawn to our debt. Fannie Mae and Freddie Mac use their access to the agency debt market to transform the illiquid, unique, and volatile cash flows from millions of mortgages into liquid, desirable, and uniform fixed-income securities -- bringing billions of investment dollars to the mortgage market.

But Congress cannot *explicitly* give Fannie Mae access to the agency debt market. The agency market exists because investors have recognized over the years the special status of Fannie Mae and Freddie Mac which results from a number of different factors: the housing mission Congress has asked us to perform, the safety and soundness regulatory regime that Congress established to protect the public interest, and the combination of benefits and restrictions in Fannie Mae’s Congressional Charter that keep us focused on the secondary market for residential mortgages. To be clear, our borrowing costs are not even close to those of the U.S. government. Our debt yields are substantially higher than Treasury yields, and are much closer to the yields on similarly-rated financial corporate debt.

Because our access to the agency debt market has developed over time in reaction to this unique combination of laws and policies, investors may well react to any change in our status by altering our access to the agency debt market. For example, as several major trade groups testified before the Subcommittee in July, repealing the Charter provision that allows the Treasury to purchase up to $2.25 billion in Fannie Mae's debt securities would likely raise consumer costs, precisely because it would signal to investors a change in the government's commitment to our role in promoting homeownership. Such a signal would disrupt the capital markets and inexorably lead to higher mortgage rates for consumers.

I know that you agree with me that as we discuss constructively ways in which GSE regulation might be improved, we all need to take care that we do no harm (even inadvertently) to this public policy success.

Second, Fannie Mae is not a "risky" participant in the financial system; indeed, it is a safe and sound company that contributes to systemic stability.

Fannie Mae's role is to transform mortgage risk into the various forms that investors want to buy, in effect serving a "risk sharing" function for the conventional conforming mortgage market. Fannie Mae shares interest rate risk with investors in callable debt and MBS; it sells interest rate risk to investors in the swap and related markets; and it shares credit risk with mortgage insurers, lenders, and others.

There is a role for this risk-sharing function because different investors have different appetites for the two major types of mortgage risk. For example, some investors want the higher returns, liquidity, and lack of credit risk they can get from investing in mortgage-backed securities (MBS), and they are willing to take the interest rate risk (the risk that borrowers will repay their mortgages if interest rates fall and thus reduce the cash flow from the MBS investment). Other investors do not want the interest-rate risk associated with mortgages, even in exchange for projected higher returns, because the risk of prepayment is difficult to evaluate. These investors purchase Fannie Mae debt, which gives them higher yields than Treasuries along with very high liquidity and more predictable interest rate risk. Fannie Mae performs a similar risk-brokerage role with regard to credit risk, working with risk-sharing partners such as lenders, mortgage insurers and others to transform the risk of default on each loan into exposures each partner is best suited to hold. In all, Fannie Mae spends half its available revenue on risk-sharing with other market participants.

Fannie Mae's and Freddie Mac's unique capital structure promotes this risk-sharing role by requiring that each company purchase extensive risk-sharing in compensation for higher leverage. Fannie Mae's Charter requires the company to share risk on mortgages with loan-to-value ratios of greater than 80 percent.[1] In addition, the company routinely obtains credit enhancement over and above this requirement in order to manage its total portfolio of credit risk, particularly when we work with lenders to expand mortgage opportunities for underserved borrowers.

Depositories do not have the same requirements as Fannie Mae with regard to sharing credit risk, and they both retain more of this risk on the mortgages they buy and employ fewer mechanisms to manage risk. Between 1996 and 1999, when Fannie Mae's credit loss rate dropped from approximately 5 basis points to a single basis point, the single-family charge-off rate of the large banks edged down from 15 basis points to 14 basis points. Not only did banks' residential mortgage credit losses start from a higher level, they stayed much higher over this period and did not drop significantly.

Fannie Mae also manages its interest rate risk extensively. As of June of this year, roughly half of the debt funding our portfolio included some form of option to hedge against the risk of rising or falling interest rates. Fannie Mae and Freddie Mac use option-based debt much more extensively, and on a much more sophisticated basis, than all of the other leveraged holders of residential mortgage assets.

