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THE TREASURY DEPARTMENT'S VIEWS ON THE REGULATION OF GOVERNMENT SPONSORED ENTERPRISES

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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THE TREASURY DEPARTMENT'S VIEWS ON THE REGULATION OF GOVERNMENT SPONSORED ENTERPRISES

Wednesday, September 10, 2003

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to call, at 10:06 a.m., in Room 2128, Rayburn House Office Building, Hon. Michael G. Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Baker, Bachus, Castle, Royce, Lucas, Ney, Kelly, Paul, Gillmor, Manzullo, Ose, Biggert, Toomey, Shays, Shadegg, Miller, Hart, Capito, Tiberi, Kennedy, Feeney, Hensarling, Garrett, Murphy, Brown-Waite, Barrett, Harris, Renzi, Frank, Kanjorski, Waters, Sanders, Maloney, Gutierrez, Velázquez, Watt, Hooley, Carson, Sherman, Meeks, Lee, Inslee, Moore, Gonzalez, Ford, Hinojosa, Lucas, Crowley, Israel, Ross, McCarthy, Baca, Matheson, Miller, and Scott.

The CHAIRMAN. The committee will come to order.

The committee is meeting today to hear from the Secretary of Treasury and the Secretary of Housing and Urban Development regarding their views on the regulation of government sponsored enterprises. Pursuant to rule 3(f)(2) of the rules of the Committee on Financial Services for the 108th Congress, the Chair announces he will limit recognition for opening statements to the Chair and ranking minority member of the full committee and the Chair and ranking minority member of the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, and the Subcommittee on Housing and Community Opportunity, or their respective designees, for a period not to exceed 22 minutes, evenly divided between the majority and the minority.

Prepared statements of all members will be included in the record, and the Chair now recognizes himself for an opening statement.

I want to first welcome Secretary Snow and Secretary Martinez back to the Financial Services Committee this morning to discuss the regulation of the housing government sponsored enterprises, or GSEs, and thank you both for joining us today. It is my understanding the Treasury Department and the Department of Housing and Urban Development have been working closely together with the President to develop a proposal to reform GSE regulation. I am looking forward to hearing your insights and recommendations.

The U.S. Housing market has been the engine of growth for the domestic economy over the past several quarters. Despite a slowdown in nearly every economic sector, the housing market has remained vibrant. Now that an economic recovery seems to be on the horizon, it is important that we act in a reasonable manner to improve the regulation of the GSEs while at the same time ensuring that we do not have an adverse impact on housing or the equity markets.

Ultimately, it is the U.S. Taxpayers and homeowners we must keep in mind as we seek to improve the current state of regulation. I hope to work in a bipartisan manner to ensure that any action this committee undertakes has broad support as well as input for the Administration.

The housing GSEs were established to provide liquidity to the housing market and to facilitate access to affordable homes. These entities have been extremely successful in this role and have enabled millions of Americans to achieve homeownership. Their operations have been the model for housing finance around the world.

However, the GSEs have developed over the years into much more sophisticated entities than originally envisioned. They have become highly complex financial institutions with obligations in the trillions of dollars. As such, it is important that the GSEs have a robust and sophisticated regulator to ensure that they continue to operate in a safe and sound manner.

A strong regulator will send a signal to the markets that these entities have solid management practices. Confidence will be restored in the GSEs, and they will be able to get back to their important work without the distractions that have been plaguing them over the past several months.

This is not to say that this committee will not continue to actively oversee their operations. If there is a change in the regulatory structure of the GSEs, this committee will have to closely monitor the development and actions of the regulator.

In my opinion, the current regulators do not have the tools or the mandate to adequately regulate these enterprises. We have seen in recent months that mismanagement and questionable accounting practices went largely unnoticed by the Office of Federal Housing Enterprise Oversight. These problems only came to light when the company announced them on their own accord. It is encouraging to know that the boards of these companies are active and engaged, seeking to operate in the best interest of their shareholders. However, these irregularities which have been going on for several years should have been detected earlier by the regulator.

I would like to thank subcommittee Chairman Baker for his hard work in reviewing the GSEs and highlighting for the committee the need for increased regulatory oversight of these entities. He has demonstrated true leadership on this important subject matter. As we move forward, I expect to draw on his expertise in this area.

Secretary Snow and Secretary Martinez, I do indeed look forward to your testimony and welcome you back.

And I now recognize the ranking member, the gentleman from Massachusetts, Mr. Frank.

[The prepared statement of Hon. Michael G. Oxley can be found on page 50 in the appendix.]

Mr. FRANK. Thank you, Mr. Chairman.

I appreciate hearing from the two Cabinet secretaries, but I would say at the outset that before we move on any legislation, I would hope we would have some additional hearings. And, in particular, I think it is important that the variety of groups in our country who care about housing be invited, because that is my major focus here, as it has been during my service on this committee.

I want to begin by saying that I am glad to consider the legislation, but I do not think we are facing any kind of a crisis. That is, in my view, the two government sponsored enterprises we are talking about here, Fannie Mae and Freddie Mac, are not in a crisis. We have recently had an accounting problem with Freddie Mac that has led to people being dismissed, as appears to be appropriate. I do not think at this point there is a problem with a threat to the Treasury.

I must say we have an interesting example of self-fulfilling prophecy. Some of the critics of Fannie Mae and Freddie Mac say that the problem is that the Federal Government is obligated to bail out people who might lose money in connection with them. I do not believe that we have any such obligation. And as I said, it is a self-fulfilling prophecy by some people.

So let me make it clear, I am a strong supporter of the role that Fannie Mae and Freddie Mac play in housing, but nobody who invests in them should come looking to me for a nickel—nor anybody else in the Federal Government. And if investors take some comfort and want to lend them a little money and less interest rates, because they like this set of affiliations, good, because housing will benefit. But there is no guarantee, there is no explicit guarantee, there is no implicit guarantee, there is no wink-and-nod guarantee. Invest, and you are on your own.

Now, we have got a system that I think has worked very well to help housing. The high cost of housing is one of the great social bombs of this country. I would rank it second to the inadequacy of our health delivery system as a problem that afflicts many, many Americans. We have gotten recent reports about the difficulty here.

Fannie Mae and Freddie Mac have played a very useful role in helping make housing more affordable, both in general through leveraging the mortgage market, and in particular, they have a mission that this Congress has given them in return for some of the arrangements which are of some benefit to them to focus on affordable housing, and that is what I am concerned about here. I believe that we, as the Federal Government, have probably done too little rather than too much to push them to meet the goals of affordable housing and to set reasonable goals. I worry frankly that there is a tension here.

The more people, in my judgment, exaggerate a threat of safety and soundness, the more people conjure up the possibility of serious financial losses to the Treasury, which I do not see. I think we see entities that are fundamentally sound financially and withstand some of the disastrous scenarios. And even if there were a problem, the Federal Government doesn't bail them out. But the more pressure there is there, then the less I think we see in terms of affordable housing.

I want Fannie Mae and Freddie Mac to continue as government sponsored enterprises with some beneficial arrangement with the Federal Government in return for which we get both the general lowering of housing costs and some specific attention to low-income housing. In particular, I am concerned right now that there has been—and it has been raised by Fannie Mae, it has been raised by one of the rating agencies that have been critical of the Federal Home Loan Bank—manufactured housing.

Manufactured housing is a very important housing resource for low- and moderate-income people. You talk about increasing homeownership among low- and moderate-income people, and disproportionately, if you look at the increases in homeownership, it has come with their ability to get manufactured housing; and I do not want to see Fannie and Freddie pushed in the direction of being tougher on manufactured housing. And many of us will be in touch with Secretary Martinez to see how we can improve this.

I have talked to my colleagues in the Congressional Black Caucus, and the Blue Dogs. This is a very important and, I think, somewhat underrated form of housing. I think we now see pressure on it that is generated in part by exaggerated fears of a financial crisis.

So I am prepared to look at possibilities here, but in particular—and this is the major point I want to make; I saw this in the letter from the homebuilders—I do not want to see any lessening of our commitment to getting low-income housing.

And here is my concern: If you move the regulator to Treasury and you leave HUD with the mission, I am not sure that it isn't "mission impossible," or at least implausible. What is HUD going to do, yell at them? I mean, if all the regulatory authority and all the clout is over in Treasury, what is left in HUD? And I noticed that the homebuilders raised that.

So my threshold question is, if you move this regulator to Treasury, if you bifurcate in terms of the Cabinet departments the responsibility for the low-income housing mission, including manufactured housing—very important to me, as I said—and other forms of housing, if you bifurcate that, what real strength is there left behind the mission if most of the regulation and most of the teeth—I guess if you put all the teeth from Treasury, having HUD gum them into doing more low-income housing doesn't strike me as the ideal situation.

And that is why I say, Mr. Chairman, in closing, that as we proceed on this, I would hope we would have a day when groups, a range of groups that are concerned with housing, could specifically address that. Thank you.

The CHAIRMAN. I think the gentleman makes a good point, and we certainly will address that.

The gentleman from Louisiana, the chairman of the Capital Markets, Insurance and GSEs Subcommittee.

Mr. BAKER. Thank you, Mr. Chairman. I want to express my appreciation to you for your continuing leadership on this most difficult issue. Without your commitment, I am fairly confident we would not be in a hearing room today to discuss potential regulatory reform. So my deep appreciation to you for this.

To Secretary Martinez and Secretary Snow, your willingness to participate here today is very warmly received. And let me just make a personal observation. Having worked with various folks over time, I have not enjoyed the professional leadership and responsiveness to what is a very difficult and controversial issue with more capability than you two gentlemen have exhibited.

There was a prior occasion, Under Secretary Gensler, during the Clinton administration, testified and took a very brave stand on issues that led unfortunately to significant market disruption the following day. It is my opinion that given the way in which you have come at this issue, working now for many months to come to the best study positions that you could offer, that much of what you have in the testimony today reflects prior legislative approaches. Much of what is in 2575 is addressed in the testimony, and I just want to publicly commend both of you as public servants for the demonstrated leadership you have exhibited.

I want to briefly and very briefly just characterize why we are here in light of the ranking member's comments as to the necessity for this hearing today. Because many members would not want to sit down and read the history of Fannie or Freddie as light reading one evening, it was first created, Fannie, by the FHA Administrator back in 1938, but only authorized at that time to acquire FHA-insured mortgage loans. It was years later they were then expanded to acquire VA-insured mortgage loans.

It wasn't until 1970, 1970, that Freddie Mac was created and that Fannie and Freddie were both given the ability to acquire conventional mortgages before they were really on the road to the big time.

There is one other additional historic period important to reflect on because of the view—what are we worried about—there is no problem, nothing bad can happen. It goes to the period when David Maxwell assumed the role as CEO of Fannie Mae in 1981. It is just instructive.

On that day, Fannie was losing a million dollars a day. They had $56 billion of home mortgages that were under water. Now, it wasn't of their own making. There were national economic circumstances no one could have predicted, but the fact is, they were in trouble. Had it not been for creative government accounting and the leadership of David Maxwell, Fannie Mae might not be with us today.

More recent history has given us another unexpected and unfortunate lesson. If I had to construct a list of the potential concerns, managerial risk at Freddie Mac would have probably been 99 on a list of 100. Needless to say, we were all shocked to see the disclosure of these events of corporate governance mismanagement. These institutions had always been held up as the model for others to emulate, and appropriately so.

The point to be made about these two brief scenarios of history is that the GSEs are just corporations. It is difficult to believe they are just like every other American corporation, but they are shareholder owned, good old American corporations, built in pursuit of profit, subject to the same earnings pressures as any other corporation. They are not infallible, although they have enjoyed acknowledged success.

Given the environment and the concerns of the committee and this Congress about the reform of corporate governance, how appropriate is it for us in this environment to reflect upon these enterprises and determine how we can enhance safety and soundness? In recognizing there may be a potential for loss, we must also recognize that these individual institutions are unusual in that they have a direct responsibility between the losses of the enterprises and the taxpayer. Do not forget that a GSE model is unique. If they make a profit, they get to keep it. If they lose money, the taxpayer gets the right to pay it off.

As of the last quarter of 2002, the combined outstanding debt of Fannie and Freddie was $1.99 trillion, not an insignificant number; and to appreciate it in the current context, consider the following remarks issued yesterday by the International Monetary Fund from its semiannual global financial stability report, released just yesterday: Recent developments have highlighted the extremely large, highly leveraged nature of these enterprises and the risks they are managing.

Now, inappropriate or not, I find the IMF's concern about capital adequacy rather unique, but if they now have this concern, certainly the Congress should share it. To provide any level of assurance to taxpayer protection, we must have world-class regulatory capability.

Let me say in defense of OFHEO, it has been dramatically underfunded since its creation in 1992, and this lack of support translates into lack of resources and capabilities to analyze the world's most sophisticated financial institutions. The regulator has not only been outmanned, it has been outlobbied. But those observations are not sufficient to explain why OFHEO has taken 10 years to develop a capital stress test and being underfunded does not explain how a glowing report of Freddie's operations was released only hours before the managerial upheaval that followed.

This is not world-class regulatory work. There are too many unanswered questions, the stakes, too high. It is up to the committee to take action needed to get appropriate answers. Taxpayers need to be assured. Potential homeowners need to have access to affordable homeownership opportunities. And contrary to the view of many, this effort will lead to enhanced mission compliance and opportunities for low-income and affordable housing.

I am of the opinion, and have been of the opinion, these enterprises do not meet the satisfactory minimum level in providing homeownership opportunities to minorities and low-income individuals. We cannot let protest in the past keep us from doing what is right in the present. It is time we create a strong, independent regulator, independently funded with all the powers necessary to take on the task.

I believe the Secretaries' testimony is pivotal in setting out the initial step the committee must take. It is not time for additional reflection. I have been criticized in the past for having too many hearings and recommended legislative approaches. Now it is time to act and put this chapter behind us and move on to doing what is right for our American economy.

Thank you, Mr. Chairman, for your courtesy.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Pennsylvania, ranking member of the subcommittee.

Mr. KANJORSKI. Mr. Chairman, before we hear from the Administration on the need to alter the current regulatory system for government sponsored enterprises, I feel it is very important to outline my views on these matters for our two distinguished witnesses who are appearing before us today.

As I said in our very first hearing on GSE regulation in March 2000, we need to have strong, independent regulators that have the resources they need to get the job done. I continue to support strong GSE regulation. A strong regulator, in my view, will protect the continued viability of our capital markets, promote confidence in Fannie Mae and Freddie Mac, insure taxpayers against systemic risk, and expand housing opportunities for all Americans.

To ensure that we have strong GSE regulation, I further believe that any further legislative reform efforts should adhere to several principles. First, a strong regulator must have a single leader for a set term with sole responsibility for making decisions. In order to conduct robust supervision, a strong regulator must also have a funding stream separate and apart from the annual appropriations process and without improper administrative interference. Moreover, a strong regulator must have robust supervisory and enforcement powers.

Accordingly, some have suggested that we should model GSE regulatory authority after those of other financial regulators. While these proposals have merit, we must determine the applicability and appropriateness of providing these banking standards to GSE before proceeding.

In order to maintain credibility, a strong regulator must additionally have genuine independence. Unless I am convinced otherwise, such independence must consist of complete autonomy from the enterprises. It must also include sufficient protection from outside special interest groups. It must further have substantial freedom from political interference.

The last point is especially important. As a result of my experience during the savings and loan bailout, I will approach any proposal to assert general oversight or supervisory controls by the Administration or the Congress over any GSE regulator with great skepticism. We must not allow politics to again cause systemic implications to our economy. Because our housing marketplace is one of the most important sectors in our struggling economy, we must also tread carefully on our forthcoming congressional examinations.

In short, we have a delicate balancing act ahead of us as we work to develop any legislation to modify the regulation of GSEs. We must focus our work on regulatory proposals and not make fundamental changes in ways in which GSEs operate to their charter or to their mission. It is also my hope that we will develop a balanced bipartisan plan of action for addressing these issues.

In closing, Mr. Chairman, I commend you for your leadership in these matters. I also look forward to working with you in a judicious and objective manner in order to ensure that we do not upset our securities markets or raise homeownership costs in the weeks ahead.

The CHAIRMAN. The gentleman yields back.

The Chair is now pleased to recognize the chairman of the Housing and Community Opportunity Subcommittee, the gentleman from Ohio, Mr. Ney.

Mr. NEY. Thank you, Mr. Chairman. I want to thank you, Mr. Chairman, for the hearing. I appreciate the opportunity. I will make this a brief opening statement because I know you want to go on with the witnesses.

I also want to start by thanking Secretary Martinez and Secretary Snow for being here. I know you have busy schedules, and as you know, this is an important issue.

As chairman of the subcommittee, I have a keen interest in the strength of our Nation's mortgage market as our members do on both sides of the aisle.

GSE regulation is an incredibly important issue for all Americans. The United States mortgage and credit markets are the envy of the world. The mortgage market has single-handedly kept the economy afloat during the recent economic times. I know we are also aware of that. I think that a consensus has emerged that it is time to create a new safety and soundness regulator for Fannie Mae and Freddie Mac at the Treasury Department.

The important role that GSEs play in the capital markets and the possible risks they could pose to the financial system, reconstituting a safety and soundness regulatory scheme, mechanism, under Treasury I believe is a prudent and necessary step. Such a move would send an important signal that we understand the importance of GSEs in the secondary mortgage markets in maintaining a stable economy and providing affordable housing to all Americans.

While there is a consensus regarding the safety and soundness regulator, I am anxious to hear from our witnesses today on what they believe should be done with HUD's oversight responsibilities for the important housing mission of the enterprises, including approval authority for any new program and enforcement of compliance with affordable housing goals. I want to commend HUD for all their diligence on this issue since I have been involved with working with HUD.

I will be asking some specific questions on the issues, but I would like to make one personal observation. I think it is important to permit the housing GSEs to have sufficient flexibility to adapt to a changing mortgage market. We know today how things change quickly in the United States. The liquidity that Fannie Mae and Freddie Mac provide to the market should not be compromised by unnecessary government regulation.

First, I believe that there are several important components that are integral to providing enhanced regulations for GSEs while not impeding their ability to support affordable housing in America. For example, I think it is imperative for HUD to continue to have an important role as it relates to the mission's charter and affordable housing goals of Fannie Mae and Freddie Mac; that role of oversight will be good for consumers, good for the Nation, and good for housing.

I also have no doubt that the Treasury Department is unparalleled in its ability to manage safety and soundness for these corporations. However, Congress has traditionally charged HUD with

the job of supervising affordable and minority housing in our country, and I believe that these goals can be reached amicably. I believe the White House is going in the right direction, as are the committee and the members, and they will be able to express their views on the intricate details of how this bill gels through.

I am also interested to hear what our witnesses think should be done regarding the capital requirements for Freddie Mac and Fannie Mae, if anything at all. Personally, I believe the minimum requirements Congress has mandated for GSEs have done a good job of setting a strong safety and soundness standard. I think it would be a mistake for this committee to change those requirements into a regulatory reform, massive bill. Likewise, I think we should allow the newly required risk-based capital requirement to take hold before we begin questioning it. I know there are many critics of OFHEO, obviously, and its risk-based capital regulation; however, we should allow a decent amount of time to evaluate its effects before we begin to completely dismantle it.

The Department of Housing and Urban Development must maintain its role of leadership in promoting housing, as it has so effectively done under Secretary Martinez. This agency has an important role in ensuring that our Nation is focused on providing decent, affordable housing for all Americans. We must respect that mission.

Mr. Chairman, I believe you are on the right track. I give you credit for this hearing, and I know that we need to do the job right versus just doing the job fast. Thank you.

The CHAIRMAN. The gentleman yields back.

The gentlelady from California, the ranking member of the subcommittee.

Ms. WATERS. Thank you very much, Mr. Chairman.

Secretary Martinez, I am pleased that you are here, and I think that this is a most important hearing. I am told that there are some other members who have been talking about having more hearings on this subject and not rushing to judgment in any way about these proposed changes.

Secretary Martinez, I oppose the transfer of program approval from HUD to Treasury and I oppose any expansion of new approval to include so-called "new activities." it is important that the mission of affordable housing for low- and moderate-income people stay with HUD, without giving the Secretary any additional authority over the program activity business process of Fannie Mae and Freddie Mac.

Under current law the GSEs must submit a new program approval request to HUD if the initiative is significantly different from a program that has been previously approved or it is an activity in which the GSEs have not previously engaged. Section 108 of H.R. 2575, Mr. Baker's bill, would give HUD the ability to micromanage the GSEs. The process can only be intended to slow down the ability of the enterprises to partner with lenders to bring new mortgage products to market, including products that assist the disabled, provide needed housing rehabilitation and provide down payment assistance. Banks are not subject to such burdensome processes.

Fannie Mae has worked with lenders to expand access to low down payment mortgages and to extend financing to those with imperfect credit. These innovations are possible because they are not stifled by an additional layer of government approval.

This morning we have the opportunity to establish the framework of how the government sponsored enterprises, the Federal National Mortgage Association, Fannie Mae, and the Federal Home Loan Mortgage Corporation, Freddie Mac, will be regulated. Fannie Mae, as the number one provider of mortgage funds to low-income families, has been a strong and consistent partner in providing homeownership. Last year they served 2.9 million families in their affordable housing goals, and 1.8 million families were served in their underserved areas, geographically targeted goals.

Nothing has happened with Freddie Mac that has raised any questions about the mission or charters of the two companies. Given housing's importance to the economy and the importance of homeownership to America's families and communities, there should be no interest in changing the GSE's mission.

Mr. Chairman, thank you. I yield back.

The CHAIRMAN. The gentlelady yields back.

