AMERICANS for TAX REFORM

Written Statement of Kelly William Cobb

Government Affairs Manager, Americans for Tax Reform

Hearing on

"Transparency, Transition and Taxpayer Protection: More Steps to End the GSE Bailout"

Capital Markets and Government Sponsored Enterprises Subcommittee

U.S. House of Representatives Committee on Financial Services

May 25, 2011

Chairman Garrett and Members of the Subcommittee, thank you for the opportunity to submit testimony for the record on the impact that the government sponsored enterprises Fannie Mae (Federal National Mortgage Association or "Fannie") and Freddie Mac (Federal Home Loan Mortgage Corporation or "Freddie") have had on American taxpayers.

When the Housing and Economic Recovery Act of 2008 (HERA) authorized the Treasury Department to purchase the obligations of Fannie and Freddie, it stated that such actions must be necessary to "protect the taxpayer."[1] Yet, since the Treasury Department put Fannie and Freddie in conservatorship, the two institutions have already cost American taxpayers $162.4 billion, a number that is expected to rise even further.[2] There are relatively no protections for American taxpayers caught footing the bill. If one thing has become clear, it's that the implied guarantee that the federal government would bail out Fannie and Freddie should they become insolvent is now an explicit guarantee.

Americans for Tax Reform (ATR) urges Congress to move toward a secondary mortgage market without an explicit taxpayer guarantee, ideally one that operates in the private sector. The secondary mortgage market is a critical component of our nation's housing sector, ensuring liquidity and the ability for lenders to issue mortgages to homebuyers. Yet, a market's success or failure should never be tied to taxpayer support, as taxpayer guarantees artificially alter a market and can contribute to its rise or fall.

As Congress looks to the future of Fannie, Freddie, and the secondary mortgage market, we urge you to take the following important steps.

First, Congress must limit taxpayer exposure to the failure of Fannie and Freddie. As placing the government sponsored enterprises (GSEs) in conservatorship has already cost taxpayers into the hundreds of billions of dollars, we support efforts to strictly cap the total amount for which taxpayers will be liable.

Currently, despite promises of taxpayer protections in HERA, the amount of money Treasury can spend on Fannie and Freddie is virtually without end. According to the Federal Housing Finance Agency, which oversees Fannie and Freddie's conservatorship, the GSEs have drawn a combined $162.4 billion from Treasury since they entered conservatorship in 2008.[3]

From a taxpayer perspective, the only thing worse than a company or industry receiving a bailout is making the amount of that bailout infinite. Such perpetual overspending is what has exposed our nation to a debt crisis in the first place.

Second, since Fannie and Freddie are now under the conservatorship of the federal government, Congress should undertake efforts to tamp down on Fannie and Freddie's taxpayer-backed spending. This is a fiscally responsible way to slow the rate that Fannie and Freddie are burning through what should be limited taxpayer funding.

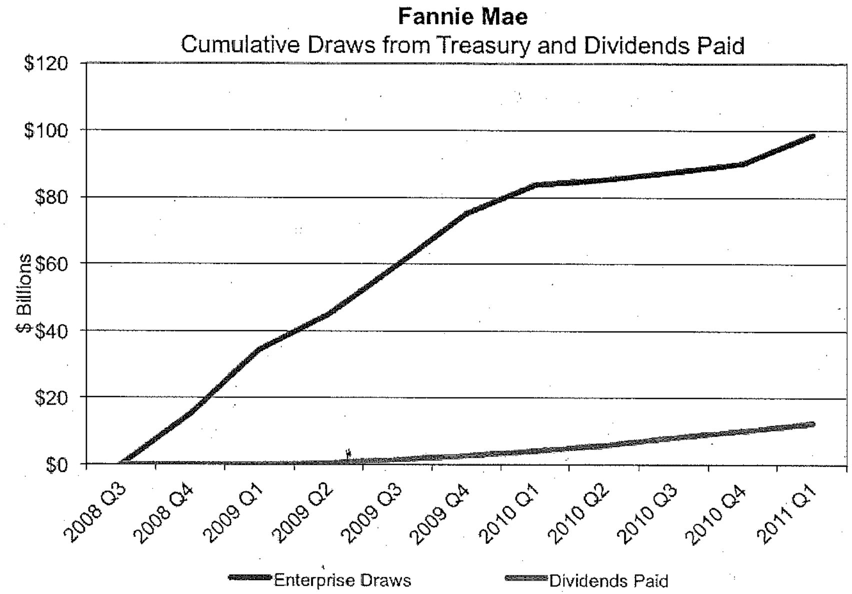
Reducing spending includes scaling back any statutory obligations for Fannie or Freddie to spend. This means eliminating mandates under the Housing and Economic Recovery Act that force Fannie and Freddie to pour 4.2 basis points of any new business into the HOPE Reserve Fund, the Housing Trust Fund, and the Capital Magnet Fund.