In contrast, other mortgage investors, such as banks and thrifts, generally retain most of the risks inherent in owning a mortgage rather than buying hedges against them. As a result, Fannie Mae's purchases of mortgages leads to greater risk-sharing with a wider array of market participants than do purchases of mortgage assets by depositories. In its proposed risk-based capital rule, OFHEO estimated that the risk in a portfolio of mortgages hedged with bullet debt alone is high enough to cause that portfolio to need a capital-to-asset ratio of 20 percent under the proposed rule.[2] That estimate supports the statement that thrifts and banks would need to hold far greater capital if they were held to the 1992 Act stress test.[3]

One result of Fannie Mae's and Freddie Mac's extensive interest-rate risk hedging is that it attracts to the mortgage market the funds of investors who might not otherwise invest directly in mortgages. Fannie Mae's bullet debt, for example, attracts investors who want a return above that of Treasuries but without the interest rate risk of callable debt or MBS. Fannie Mae's callable debt attracts still other investors who will accept some prepayment risk, but not the entirety of prepayment risk in MBS. The ability to attract more investors to the mortgage market reduces mortgage rates by increasing funds

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[1] 12 U.S.C. § 1717(b)(2).

[2] 64 Fed. Reg. 18084, 18110 (April 13, 1999).

[3] For example, after review of this statutory stress test, former FDIC Chairman William Seidman concluded: "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." Memorandum of L. William Seidman, Jacqueline Pace and David S. Chung to Freddie Mac (March 29, 2000). Similarly, a 1999 study conducted by the economic consulting firm IPS-Sendero put thrift industry data through this statutory risk-based stress test and concluded that the industry would run out of capital after 5 years and would need to triple its capital to survive the stress test. *Thrift Industry Analysis: Implications of Risk-Based Capital Stress Test Requirements* (August 1999).

available for mortgages and bringing down the rates consumers ultimately pay. For example, foreign investors have purchased one-third of the bullet Benchmark Notes Fannie Mae has issued since January 1998 -- adding liquidity to the U.S. housing market.

One only has to look back to the market downturn in the fall of 1998 for an illustration of the centrality of our liquidity to the stability of the markets and the interests of the consumer. When the commercial mortgage market dried up and even some sovereign nations found themselves unable to borrow, U.S. homebuyers enjoyed uninterrupted access to affordable housing finance. The reason for this "privileged" position of homebuyers is clear. As *Grant's Interest Rate Observer* noted: "It was the extraordinary purchases by Fannie Mae and Freddie Mac...that righted the...market."[4] Similarly, *The Wall Street Journal*, referring to Fannie Mae and Freddie Mac, explained: "Their presence helps to keep the market liquid and mortgage rates reasonable."[5]

Third, Fannie Mae debt securities offer an important investment option for smaller financial institutions, and they do not pose any systemic risk because there is no unsafe concentration at large financial institutions.

Another issue raised during the hearings relates to whether bank holdings of Fannie Mae debt constitutes a systemic risk to the financial system. The issue of systemic risk arises where there is a concentration of the debt obligations of a single issuer in a few very large financial institutions. The facts show that this scenario does not hold true today with respect to Fannie Mae:

- At the end of 1999, banks held $227 billion in GSE debt securities. Since the existing limits on bank investments relate to investments of a single issuer (and not to groups of issuers), it is important to examine bank holdings of Fannie Mae debt and not GSE debt generally.

- Fannie Mae estimates that at the end of 1999, banks held $77 billion in Fannie Mae debt securities. This is a small proportion -- 1.28 percent -- of total bank assets.

- Large banks do not hold a large amount of Fannie Mae debt as a percent of assets or capital. At the end of 1999, the 17 banks with more than $50 billion in assets (i.e., the banks most likely to cause systemic problems if they failed) held an estimated $7.5 billion in Fannie Mae debt, or 0.3 percent of their total $2.5 trillion in assets. Fannie Mae debt holdings by these banks were 3.8 percent of their equity capital.

