THE FUTURE OF HOUSING FINANCE: A PROGRESS UPDATE ON THE GSEs

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U.S. HOUSE OF REPRESENTATIVES

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THE FUTURE OF HOUSING FINANCE: A PROGRESS UPDATE ON THE GSEs

Wednesday, September 15, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Sherman, Baca, Lynch, Miller of North Carolina, Scott, Carson, Foster, Kosmas, Himes; Garrett, Manzullo, Royce, Biggert, Hensarling, Campbell, Neugebauer, and Jenkins.

Ex officio present: Representatives Frank and Bachus.

Also present: Representatives Waters and Moore of Kansas.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order. Without objection, all members' opening statements will be made a part of the record.

Pursuant to committee rules and prior discussion with the ranking member, each side will have 15 minutes for opening statements. Without objection, all members' opening statements will be made a part of the record.

I yield myself 5 minutes. Good morning. We meet today to focus on the many strategies that Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency and the Treasury Department have employed to limit capital infusions into the two housing Enterprises. This hearing is also the 6th in a series that we have so far convened this Congress to examine the future of housing finance.

Two years have now passed since the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship under procedures of the Housing and Economic Recovery Act of 2008. At the request of then-Treasury Secretary Henry Paulson, this law also provided the Treasury Department with emergency liquidity powers to support the Enterprises. To stabilize the United States housing markets, the Treasury Department has to date purchased or announced plans to buy just under $150 billion in the senior preferred stock of the Enterprises combined. Moreover, according to a June report issued by the Federal Housing Finance Agency, the Treasury Department and the Federal Reserve have

together purchased $1.36 trillion in mortgage-backed securities of the two institutions.

At this hearing, we will explore the many approaches used to protect taxpayers and limit the losses of Fannie Mae and Freddie Mac. For example, in July, the Federal Housing Finance Agency issued 64 subpoenas seeking documents related to private label securities in which the two Enterprises invested to determine if issuers of these securities are liable for Enterprise losses. Fannie Mae and Freddie Mac have also begun forcing underwriters of delinquent mortgages purchased or guaranteed by the Enterprises to buy back the faulty loans if the loans violated the representations and warrants provided at the time of sale. As a result, the four largest commercial banks have already incurred losses of $9.8 billion on the loans they have repurchased or expect to repurchase from Fannie Mae and Freddie Mac.

During the height of the housing bubble, many players in our financial markets trusted what they bought, but they did not verify that the loans lived up to the promises contained in representations and warrants. During the height of the Cold War, however, Ronald Reagan taught us better. For the housing finance system to regain its footing, we need the players in the market not only to trust but also to verify. Any new housing finance system must do both.

While the Enterprises, their regulators, and the Treasury Department have acted to limit the losses of Fannie Mae and Freddie Mac in the aforementioned ways and through several other methods, we must also consider what more can and should be done to protect taxpayers both now and going forward. In particular, we must begin to think about approaches for recouping the taxpayers' money in the long run. We found a way to pay for the savings and loan crisis, and we can surely find a way to recover the costs associated with this crisis.

Some of my colleagues may try to use today's hearing as an opportunity for political grandstanding. They, however, need to remember that people who live in glass houses should not throw stones. Under the leadership of former Chairman Mike Oxley, we tried for several years to enact bipartisan legislation to improve the regulation and activities of Fannie Mae and Freddie Mac. Unfortunately, many Republicans in Congress and officials in the Bush Administration blocked these efforts. Their delays allowed the housing crisis to fester into an ulcer.

As we now consider the future of housing finance, we have a chance to proceed differently. The Dodd-Frank Wall Street Reform and Consumer Protection Act has already laid the foundation for change by adjusting securitization rules, better regulating rating agencies, modifying appraisal practices, and standardizing mortgage underwriting. The adoption of these process reforms should simplify the debates about altering the housing finance system.

In sum, today's hearing brings us one step closer to figuring out what needs to be done to improve our housing finance system. As I have previously said, my goals in these debates are to limit taxpayers' risk and establish a more stable, long-term funding source to help hardworking, responsible, middle-class American families to buy a home with an affordable mortgage.

I look forward to hearing the perspectives of our distinguished witnesses on these matters.

I would like to recognize the ranking member, Mr. Garrett, for 4 minutes for his opening statement. Mr. Garrett.

Mr. GARRETT. Thank you. Thank you, Chairman Kanjorski, for holding this very important hearing. When you review all the material that is before us in preparation for the hearing, you could probably hold a GSE oversight hearing just about once a month and still have enough important issues to deal with. I am sure the Director would agree with that. The current state and future of mortgage finance has really been a hot topic and continues to be a hot topic with the Financial Services Committee, and we are holding several hearings over the next several weeks to look at the current state of the housing finance situation and discuss ideas on how to structure the market in the future and think about it. Unfortunately, I believe this focus is happening much later than it really should; it really should have been happening, what, about 2 years ago, since Fannie and Freddie were put into conservatorship. We are finally beginning to formally and seriously look at the way to reshape that market.

Throughout the financial regulatory reform debate, my Republican colleagues and I continuously looked for opportunities to end the bailouts of Fannie and Freddie, wind down the businesses and accurately account for their losses to the American taxpayer. But at each turn, if you remember when we did those amendments and such, the majority party and the White House have prevented those efforts from moving forward.

So to my colleagues, including Chairman Frank, who has said specifically, "There is no urgency. We have already abolished Fannie and Freddie." May I remind him that just because you say something enough times doesn't actually mean that it is true. Just because Fannie and Freddie have been put into conservatorship, that doesn't mean that they have been reformed. Fannie and Freddie are continuing to hemorrhage billions of dollars each and every quarter. With the possibility now of a double-dip recession and further value decline in homes, really, there is no end in sight. So Fannie and Freddie have not been reformed. Rather, they are being used essentially as an experimental guinea pig, if you will, for the Administration's home modification programs.

Also, I have seen a quote by Chairman Frank where he said, "The money is not being lost by anything that we are doing right now." In 2004 and 2005 when this committee was pushing ahead to institute new regulatory oversight over these companies, supporters of these entities, including Chairman Frank, said, well this was unnecessary then because they were in such terrific shape. We see where that led us.

So to say that Fannie and Freddie have already been reformed and everything is fine now is really just making the same excuses that have been made before and the same mistakes as well.

As any expert in the mortgage business will tell you, mortgage loans typically hit their peak default rates when? At 5 to 7 years. The loans underwritten by Fannie and Freddie during 2009 and this year are only 1 or 2 years old. We have no idea what the market will be like 3, 4 or 5 years from now, so we need to take con-

crete steps right now to reduce the ongoing financial risk that Fannie and Freddie pose to the American taxpayer.

One of these steps is to more rapidly increase the wind-down of these entities' retained portfolio. Fannie and Freddie's combined portfolio is $1.6 trillion. With the current market demand for GSEs' MBSs, there is absolutely no plausible reason they have to be this size. If they are so large, there is a significant amount of interest rate risk that continuously has to be hedged. As interest rates sometimes rise in the future, the hedging of these assets will get even more complicated and volatile and harder to manage. So with the current market situation and the appetite for GSEs' MBSs, we should be requiring the entities right now to reduce their portfolio size and do it soon to reduce the risk before interest rates inevitably will rise and when the conservator can actually make more money back for the taxpayer.

One closing note to the Director, I thought it was a thoughtful decision that you made to shut down the PACE program during the summer. This was a scheme that was putting taxpayers at further risk while really only benefiting a few tax security firms that were offering these products. Now we must need to make more hard decisions, as you did then, to protect the taxpayers and wind down the entities' portfolios in a more responsible manner and finally abolish these two companies.

Thank you.

Chairman KANJORSKI. Thank you, Mr. Garrett. Now we will hear from the chairman of the full committee, the gentleman from Massachusetts, Mr. Frank, for 5 minutes.

The CHAIRMAN. Mr. Chairman, I regret the fact that the ranking member has decided to continue a political debate. But if he was going to do it, I wish it had been done more fully. Obviously, we have a problem here, because Fannie and Freddie bought loans that shouldn't have been made in the first place. The point though is that beginning in the period that the gentleman from New Jersey alluded to in part, members of this committee, led by the gentleman from North Carolina, Mr. Miller, and the gentleman from North Carolina, Mr. Watt, tried to outlaw those loans. Congress had, in fact, previously asked the Federal Reserve to do that. They hadn't done it.

So in 2007, which was the first year in which we were in the majority, we did pass a bill in that year to prevent the kind of predatory loans from being made that Fannie and Freddie were buying. And here is what the gentleman from New Jersey, Mr. Garrett, had to say in the committee vote on that bill to ban predatory loans: "The increasing availability and affordability of subprime mortgage credit is and has been an important factor leading to the increase in homeownership in recent years. This bill—the bill that restricts predatory lending—may well limit now the products available to subprime borrowers, particularly minority borrowers and will deprive many of those consumers from owning or maintaining a home. What we need to do is to ensure that it does absolutely nothing to homeownership, particularly among minority communities who have benefited from the innovations that have occurred in the marketplace."

That is a song of praise to predatory loans which we tried to stop, and had the loans not been made they could not have been bought.

In fact, the gentleman was also incorrect when he said in 2004 and 2005, when Republicans were trying to restrain Fannie Mae and Freddie Mac, some of us were on the other side. No, exactly the opposite is the case. In 2003, I said I didn't think Fannie Mae and Freddie Mac were in trouble. In 2004, when President Bush ordered them to go beyond 50 percent in the number of loans that they bought from people below median income, the kind of loans the gentleman from New Jersey was defending when we tried to outlaw them, I changed my opinion. I thought this was dangerous.

In 2005, Michael Oxley, who was the Republican chairman of the committee, put a bill through this committee to restrain Fannie Mae and Freddie Mac. I actually voted for it in committee. A couple of my Republican colleagues voted against it. I later found problems with an unrelated aspect of housing. But the fact is that Mr. Oxley passed a bill through the House which he thought would restrain Fannie Mae and Freddie Mac. And the Republicans in the Senate and the Bush Administration and some in this committee didn't like the bill.

So I have never heard a more inaccurate characterization than when the gentleman from New Jersey said, when Republicans were trying to get something through, we opposed it. No, the Republican majority of this committee and the Republican majority of this House, the gentleman from Texas, Mr. Neugebauer, supported it. The gentleman from Alabama, Mr. Bachus, supported it. They put through the bill. We didn't stop them. They had a lot of cooperation. The gentleman from New Jersey didn't like the bill. But the argument that the Democrats stopped it is just absolutely the opposite of the truth in 2004 and 2005. That broke down.

As Secretary of the Treasury Paulson points out in his book, he became Secretary of the Treasury in 2006. Some in the Bush Administration had given up on trying to reform Fannie and Freddie politically. He said, no, he wanted to work with us. He approached me. And as he says in the book, we worked together. And when in the year 2006 the majority switched and 2007 came, this majority passed a tougher Fannie and Freddie regulatory bill in 2007 than the Republicans had passed in 2005. Things had moved beyond that. And then in 2008, when the Senate caught up to us, which they sometimes do, Secretary Paulson put them in a conservatorship.

So yes, we have changed Fannie and Freddie. The Fannie and Freddie that have existed since Hank Paulson used the authority, a Democratic authority gave him at his request, to put them into conservatorship has been very different. And yes, the PACE loans have been a source of controversy, and many people—the Governor of California, the Republican Governor of California, the Democratic attorney general from California are suing Fannie and Freddie because they are being too tough. Joe Nocera of The New York Times had a column criticizing Fannie and Freddie because they are insisting on too high a level of credit score before they give loans. The fact is undeniable. Fannie and Freddie, once they were put into conservatorship, are very different, and that is why I say

there is no urgency. There is no urgency because the pattern of abuse that they had been engaged in has changed.

It is also the case that over the objection of the gentleman from New Jersey and others, we outlawed finally in 2010, the financial reform bill, the kind of predatory loans that were getting people in trouble, which the gentleman from New Jersey was so fond of and a few others on his side. And The Wall Street Journal, when we did finally pass the bill in the House to restrict subprime predatory loans, calls it a Sarbanes-Oxley for housing. And Sarbanes-Oxley is of course as nasty a set of words as you can get from The Wall Street Journal.

So let's get back to where we are. Fannie and Freddie are behaving differently and are causing far less problems, thanks to the action of the Democratic majority in Congress that gave the Republican Administration the power to do conservatorship. There was bipartisanship there and let's continue it.

Chairman KANJORSKI. Thank you, Mr. Frank. And now we will hear from the gentleman from Alabama, Mr. Bachus.

Mr. GARRETT. I think we want to yield first to Mr. Neugebauer.

Chairman KANJORSKI. Okay. We have a passover here to Mr. Neugebauer for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. And I will yield a few minutes to the distinguished ranking member.

Mr. GARRETT. If the gentleman will just yield 10 seconds for me to respond to the chairman. It is odd that I am now put in the position, as I often am, to actually be the member to defend minority interests. And that is exactly what that quote was doing, as you said, quoting from me in 2004 and 2005. I was defending the rights of minorities and the minority housing interests.

I would like to enter into the record a letter of June 28, 2004, signed by 70 Republicans addressing that issue, signed by 70 Democrats, written to President George W. Bush which would have weakened those same sort of regulations that the chairman was talking about. Those regulations would have weakened the affordable housing standards that the chairman was talking about, that they were trying to do at that period of time. Any objection?

Chairman KANJORSKI. Without objection, it is so ordered. Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Two years and $148 billion later, we still have Freddie and Fannie basically operating like they were before, maybe with a little bit better underwriting and that is a good thing. But the bottom line is that the taxpayers are still on the hook for these mortgages that are being originated today. And quite honestly, one of the problems with that is that as long as we continue with Freddie and Fannie operating where they are the primary guaranteeing these single family mortgages—which, by the way, accounts for about 75 percent of the losses that they have sustained, this particular book of business—we really are not going to see any private activity in the mortgage market at all. And so I think what many of us feel like is 2 years, it is time to begin to do a model to wind this activity down, to get the taxpayers off the hook, and to move in the direction that we will be able to encourage private activity in the mortgage market. But quite honestly, as long as Freddie and Fannie are the majority

of the originations and the taxpayers pick up the tab, there is really no incentive for us to do that.

And Mr. Chairman and ranking member, I think it is time for this committee and this Congress to get the taxpayers off the hook and to get a robust, sustainable mortgage market that doesn't depend on the taxpayers to bail them out.

Chairman KANJORSKI. Thank you very much, Mr. Neugebauer. Now we will hear for 3 minutes from the gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you, Mr. Chairman. Mr. Chairman, I say to you and to Chairman Frank, I think it is time for President Obama to quit blaming President Bush for all the problems that are confronting us today. And I really think it is time that Chairman Frank, for you and the Democrats, to quit saying that some Republicans went along with you in watering down these affordable housing and underwriting standards.

The American people aren't concerned with the history of how this happened. They are concerned with taking action now to see that it doesn't happen again. And for 2 years now, Fannie and Freddie have been controlled by the Federal Government. They own 79.9 percent of those corporations. The only reason they don't own 80 percent is, if they owned 80 percent, or 0.1 of 1 percent more, they would have to be put on the books of the Federal Government. So they are just 0.1 of 1 percent from there.

We have released detailed proposals on what we want to do with Fannie and Freddie, and that is put them in receivership. They shouldn't be in conservatorship. No other corporation would be. They are failed corporations. We don't need to—they are not "too-big-to-fail." There ought to be an orderly wind-down. They ought to be in receivership. That would solve a lot of the uncertainty. The mortgage bankers have urged the Administration to resolve that uncertainty, and the housing market needs it.

We, in the Dodd-Frank bill, pushed for something very reasonable and that was for downpayments for loans. That is not a very outrageous proposal, that simply Fannie and Freddie quit approving or buying mortgages without a downpayment and without good credit history. Not only did the majority party reject our attempts to simply say in Dodd-Frank that you have to have a downpayment and you have to have good credit history, they went beyond that and the Administration and Fannie and Freddie have actually now started this Affordable Advantage program, mortgage program, that actually doesn't require a downpayment and you don't have to have a good credit history. So we are laying the seeds for the next bubble. We are laying the seeds for the next failure.

Assistant Secretary, with all respect, you have really done nothing but plan to do things. There are no proposals on the table. You have done nothing. You seem to be content in the Administration with doing nothing except having progress hearings. There has not been any progress. There have been planning sessions, but there has been no action taken. And you have 10 percent unemployment, you have 30 percent home price depreciation, and you have these bailouts. What probably bothers me worse than anything—and I think bothers the American people—is that we continue to make guarantees presently that the taxpayers will have to meet in the

future, and it is time that we quit the slow walking and we started doing things. This should be a legislative hearing, not another planning session.

I would ask permission that my full statement be included in the record.

Chairman KANJORSKI. The gentleman's full statement will be included in the record. The gentleman from California, Mr. Sherman, is recognized for 3 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman. Three points. First, we need to stabilize home prices and make sure they are stable. If we see another precipitous drop in home prices, even in some key markets, that could create a double-dip recession. The key to that is extending the $729,750 limit in the roughly one dozen most expensive housing markets in the country. If we allow this to expire at the end of the year, it will be impossible to finance homes in most parts of Los Angeles and certain other major cities. And even in areas where homes sell for less, if in the middle-class neighborhoods, the price drops precipitously, then in the working-class neighborhoods prices will drop precipitously as well and we will see a double-dip recession. I hope that we get even more than the 74 cosponsors we have for H.R. 2483, which I introduced along with Gary Miller, a fine Republican Member from California.

Second, I want to commend Mr. DeMarco for his agency's efforts against these Wall Street transfer fees. These provisions in deeds say that every time the property is transferred, somebody on Wall Street gets 1 percent of the gross purchase price. That undercuts the security of the lender; it disadvantages the home buyer; it complicates the transaction; and it lowers comps for the entire neighborhood, thus impairing the value of the substantial investment that the Federal Government has in home prices nationwide.

Finally, to set the record straight, I think the chairman was eloquent in talking about H.R. 1461, which we passed in 2005. But the former chairman of this committee might have been even more eloquent in his article, which I would like to put in the record without objection—

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. SHERMAN. —of September 9th in the Financial Times. He was quoted as describing that bill, which we passed in May 2005, which would have prevented this bubble from occurring and what Chairman Oxley said, All the hand wringing and bed wetting is going on without remembering that the House stepped up. What did we get from the Bush White House? We got a one-finger salute. Mr. Oxley did not specify which finger. But he did make it clear that it was the Republican opposition in the Senate and the White House that prevented us from nipping this crisis in the bud by stopping it in 2005. And had we done so, in the opinion of Chairman Oxley and I believe Chairman Frank as well, we would be in much better shape.

The CHAIRMAN. Would the gentleman yield?

Mr. SHERMAN. I will yield.

The CHAIRMAN. The chairman did make it clear that it was not a thumbs up. He didn't say which finger it was, but he didn't say which finger it wasn't.

Mr. SHERMAN. It was clearly a finger, not a thumb. I yield back.

Chairman KANJORSKI. The gentleman's time has expired. The Chair now recognizes the gentlelady from Illinois, Mrs. Biggert, for 2 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman. Simply put, where is the plan? When will this Administration or Congress wind down and put an end to these what we would call Frankenstein-like mortgage giants Fannie and Freddie? Fannie and Freddie have edged out the private sector over a period of years. In September 2008, these GSEs entered into conservatorship, explicitly backed by the taxpayers. The GSEs have received over $150 billion in taxpayer-backed funds and are a significant taxpayer liability upwards of $6 trillion. According to the Wall Street Journal, the GSEs were twice as leveraged as Bear Stearns. In addition and aside from the regulator, the FHFA, which runs them, Fannie and Freddie have no independent watchdog, no Inspector General reviewing their activities and the many questionable actions of the GSEs that are directed by FHFA.

The Senate leadership should without further delay schedule a vote on approving the nomination of Steve Lennox to be the FHFA Inspector General. For the GSEs, we need transparency and accountability to end the bailouts and have reform. We have needed this for a long time. The questions remain, Why were there no substantive provisions to address the GSEs included in the Dodd-Frank Act? When will the GSEs be addressed? What is the plan?

I look forward to hearing from the witnesses. I yield back.

Chairman KANJORSKI. I thank the gentlelady from Illinois. And now, we will hear from the gentleman from North Carolina, Mr. Miller, for 2 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. I agree we need to think about a plan. We have to reinvent our mortgage lending system. And since there is something like $12 trillion to $14 trillion in outstanding mortgage debt right now, that is not a small matter. But it would be very helpful in knowing how to fix what went wrong to figure out what it was that went wrong. It is particularly hard to take Republicans complaining about Democrats trying to place blame since all I have heard from Republicans for 2 years is how this was somehow the Democrats' fault. We had a financial crisis that happened 7 years, 8 months into a Republican Administration because of mortgages made during 2004 to 2006 when the Republicans were also in the majority in Congress. And I know that the Republican ministry of information has hit upon Fannie and Freddie as the culprits of all this. But when Dick Fuld sat at that seat in the Lehman Brothers bankruptcy—it appears to be what most immediately precipitated the crisis—I asked him, after having heard several Republicans somehow work Freddie and Fannie into the conversation, I asked him, "How in the world did Fannie and Freddie cause Lehman Brothers to go bankrupt?" And the answer of course was he could not come up with any role that Fannie and Freddie played at all. In fact, Fannie and Freddie were losing market shares throughout that period to private label securitizers, and investment banks in New York, and all Republican criticisms of Fannie and Freddie were parroting all the criticisms of their competitors who were not looking to have a more honest mortgage lending market. They were looking to make more

money than they were already making and they were making more money than God.

