

EMBARGOED UNTIL THURSDAY, MARCH 15th, 2007 @ 10:00 A.M.

**Hearing Before the U.S. House Committee on Financial Services
“Legislative Proposals on GSE Reform”**

**Testimony of Daniel H. Mudd
President and CEO, Fannie Mae
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Washington, D.C.**

Thank you Chairman Frank, Ranking Member Bachus, and members of the Committee for inviting me here today.

Over the past two years, Fannie Mae’s mantra has been “change, progress, more to do.” On change and progress, we have achieved several milestones. We completed the restatement of our financial results for 2001 through 2004. We’re well on our way to becoming a current SEC filer. We’ve been restructuring our company from the bottom up, and taking active steps to strengthen and improve our culture.

We still have more to do. High on that list is working with Congress to adopt a bill that will strengthen GSE regulatory oversight.

Mr. Chairman, you’ve asked me to come to this hearing to express Fannie Mae’s views on H.R. 1427, the Federal Housing Finance Reform Act of 2007. But before I do, first let me reiterate what we’ve consistently said over the past two years: We support the creation of a stronger, independently funded, bank-like regulator that combines safety and soundness supervision with authority over our mission and activities. And we seek to play a constructive, supportive role in the legislative process. I offer my testimony today in that spirit.

You have asked me to express our views on certain aspects of this legislation. I will speak as the head of our company, but I believe the outcome will affect many GSE stakeholders – homeowners, renters, our shareholders and employees, as well as the housing industry. So I will get into the details, because the details really matter. And while we may differ on certain points, we share the same overall goal – to adopt legislation.

Our views are rooted in the principle that any regulatory regime should balance the needs of oversight with the imperatives of private enterprise. In our case, the GSE charter adds another dimension to this balancing act. That charter, around which our entire business model is based, says our number-one job is to provide an unwavering, secure source of private capital for the secondary market for conforming mortgages. The conforming market includes not only lower-income families, but also middle-class families struggling and saving to own a home – teachers, nurses, police officers, and the many other working Americans who deserve the benefits of affordable mortgages and a stable mortgage market.

Finding that regulatory balance – the convergence of seemingly conflicting forces – is the standard by which all financial institution regulators in the United States are measured. And we believe that same standard should be the basis of the new regulatory regime for the GSEs.

With this balance in mind, I would like to comment on four specific elements of the legislation – capital, portfolio, new products, and the affordable housing fund.

Capital Levels

First and foremost, we support a GSE regulator with authority over our minimum and risk-based capital levels.

We also believe this reform legislation should provide the GSE regulator with a clear process that, like the interagency consultation of bank regulators, ensures proper deliberation, consultation and fairness before any new capital requirement is adopted. Clearly, any permanent increase in our minimum and risk-based capital levels would adversely affect our ability to fulfill the mission Congress gave us. In other words, the capital levels established by Congress should be the norm, not the starting point. We feel the best way to address this in the legislation would be to require the regulator to withdraw any special capital requirements when the circumstances that gave rise to those requirements no longer exist.

Portfolio

With respect to regulation of our portfolio, we also support an approach similar to that exercised by bank regulators. Bank regulators have consistently taken the approach that asset growth, by itself, does not cause a safety and soundness risk – only unplanned or poorly managed asset growth.

Fannie Mae's mortgage portfolio – our original line of business since our creation in 1938 – provides liquidity to the market by raising capital from around the globe to fund U.S. mortgages. This function is especially important when the market lacks buyers.

This is not a purely academic debate. In the 1980s, the oil patch disaster in Texas severely squeezed residential real estate capital, and in the 1990s, New England experienced significant illiquidity. The periods in between these shocks were calmer and there were plenty of investors in mortgages. But liquidity crises can and will happen because markets inevitably behave in ways we don't like or expect. That is happening now in the subprime mortgage market. Many investors are, frankly, fleeing from a market they couldn't seem to get enough of just six months ago. The result: home buyers are being left in the lurch.

Fannie Mae was created to keep such shocks from infecting the entire mortgage system, and it is a responsibility we believe this legislation should give us appropriate flexibility to meet.

To that end, the legislation should identify the safety and soundness factors that would lead to regulatory limits on the size or growth of our balance sheet. We believe “systemic risk” should not be included in these factors unless bank regulators agree on the method for applying such a standard to all financial institutions. In other words, the entire financial system, not just two companies. Finally, when portfolio limits are imposed for a specific safety and soundness condition, they should be lifted when the specified safety and soundness condition no longer exist.

New Product Approval

On new product approval, bank regulation also provides a useful guide and one that should serve as the basis for this legislation.

Submitting our new products to public review and comment would entail submitting our customers’ proprietary new products to public review and comment. This would not only be cumbersome, it would present serious competitive concerns. No regulatory approval process that I know of requires public disclosure of proprietary information. Our regulatory regime should be no different.

Banks keep regulators apprised of new business initiatives through the examination process and by regular communication with their supervisors. So should the GSEs. In practice, banks consult their regulators routinely on business plans and developments without formalized notice and approval, except for major new initiatives such as bank mergers or acquisitions. Banks are able to offer new products as the market demands without a burdensome pre-approval process. So should the GSEs.

Affordable Housing Fund

Fannie Mae supports the creation of an Affordable Housing Fund similar to that provided for in H.R. 1461, passed by the House in October 2005. First, our view is that the Fund should not only be integrated into our annual affordable housing goals, but should also be the first step in a comprehensive modernization of the complex goals-based affordable housing regime under which we operate. Secondly, we believe the legislation should provide for the GSEs to manage the fund. I believe you want us to care what happens to the grants and investments made under such a program – to ensure that they are effective community building blocks – NOT simply a levy on our business. Of course, the fund’s activities should be regulated, disclosed, reviewed and supervised by a new regulatory regime.

Conclusion

Let me close by illustrating what Fannie Mae can do when we get it right; and no other endeavor demonstrates the combined value of the many facets of our business and our mission than our work along the Gulf Coast. Throughout the Gulf Opportunity Zone, we've arranged for more than \$2.6 billion in special financing, with another \$650 million in the pipeline, to rebuild affordable housing. That's over and above the \$17.5 billion of home loans we've funded in the GO Zone since the storm. From the day after Katrina, we continued to fund loans from local banks that needed capital to keep lending. We gave borrowers time to rebuild by expressly prohibiting foreclosure of loans in our portfolio for one year after the storm. We've had a dozen employees on the ground since the storm going house to house to understand the damage and advise our loan servicers as they work with borrowers. Our employees themselves donated more than 4,000 volunteer hours.

I tell you this not to brag about Fannie Mae, because in reality Fannie Mae is only one player in a massive rebuilding effort. But I do think it's an important example of the ways our company can use *all* the tools at its disposal – portfolio, capital, products and people – to serve a public need even as it serves its shareholders. Our regulator should have the tools it needs to make sure that we safely and soundly fulfill this dual promise.

Thank you for the opportunity to be here today.