We now turn to our distinguished panel and let me say at the outset, it is rare that any committee has two distinguished Secretaries from the Cabinet testify, and we are honored to have both of you here today. And also I think you can tell by the attendance by the members that we have a great deal of interest in this entire issue, and for that I am personally thankful to the members.

And, Secretary Snow, we will begin with your testimony. Once again welcome back to the committee. You need to turn your mike on.

STATEMENT OF HONORABLE JOHN W. SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary SNOW. See, HUD and Treasury are already working in a full state of cooperation.

Thank you very much, Mr. Chairman, Ranking Member Frank, and members of the committee for this invitation to Secretary Martinez and me to appear before you today.

This committee has demonstrated a strong record of interest in effective supervision of and regulation of the government sponsored entities, as well as in affordable housing and a strong, healthy housing market. There is general recognition that the supervision, the supervisory system for housing-related government sponsored entities, neither has the tools nor the stature today to deal effectively with the current size, complexity and importance of these entities which over the last decade or so have become among the largest and most far-reaching entities on the American financial scene.

As we attempt to remedy this situation, we must be mindful that we have two corresponding objectives that should guide us: first, a sound and resilient financial system; and second, increased homeownership opportunities for less-advantaged Americans.

I am here today to outline the Administration's recommendation for important improvements that we think can be made to the oversight of our housing finance system. Secretary Martinez will discuss in particular the measures that the Administration would

like to see implemented to reinforce and strengthen the focus on the objective of increasing ownership opportunities.

First, let me outline the proposal itself, our recommendation. What is the Administration recommending? Well, we recommend that Congress enact legislation to create a new Federal agency to regulate and supervise the financial activities of our housing-related GSEs. Housing finance is so important, it is so far reaching, has such significance to the national economy that we need a strong, world-class regulatory agency to oversee the prudential operations of the GSEs and the safety and the soundness of their financial activities—consistent, however, with maintaining healthy national markets for housing finance, which always has to be a priority.

Such legislation should fulfill this underlying purpose and not merely be an exercise in moving existing agencies from one part of the government to another part of the government. In other words, we are looking for a value-added proposal here that enables the new entity to be located within a Cabinet agency which will give it more heft, more significance and more expertise and better policy guidance.

We should keep our eye on the crucial task of getting the regulatory organization right. We think that is the key thing here. In addition to the housing goals, which Secretary Martinez will discuss, the legislative objective should be to create a strong, credible and well-resourced supervisor with all the powers needed to do the job.

Let me turn now to the issue of what those powers of the new agency should be. As we see it, this new agency's power should be comparable in scope and in force and in effectiveness to those of other world-class financial supervisors, fully sufficient to carry out the agency's mandate. What does this mean? Well, as we see it, it means that the agency should have broad, general, regulatory, supervisory and enforcement authority with respect to the enterprises. In my written testimony I give a detailed description of those powers.

Another key issue with respect to financial regulation of the GSEs is capital and how capital will be treated. Capital, of course, is the fundamental element of the financial condition of an enterprise and the capital standards should not become the subject of frequent change.

But having said this, I am in no way proposing a moratorium on making any adjustments to the risk-based capital standards. The existing statutes place a clear responsibility on GSE supervisors to ensure that each GSE retains adequate capital to support its risks and to give supervisors the power and the duty to require capital changes as risks change. We would fully expect the supervisors to make full and proper use of this authority as any need arises.

At the same time, we feel that there is a need for the new agency to have even greater flexibility, even more authority to adjust risk-based capital standards for the GSEs than is provided under current law. Broad authority over capital standards and the ability to change them as appropriate are of vital importance to a credible, world-class financial regulator. Capital standards need to be flexible enough to employ the best regulatory thinking, conscious of the

enterprise' own measures of risk, and adequate to ensure that the enterprises operate in a safe and sound manner with capital and reserves sufficient to support the risks that arise in their business. We believe the legislation should provide the new agency with this more ample and more flexible authority.

Where should the new agency be located? The administration is prepared to consider putting the new agency within a Cabinet department if, Congress considers the additional benefits of the stature and the policy support that can come with that to be valuable. Any such arrangement would need to protect the independence of the agency over specific matters of supervision, enforcement and access to the Federal courts.

But it is our view that if real value is to be provided by the Cabinet agency by placing the new regulator within a Cabinet department, then we need to be able to draw upon the resources of that department for policy guidance and for expertise. At a minimum, the new agency should be required to clear new regulations and congressional testimony through the department. If that combination of operational independence and policy oversight is provided in the legislation, the Administration would be willing to support putting that new agency in the Department of the Treasury.

Another subject of enormous importance with respect to the GSEs, of course, is corporate governance. Corporate governance, good corporate governance, as we have come to recognize, requires that there be great clarity that the people running large companies are there to serve the interests of the stockholders and that their incentives and loyalties be aligned with those of the stockholders. The principle here, of course, is that one man cannot serve two masters simultaneously.

Freddie Mac and Fannie Mae are large, experienced publicly traded enterprises that have grown significantly and taken important places in our capital markets. Reflecting on that fact, we would recommend that the Congress consider whether the statutory requirement for Presidential appointment of members to these publicly traded GSE boards of directors serves a useful purpose anymore; and if you are so disposed, we would support that—that is, the Administration would support their elimination, as well.

The question arises, how broadly should these new regulatory powers be applied to the GSEs? Is it all GSEs or is it just Fannie Mae and Freddie Mac?

I want to make it clear that I have not limited myself in my remarks to one group of housing GSEs. The importance of our housing finance markets requires that all of the housing GSEs be included in a system of world-class supervision. Therefore, we see the need for and the desirability of the Federal Home Loan Banks' being under such a regime, just as we see it desirable for Freddie Mac and for Fannie Mae. However, we recognize that while broad-based support appears to exist for action on how to provide that supervisory system for Fannie and Freddie, a similar consensus may not exist with respect to the Federal Home Loan Banks. We would, however, be willing to and would look forward to working with Congress, the Home Loan Banks and other interested parties to see if a resolution can be achieved on this issue as well.

So, in conclusion, where are we? Let me review once again our main purpose in being here this morning. It is to discuss how best to promote the strength and the resilience of our housing finance markets in order to increase, make further progress in advancing homeownership throughout the Nation.

The housing-related GSEs were created by Congress to assist in that very mission. Our aim must be to give them the caliber of supervisor that the importance of their mission requires. In so doing, I am confident we will promote greater confidence in the marketplace among investors in these entities and thus, in that way, we would advance the larger goal of homeownership.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Secretary.

[The prepared statement of Hon. John W. Snow can be found on page 73 in the appendix.]

The CHAIRMAN. Secretary Martinez.

STATEMENT OF HONORABLE MEL MARTINEZ, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary MARTINEZ. Chairman Oxley, it is a real pleasure to be with you today, and Ranking Member Frank and other members of the committee; and I really am delighted to have an opportunity to join my colleague, John Snow, Secretary of the Treasury, to discuss these important matters relating to GSE oversight and regulation.

Secretary Snow has outlined the principles and priorities the Administration supports. He and I are in full agreement. Congress and the Administration have an opportunity and an obligation to strengthen the regulatory structure of the GSEs.

A strong regulator is in everyone's best interest: the Administration, the Congress, Wall Street, investors worldwide and, most importantly, the American taxpayer.

The administration has a dual goal. We must ensure that through the GSEs financing is available for low- and moderate-income families, and we must ensure that the GSEs are subject to rigorous oversight so that they are serving their public purpose. The housing sector directly accounts for about 14 percent of the Nation's total gross domestic product and the housing market actively drives closely related components of the economy as well.

The GSEs play an integral role in our Nation's housing finance system by expanding the availability of mortgage credit. The liquidity and stability they provide have helped buoy the Nation's economy. Because of the housing GSEs' impact on the economy, it is critical that we ensure their safety and their soundness.

The Office of Federal Housing Enterprise Oversight was established following the thrift crisis as an independent safety and soundness regulator. It was placed within HUD, and it was essentially to regulate Fannie and Freddie Mac. There is a misconception that HUD controls and has direct authority over OFHEO in the exercise of safety and soundness and duties. HUD does not. By statute, Congress has mandated that OFHEO's safety and soundness determinations must be made independently of HUD.

To ensure that the GSEs have appropriate financial oversight and are held accountable to their public mission, the Administra-

tion supports strengthening the power of the GSEs' regulator. Doing so would make the regulator more comparable to the stature, powers, authority, and resources of other financial regulators charged with safety and soundness oversight. Such a concept has worked well for financial regulators in other instances, including the Comptroller of the Currency and the Office of Thrift Supervision.

Currently, safety and soundness regulation is divided, with new program approvals at HUD and financial oversight at OFHEO. It is the position of the Administration that both elements of safety and soundness regulation need to be consolidated in a single regulator. As Secretary Snow noted, the Administration considers it appropriate to transfer authority over new program approval from HUD to a new, strengthened regulator. HUD supports transferring and strengthening such authority to include review of all activities, new and ongoing; and such changes will consolidate and enhance the regulator's oversight responsibility and increase investor confidence in the GSEs.

As part of this transfer, the Administration is also proposing that the HUD Secretary continue to be consulted on new activities requested by the GSEs. Many new activities directly impact the mortgage and housing markets where HUD has substantial expertise. This makes it essential that such consultation take place.

While safety and soundness regulation should be exercised by a single independent regulator, the Administration strongly supports retaining another core element of the GSEs' charter, the housing goals, at HUD.

Congress established Fannie Mae and Freddie Mac to provide market liquidity and to facilitate the financing of affordable housing for low- and moderate-income families. Congress also mandated that the HUD Secretary set housing goals to ensure that those needs are met. The affordable housing goals were created to ensure the GSEs are serving individuals in those communities that are most in need. These goals direct the GSEs to serve low- and moderate-income families and provide funding in underserved areas such as the central cities and rural areas.

A third goal directs the GSEs to finance housing for very low- and low-income families.

Today, the low- and moderate-income housing goals require that at least half of all of Fannie Mae and Freddie Mac's mortgage purchases benefit families in those income brackets. But as the President's budget noted in February, numerous HUD studies and independent analyses have shown that the GSEs have historically lagged the primary market, instead of led it, with respect to funding mortgages loans for low-income and minority households. The GSEs have also accounted for a relatively small share of first-time minority homebuyers.

HUD is the appropriate agency to develop and enforce the housing goals. Institutionally our mission is devoted to furthering the goal of affordable housing and homeownership, and HUD has the most expertise in this area. Furthermore, the housing industry looks to HUD as the agency in which this authority should reside. Therefore, to strengthen HUD's housing goal authority, the Administration considers it appropriate to:

Number one, create a new GSE housing office within HUD, independently funded by the GSEs to establish, maintain and enforce the housing goals;

Number two, grant HUD new administrative authority to enforce its housing goals;

Thirdly, to institute enhanced civil penalties for failure to meet the housing goals. Explicitly provide that the GSEs act to increase homeownership; and expand authority to set housing goals and subgoals beyond the three currently established for moderate-income, geographic area, and special affordable housing.

Let me stress that we believe such a comprehensive change to the regulatory structure will strengthen the confidence of all GSE stakeholders. Investors will be better protected under a regulatory system that empowers the regulator to do the job we expect of them, and the American taxpayers will ultimately benefit.

Secretary Snow and I look forward to working with the committee members to strengthen oversight of the housing GSEs, to ensure that they are in every way meeting their public purpose and that homeownership continues to be an affordable option for American families.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Secretary.

[The prepared statement of Hon. Mel Martinez can be found on page 69 in the appendix.]

The CHAIRMAN. And to both of you, we thank you for your excellent testimony and your continued cooperation in this endeavor. And, indeed, it is an endeavor that will be successful only if we have an opportunity to work together to craft bipartisan legislation that deals with the goals, I think that all of us share, in terms of a world-class regulator for the GSEs, as well as a continued commitment on the part of HUD towards low-income housing.

And I suspect that the turnout today from the members indicates that strong interest, and you both will be focal points moving forward to get legislation passed.

I was reading a recent brokerage firm report that indicated that Congress' efforts to strengthen the regulator for the GSEs will ultimately be looked on favorably by the capital markets, and I think both of you mentioned that a first-class regulatory structure is in the best interest of both the GSEs in this case and the markets, and that ultimately it would appear, based on this study, that that is the case. And that is clearly our effort.

Secretary Martinez, you mentioned you were talking about housing goals within HUD. How much of that can be achieved through the regulatory structure and how much has to be achieved by legislation?

Secretary MARTINEZ. I believe it is necessary for legislation to enhance the effectiveness of a regulator as it relates to goals. Right now, we can set goals, but we really need enhanced authority to enforce those goals, to enforce broader civil penalties so that, really, there will be teeth behind the goals that we set.

We also want to make sure that we create a set of subgoals because, right now, the goals are a bit broad, and we want to make sure that by setting subgoals, we then can create the right regulatory framework to give some targets and also to have the en-

hanced oversight authority which would really have to come through legislation.

The CHAIRMAN. So Congress would have to set up the overall structure of what you anticipate and then allow you to work within that framework?

Secretary MARTINEZ. Correct. And then we can have regulations to follow.

The CHAIRMAN. Secretary Snow, you mentioned the potential of including all GSEs in the regulatory change, specifically the Federal Home Loan Banks.

It has been my observation, at least at the current time, that there is a divided opinion among the Federal Home Loan Banks, in a general sense of regional difference, I guess. It appears that the West Coast entities appear to be a lot more enthusiastic about being included. In my area, in the Midwest and, I suspect, the South, there is far less enthusiasm.

Is it possible during a relatively short time period of passing legislation that we would be able to include the Federal Home Loan Banks without a consensus within that community?

Secretary SNOW. Mr. Chairman, I doubt it. I think unless a consensus develops fairly quickly that we would get bogged down in lots and lots of time-consuming efforts that would jeopardize the larger objective here of putting in place that world-class regulator I talked about for Fannie Mae and Freddie Mac. So I would not personally want to see that issue get in the way of moving forward on legislation for which there seems to be pretty much broad-based support today.

I would hope, though, that the Federal Home Loan Banks would caucus and would review the situation and meet with us and meet with Members of Congress and see if there could not be some resolution on that within the time frame to get this legislation done this year.

The CHAIRMAN. Thank you, Mr. Secretary.

Mr. Secretary—both of you actually—I would like you to indicate at least some general positions on the special exemptions that the GSEs currently now enjoy. Specifically, I think our members, and I certainly, would be interested in the tax status of GSEs and their exemption from registration under the 1933 Act.

How does that play into what your testimony has stated and in terms of our trying to pass legislation?

Secretary Snow?

Secretary SNOW. Mr. Chairman, we do not propose addressing those issues in this legislation. And I think the important focus for this legislation is that strong, effective, world-class regulator. So it would be our view that those issues do not need to be addressed now.

Some of those issues, like the 1933 Securities Act, we actually come down saying they should not be addressed on substantive grounds because we don't see the need for Freddie or Fannie to be put under the 1933 Act.

The 1933 Act basically deals with fraud in the issuance of securities. There is no evidence of that. The SEC itself has indicated, I understand, that they would not want to see that happen because given the volume of issuances by the two major GSEs, they would

swamp the resource base of the SEC; and there is no evidence of any need to deal with the fraud issue.

So we would actually oppose putting them under the 1933 Act.

The CHAIRMAN. Secretary Martinez.

Secretary MARTINEZ. I believe Secretary Snow and I have concluded that the most important thing we can accomplish through these hearings and with the proposed legislation we presented today is a strengthened regulator.

There are many other issues that could arise, and we would be happy to continue to see the development of legislation. But today, our proposal is the focus of what we recommend, and I think it solely focuses on a strong regulator, a combined regulator for all of safety and soundness, and then the strengthened aspects of regulation at HUD to give us the real tool box that we need to enforce the parts of it that would remain at HUD.

The CHAIRMAN. Thank you. My time has expired.

The gentleman from Massachusetts.

Mr. FRANK. Secretary Martinez, I was glad to hear you say that, and on page 3 you make some very strong statements about the need to enhance the Federal executive ability to impose the housing goals.

Are you going to be developing specifics that give us these?

Secretary MARTINEZ. Yes, sir. We would have very specific recommendations——

Mr. FRANK. I think that is very important.

Secretary MARTINEZ. Yes.

Mr. FRANK. The problem you have is, there could be a tension between the Treasury worrying about safety and soundness and HUD worrying about affordable housing; and there is a tension there. One way is that if affordable housing was as safe and sound as everything else, we wouldn't need a government mandate to do it. There is a certain amount of greater risk. You want to minimize it. How does HUD stay equal in this tug-of-war?

Secretary MARTINEZ. Those tensions exist today, but the problem today is that we don't have—HUD doesn't have the ability to really impact the regulatory framework within OFHEO, while at the same time there is this perception that there is some oversight that the Secretary of HUD may exercise.

Mr. FRANK. I just want to tell you, I agree with the goals you spelled out. I am skeptical of what is going to happen to the housing mission if most of the regulation is in Treasury——

Secretary MARTINEZ. We still have a consulting role. I mean, in other words, as it relates to the mission, as it relates to new program approval, the proposal is going to continue to come to HUD for consultation before product approval of new products would happen.

Mr. FRANK. I am unimpressed by the right to consult. By virtue of my job, I have got the right to consult with a lot of people who ignore the hell out of me, so that reinforces my fears.

If Treasury regulates and HUD consults, Treasury wins. And you talk about more than consulting here in terms of the goals.

Secretary MARTINEZ. Well, on the other part of it, see, the problem is that safety and soundness should all be in one place, and we believe that not only the ongoing mission of the GSEs and cur-

rent programs, but potential new programs should come under close scrutiny and regulation.

Beyond that, we at HUD would then have the real enhanced type of regulation that would enable us to assist you as you are seeking to make sure that these entities are really meeting their housing goals.

Mr. FRANK. Well, I am skeptical again if all the regulatory authority is there, they approve new programs. You set out some goals—new administrative authority went out, enforced housing goals, et cetera; and you have to show me that there is not going to be a situation where Treasury is pushing in one direction and affordable housing in the other. I will need to see specifics here to believe that——

Secretary MARTINEZ. We will give you some specifics. But the truth of the matter is, there is going to always be some tension between insisting on a certain set of goals and then also——

Mr. FRANK. I agree, Mr. Secretary, but here is my point. I think Treasury is going to be the big brother here, and if one set of goals is in Treasury and the other set is in HUD, I worry about an institutional disadvantage for the set of goals that are important to me.

Let me, with that, turn to the Secretary of the Treasury, because what I am struck by here is what is not in here; and I am glad it is not in here. We have heard descriptions of the situation regarding GSEs as a great crisis and an imminent threat to financial stability. This does not change the essential relationship of the GSEs legally.

I am not for changing that, but I think we ought to note that this is not a document put forth by people who think that the sky is about to fall or that we are going to have serious damage; and I am struck by that moderate quality.

Let me ask you, Mr. Secretary—and again I appreciate that there is not a lot of rhetoric in here about how terrible these are. I appreciate that you think we should enhance the regulation, but I get the impression that you were talking more about guarding against potential future problems developing, rather than feeling that there is an urgent need to stave off some crisis.

Are we in a crisis now with these entities?

Secretary SNOW. No, that is a fair characterization, Congressman Frank, of our position. We are not putting this proposal before you because of some concern over some imminent danger to the financial system for housing; far from it. Rather what we are saying is, since 1992, or whenever it was that OFHEO was established by statute, over a decade ago, these housing markets have developed.

Mr. FRANK. Getting bigger.

Secretary SNOW. Huge. Hugely. And those entities have grown and become now very large players on the whole financial landscape of the United States. We just feel it is time to——

Mr. FRANK. Good. I think it is important to have that, to make it clear that that is the context.

Let me just close by saying, I look forward to this, and I have given you my skepticism. Housing has been my primary issue, affordable housing has been my prime issue, and I need to be convinced. We haven't done as good a job as we should in enforcing

those goals, but I will have to be convinced that they won't be at an institutional disadvantage.

Secretary SNOW. I don't think I will convince you by this, but as I view this institutional arrangement that we are proposing, Secretary Martinez and HUD would have the clear primacy on the question of what is the mission.

Mr. FRANK. And what happens if they don't meet the mission?

Secretary SNOW. If they don't meet the mission, the Secretary is asking for enhanced authority to have disciplinary powers to strengthen his hand in seeing that the entities do meet that.

Mr. FRANK. I just worry that we are going to get them in a situation where the most important question for Fannie Mae and Freddie Mac to answer is who do you like better, your mother or your father?

Secretary SNOW. Well, as Secretary of the Treasury, if this authority comes to Treasury, I would view our responsibility as soundness and safety within the larger parameter of the goals that are given to the GSEs by——

Mr. FRANK. I appreciate that. Ten more seconds. But obviously if we can find some way to write that sort of thing into the law, because personalities change, I would feel maybe a little less skeptical.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Louisiana Mr. Baker.

Mr. BAKER. I obviously have a number of subjects I would like to cover, but I am going to focus in this first 5-minute opportunity on two different approaches. One is just a clarification, as I understand, the explanations of intent. And two are—with regard to enhancements I see in your approach over H.R. 2575.

With regard to capital, Secretary Snow, I was very pleased to hear your comments so forthrightly with regard to the moratoria issue. There has been much discussion that there would be some 5-year artificial prohibition on regulatory action. And I want to go just a bit further in understanding the broad authority for supervision of capital adequacy.

My question goes to the point that although you preface it by saying, we do not intend in any way to adversely impact the risk-based capital standard recently promulgated by OFHEO, you do wish for the new regulator to have unbridled authority to adjust minimum risk-based capital adequacy based on an assessment of risk and the leverage ratios of either enterprise. Is that a fair characterization?

Secretary SNOW. Yes, that is.