Thank you.

Chairman KANJORSKI. Thank you, Mr. Miller. We have two reservations, but I suspect that neither Mr. Royce nor Mr. Hensarling will be here, is that correct? Okay.

Mr. BACHUS. How much time do we have remaining on our side?

Chairman KANJORSKI. You have 4 minutes.

Mr. BACHUS. I would like to claim that time.

Chairman KANJORSKI. The gentleman from Alabama wants to claim 4 minutes, and we think he should be allowed to claim the 4 minutes, so we will recognize him.

Mr. BACHUS. Thank you. I appreciate that.

Secretary Barr—and this is not a question, but I note that you say here, "Private gains will no longer be subsidized by private losses." And that is what has happened in the past. I think you have acknowledged that. But if the government is going to make guarantees, if the government is going to buy mortgages and those mortgages fail, then there will be public losses. So I know your statement that you released last night says that. It also says, "capital and underwriting standards will be appropriate." And they certainly need to be. I think that is a given. I think we would 100 percent agree with that. But I am disturbed that we have programs like Affordable Advantage along with the State financing authority, but there is no downpayment required and a good credit history is not required. In fact, people are getting those without any downpayments.

I was on CNBC this morning and Wilbur Ross, who was a guest said, "When you have no downpayment because of your closing costs and Realtor fees, you start 6 percent underwater." You can't sell it, can't turn around and sell that house for the same amount. So if housing prices go down—and who knows whether they will or not, you are actually—in my mind, you are actually creating more mortgages that taxpayers may one day have to pick up. And I think that is something I would like to hear. You say excessive risk-taking will be restrained. I don't see that happening right now. When Republicans—and I think the Administration resisted our attempts to say that if you have mortgages you are going to have to have a downpayment, you need good credit history, at least if the government is going to stand behind them.

And finally, I would say, there has been a debate. I noticed that some of the statements out of the Administration are whether or not there ought to be an explicit government guarantee or an implied government guarantee, whether it needs to be implied or explicit. I will say to you there is another option, and that is that taxpayers shouldn't guarantee any of it. I think the forgotten man here—Roosevelt used the term forgotten man—is the taxpayer. I think we are all forgetting about the taxpayer. As long as Fannie Mae and Freddie Mac exist as government agencies, you are going to have the risk of taxpayer subsidies, and you are going to be subsidizing those who get those mortgages or those mortgage guarantees by people who rent, by people who don't have a mortgage, or by people who have a conventional mortgage that is not backed by the government. And I think it is time for the government to get

out of that business. As long as the government is in the business, they subsidize the business, that crowds out private investment and private capital. We have basically eliminated the private mortgage market by having a government guarantee. The government can—because of that, knowing the taxpayers stand behind it, the cost of capital for the government will be less. And we have seen that Fannie and Freddie have been operated on many occasions as an extension of some social or public policy to allow people to own homes at less than what the true cost would be.

And finally, I would say, who bails out the government? If the government has to bail out Fannie and Freddie, who bails out the government? We just can't continue to be in the rescue business or the lifeguard business. That is just not something—I think the people are speaking out. In every election, they are saying, get the government out of my pocket.

Chairman KANJORSKI. The gentleman's time has expired.

Mr. BACHUS. Thank you.

Chairman KANJORSKI. Now we have completed everything but one remaining minute on our side. I recognize the gentleman from Georgia for 1 minute.

Mr. SCOTT. I will take that minute, sir. Joe Friday said, "Just the facts, ma'am. Just the facts." You remember him? The great Joe Friday, Dragnet series. The facts are not any questions, so we can get this behind us. It was Hank Paulson, Secretary of the Treasury, and he was not President Barack Obama's Secretary of the Treasury. He was George Bush's Secretary of the Treasury who came before this committee and laid out the dire consequences if we did not act. So when you measure this deal, let's be honest. There is no—you have to figure out how you got into a problem before you can figure out how you got out. It is not a matter of calling names. It is a fact, this did not happen under President Barack Obama. The guy was out as a State Senator trying to become President. This happened under Paulson's watch who was the Treasury Secretary for President Bush.

Fact, close. Now, there is still a need out here for help and assistance with middle- and moderate-income people to be able to get their homes. Mr. Chairman, may I just add this one thing, I hope that when we pay attention here that we will to these community banks. Our community banks own 85 percent of the lenders who own stock in the GSEs. So when you start talking about dismantling and doing all of that, it isn't just as simple as that. This is a complicated area, and the need is still there.

Chairman KANJORSKI. The gentleman's time has expired. All time has expired.

We will now hear from the panel of witnesses that we have, and we want to thank you for appearing before the subcommittee today. Without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony. I hope you will hold to that 5 minutes better than members of the committee did.

First, we have the Honorable Michael S. Barr, Assistant Secretary for Financial Institutions, United States Department of the Treasury. Assistant Secretary Barr.

STATEMENT OF THE HONORABLE MICHAEL S. BARR, ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS, U.S. DEPARTMENT OF THE TREASURY

Mr. BARR. Thank you, Mr. Chairman. Ranking Member Garrett, Chairman Frank, Ranking Member Bachus, and members of the subcommittee, thank you for the opportunity to testify today about housing finance reform and the progress made since the placement of Fannie Mae and Freddie Mac into conservatorship in September of 2008. Before I talk about the conservatorship, it is important to remember how we got here.

For too many years, the GSEs were allowed to operate under an unacceptable "heads, I win; tails, you lose" system. They enjoyed the benefits of the perception of government support. They had inadequate oversight and inadequate capital. The market did not instill appropriate discipline because the market assumed they had a government backstop.

The events that led to conservatorship were symptomatic of the range of regulatory management and oversight failures throughout our financial system. As the private, unregulated mortgage market grew and market players began to loosen mortgage credit standards to pursue ever-riskier business in the booming market, the GSEs, which had initially stuck to their core business of guaranteeing well-underwritten loans, saw their market shares fall precipitously. Driven by profit motives in an effort to regain that market share, the GSEs purchased riskier mortgages without holding adequate capital or having appropriate risk management. These moves left them dangerously exposed.

As a result of the substantial deterioration in the housing market, and Fannie and Freddie's inability to raise necessary new capital, FHFA placed the GSEs into conservatorship under the authority granted to them by Congress under the bipartisan Housing and Economic Recovery Act. Since September 2008, FHFA has acted carefully to help ensure that Fannie Mae and Freddie Mac's assets are conserved while continuing to play a critical role in making mortgage credit available. By facilitating the flow of credit for responsibly underwritten mortgages, the GSEs have served as a source of stability for the housing market and helped to enable millions of Americans to continue to have the ability to take out a new mortgage or to refinance. The new loans being guaranteed by the GSEs are not contributing in any material way to the losses the GSEs now face. Quite the contrary. In fact, it is the GSEs' old book of loans, those acquired before conservatorship, which are the overwhelming source of losses. The credit quality and risk profile of the post-conservatorship book of business has dramatically improved compared to pre-conservatorship levels, and less than 1 percent of losses have come from loans originated in 2009 and 2010.

Now some have suggested that taking time to get reform right will expose taxpayers to even greater losses. That is simply not the case. The losses that Fannie Mae and Freddie Mac face are the result of mistakes made in the years leading up to the crisis, not those made today. The country is unfortunately stuck with the consequences of the poor choices the GSEs made prior to conservatorship.

The GSEs today are working hard to minimize losses through loss mitigation, and the GSEs are continuing to promote overall stability in the housing finance system, which is the most important source of loss mitigation they can provide. While we continue to bring stability in the mortgage market, we are also hard at work on the business of reform. It is not tenable to leave in place the system that we have today.

The Administration is committed to delivering a comprehensive proposal to Congress, as called for under the Dodd-Frank Act by January 2011. Our proposal will call for a fundamental change. Congress began the process of reform with the passage of HERA in 2008 and FHFA continued the path when they placed Fannie Mae and Freddie Mac into conservatorship. The next stage of reform came with the passage of the Dodd-Frank Act, which includes fundamental reform of mortgage market rules, including important ability-to-pay requirements and risk retention standards for mortgages. This Act will help to ensure that homeowners are not sold products that they cannot afford and that originators retain "skin in the game" when they originate risky mortgages.

As we move forward together towards responsible reform of our Nation's housing finance system, we are committed to ensuring that the transition to a new system occurs in an orderly fashion that is minimally disruptive to the market. In designing a new system for housing finance, we must ensure that the system is more stable, consumers are protected, sustainable credit is widely accessible, and low- and moderate-income families have access to affordable housing.

After reform, the GSEs will not exist in the same form as they did in the past: private gains will no longer be subsidized by public losses; capital and underwriting standards will be appropriate; consumer protection will be strengthened; and excessive risk-taking will be restrained.

Thank you.

[The prepared statement of Assistant Secretary Barr can be found on page 49 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Barr. We will now hear from Dr. Edward J. DeMarco, Acting Director of the Federal Housing Finance Agency. Mr. DeMarco?

STATEMENT OF EDWARD J. DeMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY (FHFA)

Mr. DEMARCO. Thank you, Mr. Chairman. Chairman Kanjorski, Ranking Member Bachus, and members of the subcommittee, thank you for inviting me here today. My written testimony covers four topics: the status of the conservatorships; the current condition of the Enterprises; projected losses by the Enterprises; and considerations for the future of the housing finance system. I will briefly summarize several key points from my written statement.

The Enterprises have been operating in conservatorships for 2 years now, since September 2008. A principal focus of the conservatorships is to maintain the Enterprises' secondary mortgage market role until legislation produces a resolution of their future. FHFA's oversight is also directed toward minimizing losses, limiting risk exposure, and ensuring the Enterprises price their

services to adequately address their costs and risk. FHFA recognizes that losses by the Enterprises translate into costs for the taxpayers, and we are doing everything in our power to minimize future losses.

Examples of these loss mitigation activities include loan modifications both through the Administration's HAMP program and through each Enterprise's proprietary modification programs, repayment plans and forbearance plans, and short sales and deeds in lieu of foreclosure. The foreclosure alternatives pursued by the Enterprises not only serve the conservatorship goal of minimizing losses but also fulfill FHFA statutory mandate in EESA to maximize assistance to homeowners while minimizing losses to the Enterprises.

FHFA reports every month to Congress on the full range of Enterprise foreclosure prevention activities through our Federal Property Manager's report. Since the first full quarter of the conservatorship, the Enterprises have completed more than 1 million foreclosure alternative transactions with borrowers.

As conservator, FHFA has also been clear that the Enterprises should actively enforce lender compliance with their contractual obligations, which includes pursuing repurchases from those institutions whose loans did not meet the Enterprises' underwriting and eligibility guidelines.

Separately, in July, FHFA issued 64 subpoenas as part of an effort to determine whether other firms have legal responsibility for some of the Enterprises' losses on private label mortgage-backed securities which to date have been borne by the Enterprises and taxpayers. In February, I communicated to Congress my position that in conservatorship, the Enterprises will be limited to continuing their existing core business activities in taking actions necessary to advance the goals of conservatorship. We continue on that course today.

When I appeared before you in late May, I pledged that FHFA would expand its reporting on the Enterprises in conservatorship. In fulfillment of that pledge, last month FHFA published the first of what will be a quarterly conservator's report on the Enterprises' financial condition. Two of the findings presented in the report are: At the end of 2007, the Enterprises had $71 billion of combined capital. From the end of 2007 through the second quarter of 2010, charges against capital totaled $226 billion. The largest contributor to these charges against capital has been the single family credit guarantee segment, accounting for $166 billion, or 73 percent of combined capital reductions over that period. During conservatorship, the Enterprises have made significant progress in improving the quality of new mortgages purchased. New Enterprise mortgage guarantees have been for borrowers with higher credit scores and loans with lower loan-to-value ratios, two factors that affect expected default rates.

Also when I appeared here in May, I was asked how much more money the Enterprises may draw under the preferred stock purchase agreements. I said that even across most severe stress scenarios modeled by the Enterprises, combined Treasury draws appear to be less than $400 billion. Based on the analysis available to me, that remains my view today. But to provide Congress and

the public with a more defined sense of the Enterprises' potential future Treasury draws, FHFA is working with the Enterprises to develop forward-looking financial projections for public release. Similar to the Supervisory Capital Assessment Program (SCAP) conducted by the Federal banking agencies last year, the results of this exercise will not be forecasts or expected outcomes but rather modeled projections in response to what-if exercises that utilize various scenarios.

As we prepare for the future, legislation is needed to restructure and strengthen our housing finance system and resolve the conservatorships. Ensuring an orderly transition will be essential. The role of the government in housing finance going forward is a key decision point.

In my written statement, I offer some issues for consideration regarding government guarantees. We look forward to working with the Administration and Congress in this endeavor.

[The prepared statement of Acting Director DeMarco can be found on page 56 of the appendix.]

Chairman KANJORSKI. Thank you, Mr. DeMarco. And now we will move on to questioning by the committee members. Let me take the first crack at it. Not that I apologize, but I think that in some of the opening statements, we have had a little bit of revisionism of history, if we might. And that tends to confuse the problem. Let me try to move with what I see the problem as being.

We are trying to get back to an active, responsible real estate market and mortgage market in this country. In order to accomplish that at the level that the country needs, it seems to me we need a methodology of having a secondary market that brings in and attracts more capital to the American market, not maybe to the exact level of the pre-crisis state but certainly a great deal higher than today.

Have either of you given a great deal of thought to whether or not just having two institutions like Fannie and Freddie, that obviously didn't compete very well to get the best price and both seemed to rely on the same conditions and failed in the same way? What if we broke up the mortgage market into 10 GSEs and carry it a little further and say, we offer the license to be purchased as we do airtime in the communications field and let the private sector get in? But if we had 10 GSEs, if any one of them failed, we would be able to allow the bankruptcy process to weed that out and clean it out and continue on. We wouldn't insulate, however, against deflation. If across-the-board deflation occurs, I don't know how we can create any situation that is going to take that into consideration and protect against it. But what are your thoughts? And instead of having just the two GSEs that have handled this problem, that we spread it over the 10 or even 15, if you will. And is there a given number that makes it so inefficient that it is not worth doing it in those small proportions?

Mr. Barr?

Mr. BARR. Mr. Chairman, I think that the question of how many entities are involved in the system of housing finance and the secondary market is only one set of factors in the development of a new housing finance system. And I think bringing it back to the fundamental level, what is the shape of that housing finance sys-

tem, what do we want it to look like, how will it deliver widely available credit for sustainable mortgages, how will it deliver on financial stability goals, how will it deliver on affordability, I think those broader and deeper sets of questions come into play in a sense first. But the question of whether you want one entity or multiple entities; if you want multiple entities, how many to have relate to those broader sets of concerns. And as you are thinking about the numbers of entities in the system involve a number of tradeoffs and you have identified some of those, the question of what part of the system is inside the new housing finance system we have created and what part is out? How do we ensure a level playing field for different kinds of approaches to financial intermediation? How do we prevent races to the bottom in that sector? If we have multiple entities involved, does it deal with the basic question of correlation of risk in the system or just add to that? And I think those are the kinds of fundamental questions we are going to need to address in the reform plan.

Chairman KANJORSKI. When do you anticipate the Treasury's reform plan to be available so it can start to be considered? And I ask this honestly. Because I hear sometimes the beating of the chest up here on the Hill at a point that it is going to take time, but we ought to get some timeframe that we are looking at so we can inform the American people that this is not going to go on interminably but in fact we have some constraints on time. When do you anticipate that?

Mr. BARR. As required under the Dodd-Frank Act, we will be submitting a plan no later than January of 2011. So that is the timeframe. I think it will give Congress the opportunity to take up legislation in earnest in the next year. And we would anticipate working very hard to get that done at that time.

Chairman KANJORSKI. What are your thoughts on this, Mr. DeMarco?

Mr. DEMARCO. Mr. Chairman, I would add two things to what Secretary Barr said. First, with regard to the system we had, we were limited to two because of the way the Enterprises were structured. That model envisioned that there would be only two companies. They were given a number of advantages not otherwise available in the marketplace, and so we did not have freedom of entry and exit. In terms of how many firms there might be in the future, if we are looking for a market model, I would think it is the market that should determine that, not a regulator or the government generally. So I would look for a market model in which there was licensing of firms to do certain things if they met certain requirements. But other than that, we should be having a model that lets the market determine that through entry and exit and that would help to spread and diversify risk.

Chairman KANJORSKI. Thank you very much. My time has obviously expired. We will now recognize the gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you. And let me say this, the subcommittee chairman asked, "How do we keep the housing market going?" And I think that is what people are asking. I am not sure that ought to be the question. I think the question should be, should the government keep the housing market going? Is it up to the govern-

ment through subsidies and guarantees to do that? Or is that the proper role of government?

Secretary Barr, you have said the government is committed to ensuring that the GSEs have sufficient capital to perform under any guarantees issued now or in the future. So you obviously envisioned Fannie and Freddie continuing to make guarantees, I suppose. Is that correct?

Mr. BARR. The basic goal of the provisions that the prior Administration put into place and that we have continued under the preferred stock purchase agreements is to ensure that the GSEs can meet their obligations now and into the future until such time as the Congress enacts reform. And when Congress enacts reform, the future state of the system will decide after that point, do we have guarantees, do we not have guarantees, do we have GSEs, do we not have GSEs. But in terms of obligations that are being issued today, absolutely, standing behind those is essential to market stability, to the continued ability of our housing finance system to function, and to not creating an environment of great instability that will harm taxpayers.

Mr. BACHUS. Let me ask this, and then I will ask Mr. DeMarco. This idea of the government guaranteeing—in the future, not the past but the future guarantees—you have said that—and this is an answer to some, particularly some on the other side, who have called for an explicit government guarantee for home mortgages is one option. You said, "Replacing the Enterprises' implicit guarantee with an explicit one does not resolve all the shortcomings and inherent conflicts in that model and it can produce its own problems." That was your statement. I read it on your Web site yesterday.

Mr. DEMARCO. Yes, sir.

Mr. BACHUS. What are some of the shortcomings with a government guarantee? And what are some of the possible consequences for taxpayers?

Mr. DEMARCO. I think, Congressman, that what I tried to articulate there was that while there are a number of industry representatives and others who have been advancing the cause of having explicit government guarantees backing a wide array of mortgages in the future housing finance system, my testimony says that I think that there are definitely some positives to that, but that some of the negatives have not been fully explored. So I have tried to identify several matters that I would think lawmakers would want to consider in determining whether and the extent to which to provide explicit government guarantees in the future housing finance system. And that goes to the ability and capacity of the government to be able to adequately price the risk that is there. It goes to the question of to the extent that there is government support for an activity that provides a subsidy, you get more of that activity. And that comes as an opportunity cost of funds not going elsewhere. It is a matter for lawmakers to weigh. And I believe that if the government is involved in providing guarantees on a broad portion of the mortgage market, that it seems likely—and past experience would suggest the government would want a say, to some degree, in how the mortgage market is working, pricing, what segments are being served, and how that gets done, and how that might af-

fect the proper pricing of mortgage credit risk or challenges that would need to be considered in a model that is relying upon government guarantees.

Mr. BACHUS. Let me say, I read part of what you said, and I would agree with it. You said, "The premise for an explicit guarantee is that the private markets are not able to price the risk of the mortgage default at reasonable levels. But we must ask—and I agree with you—whether the government can do a better job." I think the whole debate here is whether the private market or the government can do a better job. And I think most of my colleagues on this side say the private market can. You go on to say, "If a government backstop is underpriced—in other words, if the government underprices the risk—taxpayers may eventually foot the bill again." And we—I know the minority party—at any and all costs wants to see that the taxpayers don't foot that bill.

Mr. DEMARCO. May I respond?

One other thing to note here, though, is that it is for you all to decide what sort of multiplicity of guarantees there are. We still have, and I would expect would continue to have, the FHA program. That is a government guarantee program. It is one that is targeted. It is one that has certain transparencies about it.

I am getting to the larger question of going to the full, what we know today as the conventional market, to what degree is the government going to get involved there? But there may well be a role, and it is for the public benefits of that to be weighed by lawmakers.

Mr. BACHUS. Okay, thank you.

Chairman KANJORSKI. Thank you very much.

Now we will hear from the gentleman from California, Mr. Sherman.

Mr. SHERMAN. First, as to conforming loan limits for the high-cost areas, the Federal Housing Finance Agency has determined that the loans originated since the temporary loan limit went into effect have consistently outperformed the smaller conforming loans, at least that is what I have been told, and have dramatically lower delinquency rates. One issue that comes up is will Congress, even if we do extend the 729, do it late in December?

Mr. DeMarco, if Congress waits until the very end of the year to extend the current increased conforming loan limits, what do you think will be the impact of not doing it earlier? Will homes be able to open escrow in November and December without the borrower knowing whether he can get a conforming loan or she can get a conforming loan during that escrow period, and Congress perhaps not extending? How important is it for Congress to act expeditiously?