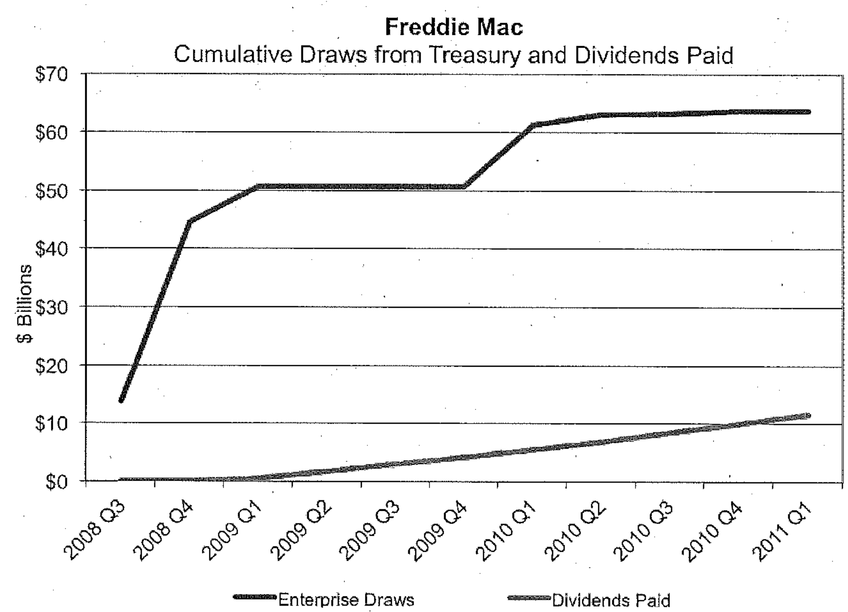
Had Treasury not temporarily halted payments to HERA housing programs from the GSEs, the Congressional Budget Office estimates it would have cost a little over $6 billion over ten years.[4] These are clearly not payments that Fannie or Freddie can afford, especially when they owe this amount many times over to the U.S. Treasury. Furthermore, neither institution should be in the business of market-distorting government programs that fund pet projects and inflate the rental and housing markets.

We also support measures to prevent or cap expenditures related to Fannie and Freddie's fallout. This includes legal fees to defend the institutions and their executives, which have already topped $160 million.[5] While Fannie and Freddie were relying on treasury money, $132 million was spent on lawsuits to defend possible fraud, corruption, and other actions that took place at the GSEs prior to when the subprime mortgage crisis hit.

Third, Congress should take steps to ensure taxpayers are repaid for any and all funds received by Fannie and Freddie. Similar to bailouts of other industries, Treasury has become the primary stockholder of Fannie and Freddie, and pays back the Treasury through dividends or (should they emerge from conservatorship) the sale of stock. To date, Fannie and Freddie have paid dividends of $24.1 billion, a mere 15 percent of what they have drawn from the U.S. Treasury.[6]

ATR supports any effort to ensure Treasury maintains the current dividend payment rate. This will require Fannie and Freddie to continue to pay back American taxpayers for what they've already taken. Dividend payments from Fannie and Freddie have increased or remained the same in every quarter since entering conservatorship.[7] Maintaining or increasing dividend rates keeps Fannie and Freddie on a path back to repayment. Such a measure is also unlikely to be difficult for either institution, as the rate of draws from Treasury appears to be slowing while dividend payments are generally moving up.





Source: Federal Housing Finance Agency

We also support legislation that would divest the institutions of non-critical assets. It is becoming increasingly clear that Fannie and Freddie must become leaner institutions, should they continue to exist in their current form at all. This takes a preliminary step to free up capital within Fannie and Freddie, and proceeds should be used either for repayment of debts owed to taxpayers or to ensure less money is drawn from the Treasury in the future. This is not a new concept. When the Treasury became a significant shareholder of General Motors, the company similarly sold or shrunk product lines to generate capital.

Finally, Congress must take the lessons of Fannie and Freddie's demise to restructure and limit government's role in the secondary mortgage market. This involves subjecting the institutions to Freedom of Information Act requests, which will permit the American people to better understand what went wrong and how a government-backed Fannie and Freddie contributed to the subprime mortgage crisis, as has become apparent.

Congress should work to ensure a responsible, slow, and steady transition away from the Fannie and Freddie GSE model, ideally leaving the secondary mortgage market to the private sector. This may mean simply an oversight role for the government to ensure continuity and stability in the housing market, including making sure primary lenders have adequate access to the secondary market. It also means ensuring that however the secondary mortgage market emerges from this crisis, the taxpayer-backed model does not continue.

When the U.S. Treasury made the implicit taxpayer backing of Fannie and Freddie explicit, it assumed $5 trillion worth of debt - an enormous risk for taxpayers.[8] We believe this is a mistake that should not be repeated.

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[1] Housing and Economic Recovery Act of 2008, Section 1117.
[2] Federal Housing Finance Agency, "Data as of May 9, 2011 on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities," Page 2. <http://www.fhfa.gov/webfiles/21275/TSYCollender05092011.pdf>
[3] Ibid.
[4] Congressional Budget Office, "H.R. 3221 Housing and Economic Recovery Act of 2008 Cost Estimate," July 23, 2008. <http://www.cbo.gov/doc.cfm?index=9597&zzz=37810>
[5] Morgenson, Gretchen. "Mortgage Giants Leave Legal Bills to the Taxpayers," New York Times, January 24, 2011. <http://www.nytimes.com/2011/01/24/business/24fees.html>
[6] Federal Housing Finance Agency. Pg. 3.
[7] ibid.
[8] Jickling, Mark. "Fannie Mae and Freddie Mac in Conservatorship," CRS Report for Congress. September 15, 2008.