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THE PRESENT CONDITION AND
FUTURE STATUS OF FANNIE MAE
AND FREDDIE MAC

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HEARING
BEFORE THE
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
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Wednesday, June 3, 2009

U.S. House of Representatives,
Subcommittee on Capital Markets,
Insurance, and Government
Sponsored Enterprises,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:07 p.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, McCarthy of New York, Baca, Miller of North Carolina, Scott, Klein, Perlmutter, Carson, Speier, Foster, Adler, Grayson, Himes; Garrett, Price, Castle, Lucas, Manzullo, Royce, Biggert, Capito, Hensarling, Barrett, Campbell, Neugebauer, McCarthy of California, Posey, and Jenkins.

Also present: Representatives Miller of California and Kaptur.

Chairman Kanjorski. The committee will come to order. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will be in order.

I ask unanimous consent that Ms. Kaptur have permission to participate in today's hearing.

Pursuant to a prior agreement with the ranking member, each side will have 15 minutes for opening statements today. Without objection, all members' opening statements will be made a part of the record. I yield myself such time as I may consume.

We meet today to examine the present condition and future status of Fannie Mae and Freddie Mac, which together have lost more than \$150 billion since the third quarter of 2007. This hearing is not only the first hearing in the 111th Congress on the two Government-Sponsored Enterprises, but is also the first in a series that the Capital Markets Subcommittee will convene to review these matters.

Last summer, Congress completed work on an 8-year project by enacting the Federal Housing Finance Reform Act. Shortly thereafter, the new Federal Housing Finance Agency placed Fannie Mae and Freddie Mac in conservatorship.

Since then, the Treasury Department has purchased \$85.9 billion in senior preferred stock at the two Enterprises. This investment could ultimately grow to as much as \$200 billion per institution under current agreements.

In recent months, the Treasury Department has supported Fannie Mae and Freddie Mac in other ways as well, by purchasing \$5 billion of their mortgage-backed securities in 2008, and requesting \$249 billion more in 2009.

In addition, the Federal Reserve now has a sizeable interest in the success of the two companies, holding more than \$71 billion of their bonds and \$365 billion of their mortgage-backed securities. In total, these growing taxpayer commitments

are quite sizeable, if not staggering.

They have also led many to conclude that the implicit government guarantee toward the Enterprises has now become an explicit one. Our hearing today will therefore examine the government's financial support for Fannie Mae and Freddie Mac, and explore the options for the future of their relationship with the government.

From my perspective, the emergency actions taken to date by the Federal Housing Finance Agency, the Treasury Department, and the Federal Reserve were needed to ensure the continued functioning of our Nation's housing finance system during this period of considerable economic turmoil. With all of these problems and imperfections, Fannie Mae and Freddie Mac have ensured that millions of Americans can continue to purchase and own their homes.

While the existence at this time of Fannie Mae and Freddie Mac is essential for our Nation's economic recovery, this is also an appropriate moment to begin to consider how we might modify their mission, operations, and ventures going forward.

As former Treasury Secretary Henry Paulson has observed, we need to use this period while Fannie Mae and Freddie Mac stabilize to decide what role they should play in the markets. I must, however, caution everyone that this debate will be a long-distance relay between Congresses, not a 100-meter sprint within the 111th Congress.

This debate over what roles and functions Fannie Mae and Freddie Mac should perform has, of course, raged for many years. Many good reform ideas have started to come to light in recent months, and we should study them closely.

Some of our choices include: reconstituting the Enterprises as they were before the conservatorship decision; splitting them into smaller operating companies like we did with AT&T; regulating the prices they charge, like a utility; creating cooperative, nonprofit ventures; or revolving them back into the government.

Many have also called for privatizing Fannie Mae and Freddie Mac, and there is some precedent for such actions. In the 1990's, for example, we enacted a law that allowed Sallie Mae to graduate from the school of Government-Sponsored Enterprises. While we could do the same here, we ought to move cautiously.

We created Fannie Mae and Freddie Mac because of a market failure, and we ought to ensure that any new system of housing finance continues to provide a stable source of funding and long-term credit to help people to purchase homes.

In short, we must keep our minds open to all reform proposals, and refrain from drawing lines in the sand about what each of us will or will not support until we have had the chance to consider the pros and cons of the many different options.

That being said, I will use one key factor in my examination of these choices: Namely, I want to ensure that community banks and retail credit unions continue to have access to a neutral source of affordable funding to help them compete against large institutions.

These mortgage providers are important participants in our markets, and we must ensure that they continue to have an opportunity to help hard-working families to achieve the American dream of homeownership.

In sum, this hearing is timely. Congress has a constitutional responsibility to conduct effective oversight of the work of the Federal Housing Finance Agency to make sure that it is operating as we intended. We also have an obligation to ensure that the Executive Branch is effectively allocating Federal tax dollars and helping as many people as possible to

remain in their homes.

Finally, Congress needs to begin to think about how it will structure the government's relationship with Fannie Mae and Freddie Mac once we emerge from this financial crisis. I look forward to a vibrant debate on these important issues.

I recognize the gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. Garrett. Thank you, Mr. Chairman. I also want to thank the chairman for your comments, saying that you are open to different ideas with regard to restructuring our mortgage finance system. I think the one agreement is that doing right and keeping the status quo is unacceptable.

You know, Fannie and Freddie played a leading role in adding fuel to the mortgage finance fire that burned down a good portion of our financial system and the economy as a whole. By financing roughly 36 percent of the subprime housing market, and increasing their leverage, they really used the governmental-granted advantages in the marketplace, and then ran up a bill to the taxpayers of \$85 billion and counting.

The total bailout costs of Fannie and Freddie are expected to climb much higher. When the Housing and Economic Recovery Act was passed, an arm-twisted CBO scored the GSE titles of the bill as \$25 billion, and said there was less than a 50 percent chance that a bailout authority would ever be used, and less than a 5 percent chance that the costs would ever run over \$100 billion.

Now, the chairman of this committee, Chairman Frank, chastised Republicans on the Floor who said that the costs would likely go well over the CBO estimates. He said, ``It is the most inflationary arithmetic I ever heard.'' Of higher cost estimates being used by Republicans, he stated, ``These numbers that are being thrown around are simply inaccurate and misleading.''

Well, speaking of inaccurate and misleading, the CBO recently updated their scores, and the cost estimates have increased by over 1,500 percent. So as we begin this month with a more formal debate over regulatory restructuring and providing the government with an explicit bailout authority, I think it is essential that any conversation begins and ends with GSEs, and any regulatory reform that does not include GSEs is not true reform.

Fannie and Freddie were a large part of the problem, and reforming them should be a large part of the solution. Also, I am very worried that proposals being discussed by the Administration and some others to create a so-called systemic risk regulator will actually create what amounts to another new set of government-sponsored entities.

By creating a new systemic risk regulator, we could essentially establish a dozen new Fannies and Freddie's that will be too-big-to-fail and have the inherent market advantage that will come with that distinction. As our distinguished ranking member from Alabama points out, privatizing profits and socializing risk is a bad business model, and we should learn from our past mistakes and not repeat them.

So going forward, I do believe it is very important that we have a viable and liquid secondary mortgage market to provide additional funding so that people can experience the American dream of owning their own homes. And one tool that I believe that we can do that with--and I may have talked about it here before--is covered bonds.

You know, covered bonds are debt instruments offered by financial institutions. They are backed by a collateralized pool of mortgages. Investors purchase these bonds, and the pool of mortgages are treated as secured collateral.