Mr. DEMARCO. Congressman, if you say, just to give this rough justice, there are 90 days from purchase to closing on a mortgage, then you would expect that for mortgages, for home purchases that begin in October, that certainty for both potential borrowers as well as lenders would be helpful in that regard.

Mr. SHERMAN. So if we don't act before we adjourn for the election, or for October, then people won't be able to open an escrow in November because they don't know whether they can close in January?

Mr. DEMARCO. Congressman, "won't be able to" is a much higher hurdle. The jumbo market is in fact performing, and it is actually coming back. The spreads on mortgages above 729, relative to those below, has been coming down, and so there would be mortgage credit presumably available. So I wouldn't say—

Mr. SHERMAN. I would hope you would go back and look at statistics. What I see in the Los Angeles area is, yes, the jumbo market is working well for the homes in Malibu. Anybody buying a home in Malibu has a banker on speed dial, probably the CEO.

But for those homes selling for $600,000; $700,000; $800,000, 99 percent of them are FHA, Fannie or Freddie, and the idea that the private market could step in, I certainly don't see it.

I look forward to working with you to see what the statistics are, not in the most expensive home markets, but places where the 417 level applies, to see whether and under what circumstances people can get loans in the $700,000 or $600,000 range.

Let's move to these private resale fees. Last month, your agency proposed guidance for Fannie and Freddie and the Federal Home Loan Banks that they should not deal in mortgages on properties encumbered by these private transfer fees. I want to commend you for moving in that direction.

We discussed these fees last time you appeared before this committee, and, as you know, they typically involve a circumstance where hidden in the documents is a statement that when the home buyer sells, 1 percent of the purchase price goes to a designee, usually an investor on Wall Street. In The New York Times expose, which I would like to add to the record without objection—

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. SHERMAN. —dated September 11, 2010, it details a case where this fee is in a separate document that wasn't even included in the documents for signature at closing.

Do you expect that this proposed guidance will become guidance, and do you expect it to become adhered to by the relevant lenders?

Mr. DEMARCO. I expect that we will finalize the guidance in some fashion, Congressman. It is currently in a public comment period, and we are looking forward to receiving public comment on this.

We cast a wide net in this proposed guidance, and I think it is very important for us to take the time to get public comment on this and to consider it so that we make sure whatever we come out with in final form is fashioned appropriately.

Mr. SHERMAN. I would hope you would take this as an additional public comment, especially as it affects the lender and the prudential standards applied—when I say the lender, the lender or guarantor of these loans.

Mr. DEMARCO. Yes, sir. Thank you.

Chairman KANJORSKI. The gentleman's time has expired.

The gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. I am going to ask Mr. DeMarco a question.

Would you agree with this notion that the goals, at least in part, led the GSEs into the junk loan market?

Mr. DEMARCO. I believe that the Enterprises began acquiring subprime and Alt-A loans and lowered their own credit standards for three reasons, Congressman: they did it to make money; they did it so they would stem their growing loss of market share; and they did it because of housing goals.

Mr. ROYCE. Okay, one of the three goals. And, certainly, for me at the time, in 2005, I remember discussions I had and we had with the Federal Reserve Chairman where he told us where these goals would lead and, in particular, with the fact that unless Congress allowed the regulators to deleverage the portfolios—over the years, we watched those portfolios grow to $1.5 trillion. We watched about $11 trillion, I think, in subprime loans go through securitization or end up in those portfolios, and the Federal Reserve actually became frantic.

And their worry was we created kind of a political beast here that was half politics and half private. And it became the most influential lobby here, at least in Financial Services, on the Hill. It was very hard for Congressmen to stand up against it.

President Clinton did. I remember one of the quotes he made. He said, "I think the responsibility that the Democrats have may rest more in resisting any efforts by Republicans in the Congress, or by me when I was President, to put some standards and tighten up a little on Fannie Mae and Freddie Mac."

That was the fact. In the Senate, we had a good bill. In the House, we had the congressional bill. The congressional bill would have made the problem worse, and that is why it was opposed by economists and by the Treasury and by the Fed, because, frankly, it would not have allowed the regulators to step in and regulate and deleverage those huge portfolios.

But here is the concern I have: Having watched in the past exactly what the Fed warned about, the systemic risk and how we were going to create this political beast that would eventually bring down the housing market and then, on top of it, the financial services sector, we are talking about reconstituting them. And at the same time, we have these further goals that your office has put out that will lead, at least economists who look at this tell us, it is going to lead to these new minimum downpayment standards—that there is going to be sort of again this road towards lower downpayments, at least that is one interpretation under this; that there is going to be a purchase of high LTV loans, junk loans, to meet those goals, potentially, again.

My worry is, how do we—if we end up reconstituting this institution, how do we constrain it? Because I guarantee you, they are not regulated by market discipline. They become an instant monopoly because they knock their competition out of business because of the government backstop that they have behind them. And at the same time, with the way in which they influence Members of Congress, they basically dictated terms and said they will not be regulated by the regulators.

So why would we go down this quasi-socialist road again of reconstituting these institutions? Couldn't we eventually phase back towards sort of a private market? I know it will take time to do. But wouldn't that be the wiser course, in your opinion, rather than the kind of involvement we have seen Congress put into this with

the goals in 1992 with the act that Congress passed, with the leverage on trying to get to zero downpayment loans and all the rest of it; wouldn't we be smarter in the long term, rather than this boom-bust cycle in housing we seem to contribute to?

Mr. DEMARCO. Congressman, I think that there is widespread agreement that reconstituting the GSEs as they were would be a very bad idea, and I would agree that one of the quite possible outcomes, one of the options that is available to Congress, is one that is far more market-based.

Mr. ROYCE. Thank you, Mr. DeMarco. I appreciate it.

Chairman KANJORSKI. The gentleman from Massachusetts, Mr. Lynch, for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

First of all, I want to thank Mr. Barr and Mr. DeMarco for your willingness to come before the committee and help us with your work.

Mr. Barr, you mentioned in your opening testimony that only 1 percent of the losses that we are seeing are related to the post-conservatorship book of loans, and that, I assume, the rest is from the, as you call it, the old book of loans.

Now, just before the break, the August break, I know, Mr. DeMarco, your office issued 64 subpoenas in connection with private label mortgage-backed securities that were sold to Fannie and Freddie.

Mr. DEMARCO. Yes, sir.

Mr. LYNCH. So I know that was just before the break, maybe mid-July, that you sent those subpoenas out. Can I ask you, where are we now? I know that there were some questions about the valuation of those securities, whether some misrepresentations were made. I know you asked for a lot of documents. I didn't go through all of the subpoenas, but I went through some of them.

Where are we now with that whole process?

Mr. DEMARCO. Sir, the information we have requested is in the process of coming in, and we are initiating our process of reviewing those documents for the purposes of doing a financial review.

The purpose here is to review the records, the mortgages underlying these securities, to make a determination as to whether there is a breach of warranty or some other misrepresentation that would suggest that the losses the Enterprises have incurred are the legal obligation of someone else. That process is going to take some time, Congressman, but we are hard at work at it now, and the records are beginning to come in.

Mr. LYNCH. Do you have a timeframe, Mr. DeMarco?

Mr. DEMARCO. I am afraid not, sir.

Mr. LYNCH. So it is open-ended?

Mr. DEMARCO. Not open-ended in terms of responding to the subpoenas, but the timeframe to go through all of these records and so forth is very hard to say.

Mr. LYNCH. Is there any opportunity that you might share with Congress, with this Committee on Financial Services, your progress or lack thereof?

Mr. DEMARCO. Congressman, I would be happy to try to find an appropriate method to periodically update the committee on the progress we are making here, recognizing sort of some of the pri-

vacy and legal sensibilities that need to be respected. I would be pleased to find a way of providing periodic updates.

Mr. LYNCH. I would really like that. I think that, just as some of these mortgage-backed securities were foisted on others, I think that Fannie and Freddie for various reasons bought into these as well and that misrepresentation resulted in major losses for the taxpayer.

Let me ask you another angle on this. While you are going after some of these private label issuers and trying to hold them accountable for selling bad products, mortgage-backed securities to Fannie and Freddie, Treasury and the Fed are pumping in at last count $1.36 trillion into some of these same companies by purchasing their securities.

Mr. DEMARCO. Congressman, I would correct that just a bit. Two things, just to clarify.

First, we are not yet pursuing anyone. We are just gathering information. We have made no determination that there have been misrepresentations or breaches of warranty. We are gathering information through the subpoenas to see if that is in fact the case.

Second, with respect to what the Federal Reserve and the Treasury have been purchasing, their purchases of mortgage-backed securities are those securities that have been issued by Fannie Mae, Freddie Mac, and Ginnie Mae. They are not—

Mr. LYNCH. I realize that. But I am just looking at the numbers here, what we are looking at as losses, the valuations on these things since they were sold to Fannie and Freddie. They just went in the toilet in a very brief period of time. So, at one point, they were AAA, and then the next thing we know, they are worth nothing.

So I am just looking at the losses you have here, one quarter, $266 billion. It is just a whole litany of losses here. You are hemorrhaging value. So I am just making a deduction that we have made everywhere else in the industry with their mortgage-backed securities that there were misrepresentations made here to some degree. Whether it is malfeasance or nonfeasance, I am not going to go there.

Mr. DEMARCO. We are going to find out. I think this is important for the American taxpayer. The American taxpayer is now backing Fannie and Freddie so that the mortgage market in this country can continue. The losses are extraordinary, and I think that we owe it to the American taxpayer to find out as part of our responsibility to conserve assets, to see where these losses are coming from and whether they are the legal responsibility of others, and we will do that.

Mr. LYNCH. You sure do.

In closing, Mr. Chairman, all I am saying is that it is counterintuitive, that we are going to hold them accountable, but we are also going to pump them full of money to try to prop up the values here. That is all I am saying.

I yield back. Thank you, Mr. Chairman.

Chairman KANJORSKI. The gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you.

So, Director, my colleague Mr. Campbell and I sent a letter to you, actually with 40 other Members of Congress, back during the summer, and it came about actually because it was on media reports, as a lot of these things are driven as far as coming out with information, that mortgage bonds had reached an all-time high price of 106.3 cents on the dollar, which, as an aside, is, if you think about it, really an incredible number for purchase of a bond and for an investment purpose. Nonetheless, that is where it was or is.

The media reports indicated that Fannie and Freddie didn't want to sell a larger percentage of their securities, even though they could, and they could do so and obviously get a good value for them, a great value for them.

It also said that the GSEs didn't want to sell more because it would more rapidly shrink their portfolios, and then, with a smaller portfolio, it would be more difficult to eventually free those entities from conservatorship and even then potentially put them back the way they were and loose on the capital markets.

So you sent a formal response, and honestly, I just got it late yesterday for the first time, and you say, "Enterprises hedge their portfolios so gains in asset prices may be offset by losses on derivatives." That is true.

If that is the case, then couldn't you actually lose less money or no money if you sold off those assets now, because then they wouldn't have to be hedged in any other way; they would be off your books?

In your letter, then, you go on to talk about how you are living up to your commitment to their current agreements with Treasury, and everything is on schedule.

So we have had discussions and what have you, and every time you come here to testify, you state that you are trying to fulfill your mission, and I know you are, of maintaining values of the entities and reducing losses to the taxpayers.

But if you are really trying to do that, preserve that value and get money back to the taxpayers, shouldn't we be selling them today when they are at these prices and not have to deal with the hedging of the risk down the road a year or two, or whenever that may be, when inflation kicks in and then that problem of hedging that would be just be astronomically harder than it is today?

Mr. DEMARCO. This is a challenge question, Congressman, and I would point out that there is more to this than just the hedging. So the Enterprises are funding long-term assets by issuing long-term liabilities. If we start rapidly shrinking the assets out of the balance sheet, I am left with long-term liabilities that need to be funding something. So it has more to do than just hedging.

I would also say that they are substantial holders—

Mr. GARRETT. If I could stop you there, so I understand what you are saying. But can't you take care of that better today? If you can tell them at 106 today, who knows what they would be worth, say, 5 years from now if the interest rates go up and what have you. So you can take care of those other underfunded assets that are on your books if you basically sell them and put that money aside to take care of that?

Mr. DEMARCO. So managing $1.5 trillion worth of retained portfolio has lots of complexities to it.

Let me just simply say that part of that is that is, it is so large that is substantial relative to what is trading in the marketplace, and I think that the Enterprises also have a responsibility to market stability, that their sales and the unwinding of their portfolio be done in a stable and predictable way in order to ensure greater market stability.

With that said, my letter to you also pointed out that, as a result of these market movements this summer, we have been in discussions with Treasury, as required by the senior preferred agreement, and we are making some adjustments to how we approach the question of disposition of assets in normal business order in order to take greater advantage of market prices.

But I think we have a responsibility to do so in a way that does not invoke market instability and also is cognizant of the fact that there is hedging and long-term funding here as well.

But we do want to—the basic point, Congressman, I do agree; we want these portfolios to be run down, and we are working very much to that end.

Mr. GARRETT. My time is moving quicker than I would like.

Secretary Barr, you made in your opening comment, I think it was in your opening comment, with regard to the purchase by Treasury of the GSEs, of the mortgage-backed securities, and I wanted to go into more detail, but in 30 seconds here. So I asked the same question to Chairman Bernanke.

When you are purchasing these things today, up until—they are guaranteed by the good faith and credit effectively of the taxpayer until, when, 2012, right? After that, that guarantee, in essence, is no longer there. So what actually are you purchasing, and what is the value of those securities that you are purchasing today after 2012 if there is not the backing and the funding by the Treasury for the GSEs' operations going forward?

Mr. BARR. There is not a sharp distinction between the activities before and after 2012. The preferred stock purchase agreements that backstop the Treasury's support for Fannie and Freddie continue into force after that date with respect to the obligations of the GSEs and with respect to the mortgage-backed securities.

The mortgage-backed securities that the Federal Reserve purchased and that in smaller part the Treasury purchased have the value that they have intrinsic to the asset, and that also continues after 2012. So there is not a sharp break. Those obligations are obligations that will be supported in either event.

Mr. GARRETT. And that is actually where I wanted my question to go, is that, from reading the Treasury's agreement with Fannie and Freddie, it seems that there is no deadline on that, and it can go on ad infinitum. Is there any deadline?

Mr. BARR. May I just briefly answer, Mr. Chairman?

Under the preferred stock purchase agreement, those are designed to put in place support for Fannie Mae and Freddie Mac such that the obligations that they are incurring today or have incurred in the past are supported. And the obligations are designed so that, as the Congress considers reform of the housing finance

system, it is not driven to instability in the housing finance system during the transition.

So whatever Congress decides about the future in Fannie Mae and Freddie Mac can be done on the basis of sound policy and good choices, whether one wants a guarantee or doesn't want a guarantee, whether the size and the shape of the government's role in the market, can all be made independently of disturbing any existing arrangements. So they are designed really to free the Congress to develop a plan that is good for the country going forward in the future.

Chairman KANJORSKI. The gentleman's time has expired.

The gentleman from Massachusetts, the chairman of the committee, Mr. Frank, is recognized for 5 minutes.

The CHAIRMAN. Thank you, Mr. Chairman.

I would hope we could focus on going forward, but my Republican colleagues seem to open a somewhat lamentable discussion of history, while others engage in distorted versions of that history.

The gentleman from California, Mr. Royce, continues to misstate what has happened. He talks about a congressional bill in 2005. He meant the bill passed by the House Republicans. The House Republicans brought that bill up. That was the bill Mr. Oxley brought forward that most of the Republican members of the committee voted for.

The gentleman from California, as he has pointed out, didn't like the bill. He offered amendments both on the Floor and in committee. No amendment was even close to supported by a majority of Republicans. They all lost.

He mentioned that President Clinton said, well, the Democrats fought this. President Clinton is a great guy. He is not infallible. From the time President Clinton said that, the Republicans controlled Congress. It is extraordinary.

The Republicans controlled Congress from 1995 to December of 2006 and did nothing, nothing legislatively. We took office in 2007 and worked with Hank Paulson and put it into conservatorship. Those are the clear facts.

We also tried to block the subprime lending, and that was somewhat controversial.

I will note, the gentleman from Alabama, to his credit in my mind, in 2007, joined the Democratic majority in supporting a subprime lending restriction bill and almost lost his ranking membership. That was widely reported in the press. Other members of this committee said, oh, no, you can't do that.

So the Republicans for 12 years did nothing to regulate Fannie and Freddie. We did it when we took the majority, working with Mr. Paulson, and that is why they are now in conservatorship.

Secondly, the Republicans have consistently and still opposed any effort to stop the predatory lending, because as the gentleman from North Carolina pointed out, it wasn't simply Fannie and Freddie buying those loans; it was others. And those are the facts.

Now, Mr. DeMarco, I just want to be very clear. You were appointed originally when President Bush was President, correct, into the FHFA?

Mr. DEMARCO. I was not appointed, Mr. Chairman. I am a career civil servant. I was hired by OFHEO.

The CHAIRMAN. You were there, and when Mr. Lockhart last year took over—I don't mean to total impute you; just to show you are totally nonpartisan in this.

Mr. DEMARCO. Yes, sir.

The CHAIRMAN. An argument has been made that Fannie and Freddie are still terrible problems and a source of losses. The view I got, and I will say, by the way, from the standpoint of Fannie and Freddie, Mr. Paulson points out in his book that when he got ready to put them into conservatorship, knowing what a drastic change that would mean for them, he was afraid they would appeal to Congress to block him. And he called myself and Senator Dodd, and we said, please, go ahead.

I have to ask you, did putting them into conservatorship make a significant difference in the way in which they operate? Are Fannie and Freddie as they have operated since the conservatorship operating essentially similarly to the way they were before, or have there been improvements from the taxpayers' standpoint?

Mr. DEMARCO. There have been many changes and improvements since conservatorship began.

The CHAIRMAN. Would you elaborate on that?

Mr. DEMARCO. Certainly. They have limited their activities to their existing core business activities. Their underwriting standards have improved substantially. And without having gone into conservatorship and having the backstop of the U.S. Treasury Department, they would have been rapidly receding from the marketplace, which would have meant we would have lost our secondary market and the housing finance crisis would have been much more severe.

The CHAIRMAN. Mr. DeMarco, I appreciate that.

Let me ask you, because we are concerned about the losses, is it correct—if not, I have full confidence in your bipartisan approach to this—is it correct that the great bulk of the losses predate the conservatorship and that since the conservatorship, losses, if any, that we can expect are severely curtailed?

Mr. DEMARCO. Yes, sir.

The CHAIRMAN. Thank you for that, because I think that ought to be clear.

Now the question is, where do we go from there? And that is why I said there was an urgency. Because we acted, the Democratic Congress, when the Republican Congress wouldn't, and put them into conservatorship, or allowed Mr. Paulson to do that, we have made drastic changes. And as you say, we would lose the secondary market.

I tend to agree more with Mr. DeMarco than some in the Administration. I want it to be more purely private, but you simply can't go from A to Z without making sure you have done it right.

Mr. DeMarco, you are going to hear, I think, from some of my Florida colleagues. They are concerned that what has gone on in Florida has, Gretchen Morgenson documented this in The New York Times, a kind of a foreclosure mill without any true notice to the people being foreclosed, and there is concern that Fannie Mae in particular has not been as helpful as it could be in protecting people's rights.

We have written you before. I hope you have read that article. I believe there is a role for you through Fannie Mae, and I think you may hear about this from Mr. Klein. I will be joining that.

Finally, let me just say, I appreciated your comment about the Federal Home Loan Banks. One of the best things we did in the financial reform bill was not bother the Federal Home Loan Banks model and leave them essentially as they were.

When they no longer have to pay off the pay off the REFCORP, which is $300 million, however much it is a year, I saw your comments that you think they should not have to continue to send that into the Treasury, but it should be used to enhance the mission of those agencies. I appreciate that, and I hope we can work together to do that.

Mr. DEMARCO. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Chairman KANJORSKI. Thank you, Mr. Chairman.

And now we will hear from the gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

Gentlemen, forgive me, I missed part of this hearing, so we may be plowing a little bit of old ground here.

Secretary Barr, in your testimony, you speak about the events leading up to conservatorship. And I read your testimony; I didn't hear it. Assuming that it was the same testimony, I didn't see any mention of Fannie and Freddie's affordable housing goals, which, as you well know, the low- and moderate-income housing goals ratcheted up from 42 percent in 2000 to 56 percent in 2008; underserved areas, from 24 percent in 2000 to 39 percent in 2008; special affordable, from 14 percent in 2000 to 27 percent in 2008.

We have had testimony before in this committee about Fannie and Freddie having to take on a lower quality of loans that were connected to these affordable housing goals. Again, I saw no mention in your testimony. Should I conclude that you believe there is no nexus?

Mr. BARR. Mr. Hensarling, I think that, primarily, if you look at what happened in the leadup to the financial crisis and the conservatorship, primarily what happened was that Fannie Mae and Freddie Mac were chasing the private market. The private market in the boom went out and did, frankly—

Mr. HENSARLING. I understand that, Mr. Secretary. But do you believe there is a nexus or not a nexus?

Mr. BARR. I think, primarily, the cause of the conservatorship and the cause of the failure of the two GSEs is fundamentally driven by profit motive and a desire to regain some market share.

