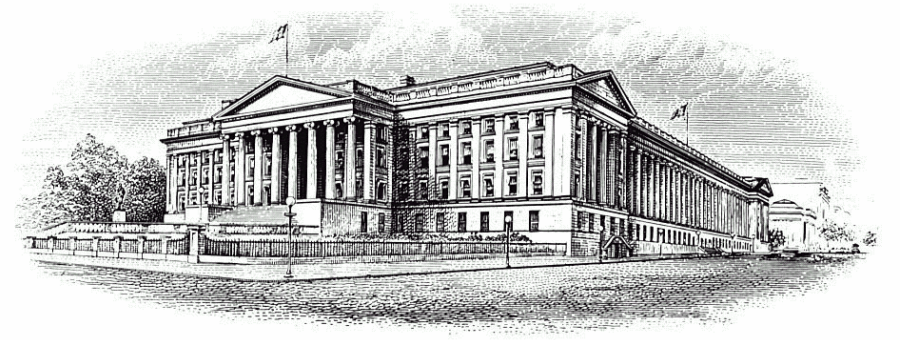

DEPARTMENT OF THE TREASURY
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Before the Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises
United States House of Representatives

GOVERNMENT SPONSORED ENTERPRISES AND FINANCIAL DISCLOSURE

Mr. Chairman, Representative Kanjorski, and Members of the Committee, I appreciate the opportunity to provide the Administration's views on government sponsored enterprises (GSEs), in general, and H.R. 4071, the Uniform Securities Disclosure Act, in particular.

I want to commend you, Mr. Chairman, and Members of the Committee for your careful consideration of GSE issues in recent years. You have recognized that, in a constantly changing financial world, we need to pay continuous attention to ensure these organizations continue to serve our objectives as effectively over the coming years as they have in the past.

We share the concerns of the authors of H.R. 4071 about the importance of providing investors with assurance as to the comparability, consistency and sufficiency of GSE financial disclosures. But the Administration cannot support H.R. 4071 because it focuses too narrowly on only two of the GSEs and because we are not prepared to support repeal of their exemptions from the Securities Act of 1933.

The Administration believes that all GSEs should comply with the same corporate disclosure requirements of the Securities Exchange Act of 1934, as interpreted and applied by the Securities and Exchange Commission (SEC). The Administration believes that this can be accomplished without the necessity of legislation.

For this reason, the Administration is pleased that Fannie Mae and Freddie Mac agreed to voluntarily register their common stock under Section 12(g) of the '34 Act, which will ensure that they are required as a matter of federal law to meet current and future SEC requirements for financial disclosure under the '34 Act. Their disclosures will be subject to the regulatory framework established by the SEC and the Office of Federal Housing Enterprise Oversight (OFHEO). We are requesting that other currently exempt GSEs make similar arrangements to voluntarily register with the SEC under the '34 Act.

Last Friday's announcement was made possible by the leadership of Chairman Pitt and Director Falcon and also by Frank Raines and Leland Brendsel. It seems to me though, that this accomplishment would not have been possible without the leadership that you, Mr. Chairman, and the members of this Subcommittee have shown over the last several years on GSE issues.

The Challenge of Multiple Objectives

This Administration is committed to the objective of affordable housing for all Americans and, as a means to that end, to improving homeownership opportunities for minorities. This Administration is also committed to the objective of a sound and resilient financial system and, as a means to that end, to protecting investors by improving the clarity of disclosures about the risks and the rewards to which their investments are exposed. The question is not whether we are committed to either of these objectives but, rather, how we strive to achieve them both simultaneously.

To do this we look to mobilize the private sector to bring even more capital to bear both in creating housing opportunities and in the financial intermediation that supports and prices the relevant risks and rewards. If we are going to rely on private capital to achieve these objectives then we need to work even harder to improve the quality of the information that shareholders and creditors receive. And if we are going to rely, in part, on the vehicle of GSEs, we have no less of a need to inspire confidence in the sufficiency and comparability of the disclosures by GSEs to the investors whose capital we seek to employ.

The GSEs are privately owned but federally-chartered companies, created by Congress to help overcome barriers to the flow of credit into certain segments of the economy – housing, agriculture, and education. They are private companies that are not backed by the full faith and credit of the federal government. Today, the largest GSEs – Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System – are focused on housing. Two other GSEs – Farmer Mac and the Farm Credit System – are focused on agriculture. One GSE –the Student Loan Marketing Association – is focused on education and is now in the process of a congressionally mandated transition to full privatization.