Investors also continue to have a full recourse on the

institution in case there is a failure. This type of securitization is widely used in Europe to provide liquidity over there, and I believe we can do it here in the United States as well.

I also want to thank Chairman Frank for his comments some time ago when he said he would hold a hearing on this important topic. And I do look forward to working with him and all my colleagues as we continue to move forward on this.

So I want to again thank the chairman, and thank the witnesses as well for coming forward. Thank you.

Chairman Kanjorski. Thank you very much, Mr. Garrett.

We will now hear from Mr. Scott for 3 minutes.

Mr. Scott. Thank you, Mr. Chairman. I want to thank the chairman and the ranking member for holding this important hearing concerning the state of Fannie Mae and Freddie Mac. This continues to be of utmost concern to our economy.

The collapse of these two mortgage giants had a profound impact on our markets and total economy. And I am interested to hear more details and opinions about the risk of a prolonged economic slump, and how long the GSEs plan to proceed in the future as well as access their current conservatorship situation.

I am further interested to hear what the Federal Housing Finance Agency has to say about the future of GSEs, and what this Agency believes they should or will look like down the line, especially as mortgage markets continue to face turmoil.

There are many ideas and proposals regarding the direction that GSEs should take: making them a government entity or absorbing them into another government entity such as the FHA; splitting them up into multiple GSEs; or privatization, simply eliminating all implicit and explicit government backing for mortgage-related instruments.

The Fannie/Freddie fallout not only affected the economy overall, but it affected Main Street as well. Many of our Nation's community banks have been hard hit because they have held some 85 percent of lenders that held Fannie and Freddie stock.

Our community banks are the backbone of communities across this country. And this is especially true in my State of Georgia, as we are currently experiencing a very large number of bank closures. This whole situation is helping to reduce bank capital and impede upon the ability of banks to make new loans and renew existing ones.

And I just want to mention one particular situation that has raised big questions. When Freddie Mac ignored the two leading rating agencies, Moody's and Standard & Poor's, on rating the market's securitization in 9 months, relying instead on the market's two small agencies, Fitch and Canadian agency Dominion Bond Rating Services, that \$1 billion deal has led to AAA ratings. Some close to the deal claim that Moody's and S&P lost the Freddie mandate as their rating method used was considered too rigorous.

So the question that has to be answered and dealt with today is this: Is it not the role of these agencies to be more vigilant in their rating process after getting chastised by Congress and the media over the handling of AAA ratings on complex securities that began to falter when home buyers could no longer pay their mortgages?

And of course the flip side of that, is that the big credit rating agencies may be making some of these institutions jump through hoops that aren't necessary.

Serious questions, and a very timely hearing. I look forward to hearing from our witnesses. Thank you, Mr. Chairman.

Chairman Kanjorski. Thank you very much, Mr. Scott.

We will now hear from Mr. Baca for 3 minutes.

Mr. Baca. Thank you, Mr. Chairman. I appreciate you convening this hearing.

Congress established Fannie Mae during the New Deal to make homeownership more affordable. And they created Freddie Mac with a similar purpose in 1970. Neither provides home loans. Instead, their purpose is to increase the funding available for home mortgage financing, either by providing credit guarantees on mortgage-backed securities or by directing investing in mortgages and mortgage-related securities through their retained mortgage portfolios.

To further their missions, the GSEs' congressional charters granted them unique privileges, shielding them from many of the financial standards and tax burdens imposed upon their competitors. These benefits created a perception that Fannie and Freddie were backed by the U.S. Government, and this implicit guarantee also provided them a funding advantage over private sector participants.

Not surprisingly, over time, the GSEs' advantages enabled them to dominate the secondary mortgage market. Today they have more than \$5 trillion in obligations outstanding, an amount that is nearly 40 percent of the size of the entire U.S. economy.

The systemic risk posed by the size of these entities was only magnified by investor perceptions that GSE securities were backed by the full faith and credit of the U.S. Government. In September, those perceptions became reality.

On September 7, 2008, shortly after Congress passed the GSE regulatory reform legislation, the Federal Government placed Fannie and Freddie into conservatorship. That rescue was one of the most extraordinary Federal interventions into the private sector, and is on track to become one of the most expensive, if not the most expensive.

As part of the GSEs' conservatorship agreement, Treasury committed up to \$200 billion to purchase preferred stock from each company through December 31, 2009. In exchange, Fannie and Freddie provided the Treasury with \$1 billion in senior preferred stock and warrants to acquire 80 percent of each GSE.

In addition to Treasury purchases of preferred stock, both the Treasury and the Fed are also scheduled to purchase trillions of dollars' worth of GSE debt in mortgage-backed securities. As of May 29th, Treasury has purchased \$167 billion of GSE MBSs using authority granted under the HERA Act of 2008. The CBO estimates in March that the GSEs' titles will cost \$384 billion. The Fed currently holds \$81 billion of GSE debt, and \$507 billion of agency MBS.

On March 18th, the Fed announced its purchases of agency MBSs will total \$1.25 trillion by the end of the year. Finally, the Treasury has also initiated a credit facility for both GSEs to provide liquidity.

Mr. Chairman, in conclusion, the magnitude of the trillion-dollar GSE bailout demands our full engagement about the future of the GSEs. Congress must work to develop a new model for housing finance. Some, like former Treasury Secretary Hank Paulson, have endorsed a utility model. Others, myself included, have proposed shrinking and privatizing the GSEs.

Whatever the GSEs' ultimate fate, we can agree that the GSEs cannot continue as before. Socializing risk and privatizing profit, as Mr. Garrett said, must end. The American people demand an end to the bailouts. Any discussion of the long-term future of the GSEs must include a bailout exit strategy.

I would like to thank our witnesses for appearing today, and look forward to the hearing and their ideas for a transition period for the GSEs. And I yield back the balance of my time.

Chairman Kanjorski. Thank you very much.

We will now recognize the gentleman from Illinois, Mr. Foster, for 2 minutes.

Mr. Foster. I would like to follow up on Ranking Member Garrett's expression of interest in covered bonds. I think we should all show some humility in our current situation and look laterally at countries that have systems that did not get into this mess.

And in particular, the American Expertise Institute has recently had some public presentations and meetings on converting the present GSE-based system and mortgage-backed security-based system to a variant of covered bonds that is known as the Danish system for mortgage origination, which I personally think has tremendous potential.

It has provided an efficient and liquid model for housing finance ever since the Great Fire of 1795 in Copenhagen, survived numerous booms and busts, and as I say, I can't see what is wrong with it.

There is a fairly worked-out scenario in these presentations for actually transitioning Fannie and Freddie into this system. And I would be very interested in pursuing this, if not in this hearing, in subsequent hearings and conversations.

Thanks you. I yield back.

Chairman Kanjorski. Thank you very much, Mr. Foster.

And now we will hear from the gentleman from Delaware, Mr. Castle, for 1\1/2\ minutes.

Mr. Castle. Thank you, Mr. Chairman, and thank you, Mr. Garrett, for holding today's hearing.

I believe debating the future of Fannie Mae and Freddie Mac is of importance as these entities have tremendous impact on our housing and finance markets. I also believe that we cannot neglect talking about the future of other elements of the housing market. While the GSEs are important, we also need to consider other aspects of housing finance and their role in the market moving forward.

The events that began unfolding last summer have led many to believe the public/private business model of Government-Sponsored Enterprises is inherently flawed. Does this model invoke moral hazard, where entities backed by the government take unnecessary risks all because they know they will be provided a lifeline if things go really bad?

On the other hand, does this argument apply to all public/private partnerships, even though some of these partnerships have worked well? Perhaps it is not necessarily the model it bought, but perhaps some of the practices adopted by the GSEs themselves that are in need of reform.