Mr. HENSARLING. Does that mean there is a nexus or not a significant nexus?

Mr. BARR. I think the argument with respect to the goals, if they contributed, it was rather minor in relation to those two other factors, which is why I would not put it at the top of the set of problems.

I should say, going forward, that I think that if Congress is considering affordability going forward, that it ought to have a clear delineation between that objective and other objectives in the housing finance system.

Mr. HENSARLING. I see the chairman of the full committee is here. Throughout most of his career, he encouraged Fannie and Freddie to get more deeply involved in affordable housing and encouraged them to do more in affordable housing.

On December 11th, Chairman Frank went to the House Floor and said, "In 2004, President Bush and, yes, the affordable goals came in 1992, President Bush raised them from 42 to 54 percent over my objection. I thought it was imprudent and said so at the time."

You don't want to take the opportunity and try to blame President Bush for one more problem here?

Mr. BARR. Sir, I don't think it really helps to blame one or another party or Member with respect to any activity. I think what we want to do is look at the basic problems in the housing finance system.

We had a race to the bottom in mortgage standards. We had a lack of uniform level playing field in the system. We had a system in which there was an implicit government backing for these GSEs, and we let the private sector benefit and the public sector take the losses.

Mr. HENSARLING. Mr. Secretary, we will move on to a new question then.

In your testimony, you list four objectives and goals for housing finance and reform, I believe on pages 4 and 5 of your testimony. I did not see any mention whatsoever of taxpayer protection. As you well know, we already have $150 billion of taxpayer loss in Fannie and Freddie. We have, as you well know, taxpayers on the hook, the Fed, their NBS over $1 trillion.

I assume that was not an accident that you did not consider, that the Administration did not consider taxpayer protection among the lead objectives and goals for housing finance reform. Is that a fair assumption?

Mr. BARR. I think taxpayer protection is absolutely critical, and that is why I talked about not having private gains and public losses. Perhaps the colloquialism did not translate effectively, but it is absolutely designed to protect the taxpayers.

I don't think we can have a system in the future in which we have these private gains that are subsidized by the taxpayer, which the taxpayer is on the hook for and which shareholders of private entities get the upside and taxpayers get the downside. We can't have that in the future.

Mr. HENSARLING. I think you have mentioned in your testimony that part of the lack of desire to achieve reform today, as I believe you testified, that most of the losses have resulted from the underwritings of 2005, 2006, and 2007. But isn't it true that the loans that are being underwritten today, albeit with a new underwriting standard, one, we have a limited track record as opposed to the longer track record; also, do we know how these loans would perform if they became underwater; and isn't the bottom line the taxpayer is still on the hook?

Mr. BARR. With respect to the losses that are being incurred today, there is a shortened time period, you are absolutely correct. On an age-adjusted basis, those loans are performing significantly better than they would on an age-adjusted basis to the old book of

loans. So we do have an apples-to-apples comparison in the conservators' report from August.

With respect to reform, we are strongly in favor of reform. I do believe the Congress took the important first step in passing here in 2008; the important second step of placing these entities into conservatorship; the important third step of passing the Dodd-Frank Act, which fundamentally transforms the regulation of the mortgage market, creates a level playing field, has ability-to-pay requirements, has risk retention with respect to risky mortgages, has a whole set of reforms that are designed to prevent the market from blowing up the way it did in the past.

Now we need to take the last step in that process, which is the housing finance sets of reform that I think the Congress should take up in this coming year.

Mr. HENSARLING. Thank you.

Chairman KANJORSKI. The gentleman's time has expired.

We will now hear from the gentleman from California, Mr. Baca, for 5 minutes.

The CHAIRMAN. Will the gentleman yield for 15 seconds?

Mr. BACA. Excuse me. Thank you very much for recognizing me. I yield the balance of my time to Chairman Frank.

The CHAIRMAN. Thank you. I won't take all of it. But I did want to say, and I appreciate the accurate quotations by the gentleman from Texas, seriously.

But the one thing I should clarify, yes, I have been a strong advocate for affordable housing. I wasn't making the distinction at the time—by affordable housing, I was always talking about rental housing. I am in fact proud—like a lot of people, I missed a lot of this. But I have always been critical of what I thought was an excessive push into homeownership.

And when I talked about the affordable housing goals, I was focusing on the multi-housing housing, which in fact did not cause nearly as many problems. And I believe what we should be doing is affordable rental housing. I was and continue to be skeptical of the notion that we do people a favor when we push them into homeownership beyond what they can sustain.

I would just take further to elaborate a little bit more, Mr. DeMarco, on that Florida situation. It was troubling to me. I had heard some complaints, and then, frankly, the article by Gretchen Morgenson was really quite troubling about decisions being made in Florida where people were getting foreclosed without notice, etc. And Fannie could play a role in that.

And we have been asking Fannie, to the extent that they are involved in that process, even the court system hasn't been doing it, Fannie could take steps to make sure that notice is given to people, and we have learned that there are problems with the papers.

So we had written you before. We are going to renew that. I would ask you to look at that and work with us to make sure that, to the extent that there is a Federal conservatorship there, Fannie in particular but maybe Freddie, that we do everything to protect the rights of the people who are there.

I thank you, and I thank the gentleman. I yield back.

Mr. BACA. Thank you very much. Along the same lines, I guess we are all very much concerned with what is going on right now with a lot of the foreclosures that are pending before us.

It seems like the institutions, though, and either one of you can answer it, a lot of the institutions right now are foreclosing, and there seems to be a lot of problems in the documentation and losing of the documentation within the banking industry, too, as well.

I don't know if the Treasury or others can be involved in part of that process, because the consumer who is being foreclosed right now gets a notice and in that process, they fill out the documents, and then they don't tell them specifically what those documents should be. And then what happens is, during that whole process, they are losing their homes because they are not complying.

It seems like now it is another gimmick that is being used by some of the banking institutes to foreclose on individuals. What can be done in that area, or how are we addressing that?

Mr. BARR. Let me try and address a bit of that. I do think there were serious problems in the documentation process, in the foreclosure process. Treasury, through the lever of our Home Affordable Mortgage Program, has been putting pressure on services to do a better job in that. I think they have made significant progress over the last number of months in reducing documentation problems.

We have engaged both with Fannie Mae and Freddie Mac as compliance agents and directly with the servicers to deal with the lost documentation process and require additional reviews. I still think there are problems out there in the market and homeowners are having difficulty in that way, and I think that we need to continue to focus on making better improvement.

Mr. BACA. Right. Because they are still being penalized, and they are being foreclosed, and they shouldn't be, because of the deadline that they said, yet they are the ones who are late to respond back. Yet the homeowner is the one who ends up being penalized.

The CHAIRMAN. There is one other point I wanted to make in support of my colleague from California, Mr. Sherman, although he is echoed here, not echoed, but joined by the gentleman from California, Mr. Miller, on the other side, and that is on the conforming loan limit being raised.

Two points that are relevant. First, we had a vote on that in the House. We had some language in there in the FHA bill, and I thought it was best. My argument to the Rules Committee was, let's have votes.

The vote on that was more than 300 Members of the House, three-quarters of the House voted in favor of the higher loan limits, not just those of us in the affected area.

Secondly, I did note that in a very good paper written by Alan Blinder and Mark Zandi, kind of bipartisan, about how we ended the great recession, they specifically credited the increase in the conforming loan limit as one of the factors that had helped the private market in a good way. So I would just add to what the gentleman from California said, and I hope we do do it before we adjourn.

I thank the gentleman from California.

Mr. BACA. I yield back the balance of my time.

Chairman KANJORSKI. The time has expired.

We will now hear from the gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Mr. DeMarco, on page 8 of your testimony, you talk about how work is under way to develop projections that are comparable between the Enterprises and therein say that there are some differences between the Enterprise-generated results and results from FHFA-directed exercises. But you say that is consistent with what you said in the past; even under severe stress scenarios, that Treasury draws remain under $400 billion.

Would you support legislation to set a cap for Fannie and Freddie at $400 billion so that they can't borrow any more from the taxpayers? I know that cap was taken off around Christmas at some point.

Mr. DEMARCO. Congresswoman Biggert, I believe we owe investors in these securities and we owe the financial system clarity and certainty with regard to what the government is doing here with respect to Fannie and Freddie, and we have been clear about the securities that they are issuing today so that our mortgage market continues to function and will have the backing of the Treasury Department under the terms of the senior preferred agreement. Those terms are public. People are trading billions of dollars of securities based on that. I don't think that we should come back in and alter the terms of that at this time.

Mrs. BIGGERT. Okay. I am hearing from constituents about the fact, they are saying that Fannie and Freddie through the States are providing mortgages, just as in the past, where there is no downpayment.

Mr. DEMARCO. Yes, I would very much like to respond to that, if I may, because Congressman Bachus raised it as well. There have been some news reports recently about a so-called affordable advantage program. I would like to explain this and provide some clarity around this.

This program is an agreement between Fannie Mae and several State housing finance agencies. It is a limited term agreement. Think of it as an addendum to an ongoing purchase agreement that Fannie has with the HFAs.

Under the terms of this with the several HFAs, apparently Fannie has agreed to buy certain mortgages with little or no money down that it involves recourse back to the HFA and that has a great deal of underwriting and review by the HFA.

I have had great communication with both Fannie Mae and Freddie Mac during the period of this conservatorship, and any significant actions that have been taken by these companies have been reviewed and approved by the conservator. This one got away from us. There was a miscommunication, and this agreement with these HFAs was signed without my knowledge.

When I learned about it after the fact, I reviewed what had been done. I saw that there was now a legal contract with the HFAs, and I made clear to Fannie Mae a couple of things: one, we were going to honor and respect that contract for its duration, it ends next March; and two, we were not doing this in the future.

There were several other requests that had come into Fannie Mae from other parties for similar no-down-payment or very little

downpayment mortgages, and I said, absolutely not. So we have had nothing further on this, and when this particular program with these HFAs expires, it will not be renewed.

Mrs. BIGGERT. But how much is the value of them?

Mr. DEMARCO. The amount of loans that have been made under this program I believe is less than $10 million.

Mrs. BIGGERT. It seems pretty risky, going back to where we were before.

Mr. DEMARCO. Congresswoman, I agree.

The basic premise here is I believe borrowers should have a downpayment if they are going to purchase a house, and I found that the terms of this program did not fit with what we are trying to accomplish here in conservatorship, and that is why you won't be hearing about additional programs such as this.

Mrs. BIGGERT. I am not sure that—I don't think you answered my previous question. Would you support legislation for a cap on the amount of money at $400 billion?

Mr. DEMARCO. Congressman Biggert, as I understand the way you have represented it, I would not, because I believe that would change the terms of the agreement under which investors today are purchasing securities issued by Fannie Mae and Freddie Mac.

Mrs. BIGGERT. Thank you.

I yield the remainder of my time to Mr. Royce from California.

Mr. ROYCE. I appreciate the gentlelady for yielding.

In point of fact, Chairman Frank said in September of 2003, I do think I do not want the same kind of focus on safety and soundness that we have in OCC and OTS. I want to roll the dice a little bit more in this situation towards subsidizing housing.

Now, that is, frankly, the fact. And I do think that President Clinton was right in terms of his observation that the responsibility that the Democrats may have rests more in resisting any efforts by Republicans in the Congress or by me when I was President to put some standards and tighten up a little bit on Fannie Mae and Freddie Mac.

For those of us who were involved in trying to put those standards on and watching the Senate Republicans succeed in putting a bill out to deleverage those portfolios, it is a rewrite of history today not to acknowledge that we might be going down the same road again.

Thank you, Mr. Chairman.

Chairman KANJORSKI. The gentleman's time has expired.

We will now hear from the gentleman from North Carolina, Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

I joined this committee in 2003, and it was like walking into Harlan, Kentucky, and I didn't know the Hatfields, and I didn't know the McCoys, but I did know they didn't get along with each other.

What Republicans on this committee now remember, apparently remember, was that they were voices in the wilderness years ago saying that subprime lending was the road to ruin, and Fannie and Freddie were hugely responsible, and they warned us about Fannie and Freddie.

And that is not what I remember at all.

Fortunately, these meetings are transcribed, and they live on in videotape. I have gone back and checked, and that is not what they said at all, just as I remembered. In fact, they praised subprime lending as being just the type of the kind of innovation that can come from unfettered capitalism; it was leading to this huge spike in homeownership by people who never would have qualified for mortgages under some stultifying set of regulations like what Democrats might propose.

And they did criticize Fannie and Freddie, but their criticisms of Fannie and Freddie were almost entirely repeating the talking points of Fannie and Freddie's bitter rivals, the companies that were almost entirely without government regulation, the private label securitizers, such worthy companies as Goldman Sachs, Merrill Lynch, Bear Stearns, Lehman Brothers, and AIG, which was in competition with Fannie and Freddie, as well, because you all essentially insure your own securities.

The criticism was that those private label securitizers, those unregulated companies, were running rings around Fannie and Freddie in affordable housing and that Fannie and Freddie were not doing nearly enough for affordable housing.

And the Bush Administration kept raising the affordable housing goals, but then said that Fannie and Freddie could meet that goal, when Fannie and Freddie were saying, we don't buy mortgages like the mortgages they are buying.

HUD, under the Bush Administration, said that Fannie and Freddie could meet that goal by buying the private label mortgage-backed securities, what we now call toxic assets, from those companies.

Mr. DeMarco, to what extent did the $255 billion in private label subprime mortgage-backed securities, how much of the losses are as a result of those securities?

Mr. DEMARCO. If I may pause for just a minute, Congressman.

It is less than 10 percent of the total, Congressman. I will get the exact number for you.

Mr. MILLER OF NORTH CAROLINA. Okay. You said most of it has come from nontraditional mortgages that Fannie and Freddie did begin to buy in the last decade. "Nontraditional" covers a lot of ground.

Mr. DEMARCO. It is nontraditional and traditional. They have taken a huge hit on their credit guaranteed book.

Mr. MILLER OF NORTH CAROLINA. But I assume that the nontraditional led, and then traditionals have more recently become—

Mr. DEMARCO. Yes.

Mr. MILLER OF NORTH CAROLINA. It is only when the housing crisis really hit that the traditional became a problem; is that correct?

Mr. DEMARCO. I suppose so. Certainly, as house prices and unemployment have risen, it has affected quite a broad range of home buyers.

Mr. MILLER OF NORTH CAROLINA. Okay. Of the nontraditional, how much of that was Alt-A, which did not really include predatory terms, but certainly with benefits of hindsight and certainly at the time should have appeared foolish, poorly underwritten loans, loans that required little documentation, stated income. But the

terms were not—the interest rate may have been higher, but the terms were not terrible different from prime loans.

How much were Alt-A, and how much did Fannie and Freddie buy any of the kind of 2/28s, 3/27s with a 30 to 50 percent increase in monthly mortgage payment and a 3 percent prepayment penalty, the kind of subprime mortgage lending in the last decade that I consider predatory?

Mr. DEMARCO. I am sorry, Congressman, there are a lot of different questions rolled up into that. If you would indulge me, I would prefer to be able to prepare that in an orderly fashion for you in writing so I can give accurate answers.

Mr. MILLER OF NORTH CAROLINA. If you could provide that for me, that would be fine.

And Mr. DeMarco, I think you probably know that I have praised you for beginning to pursue claims against the mortgage-backed securitizers that sold Fannie and Freddie $255 billion in subprime mortgage-backed securities, in issuing subpoenas in July. I don't think it should be the Federal Government's role to take sides in private litigation, but your claims are almost identical to those of many private litigants, pension funds, that feel cheated in the very same way, who have been stymied so far in their litigation. It is not uncommon for litigants with similar claims to sort of compare notes, share information.

Are you in contact with those private litigants, the pension funds and insurance companies that bought the same kind of securities you bought?

Mr. DEMARCO. Congressman, no. We have issued the subpoenas. We are gathering this information. At this point, we are simply gathering the information and determining what it tells us. Whatever our path is from there is yet to be determined, and I will certainly rely upon the advice of counsel in that process.

Chairman KANJORSKI. The gentleman's time has expired.

I now recognize the gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you.

I apologize that I haven't been able to stay for the whole hearing. But I think one of the fundamental questions I have been asking and been talking to a lot of folks about, and Mr. DeMarco, you and I have actually had this discussion as well, is, Congress is considering GSE reform and the fate of Freddie and Fannie.

At one time, we had a functioning private market in this country, and there are other countries that have mortgage financing that doesn't necessarily have government backing. Can you see in the future the ability for, if Congress decides to get the taxpayers out of the bailout business, of having a functioning private mortgage market where the government is not on the hook?

Mr. DEMARCO. Yes, sir, I can envision such an environment. I believe this country has, despite the incredible difficulties it has had the last few years and the losses suffered, we have a strong and robust financial system. It is getting stronger every day. Congress took a lot of action this summer to enhance regulatory oversight. That will contribute to it. I can envision a market system for a good chunk of the U.S. mortgage market. Yes, sir.

Mr. NEUGEBAUER. Mr. Barr?

Mr. BARR. I would agree with Director DeMarco that we have a long history of a vibrant and innovative financial sector that has played a strong role in housing finance and business finance and commercial finance all across the market. We do need to attract private capital back into the market.

I think that, as Congress considers the future shape of reform, as I said just a few moments ago, I do think it is important that we not go back to the system that we had in the past where there were basically private gains and public losses. We can't have that kind of system in the future.

I do think there is a question as to what extent there should be a government guarantee in the mix of ways that we are approaching, revitalizing and having a strong and robust housing system; what the role of that guarantee should be, when it should come into play if it exists, and how it is priced, I think are important questions for the Congress.

As Director DeMarco suggested, it is hard to imagine not having some kind of role similar to the role FHA plays, for example. So I do think that there needs to be a mix of strategies used to bring the private capital back into the system and ensure we have a strong and vibrant system into the future.

Mr. NEUGEBAUER. Are you familiar with the Canadian system?

Mr. BARR. I am. I am not an exert on Canada, but I am familiar with their approach.

Mr. NEUGEBAUER. I don't think that they have a guarantee on those mortgages, do think?

Mr. BARR. The Canadian system is quite different from ours. In part, they have a quite tightly regulated but also highly concentrated banking system. They rely not on a 30-year fixed-rate mortgage, but on a shorter term, adjustable-rate mortgage. It is possible to create a system similar to that. Other countries have used the covered bond market as an approach.

I think, in each instance, when you look at the international examples, it is important to look not just at what is on the books, but what may also be implicitly there. A number of countries with concentrated banking sectors where there doesn't appear to be a government guarantee involved, there is an implicit backing for the financial institutions, which I think we don't want to recreate,

So I do think international examples can help, but we have to go a couple of layers deeper to know whether that is the kind of system we want or not.

Mr. NEUGEBAUER. So the question I have is, is there any incentive for the private market to get back into this market, given the fact that Freddie and Fannie are in existence and we are continuing this—I don't know what this is called, but this freeze in time where we just are continuing to let Freddie and Fannie do what they were doing before the crisis?

Mr. BARR. Let me just echo a little of what Director DeMarco said before, which is that Fannie and Freddie are not doing what they did before the conservatorship. That is, they have fundamentally changed the nature of their underwriting. They are still operating under the strictures of the conservatorship. Their underwriting standards have changed. They are not involved, for exam-

ple, in purchasing Alt-A loans as they were so significantly in 2006 and 2007.

I do think that Congress now needs to turn to the task of reforming the housing finance system, including Fannie Mae and Freddie Mac, and deciding what kind of system we want to have in the future. I think very strongly, I know that Treasury believes, we should not return to the system we had in the past. We can't recreate these entities the way they were.

Mr. NEUGEBAUER. But hasn't the Administration, you just basically said whatever capital this company needs, that we are going to keep putting it into it. So why would the private sector securitize outside of Fannie and Freddie as long as Freddie and Fannie are still there and as long as you all are committed to keep just throwing money at that company?

Mr. BARR. I think I would like to separate out the steps that we took and that the prior Administration took to bring stability to the housing finance system. I think those are absolutely critical as the Congress decides what the future system should look like. It is not a statement that the future system should look like the past.

Quite the opposite. It is a statement that says, as we figure out what the new system should look like, we can't disrupt the market, we can't disrupt the ability of homeowners to get mortgages, and that is absolutely critical to maintain so that Congress can decide what the right system is for the future.

Chairman KANJORSKI. The gentleman's time has expired.

Now the gentleman from Indiana, Mr. Carson, for 5 minutes.

Mr. CARSON. Thank you, Mr. Chairman.

And thank you, Congressman Moore.

The Basel III rule agreed to on September 12th includes a liquidity requirement for banks that will encourage them effectively to buy the debt of Fannie and Freddie as well as mortgage-backed securities they back. Specifically, those banks will be required to enough high-quality liquid assets, and Fannie and Freddie counts as a high-quality debt. How will you ensure that Fannie and Freddie will not inadvertently take on more risk than they can effectively handle?

Mr. BARR. Let me just say a little bit about the capital rules and then maybe turn it over to Director DeMarco.

I think the capital rules are an important step in bringing greater stability now and in the future to our financial system. It will significantly increase the financial requirements for our firms as well as will improve their ability to withstand liquidity crises.