Mr. BAKER. Secondly, that with regard—and this is perhaps something for both gentlemen. With regard to product approval, as I read the testimony, it appears that the broad authority again granted or requested in that instance is not only to prospective, but to currently authorized products that you may wish to review for whatever reason. In other words, you are looking for a broad grant of authority with regard to product approval. Is that a fair characterization?

Secretary SNOW. Yes, sir.

Mr. BAKER. Then there are two points that I find very important that are beyond what has been proposed in 2575. One is with re-

gard to the importance of the Presidential appointment of board members. Some have expressed concern that if the agency is located within the Treasury, that that will politicize the environment in which managerial decisions may be made. This sends an extraordinary message, in my opinion, to the broader market that you want the management of this enterprise to be separate and distinct from political appointment, which is a—the first time this proposal has been proffered. Is that correct?

Secretary SNOW. Yes. Very much so, Mr. Baker. We view these as large, substantial and important private enterprises, and private enterprises don't have their board membership determined by a political process involving the President of the United States. They have it through a nominating committee.

And we think that normal corporate governance processes that apply to other major companies and other financial institutions, and which is now recognized as the right way to do things, that is the nominating committee taking the lead on board membership, should apply as well to Freddie and Fannie.

Mr. BAKER. Terrific.

The next is, with regard to—I had recommended at one time consideration of a receivership process in the unlikely—acknowledged unlikely event there would be adverse economic developments, and it would be a necessity to act. In lieu of granting the regulator customary receivership authority, what I understand is an enhanced conservatorship, fairly unlimited, where the regulator could make appropriate decisions on behalf of the taxpayer, liquidate assets as required, satisfy creditor claims, whatever is necessary up to the very last chapter of the process, which would be included in a receivership, but not in your plan, and that would call for the revocation of the charter, which would now, under this view, be left for congressional determination; that you view it appropriate for something of that magnitude to be determined as a matter of public policy, not as an executive responsibility to close out. Is that a fair description?

Secretary SNOW. That is precisely what we are suggesting.

Mr. BAKER. Well, let me say on both of those last two points, these are significant improvements over proposals in the past, and I think you are to be credited.

I have a significant list of other things, but I will defer for other Members. Thank you very much, sir, for your leadership.

The CHAIRMAN. The gentleman yields back.

The gentleman from Pennsylvania Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Secretary, let me get this straight. You did answer Mr. Frank's testimony that there is nothing occurring of high risk. And since we are talking about reforming some of the largest financial institutions and their regulatory mechanism, what is the pressure to do this in the next 6 weeks? Congress is anticipated to adjourn sometime late October, early November, and this proposal comes to us timely in terms of we are glad to have the Administration make a proposal. But I think to put a 6-, 8-week time frame on it raises some interesting questions.

Secretary SNOW. Well, Congressman, obviously you will have to decide what priority to give it and whether to deal——

Mr. KANJORSKI. So there is nothing essential that we move through and have daily hearings here and move a piece of legislation because there is no high risk to the system?

Secretary SNOW. No. We are not before you, as I answered Congressman Frank, because of an imminent risk that we perceive of any kind. Rather there seems to be a coming together of the parties who take an interest in this subject behind a set of proposals that I think are pretty close to what I have outlined here, maybe not precisely, but pretty close, that gives us an opportunity to use that momentum to move forward, if the Congress chooses to do so, and we would urge you to do so.

Mr. KANJORSKI. I am impressed with the work you have done, but I worry about some of your definitions. I agree that we should have a strong, independent, world-class regulator. Now, my question to you is can you name any world-class regulator or financial institutions of the United States that has their policy set and their testimony reviewed by Treasury?

Secretary SNOW. No. We don't review the——

Mr. KANJORSKI. So are you using the terminology "world-class," but you are not talking about making the type of regulator here that regulates the banking system or other entities in this government? You are talking about a usurpation of authority over the regulator by Treasury.

The idea—let me put it very succinctly. The idea that Treasury on behalf of the Administration would be reviewing testimony that is going to be made to this Congress is most offensive for a very simple reason. The World Trade Center disaster, the EPA's Administrator was going to release notice to the American people of hazardous materials in New York. It was this Administration that put a clamp on the release of that information.

Why should we as the Congress in representing the American people assume that if there were real dire information that was going to be released or disclosed by the Administrator at a time that was not propitious to the Administration, politically or otherwise, that they wouldn't put a clamp on that testimony?

Secretary SNOW. Congressman, as I am sure you are aware that Treasury has that very authority today with respect to the IRS.

Mr. KANJORSKI. Well, the IRS——

Secretary SNOW. The IRS is an institution of great sensitivity.

Mr. KANJORSKI. I am not sure that quite frankly we should brag about the IRS. Didn't we just recently have to pass a Taxpayers' Bill of Rights?

Secretary SNOW. You asked me whether or—Congressman, whether or not there was any entity in Treasury which would serve as a predicate for this. I am saying the IRS is a predicate.

Mr. KANJORSKI. Well, if that is the best example you can give as a world-class regulator, the IRS, I don't think the American people——

Secretary SNOW. You asked for review of testimony, and I said Treasury does review IRS.

Mr. KANJORSKI. I asked for an example of a world-class, strong regulator.

Secretary SNOW. Until I think it is the mid-1990s, that Treasury did have that—did review the testimony of the OCC.

Mr. KANJORSKI. And thank heavens we put that aside. What I am suggesting is, look, I am one of the few members of this committee who was here in the S&L crisis, and I think if we are going to attach anything, it was a conference committee that adopted a piece of legislation in 1982 that almost destroyed the financial—the S&L industry in this country and caused a catastrophe 10 years later that we are still paying to bail out in this country.

And I don't think that, one, we should rush to judgment. Two, I certainly don't want political influence, whether it be the Administration or this Congress, getting involved with an independent, strong, world-class regulator.

The day that the Federal Reserve wants to concede that the Secretary of the Treasury and the White House should pass on its testimony, that is when we should allow the regulator of these entities to have their testimony passed on by the White House and Treasury, and not until that day, if we are going to use the term world-class, and I believe we should.

And I think that using that term "world-class" sets a standard now for Treasury and for Housing to really work with this committee and the Congress to establish a world-class, independent, strong regulator, which doesn't mean that they have to carry their testimony and have it filtered by the Administration or Secretary of Treasury.

Secretary SNOW. Congressman, can I just respond to put this—to give you our perspective on it and why we are recommending it as we are?

The Treasury's role would be limited basically to policy. The regulatory functions, the day-to-day supervision, the day-to-day oversight, the enforcement actions, the litigation and so on would be fully and completely under the control of the new regulator.

Mr. KANJORSKI. The housekeeping would be under the regulator?

Secretary SNOW. I would not call litigation and enforcement housekeeping. That is the guts of what regulators do.

Mr. KANJORSKI. Regulators have a responsibility to come to this Congress and the American people and, without a filtering process, to tell us what the status is of the bodies they regulate, what they are in, what is the problem. They don't have the responsibility of coming up here and giving us filtered information that meets the considerations and the interests of the Administration at any given time.

I am not just suggesting this Administration, but the policy we are talking about establishing here and the world-class regulator is going to be in place for the next 10, 20, 30 years, and I would not be very impressed with Mr. Greenspan coming up here and talking for an hour or two to tell us how the economy is if I knew that the Administration and the Treasury just spent the last 2 weeks filtering his testimony.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Iowa Mr. Leach.

Mr. LEACH. Let me just begin by thanking Chairman Baker and Chairman Oxley for an extraordinary job of bringing us to this point, and also the two Secretaries for moving their departments as far as they have. But, the big picture is, and I think it has to be emphasized, that these are two private sector enterprises, but

they have public powers, and one of the great questions is should they be regulated at a different level than all other private sector organizations? And up to this point in time, regulation of these GSEs has been largely written by the GSEs, and that should be understood. And now the question becomes where do we go from here?

And I think the Secretary is exactly right, that these should come under the executive branch. And clearly he was being a little understated when he said an executive branch department. It must be the Treasury.

And here then the question becomes, what about the Federal Home Loan Bank System? It is absolutely imperative that they be regulated the same way, and there shouldn't be a compromise on this. It is just definitive that OFHEO is an inadequate regulator, well-meaning but inadequate. The Finance Board is grossly inadequate, and its inadequacy is so stunning that not to insist that it be brought under Treasury in the same kind of way at this time would be a massive mistake.

Now, in the initial organization that we set up between OFHEO and Treasury and HUD, there is an effort by the GSEs to bifurcate responsibility and, for example, have the mission with HUD, and frankly, it is a mission that HUD has never looked at very seriously. I am not relating to any particular Secretary, it is just not a mission that HUD has taken seriously. I think it is clearcut that mission should go with the regulator. It should be at Treasury as well.

Now, finally, there is a little bit in the background of this that I am uncomfortable with. And Chairman Baker was quite thoughtful in his delineation and questioning of you, Secretary Snow, but the press has reported that kind of in a compromised way that there have been quiet understandings that have been developed between Treasury and the GSEs about no change in some sort of regulatory framework that exists for a 5-year period. I will tell you that that is nonsense.

The notion that a publicly empowered, private sector enterprise should have lower capital standards than a private sector enterprise is really defiant of common sense, and I think that you ought to have a full understanding that a regulator should respond to the public interests and to the competitive interests of the American enterprise in as equitable a way as possible, and that no new regulator should be shackled by any understandings prior to its establishment.

And that doesn't mean that the current framework isn't—is all bad, because it certainly isn't. There are aspects that are quite thoughtful. But to shackle a new regulator with any implicit understandings to begin with, I think, would be defiant of the idea of the independence of that regulator and also defiant of common sense.

Here, America is a little bit embarrassed. I mean, the IMF this week, of all things, and I am amazed that they have entered into this fray, but it suggested that the GSEs are undercapitalized. Whether they are right or not is not so much the question as it is—it is very interesting that you are getting both world and national attention to American regulatory oversight. And I think it is something we can't take lightly.

And so I would be very, very concerned that there be implicit agreements made in advance that don't fit the circumstance, and I would also be very concerned if we don't do it in a profoundly correct direction rather than in a slightly correct direction at the very beginning.

And, Mr. Secretary, I would like you to comment on that, if you would.

Secretary SNOW. Well, I am in very broad agreement with what you just said and don't take exception to it, to any of it.

The legislation, in my mind, would be much better, as I suggested, if it could include the Federal Home Loan Banks. I think it—if it doesn't, then one big piece of this integrated set of relationships is left out, and I think will eventually be picked up, but the sooner it can be picked up, the more coherent the regulatory framework would be. I agree with you.

On the issue of implicit understandings, there can't be any. There aren't any. There was some newspaper article to the effect of some 5-year moratorium. That is why I explicitly dealt with that in my comments. Where that came from I have no idea, but there can't be any shackles or any restrictions of that sort on the new regulator.

At the same time, I make the point that things like these risk-based capital standards probably should not be changed willy-nilly. There is some logic in a regulator having some precedental value of rules that have been entered into. But what we are asking for here is that the current statutory restrictions on the regulator in the construct of those risk-based standards be removed. That is the—that all of those restrictions, all of those definitions of how the regulator should do it be removed.

So I am in broad agreement. There are no understandings, implicit or otherwise, that would restrict the new regulator. The new regulator, though, will enter the fray working with a set of arrangements that it will want to review, but which are in place, and which will set the rules of the road for some interim period of time as the new regulator begins to review and think through what, if any, more appropriate sets of arrangements should be established.

The CHAIRMAN. The gentleman's time has expired.

Secretary MARTINEZ. May I just quickly comment, Mr. Chairman? Mr. Leach—and I don't take any personal offense about the comment about the seriousness with which HUD has approached its purpose, and I won't comment on prior HUD Secretaries, but I do want you to know that as I have looked at my responsibilities and tried to exercise them, that I have also found the resources that HUD has had available to exercise that mission seriously are not there, which is why I have insisted—and this proposal includes a number of things that I think are vitally important to us being able to fulfill that mission.

One of them, for instance, which I think is tremendously important, is the assessment authority, to give us the teeth necessary to really enforce the goals that Fannie and Freddie—which, by the way, I should also state they have always made and met the goals that HUD has set for them.

But I still believe having an enhanced opportunity to do that type of mission would really be the kind of seriousness of purpose that would allow us to fulfill it.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Vermont Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman.

And thank you both, Mr. Martinez and Mr. Snow, for being with us today.

Let me begin, very briefly, by concurring with the statement that Mr. Frank made a few moments ago. Clearly there is a major housing crisis in this country. Barbara Lee and I and others are working on a national affordable housing trust fund concept, which has over 200 cosponsors.

Mr. Chairman, I hope that this committee would be able to work with Mr. Martinez, putting on a major conference which gives us the opportunity to hear from housing advocates all over this country as to how we can solve the housing crisis. And I hope that that is something that we could do.

But let me for a moment change directions and ask Secretary Snow a few questions. Mr. Secretary, let me begin by thanking you very much for the meeting that we held in your office last July with some Members of Congress, the AFL-CIO, the AARP and other groups who were very concerned about the proposed cash balance pension regulations that were drawn up by the Treasury Department.

As you know, it is our view that these proposed regulations would not only be a disaster for older American workers, but that, in fact, they would be illegal and are in violation of Federal age discrimination law. Now, since that meeting that you graciously hosted, several positive developments have taken place for workers who have seen their pensions slashed by up to 50 percent as a result of cash balance pension schemes.

Number one, on July 31st, the Southern Illinois Federal District Court ruled that IBM's cash balance pension conversion violated the pension age discrimination laws that are on the books. They are illegal.

Number two, just last night an amendment that I offered to the Treasury/Transportation appropriations bill to prohibit the Federal Government from using any taxpayer dollars to assist in overturning this pro-employee Federal court ruling won with overwhelming support, bipartisan support, 258 to 160.

So what I would like to ask the Secretary are two questions. First, Mr. Secretary, given the IBM court decision and last night's overwhelming vote against cash balance plans, will you commit today to either withdraw the proposed regulations on cash balance plans or at least commit to not moving forward to finalize them?

Second question, Mr. Secretary, I want to ask you about a very serious related issue. According to an article in today's Wall Street Journal, quote, "in an unexpected move that involved doctored Treasury documents, the House passed an amendment that could prevent the Treasury from issuing controversial pension regulations." From the Wall Street Journal.

On Monday, an IBM lobbyist, Susan M. Semantakowski, sent a document she called the, quote, "Treasury Statement of Opposi-

tion," end of quote, to various lawmakers' staffs, including Mr. Gutknecht. The Treasury document on official Treasury letterhead, and I have that document here, noted, quote, "Treasury strongly oppose the Sanders amendment," end quote, and advised lawmakers to oppose the amendment, which it said will weaken the defined benefit plan.

Tara Bradshaw, a spokeswoman for the Treasury Department, said, "the agency didn't issue the document. It is a Treasury-generated fact sheet, stating our position on a set of past documents that were never offered."

However, they were not sent in the format that you provided, and therefore appear to have been doctored. We were not aware the document had been circulated beyond a very limited number of select staff.

Mr. Secretary, my question to you, second question, is did the Treasury Department authorize sending out these talking points against this amendment? Your spokesperson indicates that it was not the case? Number two—well, can you tell me that, sir?

Secretary SNOW. I am not aware of any authorization for any talking points of the sort you are commenting on.

Mr. SANDERS. Do you agree with your spokeswoman, Tara Bradshaw, that the agency didn't issue this document?

Secretary SNOW. Yes. Certainly I am not aware of it. If she said it, then she would know, and I would agree with her.

Mr. SANDERS. If that is the case, would you agree with me that this is a very serious fraud? If IBM or any other company was sending around doctored Treasury documents using the letterhead of the U.S. Department of Treasury, is this a potentially very serious violation of Federal law?

Secretary SNOW. Congressman, I better not comment, because I really don't know the facts on this, but it is certainly something that I intend to look into, now that you have brought it to my attention. This is really the first I have heard of this.

Mr. SANDERS. Well, this was in the Wall Street Journal today.

Sir, if your spokesperson is correct, and if a private corporation was using the letterhead of the Department of Treasury to fight against an amendment which, in fact, won overwhelmingly, I would hope that you would agree with me that is a hugely serious issue warranting an investigation by your Department and the Department of Justice. Can I have your commitment to go forward on that?

Secretary SNOW. I will certainly look into this and try and get at the base of what the facts are and take whatever steps are appropriate in response.

Mr. SANDERS. Can I expect to hear from you——

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Ohio Mr. Ney.

Mr. NEY. Thank you, Mr. Chairman. I want to ask a question of Secretary Snow.

I am aware, as you are, of the strength of the housing market in the United States and how that has supported our Nation's economy, which, as I stated earlier during a recent economic downturn. The market, as you know, relies on a constant flow of liquidity provided by the secondary mortgage markets, and the strong

capital base among the regulated companies. I think we can all agree that the stability of a strong capital regime is important not only for safety and soundness, but also to signal the strength of this sector of our economy.

Now, it is my understanding that you are recommending no change to minimum capital standards for Fannie Mae and Freddie Mac and no current change to the newly adopted risk-based capital standards. I state this because it is important to have stability in the capital markets. Is that correct?

Secretary SNOW. Yes. That is right. What we are recommend—no, we are not recommending any change in the current standards as part of this legislation. That is correct.

Mr. NEY. Mr. Chairman, the second question, we all recognize the issue of GSE regulations as vital to our Nation's housing markets, and as Chairman of the housing subcommittee, I believe that your comments about the need to strengthen the safety and soundness are critical to the stability of the U.S. Housing markets. I commend you on that.

As we move forward, I just want to make sure that we are all taking from the same page. So to be clear, what we are talking about today is moving safety and soundness regulation of Fannie Mae and Freddie Mac to the Treasury Department?

Secretary SNOW. Yes.

Mr. NEY. We are not really talking about any adverse change to the housing mission, nor are we talking about any changing to the GSE charter or status in the marketplace. Is that correct?

Secretary SNOW. That is basically correct, although, as Secretary Martinez has said, the Administration is recommending strengthening the hand that HUD has on that side. And we are recommending one change, and that is that the President no longer have responsibility for appointing some number of directors to the two entities. Other than that, no.

And we would, of course, want to see the strong regulator put in place, and then the strong regulator would deal with subsequently the issues you raise, like what are the appropriate risk-based capital standards. But we are not changing those in the legislation.

Mr. NEY. Thank you, Mr. Secretary. Thank you.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Illinois Mr. Gutierrez.

Mr. GUTIERREZ. I want to thank you. I want to thank Treasury Secretary Snow and HUD Secretary Martinez for appearing before us today. It is clear, after having read their statements and listening to their testimony, that they understand the vital role of GSEs in making home ownership a reality for low-income and minority families. And I want to tell them both that I look forward to working with them in this process to improve the financial regulation of the companies and allowing their important role to continue.

You know, we have the best housing finance system in the world, but it is not for everyone. Home ownership rates are at historic highs, 68 percent, but it is only at 47 percent for African Americans and 46 percent for Hispanics. The GSEs have a congressionally chartered mission to make home ownership more affordable and more available.

I want to make sure that in this legislative process, these companies are able to continue their work to reach potential homeowners in underserved populations and underserved areas of our Nation. HUD establishes clear goals that companies must meet in lending to low- and moderate-income Americans in underserved areas, and special needs populations, and I was delighted to hear from Secretary Martinez that they have always met the expectations of HUD.

And I know the Secretary wants more resources in order to make those housing opportunities available to more. I know that many of us work with both Freddie Mac, and I particularly with Fannie Mae in my congressional district, and I understand they have pledged $700 million in housing capital to several—4.6 million minority Americans by the end of the decade. I want to applaud those efforts.

In whatever final regulatory structure is determined for housing GSEs, we should be careful to preserve the ability of all housing GSEs to improve the secondary mortgage market by developing innovative new products which are consistent with their mission. And they have many. Parents can help now. We have got it down to 5 percent. There is all kinds of things taken into consideration so that people can get into it, and I think that is what makes Fannie Mae and Freddie Mac unique.

So I support strengthening. And I would just like to ask Secretary Martinez and Secretary Snow if they can just assure us today that the new structure that is being proposed will not disrupt the important mission these companies play for potential homeowners in underserved populations and in underserved areas of our Nation?

Secretary Martinez.

Secretary MARTINEZ. Sir, I believe that it is important for us to keep in mind that the GSEs and Fannie and Freddie, specifically, play a vital role in the housing market in our country; that they have had a tremendous impact in the booming housing market that we have enjoyed over the last several years.

In addition to that, I just also want to make sure that we state that President Bush is committed to increasing minority home ownership. We have had that as a focus in our Department. And Freddie Mac and Fannie Mae have been part of the Administration's American dream—Blueprint for the American dream, commitment partners in that effort. They do good work. We want to ensure that also is the case into the future. By providing us with some additional tools for us to fine-tune the housing goals, I think it would only enhance our ability to enforce the housing goals, but also their ability to meet them.

I also believe, Congressman Gutierrez, that as we look to expand the role of homeowners, as you expressed and as we are working together to do, that creating more investor confidence in the GSEs, that giving the financial markets that confidence of a strong, world-class regulator will invite more investors to come into the housing market to invest, therefore providing more liquidity and hopefully lower mortgage rates, and that at the end of the day is the real key to increasing home ownership for low- and moderate-income people.

Mr. GUTIERREZ. I thank you, Mr. Secretary, for that response. I look forward to working with you and Secretary Snow in achieving what we need to achieve to put confidence that is necessary into it, but allowing them the ability to be innovative, to be creative, and to put the products out there.

I would like to yield the rest of my time to the gentleman from Vermont Mr. Sanders.

Mr. SANDERS. I thank my friend very much.