So the question is raised: What do we do with Fannie and Freddie in the future? Should they return to GSE status after we have exhausted the conservatorship role? Should they become an official government entity? Or do we privatize them and eliminate the government backing role altogether?

I am looking forward to the testimony of the panel before us to try and hash out this issue. I also hope that the experts before us today will be able to address the future of the housing and mortgage market in general, as Fannie and Freddie are simply parts of the greater debate this committee needs to address.

Thank you, and I yield back the balance of my time.

Chairman Kanjorski. Thank you very much, Mr. Castle.

And now we will hear from the gentleman from California, Mr. Royce, for 1\1/2\ minutes.

Mr. Royce. Thank you, Mr. Chairman.

I think I have warned 16 times in this committee about the danger of government involvement in the market with respect to

GSEs. The goal of government should be to be a regulator. What we did was we replaced political pull with market forces.

And in 2003, I introduced the first legislation to bring Fannie and Freddie under one regulator. In 2005, I got the amendment onto the House Floor, frankly, that would allow the GSEs' regulator to control for systemic risk, to actually step in--which is exactly what the regulators wanted to do. But political pull and the lobby by Fannie and Freddie prevented this from happening.

Now we have \$6 trillion worth of a mortgage market out there. And basically what we did was we allowed a quasi-political Government-Sponsored Enterprise here to borrow at a much lower rate in the market. We allowed them to form a system in which they could arbitrage and in which they could build up a portfolio of \$1.5 trillion.

And then forces in Congress forced the majority of that loan portfolio to be in subprime and Alt-A loans. And when we called attention to this repeatedly, we were told, there is no risk, or we are going to roll the dice on this risk.

Well, the consequences have been not only to drive up a balloon in the housing market, but with the collapse, to lose billions of dollars for stockholders; but more importantly, to lose for those who were involved in the housing market, and the side effect that this has had on housing prices in the United States.

So the observation I would make first is, I would get ahold of any member who is interested in this debate. I would get ahold of economist Thomas Sowell's new book, 'The Housing Boom and Bust,' and see the role that Congress played in terms of helping create this crisis. And second, I would think long and hard in the future about creating political manipulation into the market. We should be the regulators. We shouldn't be tying the hands of the regulator.

In 1989, we had, from Freddie Mac, the chairman of that organization come up here and say it would risk safety and soundness to allow these kinds of portfolios to develop. And instead, we allowed a 101 to 1--a 101 to 1 leverage out of these institutions, and the resulting collapse, and the systemic risk. And we ignored the very institutions and regulators that tried to warn us, and we tied the hands of those regulators.

That is the debate we should be having today, and we should be learning a lesson from it. I thank you, Mr. Chairman.

Chairman Kanjorski. Thank you, Mr. Royce.

We will now hear from the gentlelady from West Virginia, Ms. Capito.

Mrs. Capito. Thank you, Mr. Chairman. I would like to thank you for holding this hearing today. It is my hope, as others have shared, that this will be the first in a series of discussions on the future of the GSEs, Fannie and Freddie.

As we are all too well aware, the long debate over whether or not the GSEs' Federal guarantee was explicit or implicit was resolved last fall; due to an overabundance of risk on their portfolios, Fannie and Freddie were placed in conservatorship by the Treasury and the Federal Housing Finance Agency.

Since then, the government has set up new management teams within the two GSEs to control day-to-day operations, but remains in tight control of other overall operations. I look forward to hearing the Director of FHFA--did I get that right?--on the current status of the GSEs, the role they continue to play in the mortgage markets, and the future of the two entities.

The current situation is not ideal, and it is my hope that we can return the GSEs to the private markets as quickly as possible. What shape or form this will take is unknown at this

time, but it is clear that the previous business model was not sustainable as it allowed the GSEs to take on too much risk, leaving the taxpayers to step in when the losses became too great. There are many proposals out there for the future, and our witnesses will be elaborating upon them.

One issue that does concern me, and that I have heard from numerous constituents throughout the last several months, is the effect that adverse market fees from the GSEs are having on my constituents' abilities to purchase a home. In some cases, these additional fees are actually pricing home buyers out of the market.

I look forward to hearing the Director speak on the genesis of these fees and their effect on liquidity in the mortgage markets. I look forward to hearing from all of our witnesses today, and I want to thank the chairman for holding the hearing.

I yield back.

Chairman Kanjorski. Thank you very much, Ms. Capito.

And now we will hear from the gentleman from Florida, Mr. Klein, for 3 minutes.

Mr. Klein. Thank you, Mr. Chairman. Thank you for holding this hearing, and I thank Ranking Member Garrett as well.

The current downturn has certainly showed weaknesses at Freddie and Fannie, and it is important to determine the proper structure and goals of these programs going forward. However, it is equally important to ensure that FHFA is currently doing everything possible to stabilize the mortgage market and prevent foreclosures.

I am particularly concerned about the current condition of housing markets where I come from in south Florida, particularly because of the lack of the quantity of staff at Freddie Mac and Fannie Mae servicing Florida. I have heard from plenty of loan modification specialists, law firms, and other distressed asset management in my district and throughout Florida, that are ready to assist Fannie with the vastly increased caseload of foreclosures, modifications, and refinancings, yet they are having trouble being approved by Freddie and Fannie because of red tape.

My concern is that foreclosures are occurring because there isn't enough staff to do proper loan modifications. And we also understand it is unacceptable--and we all know it is unacceptable--for families to lose their homes to foreclosure because there isn't enough staff to do proper loan modifications.

I would just like to point out, as I said, that we have had some conversations, and we certainly recommend and ask that as we work through this difficult time period, that we have the staff and support to get these modifications working through the process.

I look forward to hearing the comments and I look forward to working with all of our members and the representatives to accomplish this. Thank you, Mr. Chairman.

Chairman Kanjorski. Thank you very much, Mr. Klein.

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

Mr. Hensarling. Thank you, Mr. Chairman. From my perspective as a member of this committee, and as a member of the Congressional Oversight Panel for the TARP program, I believe there are a number of ``but for'' causes of our economic recession.

None loom larger than the monopoly powers that were granted to Fannie and Freddie, coupled with the so-called housing mission, that essentially mandated they loan money to people to buy homes that ultimately they could not afford to stay in.

Many of you have said, though, that under H.R. 1427, passed

in May of 2007, that somehow this situation has been rectified. Since that legislation has passed, the conforming loan limits have increased to \$729,000, increasing taxpayer liability. The portfolio limits of the GSEs have been increased to \$900 billion, more taxpayer exposure.

Their share of new mortgages have gone from 50 percent to 90 percent, more taxpayer exposure. Taxpayers have now been forced to invest almost \$87 billion through the preferred stock agreements. They are exposed to up to \$400 billion under those particular agreements.

The Congressional Research Service has estimated the cost of the conservatorship to be \$384 billion, at a time when Americans are struggling to pay their taxes and keep their jobs.

I am glad, Mr. Chairman, that you are holding this hearing since certainly H.R. 1427 hasn't taken care of the worst of Fannie and Freddie. Ultimately, we need to see this conservatorship have a time certain to end, and transition these Enterprises back to the private market and get the hand of government out of this Enterprise that has caused this taxpayer debacle for generations to come.

Thank you, and I yield back the balance of my time.

Chairman Kanjorski. Thank you very much, Mr. Hensarling.

Now we will hear from the second gentleman from Texas, Mr. Neugebauer, for 1\1/2\ minutes.

Mr. Neugebauer. Thank you, Mr. Chairman. I look forward to the testimony of our witnesses today.