I do think, as Congress takes up the question in the future of Fannie Mae and Freddie Mac, we are going to need to address the way in which other participants in the financial system interact with those institutions if they continue into the future; or if they don't continue into the future, what the role of financial intermediation is with respect to the link between the housing finance entities and the rest of our financial sector, so that we are not increasing systemic risk, but rather reducing it.

Mr. DEMARCO. In terms of what was done just a few days ago among the international bank regulators, I am sorry, Congressman, I am not familiar with what exactly it might say, so I would be happy to take a look at that.

But I would note that, obviously, the debt and mortgage-backed securities being issued by Fannie and Freddie today are both issued with the backstop of the senior preferred agreement with the Treasury Department, and in fact, the Federal Reserve and the Treasury Department hold those securities in large volume.

Mr. CARSON. Thank you, Mr. Chairman. I yield back.

Chairman KANJORSKI. The gentleman from Illinois, Mr. Manzullo, is recognized for 5 minutes.

Mr. MANZULLO. Thank you, Mr. Chairman. The frustration level of the American people has exceeded to be the boiling point. And I am not saying that the two of you here are responsible for that. I just want to share that with you. And here is the whole point, now that I have made that caveat.

Mr. BARR. We appreciate that, thank you.

Mr. MANZULLO. I just got another e-mail from a world-class manufacturer in my congressional district. He has orders. The Institute for Supply Management is up I think 9 or 10 months in a row. He has orders—O–R–D–E–R–S—to manufacture. He has people he wants to hire. He has gone to eight banks. Every one says the same thing. The banks say, it is the examiners. The examiners say it is the regulators. The regulators are saying, we have changed nothing. And so we can recover right now, but the Federal Government is stopping the recovery in manufacturing. I have 25 percent unemployment back home. One out of four people works in manufacturing. Effectively, it is at 25 percent, if not more. For every 10 applications that go to a bank, nine are turned down, nine. And of those nine, four to five normally would be given. And many of those are on the stuff that you have on your hands, what is in foreclosure and short sales.

So here we are now. Even in Rockford, Illinois, a city with that amount of unemployment, people are ready to buy. They are ready to move this stuff. They are ready to restart the supply chains of manufacturing not only in traditional manufacturing but in the housing market, and the clog to the entire recovery for this recession is here with the regulators. I have talked to them; and they have said, "We have changed nothing." I want to know what you, Mr. DeMarco, can do or anybody else to unplug that clog. The recovery is here. Washington is stopping it.

Mr. DEMARCO. So, Congressman, I appreciate the challenge and the frustration and the real impact this has on individual families and communities. I regulate, as you know, the entities involved in the secondary market for mortgages. In fact, I would not, as a regulator, say nothing has changed. I think a lot has changed with respect to mortgages. It is a change that needed to happen. It is a change that is still under way. We needed to improve the underwriting standards in the extension—

Mr. MANZULLO. But the standards are being met by the people who are applying.

Mr. DEMARCO. If I may, Congressman, yes, I think that those changes have been made. But I think that with the Enterprises operating in conservatorship, awaiting congressional action on housing finance reform, we have a function in the secondary mortgage market. So there is a secondary mortgage market outlet for creditworthy borrowers seeking a mortgage. So I can't explain what

might be a particular problem for a particular constituent of yours, but we have a functioning mortgage market right now.

Mr. MANZULLO. This is not a particular constituent. I am talking about the hundreds of thousands of people across America.

Mr. DEMARCO. Forgive me for saying it that way, Congressman. But yes. But all I can tell you is that the secondary mortgage market is open and operating to purchase these mortgages.

Mr. MANZULLO. No. I understand that—and obviously that 80 or 90 percent of the homes financed today are going through Fannie Mae or Freddie Mac. This has to be resolved. It is not an issue of dishonest people or incompetent people in the different areas that I mentioned. But the problem is we could have all the mortgage foreclosure help, all the programs we want, and nothing is going to happen. We can't buy our way out of this recession. We have to work or manufacture our way out of it. But now people want to buy homes. Arbitrarily, even coming in with the whole deal on the appraisals again, at the last minute, we need another appraisal. Another closing was stopped because somebody couldn't explain a $17 charge on their credit report. This is a real problem. We are there, Mr. DeMarco. We are there, and there was a summit in this city, what, 2 weeks ago dealing with the lack of credit and with foreclosures in the home market. But there is nothing more the government can do except to unfreeze this credit and make sure that people who deserve the credit get it.

Mr. BARR. Can I just add to the comment before? With respect to business credit, I do think that there has been an excessive tightening. It is common in any downturn. It has been much more pronounced in this downturn. It has been I know frustrating to businesses around the country. It is frustrating to us. I do think there are steps that we can take to help on a regulatory front but also with the pending small business and jobs bill.

Mr. MANZULLO. But that bill is not going to do it because it doesn't change the underlying standards for lending the money. Banks have money. The community banks have money. They don't need more money from the Federal Government. They don't need another program. They are not lending the money out because they are being hammered by the regulators because the examiners will come in and just arbitrarily classify a loan. Don't talk to me about another Federal program.

Mr. BARR. I do think that with respect to examinations, you do find, again, on any downturn a tightening and an excessive tightening that is in a sense the mirror image of—

Mr. MANZULLO. What are you going to do to stop extensive tightening?

Mr. BARR. We obviously don't have regulatory authority ourselves over this sector, but we do have the ability to talk to other regulators, which we do on a regular basis. Treasury has.

Chairman KANJORSKI. The gentleman's time has expired.

Mr. MANZULLO. Thank you.

Chairman KANJORSKI. We have the gentleman from Kansas waiting anxiously. We recognize Mr. Moore for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. Mr. Barr and Mr. DeMarco, thank you for your service. Mr. Barr, I understand that Treasury has been collecting comments from all stakeholders

on what the government should do to replace Fannie Mae and Freddie Mac and create a stronger housing finance system. I have heard one suggestion that concerns me and that is simply to end Freddie and Fannie and privatize the entire housing finance system. Is Treasury receiving comments from private industry stakeholders that full privatization would be a good idea? And is it a good idea?

Mr. BARR. Representative Moore, we have received a range of public comments on privatization, on nationalization, on a wide variety of different strategies looking at the housing finance system in the future. As with any topic this complex, there are conflicting views on each of the suggested approaches. The potential downsides of having a system in which there is no government involvement include the lack of standardization, a potential lack of consumer protection, a potential lack of key products that the country has become reliant on, such as the 30-year fixed-rate mortgage with a to-be-announced market, and the potential for a lack of standardization and liquidity.

The potential upsides of having a full privatization include removing some element of direct taxpayer risk, increasing the ability for private sector capital to flow into the market, potentially reducing the relative amount of capital flowing into housing vis-a-vis business to the extent that there is a mismatch in subsidy rates. And we are looking at those tradeoffs. Again, as with any area this complex, choosing an approach that sounds pure in advance is usually less satisfying once one gets into the details of it.

Mr. MOORE OF KANSAS. Thank you, sir. Mr. DeMarco, the other side has raised several concerns that the GSEs are taking a lot of risk with respect to low downpayment loans. Is that really the case? And how many home purchase loans have Fannie and Freddie bought in the past 12 months in which the downpayment was below 5 percent and below 10 percent respectively? If you don't have the exact numbers, could you please give us those numbers in writing as soon as you can? And can you at least give us a general sense whether the value is high or low, sir?

Mr. DEMARCO. I will certainly provide the precise numbers to you and to the committee, but I can assure you that the numbers are quite low. Particularly with respect to less than 5 percent down, it is very little. It is almost virtually nonexistent.

Mr. MOORE OF KANSAS. Thank you.

Mr. DEMARCO. Actually, can I clarify one thing? I don't want there to be a misunderstanding here. The one exception to this is that we do have a refinance program operating, the Home Affordable Refinance Program, or HARP. So there are refinances going on in the HARP program where we have allowed for refinances of existing mortgages that Fannie and Freddie own up to a current loan to value of 125 percent. And the purpose of doing that is that it benefits the homeowner, enabling them to take advantage of lower mortgage rates. But it also benefits the credit risk of Freddie and Fannie by having improved pricing on that mortgage and a homeowner with an improved balance sheet, so it reduces the credit risk. Whenever we go over this data, I have to be careful about carving out that exemption for the HARP program.

Mr. MOORE OF KANSAS. Okay. Mr. DeMarco, at a Capital Markets Subcommittee hearing in July, John Taylor from the National Community Reinvestment Coalition indicated his strong concerns about fees being charged by Fannie and Freddie. His response to why he was concerned, "Because we think it is unfair. The notion that because somebody lives in a declining market that somehow they have to pay a premium seems fairly anti-American to me. You ought to be able to judge the person on their capabilities, their individual financial status, their creditworthiness, and so on, not by the neighborhood they necessarily live in."

These fees that are charged in lieu of adequate private mortgage insurance seem to be driving mortgages away from the GSEs into FHA. This seems to be in large part because these fees can't be financed. Mr. DeMarco, is that true? And if so, what are these fees being used for?

Mr. DEMARCO. The pricing on mortgages prior to this housing finance debacle we have had, we clearly were underpricing credit risk. I believe the typical conversation about Fannie and Freddie pricing today is regarding what are called loan-level price adjustments. But I think the Congress needs to understand that Fannie and Freddie have base guarantee fees that they apply; and then the loan-level price adjustment is essentially the risk-based pricing that gets placed on a mortgage that allows for pricing for the particular risk characteristics provided by that mortgage. I have a responsibility as conservator, and I have certainly heard it in the last few hours in front of this committee, that we are supposed to be operating these conservatorships so that we are pricing to the risk that mortgages have. So I think with respect to the pricing that is going on today, that is what I would say we are doing. The Enterprises are pricing their guarantee fees to cover expected losses, operating expenses, and to be able to have a measured rate of return that is certainly reflective of their responsibility to make dividend payments to the Treasury Department on a senior preferred.

Mr. MOORE OF KANSAS. I thank the gentleman. I yield back, Mr. Chairman.

Mr. DEMARCO. It is not a question of fairness, Congressman. It is a question of being economic and risk-based pricing in the business that we are doing today in conservatorship.

Chairman KANJORSKI. Thank you. We are going to wind this hearing up by hearing from our two members from Kansas. And I will now recognize the gentlelady from Kansas, Ms. Jenkins.

Ms. JENKINS. Thank you, Mr. Chairman. I would like to yield my time to the gentleman from California, Mr. Royce.

Mr. ROYCE. I thank the gentlelady. Mr. Chairman, the talking points did not come from Fannie and Freddie's competitors in 2005. It came from the Federal Reserve; the Chairman of the Federal Reserve came down here and spoke to us. And I just pulled out the quote he gave us in 2005 as a warning in terms of the pending problem if we did not address this problem with Fannie and Freddie. He said, "If legislation does not limit GSE portfolios, we run the risk of solidifying investors' perceptions that the GSEs are instruments of the government, that their debt is equivalent to government debt. GSEs will continue to grow faster than the overall home mortgage market. They can grow virtually without limit and

without restrictions on the size of the GSE balance sheets. We put at risk our ability to preserve safe and sound financial markets in the United States."

Now this is what caught Jim Leach's attention and, frankly, the attention of Richard Baker, myself, Mr. Garrett, Mr. Hensarling, Chris Shays, and others on this committee who took the Fed seriously and took the Treasury Department—both under the Clinton Administration and under the Bush Administration—seriously when they looked at what we had done in the 1992 passage of the GSE Act to set up this house of cards that would eventually lead to two-thirds of the mortgage market, the subprime mortgage market, being handled by Fannie and Freddie and FHA—65 percent in 2001, 68 in 2002, 67 in 2003. These were making the purchases of the junk put out by Countrywide, right? And convincing the rest of the market that they should get into this line of business as well.

Now the testimony that Mr. DeMarco gave I thought was a very strong case, and the question I would ask him is, do you believe that the private market eventually can handle the vast majority of this market down the road if we properly handle the phase-in? Because right now we have a real problem in terms of how we sustain this. But in the long term, I would like to see us get away from a situation where there is so much political pull replacing market discipline and where the biggest lobby on the Hill is a GSE.

I would make one other quick observation, and that goes to the issue made by Mr. Ed Pinto, the former Chief Credit Officer of Fannie Mae. He said, "The new goals put out on September 2nd are likely to prove more risky than those that led to Fannie and Freddie's taxpayer bailout. Meeting these goals will necessitate a return to dangerous minimal downpayment lending along with other imprudent lending standards. So to what extent will the GSEs be allowed to purchase again high LTV loans and junk loans to meet these goals?"

That is my second concern. But let me go to my first question to you. Long term, do you think we can get back to a private market here?

Mr. DEMARCO. With respect to the first question, Congressman, I believe that if Congress decides that it would like to see the bulk of the conventional mortgage marketing be handled in purely private hands, I believe that is achievable. It is not the only option. I believe it is achievable.

With respect to the second question regarding housing goals, I am not familiar with the full extent of that quote. I will say that FHFA did issue final housing goals for Fannie and Freddie for 2010 and 2011. We are required to by statute. And I believe that continuing the housing goal regime is important because one of the things we are doing in conservatorship is to assure that they meet their existing core mission responsibilities under the statute. And I believe that the housing goals are one reflection—one set of metrics as to whether they are accomplishing that congressional mandate or not. We have substantially changed the goals. Congress did in HERA, and so this rule that we just finalized is a substantially different set of housing goals than had existed prior. And we also, in setting the final goal levels for Fannie and Freddie, have

tied them to what the primary market is actually producing. And to put it simply, the goals are that Fannie and Freddie keep up with, be proportionate to what the primary market produces, not to have to exceed it.

Mr. ROYCE. I understand that. But I remember also in the 1992 Act—and I think the 1992 Act was a disaster—but there was a provision in there on the need to maintain the sound financial condition of the Enterprises. And what the former Chief Credit Officer of Fannie Mae is now saying is that you are actually likely to put at risk sort of this going concern concept for the GSEs, given the fact that you are headed down that road again towards minimal downpayment lending, and so forth. And I think that has to be considered because we know that Congress is reluctant to address this issue.

Mr. DEMARCO. We will take that under consideration, Congressman. And I have tried to be clear to the committee in response to the question from Congresswoman Biggert that I am not looking for the Enterprises to engage in very low or no downpayment lending. And I also, as part of the final rule, made absolutely clear that we expect them to not undertake bad mortgages or to have loss leaders or anything of the sort with regard to satisfying the housing goals.

Mr. ROYCE. Thank you, Mr. DeMarco. Thank you, Mr. Barr.

Chairman KANJORSKI. The gentleman's time has expired.

Mr. DeMarco, before we close, I will just ask one thing to follow up on Mr. Manzullo's question. I am acutely aware—and you responded to my letter on Friday about the inadequate Federal Home Loan Bank system responding to commercial loans and encouraging and priming that market. Is there anything you can do to get out there and start encouraging the Federal Home Loan Banks to get involved in commercial loan activity in the country? And are you intending to do so?

Mr. DEMARCO. Mr. Chairman, only with respect to what is authorized in the statute. I believe with any government sponsored enterprise, their activity should be limited to the specific areas that Congress has targeted for them. So generous support of commercial lending is not part of the charter of the Federal Home Loan Bank system. But there are provisions—and you have certainly been a proponent of it, I am well aware of that, sir—with regard to certain of the programs they have, the community investment program for community financial institution members. There is a broadened set of eligible collateral because it has been clearly stated the intent of Congress is that for community financial institutions, they be able to take down advances for a broader set of community development purposes, and there is a broader set of eligible collateral for that.

The letter that I sent you on Friday made clear, I reiterated my commitment that I made in the comment letter to the GAO in response to their study this summer that we were going to back and look at how they were examining each of the Home Loan Banks with respect to their implementation of these authorities under the statute. So we will do so, but we will do so consistent with what the statutory mandate and limits are. Yes, sir.

Chairman KANJORSKI. I appreciate that, Mr. DeMarco. I think I heard an undertone from the whole committee in terms of commercial lending and business activity that after every one of these events, as Mr. Barr well pointed out, there seems to be a slow response to the banking community, and the regulators get hesitant of what they will approve, and I can see that happening. I am hearing from community banks, from regional banks. I am hearing from a cross section of lenders and they would like to do more but they are being constrained by their regulators. Maybe you all can have a couple of summit meetings yourselves down here and get together and make sure it is not only your decision here in Washington but you send that out into the field. I know in one of our past recessions, the Washington regulators actually went out and convened meetings in the regions to encourage it. Maybe it is time we start doing that, because I agree with Mr. Manzullo. There are a lot of jobs out there that can be and will be created. But there is a need for money, operating capital.

Mr. DEMARCO. Mr. Chairman, if I may, because I think that is an excellent suggestion, I would like to point out something that FHFA is in fact doing. Congress, in establishing FHFA, said we should all have a division of housing mission and goals, and we have such a division, sir. And in fact, the team in that division that works on these matters is, in fact, going out into the field and is holding field hearings, is meeting with community development participants out in the field. They are going around the country and actually seeing what is going on and trying to hear in local markets what are the needs, what are the concerns. And with respect to the Federal Home Loan Bank system, we are trying to better understand how the programs available through the bank system are working or are not working, how they could be improved. And we are in the process of refreshing the regulatory framework we inherited from the Federal Housing Finance Board regarding those programs. We are in the process of refreshing them to make them more responsive to the needs of local communities. But an important input of that has been sending my staff out across the country to gather this input.

Chairman KANJORSKI. I appreciate that. We want to thank you, Mr. DeMarco, for your activities and certainly that new initiative that you are talking about. And Mr. Barr, I want to thank you for your participation in the hearing. I think it has been informative. We have rewritten history to some extent, but that is always the case when you are 7 weeks out from an election. We hope that ultimately history will be written in the years ahead and have a little more truth to it on both sides, if I may say.

That being the case, and no further activity before the committee, the Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record. And without objection, all other things having been handled, the panel is dismissed, and this hearing is adjourned.

Mr. BARR. Thank you, Mr. Chairman

Mr. DEMARCO. Thank you, Mr. Chairman.

[Whereupon, at 12:00 p.m., the hearing was adjourned.]

A P P E N D I X

September 15, 2010

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON THE FUTURE OF HOUSING FINANCE: A PROGRESS UPDATE ON THE GSEs

SEPTEMBER 15, 2010

Good morning. We meet today to focus on the many strategies that Fannie Mae, Freddie Mac, the Federal Housing Finance Agency, and the Treasury Department have employed to limit capital infusions into the two housing enterprises. This hearing is also the sixth in a series that we have so far convened this Congress to examine the future of housing finance.

Two years have now passed since the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship under the procedures of the Housing and Economic Recovery Act of 2008. At the request of then-Treasury Secretary Henry Paulson, this law also provided the Treasury Department with emergency liquidity powers to support the enterprises.

To stabilize the U.S. housing markets, the Treasury Department has to date purchased or announced plans to buy just under $150 billion in the senior preferred stock of the enterprises combined. Moreover, according to a June report issued by the Federal Housing Finance Agency, the Treasury Department and the Federal Reserve have together purchased $1.36 trillion in the mortgage-backed securities of the two institutions.

At this hearing, we will explore the many approaches used to protect taxpayers and limit the losses of Fannie Mae and Freddie Mac. For example, in July the Federal Housing Finance Agency issued 64 subpoenas seeking documents related to private-label securities in which the two enterprises invested to determine if issuers of these securities are liable for enterprise losses.

Fannie Mae and Freddie Mac have also begun forcing underwriters of delinquent mortgages purchased or guaranteed by the enterprises to buy back the faulty loans if the loans violated the representations and warranties provided at the time of sale. As a result, the four largest commercial banks have already incurred losses of $9.8 billion on the loans they have repurchased or expect to repurchase from Fannie Mae and Freddie Mac.

During the height of the housing bubble, many players in our financial markets trusted what they bought, but they did not verify that the loans lived up to the promises contained in representations and warranties. During the height of the Cold War, however, Ronald Reagan taught us better. For the housing finance system to regain its footing, we need the players in the market not only to trust, but also to verify. Any new housing finance system must do both.

While the enterprises, their regulator, and the Treasury Department have acted to limit the losses of Fannie Mae and Freddie Mac in the aforementioned ways and through several other methods, we must also consider what more can and should be done to protect taxpayers both now and going forward. In particular, we must begin to think about approaches for recouping the taxpayers' money in the long run. We found a way to pay for the savings-and-loan crisis, and we can surely find a way to recover the costs associated with this crisis.

Some of my colleagues may try to use today's hearing as an opportunity for political grandstanding. They, however, need to remember that people who live in glass houses should not cast stones. Under the leadership of former Chairman Mike Oxley, we tried for several years to enact bipartisan legislation to improve the regulation and activities of Fannie Mae and Freddie Mac. Unfortunately, many Republicans in Congress and officials in the Bush Administration blocked these efforts. Their delays allowed the housing crisis to fester into an ulcer.

As we now consider the future of housing finance, we have a chance to proceed differently. The Dodd-Frank Wall Street Reform and Consumer Protection Act has already laid the foundation for change by adjusting securitization rules, better regulating rating agencies, modifying appraisal practices, and standardizing mortgage underwriting. The adoption of these "process" reforms should simplify the debates about altering the housing finance system.

In sum, today's hearing brings us one step closer to figuring out what needs to be done to improve our housing finance system. As I have previously said, my goals in these debates are to limit taxpayer risk and establish a more stable, long-term funding source to help hardworking, responsible middle class American families to buy a home with an affordable mortgage. I look forward to hearing the perspectives of our distinguished witnesses on these matters.