Mr. Snow, you didn't get a chance to answer the question, the first question. That is, given the IBM decision from the Southern District of Illinois and last night's vote on cash balance plans, will you commit today to either withdrawing the proposed regulations, or at least commit to not moving forward to finalize them?

Secretary SNOW. Congressman, I want to review that legislation that carried last night. In the process of reviewing those court decisions, I have not yet fully digested the three major decisions that have come down since our good meeting over at Treasury, but let me say this to you. We take seriously these concerns that you, among others, have been in the forefront of raising. I think I expressed to you my commitment to deal with this issue with the utmost seriousness that it deserves. And let me say, without making the commitment you are asking me to make, that I will commit to work with you toward finding a satisfactory resolution to what now is a very, I will grant you, tangled situation.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from the first State Mr. Castle.

Mr. CASTLE. Thank you, Mr. Chairman.

I would just like to thank the distinguished Cabinet Secretaries for being here, for making real proposals before this committee. We are used to attacking and defending. We often don't get red meat such as this to deal with. I for one have enjoyed this morning and enjoyed what you have done.

I just would like to clarify a couple of things. Let me start with you, Secretary Snow. On page 6 of your written testimony, you stated in the context of this accommodation of operational independence and policy oversight, the Administration, quote, would be willing to support proposals to establish a new agency at the Bureau of the Treasury.

That is not quite as strong as, we are proposing, or we absolutely agree with. Is there a reason why that is not quite as solid?

Secretary SNOW. Yes. I will tell you, Congressman Castle, what the hesitancy there is. We don't see a lot of merit in simply putting OFHEO in Treasury. If you want to do that, you might as well just leave it where it is. What we are talking about—and I understand this sensitivity on politicization, but what we are talking about is putting it in Treasury so that the policy resources of Treasury, the expertise of Treasury can be brought to bear on the new regulator not in a way that is politicized. I want to make that clear, but in a way that brings this—the range of expertise that Treasury has, dealing with all financial markets—to bear on the question of these important housing markets which also impinge on all of those.

Mr. CASTLE. But it is not a hesitancy to have this regulatory agency in Treasury, it is more of what you just stated.

Secretary SNOW. No. If we got it on those terms, we would strongly recommend it.

Mr. CASTLE. What about funding sources? You stated on page 2, inadequate resources. Would the funding sources be dedicated sources or subject to appropriations? Have you given any thought to that?

Secretary SNOW. We feel that, again, it would be best and we would strongly recommend that it not go through the appropriations process. We think the strong, independent regulator concept is enhanced by the self-funding rather than being dependent on Congress, which opens it up to politicization.

Mr. CASTLE. Thank you.

Tell me the rationale—and honestly I don't understand the technical differences in some of these things as perhaps I should, but the inclusion of the Federal Home Loan Banks. Most of the concern here has been aimed at Fannie Mae, Freddie Mac, and you don't hear as much about the Federal Home Loan Banks. And I see in these proposals that they are included, probably rightfully so, but I would like to hear the rationale.

Secretary SNOW. The rationale is that the Federal Home Loan Banks, in the aggregate, have a very large impact on financial markets and raise similar sorts of soundness and safety issues, and are very similar in nature in many ways to the other government-sponsored entities, to Fannie and Freddie, and, therefore, we feel logically there is a fit. They are doing basically the same thing with the same sort of Federal involvement, and the same sort of soundness and safety issues. That is the rationale.

Mr. CASTLE. Secretary Martinez, you sort of have been answering this through this morning, but just in sort of a general sense, it is your conclusion that if this restructuring took place pretty much as outlined by the two of you here this morning, either by legislation or fiat of the executive branch or whatever it may be, that the focus on housing that you speak about, particularly low-income and middle-income-type housing, is a mission that you could carry out better than you do today?

Is the bottom line, is the scale—this would be an improvement in terms of the delivery of your services?

Secretary MARTINEZ. I think it would be a tremendous improvement because the real importance to our mission is in the housing goal—in the—is not in the new product approval, in which we would only have that consultation role. But it is in the other part, which is in the housing goals, and the setting of the goals, and the enforcing of these housing goals. I think that in that instance that we will have a tremendously enhanced ability to do the job.

I believe also, dovetailing into the answer that Secretary Snow gave to you with respect to the location of the regulator, I believe it is tremendously important that we have a world-class, fine regulator with all of the tools needed in that tool box to be an effective regulator. That is far more important than the location of the regulator. And in the way we have described it here, safety and soundness, including current and new program approval, should be under one roof with one regulator, not bifurcated, not divided.

And then the second part, the housing goals would remain at HUD. And also very important, the fair lending—observance of fair

lending would also remain at HUD. But with the scheme we are proposing, it will enhance our ability to meet the desired goals of why the GSEs were created, which is providing mortgage money to low- and moderate-income families, to first-time home buyers and minority home buyers.

Mr. CASTLE. Thank you, gentlemen. I agree with what you are trying to do. I hope we can work together to make sure we do it correctly.

I yield back.

The CHAIRMAN. The gentleman yields back.

The gentlelady from California Ms. Waters.

Ms. WATERS. Thank you very much.

First of all, let my say to Secretary Snow that when I rushed in this morning and gave my opening statement, I failed to acknowledge you, and let me apologize for that. I am certainly pleased that you are here and have enjoined working with you, and appreciate the assistance that you gave to us on the Haiti issue. So welcome.

Secretary SNOW. Thank you very much.

Ms. WATERS. We are glad that you are here.

My question is directed to toward Secretary Martinez. In your testimony, you described how you would like to strengthen HUD's housing goal authority by way of creating a new GSE housing office within HUD, independently funded by the GSEs to establish, maintain and enforce the housing goals.

You also go on to describe that it would grant HUD new administrative authority to enforce its housing goals, institute and enhance civil penalties for failure to meet housing goals, explicitly provide that the GSEs act to increase home ownership and expand authority to set housing goals, set goals beyond the three currently established for moderate-income, geographic area and special affordable housing.

Mr. Martinez, I am very much aware of Fannie Mae's contribution to affordable housing. Fannie Mae provides the most affordable housing capital for low- and moderate-income and minority households of any company in the Nation. In 2002, Fannie Mae financed over $136 billion in loans to nearly 985,000 minority families.

Fannie Mae also, I am told, must achieve specific affordable housing goals set for the company by you, the Department of Housing and Urban Development. And the company has surpassed every goal since HUD first began setting goals in 1994.

Above and beyond the HUD goals, Fannie Mae leads the market in providing home financing, of course, to minorities.

Secretary Martinez, if it ain't broke, why do you want to fix it? Have the GSEs ever missed their housing goals?

Secretary MARTINEZ. The housing goals as formulated currently have always been met by the GSEs, but what we are talking about here is to enhance those goals, because while I am not here to suggest to you that GSEs are not valuable and have not played a tremendously important role, and that they are a tremendous asset to the housing market, I also must point out to you that our studies show, and other independent studies also show, that they have historically lagged the primary market instead of led it with respect

to funding mortgage loans for low-income and minority home buyers.

So they have also accounted for a relatively small share of first-time minority home buyers as compared to the market at large, without the advantages of being a government-sponsored enterprise.

Ms. WATERS. As compared to the market at large?

Secretary MARTINEZ. Correct.

Ms. WATERS. Meaning all of the banks and financial institutions and the mortgage companies, they have lagged in first-time home buyers?

Secretary MARTINEZ. Correct.

Ms. WATERS. I would like to see that study.

Secretary MARTINEZ. Well, my point in that is not to suggest that we don't value their contribution. We tremendously value it. But at the same time we also believe that in order for us to fulfill our mission like you expect us to do, that we have got to have the tools to do it. We need to have an office that is devoted to GSE oversight and regulation, those parts of it that we will keep at HUD.

In addition to that, we need to have the financial ability for assessment, just like other regulators of financial institutions do, so that it is depoliticized and it is handled as a regulatory matter. We believe that those things being done in the way we are proposing here will enhance what you and I are both trying to do, which is get more home ownership opportunities into minority households and into low- and moderate-income people so they can taste the dream of owning a home.

Ms. WATERS. Well, certainly, Mr. Secretary, we certainly do have the same goals. What I don't want to see is an expanded bureaucracy. You are talking about setting up a whole new office, and you are talking about having them pay for it. As you know, many communities depend on these GSEs for all kinds of new activity that will lead to home ownership. And they support this in many different ways, and sometimes some very constructive ways. I don't want that stifled. I don't want another layer of bureaucracy to prevent that kind of flexibility. And I am really worried about them, if they have met all of their goals, and you think that they need to have new goals set because they are good at what they do, why don't you just set new goals and let them continue to do what they do, rather than setting up a whole new bureaucracy to do it?

Secretary MARTINEZ. Because right now we don't have the ability to fine-tune the goals, to set them the way that we want to set them. That is why we are asking for the additional power through this legislation. In addition to that, I truly believe——

Ms. WATERS. And you are saying that you have to have a whole new office to do that?

Secretary MARTINEZ. Here is what I want you to understand. I don't want to juxtapose your appreciation for GSEs and mine. We are on the same boat. We agree that they have been good and valuable, they do a lot of good in neighborhoods. They have created liquidity in the mortgage markets.

What I am looking to do is to enhance that opportunity, to give the markets more confidence in the GSEs, and then give us the

ability to live up to the responsibility we are given by Congress, which is to oversight appropriately.

In order for us to get it done and get it done right, I believe that we need these enhanced opportunities and these enhanced powers, and that really is as a result of having been in HUD for a couple of years, having had an opportunity to look at issues that have come up, and not always felt like we had—we had the expectations that we would carry it out, but not always the ability to carry out our mandate.

Ms. WATERS. We may not have—is my time up? Okay. Thank you.

Mr. BAKER. [Presiding.] Mr. Royce.

Mr. ROSS. Thank you, Mr. Chairman.

Secretary Snow and Secretary Martinez, we thank you both for your testimony. And I want to share with you, I have proposed to create an independent regulator in the Treasury Department with greater enforcement powers to oversee the three housing GSEs, Fannie, Freddie and the Federal Home Loan Banks.

And I think this proposal is important not only because it creates a new agency in Treasury, but also because it includes regulation of all three housing GSEs, and it mandates the new agency Director to work with other financial institution regulators through FFEIC. This country needs a world-class regulator of the housing finance sector, and I think we all know that Treasury has the expertise to create one.

Experts believe that all three GSEs need to be in the mix if we want to achieve effective safety and soundness oversight. These are the largest derivative players in the world. We are talking in each case about portfolios that are in excess of half a trillion dollars in interest rate derivatives. So the new regulator needs to see the whole market to ensure the best practices of risk management.

There is another argument for including all three GSEs in regulatory reform. The bond market experts that I have talked to have told me that if Fannie and Freddie receive a new regulator under Treasury, and if the home loans remain under the finance board, then on a relative basis, Fannie and Freddie would have a competitive advantage in the bond market, and thus a lower cost of capital.

We should not enact legislation that favors one group of GSEs over the other. I know some of my colleagues are concerned that while right on the merits, inclusion of the Home Loan Banks could derail regulatory restructuring for Fannie and Freddie, and others have suggested that we should not include the home loans in any legislative effort because it is politically difficult.

Well, I disagree with both of those views. Over the last 2 months, I have sensed momentum building for this proposal to include the three GSEs. Some of the most significant players in the bank system have endorsed this concept. These are not just west coast players. I know this as a fact. I have had conversations with them. I believe support is much broader than the Chairman indicated. And as the others understand they are going to be at a cost of capital disadvantage, they will come around as well.

So, Secretary Snow, we have an historic opportunity here to create the optimal world-class regulatory framework to protect the financial system and the taxpayer, and I think this is the time for

us to show leadership. We heard from Federal Reserve Chairman Greenspan. He said we need all three GSEs included, to view GSEs in total. You have said all three should be in. We know it is the right thing to do. We know momentum is building for it. Why don't we just do it?

Secretary SNOW. Well, Congressman, I am in broad agreement with everything you have said. And I, of course, reviewed, before coming up here today, H.R. 2803, your legislation, and see, as you know, broad complementarity between your legislation and what we are proposing as a set of concepts.

No, for the reasons you state, this is one market. They are part of this market, and they ought to be included. And the reason I suggested earlier that I thought that, despite some holding back on their part now, there was a good prospect that they could come aboard, is the very cost of capital discrepancy which would be created, which I think there is a growing recognition of. And that will compel their entry into this regulatory system, or else they will be at a terrible competitive disadvantage. So I think, at least I am hopeful, that as they see this legislation moving, they are going to want to be aboard.

Mr. ROYCE. Well, I think we should include—you know, as we move forward, I think for all of the reasons that you have indicated, Secretary Martinez has indicated, we should put forward this legislation in the optimal version and see if we cannot gather political support for it as we mark up the legislation. That is what I am proposing.

Secretary SNOW. Congressman, I would very much agree with you and hope that we can do that. I do want to make this point clear, though, that from the Administration's point of view, from Treasury's point of view in particular, just changing the geography creates no rationale to put it in Treasury.

The rationale for putting it in Treasury is this broader market knowledge which can be brought to bear on these issues because these markets integrate with lots of other markets.

Mr. ROYCE. And the expertise and managing those and so forth. Thank you, Mr. Chairman.

Mr. BAKER. The gentleman's time has expired.

Mrs. Maloney.

Mrs. MALONEY. Thank you, Mr. Chairman.

I thank you, Secretary Snow and Martinez, for your testimony, and I am pleased that the Administration has joined the debate on reform of the GSE regulators. I personally have long believed that the GSE regulators should be strong and independent and not subject to the yearly appropriations process to preserve safety and soundness, and I have cosponsored legislation in the past, advocating this position. I believe the current situation where OFHEO's resources appear to be stretched thin as it deals with the Freddie Mac restatement is an example of why this reform is needed.

But before I get into specific questioning, I also want to say that I am very concerned with the developments at the Federal Housing Finance Board on the issue of multidistrict bank membership. If we are going to have a 21st century Federal Home Loan Bank system, I believe it needs to reflect the reality of today's financial services industry where company operations are no longer confined by re-

gion or state lines. And I want to let you know that I want to work with you to resolve this issue, if it is determined that legislation is needed to make multidistrict membership possible.

My first question deals with GSE loan limits. Currently the GSE loan limit is well below the cost of the average moderate family home in the district that I represent, and many others across the nation. And I would like to know, is there any inclination on behalf of the Administration to further reduce that limit in any legislation, and do you favor keeping the process the same for setting the loan limits?

Secretary MARTINEZ. Congresswoman Maloney, if I might try to answer that. I would say that we have reviewed that at HUD from time to time, and have concluded that under the various suggestions that have been made, the limits would probably remain the same, given a different way of analyzing it from what currently is done.

And at this time we would be willing to discuss this further with Members if this is your desire, but we do not have a proposal to alter the current way in which the loan limits are set. It is not part of what we are proposing today, but we would be open to discussing it further.

Mrs. MALONEY. Thank you.

And, Mr. Snow, you mentioned the wider range of knowledge of Treasury, and I would like to really question how GSEs would fit into Treasury's role as a participant in the capital markets. And as you know, the Federal deficit will well exceed a record half trillion dollars in fiscal year 2004, and are you concerned that there could be a potential conflict between Treasury's role as a participant in the capital markets actively working to finance the U.S. debt, which now will be with us for many years, and the role as a regulator of GSEs, who are massive participants in the markets in their own right, and would—do you see a conflict, or would you favor specific measures to prevent conflicts?

Secretary SNOW. Congresswoman, today, recognizing that both Treasury and the GSEs are large participants in the debt markets of the United States, we have a process for very close coordination. And before the GSEs go into the market with their debt instruments, they coordinate with Treasury so as to make sure that we know what they are doing, and we aren't acting in some way which exacerbates some market condition.

I don't see any reason why that would change. And whether we go forward with—whether you go forward with legislation to create this new entity, or whether that entity is in or out of the Treasury, that coordination, which is a well-established practice, would continue.

Mrs. MALONEY. So you don't think there would ever be a situation where Treasury would threaten GSEs because of how their debt issuances could increase competition with the U.S. government and the debt market?

Secretary SNOW. No, "threaten" is the wrong word. There is an interesting coordination, though, and that coordination goes on today where we regularly are in conversations with the GSEs about their debt issuances. That is I think an important practice, to con-

tinue to preserve orderly markets, but it is not a matter of threatening. It is a matter of maintaining orderly markets.

Mrs. MALONEY. My time is up. Thank you very much.

Mr. BAKER. I thank the gentlewoman for yielding.

Mrs. Kelly.

Mrs. KELLY. Secretary Martinez and Secretary Snow, thank you very much for your patience with our questions.

Secretary Snow, I want to congratulate you on the structure of what I perceive to be an attempt to remove politics from a regulating system. The independent funding that you have asked for the new agency is one step. The other step is the fact that you would remove all presidential appointments from the boards. I think that limiting those two political possibilities with regard to this new agency really goes a long step toward removing politics, and I congratulate you on that because I think the American public really does not want a political situation. This is a financial situation and should be not involved in political structures, but if you are asking for no presidential appointments on the Fannie and Freddie boards, would you also call for no presidential boards on the boards of the Federal Home Loan Banks?

Secretary SNOW. That is an issue that I have not addressed in my testimony and for some reason have not had a chance to give much thought to. Let me think about that and get back to you because I have not. Maybe Secretary Martinez——

Secretary MARTINEZ. I believe that currently board members of the home loan bank boards are not Presidential appointments.

Secretary SNOW. The Federal Housing——

Mr. MARTINEZ. That is right. There are no Presidential appointments.

Mrs. KELLY. So what you are saying then, there would be no Presidential appointments to the boards of Fannie, Freddie, any of the GSEs, including the Federal Home Loan Banks, if the Federal Home Loan Banks were to be a part of this agency; is that correct?

Secretary SNOW. That is my understanding. Because they are currently appointed by their——

Secretary MARTINEZ. Members of the Federal Housing Finance Board.

Secretary SNOW. By their board members, yes.

Mrs. KELLY. I wanted to ask one more question, and that is, in your testimony, you talk about timely corrective action. Would you be willing, both of you, to talk about what you consider to be timely corrective action? What do you envision in terms of some kind of an absolute stringent action and a strong fine? What are we talking about here?

Secretary MARTINEZ. Well, I would say—and, by the way, I also want to point out that our request is also that those parts of HUD's oversight over the GSEs that remain would also be independently funded, just as the Treasury would be. But I would say that, for instance, if we were to find a deficiency in meeting housing goals that we would immediately have the opportunity for enhanced civil penalties that could accrue or to take other administrative actions to enforce our housing goals so that we could direct the GSEs to take certain actions to enforce the housing goals. Right now, while they have always met them in the past, I think the goal setting as

well as our enforcing of the failure to meet them would be a little up in the air.

Mrs. KELLY. Secretary Snow, do you want to answer that?

Secretary SNOW. With respect to the soundness and safety and that whole range of the regulatory jurisdictions, the timing would depend on the regulator's determination of what is needed. I wouldn't put any strictures or constraints on the regulator.

Mrs. KELLY. So you would leave it up to the regulators?

Secretary SNOW. To act as needed, yes.

Mrs. KELLY. I would like to explore that with both of you a little bit more, but I am going to yield my time. Thank you very much for being here.

Mr. BAKER. [Presiding.] I thank the gentlelady for yielding back.

Mr. Gonzalez.

Mr. GONZALEZ. Thank you, Mr. Chairman.

I am going to make some general observations which will be the backdrop for the questions.

You have heard a lot about consensus. My understanding of the consensus that has been reached among members is that OFHEO did not do a great job, and we can improve on it, and we should improve on it. That is our responsibility and duty. But I haven't heard the consensus that we are going to change the character or the purpose of a GSE. Because I would challenge everyone to say if you don't have them in the present capacity in what they do, then who would fill that void? And there is room for everyone out there. I truly believe that. I believe in the competition and I believe in the products being out there, whether it is the private sector or GSE. It is a combination. But there is a demonstrated need for the GSE. That is why they were created and why they continue to be viable today.

There should be constant, effective oversight. How are we going to do that? We can do it better than OFHEO. My fear, though, which you all have outlined, and my understanding is that you all are in agreement, there is a meeting of the minds that you understand GSE's role, how pivotal and important they are, and you want to maintain that. So I am hoping that I am reading that correctly.

Secretary MARTINEZ. Let me leave no doubt about that. You are reading that totally correctly. There is no misunderstanding there.

Mr. GONZALEZ. I appreciate that because then we are all on the same page when it comes to that. Let us just see when we get to the last chapter it remains in that form.

My question to you is, my fear is—which you have outlined—really it does contemplate indirectly or de facto changing the charter, changing the mission, changing the status, and even micromanaging GSEs if you think about what you all are proposing. Because if you go over just your statements, which are general in nature, I know, but the powers are going to be so broad that this world-class regulatory agency is going to have that they could affect it, and I can say de facto or even directly with some of the powers that you would have.

So the first question, and it will address it and will allow you to elaborate on it, let us say Secretary Martinez is in sync with the GSEs as to the goals, the mission, the product that gets them

there, the means to the end. But you are only consulting. They only consult you, this world-class regulatory agency that may be within Treasury or I don't know where. Which—my second question is world-class regulators require world-class expenditures and finances, but that is the second part of the question. The first one is the Secretary is in sync with GSE and such, they know the products that will get them there but wouldn't Treasury, if the regulator was in Treasury, have the final say? Don't they trump you? Don't they trump the GSE, which goes back to micromanagement?