- The 716 banks that are estimated to hold 100 percent or more of their capital in Fannie Mae debt securities combined hold only 2 percent of total bank assets. Only one bank with more than $10 billion in assets has over 100 percent of its capital in Fannie Mae debt, and that bank has $18 billion in assets. Furthermore, 492 of the 716

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[4] Grant's Interest Rate Observer, May 7, 1999.
[5] The Wall Street Journal, October 29, 1998, p. C1.

banks had less than $100 million in assets each. Total assets of these banks came to $23 billion and each averaged $46 million in assets and held an average of $5 million in Fannie Mae debt.

Indeed, small banks tend to hold GSE debt rather than MBS -- and the reverse tends to be true among the larger banks. At the end of 1999, banks with less than $100 million in assets held two and a half times as much GSE debt as MBS. Banks with more than $50 billion in assets held more than seven times as much MBS as agency debt.

These purchasing patterns mean that smaller banks depend on Fannie Mae and other GSEs to assume the prepayment risks in mortgages. They tend to buy GSE debt (a more predictable investment) instead of MBS because they do not have the expertise or access to callable debt necessary to manage the prepayment risk embedded in MBS. Therefore, forcing small institutions to divest themselves of Fannie Mae debt securities could **increase** their risk as these institutions replaced Fannie Mae securities with less predictable, higher risk, and less liquid investments. As the Deputy Comptroller for Risk Evaluation of the Office of the Controller of the Currency noted recently, capping bank investments in Fannie Mae and Freddie Mac debt would require banks "to expand into something that has more credit risk or more optionality."[6]

Fourth, Fannie Mae purchases of MBS and whole loans fulfill the company's Charter requirement to provide liquidity for both consumers and investors.

Fannie Mae's fundamental role in the mortgage market is to provide liquidity -- to buy mortgages and give lenders the cash they need to make more mortgage loans. That is one of the primary purposes laid out in Fannie Mae's Charter: "to promote access to mortgage credit… by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."[7]

Liquidity is critical both for originators of mortgages and those who invest in mortgages. Liquidity is important for mortgage originators because it provides assurance that should they want to sell in the future, there will be an orderly and liquid market available. The lack of such a liquid market, even if it occurred only occasionally, would produce

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[6] *Agency Debt Not a Threat to Banks* -- *U.S. Regulator*, Reuters, June 30, 2000.
[7] The Charter sets forth the following purposes for the company:

> To provide stability in the secondary market for residential mortgages; to respond appropriately to the private capital market; to provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and to promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing. 12 U.S.C. § 1716.

volatility in MBS pricing and higher mortgage interest rates. The value of the steady participation of Fannie Mae and Freddie Mac was best demonstrated in the 1998 credit crunch.

Mortgage assets are sold into the secondary market by the lenders who originate mortgages. Lenders have the choice to sell the mortgages they originate either in the form of individual loans or in pools of loans (commonly referred to as MBS). The difference between the sale of individual loans and MBS is that MBS carry a third-party credit guarantee. In the case of loans below the conforming loan limit, Fannie Mae and Freddie Mac may serve as the credit guarantor. In the early 1970s, before the introduction of the MBS structure, lenders sold all of their loans to investors in the form of individual loans. Generally, lenders sold these loans to investors without a credit guarantee, which narrowed the universe of possible investors because many investors were not equipped to measure and price the credit risk of these loans.

When the MBS structure was introduced, the universe of possible investors in mortgage assets grew substantially -- because there were many investors who were willing to carry the interest rate risk on MBS and willing to pay Fannie Mae or Freddie Mac (or another guarantor) to carry the credit risk. Because the universe of investors grew, the price of mortgages was driven up by the additional bidders -- and the yields on mortgages fell.