And I believe the task ahead for this committee and for Administrator Lockhart and his team is, number one, stop the bleeding. As obviously you are going to testify, the American taxpayers have had to put an extremely large amount of money into this entity, and it looks like we are going to have to put more.

Number two, as we go down the road, is how do we keep this from happening again? Because certainly we want to take steps in the future that do not put us back in the position that we are in now.

Number three, making sure that we develop an exit strategy that protects the money that the taxpayers have already invested in these entities.

And number four, while we are doing all of this, though, we have to ensure that there is a substitute, another entity, another way to ensure that there is not a major disruption in housing finance in this country.

If we do not have a way to transition to a housing finance source that will take up the slack--because what we are going to see is testimony that basically, the only game in town now is Freddie and Fannie and FHA--if we do not have entities in place to take up that slack, we will cause another major disruption in the housing market at a time when American families have already lost a substantial part of their equity. We do not want to be in a situation where we are creating that.

So it is easy to identify the problems that need to be addressed. Obviously, many people have reasons why we got here, but more importantly, the important question is, where do we go from here? I look forward to hearing from the witnesses today as to where do we go from here.

Thank you, and I yield back.

Chairman Kanjorski. Thank you very much, Mr. Neugebauer.

And now we will introduce the panel, if I may. I want to thank you for appearing before the committee today, and your written statement will be made a part of the record.

Today, the Honorable James B. Lockhart, Director of the Federal Housing Finance Agency, will present a single statement on behalf of the Agency. Also joining him at the table are two

of his Deputy Directors: Mr. Edward DeMarco, Chief Operating Officer and Senior Deputy Director for Housing Mission and Goals; and Mr. Christopher Dickerson, Deputy Director for Enterprise Regulation. These two individuals have the responsibility for regulating Fannie Mae and Freddie Mac.

Mr. Lockhart, you are recognized for such time as you may consume to make your remarks.

STATEMENT OF THE HONORABLE JAMES B. LOCKHART III, DIRECTOR, FEDERAL HOUSING FINANCE AGENCY; ACCOMPANIED BY MR. EDWARD J. DeMARCO, CHIEF OPERATING OFFICER AND SENIOR DEPUTY DIRECTOR FOR HOUSING MISSION AND GOALS, FEDERAL HOUSING FINANCE AGENCY, AND MR. CHRISTOPHER DICKERSON, DEPUTY DIRECTOR FOR ENTERPRISE REGULATION, FEDERAL HOUSING FINANCE AGENCY

Mr. Lockhart. Thank you, Mr. Chairman. Chairman Kanjorski, Ranking Member Garrett, and committee members, thank you for inviting me to speak today about Fannie Mae, Freddie Mac, their future, and Federal involvement in the housing finance system.

With almost \$12 trillion in outstanding mortgage debt, housing finance is critical to the U.S. economy. As the conservator, FHFA's most important goal is to preserve the assets of Fannie Mae and Freddie Mac. That is our statutory responsibility.

As the regulator, FHFA's mission is to ensure the Enterprises provide liquidity, stability, and affordability to the mortgage market in a safe and sound manner. That is also our statutory responsibility, as it is the public purpose that Congress gave the Enterprises.

The Enterprises own or guarantee 56 percent of the single-family mortgages in this country, for a total of \$5.4 trillion. Given that massive exposure, the best way to preserve their assets and fulfill their mission is to stabilize the mortgage market and strengthen their safety and soundness.

Working with the Federal Reserve, the Bush and Obama Administrations, and other regulators, that has been our top priority since the conservatorship began, and will continue to be so. Supporting mortgage modifications and refinancings for homeowners into safer mortgages are an important element of stabilizing the housing market, and thereby the U.S. economy.

The form in which Fannie Mae and Freddie Mac exit from conservatorship once the housing market is stabilized should be addressed by Congress and the Administration, and I think it is a great first step to have this hearing.

FHFA continues to classify Fannie Mae and Freddie Mac as critical supervisory concerns. As there were significant risks that they would be unable to fulfill their missions, we placed them into conservatorship last September. Since then, the Treasury Department has purchased \$86 billion in their senior preferred stock.

The Enterprises' short-term financial outlook remains poor, which will result in additional requests for preferred stock investment from the Treasury Department. However, both Enterprises have stress-tested their capital or shortfalls, and expect the Treasury's commitment to fund up to \$200 billion in capital for each of them to be sufficient.

The senior preferred stock purchase agreements have given investors confidence that there is an effective guarantee of GSE's obligations. In addition, the combined financial support of the Treasury Department and the Federal Reserve of over three-quarters of a trillion dollars to date for housing GSE debt and MBS have ensured they remain liquid.

Because of this support, both Enterprises have been able to maintain a critically important presence in the secondary mortgage market. Their combined share of mortgage originations

in the first quarter of 2009 and also in 2008 was 73 percent. That was double the 37 percent in 2006.

While the Enterprises have continued to support the secondary mortgage market, new senior management teams have worked with FHFA to establish and implement comprehensive remediation programs. The Enterprises have made progress, but they face numerous, significant challenges to their operations. The staffs of the Enterprises and FHFA have been working hard to help to strengthen their safety and soundness.

In the current mortgage crisis, the Enterprises have focused on mortgage availability, mortgage affordability, and foreclosure prevention. Loan modifications undertaken for their own book of business are critical for eliminating their own credit losses and, even more importantly, stabilizing the mortgage market.

The Enterprises and FHFA worked closely with the Administration to develop the Making Home Affordable Program. Both Enterprises have undertaken a home affordable refinance initiative to enable homeowners who are current on their Enterprise-owned or guaranteed mortgages to refinance at lower rates. FHFA expects both modifications in the refinance program, which is expected to really ramp up rapidly by late summer.

In my written testimony, I summarize what went wrong in the housing and mortgage markets. I identified some lessons learned and raised basic questions that policymakers face at this juncture.

I will now focus on my thoughts on the potential roles for the Federal Government in the housing finance market, and some principles that I think should guide policy choices going forward.

The starting point has to be the future role of the secondary mortgage market, which connects global investors to local lenders and borrowers. Doing so helps to lower borrowing costs for home buyers, in part because large institutional investors may be better able to fund mortgages and manage the risk in those mortgage portfolios. Whatever options are chosen, the country's financial system will continue to require a vibrant secondary mortgage market, including the functions performed by the Enterprises.

There are three specific roles in the secondary mortgage market. The first role is that of a liquidity provider to the secondary mortgage market for mortgage-backed securities. The second role is that of a structurer and/or insurer of the credit risk of conventional mortgage-backed securities. Private firms are limited in their ability to ensure against catastrophic events, but government insurance comes with significant risks and moral hazards.

A third role is to alter the allocation of resources by providing subsidies to attempt to increase the supply or reduce the cost of mortgage credit to targeted borrowers. Such a role has really been central to all the housing GSEs, not just Fannie and Freddie but the Federal Home Loan Banks, which we now regulate. Unfortunately, as the present crisis shows, it has had some mixed results.

With these roles in mind, I would like to turn to what I consider are some of the basic principles you have to consider as you are looking at the future of the mortgage market and Fannie and Freddie.

The first principle is these institutions should have well-defined and internally consistent missions, missions that do not encourage excessive risk-taking.

A second principle is that there must be a much clearer demarcation of the responsive roles of the Federal Government and the private sector in the secondary mortgage market. Any

Federal risk-bearing should be provided explicitly and at an actual, real cost. The old hybrid model, as many of you said, of private, for-profit ownership underwritten by an implicit Federal guarantee poses a large systemic risk to the U.S. economy, as we found out.

