



EXCHANGE

Subcommittee on Capital Markets

Richard H. Baker, Chairman
Securities, Insurance, Government-Sponsored Enterprises

The News from U.S. Rep. Richard H. Baker
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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 led 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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