Secretary MARTINEZ. What I view as a more important function of HUD's role as the housing-oriented department is the housing goals. I believe that as to safety and soundness, where now we have absolutely no oversight over the GSEs because it is done by OFHEO which by statute is independent of HUD and the only change would be that also the current and new programs would then be reviewed by Treasury or by the new regulator, the fact of the matter is that new program approval is not as vital a function towards the housing goals of the GSEs as the goals themselves. So we believe that under this regulatory scheme it will not lead to necessary conflict but it also will enhance our ability to enforce the goals and set the goals more appropriately, while giving Treasury the ability to do appropriate oversight over safety and soundness.

Don't forget that we are looking now at entities that are in the neighborhood of $1.5 trillion. These are very vital entities to the American economy, and I believe that by definition HUD is not a financial regulator. Some of these other regulations that you might define as micromanaging are really no different than the regulations that today any commercial bank has to live by in terms of bank examiners and other bank regulators.

So I don't believe that we are really looking to micromanage the entities. In fact, they are successful, and they are vital. What we are looking to do is enhance the confidence that the investor community would have in this regulatory scheme that would then give them an enhanced ability to continue to attract more and more market from around the world into the housing market for the American taxpayer.

Mr. GONZALEZ. But the new regulator has the final say as to how you get from A to B?

Secretary MARTINEZ. It has the final say as to safety, soundness and current and new product approval, but it does not have the final say as to what the housing goals should be. And even today we have that current tension.

Mr. GONZALEZ. I understand that, but how you achieve those goals is pretty important, isn't it?

Secretary MARTINEZ. Yes. But the regulator doesn't tell Freddie and Fannie—HUD doesn't tell Fannie Mae and Freddie how to achieve those goals. We tell them here are the housing goals——

Mr. GONZALEZ. The Treasury, would because they would have final say over a particular product at any given point in time.

Mr. BAKER. That has to be the gentleman's last question because he has expired his time. But would you care to respond?

Mr. GONZALEZ. If Secretary Snow or Secretary Martinez would answer.

Secretary MARTINEZ. I think since I have been in the line of questioning maybe I should finish what I started, but I do believe that at the end of the day with consultation from HUD that we would achieve the kind of joint decision that is necessary and that responsibly we should come to it. I mean, it is not an either/or. I think we can work together to get this done; and, frankly, I would be greatly relieved not to have the appearance of authority without the actual authority that currently HUD enjoys.

Secretary SNOW. Could I just respond as well that we think of this new regulator—the GSEs take their mission and their goals from HUD and, within those set of parameters, the new regulator would regulate with respect to safety and soundness. On this issue of micromanagement, the powers that we are seeking to give the new regulator are the powers that first-class bank regulators have, that the OCC has or Federal Reserve has, and I do not think anybody says that the Federal Reserve or the OCC is micromanaging the Nation's banks and neither by using these powers will the new regulator be involved in micromanaging these financial institutions.

Mr. BAKER. The gentleman's time has expired.

Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman.

I first want to compliment Mr. Baker for having pursued this issue. He has been looking at it for quite a few years and has kept it alive, trying to point out some of the problems that the GSEs face with the excess of debt and some of the problems that we face. But I think that, from the conversation I have heard today, the consensus is that we just do not have enough regulations and all we need is a world-class regulator and everything is going to be okay.

I think we are failing to look at the real problem and the cause of our crisis we face. I am concerned that we are going to have a world-class adjustment to the distortions that we, the Congress, the Fed, and the Treasury have created over these last several decades; and it seems like there is essentially no concern about that.

These programs were originally set up to help poor people get affordable housing; today we have a program that helps people buy a house for over $300,000 and get subsidy for their mortgage payment. At the same time, the administrators of these programs make millions of dollars. So I think we have lost our way on this.

But the biggest concern I have is that Congress is not looking at the real problem, and to me it has been this implied credit and implied guarantee of this credit, are we going to get rid of this line of credit? Not likely, because that would cause a bit of chaos. But that is what has really blown these markets up, and they are distorted.

Also, we have the Fed very much involved in this. They probably wouldn't admit it, but the Fed on occasion will buy GSE securities. Foreign central banks buy these securities because it is implied that the Fed is going to come to the rescue.

Right now, overseas foreigners are buying less of these securities, and the dollar is a little weaker, and what is going to happen when they quit buying them or selling them and what is going to happen to our investors who buy Ginnie Mae and Freddie Mac? When the

dollar weakens, interest rates go up. Already the interest rates are rising long term. Could a world class regulator deal with that? Not likely. I mean, I am concerned that there is going to be a panic out of these things. As the dollar goes down, interest rates go up. And we still haven't looked at the problem and that is this allocation of credit, taking money out of the market, excess of credit to begin with because the Fed is pumping it up just like they pumped up the credit into the NASDAQ and you had to have a burst in that bubble.

Some people think there could be a bubble here. Who knows, though? It might be a great bit of distortion, but there will be a correction.

I am concerned, and I would like Secretary Snow to comment on this. Do you have a concern yourself about what could happen here? This is a huge amount of debt, a lot of investors, a lot at stake. What happens if mortgage rates go up three points in the next year and the dollar keeps weakening? We have a huge current account deficit, and the currency always goes down when you run an account deficit like this.

So I would say that we are missing the whole point here thinking that all we need to do is come up with a new agency and a world-class regulator and we are going to do some good if we don't address the subject of the dollar and interest rates.

Secretary SNOW. Congressman, as you know, the dollar and the interest rates are largely a function of monetary policy, right? And, no, we are not proposing to put the Fed under this new regulator. What we are proposing to do is to put these housing entities that have such impact on financial markets under this new regulator and give that new regulator the complete authority that would be needed to deal with the soundness and safety of the financial system that it oversees. That would be helpful.

Some of the issues you deal with are properly approached through a sophisticated, risk-based set of capital standards with a sophisticated regulator applying those risk-based capital standards and adjusting the capital requirements to the risks; and those risks include the ones you have outlined, the risks of interest rates going up 300 basis points or falling 300 basis points. That is what that sophisticated new regulator would be required to look at.

We are saying, remove the current statutory restrictions on how you look at risk-based capital. Let the regulator free to apply the most sophisticated and current and modern approaches to the question of appropriate capital structure for these entities.

So, no, we do not go the whole way here in dealing with some of the external factors that drive these markets, but taking those external factors is something we cannot control through this entity. We give the entity the ability to set the capital standards in a way to take those factors into account.

The CHAIRMAN. [Presiding.] The gentleman's time has expired.

The gentleman from North Carolina, Mr. Watt. Do you want to try the other mike? This is not a conspiracy. It is like pitching from the stretch.

Mr. WATT. Nice to know that my baseball coach is not conspiring against me.

The CHAIRMAN. Only once a year.

Mr. WATT. Thank you, Mr. Chairman.

I thank Secretary Martinez and Secretary Snow for being with us. It has been interesting.

I guess I have the capacity intellectually to differentiate between regulation of safety and soundness on one hand and the mission of the GSEs on the other hand as a practical matter. However, there are some real concerns that I have and I guess I need to put them out not necessarily for an answer today but to try to talk through publicly what my attitude might be unless some of these questions can get answered.

It is a very powerful statement in your testimony, Secretary Snow, and that you have reinforced, that this Administration views the GSEs as, quote, "private enterprises." private enterprises really have not done very well in achieving things other than making money. Most them do not really give much of a damn about poor people and whether they have housing or not, and it seems to me that an overemphasis in that direction can only make matters worse.

Secretary Martinez was absolutely right in his response to an earlier question when he said that the problem is that HUD has never had the resources to meet the mission that it has been given, and I wonder whether this further bifurcation doesn't exacerbate that.

I also wonder whether this may be a massive shell game, much on the order of what we did with the INS when this Administration decided we didn't need something called an INS anymore. Let us transfer the responsibilities over to the Attorney General and let the Attorney General deal with this.

There seems to be a growing first and second team, first and second class of departments and the importance of departments in this Administration. Those that control the financial aspects of what is going on in the world and the security aspects of what is going on in the world seem to be getting bigger and bigger and bigger, and the ones that have some involvement with the human aspects of what is going on in our domestic environment seem to be getting smaller and smaller and smaller with less emphasis. So I am worried about that.

I do not know how transferring oversight from OFHEO to the Treasury does anything other than move a shell. It is kind of enlightening to me that there is nobody here at this table to testify on behalf of OFHEO. Where are they? What do they think about this? Are they so second class now in this hierarchy that we are not even going to regard their opinion? They have been the regulators. They are the regulators currently.

So there are some bigger issues going on here that I have trouble dealing with, and I will keep trying to grapple with them. I am trying to keep an open mind about this. I am not adverse to what is being proposed. I just don't see much other than a shell game going on here, moving something from one agency to another and in the process weakening the bargaining power of poor people and lower income and middle income people who need housing, when it is quite obvious to me that the private enterprise mentality of the GSEs and this Administration is directly at odds with the public mission of providing more housing to lower income people.

The CHAIRMAN. The gentleman's time has expired. You may respond.

Secretary MARTINEZ. If I may comment on a couple of issues that Mr. Watt has raised.

First of all, Mr. Watt, let me say that I don't believe we are intrinsically changing the mission of the GSEs, because we are not touching the charter, and their mission is really given by their charter, not by what we are talking about here, which is the regulations of their safety/soundness, new program approval, and their housing goals.

Secondly, sir, I hope you will support this proposal that we have, because we are not going to create a smaller HUD. We are going to strengthen HUD. You are going to give me by this legislation a new GSE housing office within HUD. You are going to give me the ability to have that office independently funded so I do not have to have that office be only funded through the political process, and that is the way other financial regulators are funded. You are going to also give me the ability to have enhanced administrative authority to ensure those housing goals that we set are being followed. I am going to have enhanced civil penalties to enforce those housing goals, and the housing goals essentially are what you and I——

Mr. WATT. Until the Treasury tells you, you can't do it.

Secretary MARTINEZ. That is not correct. That aspect of what I do will not in any way be under Treasury. The part that is less important to what we do but that is more connected to safety and soundness has to do with new and current program approval. Those things are more closely connected to safety and soundness. They should be under one regulator, not divided under two regulators.

The CHAIRMAN. The gentleman's time has expired again.

Secretary MARTINEZ. One last thing, if I may say, if in fact there is an inference that right now because OFHEO somehow is under HUD that OFHEO and I are working together in oversight of GSEs, that is a misperception.

Mr. WATT. All the more reason they should be on the table, it seems to me.

The CHAIRMAN. The gentleman from Connecticut.

Mr. SHAYS. I want to thank you both for being here.

As someone who is tremendously concerned about the GSEs, I think this Office of Housing Finance Supervision is a step in the right direction. When I hear some of my colleagues talk about the present system working so well, in my judgment OFHEO is a joke. Congress gives them about one-third the money to regulate, and you all are asking that this office of supervision have no more power than the OCC, the FDIC, the Federal Reserve, and OTS, Office of Thrift Savings. So you are asking that they have no more power, but people in this committee do not think that the 20th and 40th largest companies or the second and fourth largest financial institutions should have the same kind of regulation. It blows me away.

Now, I have to say to you, Secretary Snow, you blew me away when you said this, that you didn't think they should come under any security regulation in the 1933 Act because you said there is

no evidence of fraud or corruption within any of the GSEs, which I think is about as an irrelevant a comment as you can think of.

That is like saying the S&Ls, no problem here, but it blew up in our face. The auditors doing consulting, this committee came and said, no, we don't mind auditors doing consulting. That blew up in our face.

Enron, the directors didn't direct, the managers didn't manage, the employees didn't speak out, the lawyers didn't do their job, the auditors didn't do their job, the bankers didn't do their job, the investors didn't do due diligence, the rating agencies didn't do their job, but we saw no problem with Enron.

But when we saw the problem with Enron, we then said we are going to have Sarbanes-Oxley. And, Secretary Snow, when we did Sarbanes-Oxley, the GSEs didn't come under it because they didn't come under the '33 and 1934 Act. So then what did we do? We voluntarily got them to comply to the 1934 Act.

I don't understand how we can say that trillions of dollars of transactions shouldn't be looked at. And could you explain to me why your position would be diametrically opposite to Allen Greenspan who didn't say we haven't seen corruption? He said, of course they should be under it. They are a Fortune 500 company. Please explain to me why.

Secretary SNOW. Well, Congressman, as you I think know, we have been in the forefront of urging both Fannie, Freddie and the home loan banks to go under the 1934 Act.

Mr. SHAYS. Why urge? Why is it their decision? And Freddie hasn't even done it yet. And let me ask you this: With all due respect, isn't it true that Freddie is in a little problem right now?

Secretary SNOW. If I could just complete the answer, because I think you will get the full picture then.

Mr. SHAYS. I am sorry.

Secretary SNOW. We don't have the authority to mandate they go under the '34——

Mr. SHAYS. You can recommend.

Secretary SNOW. Well, that is what I am saying.

Mr. SHAYS. But you recommended they may not.

Secretary SNOW. No. Let me just finish the answer, and then I think you will get the full story.

We have urged them to go under the 1934 Act. Now, you know the 1934 Act. The 1934 Act deals with corporate disclosures. It is the act which is the subject of Sarbanes-Oxley, and it is the fundamental act to oversee the regulation of the securities markets. We think it is essential that those entities all be under the 1934 Act.

Mr. SHAYS. What about the 1933 Act?

Secretary SNOW. Now let me move to the 1933 Act and make a distinction. The 1933 Act deals with a different subject. It deals with registration of securities, which is a separate subject, related but separate.

Mr. SHAYS. You don't think that is important?

Secretary SNOW. If you will let me, I will finish and tell you what I do think. I think that there is no need demonstrated for those entities to go under the 1933 Act. And maybe you weren't here when I addressed this earlier, but what I said earlier is——

Mr. SHAYS. I just don't want to take my time. You have said there is no need, and I understand. We just have a dispute.

Secretary SNOW. But I am trying to explain why there is no need. There is no evidence of any fraud in the issuance of securities.

Now, what the 1933 Act deals with——

Mr. SHAYS. I need to interrupt you because you have just repeated your statement. But the bottom line is it has a lot to do with their reserve requirements, and we know that these institutions have half the reserves set aside, and I just want to get to the second point. You, to Mr. Baker, said that this new authority can exchange reserve requirements, correct?

Secretary SNOW. Yes. We——

Mr. SHAYS. But you said——

Secretary SNOW.——are proposing a broad expansion in the authority with respect to risk-based reserves.

Mr. SHAYS. But not minimum?

The CHAIRMAN. The gentleman's time has expired.

Mr. SHAYS. Can he answer that question? Not the minimum?

The CHAIRMAN. The gentleman's time has expired. The Secretary could answer——

Mr. SHAYS. The gentleman was allowed to answer the question——

The CHAIRMAN. The Secretary may respond.

Secretary SNOW. We see no need to change the minimum standards now. What we are proposing, though, is that the agency have all the authority it needs to deal with capital standards, and my comments I think were misconstrued by you when you said I was making some observations with respect to general practices at these agencies. I was simply talking about the 1933 Act, and there we see no need for inclusion. In fact, as I said earlier, I think the SEC has observed that they don't want to see that happen because the issuances are so vast that they would overwhelm the process. Congressman, as you probably know, today, the Treasury has authority with respect to the issuance of debt instruments by those entities, and we have seen no necessity to exercise that jurisdiction.

The CHAIRMAN. The gentleman from New York, Mr. Crowley.

Mr. CROWLEY. I thank the Chairman.

I sat here through two and a half hours of testimony, and I appreciate it, and I know both of you gentlemen have as well. Both Secretaries have given—it is interesting to me in sitting here listening to the discussion and your testimony earlier that two Secretaries woke up one morning and decided that one would transfer part of their jurisdiction to the other without considerable amount of discussion and including discussion I am assuming with the apolitical wing of the White House in drafting just how that would come about, and I am sure there was considerable discussion, Secretary Martinez, within your agency as to whether or not this should happen in the first place.

Obviously, transferring jurisdiction means responsibility shifting and a failure to some degree of HUD, not speaking specifically of your reign during this time but certainly throughout the history of HUD to properly investigate and to oversee these entities and now shifting them to Secretary Snow's division.

I know back in 2002 there was an amendment of VA HUD that was proposed I believe by Mr. Hinchey to increase the funding for OFHEO to help them in terms of their needs to properly regulate Freddie Mac and Fannie Mae, and I will just note that that amendment was defeated. If it was even allowed to be brought up on the floor I believe it was defeated by this Congress.

I think it is interesting that back in 2002 there was an attempt made to try to bolster the oversight capabilities of HUD, that it was defeated by this Congress and now the result is that we see that the answer is to shift responsibility from the entity that we did not properly in my opinion give resources to enough to do the job, and we all have had problems with the oversight, to properly do the job, so the answer is let us not try to fix it within HUD, let us transfer responsibility, in fact creating more bureaucracy. I think it is interesting under this Administration of a Republican presidency and Republican government both in the House and the Senate they are actually creating more bureaucracy, is rather interesting from my point of view as a Democrat.

Secretary Snow, I can't help but have you here in front of me as well at this time to just comment on the overall issue that really I think is the heart of what Americans are concerned about right now. Some of it relates to what we are talking about. You mentioned earlier that there is no apparent immediate need to do this. I am concerned somewhat about what effect this may have on the overall market, the secondary market but also the market in general.

We know that jobs continue to be lost in this country. I just note for August alone 93,000 jobs were lost in this country. That was after the $350 billion tax cut. The President's package went into effect, and we were told we were going to see an increase in job creation. In fact, we continue to lose jobs. At this rate, the President will not see the 1.4 million jobs that he has promised through the end of 2004 if this continues, and I believe it probably will continue.

My question really is, what is happening in this economy? I asked the same question of Chairman Greenspan and got a roundabout answer. And where are the jobs that this country needs in order to get us back on our feet?

Secretary SNOW. Jobs depend upon growth and getting a strong recovery. The recovery is beginning to get under way. In fact, it is accelerating; and with the recovery I am confident we will see jobs expand and unemployment come down. But employment is a lagging indicator, and one of the things that is remarkable, Congressman, about the American economy today is the intensity with which companies and businesses are pursuing productivity.

The last 3 years have been a period of relatively weak demand following periods of ebullient demand, very strong demand, and now without that strong demand, companies have looked at their cost structures and they have taken out an extraordinary amount of costs. They have learned to do more with less. They have gotten more productive, as revealed by those productivity numbers that came out for the last quarter. While that is good in the long run because it make the pie bigger and creates more overall wealth, it is complicating in some ways this jobs picture. But with the strong

growth we are going to see, I am confident, in the quarters ahead as growth is now forecast at over 4 percent by many outside forecasters for the second half and over 4 for '04. We will see those jobs come back.

Mr. CROWLEY. Do you want to change the President's anticipation of job growth of 1.4 million?

The CHAIRMAN. The gentleman's time has expired.

Before I recognize the gentleman from Texas, I know, Mr. Secretary, you have a very important appointment at the White House at one o'clock; is that correct?

Secretary SNOW. Yes, Mr. Chairman.

The CHAIRMAN. We will be recognizing Mr. Hensarling for the last round of questioning, and the Chair would indicate that members have 30 days in which to submit written questions to either you or to Mr. Martinez. The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman. Not wanting to hold up the President of the United States, I shall be brief.

Not long ago, the Administration nominated Mark Brickell to head up OFHEO. Should Congress pass legislation transferring OFHEO's responsibilities to a new agency, is it the Administration's intention to nominate Mr. Brickell to head that agency? Do either of you gentlemen have insight into that?

Secretary MARTINEZ. I don't believe I have any information about that that I can share with you.

Mr. HENSARLING. Secretary Snow?

Secretary SNOW. Neither do I, except to say we have a high regard and support the pending nomination of Mr. Brickell.

Mr. HENSARLING. There was an article in the Wall Street Journal today alluding to a study floating around in the other body indicating that a failure of the GSEs could cost the taxpayers hundreds of billions of dollars. I am curious, are you familiar with the study and, if so, do you consider it unduly alarmist? What opinion might you have on potential taxpayer exposure?

Secretary SNOW. I have not seen that study. I just saw the newspaper reference to it, Congressman. We look forward to getting into that, but, no, I have not seen it.

Mr. HENSARLING. Finally, in the discussion of including the Federal Home Loan Banks into the ambit of potential legislation, do you consider the safety and soundness issues to be similar, or to be identical? Also, given that the Federal Home Loan Banks are not publicly traded companies, should they be under the same regulatory burden and financial disclosure of publicly traded companies?

Secretary SNOW. As you know, some of them have sought to get under, to make the same disclosures as publicly traded companies and probably will move in that direction in the future. Yes, I think for reasons I went over earlier that they present the same sorts of issues. They are in the same fundamental markets, and their soundness and safety regulation ought to be comparable to the other GSEs.

Mr. HENSARLING. Mr. Chairman, I yield the balance of my time to Mr. Baker.

The CHAIRMAN. I thank the gentleman.

Mr. BAKER. Mr. Chairman, I believe the gentleman is going to yield to me.

The CHAIRMAN. I am sorry.

Mr. BAKER. I will make it real quick.

Just for points of clarification, Mr. Secretary, on the capital issue, I understand the position currently is we do not seek nor do we expect to change any capital standard immediately on establishing whatever this new regulatory body would look like. But coupled with that is the statement that we do not, however, wish to limit our authority to change capital standards as we see fit both with regard to minimum or risk-based, based on a staff analysis of the risk assessment of the institutions or leverage or whatever standards professionals may choose to use. You do not want to have a regulatory system that constrains your ability to act in the public interest.

Secretary SNOW. That is right. That ought to be the decision of the new regulator.

Mr. BAKER. Thank you. I thank the gentleman for yielding.

The CHAIRMAN. The gentleman's time has expired.

On behalf of the entire committee, let me thank both of you gentlemen for what was an extraordinary hearing. We have covered a lot of ground. We appreciate both your strong leadership on this issue, and the committee now stands adjourned.