The third principle is to base any organization that provides mortgage guarantees or insurance on sound insurance principles. That requires strong underwriting, strong capital positions, risk-based pricing, and flexibility to react to changes in the marketplace.

The fourth principle is to create a regulatory and governance structure that ensures risk-taking is prudent. From nearly the first day on my job 3 years ago, I pointed out the folly of allowing the Enterprises to have such large portfolios, which we did cap, and also the folly of allowing them to be legally leveraged on mortgage credit by over 100 to 1. And of course many others, including many in this room, did as well. Congress did provide a strong regulatory structure of the housing GSEs as part of HERA last July. But unfortunately, it was much too late.

The fifth and final principle is that the housing finance should be subject to supervision that seeks to contain both the riskiness of individual institutions and the systemic risk associated with housing finance. The latter type of supervision would include countercyclical capital and policies that counter the private sector's tendency to generate lending booms and busts.

With those principles in mind, there are really three basic structures for the future of Fannie Mae and Freddie Mac: a government agency; a hopefully much improved GSE; and a fully privatized firm.

The first option would be the equivalent of nationalizing the Enterprises, which I am opposed to because I believe government insurance programs are particularly high risk and rife with moral hazards.

The second alternative would be to keep the Enterprises as GSEs, building upon HERA. They could be a public utility or a cooperative structure. They could continue with Treasury net worth protection or government reinsurance for catastrophic risk. But extreme care would have to be taken to prevent the inherent conflict always present in the GSE model.

A third option is to establish purely private sector firms to supply liquidity to mortgage markets with or without some form of government catastrophic reinsurance. Private firms could offer greater competition and improve operational efficiency. However, to maintain the level of liquidity the MBS market has enjoyed under Fannie Mae and Freddie Mac, a high degree of standardization and quality control across firms would be necessary.

I would like to close with a few personal thoughts. Having worked at several private sector insurance companies and having advised many others, and actually run several government insurance programs, I can tell you government insurance programs are high risk. They invite the private sector to shift risk to the government.

Among other issues, it is often difficult in a political environment to calculate or charge an actuarially fair price. It is difficult to resist pressure to broaden the mission and prevent inadequately compensated increases in risk-taking.

Nevertheless, government has an important role to play in providing certain types of insurance, especially reinsurance against catastrophic risk. But again, that insurance has to be prefunded and then actuarially sound, and that is difficult in the government.

The Enterprises and the Federal Home Loan Banks are playing

a vital role in helping to stabilize housing in the economy today. Fannie Mae's and Freddie Mac's participation and leading role in the Making Home Affordable Program is extremely important in helping to stabilize the mortgage market and their own books. As Congressman Neugebauer said, that will help stop the bleeding if we can make this program work.

As markets and the Enterprises stabilize, there will be a need to address the complex issues I have outlined in this testimony. It is important to get the mortgage market model right and the restructuring of the GSEs right for the U.S. economy and also for all present and future American homeowners and renters.

I will be happy to answer any questions, as will my colleagues. Thank you.

[The prepared statement of Mr. Lockhart can be found on page 135 of the appendix.]

Chairman Kanjorski. Thank you very much, Mr. Lockhart.

Mr. Lockhart, you know, part of the problem that we have, and I would probably like to clear it up very early, is we have never had a definitive set of hearings or a commission appointed to designate what the cause of the disaster, the economic crisis over the last year, year-and-a-half, has been.

And I hear many of my colleagues, as I hear other commentators throughout our economy, asserting that it was caused for several reasons, and quite extreme reasons. I never knew that CRA was so extensive within our system that they brought down the whole system, but I have heard some people make that charge.

I have also heard people make the charge that Fannie Mae and Freddie Mac brought down the system. And I guess I want to ask you the question: Is that your opinion? I can express mine, that Fannie and Freddie fell after the credit crisis occurred. And the credit crisis basically occurred more in the securitization in the private markets, particularly of subprime loans, than of Fannie and Freddie. They followed in the destruction of credit in the country.

Is that relatively true?

Mr. Lockhart. There are many, many factors and lots of people guilty over this bubble we had in the economy and, in particular, the housing market.

There was excess liquidity. As former Secretary Paulson used to say, risk was mispriced, not only in the housing market but across financial markets and across financial institutions.

Certainly, in the housing market, underwriting standards fell dramatically and, in particular, the subprime and Alt-A market. Most of that did go into the private label securities. I have to admit that Fannie and Freddie were big buyers of those securities, but only the AAA ones. They and everybody else, including the rating agencies, did not do enough analysis on those securities.

Certainly, to keep some market share--and their market share actually dropped over about a 3-year period, from over 50 percent to about 33 percent--they did lower their standards in 2006 and 2007. They didn't lower them as far as the rest of the market, but they did lower their standards.

I do not think Fannie and Freddie were the cause. As I said, there were a lot of reasons for what happened, including the poor regulatory structure that OFHEO had. We didn't really have the powers to stop them from being 100-to-1 leveraged. We actually had an extra capital charge on them. We froze their portfolios, and still there were problems.

There were a lot of different reasons. Regulations: We were too slow to get the new legislation. The housing market bubble was caused by worldwide financial issues and not just Fannie and Freddie.

Chairman Kanjorski. And as you know, the reform legislation, to correct your present agency and give you the powers of a world-class independent regulator, that started considerably before it actually became law. If I remember, in 2005 we put that legislation forth and it failed to get Senate confirmation, and therefore did not proceed to the President for his signature.

But after that, it was not enacted, either. And not to place blame, because I think that is the worst mistake we can make in placing blame. It was a Republican Administration, a Democratic Administration, a Republican Congress, a Democratic Congress. But so we do entertain the facts that at all times during this immediate runup to this crisis, that is the 4 or 5 years of the real estate bubble, the Senate and the House were in the control of the other party than they are now, that is, the Republican party. Is that correct?

Mr. Lockhart. Yes, sir.

Chairman Kanjorski. And the Presidency of the United States was in the control of a Republican. Is that correct?

Mr. Lockhart. That is correct. And that Republican was asking for reform from almost to the day he took the job. Yes, sir.

Chairman Kanjorski. And his party's Congress did not respond. Is that correct?

Mr. Lockhart. As I understand the history, and I wasn't here in 2005 so you will have to bear with me, but they wanted stronger legislation than was passed.

Chairman Kanjorski. There is no question that he wanted stronger legislation. But the people who controlled the House and the Senate were his own party. Is that correct?

Mr. Lockhart. That is correct.

Chairman Kanjorski. Now, I do not want to place blame.

[laughter]

Chairman Kanjorski. I think if we could leave today's hearing--I enjoin my colleagues on the other side that they appreciate my attempts here--I think we have to finally draw the lines on finding fault. It is not going to get us anywhere.

The one thing that does disturb me, though, as we talk through that, there is a tendency to think that maybe if this had been done totally in the private market and government had not been involved.

Do you see that as a viable alternative, that we can just let Fannie Mae and Freddie Mac dry on the vine, become prunes, and forget about them and let the private market go on? Or will there be a negative impact in the United States in terms of real estate, ownership of real estate?

And so that history is correct, Fannie and Freddie were not instrumentalities forced upon the American people even though one of them was done in the depressionary times. It was to fill a void that the private market was not filling. We did not have a secondary market in real estate until government took the responsibility of establishing Fannie Mae. Is that correct?

Mr. Lockhart. That is correct. In the recent decade, the private market through these private label securities did increase their market share pretty dramatically from Fannie and Freddie and from the FHA, for that matter.