Statement by Ranking Member Spencer Bachus
Capital Markets Subcommittee Hearing On
"The Future of Housing Finance: A Progress Update on the GSEs"
Wednesday, September 15, 2010

Thank you, Chairman Kanjorski.

During the two years that Fannie Mae and Freddie Mac have been controlled by the Federal government, House Republicans have introduced a number of measures to immediately address the failures of the GSEs. We have released a detailed set of principles to protect taxpayers from further losses and future bailouts, and we have suggested ways to build a more sustainable housing finance system based on private capital. We offered amendment after amendment during the regulatory reform conference to end the GSE bailouts and to wind down Fannie Mae and Freddie Mac. The Democrats rejected every one.

The Democrats have offered nothing. They have done nothing. And they seem content to do nothing. 'Progress' hearings and planning conferences are not enough. Putting aside the human costs of 10 percent unemployment and 30 percent home price depreciation, the bailouts of Fannie Mae and Freddie Mac have cost taxpayers more than $150 billion. And it looks like hundreds of billions of dollars in additional losses are coming.

Mr. Chairman, instead of continuing the strategy of 'slow-walking' and postponing hard decisions, it is time for our leaders to take real action to end these bailouts. The Democrats on this committee have had two years to act, and now Chairman Frank is claiming that talks of ending this congressional session a week earlier than scheduled will prevent any opportunity for legislative action to address Fannie and Freddie. This is yet another ridiculous excuse for delaying reform, which is why I again call on the Chairman to hold a legislative hearing on Representative Hensarling's GSE bill and act quickly to protect the taxpayers.

Without leadership, this problem cannot be solved. Republicans are ready to lead. I yield back the balance of my time.

EMBARGOED UNTIL DELIVERY

Assistant Secretary for Financial Institutions Michael S. Barr
Written Testimony
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
House Committee on Financial Services
September 15, 2010

Chairman Kanjorski, Ranking Member Garrett, and members of the Subcommittee, thank you for the opportunity to testify today about housing finance reform and the progress made since the placement of Fannie Mae and Freddie Mac (the GSEs) into conservatorship in September 2008.

Before I talk about the state of the GSEs in conservatorship, it is important to remember how we got here.

Events Leading to Conservatorship

The GSEs were allowed to operate under an unacceptable "heads I win, tails you lose" system. They enjoyed the benefits of the perception of government support. They had inadequate oversight and inadequate capital, and the market did not instill appropriate discipline at Fannie Mae and Freddie Mac because the market assumed that they had a government backstop.

The events that led the last Administration to need to put the GSEs into conservatorship was symptomatic of a range of regulatory, management, and oversight failures throughout our financial system. As the private, unregulated mortgage market grew, and market players began to loosen credit standards to pursue ever-riskier business in a booming market, the GSEs, which initially stuck to their core business of guaranteeing well-underwritten loans, saw their market shares fall precipitously. Driven by profit motives and an effort to regain market share, the GSEs sought, and were permitted, to guarantee and to purchase riskier mortgages without holding adequate capital or employing appropriate risk management techniques. These moves left Fannie Mae and Freddie Mac dangerously exposed when the housing bubble began to burst.

As a result of the substantial deterioration in the housing market and Fannie Mae and Freddie Mac's growing inability to raise new capital, FHFA placed the GSEs into conservatorship on September 6, 2008 under the authority granted to them by Congress under the bi-partisan Housing Economic Recovery Act of 2008 (HERA). Under HERA authority, Treasury agreed to provide financial support to the GSEs through the establishment of Preferred Stock Purchase Agreements (PSPAs). The goal of the PSPAs and subsequent amendments was to preserve overall stability in financial markets and to allow the GSEs to continue to provide liquidity in the secondary market. The PSPAs ensured that the GSEs would be able to meet their obligations and continue to support the housing finance system, which was then on the verge of collapse.

Fannie Mae and Freddie Mac Under Conservatorship

Since September 2008, FHFA, in its role as conservator, has acted carefully to help ensure that Fannie Mae and Freddie Mac's assets are conserved while continuing to play a critical role in

making mortgage credit available. By facilitating the flow of credit for responsibly underwritten mortgages, the GSEs have served as a source of stability for the housing market and enabled millions of Americans to continue to have the ability to take out a new mortgage or refinance.

Important progress has been made towards stabilizing the housing market; however, this critical sector of the economy remains fragile. Private capital has not yet returned to the market, and the GSEs and the government continue to play an unfortunately outsized, though necessary, role in ensuring the availability of mortgage credit. Roughly 95% of the mortgages originated in this country are currently financed through either the GSEs or Ginnie Mae (GNMA), via the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), and the Department of Agriculture (USDA). Put simply, without the GSEs and GNMA, there would be no functioning mortgage market today.

The new loans being guaranteed by the GSEs are not contributing in any material way to the losses the GSEs face. Quite the contrary. In fact, the FHFA Conservator's Report released on August 26th shows that it is the GSEs' old book of loans, those acquired before conservatorship, which are the overwhelming source of losses. The losses that the GSEs are continuing to report today are the result of delinquencies and defaults on loans that were originated and guaranteed in 2006, 2007, and 2008. Those loans account for over 70% of all credit losses in the single-family guarantee book, with the balance of realized losses almost entirely coming from 2005 and earlier. Less than 1% of losses have come from loans originated in 2009 and 2010. The conservatorship is working in keeping GSE activities within prudent bounds.

Another myth that the FHFA Conservators' Report dispels is the perception that the retained portfolios were the main source of the GSEs' problems. Early on, large losses were recorded on the securities held in the retained portfolios as the secondary market prices for those securities declined sharply at the onset of the crisis. However, the retained portfolios have not been the largest drivers of loss over time. The bulk of the cumulative losses (73%) have occurred in the single-family guarantee book.

FHFA, acting as conservator, has carefully sought to ensure that the GSEs do not assume undue incremental risk to the taxpayer through their new loans. As a result, the credit quality and risk profile of the post-conservatorship book of business of the GSEs has dramatically improved compared to pre-conservatorship:

- Guarantee fees have been increased and the GSEs have risk-adjusted their pricing.
- Alt-A loans now account for 0% of the new book of business since conservatorship; this compares to 22% for Fannie Mae in 2006 and 18% for Freddie Mac in 2006.
- Low credit (<620 FICO scores) purchases are now only 1% as compared to 5% for both Fannie Mae and Freddie Mac from 2001-2008.
- Average FICO scores of new business improved from roughly 715 in 2006 to 750 or more for both Fannie Mae and Freddie Mac in 2010.
- While new mortgages with loan-to-value ratios greater than 90% are slightly up in 2010 from 2009, much of this is related to the Home Affordability Refinance Program (HARP) for GSE loans, which is a loss mitigation mechanism that reduces the risk of default and any potential losses at the GSEs.

The new, higher credit quality book of business from 2009 has seen substantially lower cumulative default rates when adjusted for loan age:

- 2009 cumulative defaults for Freddie Mac and Fannie Mae were 1.1% and 1.2%, respectively, in the loans' first 18 months, as compared to cumulative default rates for the first 18 months for loans originated in 2007, which were 22.3% and 28.7% for Freddie Mac and Fannie Mae, respectively. This performance is better than even earlier vintages (pre-2005).

The resulting quality of the loan book has made a huge difference. As I indicated previously, less than 1% of the post-conservatorship credit losses are a result of loans guaranteed in 2009 and 2010.

The country is unfortunately stuck with the consequences of the poor credit choices the GSEs made prior to conservatorship. No one can undo those decisions. Some suggest that taking time to get reform right will expose taxpayers to even greater losses at Fannie Mae and Freddie Mac. That is simply not true. The losses that Fannie Mae and Freddie Mac face are the result of mistakes made in the years leading up to the crisis, not the consequences of actions by the GSEs since 2008. There is nothing we can do to decrease the obligations Fannie Mae and Freddie Mac incurred ahead of this crisis; those exposures are already baked in. Given this unfortunate truth, the most responsible course is to minimize the risk that those losses get worse.

The GSEs today are working hard to apply loss mitigation techniques through loan modifications and foreclosure prevention. They are also managing their foreclosure and real estate disposition process to recover the value on those exposures. The GSEs are continuing to promote overall stability in the housing finance system. Housing market stability is the most important source of loss mitigation for the GSEs. If there is another downturn in the housing market, delinquencies and defaults could rise even further as performing loans from today would become delinquent.

Housing Finance Reform Process

While we continue to bring stability to the mortgage market, we are also hard at work on reform. It is not tenable to leave in place the system that we have today. The Administration is committed to delivering a comprehensive proposal for reform of Fannie Mae, Freddie Mac, and our broader system of housing finance to Congress by January 2011, as called for under the Dodd-Frank Act. Our proposal will call for fundamental change.

Congress began the process of reform with the passage of HERA in 2008. The prior Administration continued the path of reform when it placed Fannie Mae and Freddie Mac into conservatorship in September 2008. That action arrested the sharp deterioration of market confidence in these two institutions that was intensifying the broader financial crisis. And it finally put an end to the harmful practices that had contributed to the firms' failures.

This Administration put in place a housing market stability plan soon after coming into office. The plan included continuing to ensure that the GSEs have the necessary financial resources to

meet their obligations on an ongoing basis, continuing to buy (alongside the Federal Reserve) agency mortgage-backed securities, and initiating foreclosure prevention plans, a first-time homebuyer tax credit, and state and local housing agency initiatives. These programs have helped to stabilize the market.

The next phase of reform came with the passage of the Dodd-Frank Act, which improves the regulation of lending standards so that the mistakes of the past are not repeated in the housing market in the future. The Dodd-Frank Act includes fundamental reform of mortgage market rules, including ability-to-pay requirements and risk retention standards for mortgages. This new Act will help to ensure that homeowners are not sold products that they cannot afford and that originators retain skin in the game when they originate risky mortgages. These necessary reforms are critical steps, and more remains to be done.

The Administration is committed to maintaining an open dialogue with the public, Congress, and other stakeholders as we all work together towards responsible reform. It is imperative that we get all of the best ideas, representing a wide range of views, onto the table and debated in a constructive fashion.

To that end, earlier this year the Administration began outreach efforts to key stakeholder groups and policy experts to assess existing GSE reform proposals. In April, Treasury and the Depart of Housing and Urban Development (HUD) posted seven questions for public comment, to which we received over 300 responses from a broad cross-section of stakeholders. There was a wide range of views represented in the comments; some argued for removing government support for the market all together while others argued to leave the system broadly in place as it is today. Some argued that we provided too much support for housing while others emphasized that we provided too little support for affordable rental options.

In August, Treasury and HUD hosted a Conference on the Future of Housing Finance in which we heard a wide range of perspectives from people with substantial expertise, ranging from academic experts, consumer and community organizations, industry groups, market participants, Congressional staff, and other stakeholders. We had a robust, constructive, honest debate. We are looking forward to continuing our outreach efforts over the coming weeks and months and the Administration is committed to working together with Members from both sides of the aisle as we move forward together towards reform of our nation's housing finance system.

Objectives and Goals for Housing Finance Reform

Earlier this year, Secretary Geithner and Secretary Donovan testified to the full committee and laid out, as a guide, some important objectives for reform and characteristics of systems that meet those goals. They are worth re-iterating. A stable, well-functioning market should achieve the following objectives:

- *Widely available mortgage credit.* Mortgage credit should be available and distributed on an efficient basis to a wide range of borrowers, including those with low and moderate incomes, to support the purchase of homes they can afford. This credit should be

available even when markets may be under stress, at rates that are not excessively volatile.

- *Housing affordability.* A well-functioning housing market should provide affordable housing options, both ownership and rental, for low- and moderate-income households. The government has a role in promoting the development and occupancy of affordable single and multifamily residences for these families.

- *Consumer protection.* Consumers should have access to mortgage products that are easily understood, such as the 30-year fixed rate mortgage and conventional variable rate mortgages with straightforward terms and pricing. Effective consumer financial protection should keep unfair, abusive or deceptive practices out of the marketplace and help to ensure that consumers have the information they need about the costs, terms, and conditions of their mortgages.

- *Financial stability.* The housing finance system should distribute the credit and interest rate risk that results from mortgage lending in an efficient and transparent manner that minimizes risk to the broader financial and economic system and does not generate excess volatility. The mortgage finance system should not contribute to systemic risk or overly increase interconnectedness from the failure of any one institution.

The housing finance system could be redesigned in a variety of ways to meet these objectives. However, the Administration believes that any system that achieves these goals should be characterized by:

- *Alignment of incentives.* A well functioning mortgage finance system should align incentives for all actors – issuers, originators, brokers, ratings agencies and insurers – so that mortgages are originated and securitized with the goal of long-term viability rather than short term gains.

- *Avoidance of privatized gains funded by public losses.* If there is government support provided, such as a guarantee, it should earn an appropriate return for taxpayers and ensure that private sector gains and profits do not come at the expense of public losses. Moreover, if government support is provided, the role and risks assumed must be clear and transparent to all market participants and the American people.

- *Strong regulation.* A strong regulatory regime should (i) ensure capital adequacy throughout the mortgage finance chain, (ii) enforce strict underwriting standards and (iii) protect borrowers from unfair, abusive or deceptive practices. Regulators should have the ability and incentive to identify and proactively respond to problems that may develop in the mortgage finance system.

- *Standardization.* Standardization of mortgage products improves transparency and efficiency and should provide a sound basis in a reformed system for securitization that increases liquidity, helps to reduce rates for borrowers and promotes financial stability. The market should also have room for innovations to develop new products which can bring benefits for both lenders and borrowers.

- *Support for affordable single and multifamily housing.* Government support for multifamily housing is important and should continue in a future housing finance system to ensure that consumers have access to affordable rental options. The housing finance system must also support affordable and sustainable ownership options.

- *Diversified investor base and sources of funding.* Through securitization and other forms of intermediation, a well functioning mortgage finance system should be able to draw efficiently upon a wide variety of sources of capital and investment both to lower costs and to diversify risk.

- *Accurate and transparent pricing.* If government guarantees are provided, they should be priced appropriately to reflect risks across the instruments guaranteed. If there is cross-subsidization in the housing finance system, care must be exercised to insure that it is transparent and fully consistent with the appropriate pricing of the guarantee and at a minimal cost to the American taxpayer.

- *Secondary market liquidity.* Today, the U.S. housing finance market is one of the most liquid markets in the world, and benefits from certain innovations like the "to be announced" (or TBA) market. This liquidity has provided a variety of benefits to both borrowers and lenders, including lower borrowing costs, the ability to "lock in" a mortgage rate prior to completing the purchase of a home, flexibility in refinancing, the ability to pre-pay a mortgage at the borrowers' discretion and risk mitigation. This liquidity also further supports the goal of having well diversified sources of mortgage funding.

- *Clear mandates.* Institutions that have government support, charters or mandates should have clear goals and objectives. Affordable housing mandates and specific policy directives should be pursued directly and avoid commingling in general mandates, which are susceptible to distortion.

Transition

There are several important challenges that we will face in transitioning from our current housing finance system to a new one. The GSEs and the government are currently playing an outsized role in the housing finance market. Today they are practically the only game in town. This situation is neither sustainable nor desirable, but if the GSEs were to suddenly exit the market the stability of the housing market would be undermined. Mortgage rates would skyrocket and most homeowners would be unable to obtain mortgage credit. The transition to a new system must occur in an orderly fashion that is minimally disruptive to the market. Enabling households to maintain access to credit at reasonable rates throughout the transition is essential to our housing and broader economic recovery.

We also recognize that financial markets and the public are depending on the ability of the GSEs in their current form to perform on their obligations. The government is committed to ensuring that the GSEs have sufficient capital to perform under any guarantees issued now or in the future and the ability to meet any debt obligations. The Administration will take care not to pursue

policies or reforms that would threaten to disrupt the function or liquidity of GSE securities or the ability of the GSEs to meet their obligations.

Designing an effective transition mechanism that ensures the GSEs' financial obligations are met and borrowers have continuous access to mortgage credit is critical to an effective reform plan.

Conclusion

The FHFA has carefully overseen the GSEs since they were placed into conservatorship by the Bush Administration in 2008, under the HERA legislative authority, to conserve their assets and ensure that Americans are still able to access the market for mortgage credit.

Fixing our nation's housing finance system is critically important to our economy and to our country's future. The housing market supports millions of jobs for Americans in construction, manufacturing, real estate, finance, and other industries. Moreover, for the majority of Americans homeowners, their house is their largest financial asset and the single largest purchase that they will make in their lifetimes. Housing is equally important to the tens of millions of families who choose to rent; their quality of life is directly affected by access to affordable, quality rental housing in good neighborhoods.

A new system must be designed to ensure that our housing finance system is more stable, consumers are protected, sustainable credit is widely accessible and important housing policies, such as affordable housing for low- and moderate-income families, are administered effectively and efficiently.

After reform, the GSEs will not exist in the same form as they did in the past. Private gains will no longer by subsidized by public losses, capital and underwriting standards will be appropriate, consumer protection will be strengthened and excessive risk-taking will be restrained.

Statement of

Edward J. DeMarco, Acting Director

Federal Housing Finance Agency

Before the U.S. House of Representatives
Subcommittee on Capital Markets, Insurance, and
Government-Sponsored Enterprises

The Future of Housing Finance: A Progress Update on the GSEs

September 15, 2010

Statement of Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Before the U.S. House of Representatives
Subcommittee on Capital Markets, Insurance, and
Government-Sponsored Enterprises

The Future of Housing Finance: A Progress Update on the GSEs

September 15, 2010

Chairman Kanjorski, Ranking Member Garrett, and members of the Subcommittee, thank you for inviting me to speak on the conservatorships of Fannie Mae and Freddie Mac (Enterprises). Given the enormous losses at those institutions and exceptional market reliance over the past three years on all of the housing government-sponsored enterprises (GSE), there has been considerable discussion about their role, performance, and future. I appreciate the opportunity to provide you with information on the strategies that the Federal Housing Finance Agency (FHFA) is pursuing to limit the need for future capital infusions into Fannie Mae and Freddie Mac from the U.S Department of Treasury (Treasury). I hope that my comments will help to build the foundation for the upcoming Congressional consideration of the future structure of the housing finance system.

Today I will highlight:

1) the status of the conservatorships;
2) the current condition of the Enterprises;
3) projected losses by the Enterprises; and
4) considerations for the future of the housing finance system.

Conservatorship Status

The Enterprises have been operating in conservatorships for two years now, since September 2008. The statutory purpose of conservatorship is to preserve and conserve each company's assets and put them in a sound and solvent condition. The goals of conservatorship are to help restore confidence in the companies, enhance their capacity to fulfill their mission, and mitigate the systemic risk that contributed directly to instability in financial markets. The Enterprises are responsible for normal business activities and day-to-day operations, subject to FHFA supervision. FHFA exercises oversight as safety and soundness regulator, and, as conservator, holds the powers of the management, board, and shareholders of each Enterprise.

The Enterprises' substantial market presence over the last two years demonstrates that they continue to support housing finance in this country despite their financial condition. However, neither company would be capable of serving the mortgage market today without the ongoing financial support provided by the Treasury.

A principal focus of the conservatorships is to maintain the Enterprises' secondary mortgage market role until legislation produces a resolution of their future. FHFA's oversight is also directed toward minimizing losses, limiting risk exposure, and ensuring the Enterprises price their services to adequately address their costs and risk.

Minimizing Losses

FHFA recognizes that losses by the Enterprises translate into costs for the taxpayers, and we are doing everything in our power to minimize future losses. The Enterprises' single-family credit guarantee business has been the largest contributor to the charges against their capital and the corollary need to draw on the Treasury. Losses in this segment of the Enterprises' activities accounts for $166 billion of the total $226 billion in losses since year-end 2007, representing 73 percent of charges against capital over that period. The Treasury draw of $148 billion is less than the Enterprises' aggregate losses because the initial losses to the companies of $78 billion were borne by the Enterprises' shareholders.

To stem additional losses, all mitigation measures are critical. Loan modifications are often a lower-cost resolution to a delinquent mortgage than foreclosure. Similarly, providing opportunities for borrowers to refinance into a more affordable mortgage helps mitigate future credit losses. Since the Enterprises own or guarantee about half the mortgages in the country, efforts that provide stability to borrowers also serve to restore stability to housing markets, which directly benefits the Enterprises by reducing credit exposure.

The Enterprises' foreclosure prevention efforts—including loan modification and refinancing programs as well as short sales and deeds in lieu of foreclosure—also fulfill the Emergency Economic Stabilization Act of 2008 mandate that FHFA "maximize assistance to homeowners," while minimizing losses to the Enterprises. FHFA reports monthly to Congress on the full range of Enterprise foreclosure prevention activities through the *Foreclosure Prevention / Federal Property Manager's Report*, the latest edition of which can be found on the agency's website at http://www.fhfa.gov/webfiles/16687/2q10fprfinal.pdf .

Over the 12 months ending June 30, 2010, the Enterprises permanently modified more than 400,000 mortgages, including approximately 225,000 permanent Home Affordable Modification Program (HAMP) modifications, and completed over 185,000 repayment plans and more than 50,000 forbearance plans to help homeowners stay in their homes. The Enterprises have helped other homeowners avoid foreclosure by completing more than 90,000 short sales and deeds in lieu of foreclosure.