Although GSEs were created to help bring the capital of private investors to bear on these societal goals, only Farmer Mac – the most recently created GSE – is fully subject to the disclosure regime that informs investors and is administered by the SEC under our nation's securities laws.

Given the size and importance of each of the GSE's operations in our capital markets and banking system, continued operation outside of the SEC-administered corporate disclosure regime is inconsistent with our objective for investor protection and for a sound and resilient financial system and will only hamper our efforts to bring even more capital to bear on the objective of affordable housing and, more generally, on all the objectives served by GSEs.

In sum, the GSEs – and particularly the three housing GSEs – are no longer modest experiments on the fringes of our financial system. They are large, rapidly growing and important players in our capital markets and in our banking system. As such, they need to be role models for our system of investor protection, not exceptions to it.

All GSEs Should Be In Compliance With the '34 Act

H.R. 4071 – the Uniform Securities Disclosure Act – would repeal Fannie Mae's and Freddie Mac's exemptions from both the Securities Act of 1933 and the Securities Exchange Act of 1934. The '33 Act requires a public company to submit a registration statement and prospectus when bringing new issues to market. Registration under the '34 Act triggers periodic disclosure requirements about the financial condition and management of companies that issue securities.

We do not see a basis for removing the '34 Act exemptions only for Fannie Mae and Freddie Mac. Instead, we support the application of the '34 Act disclosure requirements to all currently exempt GSEs, triggered by their voluntary registration under the '34 Act.

Fannie Mae and Freddie Mac are two well run companies that have done much in recent years to provide their investors with high quality financial disclosures. However, as they have recognized and the Administration has agreed, the time has come for their investors to be assured that the level and quality of the corporate disclosures they receive are the same as those that are made by any other company that actively participates in our capital markets.

The only way to achieve this assurance of comparability is to have each GSE agree to comply with the disclosure requirements of the '34 Act as interpreted and applied by the SEC. This ensures that investors will receive the benefit of knowing that GSE disclosures are consistent with those of other companies as determined by the SEC, consistent with the changes in disclosure requirements as they are implemented over time by the SEC, and that GSE disclosures are available on a consistent basis through the SEC's EDGAR system. To accomplish this, the Administration is requesting that each of the GSEs initiate a process with the SEC that will result in the application of the disclosures required under the '34 Act.

The Administration is pleased that Fannie Mae and Freddie Mac reached agreement last Friday with the SEC and the OFHEO to do exactly this – to establish a regulatory framework

that will ensure their complete compliance with the requirements of the ’34 Act. As Secretary O'Neill said, we applaud "Fannie Mae and Freddie Mac's self-initiated compliance with the corporate disclosure requirements of the Securities Exchange Act of 1934. The President has called on corporate leaders across the nation to examine their disclosure practices and ensure that they are doing everything they can to provide investors with accurate, timely and useful information consistent with best practices. Frank Raines and Leland Brendsel are stepping up to that challenge."

Under Section 12(g) of the ’34 Act an issuer that is not otherwise subject to the requirements of the Act may register its common stock with the SEC, thereby triggering obligations under Section 13 of the Act to file periodic financial and material event disclosures with the SEC on an ongoing basis. The Section 13 disclosure requirements include filing 10-K annual reports, 10-Q quarterly reports, and 8-K material event reports.

Although the process begins at the initiative of the company, once the initial filing is made, the issuer is henceforth required to make all the appropriate filings, reports and disclosures in the same manner as any other company subject to the ’34 Act. Fannie Mae and Freddie Mac have agreed with the SEC to register their common stock under Section 12(g) of the ’34 Act.

In addition, to ensure compliance with all of the provisions of the ’34 Act, as part of the regulatory framework agreed last week, OFHEO has agreed to promulgate a rule requiring that Fannie Mae and Freddie Mac, and their respective officers and directors, file all statements, reports and forms required by Sections 14 and 16 of the ’34 Act with the SEC (and concurrently with OFHEO). The effect of this rule will be that Fannie Mae and Freddie Mac will have to comply with the SEC’s requirements that officers and directors report any purchases or sales of common stock of the companies, that the companies file with the SEC proxy statements relating to annual or special shareholder meetings, and that their proxy statements be subject to review and comment by the staff of the SEC. As SEC Chairman Pitt said on Friday, "[t]his agreement also reflects a commitment to the goals the President has called upon us to meet, and toward which we are working: exemplary corporate governance, complete transparency of financial information and full and fair disclosure."