Chairman Kanjorski. And they did it--

Mr. Lockhart. And unfortunately, they did it in an unregulated and an unsafe and unsound fashion.

Chairman Kanjorski. I just want to say, they did not do it in a very superior way, did they?

Mr. Lockhart. That is correct.

Chairman Kanjorski. If we had to say anything in making the comparison between the government agency of creating a secondary market and Wall Street left to its own designs, Wall

Street those last 2 or 3 years became an absolute disaster

Mr. Lockhart. Right. And I think going forward we need a private sector of the market, though. There is a lot of activity going on--

Chairman Kanjorski. Okay. We are going to try Wall Street again.

Mr. Lockhart. A much reformed version with much more transparency and much stronger underwriting. One of the things we did in 2007 is we told Fannie and Freddie that they couldn't buy any more private label securities unless they conformed to the nontraditional mortgage guidance, the subprime guidance. Those kinds of rules have to come forward so that we do have much better transparency.

Chairman Kanjorski. Last night, I had an interesting dinner with an interesting gentleman, and members of the committee were there--Mr. Simon, who is a financier, and quite renowned in the United States.

He made a proposal to us, and I think it merits consideration. I would like your opinion of what it roughly is. He feels that one of the major blows to the securitization market was the failure of the rating systems, the institutions that were there to rate and did in fact create all these AAA ratings that we found out much later on were nonsense.

And his suggestion and opinion was that we should take up forming a nonprofit, governmentally sponsored and supervised, super rating agency that does not make money from the issuer, but gets paid independently and separately, either through an assessment or a fee; and that it have to rate all of these bundled securities or securitized operations.

Have you given any consideration to that type of thought?

Mr. Lockhart. There is no doubt that the rating agencies failed. If you look at the AAAs that Fannie and Freddie bought, about 60 percent of them are now junk and only 5 percent are still AAA, not on downgrade. So there is no doubt that they failed and there is no doubt that they should be reformed.

I had not really thought about that. There is somewhat of an analogy in the insurance world, where the NAIC does rate for insurance companies. Whether that works or not, I am not sure. It is something that could be considered.

More importantly, we need to reform the rating agency, and we need to get them back to rating and not consulting and getting fees for structuring bonds.

Chairman Kanjorski. Thank you, Mr. Lockhart. I have already run over my time. And now I would like to recognize Mr. Garrett of New Jersey to proceed with his time.

Mr. Garrett. Thank you, and I too will not try to lay blame or be partisan on any of these things. I appreciate the fact that you are just laying out the history of things, that it was--the reforms did get through the House. They were requested by--well, you were here sometimes. Other people during the Bush Administrations were here. I remember Secretary Snow was here and a number of people pushing for limitations on portfolio, and other limitations as well.

We were able to get it through the House. It did go to the Senate, and then Senator--not President--Obama, I guess, was in the Senate at that time, and not being partisan one way or the other, just saying that we just couldn't get cloture, as I recall, to be able to get that piece of legislation to the President's desk.

Had we done it at that time, perhaps we wouldn't be sitting here today looking back to say, why didn't the world-class regulator do the job? Because the world-class regulator potentially could have been doing the job.

I also find interesting your comment with regard to whether the GSEs or other Federal regulations were part and parcel of

the cause of it. Just very quickly, you ran down--you said it was excess liquidity. I guess that is in part and parcel--although I am not an economist--due to the excess by the Fed on monetary policy.

You talked about lowering of underwriting standards. And I guess that is part and parcel again of the Fed and the Boston Fed and others, which instructed Wall Street to lower their underwriting standards. And also with regard to the GSEs, I appreciate your candor saying that those standards themselves were actually lowered at a period of time.

And so we can't say that this one factor was the cause of it. But certainly we can say that this one factor helped to exacerbate a problem when they bought up some of these bad securities that had bad underwriting standards.

With that all said, one of my objectives has been to try to lower the risk that the GSEs have posed to the taxpayer. Both Enterprises have a significant amount of interest rate risk due to their hedging practices, with a limited number of counterparties.

We have discussed this before, just a handful that you are able to deal with. These interest rate swaps really are basically standardized, bilateral transactions to help you manage your portfolio and hedge the risk.

Now, there are new clearinghouses that have been popping up, if you will, being established, and they have the potential to significantly reduce the counterparty risk posed to the Enterprises through these transactions if you were just to funnel them through. And of course, you know how that works.

So could you elaborate how you are working to try to reduce the risk to the taxpayer with their counterparty risk through clearinghouses like this for these swaps?

Mr. Lockhart. Counterparty risk is a big issue in the financial markets today. There has actually, over the last year, been a concentration of counterparties as there have been mergers and acquisitions, whether it is the mortgage market, the deposit market, or other areas.

Certainly as the quality of some financial institutions has suffered, that has meant that Fannie and Freddie and many others have had to concentrate their derivatives activity. Fannie and Freddie both hold well over \$1 trillion of derivatives, as do the Federal Home Loan Banks.

So one of the concerns we have about counterparty risk is what can be done about it. We have certainly talked to them, and they are looking very seriously about starting to move some of their business into clearinghouses and exchanges to diversify the risk and lower the risk.

Mr. Garrett. The product here is basically a standard product that we are dealing with. Right?

Mr. Lockhart. Right. Fannie and Freddie hedged the interest rate risk and the prepayment risk, basically. They used swaps to a large extent. Sometimes they used more exotic instruments, but they do a lot of interest rate swaps.

Mr. Garrett. Is there something holding you back, then, or is there a timeline that--

Mr. Lockhart. As you said, these are relatively new vehicles. We are looking at them. We want to make sure that they are done in a safe and sound manner.

Mr. Garrett. On another note, with regard to the portfolio, which is one of the areas that there was a request 4 years ago to try to rein them in, what is the purpose of keeping the portfolio where it is now?

Actually, it has gone up since this whole problem began. I know it is supposed to begin to run down starting in 2010, next year. But why don't we just begin running that down right now and then just say, we are going to eliminate that?

Mr. Lockhart. The key thing that the portfolio has been used for since the conservatorship is to support the mortgage-backed securities market. Now, obviously, the Treasury has been buying a lot. The Fed has been buying a lot. And that is extremely important to getting those mortgage rates down.

Since the conservatorship, we have seen mortgage rates drop about 150 basis points, 1½ percent, to about 5 percent from 6½ percent. And part of that has been the Treasury, the Fed, and also Fannie and Freddie buying those mortgage-backed securities.

Obviously, the Fed and Treasury have much more firepower. And at this point, the portfolios are relatively stagnant.

Mr. Garrett. They are stagnant. But are you actually--well, they went up over the course of--

Mr. Lockhart. They went up, and now they are coming down.

Mr. Garrett. And so can you give us a timeline projection, then, on when they will be--

Mr. Lockhart. Well, a lot of it will depend on what happens in the mortgage market. I mean, to be perfectly honest, what we need to do is to stabilize this mortgage market, and then we need to figure out, you know, what to do with the portfolios.

The key job, the number one job, is to stabilize the mortgage market. And that is by bringing mortgage rates down. It is by modifications. It is by refinancing.

Mr. Garrett. And I guess that is my last question, if you will, is that your overall job--and this is one of your opening comments, is what is the job of the conservator. And you said it was to preserve the assets of the GSES. What you didn't say in any sentence or paragraph after that, and balance it against the interest to the taxpayer.

Do you see that actually--are you charged with that or you see that as part of your role?

Mr. Lockhart. Oh, very much so. If the assets of Fannie and Freddie go down, that means more money from the taxpayer.

Mr. Garrett. Absolutely.