Lenders quickly realized that they could get better prices for the mortgages they originated if they securitized them into MBS because there is more investor demand for MBS than for individual mortgage loans. Lenders also began to prefer securitizing their mortgages because they could sell MBS (but not whole loans) into the forward-delivery MBS market. This market allows lenders to sell loans that have not yet closed (loan commitments). Selling mortgages into this market allows lenders to manage their interest rate risk -- i.e., the risk that rates will rise before the loans close, leaving the lender with a substantial loss. Today, lenders securitize nearly 90 percent of the mortgages they originate.[8] For non-government mortgages below the conforming loan limit (currently $252,700), lenders generally securitize their mortgages with Fannie Mae or Freddie Mac.

Fannie Mae is one of many bidders for MBS -- and the fact that it guarantees the credit risk on a particular MBS does not give Fannie Mae an advantage over other investors in the bidding process. Other investors include Freddie Mac, the Federal Home Loan Banks, mutual funds, commercial banks, thrifts, insurance companies, pension funds, and foreign investors. Since the proportion of loans that are securitized has risen dramatically over the past few decades, it is not surprising that an increasing percentage of Fannie Mae's portfolio purchases are MBS. In 1999, $125 billion of the $195 billion in mortgages Fannie Mae purchased for portfolio were Fannie Mae MBS.

But it is incorrect to call these "repurchases." Of the $125 billion in Fannie Mae MBS purchased for the portfolio last year, $37 billion were sold to us directly by the

[8] In 1986, lenders securitized 60 percent the mortgages they originated, compared to 89 percent in 2000.

originating lender. Another $60 billion in Fannie Mae MBS purchases for portfolio were brokered to us by securities dealers, but Fannie Mae was the first purchaser of those loans. So, on $97 billion of the $125 billion in Fannie Mae MBS purchased for portfolio last year -- nearly 80 percent of the total -- Fannie Mae was the first and only source of permanent funding for the mortgage, just as would have been the case had Fannie Mae purchased the individual loans.

If Fannie Mae's bid were to be removed from the marketplace, the result would be less demand by investors (e.g., fewer bids), lower MBS prices, and higher mortgage rates for consumers. Investors other than Fannie Mae and Freddie Mac would be discouraged from investing in mortgage assets -- further driving up mortgage rates -- because they would see reduced liquidity in the mortgage market. And these investors would not have the same assurance that they would be able to sell mortgage assets profitably in the future. Thus, eliminating Fannie Mae's bid for MBS would mean that the company would not be able to fulfill its chartered purpose to provide liquidity in housing finance. It is the law of marketplace supply and demand at work; since the introduction of MBS in the early 1980s, it has broadened the universe of investors who want to buy mortgages, improved the flow of mortgage financing, and kept mortgage rates lower than they otherwise would have been.

Fannie Mae and Freddie Mac take the exact same risk when they own whole loans as when they own MBS that they have also guaranteed. When Fannie Mae purchases an individual mortgage loan, it holds both the credit risk and the interest risk (both of which it hedges or shares with partners, such as mortgage insurers and holders of callable debt). When Fannie Mae securitizes a pool of loans for a lender, it takes on only the credit risk. And if Fannie Mae purchases that same MBS for portfolio, the company then takes on the interest rate risk as well. Because the risks are identical, the capital charges for whole loans and MBS held in portfolio are also identical.

Fifth, Fannie Mae's efforts to expand the conventional market are consistent with its Congressional Charter.

In my May 16 testimony, I noted that Fannie Mae would grow in the coming years because so many Americans have yet to achieve the dream of homeownership. Minorities, women-headed households, new immigrants, and the residents of central cities and other underserved areas all have homeownership rates well below the national average. These are the fastest growing markets, and Fannie Mae is committed to help these families buy their own homes or gain access to affordable rental housing.

Fannie Mae can also help serve borrowers who are now served by the subprime market or by higher-priced government loans even though they qualify for lower-cost conventional financing. The Office of Thrift Supervision estimates that more than half of the borrowers in the subprime market are A-minus borrowers -- just a notch below qualifying for conventional financing.[9] Fannie Mae's Timely Payment Rewards (TPR) mortgage offers these borrowers a lower rate than they would pay in the subprime market, with the potential to reduce that rate by a full percentage point if they make their mortgage payments on time for 24 months. Since its introduction in late 1999, 56 percent of TPR loans have served first-time homebuyers. The broader the conventional market, the better the terms for homeowners: more transparency, better standards, and lower rates.