The SEC and OFHEO, and Fannie Mae and Freddie Mac, have worked hard so that this framework can provide a role model for smart, efficient regulation. This arrangement reinforces the principle of functional regulation, ensuring that the SEC administers and enforces our regime for investor protection, that OFHEO maintains its responsibilities for the safety and soundness of the housing enterprises’ operations and that there will no duplication or overlap between them.

It should be noted that OFHEO, of course, retains its own authority to require such public disclosures of Fannie Mae and Freddie Mac as it deems necessary or appropriate under its safety and soundness mandate to regulate the enterprises. This is an area of some considerable interest to me, having worked on several projects to develop enhanced risk disclosures for financial intermediaries prior to my service at the Treasury. I look forward to working with Director Falcon to consider whether and how enhanced risk disclosure concepts might be applied to the housing enterprises.

We have requested the other GSEs to begin working with the SEC and their regulators to achieve a comparable arrangement with the SEC that would subject them to the same set of disclosure requirements.

A Study of Initial Offering Disclosures for All Issuers of Mortgage-Backed Securities

The Administration is not prepared to support repeal of the GSEs' exemptions from the ’33 Act, and the Office of Federal Housing Enterprise Oversight is not pursuing a securities registration regime for Fannie Mae and Freddie Mac.

However, the Administration would like to promote a more level-playing field with respect to initial offering disclosures between GSE and non-GSE mortgage-backed securities (MBS) issuers and wants to ensure the adequacy of disclosures to investors in all mortgage-backed securities. As announced last Friday, the Treasury, SEC, and OFHEO will conduct a study of how this can best be achieved consistent with the Administration's objectives for both affordable housing and a sound and resilient financial system. The three agencies will study the disclosures now provided by MBS issuers with a view to ensuring that our MBS market continues to function smoothly, that investors receive the information they need to price these instruments, and that issuers do not face duplicative requirements. We will study how we can create a more level playing field and greater comparability of disclosures.

Requiring the GSEs to register their securities under the ’33 Act could have certain benefits, including uniformity and consistency of disclosures for new offerings. But such a change has the potential for disrupting a large and well-functioning market and imposing burdens and added costs. Consequently, application of the ’33 Act to the GSEs mortgage-backed market without much greater consideration of the costs of moving from one regime to the other would likely, in the short run, compromise our objectives for both affordable housing and for a sound and resilient financial system.

At present, out of a total mortgage-backed market of $3.9 trillion, there are over $2.3 trillion in GSE issued mortgage-backed securities outstanding that have come into the market completely outside of the requirements of the ’33 Act. There are also, at present, $916 billion in mortgage-backed securities issued by non-GSEs that are subject to some but not all of the provisions of the ’33 Act, under certain limited exemptions for “mortgage-related securities.”

We would like to take a fresh look at the initial offering materials of mortgage-backed securities. To do this, the Treasury, SEC, and OFHEO will conduct a joint study. Together we will listen carefully to the securities industry, investors, Fannie Mae, Freddie Mac, Ginnie Mae, private-label issuers and others in the regulatory community to gain a fuller understanding of the market structure, the nature of competition, and the risks being priced and transferred. This will serve as background to a fundamental reconsideration of the initial offering disclosures that would best serve all of the participants in mortgage-backed markets and be most consistent with our twin objectives for affordable housing and a sound and resilient financial system. Our overall aim will be to recommend how investors can receive clear, concise and useful information about the risks and rewards of MBS.

We will complete our review of initial offering disclosures of all MBS issuers, and report back to this Committee, and other interested congressional committees, early in the first session of the next Congress.

Conclusion

Our system of regulating securities markets has served our country well for almost seventy years. That does not mean that we can be content. Our financial markets and financial institutions have evolved and expanded in ways that were unimaginable just a few decades ago. Constant attention is necessary to ensure that our system of investor protection and our system of government sponsored enterprises continues to serve us as well in the future as they have in the past.

Thank you again for providing me with the opportunity to discuss these important issues with the Committee today.

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