Mr. Lockhart. So part of the job is to try to, over time, limit the draws from the Treasury Department. In my view, the best way to do that again is to stabilize the mortgage market through modifications and refinancings.

Mr. Garrett. Yes. And we have had correspondence in the past with regard to the last point, and that is as far as the statutory authority to the GSEs to enter into these modifications. Some outside experts have said that there is not that statutory authority to enter those modifications, and in fact that doesn't actually inure to the benefit to the taxpayer as well as a side issue as well.

I just want to comment on your statutory authority to engage in what--

Mr. Lockhart. Right. You are asking about the modifications that are higher than an 80 percent loan-to-value.

Mr. Garrett. Right. Right.

Mr. Lockhart. Our view is that these are the risks that they are already holding. They already hold these mortgages. And by lowering the payment through a refinancing, they are lowering their risk and therefore helping the taxpayer, potentially, going forward.

The guarantee fees on these new mortgages tend to be higher than the ones they are replacing. So it is really a benefit to the third party.

Mr. Garrett. My understanding is that Fannie Mae's financial statement indicated that would actually increase risk for the GSE.

Mr. Lockhart. Not on refinancings. I think what they may have said is that modifications could potentially have the impact of increasing short-term losses. But my view is, over

the long term, they will be a benefit to the GSEs and to the taxpayers.

Mr. Garrett. What is your foreclosure rate now?

Mr. Lockhart. The foreclosure rate is relatively low at Fannie and Freddie at the moment. We are talking about 100,000 properties.

Mr. Garrett. That is on everything. I am just talking about what we are talking about here, on the refinance side.

Mr. Lockhart. On the refinance side it is too early for these new refinancings to--

Mr. Garrett. Oh, really?

Mr. Lockhart. They haven't missed a payment let alone re-default. Yes.

Mr. Garrett. So the figure that I was, I guess, thinking about, the 70 percent figure, that is--

Mr. Lockhart. If you are talking about the historical redefault rate at Fannie and Freddie--

Mr. Garrett. Yes.

Mr. Lockhart. --it has actually been relatively low, around 30 percent. But in the last year, it has been raising quite rapidly with the downturn in the economy.

Mr. Garrett. Right. But that is what we are talking about with these--with this provision, as far as the modifications.

Mr. Lockhart. Again, these new modifications are significantly deeper than the ones even a year ago. I just saw a chart that a year ago in the first quarter, only 2 percent of the modifications had payment reductions of 20 percent. This quarter, the first quarter of this year, it was 52 percent.

The modifications have changed so dramatically over the last year that it is really hard to use those historical numbers to say that we are going to have those high redefaults.

Now, the economy still has troubles. And certainly the reasons for the default tend to be lost jobs, lower income--

Mr. Garrett. Right.

Mr. Lockhart. --and the things that are affected by the economy.

Mr. Garrett. I appreciate it.

Mr. Lockhart. Thank you.

Chairman Kanjorski. We are in the midst of four votes right now. They should take probably 30 minutes. And we will recess until that time.

[recess]

Chairman Kanjorski. The committee will reconvene. And we probably will get interrupted very shortly for another vote, but we are going to continue questioning while we can.

Mr. Campbell, you are recognized for 5 minutes.

Mr. Campbell. Thank you, Mr. Chairman, and thank you, Director Lockhart.

There is a Bloomberg report out today about a letter from then-SEC Chairman Christopher Cox written to you, I guess, in January of this year with a number of subjects, including suggestions that perhaps Fannie and Freddie are being encouraged to make loans that might not be in the best interests of the profitability of that entity, or something.

Are you familiar with this letter?

Mr. Lockhart. We don't comment on correspondence from Board members. I can tell you that Chairman Cox was a member of the new Board that was created out of HERA. I can also tell you that we worked closely with Chairman Cox over the 3 years that I was at OFHEO, and now FHFA, where he was very involved, actually, in the Fannie fines that we did about 3 years ago.

The issue as reported, and I will comment on the issue as reported in the Bloomberg article, and the issue, I think, if you want to sum it up, is: Does modifying mortgages and refinancing them cause damage to Fannie and Freddie? And in my

view, as I think I said earlier, they sit on \$5.4 trillion of mortgages. That mortgage book is so large and so important that what they can do to stabilize the market will be good.

Now, one of the problems is, from an accounting standpoint, when you modify a loan, they have to take it out of their mortgage-backed securities and they have to write it down as if it wasn't modified. There is a large deduction.

There is a short-term cost. My view is if it goes into foreclosure, the costs will be worse on that mortgage, but more importantly, it will be worse than the neighborhood and it will be worse for their \$5.4 trillion book.

So the view I have had, and I share it with the management of Fannie and Freddie, is that their number one job at the moment is to help try to stabilize the mortgage market.

Mr. Campbell. Even if that, maybe in the short term or whatever, is not the best thing for the financial result of Fannie and Freddie?

Mr. Lockhart. It is really a very short-term negative on the financial result because they get to take it back in. In fact, that accounting is going to change January 1st of next year with the consolidation of all their mortgage-backed securities. It is an extremely short-term effect, and then some of that actually may be written back.

Mr. Campbell. Let me ask you, Director Lockhart, if I can, could we, the members of this committee, see this letter?

Mr. Lockhart. I don't think that is appropriate, but I will check with my lawyers.

Mr. Campbell. Okay. Yes. Because I don't--Mr. Chairman--

Mr. Lockhart. I think it was an SEC letter so it may be better to ask the SEC.

Mr. Campbell. Okay. Mr. Chairman, there was a letter written from then-SEC Chairman Christopher Cox to Director Lockhart in January. And so that is something I think the committee members should be able to see.

And I will just say I would have a hard time understanding why members of the committee, given that Fannie and Freddie are under receivership--

Mr. Lockhart. Conservatorship.

Mr. Campbell. Conservatorship, sorry; you are correct, my bad--would not be allowed to see this letter. But I would hope that the chairman and the committee would support that position.

Mr. Lockhart. I can tell you this letter has been discussed at the first meeting of the new Board, as the new Secretaries came in. We have gone through the contents, and we are continuing to look at those issues. And we will continue to work through those issues.

It is an advisory board and they have been very helpful. I think it is very useful to have that kind of dialogue. But I think to the extent that dialogue gets out into the public, it is not as helpful and we may not have as much dialogue in the future.

Chairman Kanjorski. It is a very confidential letter. The only people that I know who have it are the press.

[laughter]

Mr. Campbell. I guess that probably makes my point for me. Thank you, Mr. Chairman. I think since we have an oversight responsibility, we should be seeing that letter.

But another question is that I believe the SEC--I think your belief, sir, is that we have about \$150 billion in risky--Fannie and Freddie have about \$150 billion in risky outstanding mortgages. But the SEC believes that it is closer to \$1.7 trillion.

How do you reconcile that difference, or why do they feel it is so dramatically higher than, I believe, if I have the

numbers right, that you believe?

Mr. Lockhart. I don't know where the \$150 billion came from. It might be that they have about \$170 billion in private label securities, which are risky. There is no doubt about it.

They also have the rest of their book, which is well over \$5 trillion. There are obviously higher-risk mortgages in that book. There is some subprime, not a lot, but there are Alt-A mortgages, interest-only mortgages, option ARMs and a series of other things.

Mr. Campbell. That add up to about--

Mr. Lockhart. They don't add up to \$1.7 trillion. The SEC double-counted some of the mortgages. The number, I would say, is about 1.4 out of the 5.4.

Mr. Campbell. Okay. I would love to ask more questions, but I believe my--well, then I will ask a question we discussed earlier.