Some have tried to use Fannie Mae's partnership with Chevy Chase Bank and Home Depot to argue that Fannie Mae is exceeding the bounds of its Charter. The facts make a very different case: this initiative is a model of how the new housing program provision of our existing Charter is supposed to work. Through this partnership, Fannie Mae is pursuing a specific 1980 Congressional mandate in its Charter to increase liquidity in energy-efficiency home improvement loans, at the request of one of its lender-partners. Chevy Chase Bank asked Fannie Mae to join Chevy Chase in competing for energy-efficiency home improvement loans from Home Depot. Fannie Mae's Charter specifically authorizes the company to purchase these loans, [10] and the Department of Housing and Urban Development has given Fannie Mae specific program approvals for this kind of business. All of the loans Fannie Mae has purchased under the Chevy Chase agreement qualify under Department of Energy (DOE) regulations as energy-efficiency loans, which means that home improvements made with these loans meet DOE standards for residential energy efficiency. The DOE list does not include hot tubs or gourmet kitchens, and the loans Fannie Mae has purchased under this agreement -- loans with an average balance of $6,500 -- have been used to purchase and install energy-efficient windows, doors, siding, roofing, and air-conditioning and heating systems.

Sixth, Fannie Mae competes in the marketplace with companies that also receive benefits as the result of their ties to the government.

There has been the suggestion during the hearing process that Fannie Mae and Freddie Mac compete unfairly with "nonsubsidized" mortgage market participants -- even though the largest mortgage lenders in the country receive substantial government support. In the first quarter of 2000, five of the six top mortgage lenders were depositories or affiliates of depositories that receive government support in several ways:

- Their deposits (amounting to $2.9 trillion as of March 2000) are explicitly guaranteed by the full faith and credit of the United States.[11]

- By being part of the national payments system and connected to the Federal Reserve's clearance apparatus banks in particular, but thrifts also, have access to hundreds of billions of dollars in non-interest-bearing checking account balances.

[9] Office of Thrift Supervision, *What About Subprime Mortgages?*, Mortgage Market Trends, Volume 4 Issue 1, June 2000.
[10] 12 U.S.C. § 1717(b)(3). See also National Energy Conservation Policy Act, Pub. Law 95-619, 92 Stat. 3206 (Jan. 19, 1978).
[11] *Quarterly Banking Profile*, First Quarter 2000, FDIC, page 18.

Commercial banks held $708 billion of such deposits at the end of the first quarter of this year.[12]

- In the Federal Home Loan Bank System, banks and thrifts have their own in-house government-sponsored enterprise that competes with the Federal Reserve in providing liquidity to their members. At the end of June 2000, the Bank System had a combined balance sheet of $621 billion.

Federal Reserve Chairman Alan Greenspan has estimated the value of these government guarantees of the banking system at between 10 and 12 basis points.[13] There is no evidence that any of this "subsidy" is passed on to consumers.

The only one of the top six mortgage lenders that is not a depository is Countrywide Credit Industries, which is at a disadvantage in the marketplace because it cannot share in the benefits of deposit insurance and access to the Bank System. Like many other smaller independent mortgage banks, Countrywide is able to compete because Fannie Mae and Freddie Mac provide an outlet for the mortgages it originates.

Areas for Further Oversight

In your request for comments, you asked for constructive suggestions regarding avenues the Subcommittee might pursue in its oversight of the housing finance system. If the Subcommittee's goal is to provide consistency in the regulation of the housing GSEs and improve safety and soundness, we recommend that the Subcommittee examine whether all of the federally-chartered participants in the U.S. mortgage finance system hold adequate capital to match the risks they take. In particular, the Subcommittee might want to focus on how these participants manage interest rate risk.