In fact, since the first full quarter of the conservatorships in October 2008, more than one million (1,013,669) homeowners have received assistance from the Enterprises in the form of loan modifications, repayment plans, forbearance plans, and other foreclosure alternatives. During this same time period, nearly six million families have been able to

take advantage of refinance opportunities, lowering their interest rates or switching to safer lending products backed by the Enterprises.

Given the extent of the Enterprises' loss mitigation options for borrowers, I am very supportive of their efforts to discourage borrowers who can otherwise make their mortgage payments from walking away from their obligations. Both FHFA and the Enterprises are concerned about borrowers who have an ability to pay but who choose to default on their mortgages. So-called "strategic defaults" not only result in increased losses for taxpayers, but also have a deleterious effect on neighborhoods.

I have also been clear that the Enterprises should actively enforce lender compliance with their contractual obligations, which includes pursuing repurchases from those institutions whose loans did not meet the Enterprises' underwriting and eligibility guidelines. Lenders are obligated by the representations and warranties they made to the Enterprises to repurchase loans that did not meet contractual selling requirements.

Although the Enterprises have made progress in enforcing lenders' representation and warranty obligations, outstanding repurchase requests continue to be of concern to FHFA. During 2009, the Enterprises' lenders repurchased $8.7 billion of single-family mortgages, and slightly higher volumes are being repurchased in 2010. However, as of the end of the second quarter 2010, Fannie Mae had $4.7 billion in outstanding repurchase requests, and Freddie Mac had $6.4 billion in outstanding repurchase requests.

More than one-third of these repurchase requests have been outstanding for more than 90 days. Many of the lenders with aged, outstanding repurchase requests are among the largest financial institutions in the United States. The delays by lenders in repurchasing these loans are a significant concern to FHFA. There are ongoing discussions between the Enterprises and lenders to reach a workable solution. If these discussions do not yield reasonable outcomes soon, FHFA may look to its supervisory and conservatorship authorities provided under the statute to resolve the situation.

Separately, in July FHFA issued 64 subpoenas as part of an effort to determine whether other firms have legal responsibility for some of the Enterprises' losses on private-label mortgage-backed securities (MBS), which, to date, have been borne by the Enterprises and taxpayers. As we receive information from these parties, we will look to determine whether misrepresentations, breaches of warranties, or other acts or omissions by private-label MBS counterparties require repurchase of loans underlying the securities. Because the Enterprises themselves had difficulty obtaining the loan documents needed to perform this assessment, FHFA issued subpoenas for various loan files and transaction documents to trustees and servicers controlling or holding the documentation. FHFA will determine whether private-label MBS issuers and others are liable to the Enterprises for certain losses they have suffered on private-label MBS and, when appropriate, will seek to recover those losses.

Another key counterparty for the Enterprises is the mortgage insurance industry, which offers a critical form of credit enhancement. Similar to other mortgage market

participants, mortgage insurers have sustained substantial losses. While FHFA has concerns and is carefully monitoring the situation, several of the largest mortgage insurers have raised new capital this year, one new company entered the market, and all have worked closely with their state regulators to take steps necessary to continue to pay claims. To date, mortgage insurers, with one exception, have paid all agreed-to claims owed. The only company that has not had sufficient capital to make full payments has committed to deferred payments to satisfy its obligations in the future. In contrast to the mortgage insurers, the bond insurers that wrap non-agency MBS are in very poor financial condition, and their losses may ultimately jeopardize their ability to pay future claims. Many of these companies have been subject to rating agency downgrades and state regulatory actions, and two have filed for bankruptcy.

Limiting Risk Exposure

In February, I communicated to Congress my position that, in conservatorship, the Enterprises will be limited to continuing their existing core business activities and taking actions necessary to advance the goals of conservatorship. I have not authorized any new products due to the operational challenges inherent in new product offerings and the need for the Enterprises to devote full attention to loss mitigation activities and remediation of internal weaknesses. This type of limitation on new business activities is consistent with standard regulatory practice for addressing companies that are financially troubled. This approach is even more pertinent for the Enterprises, given their uncertain future and reliance on taxpayer funds.

Rather than developing and offering new products, the Enterprises must maintain their focus on mitigating credit losses and remediating internal operational weaknesses while employing prudent underwriting standards and guaranteeing proven mortgage products. Since the end of 2008, both Fannie Mae and Freddie Mac have mostly eliminated their purchases of Alt-A and interest-only loans, two of the poorest performing mortgage products in the market. The Enterprises' withdrawal from this business is significant because interest-only loans previously purchased by the Enterprises have serious delinquency rates of more than 18 percent, and Alt-A loans have serious delinquency rates of more than 12 percent. These products, which may be appropriate in limited circumstances, have produced substantial losses for the Enterprises.

Figure 1: Characteristics of Single-Family Mortgage Acquisitions

Percent of New Single-Family Business[1]
(Categories overlap and are not additive)

	Fannie Mae				YTD	Freddie Mac				YTD
	2006	2007	2008	2009	Jun '10	2006	2007	2008	2009	Jun '10
Alt-A[2]	22%	17%	3%	0%	0%	18%	22%	7%	0%	1%
Interest-Only	15%	15%	6%	1%	2%	17%	21%	6%	0%	0%
Credit Score <620	6%	6%	3%	0%	1%	5%	6%	3%	1%	1%
LTV >90 Percent	10%	16%	10%	4%	8%	6%	11%	9%	4%	9%
Average LTV	73%	75%	72%	67%	69%	73%	74%	71%	67%	70%
Average Credit Score	716	716	738	761	758	720	718	734	756	750

Notes:
[1] New business is defined as issuance of MBS plus purchases of whole loans and does not include purchases of mortgage-related securities.
[2] Refer to sources for Alt-A definitions. Freddie Mac's year-to-date figures include Alt-A purchases of $1.5 billion due to a long-term standby commitment termination and a subsequent PC issuance. There was no change to the Alt-A exposure on these mortgages as a result of these transactions.

Sources:
Enterprises' Forms 10-K, credit supplements to SEC disclosures, and management reports.

Pricing to Cover Costs

Another important element of conserving and preserving the Enterprises' assets is that they are pricing to cover their expected costs by setting guarantee fees at appropriate levels. FHFA published its latest study on the Enterprises guarantee fees in July. The report can be found on FHFA's website at http://www.fhfa.gov/webfiles/15918/GFEEJuly2010F.pdf (and more detailed information also can be found there). It is clear that the industry as a whole underpriced mortgage credit risk significantly over the past decade, when credit losses were at historic lows and house prices appreciated rapidly.

Each Enterprise initiated changes in their national guarantee fee pricing in 2008 to correct for the underpricing of credit risk in prior years and reflect the real risks of backing mortgages in an environment of house price decline. In light of increasing mortgage delinquencies and forecasts for worsening house prices, the Enterprises updated their costing models several times in 2009, as they had in 2008, to reflect changes in the market environment as well as borrower risk factors such as loan-to-value (LTV) ratios and credit scores

With the price adjustments just described, the average total guarantee fee charged by Fannie Mae and Freddie Mac on most single-family mortgages acquired on a flow basis in 2009 was sufficient to cover model lifetime estimated costs, including a return on economic capital at a rate commensurate with the interest rate on Treasury-held senior preferred stock. The exception is pricing on Home Affordable Refinance Program (HARP) loans, which falls short of covering expected costs; however, HARP loans lower

Enterprise credit risk and have improved pricing relative to the existing Enterprise loans they replace.

Condition of the Enterprises

To ensure that the public has access to accurate and up-to-date information about the Enterprises' business activities, performance, and financial condition, FHFA initiated issuance of a quarterly report, the *Conservator's Report on the Enterprises Financial Condition*. This report is available on the agency website at http://www.fhfa.gov/webfiles/16592/ConservatorsRpt82610.pdf. Publishing this quarterly report fulfills the pledge I made to this Subcommittee in late May to expand public information on Enterprise performance.

Let me highlight for you some of the findings presented in the report. First, as noted earlier, at the end of 2007, the Enterprises had $71 billion of combined capital. From the end of 2007 through the second quarter of 2010, charges against capital totaled $226 billion. Of the three business segments – Investments and Capital Markets, Single-Family Credit Guarantee, and Multifamily – the largest contributor to charges against capital to date has been the Single-Family Credit Guarantee segment, accounting for $166 billion, or 73 percent, of combined capital reductions over that period.

The losses from the single family credit guarantee business, particularly mortgages purchased by the Enterprises in 2006 and 2007 and originated in California, Arizona, Florida, and Nevada, have required the Enterprises to build their loan loss reserves. House price declines and prolonged economic weakness, especially the rise in unemployment, have led to higher credit losses overall.

During conservatorship, the Enterprises have made significant progress in improving the quality of new mortgages purchased. In addition to eliminating riskier types of products, the Enterprises have tightened their underwriting guidelines and reduced risk layering. New Enterprise mortgage guarantees have been for borrowers with higher credit scores and loans with lower LTV ratios, two factors that affect expected default rates. Due to the focus on improved purchase quality and underwriting standards, the loans that the Enterprises purchased in 2009 and 2010 have had much lower rates of delinquency in their initial months of repayment than did mortgages originated between 2006 and 2008.

The Enterprises have also suffered losses on their investments, accounting for $21 billion, or 9 percent, of charges against capital from the end of 2007 through the second quarter of 2010. These losses stemmed from impairments of private-label MBS, fair-value losses on securities, and fair-value losses on derivatives used for hedging interest rate risk.

Projected Losses

When I appeared before this Subcommittee in late May, I was asked how much more money the Enterprises may draw under the Preferred Stock Purchase Agreements (PSPAs). At that time, I said that even across most severe stress scenarios modeled by

the Enterprises, combined Treasury draws appeared to be less than $400 billion. My answer at that time was based upon FHFA's review of Enterprise-generated loss projections derived from each company's own internal forecasts that relied upon each company's own assumptions and models.

To provide Congress and the public with a more defined sense of the Enterprises' future draws under the PSPAs, FHFA is in the process of working with the Enterprises to develop a sample of forward looking financial projections for public release. Similar to the Supervisory Capital Assessment Program (SCAP)[1], conducted by the federal banking agencies last year, the results of this exercise will not be forecasts or expected outcomes, but rather modeled projections in response to "what if" exercises that utilize various scenarios.

As I just noted, the Enterprises undertake various financial projection activities for their own purposes and to provide information to FHFA. While these Enterprise-generated exercises are useful, given that each Enterprise models various scenarios in a different manner, it is difficult to compare results between the Enterprises. With that in mind, one of the main goals of FHFA in presenting Enterprise financial projections to the public is to present the results in a comparable way. In my view that would be more useful than presenting independent modeling results from each company that are more difficult to interpret and compare.

Work is underway to develop projections that are comparable between the Enterprises. There are some differences between the Enterprise-generated results and the results from the FHFA-directed exercises, but consistent with my previous statements, even under severe stress scenarios, Treasury draws remain under $400 billion. In less severe stress scenarios, losses are much less than that. When this preliminary work is finalized in the coming weeks, we will make the results and the details surrounding the projections available to the public. FHFA will periodically update and refine these projections and will report such updates as part of the quarterly conservator report.

Future of the Housing Finance System

I would like to turn now to the future of housing finance. As I stated in my testimony in May before this Subcommittee, the main purpose in addressing housing finance reform should be to promote the efficient provision of credit to finance mortgages for single-family and multifamily housing. Legislation is needed to restructure and strengthen our nation's housing finance system and to resolve the Enterprise conservatorships.

Ensuring an orderly transition will be essential to avoid disrupting the housing finance system at this critical juncture, when markets are still very fragile. It is also important to

[1] The Supervisory Capital Assessment Program stress tests were conducted by the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency to assess the capital adequacy of U.S. domestic bank holding companies with assets above $100 billion.

consider how the recent enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act will address certain deficiencies and make substantial changes to some long-standing policies and practices. The new law may affect the products offered to consumers and the manner in which financial institutions engage in various lending activities, as a result of new risk retention and borrower protection standards.

Currently all conventional mortgages purchased by Fannie Mae and Freddie Mac benefit from the financial support agreements with Treasury. In the future design of our housing finance system, careful consideration should be given to targeting subsidies to specific groups that lawmakers determine warrant that benefit. For example, the explicit government guarantees that the Federal Housing Administration and Veterans Administration provide reflect policymakers' judgment as to the public benefits from targeting certain borrowers with those programs. There may be other categories of borrowers for whom a direct form of government subsidy is appropriate, as determined by Congress.

It is reasonable to question whether all conventional mortgages warrant a government guarantee. Recently there has been a growing call for some form of explicit federal insurance to be a part of the housing finance system of the future. While such an outcome has certain merit and some attractive features, I believe that the potential costs and risks associated with such a framework have not yet been fully explored. To put it simply, replacing the Enterprises' "implicit" guarantee with an explicit one does not resolve all the shortcomings and inherent conflicts in that model, and it may produce its own problems. I offer three observations in that regard for your consideration.

First, the presumption behind the need for an explicit federal guarantee is that the market either cannot evaluate and price the tail risk of mortgage default, at least at any price that most would consider "reasonable," or cannot manage that amount of mortgage credit risk on its own. But we might ask whether there is reason to believe that the government will do better? If the government backstop is underpriced, taxpayers eventually may foot the bill again.

Second, if the government provides explicit credit support for the vast majority of mortgages in this country, it would likely want a say with regard to the allocation or pricing of mortgage credit for particular groups or geographic areas. The potential distortion of the pricing of credit risk from such government involvement risks further taxpayer involvement if things do not work out as hoped.

Third, regardless of any particular government allocation or pricing initiatives, explicit credit support for all but a small portion of mortgages, on top of the existing tax deductibility of mortgage interest, would further direct our nation's investment dollars toward housing. A task for lawmakers is to weigh such incentives against the alternative uses of such funds.

I would be remiss if I did not mention the Federal Home Loan Banks (FHLBanks), which factor into any discussion of the future role of housing GSEs. FHLBank assets have been

on a decline since September 2008 and now stand at $937 billion. Over that same time period, advance activity has steadily declined. As of June of this year, advances were at $540 billion, 46 percent lower than record levels reached in October 2008. While the decline appears to be slowing, it represents a stark contrast to the 2007 response to the liquidity crisis, when the FHLBanks increased advances to members by 58 percent in 15 months. The steady decline since that time is primarily a reflection of member balance sheets, which are now characterized by strong deposit growth and tepid loan demand.

Although the credit quality of mortgages held by the FHLBanks is much better than the industry average, the FHLBanks have pulled back from mortgage purchase activity as well. As of June 2010, the FHLBanks held $66.8 billion in mortgage loans, which represents only 7 percent of their combined assets. The decline results from both the reduction in new activity and an increase in prepayments. Overall, the cutback in mortgage holding reflects an assessment by many FHLBanks that the returns associated with mortgages are insufficient to outweigh the associated funding and hedging risks.

Ten of the 12 FHLBanks reported a net profit in the second quarter of 2010, and the 12 collectively reported a net income of $326.4 million. This figure is nearly unchanged from the first quarter of 2010, as credit impairments on private-label MBS were offset by higher net interest income and lower mark-to-market losses. However, the FHLBanks have not escaped without some financial adversity associated with the deterioration of mortgage markets. As of June 30, 2010, the FHLBanks held private-label MBS equivalent to 4.9 percent of assets. To date, shortfalls of principal or interest have occurred on only 1 percent of the number of private-label MBS held by the FHLBanks. Still, collectively the System has taken $3.3 billion in credit-related impairments on these investments and recorded an additional $10.8 billion in noncredit-related, other-than-temporary-impairments.

Three of the FHLBanks that have recognized other-than-temporary-impairments on their private-label MBS investments—Pittsburgh, Seattle, and San Francisco—have filed complaints in state courts that allege fraud, misrepresentation, and violations of state and federal securities laws in connection with their purchase of certain securities. The complaints seek rescission of the purchase transactions and the defendants' repurchase of the securities for the original purchase price. The aggregate original principal amount of the securities in question is approximately $20 billion.

Before concluding, I would like to raise one more important safety and soundness matter concerning the FHLBanks. Based on recent trends, it appears that the FHLBanks will fulfill their obligation within the next 18 months or so to pay a portion of the interest on bonds issued by the Resolution Funding Corporation (REFCORP) as part of the savings and loan clean-up of 1989. Today, each FHLBank's REFCORP obligation is 20 percent of its net earnings.

In the 20 years in which the FHLBanks have had this obligation, their retained earnings, a key component of their capital structure, have been less than would otherwise have been the case. With this obligation, most or all FHLBanks have not rebuilt or maintained

retained earnings adequate to the size and risks of their current business. As their safety and soundness regulator, this is of concern to FHFA. The fulfillment of the REFCORP obligation presents an opportunity to help the FHLBanks work through current financial problems and be better prepared for the future by accelerating the rate at which the FHLBanks build their retained earnings. I have asked FHFA staff to begin work on an approach that would achieve that end when the REFCORP obligations are satisfied.

I would be happy to provide additional information to the Subcommittee regarding the activities and performance of the housing GSEs and look forward to working with the Administration and Congress on legislative action to restructure the housing finance system, including an ultimate resolution of the Enterprises. I recognize you have difficult and important decisions to make in the coming months, and FHFA looks forward to offering technical assistance to both the Administration and Congress in considering policy alternatives.

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

November 8, 2010

The Honorable Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets
Insurance and Government Sponsored Enterprises
Financial Services Committee
U.S. House of Representatives
2188 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Kanjorski:

After the September 15, 2010, hearing on the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises on "The Future of Housing Finance: A Progress Update on the GSEs," your office sent us several questions for the record. I am happy to provide responses to those questions, below.

Q. Given the reservations raised by FHFA in the proposed rule on manufactured housing, has FHFA sought to engage the manufactured housing industry to cooperatively develop a secondary lending program for manufactured home loans secured by personal property that could overcome these concerns and still meet the overarching goals of serving the entire manufactured housing market as outlined by Congress?

A. In the Housing and Economic Recovery Act of 2008, Congress provided that in determining whether an Enterprise has complied with the duty to serve very low-, low-, and moderate-income families in connection with manufactured housing, FHFA may consider loans secured by personal property. FHFA has reached out to representatives of the manufactured housing industry extensively in the course of its rulemaking.

In addition to hosting a series of meetings with the Manufactured Housing Association for Regulatory Reform and the Manufactured Housing Institute in Washington, DC, FHFA has traveled to three states – Texas, Tennessee, and Wisconsin – to gain input directly from manufactured housing practitioners. These included meetings with Palm Harbor Homes, CountryPlace Mortgage, Clayton Homes, Inc., 21st Mortgage Corporation, Vanderbilt Mortgage and Finance, Inc., Liberty Homes, Inc., Freedom Homes of Dorchester, LLC, and Home Source One. FHFA also hosted meetings in Washington, DC with Hometown American Communities and American Residential Communities.

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Further, on June 2, 2010, FHFA participated in a Manufactured Housing Roundtable hosted by Congressman Joe Donnelly in Elkhart, IN, and attended by manufactured housing industry representatives. This Roundtable addressed barriers to participation and potential solutions in real estate and personal property lending for manufactured housing. FHFA is currently reviewing and evaluating the over 3000 comment letters received on its proposed duty to serve regulation, many of which address how the Enterprises could appropriately serve the market for personal property loans on manufactured housing.

Q. In the proposed manufactured housing rule, FHFA indicated there would be significant difficulty in requiring the GSEs to develop a secondary market for manufactured home loans secured by personal property. However, both Ginnie Mae and the Federal Housing Administration (FHA) have been able to develop programs for manufactured home loans secured by personal property. Can you give us an indication why these agencies have been able to overcome seemingly similar challenges to developing products to serve this area of manufactured housing that FHFA feels would be insurmountable with respect to Fannie Mae and Freddie Mac? In other words if FHA and Ginnie Mae can overcome these obstacles, why couldn't Fannie Mae and Freddie Mac?

A. Historically, there have been difficulties with FHA personal property lending and Ginnie Mae securitization of manufactured housing loans. Ginnie Mae testified in 2006, for instance, that it had experienced $514 million of losses on defaulted Title 1 manufactured housing portfolios. The FHA Modernization Act of 2008 strengthened the FHA program for personal property lending on manufactured homes, and on June 10, 2010, Ginnie Mae announced its plans for the implementation of a new mortgage backed security program for manufactured home loans. For Fannie Mae and Freddie Mac, FHFA is continuing to consider appropriate ways in which they could best serve the very low-, low-, and moderate income borrowers targeted for assistance by the duty to serve. As part of our analysis of these issues, FHFA may consult with FHA and Ginnie Mae regarding lessons that might be learned from their programs.

Q. What conditions would FHFA feel would have to be met, in terms of risk management and consumer protection, to follow through on Congress' guidance that the GSEs (including Fannie Mae and Freddie Mac) develop a program for manufactured home loans secured by personal property?

A. In the Housing and Economic Recovery Act of 2008, Congress provided that in determining whether an enterprise has complied with the duty to serve very low-, low-, and moderate-income families in connection with manufactured housing, FHFA may consider loans secured by personal property. In accordance with this guidance from Congress, FHFA took a careful look at personal property loans in developing the proposed regulation.