[Whereupon, at 12:45 p.m., the committee was adjourned.]

A P P E N D I X

September 10, 2003

Opening Statement

Chairman Michael G. Oxley

Financial Services Committee

Housing Government Sponsored Enterprises Regulation

September 10, 2003

I want to welcome Secretary Snow and Secretary Martinez to the Financial Services Committee this morning to discuss the regulation of the housing government sponsored enterprises or GSEs, thank you for joining us today. It is my understanding that the Treasury Department and the Department of Housing and Urban Development have been working closely together with the President to develop a proposal to reform GSE regulation. I am looking forward to hearing your insights and recommendations.

The U.S. housing market has been the engine of growth for the domestic economy over the past several quarters. Despite a slowdown in nearly every economic sector, the housing market has remained vibrant. Now that an economic recovery seems to be on the horizon, it is important that we act in a reasonable manner to improve the regulation of the GSEs, while at the same time ensuring that we not have an adverse impact on the housing or the equity markets. Ultimately, it is the U.S. taxpayers and homeowners that we must keep in mind as we seek to improve the current state of regulation. I hope to work in a bipartisan manner to ensure that any action this Committee undertakes has broad support as well as input from the Administration.

The housing GSEs were established to provide liquidity to the housing market and to facilitate access to affordable homes. These entities have been extremely successful in this role and have enabled millions of Americans to achieve homeownership. Their operations have been the model for housing finance around the world. However, the GSEs have developed over the years into much more sophisticated entities then originally envisioned. They have become highly complex financial institutions with obligations in the trillions of dollars. As such, it is important that the GSEs have a robust and sophisticated regulator to ensure that they continue to operate in a safe and sound manner.

A strong regulator will send the signal to the markets that these entities have solid management practices. Confidence will be restored in the GSEs and they will be able to get back to their important work without the distractions that have been plaguing them over the past several months. That is not to say that this Committee will not continue to actively oversee their operations. If there is a

change in the regulatory structure of the GSEs, we will have to closely monitor the development and actions of the regulator.

In my opinion, the current regulator does not have the tools, or the mandate, to adequately regulate these enterprises. We have seen in recent months that mismanagement and questionable accounting practices went largely unnoticed by the Office of Federal Housing Enterprise Oversight. These problems only came to light when the company announced them on its own accord. It is encouraging to know that that the boards of these companies are active and engaged, seeking to operate in the best interest of their shareholders; however, these irregularities, which had been going on for several years, should have been detected earlier by the regulator.

I would like to thank Subcommittee Chairman Baker for all his hard work in reviewing the GSEs and highlighting for the Committee the need for increased regulatory oversight of these entities. He has demonstrated true leadership on this important subject matter, and as we move forward, I expect to draw on his expertise in this area.

Secretary Snow, Secretary Martinez, I look forward to your testimony.

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CONGRESSMAN JOE BACA
September 10, 2003

I would like to commend Secretaries Snow and Martinez on the measured, principled approach to the issue of GSE regulation. While I support moving safety and soundness regulation to the Treasury Department, I am opposed to any change in the mission, charter or status as Government Sponsored Enterprises for Fannie Mae and Freddie Mac. The GSEs provide the liquidity and stability needed to keep mortgage credit available and at the lowest possible cost to homeowners and rental housing providers.

Clearly, the events of this summer underscore to all of us the volatility of the capital markets. They are at once dynamic, but are also apt to react and indeed overreact to perceptions. If the markets perceive that Congress is unsure of its support of the GSEs' housing mission, this can have an impact in the capital markets, interest rates, and-ultimately - upon the ability of low-income home buyers to purchase homes. Strengthening Fannie Mae and Freddie Mac's safety and soundness regulator will assure capital markets that the companies are subject to rigorous oversight, and that assurance will strengthen the GSEs ability to bring low cost funding to the mortgage market to fulfill their mission of expanding homeownership.

Innovation is critical to the GSEs achieving their mission of reaching underserved communities to expand homeownership. I would like to insert for the record a letter from Angelo Mozilo, CEO of Countrywide, the nation's largest independent mortgage lender. I share his views that new legislation must not impair innovation, or in anyway impede the GSEs ability to find creative means to expand access to mortgage credit for low income and minority Americans.

I would additionally like to insert for the record a letter a letter from C. Kent Conine, President of the National Association of Home Builders, who also supports the GSEs ability to innovate in the marketplace.

When interest rates rise, for any reason, minority families are often the ones who lose opportunities to purchase homes. According to Fannie Mae's own research, with each 25 basis point rise in interest rates some 78,166 Hispanic and 107,158 African American families become unable to afford a home purchase. For example Fannie Mae provided loans to 985,000 minorities in 2002. Almost a fifth of that number would not be able to purchase a home if interests rates rise. We feel the brunt of interest rate hikes the most, and therefore, we have an interest in a stable, steady GSE regulatory environment.

If we venture down the path of changing the regulator for the GSEs, I would underscore the importance of moving quickly and deliberately. The longer uncertainty continues in

the capital markets, the more likely that mortgage costs increase, eliminating homeownership opportunities for Hispanic and other minority homebuyers.

ANGELO R. MOZILO, LL.D.
CHAIRMAN AND CHIEF EXECUTIVE OFFICER

4500 PARK GRANADA
CALABASAS, CALIFORNIA 91302
(818) 225-3000

August 21, 2003

The Honorable Richard Shelby
Chairman, Senate Banking, Housing and
Urban Affairs Committee
Washington D.C. 20510

The Honorable Michael Oxley
Chairman, House Financial Services Committee
Washington D.C. 20515

Dear Chairmen Shelby and Oxley:

As you and your colleagues consider various proposals to change the structure of Fannie Mae's and Freddie Mac's regulatory oversight, I am writing to share my views and concerns as a long-time participant in the housing finance system. I applaud your efforts to ensure that these companies are effectively and competently regulated. However, I urge you to avoid any proposal that seeks to micromanage these companies and to constrain their ability to innovate and respond to market demands. It is critical that the appropriate balance be struck between safety and soundness and the industry's ability to quickly and effectively provide new and innovative products to the housing market..

Since 1969, Countrywide has helped millions of American families realize the dream of homeownership. We founded Countrywide with the objective of making homeownership more accessible and affordable. Our long-term experience in helping consumers manage what is probably their single most important asset provides us with a special perspective on the housing finance system.

We in the mortgage banking industry have seen several incredible years, with volume records being broken year after year and with housing emerging as a source of stability and growth in a sluggish economy. The success of housing is a product of several forces including Congress' and other policy-makers' continuing commitment to promoting homeownership and the efficiencies that have resulted from having the GSEs as secondary market partners. You and your colleagues in Congress should be applauded for your role in this success – a role that also comes with significant responsibility.

At Countrywide, we see everyday the benefits that the GSEs provide to the primary market and to the borrowers that we in the primary market serve. Through the tools that their GSE status provides as well as a regulatory structure that does not stifle innovation, Fannie Mae and Freddie Mac have helped the primary market to streamline processes, reach new market segments, and manage daunting volumes. Each day we see the borrower who benefits from community lending programs resulting from our partnership with Fannie Mae. Initiatives such as low- or no-down payment programs for teachers and other public employees, as well as mortgage revenue bond programs that provide lower interest rates and down payment subsidies for first-time homebuyers, are clear examples of programs that provide homeownership opportunities to those who might otherwise be denied participation in the American Dream.

Certain current legislative proposals pose the risk of interfering with the GSEs' ability to work with individual lender partners to develop and bring to market creative housing and housing finance initiatives. Among the congressional proposals to strengthen safety and soundness are misguided and misplaced proposals to encumber innovation in the mortgage finance markets by complicating the existing program approval process at HUD. An overly cumbersome regulatory process that micromanages business development and innovation will reduce, or even eliminate, the incentives for the GSEs and their primary market partners to pursue such efforts. We must encourage, not dampen, innovations such as those that gave rise to Desktop Underwriter and Loan Prospector and enabled the industry to manage the overwhelming consumer demand of the past couple of years.

Innovation is vital to maintaining and enhancing the overall liquidity function that these companies serve. Also key to liquidity is a sound approach to capital, an approach that appropriately matches capital to risk without constraining the companies' ability to fulfill their affordable housing mission. Overcapitalization of the GSEs could have unintended consequences for the housing markets in that less capital could be available to the housing markets.

Fannie Mae and Freddie Mac are central elements of the most successful housing finance system in the world. Through the efficient delivery of capital for mortgage funding and their efforts to make homeownership more affordable and available, these companies have helped make housing a bulwark of the economy. This is a system that Countrywide has been proud to play a role in for decades, and preserving the GSEs'

ability to fulfill their mission, while ensuring effective and robust regulation, will further strengthen this system.

Sincerely,

Angelo R. Mozilo

ccs: The Honorable Paul Sarbanes, Ranking Member,
Senate Banking, Housing and Urban Affairs Committee
The Honorable Barney Frank, Ranking Member,
House Financial Services Committee
The Honorable John Snow, Treasury Secretary

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September 9, 2003

The Honorable Barney Frank, Ranking Member
House Financial Services Committee
2229 Rayburn House Office Building
Washington, D.C. 20515

Dear Ranking Member Frank:

The National Association of Home Builders (NAHB) and its 211,000 members have been and remain stalwart supporters of the housing finance system in this country. An essential component of the housing finance system is the secondary mortgage market provided by the housing Government Sponsored Enterprises (GSEs) -- Fannie Mae and Freddie Mac. The GSEs provide the liquidity and stability needed to keep mortgage credit available and at the lowest possible cost to home owners and rental housing providers. The housing finance system and the home building industry are the keys to the healthy and vibrant housing market that has sustained our economy in recent years.

NAHB endorses a strong, credible and efficient regulatory system with adequate authority and resources to ensure the continued success and vitality of the nation's housing finance system. Such a regulatory structure should protect the safety and soundness of the GSEs and the interests of taxpayers. However, we oppose any changes that ignore the importance of the GSEs' housing mission and weaken the longstanding federal commitment to a "decent home and a suitable living environment for every American family." The challenge is to maintain the financial safety and soundness of these entities while preserving their demonstrated ability to promote and advance housing opportunity. NAHB strongly believes that Fannie Mae's and Freddie Mac's ability to spur innovative solutions and to develop new products that increase homeownership will continue only if the mission of these corporations is regulated by an agency with a thorough understanding of and extensive involvement in housing-related issues.

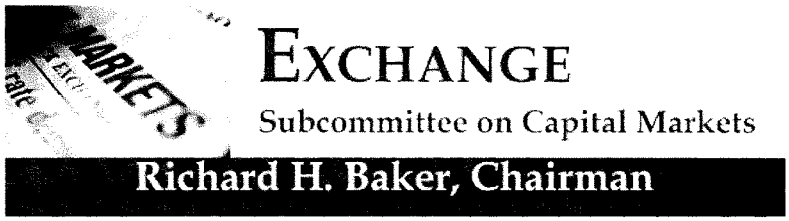
For this reason, NAHB strongly recommends that the Department of Housing and Urban Development should retain its current status as the mission regulator for Fannie Mae and Freddie Mac, including approving new programs and establishing annual affordable housing goals. HUD is the cabinet agency that speaks for housing; a role that NAHB has staunchly supported. The agency contains the expertise and experience to know what policies and programs are best suited to specific household types. HUD has 70 years experience operating mortgage insurance programs. HUD sits at the center of housing issues and is best suited to evaluate new ideas and set goals for current programs. HUD must retain its leadership in housing.

The Treasury Department regulates financial institutions because of its expertise and experience with financial issues, but the agency lacks experience in and knowledge of housing. Although the agency has oversight for two important housing tax programs, low-income housing tax credits and mortgage revenue bonds, the operation of these programs is left to states and HUD sets program specifics. Treasury has little experience in evaluating the effectiveness and appropriateness of housing policies, especially those pertaining to mortgages. Treasury is the wrong place to put mission oversight.

The country is facing a number of housing challenges, including closing the minority homeownership gap and housing America's workforce. Fannie Mae and Freddie Mac and the home building industry are important to success in both of these areas. I look forward to the continued good working relationship that NAHB has with you and your office as we seek to enhance our housing and housing finance system to best meet the challenges ahead.

Best regards,

C. Kent Conine
2003 President



The News from U.S. Rep. Richard H. Baker
Sixth District, Louisiana
FOR IMMEDIATE RELEASE: September 10, 2003
CONTACT: Michael DiResto, 225-929-7711

Opening Statement
The Honorable Richard H. Baker, Capital Markets Subcommittee Chairman
House Financial Services Committee
September 10, 2003
Hearing on Regulatory Structure of the Housing GSEs

Mr. Chairman, I wish to express my appreciation for your leadership on this most difficult issue. Without your continuing interest, I am not sure that resolution of the current concerns would have been easily obtained. I also appreciate the willingness of Secretary Martinez and Secretary Snow to participate in the committee's deliberations, as the mere discussion of these issues, in the past, has lead to unjustified market disruption.

I am confident, however, that our work here today will only enhance homeownership opportunities and assist in the stabilization of the secondary market for home mortgages.

It is appropriate to review the sequence of events that brought us here today, if only in a brief way. It was the FHA administrator, in 1938, that first authorized Fannie Mae to acquire FHA insured mortgage loans, and it was not until after WWII that their authority was expanded to even allow purchase of VA loans. It was not until 1968 that the Charter Act created a totally shareholder owned corporation to be known as a Government Sponsored Enterprise, which separated Ginnie Mae from Fannie.

It was in 1970 that Congress created Freddie Mac and the secondary market for conventional home mortgages. Fannie and Freddie were finally on their way to the big time.

There is one additional time period to revisit, because it provides us with an important insight, all too often overlooked. When David Maxwell assumed the office of CEO of Fannie Mae in 1981, Fannie was losing $1 million a day, and had $56 billion of home mortgages that were under water. Were it not for creative government accounting and the leadership of Maxwell, Fannie may well not be with us today. Not only can economic reversal bring havoc to housing markets in the future, history is clear: It is not only possible, it has happened in the past.

More recent history has given us another unexpected lesson as well. In thinking through all the possible adverse developments for GSEs, managerial risk at Freddie Mac was very low on my list. Both Fannie and Freddie have been held up for years as examples of corporate governance excellence, for others to emulate.

The point to be made about the historic period of financial duress for Fannie and the recent managerial misconduct of Freddie, is that GSEs are subject to the same market risks as any other corporation. They are shareholder-owned, good old American corporations, in pursuit of profit, subject to the same earnings pressures as every other corporation. They are not infallible, although they have enjoyed success.

In recognizing there is the potential for loss, we must also recognize we have the direct responsibility to stand between potential losses of the enterprises and the taxpayers of this country. Do not forget that the GSE business model is unique. If they make a profit, they get to keep it. If they lose money, the taxpayer gets the "right" to pay it off. As of the last quarter of 2002, the combined outstanding debt of Fannie and Freddie was $1.499 trillion. This is not an insignificant number. And to appreciate it in the current context, consider the following remark by the IMF, from its semiannual Global Financial Stability Report released just yesterday: "Recent developments have highlighted the extremely large, highly leveraged nature of these enterprises and the risks they are managing."

To provide any level of assurance of taxpayer protection, we must have a regulatory system that is world class.

Let me say in defense of OFHEO, that it has been dramatically under funded since first created in 1992. This lack of support has limited the scope of analysis and the manpower needed to tackle review of the most complex financial institutions in the world. The regulator has not only been out-manned, it has been out-lobbied.

But these observations are not sufficient to explain why it has taken OFHEO ten years to develop a capital stress test, which was then quickly modified, and now questioned as to whether it provides an appropriate measure of enterprise risk. And being under funded does not explain how a glowing report of Freddie's operations was released only hours before the managerial upheaval that followed. This is not world-class regulatory work.

There are too many unanswered questions. The stakes are too high. It is up to this committee to take the action needed to get the answers. Taxpayers need to be assured their wallets are safe. Potential homeowners need to have access to affordable homeownership opportunities.

We cannot let protests of the past keep us from safekeeping our future. It is time to create a strong, independent regulator, independently funded, with all the powers necessary to take on this difficult task.

I believe the Secretaries' testimony will be pivotal in taking the next step toward that goal, and I want to express my deep appreciation to the administration for working so closely with us over the course of many weeks. Today the administration is outlining a serious response to a complex and extremely important issue of public policy, recommending strong and far-reaching guidelines, but it will be up to us to finish the journey. I yield back the balance of my time.

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www.baker.house.gov

OPENING STATEMENT OF REP. ARTUR DAVIS
Hearing on Fannie Mae and Freddie Mac Regulation
Before the Committee on Financial Services
September 10, 2003

Mr. Chairman, Mr. Frank, members of the Committee on Financial Services, good morning and thank you for the opportunity to share my thoughts on the impact of reforming our system of regulating two of our Government Sponsored Entities (GSEs), Fannie Mae and Freddie Mac. These two entities combined owned or backed 45 percent of the $7.1 trillion U.S. mortgage debt outstanding as of the end of March. Thus, any alteration in the regulation of these two entities will undoubtedly have an impact on the housing finance system and the housing market.

Our mortgage finance system, with its emphasis on homeownership, innovative uses of technology, and the proliferation of product choices is uniquely American. In many ways the Seventh District of Alabama – with its contrasting urban and rural constituencies, its range of wealthy and impoverished residents, and its diversity of population – represents the heart of the American Dream. It is in places like the Seventh District that the American Dream takes root and grows; where there is the most potential for people to raise themselves up through homeownership. Unfortunately, most traditional lending organizations have overlooked the people that live in the Seventh District. Thus, the efforts of Fannie Mae and Freddie Mac have made the dream of homeownership a greater reality for these residents.

This reality notwithstanding, there is another reality we must confront today – that serious irregularities occurred at Freddie Mac. The fact that one of the two primary GSEs was able to so under-report its revenue without its regulator (a regulator I note that only regulates two entities) noticing, is unacceptable. Change it seems is imminent.

As we begin our discussion of what kind of change needs to occur, we must keep two primary items in focus. First, we cannot alter the regulatory structure of Fannie Mae and Freddie Mac so drastically that we impede their affordable housing mission. This mission is simply too critical to the citizens of America, particularly those living in districts like mine. Second, we must focus our debate on problem areas and not create problems that do not exist. While there were lapses at Freddie Mac, at no time did these lapses relate to the performance of Freddie Mac's mission or the adequacy of its capital. It is extremely important that we remain mindful of this fact as we tighten their regulation.

Just this week, the Low Income Housing Coalition released its "Out of Reach 2003" report, which found that a worker must earn at least $15.21 an hour to afford the average cost of $791 per month for a typical two-bedroom apartment. In Alabama, a worker must earn $9.33 per hour. The federal minimum wage, however, is only $5.15 per hour. Thus, a worker in my home State needs to earn twice as much as the minimum wage in order to afford an apartment, let alone a home. With increasing housing prices, interest rates creeping up, and a greatly stressed economy, we cannot over reach here. We cannot impede the mission, market status, or Charter of Fannie Mae and Freddie Mac. Rather, we must act with precision, altering only those areas in need of adjustment and consequently leaving the American Dream in tact.

Opening Statement of Congressman Tom Feeney
To the Committee on Financial Services
Regarding Hearing on Regulatory Oversight of the Government Sponsored Enterprises
September 10, 2003

Mr. Chairman thank you for the opportunity to speak on these very important issues. It is good to see you again, my friend, Secretary Martinez, as well as you, Secretary Snow. For a number of years I have been involved in the real estate industry in Florida and have seen first hand the impact that homeownership can have on families and communities. I can tell you that homeownership helps promote a safer and a more involved community. America was the first country on Earth where the average family could own the home they lived in and the land they lived on. As we hear today from Secretary Snow and Martinez, I would encourage all of us to listen to and understand the competing view in this debate to ensure homeownership opportunities remain available to millions of Americans. I would also reinforce with all the members of the committee and the Administration that whatever action is taken following these hearings we should take great care to not alter the mission, charter or status of Fannie Mae and Freddie Mac.

Nothing we know about the events that have been uncovered at Freddie Mac suggest that there is any fundamental need to change the way the housing finance system operates. It is clear that what we have here is a failure of individuals both at Freddie Mac and at OFHEO. While it's completely appropriate of us to make adjustments to the regulator, we must not regulate, micromanage or centrally plan individual human behavior. However, we can do tremendous harm to the most successful housing finance system in the world if we overreact. It's also critical that we not be tempted by those who would have us do in legislation what they have failed to do in the marketplace.
I look forward to hearing from Secretaries Snow and Martinez and working with the Committee on a successful resolution to this very important issue that will impact millions of homebuyers across this nation for years to come.

September 10, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Full Committee Hearing on Regulatory Oversight of the Government Sponsored Enterprises

Thank you, Mr. Chairman, for holding this important hearing. I appreciate Secretaries Snow and Martinez making themselves available to us this morning to address the current system of regulatory oversight of our Government Sponsored Enterprises (GSE).

Late last year, in the wake of the Enron scandal and subsequent revelations of widespread problems in the accounting industry, the Federal Home Loan Mortgage Company (Freddie Mac) announced that it would have to restate its earnings after it fired its former auditor, Arthur Anderson.

This reevaluation kept Freddie Mac from upholding their voluntary agreement to file with the Securities and Exchange Commission (SEC) as the Federal National Mortgage Association (Fannie Mae) did in April of 2003. Two months later the Office of Federal Housing Enterprise Oversight (OFHEO) released its annual report to Congress addressing the upcoming earnings restatement by Freddie Mac, while expressing satisfaction with the independence of their internal and external audits and confidence in the actions of Freddie Mac's Board of Directors.