As you know, the Federal Home Loan Banks (FHLBs) have recently moved into the mortgage acquisition business. The capital requirements for the FHLB System, however, were designed for the advance business and do not require the FHLBs to hold sufficient high-quality capital for risks involved in mortgage acquisition. Indeed, the current FHLB capital structure, even with the improvements made in the Gramm-Leach-Bliley Act, permits the FHLBs to operate largely with capital that is not true permanent equity under generally accepted accounting principles (GAAP). Even with the new Class B shares created in the new law, the FHLBs' capital stock essentially consists of subordinated debt.

In 1992, Congress decided that Fannie Mae's and Freddie Mac's mortgage purchase business needed sufficient true permanent equity capital to meet a stringent stress scenario. As the FHLBs enter the mortgage purchase business, the Subcommittee should

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[12] Ibid., page 4.
[13] Testimony before the Subcommittee on Finance and Hazardous Materials, Committee on Commerce, U.S. House of Representatives, April 28, 1999.

consider requiring the FHLBs to raise permanent, high-quality GAAP capital to support this business, subject to the same stress test as Fannie Mae and Freddie Mac. Without such a requirement, the mortgage business of the FHLBs will create precisely the same risks to the housing finance system that Congress reduced in the 1992 Act with regard to Fannie Mae and Freddie Mac.

H.R. 3703

Fannie Mae continues to believe that H.R. 3703 in its current form would make homeownership more costly, without compensating benefits to consumers or enhancement to safety and soundness. In my May 16 testimony, I noted a straightforward test for examining policy proposals to change the housing finance system:

- Does it reduce costs for consumers?
- Does it improve the safety and soundness of the housing finance system?
- Does it expand opportunities for homeownership?
- Does it allow innovation in the market without cumbersome regulatory requirements?

In its current form, H.R. 3703 does not meet the elements of this test. Instead it would impose on Fannie Mae and Freddie Mac a cumbersome regulatory structure that would likely delay implementation of the risk-based capital test and stifle the innovation the system needs to allow more borrowers the chance to buy homes of their own.

Regulatory Structure. H.R. 3703 would create a regulatory structure that does not improve regulatory oversight. The bill would create a five-member board with ill-defined powers — a structure prone to delay, inefficiency and a lack of regulatory certainty. Because the bill does not attempt to harmonize capital, tax, and mission requirements across the housing GSEs, the new regulator would have the cumbersome responsibility of carrying out two entirely different schemes of regulation. Additionally, the uncertainty of any transition and the broad authority in the bill for the regulator to change the risk-based standard would further delay implementation of the risk-based capital requirements of the 1992 Act. Fannie Mae supports efforts to improve regulation and oversight. Efforts in this regard, however, must improve the efficiency and effectiveness of regulation and should level the capital, mission, and tax playing field for all of the housing enterprises.

Innovation. H.R. 3703 would impose on Fannie Mae and Freddie Mac a burdensome regulatory process requiring that any new product, or new business process, be subjected to a formal notice-and-comment process, with publication in the *Federal Register*. It would give the proposed multi-headed regulator the responsibility of deciding whether the public should have access to a new product based on a vague "public interest" standard. Such a process would be excessively slow, reveal to our competitors — and to the competitors of our lender partners — proprietary product development efforts, and be unpredictable in result. It would choke off innovation, stifling our ability to adapt with the lenders we serve in the changing mortgage market. It would also directly contradict the goal of the 1992 Act to allow Fannie Mae and Freddie Mac to innovate in pursuit of our mission.

Conclusion

Focusing on the individual elements of the bill is important, but at the same time such an approach fails to address a basic underlying issue that lies at the heart of the Subcommittee's work. What is fundamentally wrong with H.R. 3703 is that it takes the careful balance of benefits and responsibilities established in the 1992 Act, and weakens that balance with a set of changes which foster instability in the system, without any offsetting benefits or improvements. The 1992 Act established rigorous safety and soundness requirements; it focused Fannie Mae and Freddie Mac more than ever on their affordable housing mission; and it created an environment conducive to innovation. This is a structure that has demonstrated value — for the market and for homebuyers.

Mr. Chairman, thank you again for the opportunity to comment. We look forward to continuing to work with the Subcommittee on these important issues.

Very truly yours,