FHFA found that interest rates charged for personal property loans are typically higher than those for real estate-secured loans. These loans also normally have shorter maturities and offer fewer consumer protections than real property loans, and delinquencies and defaults are high. Moreover, Fannie Mae and Freddie Mac have very limited experience in dealing with personal property loans. In its proposed regulation, FHFA indicated that supporting the manufactured housing personal property lending market would not be consistent with Enterprise conservatorship and would require substantial new efforts by the Enterprises to ensure safe and sound operations and sustainable homeownership for families.

FHFA has been clear in stating that the Enterprises in conservatorship are focused on minimizing losses and focusing on existing core business activities. As is standard regulatory practice in working with troubled financial institutions, FHFA has also said that the Enterprises may not initiate new products or enter into new lines of business. Given the very limited infrastructure to support manufactured housing at either Enterprise, both companies would need to invest a significant amount of capital to introduce manufactured housing programs with meaningful and enforceable consumer protections. Given that the Enterprises are already operating with the full support of the U.S. Treasury, FHFA must carefully consider any additional expenditure of taxpayer dollars.

For the final rulemaking, FHFA is reviewing comment letters received on manufactured housing finance, including those from commenters who have suggested how some of the concerns raised in the proposed rule have been or might be mitigated, and how the Enterprises might play an appropriate role in this market. These suggestions are under consideration in the development of the final regulation.

Q. Earlier this month, FHFA established new housing goals for Fannie Mae and Freddie Mac, as required by Housing and Economic Recovery Act of 2008. The purpose of the goals is to ensure the enterprises are focusing on core business activities to support critical segments of the mortgage market. With so much of the mortgage business now going to FHA, and with much of Fannie and Freddie's business focused on loan modifications, how did you benchmark goals in a way that attracts private capital back to the mortgage market, so in years ahead, the FHA is not financing loans that should be done in the private sector?

A. As required by the Housing and Economic Recovery Act or 2008, beginning in 2010, nonconventional loans, including all FHA loans, do not count toward the housing goals. A declining FHA market share is built into the market model upon which the benchmarks are based. FHA's home purchase market share was estimated to be 30 percent of single-family mortgages in 2009. FHFA projects that FHA's corresponding market shares will be 29 percent in 2010 and 25 percent in 2011. As the FHA market share decreases, the model projects that there

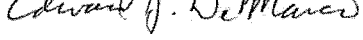
will be a larger share of non-FHA, goal-qualifying loans available for the Enterprises to purchase, and thus, all else equal, a higher benchmark.

Q. CDFIs have been responsible, sound lenders in low-wealth communities and reliable partners to Fannie Mae in assisting them serve all markets. Recently, several CDFIs have received letters from Fannie Mae informing them that, "In order to comply with a directive from our regulator [FHFA]...Fannie Mae is suspending its intermediary product line." Fannie Mae's intermediary product line provided many CDFIs with an efficient, predictable source of capital to carry out their important housing development work. Why has FHFA required Fannie Mae suspend its intermediary product line?

A. FHFA determined that Fannie Mae should cease lending to community-based financial institutions and intermediaries (CDFI loans) because this activity runs contrary to Fannie Mae's charter act. The CDFI loans from Fannie Mae were either unsecured or partially secured by pledges of funds in reserve accounts, and some of the loans were used to fund mortgages. None of the loans from Fannie Mae were secured by mortgage collateral, which is a requirement under Fannie Mae's charter act. In these transactions, Fannie Mae was the lender and was performing a primary market function. In addition, Fannie Mae was funding mortgages, which is prohibited under its charter act.

I hope this information is helpful to you. If you have further questions or require additional information, please contact Peter Brereton, Associate Director for Congressional Relations, on my staff at (202) 414-3799. We would be happy to meet with you to discuss this information.

Sincerely,



Edward J. De Marco
Acting Director

Congress of the United States
Washington, DC 20515

June 28, 2004

The Honorable George W. Bush
President of the United States
The White House
Washington, DC 20050

Dear Mr. President:

We urge you to reconsider your Administration's criticisms of the housing-related government sponsored enterprises (the "GSEs") and instead work with Congress to strengthen the mission and oversight of the GSEs.

We write as members of the House of Representatives who continually press the GSEs to do more in affordable housing. Until recently, we have been disappointed that the Administration has not been more supportive of our efforts to press the GSEs to do more. We have been concerned that the Administration's legislative proposal regarding the GSEs would weaken affordable housing performance by the GSEs, by emphasizing only safety and soundness. While the GSEs' affordable housing mission is not in any way incompatible with their safety and soundness, an exclusive focus on safety and soundness is likely to come, in practice, at the expense of affordable housing.

We have been led to conclude that the Administration does not appreciate the importance of the GSE's affordable housing mission, as evidenced by its refusal to work with the House and Senate on this important legislation. It now appears that, because Congress has not been willing to jeopardize the GSE's mission, the Administration has turned to attacking the GSEs publicly. We are very concerned that the Administration would work to foster negative opinions in the financial markets regarding the GSEs, raising their cost of financing. If the intent is to get pro-housing members of Congress to weaken their support of the GSEs' mission, it is a mistaken strategy.

Our position is not based on institutional loyalty, but on concern for the GSE's affordable housing function. We appeal to you to agree to work on legislative proposals that foster sound oversight and vigorous affordable housing efforts instead of mounting assaults in the press. We also ask you to support our efforts to push the GSEs to do more affordable housing. Specifically, join us in advocating for more innovative loan products and programs for people who desire to buy manufactured housing, similar products to preserve as affordable and rehabilitate aging affordable housing, and more meaningful GSE affordable housing goals from HUD.

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The President
Page Two

For example, as a President that has a sincere appreciation for rural America, we urge you to direct the Rural Housing Service to place a high priority on working with the GSEs to close as many loans as possible this year to preserve the Section 515 rural housing stock, which is home to some of this country's poorest citizens.

In closing, we reiterate that an exclusive emphasis on safety and soundness, without an appropriate balance in focus on the affordable housing mission of the GSEs, is misplaced. Strong safety and soundness regulation and a vigorous affordable housing mission are not only compatible, but will reinforce each other. We ask you to work with us to craft legislation that achieves the proper balance in both areas.

Sincerely,

REP. BARNEY FRANK

REP. NANCY PELOSI

REP. PAUL E. KANJORSKI

REP. STENY H. HOYER

REP. MAXINE WATERS

REP. JOHN D. DINGELL

REP. CAROLYN B. MALONEY

REP. TOM LANTOS

REP. LUIS V. GUTIERREZ

REP. [illegible]

REP. MELVIN L. WATT

REP. LUCILLE ROYBAL-ALLARD

REP. GEORGE MILLER

REP. CHARLES B. RANGEL

REP. DARLENE HOOLEY

REP. ROBERT T. MATSUI

REP. RUBEN HINOJOSA

REP. MARCY KAPTUR

REP. EARL BLUMENAUER

REP. ELEANOR HOLMES NORTON

REP. SANFORD D. BISHOP, JR.

REP. DONALD M. PAYNE

REP. JULIA CARSON

REP. BRAD SHERMAN

REP. GREGORY MEEKS

REP. BARBARA LEE

REP. MICHAEL CAPUANO

REP. CHAKA FATTAH

REP. EDOLPHUS TOWNS

REP. JAMES P. MORAN

REP. BENNIE G. THOMPSON

REP. SAM FARR

REP. DANNY K. DAVIS

REP. DENISE MAJETTE

REP. BRAD MILLER

REP. ROBERT C. SCOTT

REP. RAUL M. GRIJALVA

REP. BETTY McCOLLUM

REP. ANNA G. ESHOO

REP. JOSEPH CROWLEY

REP. JAY INSLEE

REP. DONNA M. CHRISTENSEN

REP. DENNIS MOORE

REP. BOB ETHERIDGE

REP. HAROLD E. FORD, JR.

REP. JAMES R. LANGEVIN

REP. Wm. LACY CLAY

REP. JAMES P. McGOVERN

REP. STEVE ISRAEL

REP. CHARLES A. GONZALEZ

REP. CAROLYN McCARTHY

REP. MAX SANDLIN

REP. JOE BACA

REP. JOHN LEWIS

REP. DAVID SCOTT

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REP. ARTUR DAVIS

REP. ROBERT A. BRADY

REP. JOHN F. TIERNEY

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REP. RICHARD E. NEAL

REP. JIM McDERMOTT

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REP. STEPHEN F. LYNCH

REP. CHRIS BELL

REP. MICHAEL M. HONDA

REP. ROBERT MENENDEZ

REP. MIKE ROSS

REP. JIM MARSHALL

REP. GARY L. ACKERMAN

REP. DAVID E. PRICE

REP. NICK J. RAHALL, II

Oxley hits back at ideologues

Financial Times
By Greg Farrell in New York
Published: September 9 2008 19:25 | Last updated: September 9 2008 19:25

In the aftermath of the US Treasury's decision to seize control of Fannie Mae and Freddie Mac, critics have hit at lax oversight of the mortgage companies.

The dominant theme has been that Congress let the two government-sponsored enterprises morph into a creature that eventually threatened the US financial system. Mike Oxley will have none of it.

Instead, the Ohio Republican who headed the House financial services committee until his retirement after mid-term elections last year, blames the mess on ideologues within the White House as well as Alan Greenspan, former chairman of the Federal Reserve.

The critics have forgotten that the House passed a GSE reform bill in 2005 that could well have prevented the current crisis, says Mr Oxley, now vice-chairman of Nasdaq.

He fumes about the criticism of his House colleagues. "All the handwringing and bedwetting is going on without remembering how the House stepped up on this," he says. "What did we get from the White House? We got a one-finger salute."

The House bill, the 2005 Federal Housing Finance Reform Act, would have created a stronger regulator with new powers to increase capital at Fannie and Freddie, to limit their portfolios and to deal with the possibility of receivership.

Mr Oxley reached out to Barney Frank, then the ranking Democrat on the committee and now its chairman, to secure support on the other side of the aisle. But after winning bipartisan support in the House, where the bill passed by 331 to 90 votes, the legislation lacked a champion in the Senate and faced hostility from the Bush administration.

Adamant that the only solution to the problems posed by Fannie and Freddie was their privatisation, the White House attacked the bill. Mr Greenspan also weighed in, saying that the House legislation was worse than no bill at all.

"We missed a golden opportunity that would have avoided a lot of the problems we're facing now, if we hadn't had such a firm ideological position at the White House and the Treasury and the Fed," Mr Oxley says.

When Hank Paulson joined the administration as Treasury secretary in 2006 he sent emissaries to Capitol Hill to explore the possibility of reaching a compromise, but to no avail.

The New York Times

September 11, 2010

Resale Fees That Only Developers Could Love

By JANET MORRISSEY

REBECCA AND TRENT DUPAIX of Eagle Mountain, Utah, spent a year searching for their dream home. The couple, who have five children, considered 15 to 20 houses before finding "the one."

They were thrilled when they closed on a $227,000, rock-and-stucco home with five bedrooms and two and a half baths in March 2009.

But four months later, when a local television reporter was doing a story on housing taxes in their subdivision, the Dupaixs discovered that their sales contract included a "resale fee" that allows the developer to collect 1 percent of the sales price from the seller every time the property changes hands — for the next 99 years.

Mrs. Dupaix, 34, says she and her husband had no clue about the fee when they closed on the house. "Of course we were upset," she says. "We didn't know about it, and our closer at the title company didn't know about it."

Other buyers gutsy enough to venture into the battered housing market in the hope of scoring a bargain might be wise to check the fine print before popping open the Champagne and signing on the dotted line.

A growing number of developers and builders have been quietly slipping "resale fee" covenants into sales agreements of newly built homes in some subdivisions. In the Dupaix contract, the clause was in a separate 13-page document — called the declaration of covenants, conditions and restrictions — that wasn't even included in the closing papers and did not require a signature.

The fee, sometimes called a capital recovery fee or private transfer fee, has been gaining popularity among companies that have been frantically searching for new ways to gain access to cash in the depressed housing market.

"Developers are desperate," says David Steffensen, a lawyer and a former developer in Salt Lake City. "They're facing projects that are upside down" because the property value has fallen below the loan balance and lenders are refusing to refinance. "It's a ticking time bomb," he adds.

Freehold Capital Partners, a real estate financing firm founded by the Texas developer Joseph B. Alderman III, has been leading the charge. According to William White, Freehold's chief operating officer, the firm has signed up more than 5,000 developers who are adding the covenant to developments worth hundreds of billions of dollars that will be built out over the next decade in 43 states.

Many developers see the resale fee as a creative way to get new financing. They are hoping to one day use the trickle of cash from these fees as collateral for a loan, or to get cash up front if pools of the fees are packaged into securities to be bought and sold on Wall Street. Freehold has begun shopping the idea of securitizing the resale fees, much as subprime loans were packaged and sold to investors.

Someone selling a home for $500,000, for example, would have to pay the original developer $5,000. If the home sold again two years later for $750,000, the second seller would have to pony up $7,500 to the developer, and so on. Even if a home declines in value, the seller still must pay the 1 percent fee. Freehold gets a cut of the resale fee; if the fees are securitized, it retains a percentage of the cash generated from the securitization.

Freehold's principals and lawyers have been aggressive in sales pitches to developers, but have declined to give details on their clients, securitization efforts or the company itself. Freehold moved its corporate office from Round Rock, Tex., to New York this year as it stepped up efforts to securitize the resale fees.

Mr. White characterizes the resale fee as a win-win deal for the developer and the home buyer. The fees let developers spread out the cost of building the roads, utilities and other infrastructure across all homeowners in a subdivision, rather than just the initial buyers. As a result, he said, the developer can lower the initial price of a home to the first buyer.

For example, he says, a typical $250,000 home may be able to sell for about $5,000 less. "The fee is a fair and equitable way to spread development costs, and results in lower costs to the average consumer," Mr. White says.

Ted Thieman, founder of the real estate developer Thieman Enterprises in Vandalia, Ohio, sees Freehold's securitization plan as the holy grail that will provide him with badly needed cash. He signed up with Freehold last year after lenders refused to provide financing for him to develop land in Dayton, Ohio.

"People are going bankrupt out here, and there's no cash flow in our developments anymore," he says. "This is the only source that's available to us."

Jeff Moseley, founder of Badger Creek Development in Brunswick, Ga., says he signed up with Freehold after watching his business tank with the economy. "I can't sleep at night," he says, adding that he had laid off all 32 of his employees.

He is hoping Freehold's resale fee program will breathe new life into his business. "I thought it was an intriguing and compelling story," says Mr. Moseley, who owns two development projects, encompassing about 220 lots.

Under his deal with Freehold, he will get about two-thirds of the revenue from the securitized fees while Freehold and other parties will get one-third.

Some developers are skeptical. Qualico, a Canadian company that owns Reytex Homes of Austin, Tex., turned down Freehold's sales pitch when it was buying land from a Freehold affiliate in Texas. Qualico wanted to use the land to build entry-level homes and didn't think the fee would fly with that market segment. First-time buyers are more likely than others to trade up and quickly sell a home, so the home often has little time to appreciate enough to offset the fee.

The resale fee "has disaster written all over it," says Rick Akin, partner of the law firm Akin & Chardavoyne, which represented Qualico.

MR. ALDERMAN, 45, has a history in the real estate industry, dating back to 1990, that includes a few bumps in the road. In March 1994, he filed for Chapter 7 bankruptcy protection for businesses that operated as Alderman Homes Inc. and First Quality Homes Inc., which had offices in Texas and Florida.

He has also held positions as either a senior executive or registered agent for seven other businesses, many of which the Texas Comptroller of Public Accounts lists as "not in good standing" — a designation applied when a company has either not paid franchise taxes or failed to file a tax report or both.

Mr. Alderman says that the businesses were deemed not in good standing because he or his accountant didn't file reports by the deadline and that no franchise fees are due. "My credit is perfect," he adds.

Negotiations involving Mr. Alderman have sometimes been contentious. Mr. Akin says he had "tortured negotiations" with Mr. Alderman in 2006, when Qualico was trying to buy two parcels of land near Austin from Mr. Alderman's development company. Mr. Akin says Mr. Alderman haggled over issues including who would pay to extend sewer and water services to the land tracts, as well as who would be reimbursed for building parks and streets in the subdivisions through the city's Public Improvement District program.

"He wanted to be reimbursed for the money that we were going to spend for public improvements," says Mr. Akin.

He says Mr. Alderman also did not resolve issues like easements and back taxes that affected the legal claim to the title. When Mr. Akin decided to cancel the purchase agreement on the second tract of land over title issues, he says he had to sue Mr. Alderman's company to get back his client's $1 million deposit. "In the over 25 years that I've been doing this, he was one of the most difficult sellers I've ever dealt with," says Mr. Akin.

The dispute was settled out of court. Mr. Alderman says Qualico wanted to back out of both land purchases, but was allowed out of only one. He says the $1 million deposit wound up being applied to the first tract's purchase. "If Mr. Akin believes that is hard negotiating, then so be it," he says.

A COALITION of real estate trade groups, including the National Association of Realtors, the American Land Title Association and the Center for Responsible Lending, opposes resale fees and is lobbying federal and state authorities to ban them.

"The idea that someone who has no ownership stake or interest can continue to collect revenue off of a property that they may have built up to 99 years ago exploits an already complex transaction and doesn't pass the smell test," says Justin Ailes, director of government affairs at the land title association. The fee could hurt real estate values in the future if buyers are reluctant to purchase properties that have a 1 percent fee attached.

The coalition wrote to the Treasury secretary, Timothy F. Geithner, and to the Department of Housing and Urban Development, the Federal Housing Finance Agency, the Federal Trade Commission and others, urging them to bar the fees or use the consumer protection agency — to be created by the financial overhaul — to fight them.

Often, the fee is within dozens or hundreds of pages of documents, and for some buyers, like the Dupaixs, it may be in a separate declaration that does not require a signature. Buyers may not be aware of the fee until the closing — or, worse, when they try to sell the home years later and the fee shows up in the title search, Mr. Ailes says. If the seller won't pay the fee, he says, a lien is slapped on the property.

"I am yet to find an owner that reads 300 or 400 pages" at closing time, says Charlie Orden, a broker and owner of the realty office Re/Max Town Centre in Orlando. And even if they do see it at closing, few buyers are going to walk away from a home at that point. He says he has started looking for the clause to warn potential clients well in advance.

Opponents have made some headway. The Department of Housing and Urban Development recently issued a letter indicating that the fees violated its regulations and that the agency would not insure mortgages on properties that included them.

The Federal Housing Finance Agency is considering a proposal to prohibit the transfer fees on all mortgages financed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks. And 17 states have either banned or placed conditions on the practice.

Some bankers say Freehold will have a tough time selling the idea to Wall Street. The uncertain economy and housing market have made it next to impossible to predict when and how often a home will sell, or where home prices are headed — information that is needed to estimate cash flows to value the securities.

And some worry that an all-out ban of resale fees by states or the federal government could make the securitized paper worthless.

Dave Ledford, a senior vice president at the National Association of Home Builders, says he's not sure Freehold can deliver on its big promises. "It's almost in the category of 'too good to be true,' " Mr. Ledford says.

Mr. White dismisses the criticism as sour grapes. He contends that Realtors oppose the fee because homebuyers might pressure them to lower their commissions to offset it. "Apparently 6 percent to a Realtor is justified, yet 1 percent to pay for roads and utilities isn't," Mr. White says. He says he believes title companies are worried that they might face legal claims if they miss the fee during a search.

As for bundling the future cash flow into securities, Mr. White sees little risk. The fee represents "a stable passive income stream," he says, that will be generated whether home prices go up or down. Even if the federal government or other states ban the fees, the ban would most likely apply only to future developments, not existing ones, he says.

Mr. White says his firm encourages full disclosure of the fees. However, he was unwilling to disclose the names of the developers and residential developments that currently charge the fees.

In fact, Freehold was the financing company behind the fee in the Dupaix contract. Even the home builder, Prestige Homes, wasn't aware of the fee, and demanded that the developer, Development Associates Inc., remove the clause from the paperwork, says Michael Cameron, the real estate agent who handled the sale for Prestige.

Mr. Cameron says Development Associates amended the "covenants, conditions and restrictions" document without the knowledge of the builder or buyer, and didn't present the amended document at closing. He says Prestige pulled out of the subdivision after the incident. "It's not good for the buyers, it's not good for our reputation, and quite honestly, we thought it was unethical," he says.

Nate Shipp, owner of Development Associates, says he signed up with Freehold on the condition that Freehold securitize income from the fees and then pass on some of that revenue to his company so it could lower the price for buyers. But so far, Mr. Shipp says, he has not received any money from the arrangement.

He says Freehold insisted that he add the resale covenant into the sales documents on all lots in his subdivision to qualify for its program. Because Mr. Shipp hadn't received cash from a securitization, he has been deleting the clause from the sales contract as each home is sold. He says the fees on the Dupaix property and about 11 others were accidentally left in. "It was an honest mistake," he says.

AS for Mrs. Dupaix, she says a resale fee wouldn't necessarily turn her off of a home if the price were right.

If she had known of the fee in advance, she says, "we would have negotiated to get the price lower."

Source: http://www.nytimes.com/2010/09/12/business/12fees.html