It concerns me greatly that the responsible federal regulator, OFHEO, was clearly unaware of these problems inside the management of Freddie Mac and was previously unaware of their need for an earnings restatement. OFHEO simply was not doing its job.

I am pleased to be an original cosponsor of Chairman Baker's legislation moving Fannie Mae and Freddie Mac under the supervision of the Office of Thrift Supervision (OTS).
Today, I look forward to hearing from our distinguished witnesses on this proposal and the current nature of these large GSEs and the privileges appropriate given their standing in the secondary market.

Thank you again, Mr. Chairman, for calling this important hearing and I look forward to an informative session.

OPENING STATEMENT OF
LUIS V. GUTIERREZ
COMMITTEE ON FINANCIAL SERVICES
"TREASURY DEPARTMENT'S VIEWS ON THE REGULATION OF GOVERNMENT SPONSORED ENTERPRISES"
SEPTEMBER 10, 2003

I would like to thank Treasury Secretary Snow and HUD Secretary Martinez for appearing before us today. It is clear that you understand the vital role the GSEs play in making homeownership a reality for low-income and minority families, and I thank the Secretaries for their work in improving the financial regulation of those companies and allowing their important role to continue.

The U.S. has the best housing finance system in the world, but not for everyone. Although the homeownership rate is near its highest level in history, 68 percent, for African-Americans, the homeownership rate is 47.3 percent and for Hispanics it is 46 percent.

Owning a home strengthens families and communities. It is the most important investment available to Americans and is an invaluable tool in helping close the gap in wealth facing minority families. The GSEs have a Congressionally-chartered mission to make homeownership more affordable and more available and I want to make sure that in this legislative process these companies are able to continue their work to reach potential homeowners in underserved populations and underserved areas of our nation.

HUD establishes clear goals the companies must meet in lending to low-and moderate-income Americans, underserved areas and special needs population. The companies meet these goals every year by developing products and partnerships that bring mortgage lending to communities where mortgages have been inaccessible. I understand that Fannie Mae has pledged to provide more than $700 billion in housing capital to serve 4.6 million minority Americans by the end of the decade. I applaud these efforts.

And whatever final regulatory structure is determined for the housing GSEs, we should be careful to preserve the ability of all housing GSEs to improve the secondary mortgage market by developing innovative new products which are consistent with their mission.

Mr. Chairman, I fully support strengthening the financial regulatory oversight of these companies. However, we must not diminish the importance of the GSEs' mission.

I trust you will both place high importance on the role these companies must play if we are to succeed in expanding homeownership which will strengthen families and communities throughout the country.

Statement of Congressman Rubén Hinojosa (D-TX)
House Financial Service Committee Hearing on the Treasury Department's Views on the Regulation of Government Sponsored Enterprises
September 10, 2003

Secretaries Snow and Martinez, I would like to commend you on your leadership and thoughtfulness on the important topic of housing GSE regulation and oversight. In particular, I would like to commend you for recognizing the role homeownership and housing play in the economy, and for your clear acknowledgement that the GSEs are an essential pillar underpinning a very significant sector of the economy. As we contemplate moving the safety and soundness regulator to the Treasury Department, I want to endorse your recommendation of strengthening the GSE's safety and soundness regulator while making no change in the mission, charter or status as a Government Sponsored Enterprise for these companies.

Beyond my interest in this topic as a member of the Financial Service Committee, I have been paying close attention to the issue of GSE regulation for some time for one particular reason: Fannie Mae plays an essential role in helping to finance affordable housing in the border region of South Texas. Several years ago, Fannie Mae was the first major financial institution of its size to open a Border region partnership office focusing solely on partnering with non-profits, banks, community development groups, housing authorities—essentially anyone involved in housing—to increase the supply of decent, affordable housing for rent and for sale in the border region of South Texas. When few other lenders were capable or interested in doing business in my part of Texas, Fannie Mae stepped up to the plate, reached out, and brought a huge amount of investment capital to bear in our area.

Secretaries Snow and Martinez, I simply want to underscore: please be extremely mindful of the affect the changes you propose today and going forward could have on minorities' access to homeownership opportunities. Regulating the GSEs for safety and soundness is one matter – and a very important matter to financing homeownership at that-- but whatever you do, let's not interfere with their abilities to innovate and, indeed, to specifically reach out to meet the needs of special populations. While it is important to enhance the confidence the markets have in the GSEs' risk management, the GSEs need to have the flexibility in their product development to fulfill the responsibilities of their Congressional charter and housing mission in underserved areas of the country like the Texas border region.

OPENING STATEMENT OF CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON REGULATORY OVERSIGHT OF GOVERNMENT SPONSORED ENTERPRISES

WEDNESDAY, SEPTEMBER 10, 2003

Mr. Chairman, before we hear from the Administration on the need to alter the current regulatory system for government-sponsored enterprises or GSEs, I feel it very important to outline my views on these matters for our two distinguished witnesses who are appearing before us for the first time to comment on these issues.

As I said at our very first hearing on GSE regulation in March 2000, "we need to have strong, independent regulators that have the resources they need to get the job done." I continue to support strong GSE regulation. A strong regulator, in my view, will protect the continued viability of our capital markets, promote confidence in Fannie Mae and Freddie Mac, insure taxpayers against systemic risk, and expand housing opportunities for all Americans.

To ensure that we have strong GSE regulation, I further believe that any future legislative reform efforts should adhere to several principles. First, a strong regulator must have a single leader for a set term with sole responsibility for making decisions. In order to conduct robust supervision, a strong regulator must also have a funding stream separate and apart from the annual appropriations process and without improper administrative interference.

Moreover, a strong regulator must have robust supervisory and enforcement powers. Accordingly, some have suggested that we should model GSE regulatory authority after those of other financial regulators. While these proposals have merit, we must determine the applicability and appropriateness of applying these banking standards to GSEs before proceeding.

In order to maintain credibility, a strong regulator must additionally have genuine independence. Unless I am convinced otherwise, such independence must consist of complete autonomy from the enterprises. It must also include sufficient protection from outside special interest groups. In must further have substantial freedom from political interference.

This last point is especially important. As a result of my experiences during the savings and loan bailout, I will approach any proposal to assert general oversight or supervisory controls by the Administration or the Congress over any current or future GSE regulator with great skepticism. We must not allow politics to again cause systemic implications for our economy.

Because our housing marketplace is one of the most important sectors in our struggling economy, we must also tread carefully in our forthcoming congressional examinations. In short, we have a delicate balancing act ahead of us as we work to develop any legislation to modify the regulation of GSEs. We must focus our work on regulatory proposals and not make fundamental changes to the ways in which the GSEs operate, to their charters, or to their mission. It is also my hope that we will develop a balanced, bipartisan plan of action for addressing these issues.

In closing, Mr. Chairman, I commend you for your leadership in these matters. I also look forward to working with you in a judicious and objective manner in order to ensure that we do not upset our securities markets or raise homeownership costs in the weeks ahead.

GARY G. MILLER
42ND DISTRICT, CALIFORNIA

ASSISTANT WHIP AT LARGE

COMMITTEE ON FINANCIAL SERVICES

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

BUILDING A BETTER AMERICA CAUCUS, CHAIRMAN

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Statement of Congressman Gary G. Miller
Hearing on Regulatory Oversight of the Government Sponsored Enterprises
House Committee on Financial Services

September 10, 2003

As a homebuilder and developer for more than 30 years, I have witnessed what answering the needs of homebuyers can mean to a community. This country is home to people of many different origins, but everyone has the same dream - to own their own home. In my career, I have enjoyed watching many people achieve this dream.

I have made helping Americans achieve the dream of homeownership one of my top priorities in Congress. I firmly believe that homeownership benefits our communities and national economy. Indeed, it is the key to promoting long-term economic stability for our citizens and nation.

Government Sponsored Enterprises (GSEs) have been at the forefront of creating affordable housing opportunities for American families. In my district, for example, Fannie Mae has created employer-assisted housing programs for the City of Brea Police Department to allow police officers to live in the communities they serve. They have helped to finance affordable housing initiatives in Anaheim, California. Across the district, they have been able to offer innovative programs to allow those with blemished credit to afford the dream of homeownership, to help seniors convert the equity in their homes into cash to help them meet their needs, and to help families and individuals with special needs become homeowners. All of this, in partnership with lenders, is intended to meet the ever-growing needs of our communities.

As we move forward in addressing deficiencies in GSE supervision, we must not lose sight of Congress' original goal in chartering GSEs. The mission of Fannie Mae and Freddie Mac is to provide stability and on-going assistance to the secondary market for residential mortgages, and to promote access to mortgage credit and homeownership in the United States. Regardless of the regulatory reforms we make, Congress must be unwavering in our commitment to help Americans achieve the dream of homeownership and continue to ensure the accessibility of mortgage funds at the lowest cost. We must completely understand the implications of changes to the regulatory structure in meeting the goals of the charter, being careful not to inadvertently hinder the ability of GSEs to be innovative in meeting the needs of potential homebuyers.

While there is no question that regulatory changes must be made to ensure the safety and soundness of the secondary mortgage market, I urge my colleagues to remain mindful that strong regulation provides a means to achieve our ultimate goal of expanding the supply of affordable mortgage credit across this nation. I look forward to hearing from Secretary Snow and Secretary Martinez for suggestions on how to best sustain America's robust housing finance system into the future.

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Opening Statement
Representative Ed Royce (CA-40)
10 September 2003
"GSE Oversight"

Mr. Chairman, thank you for holding this hearing on GSE Oversight. I look forward to hearing the testimony from Secretary Snow and Secretary Martinez.

Government Sponsored Enterprises (GSEs) focused on home ownership have been in existence since 1932. And, since that time, GSEs have played an important role in developing the secondary mortgage market in the United States. Fannie Mae and Freddie Mac buy mortgages from originators in order to provide liquidity in the market, and the Federal Home Loan Bank System provides advances to banks and thrifts so that those organizations can offer mortgage products to their customers.

Like the rest of corporate America, over time the GSEs have developed comprehensive business models to achieve their mission and to get results for their stakeholders. As a result, the housing GSEs have become three of the most sophisticated financial institutions in the world. In total, the three GSEs have over $2 trillion in debt, and a derivative portfolio with a notional amount totaling over $1.9 trillion. Due to their evolving business models, the three housing GSEs now must protect their balance sheets, not only from credit risk, but also from interest rate risk. With these facts in mind, I think that it is crucial that these organizations are subject to competent regulation.

I have authored legislation that would create an independent regulator in the Treasury Department with greater enforcement powers to oversee the three GSEs. My proposal is important, not only because it creates a new agency in the Treasury, but also because it includes regulation of all three housing GSEs and it mandates the new agency director to work with other financial institution regulators through the Federal Financial Institutions Examination Council.

I offered my legislation because this country needs a world-class regulator of the housing finance sector. To that end, I believe the Treasury has expertise in constructing and monitoring financial institution regulatory bodies. Experts believe that all three GSEs need to be part of the equation in order to achieve effective safety and soundness oversight. Since Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are the largest derivatives players in the world, the new regulator needs to see the whole market to ensure the best practices of risk management.

In addition, bond market experts have told me that if Fannie Mae and Freddie Mac receive a new regulator under Treasury -- and if the Federal Home Loan Banks remain under the Finance Board -- then on a relative basis Fannie Mae and Freddie Mac would have a competitive advantage in the bond market because investors have more confidence in Treasury regulation. This could result in a higher cost of capital for Federal Home Loan Banks. Congress should not enact legislation that favors one group of GSEs over another.

I know some of my colleagues are concerned that -- while right on the merits -- inclusion of the Federal Home Loan Banks could derail regulatory restructuring for Fannie Mae and Freddie Mac. Others have suggested that we should not include the Federal Home Loan Banks in any legislative effort because it is politically difficult. I disagree with both of these views. Over the past two months I have sensed momentum building for my proposal, as some of the most significant players in the FHLB System have endorsed my concept. We have an historic opportunity to create the optimal regulatory framework to protect the financial system and the taxpayer. This is the time for us to show leadership.

STATEMENT OF MEL MARTINEZ
SECRETARY
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE
UNITED STATES HOUSE
COMMITTEE ON FINANCIAL SERVICES

SEPTEMBER 10, 2003

Chairman Oxley, Ranking Member Frank, Distinguished Members of the Committee:

I welcome the opportunity to join Secretary Snow in describing for the Committee the Administration's views on improving and reforming regulatory oversight of the housing government-sponsored enterprises.

Secretary Snow has outlined the principles and priorities the Administration supports. He and I are in full agreement; Congress and the Administration have an opportunity *and an obligation* to strengthen the regulatory structure of the GSEs. A strong regulator is in everyone's best interests – the Administration, Congress, Wall Street, investors worldwide, and most importantly, the American taxpayer.

The Administration has a dual goal. We must ensure that, through the GSEs, financing is available for low- and moderate-income families. And we must ensure that the GSEs are subject to rigorous oversight, so that they are serving their public purpose.

The housing sector directly accounts for about 14 percent of the nation's total Gross Domestic Product, and the housing market actively drives other closely related components of the economy as well. The GSEs play an integral role in our nation's housing finance system by expanding the availability of mortgage credit. The liquidity and stability they provide have helped buoy the nation's economy. Because of the housing GSEs' impact on the economy, it is critical that we ensure their safety and soundness.

The Office of Federal Housing Enterprise Oversight was established following the thrift crisis as an independent safety and soundness regulator, within HUD, for Fannie Mae and Freddie Mac. There is a misconception that HUD controls and has direct authority over OFHEO in the exercise of its safety and soundness duties. HUD does not. By statute, Congress has mandated that OFHEO's safety and soundness determinations must be made independently of HUD.

To ensure that the GSEs have appropriate financial oversight and are held accountable to their public mission, the Administration supports strengthening the powers of the GSEs' regulator. Doing so would make the regulator more comparable to the stature, powers, authority, and resources of other financial regulators charged with safety and soundness oversight. Such a concept has worked well for financial regulators in other instances, including the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

Currently, safety and soundness regulation is divided, with new program approval authority at HUD and financial oversight at OFHEO. It is the position of the Administration that both elements of safety and soundness regulation need to be consolidated in a single regulator.

As Secretary Snow noted, the Administration considers it appropriate to transfer authority over new program approval from HUD to a new, strengthened regulator. HUD supports transferring and strengthening such authority to include review of all activities, new and on going. Such changes will consolidate and enhance the regulator's oversight responsibility, and increase investor confidence in the GSEs.

As part of this transfer, the Administration is also proposing that the HUD Secretary continue to be consulted on new activities requested by the GSEs. Many new activities directly impact the mortgage and housing markets, where HUD has substantial expertise. This makes it essential that such consultation take place.

While safety and soundness regulation should be exercised by a single, independent regulator, the Administration strongly supports retaining another core element of the GSEs' charter – the housing goals – at HUD.

Congress established Fannie Mae and Freddie Mac to provide market liquidity and to facilitate the financing of affordable housing for low- and moderate-income families. Congress also mandated that the HUD Secretary set housing goals to ensure that those needs are met. The affordable housing goals were created to ensure the GSEs are serving individuals in those communities that are most in need.

These goals direct the GSEs to serve low- and moderate-income families and provide funding in underserved areas, such as central cities and rural areas. A third goal directs the GSEs to finance housing for very low and low-income families.

Today, the low- and moderate-income housing goal requires that at least half of all Fannie Mae and Freddie Mac mortgage purchases benefit families in this income bracket. As the President's budget noted in February, numerous HUD studies and independent analysis have shown that the GSEs have historically lagged the primary market, instead of led it, with respect to funding mortgage loans for low-income and minority homebuyers. The GSEs have also accounted for a relatively small share of first-time minority homebuyers.

HUD is the appropriate agency to develop and enforce the housing goals. Institutionally, our mission is devoted to furthering the goal of affordable housing and homeownership, and HUD has the most expertise in this area. Furthermore, the housing industry looks to HUD as the agency in which this authority should reside.

Therefore, to strengthen HUD's housing goal authority, the Administration considers it appropriate to:

Create a new GSE Housing Office within HUD, independently funded by the GSEs, to establish, maintain, and enforce the housing goals;

Grant HUD new administrative authority to enforce its housing goals;

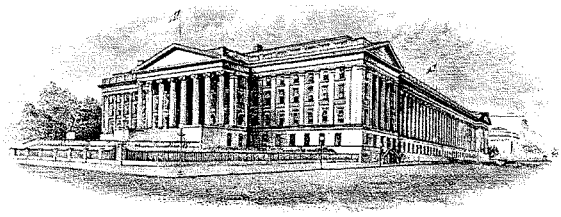
Institute enhanced civil penalties for failure to meet housing goals;

Explicitly provide that the GSEs act to increase homeownership, and;

Expand authority to set housing goals and subgoals beyond the three currently established for moderate-income, geographic area, and special affordable housing.

Let me stress that we believe such a comprehensive change to the regulatory structure will strengthen the confidence of all GSE stakeholders. Investors will be better protected under a regulatory system that empowers the regulator to do the job we expect of them... and the American taxpayers will ultimately benefit.

Secretary Snow and I look forward to working with the Committee members to strengthen oversight of the housing GSEs – to ensure that they are in every way meeting their public purpose and that homeownership continues to be an affordable option for America's families.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

Embargoed Until 10:00 am EDT
September 10, 2003

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Testimony of
John W. Snow
Secretary of the Treasury
Before the Committee on Financial Services
United States House of Representatives
Washington, D.C.
September 10, 2003

Thank you Chairman Oxley, Ranking Member Frank, and members of the Committee for inviting Secretary Martinez and me to appear before you today. This Committee has a strong record of interest in the effective supervision and regulation of government sponsored enterprises.

There is a general recognition that the supervisory system for housing-related government sponsored enterprises (GSEs) neither has the tools, nor the stature, to deal effectively with the current size, complexity, and importance of these enterprises. As we attempt to remedy this situation, we must be mindful that we have two core objectives that should guide us: a sound and resilient financial system, and increased homeownership opportunities for less advantaged Americans.

To serve both of these objectives we need to devote careful attention to the resilience of our system of housing finance. That system is the envy of the world, but we cannot be complacent. I am here to outline the Administration's recommendations for important improvements that we can make to the oversight of our housing finance system. Secretary Martinez will discuss in particular the measures that the Administration would like to see implemented to reinforce the focus on the objective of increasing homeownership opportunities.

Recommendation

The Administration recommends that Congress enact legislation to create a new Federal agency to regulate and supervise the financial activities of our housing-related government sponsored

enterprises. Housing finance is so important to our national economy that we need a strong, world-class regulatory agency to oversee the prudential operations of the GSEs and the safety and soundness of their financial activities consistent with maintaining healthy national markets for housing finance. Such legislation should fulfill this underlying purpose and not be merely an exercise in moving existing agencies from one part of the government to another.

We should keep our eye on the crucial task of getting the regulatory organization right. In addition to the housing goals which Secretary Martinez will discuss, the legislative objective should be to create a strong, credible, and well-resourced supervisor with all of the powers needed to do its job.

It is of central importance in this endeavor that Congress provide the new agency with a clear mandate. This mandate should be to oversee the prudential operations of the enterprises and the safety and soundness of their financial activities in order to foster liquid, efficient, competitive, and resilient national housing financial markets, including secondary mortgage markets.

Powers of the New Agency

This new agency's powers should be comparable in scope and force to those of other world-class financial supervisors, fully sufficient to carry out the agency's mandate. This means that the agency should have general regulatory, supervisory, and enforcement powers with respect to the enterprises, including responsibility for ongoing prudential review of GSE activities in keeping with the terms of their charter, with the evaluation of new activities being made in consultation with the Secretary of Housing and Urban Development. With respect to conservatorship/receivership powers, the new agency should have all of the authority necessary to direct the liquidation of assets and otherwise to direct an orderly wind down. However, rescinding a GSE charter would require an act of Congress.

Taking into account the particular nature and unique mission of the enterprises as chartered by the Congress, the powers of the new agency should meet the following standards, which are widely recognized as essential for effective financial supervision. The agency must have an integrated package of clear authorities, including the following:

- The agency should possess operational independence and adequate resources, including provision for ongoing supervision, and powers to address compliance with laws as well as safety and soundness concerns.

- The agency should have authority for and supervisory practices that consist of some form of both on-site and off-site supervision.

- The agency should have the authority to review and reject any proposals to transfer significant ownership or controlling interests to other parties.

- The agency should have the authority to establish and enforce the criteria for acquisitions, new lines of business, or investments by the GSE and for ensuring that corporate

affiliations or structures do not expose the GSE to undue risks or hinder effective supervision.

- An essential element of supervision is the ability of the agency to supervise the consolidated GSE organization. The agency should decide which prudential requirements will be applied on an enterprise-only (solo) basis, which ones will be applied on a consolidated basis, and which ones will be applied on both bases.

- The agency should have the authority to ensure that the GSE has in place systems that accurately measure, monitor, and adequately control market risks; the agency should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.

- The agency should have at its disposal adequate supervisory measures to bring about timely corrective action when a GSE fails to meet prudential requirements, including when there are regulatory violations.

- The agency should have independent litigation authority and related powers.

- The agency should set prudent and appropriate minimum capital adequacy requirements for the GSE. Such requirements should reflect the risks that the GSE undertakes, and should define the components of capital, bearing in mind the ability of the GSE to absorb losses.

Capital

The regulator should also have authority with regard to capital for the GSEs. A key issue is the setting of appropriate levels for risk-based capital. The current statute establishes the standard for the basic, minimum capital, the resources that are reserved for the general, indefinable, perhaps unforeseen risks that are present with any financial enterprise.

The statute also treats, in some detail, the question of risk-based capital. We do not propose any changes at this time to the risk based capital regulation that is now in place. That rule took ten years to develop and is in only its first year of operation. Capital is the fundamental element of the financial condition of an enterprise, and the capital standards should not become the subject of frequent change. There is a need for stability in capital standards. There is some degree of flexibility in the current risk-based capital rule to deal with changes in the risk profile of the enterprises, at least with regard to the near term.

Having said this, I am in no way proposing a moratorium on making any adjustments to risk-based capital. The existing statutes place a clear responsibility on GSE supervisors to ensure that each GSE retains adequate capital to support its risks and they give supervisors the power and duty to require capital changes as risks change. We expect the supervisors to make full and proper use of that authority as need arises.

But ultimately, the new agency should have more flexible authority to adjust risk-based capital standards for GSEs than what is currently provided in the law. Broad authority over capital standards and the ability to change them as appropriate are of vital importance to a credible, world class financial regulator. Capital standards need to be flexible enough to employ the best regulatory thinking, conscious of the enterprises' own measures of risk, adequate to ensure that the enterprises operate in a safe and sound manner, with capital and reserves sufficient to support the risks that arise in their business. We believe that legislation should provide the new agency with this more flexible authority.

Duties

The new agency must have the duty to exercise its authorities for a number of essential tasks, such as the following:

- An essential part of the agency's responsibility must be the evaluation of a GSE's policies, practices, and procedures related to the extension of credit and the making of investments and the ongoing management of the credit and investment portfolios, including GSEs' fulfillment of their missions.
- The agency should satisfy itself that the GSE establishes and adheres to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and loan loss reserves.
- The agency should satisfy itself that the GSE has management information systems that enable the management to identify concentrations within the portfolio, and the agency should set prudential limits to restrict GSE exposure to single counterparties or groups of related counterparties.
- The agency should satisfy itself that the GSE has in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks. The agency should determine that the GSE has adequate and well-tested business resumption plans for all major systems, with remote site facilities, to protect against disruptive events.
- The agency should determine that the GSE has in place internal controls that are adequate for the nature and scale of its business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the enterprise, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets, and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
- The agency should determine that the GSE has adequate policies, practices, and procedures in place, including strict rules for identifying customers/counterparties, that promote high ethical and professional standards in the financial sector and prevent the enterprise being used, intentionally or unintentionally, by criminal elements.

- The agency should have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from GSEs on a solo and consolidated basis.
- The agency should have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
- The agency should satisfy itself that each GSE maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the agency to obtain a true and fair view of the financial condition of the enterprise and the profitability of its business, and that the enterprise publishes on a regular basis financial statements that fairly reflect its condition.
- The agency should set risk-based capital standards and review and change them as prudent.
- The agency should exercise authority over new lines of business, new types of investments, and acquisitions.

Application to All GSEs

In my remarks, I have not limited myself to one group of housing GSEs. The importance of our housing finance markets requires that all of the housing GSEs be included in a program of world-class supervision. We see the need for this for the Federal Home Loan Banks just as we see it for Fannie Mae and Freddie Mac.

We recognize the development of a consensus for action on how to provide that supervisory system for Fannie Mae and for Freddie Mac and are ready to work with Congress on a new agency for their supervision. A similar consensus may not exist with regard to the Federal Home Loan Banks, but we look forward to working with Congress, the Home Loan Banks, and other interested parties to achieve a resolution of these matters.

Location of the New Agency

Today we recommend that Congress create a new regulatory agency that is strong, credible, possessing all of the standards and duties for effective financial supervision as I have outlined above. The Administration is prepared to consider placing the agency within a cabinet department, if Congress considers the additional benefits of stature and policy support that can come from such an arrangement to be valuable.

Any such arrangement would need to protect the independence of the agency over specific matters of supervision, enforcement, and access to the federal courts. The agency should be structured like other financial institution regulators currently embedded in cabinet departments. But to provide real value, placing the new agency within a cabinet department should draw upon the resources of that department for depth of policy guidance. At a minimum, the new agency should be required to clear new regulations and congressional testimony through the department.

In addition, while the agency should be adequately funded by assessments on its regulated entities, without going through the appropriations process, the agency budget and fee assessments should be subject to review by the Administration to avoid any long-term temptation to gold-plate agency operations and to ensure an appropriate allocation of resources among the agency's responsibilities.

In the context of this combination of operational independence and policy oversight, the Administration would be willing to support proposals to establish the new agency as a bureau of the Treasury.

Corporate Governance

In addition, good corporate governance, as we all have come to recognize, requires that there be great clarity that the people running large companies are there to serve the interests of the shareholders and that their incentives and loyalties be clearly aligned in this way. One man cannot serve two masters. Fannie Mae and Freddie Mac are large, experienced, publicly-traded enterprises that have grown significantly and taken important places in our capital markets. Reflecting on that fact, the Congress should consider whether the statutory requirement for presidential appointment of members to publicly-traded GSE boards of directors has become obsolete, and we would support their elimination.

Before I conclude, I wish to make one more essential point. We are pleased with the action of Fannie Mae to register under the Securities Exchange Act of 1934. Such registration operates as an important window into the operations of that GSE to see how it is promoting its mission in keeping with the highest standards of corporate disclosure. This is consistent with our view that GSEs should serve as models of good corporate governance and disclosure, not as exceptions from these standards.

We all regret that Freddie Mac has not yet been able to fulfill its pledge to come into compliance with registration under the 1934 Act, but we look forward to their doing so in the near future. Secretary Martinez and I recently joined with Federal Housing Finance Board Chairman John Korsmo in calling upon the Federal Home Loan Banks also to come into compliance with the 1934 Act, as administered by the Securities and Exchange Commission. Their doing so will be a crucial immediate step in regularizing their important participation in our nation's capital markets.

Conclusion

Treasury will continue, in a study, to review GSEs and the secondary mortgage markets, and the operation of the regulatory system that supervises the GSEs to ensure that they are subject to proper standards of capital, corporate governance, and other levels of conduct, and in general serve the objects I described in the beginning of my remarks. We will keep you posted on the results of our studies.

In conclusion, let us consider once again our purpose here this morning. It is to discuss how best to promote the strength and resilience of our housing finance markets, in order to increase our

progress in advancing home ownership throughout the nation. The housing-related government sponsored enterprises were created by Congress to assist in that mission. Our aim must be to give them the caliber of supervisor that the importance of their mission requires.

-30-

Response to Questions for the Record
Committee on Financial Services Hearing on GSE Regulatory Reform
September 10, 2003
John W. Snow
Secretary of Treasury

Related Questions from Multiple Members of Congress

Question – Congresswoman Brown-Waite: What expertise does Treasury have, that HUD does not, to justify Treasury as the mission regulator?

Question – Congresswoman Harris: Secretary Snow, Fannie Mae and Freddie Mac will play a critical role as the Administration strives to increase the rate of minority homeownership rate. Achieving this goal will require Fannie Mae and Freddie Mac to develop programs that reach underserved markets. How does the Treasury Department plan to structure such programs, so that they accomplish their housing mission while retaining their safety and soundness?

Question – Congresswoman Velazquez: Secretary Snow, there has yet to be a decision made on who should oversee the GSE's mission, which is currently regulated by HUD. Regulating the mission ensures that the GSEs are meeting their affordable housing goals, following fair lending principles, and disseminating data about their loan activities, among other things. This is different from the oversight of safety and soundness the Treasury would be charged with. What in the Treasury's expertise equips the agency to oversee the GSEs mission?

Question – Congresswoman Lee: In listening to your testimony, it sounds like this proposal will impose a more cumbersome bureaucracy which will hinder and hamper the GSE's ability to be innovative and bring new affordable housing products to the market. It appears that this reorganization will prevent GSE's from providing affordable housing to the most-needy communities. Of course, maintaining a safe and sound market is critical for both Fannie Mae and Freddie Mac; however, providing an affordable market is critical to millions of Americans, particularly low and moderate income Americans. How will dismantling OFHEO, and creating 3 new offices within both Treasury and HUD help Fannie Mae meet its affordable housing mission and goals? Additionally, I'm concerned with the "broad authority" Treasury will have to approve or reject new initiatives that may seem like a risk to the market, but allow Fannie Mae and Freddie Mac to meet the housing goals?

Question – Congressman Sherman: One proposal that may be considered by Congress with respect to the Government Sponsored Enterprises involves transferring the regulatory authority for new program approval from the Department of Housing and Urban Development to the Department of Treasury. Could you please explain what expertise the Department of Treasury currently has in regulating housing programs? Should the Department acquire this regulatory authority, what assurance can you give the Committee that new program approval will not be slowed by the Department's bureaucracy and potential lack of experience in this area?

Answer: The Administration's proposal for regulatory reform of the housing government sponsored enterprises (GSEs), while creating a new regulatory agency to oversee the prudential operation of the GSEs, would strengthen the authority of the Department of Housing and Urban Development (HUD) to promote the housing goals of Fannie Mae and Freddie Mac. In particular, HUD would continue to have responsibilities for setting the affordable housing goals for Fannie Mae and Freddie Mac and enforcing the Fair Housing Act. Under our proposal, HUD would also be provided explicit enforcement authority over the housing goals to ensure that Fannie Mae and Freddie Mac are meeting their housing promotion requirements.

It is also important to note that the Administration is not requesting that the new regulatory agency be made a bureau of the Treasury Department. We have said that such a recommendation could be contemplated and would be supportable if the new agency were established with adequate elements of policy accountability to the Secretary of the Treasury. To allow the Treasury Department to provide real value to the new regulatory agency, at a minimum, the new agency should be required to clear new regulations through the department, much as OMB does today for OFHEO regulations. The Treasury Department should also have review authority over the new agency's budget to ensure that resources are being properly allocated. And to ensure policy consistency, a new Treasury bureau should clear its policy statements to the Congress through the department. Nevertheless, in any such arrangement, the new supervisory agency should have independent responsibility over specific matters of supervision, enforcement, and access to the Federal courts.

The Administration has proposed that the authority for approving new activities of the housing enterprises be transferred from HUD to the new regulatory agency. This proposal is consistent with availability of one of the central tools that every effective financial regulator has—the ability to say "no" to new activities that are inconsistent with the charter of the regulated institutions, inconsistent with their prudential operation, or inconsistent with the public interest. The current financial regulator for Fannie Mae and Freddie Mac lacks that authority, one of its most serious weaknesses. If we are serious about creating an effective, credible financial regulator, it must have the authority, in consultation with the Secretary of HUD, to review new activities as well as to review their ongoing activities. Through this consultative process, HUD would continue to have an important role to play in providing its expertise on new activities that have a direct impact on the housing and mortgage markets.

It is important to understand that the Treasury Secretary's formal role in review of new activities would only arise in these few cases when a new activity was such a departure from existing norms as to require formal promulgation of a new regulation. We would not expect approval of new activities to require new regulations in most cases.

We see no reason why the GSEs' innovation would be stifled under a process whereby the new regulatory agency has authority to approve new activities. Our nation's bank and thrift regulators have fostered and encouraged innovation using the same type of approval authority, and we see no reason why providing similar authority to the new regulatory agency would stifle innovation by housing GSEs.

Drawing upon the statements of those who have recommended placing the new regulatory agency within Treasury, it seems that it is believed that the Treasury would lend stature, authority, depth of experience, and a broader perspective to the new agency. I would note that none of those things would be available if the Treasury Secretary is walled off from the policy-making processes of the new agency.

Question from Congresswoman Brown-Waite

Question: Should the new regulator be empowered to regulate assets currently held that are not related to the mission of the GSEs?

Answer: The Administration supports providing the new regulatory agency with broad review authority over the GSEs' investment activities. The GSEs are provided a set of benefits to accomplish a public mission, and providing the new regulatory agency with the authority to review the GSEs' investment activities is important in ensuring that the GSEs stay focused on their mission.

One of the specific elements of regulatory reform that we have suggested is the ability of the new regulatory agency to review the overall activities of the GSEs with respect to the permissibility of such activities under the GSEs' charter acts. Such authority would include a review of the GSEs' investment activities. We also have suggested that the new regulatory agency have specific authority to restrict the GSEs' investments based on an overall review of the GSEs' operational and management standards.

Question from Congresswoman Harris

Question: Secretary Snow, congressional hearings and speculation regarding impending structural reform has produced market uncertainty. Please comment on how the Treasury Department's proposal will remedy the disruptions that have developed in the secondary-mortgage markets.

Answer: One of the Administration's guiding core objectives in creating a strong, world-class regulator for the housing GSEs is a sound and resilient housing finance market. The GSEs play such a major role in our housing finance system that we need this strong, world-class regulatory agency to oversee their prudential operations, including safety and soundness, consistent with maintaining healthy national markets for housing finance. Having a clear mandate, a new stronger regulator will foster liquid, efficient, competitive, and resilient national housing markets, including secondary mortgage markets. If such a regulatory agency were established, we would expect that disruptions in the secondary mortgage market would be reduced because prudential supervision would improve.

Questions from Congresswoman Velazquez

Question: There has been much debate on whether or not to include the Federal Home Bank System within the purview of a new housing GSE regulator. If a new regulator is seen as stronger than the existing Finance Board, investors would attach more confidence to Freddie/Fannie debt obligations, potentially making their debt more attractive. Federal Home Loan Banks may have to pay higher costs for their funding and, as a result, would become less competitive as a source of funds for their member banks. Do you believe that the exclusion of the Federal Home Bank System from the oversight responsibilities of the new regulator would give Freddie and Fannie a competitive advantage?

Answer: The importance of our housing finance markets requires that all of the housing GSEs be included in a single program of world-class supervision. We see the need for this for the Federal Home Loan Bank System just as we see it for Fannie Mae and Freddie Mac.

It is difficult to predict how capital markets would respond if the Federal Home Loan Bank System were not included in a new regulatory agency for the housing government sponsored enterprises. As you indicated in your question, the result depends on capital market participants' perception of the strength of the new regulatory agency. However, in this regard, what is vitally important is that any improvement in funding costs that might occur for Fannie Mae and Freddie Mac is the result of creating a stronger regulatory oversight regime in fact, not just the market's perception that stronger oversight exists. That is why an essential element of regulatory reform for the housing GSEs is that the new regulatory agency be provided powers that are comparable in scope and force to those of other world-class financial regulators, fully sufficient to carry out the agency's mandate, with accountability to avoid dominance by the entities it regulates. We believe that this is just as important for the Federal Home Loan Banks as it is for Fannie Mae and Freddie Mac.

Question: Typically, corporations tie the compensation of their employees to the profitability of the company. In Freddie Mac's case, corporate executives made the decision to underestimate the profitability of their company, ensuring that their earnings displayed steady incremental growth. I am concerned that employees may have lost out on additional compensation, given this pattern of profits understatements. Given Freddie Mac's ties with the federal government, do you believe that the government has an obligation to ensure that this scandal has not unfairly affected its employees?

Answer: All of the specific issues associated with the current investigation of Freddie Mac are best directed to those agencies involved with the investigation.

Question: For a regulator to be viewed as credible, it must have a high degree of independence. There are various mechanisms that provide regulators with this, including the composition of its leadership and whether or not the regulator is provided with permanent budget authority. I would like to ask both of you to provide your perspective on what level of independence a new GSE regulator should have and how you believe it should be accomplished? How would you constitute the leadership of the new regulator to ensure that it is politically independent? Given

that banking regulators typically have permanent budget authority, do you believe that the new regulator should as well?

Answer: The degree of independence for a new GSE regulatory agency is vitally important with regard to specific matters of supervision, enforcement, and access to the Federal courts. The ability of the new regulatory agency to take actions regarding supervision and enforcement outside of the political process is important for ensuring that the new agency can properly oversee the operations of its regulated entities. Without such independence, a regulator may be prevented from taking the appropriate regulatory actions if such actions have unpopular political consequences. Likewise, providing the new regulatory agency with access to the Federal courts provides the new agency with a necessary tool to perform its duties, and such access is consistent with the powers of our nation's other financial regulators.

Permanent budget authority is also an important component of independence for the new GSE regulatory agency.

While political independence for the new regulatory agency is important, the structure and location of the new regulatory agency deserves special consideration. While some have argued that the new regulatory agency should be made a bureau of the Treasury Department, the Administration has not broadly endorsed such a recommendation. We have said that such a recommendation could be contemplated and would be supportable if the new agency were established with adequate elements of accountability to the Secretary of the Treasury with regard to matters of policy. The direct involvement of the Treasury Department in providing policy guidance to the new regulatory agency is important because, unlike the Treasury Department's other financial institution regulatory bureaus, the new regulatory agency would only be responsible for regulating a very limited number of very large financial institutions, which increases the possibility of regulatory capture. In addition, even though the obligations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are not backed by the full faith and credit of the United States government, market participants have come to believe that some sort of implied guarantee exists, weakening market discipline of the enterprises. It is vitally important that the Treasury Department be able to monitor the new regulator's policies to ensure that such policies are not reinforcing any such market misperception of an implied guarantee.

To allow the Treasury Department to provide real value to the new regulatory agency and to address fundamental concerns regarding regulatory capture and the misperception of an implied guarantee, at a minimum, the new agency should be required to clear new regulations and policy statements to Congress through the department. The Treasury Department should also have review authority over the new agency's budget to ensure that resources are being properly allocated. Nevertheless, in any such arrangement, the new supervisory agency should have independent responsibility over specific matters of supervision, enforcement, and access to the Federal courts.

Questions from Congressman Sherman

Question: In the Los Angeles metropolitan area, the median home price for the June 2003 reporting period was $339,100, compared to $280,720 one year ago. Los Angeles is not the only area of the country where median home prices exceed the conforming loan limit of $322,700. On average, a conforming loan is 28 basis points less than a jumbo -or non-conforming -loan. Should homebuyers in high costs areas like my district in the San Fernando Valley be penalized by having to pay 28 basis points more than other American homebuyers because the area is an inherently high cost place to buy a home? Should Congress consider raising the conforming loan limit for areas that are historically high cost to the level currently enjoyed by Hawaii, Alaska, the Virgin Islands and Guam?

Answer: In creating the GSEs, Congress provided the GSEs with certain benefits in exchange for performing a public mission. The activities that the GSEs are authorized to undertake in meeting that public mission are set forth in the GSEs' charter acts. One limitation on the GSEs' activities is that they can not purchase loans above the conforming loan limit. In developing principles for regulatory reform the Administration has developed a proposal that seeks to improve the regulatory oversight of the GSEs. We have not considered broad changes to the GSEs' charter acts at this time, such as changing the calculation of the conforming loan limit. If such charter changes are considered, we would urge Congress to evaluate carefully whether the private market is failing to meet the credit needs of our nation's citizens.

Question: With respect to your testimony about capital for Fannie Mae and Freddie Mac, the point you raised about the need for stability in capital standards and that the current risk-based capital standard should be given time to work caught my attention. It is my understanding that with all we have learned about Freddie Mac in recent months that those issues are related to accounting standards and operations management. These are serious issues. However, is my understanding correct that Freddie Mac and Fannie Mae are quite well capitalized at the moment?

Answer: I would defer to the judgment of the appropriate regulator as to whether or not a GSE is adequately capitalized.

Question: Could you please confirm that the United States Government is not liable or secondarily liable for any liability of or security issued by Fannie Mae or Freddie Mac?

Answer: You are correct, the obligations (e.g., debt and mortgage-backed securities) of Fannie Mae and Freddie Mac are <u>not</u> backed by the full faith and credit of the United States Government. This requirement is clearly stated in the enabling legislation of Fannie Mae and Freddie Mac. Fannie Mae's enabling legislation, codified at 12 U.S.C. 1719 (b), states that Fannie Mae must insert language in its obligations "clearly indicating that such obligations, together with the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the corporation." Corresponding language for Freddie Mac can be found in 12 U.S.C. 1455 (h)(2).

Questions from Congressman Baca

Question: Minorities are largely dependent on GSEs to purchase homes. They provide the affordable home mortgage loans that Americans need to finance homeownership. Any movement towards higher interests rates or instability in the housing market will cause minorities to lose access to homeownership. According to Fannie Mae's own research, with each 25 basis point rise in interest rates some 78,166 Hispanic and 107,158 African American families become unable to afford to purchase a home. Some instability of the markets may come from a long protracted debate on regulation that may include issues not directly related to the- GSEs. Secretary Snow, how can we streamline this process so that minority households do not get hurt?

Answer: The Administration is committed to a sound and resilient housing finance market and to increased homeownership opportunities for less advantaged Americans. Ensuring that the GSEs are subject to rigorous oversight will enable the GSEs to serve their public purpose, both today and in the future. And it will allow investors to have greater confidence in the supervisory system for GSEs. The Administration has attempted to streamline the process by setting forth the essential minimum elements of credible regulatory supervision for the housing GSEs. The sooner that we get the job done right, the better.

Question: There are large disparities in homeownership levels. 74.7% of non-Hispanic whites are homeowners. But only 47.4% of Hispanics are homeowners and 48.9% of African Americans are homeowners. Minorities are on track to add 7.5 million households between 2000 and 2010 and another 7.8 million households. These minority households must have access to affordable home mortgage loans if they are to join the ranks of homeowners. This will not happen if the housing market collapses. Secretary Snow, as we reexamine the housing market, how can we assure minority Americans access to home mortgage loans?

Answer: As HUD has documented, the GSEs generally lag other providers of mortgage credit in serving minorities. The Administration's proposal would strengthen the GSEs' affordable housing goals by providing HUD with the authority to create additional housing goals and by granting HUD more authority to enforce its housing goals. We believe that this is vital to ensure that the GSEs are effectively meeting the affordable housing needs of our nation. In addition, we need to upgrade the prudential supervision of the GSEs to increase the likelihood that they operate in a safe and sound manner to continue to fulfill their housing mission effectively in the days to come.