It is my understanding that some of the early default rates, first payment default, that sort of thing, on loans made since the first of the year--so in other words, long after we knew about this crisis--at Fannie and Freddie are equivalent to some default rates that were done before all of the subprime stuff kind of became out there.

Is that true? And if so, is that part of the strategy of helping the housing market by continuing to make loans to subprime and other lower-qualified buyers and lower underwriting standards?

Mr. Lockhart. It does no one any good and it is one of the lessons we really learned in the last 2 years. To make a loan that we think they are going to default on, or Fannie and Freddie think they are going to default on, hurts the individual. It hurts the neighborhood. It is just terrible. It is certainly not part of the strategy to make loans that we or Fannie and Freddie think there are going to be defaults on.

Fannie and Freddie have tightened their credit standards over the last year, since the conservatorships. Frankly, they have gotten grief from many groups for doing that. I think it is appropriate. You have to take a balanced look at the credit, and it certainly does no one any good to make a loan that someone is going to default on.

Mr. Campbell. Do you know what the first payment default rate is?

Mr. Lockhart. I don't have the number in front of me. I can provide it to you. It is not only a function of the loan, but it is a function of the economy. It also, as I told you earlier, can be a function that the underwriting was poorly done. In that case, Fannie and Freddie have the right to return it to the financial institution that sold it to them.

Mr. Campbell. Thank you for your forbearance there, Mr. Chairman.

Mr. Garrett. Will the gentleman yield on that--

Mr. Campbell. I am happy to yield whatever time the chairman will allow me to have.

Mr. Garrett. Maybe, actually, it would be--along the analogy that there may be some costs involved short-term on some of the aspects of things, but in the long term, the overall goal, overarching goal, is just to stabilize the marketplace, maybe it is not a bad thing--from that analysis, it may not be a bad thing to say, we are going to underwrite loans on rates--at terms that aren't necessarily likely to get paid back because it will prop up the economy over the long term. I am just--

Mr. Lockhart. Again, Congressman, a default doesn't help anything, and it certainly doesn't help individuals, neighborhoods, and--

Mr. Campbell. Particularly a first payment default, if that

information that I have is correct.

Mr. Lockhart. Right.

Chairman Kanjorski. We have two votes. We will take a recess that will probably consume at least 15 minutes, and then we will reconvene. The committee stands in recess.

[recess]

Chairman Kanjorski. The subcommittee will reconvene.

We will recognize Mr. Hensarling of Texas for 5 minutes.

Mr. Hensarling. Thank you, Mr. Chairman.

Mr. Lockhart, in your testimony, you stated that, ``As conservator, FHFA's most important goal is to preserve the assets of Fannie and Freddie. But as regulator, FHFA's mission is to ensure liquidity, stability, and affordability in the mortgage market.''

It seems to me that kind of gets to the crux of the matter. How do you reconcile these two missions? How are you serving two masters?

Mr. Lockhart. We actually reconcile it pretty easily because the safety and soundness that you left out of that statement is also important on the mission side. And certainly conserving assets is a safety and soundness principle.

What my view is, and this is critical, is that the best way to conserve assets for Fannie and Freddie is to be able to be aggressively modifying loans, refinancing loans, and ensuring the liquidity in the mortgage market. They sit on \$5.4 trillion of mortgages and, if the market continues to fall, those losses will continue to mount.

The best way to conserve assets is for them to continue to fulfill their mission of providing liquidity, stability, and affordability to the housing market.

Mr. Hensarling. Under what scenario would you recommend an alteration of the status from conservatorship to receivership? Already we are at about \$85 billion of taxpayer exposure--\$400 billion has been authorized. But yet Uncle Sam is 80 percent owner of the GSEs, ostensibly really on the hook for \$5.3 trillion, I believe.

Is there a scenario under which you say conservatorship simply is not working?

Mr. Lockhart. We had looked at receivership versus conservatorship last August and September as we considered what to do with Fannie and Freddie, and we weighed the pluses and minuses. It was our view that conservatorship was the better alternative for the mortgage markets and for the U.S. economy, and that is still my view. If we are going to stabilize the mortgage markets, receivership might have the wrong impact and might destabilize the markets.

At this point, we are not contemplating receivership. I really don't see the advantage of receivership versus conservatorship.

Mr. Hensarling. Is the taxpayer on the hook for the \$5.3 trillion or not?

Mr. Lockhart. The taxpayer is on the hook for the senior preferred facility that the Treasury Department negotiated, which is \$200 billion each to Fannie and Freddie.

Mr. Hensarling. But the \$5.3 trillion, the Federal Government is an 80 percent owner. Correct? Of the GSEs?

Mr. Lockhart. The Federal Government has an 80 percent warrant. It has never exercised that warrant, but it has the right to exercise that warrant. It is a common warrant. And as you know, if you are a shareholder, you are not responsible for the debts of a company.

Mr. Hensarling. Well, it is a very unique shareholder at the moment.

It seems to me that part of the problem that was created was the whole implicit versus explicit guarantee. And we know

that one of the reasons that Fannie and Freddie seemingly are the only game in town, and their market share of new mortgages is roughly doubled, is because of that guarantee.

Is there any scenario where you would recommend that the full faith and credit of the United States be behind all \$5.3 trillion of MBS?

Mr. Lockhart. The implicit guarantee was a problem. We talked about it in this room many times, and other places, that there was no market discipline for these two companies because of that. And we didn't have the powers as others regulated to, for example, control their growth, and the market wasn't doing it, either.

My view is that there is no reason at this point to make that explicit. I think the \$200 billion senior preferreds give an effective guarantee, and I think that is all that is necessary at the moment. Certainly, there are buyers of their debt and mortgage-backed securities--

Mr. Hensarling. Don't you think the buyers of this paper think that, once again, Congress would come to the rescue and bail them out?

Mr. Lockhart. The buyers of this paper think that there is strong support from the U.S. Treasury through the senior preferred, yes.

Mr. Hensarling. So what is the exit strategy?

Mr. Lockhart. The exit strategy is partially the new structure we have been talking about here today. And you can't do that, in my mind. You can't bring them out of conservatorship until the market is stabilized and you can see a profitable future.

There may be a portion, as in receivership, that gets left behind in what you might call a bad bank, if you will, that is protected by the senior preferred. And then there is a bridge to a new organization.

Mr. Hensarling. Thank you. I see I am out of time.

Chairman Kanjorski. The gentlelady from Illinois, Mrs. Biggert.

Mrs. Biggert. Thank you, Mr. Chairman.

I have several questions, Director Lockhart, so if we could run through them rather quickly in my time allotted.

Mr. Lockhart. Okay.

Mrs. Biggert. Number one is many consumers in my district are thinking long and hard about purchasing a condo based on all of the new GSE requirements, which are also causing strain for home builders and community bankers. You know, so many people start and then they say, well, I am just not going to go through the process when they get into that.

Could you comment on that?

Mr. Lockhart. The GSEs have historically had standards for a new condo that 70 percent has to be pre-sold. During the period when they lowered the credit standards in many areas, they lowered the credit standard there as well. Now, they have restored that old standard.

In some markets, there is a big issue of very empty condos. Again, it doesn't make sense to make a loan that might go into default. So, they continue to work with condo developers, and to the extent that they see that it is a good project, they can bend and change those rules. But it is something that they think, from a safety and soundness standpoint, makes sense.

Mrs. Biggert. So it is a waiver, or just bending the rules?

Mr. Lockhart. It would be a waiver. Bending the rules is probably not the right phrase. Basically, they look at projects, and to the extent that they see that it is a good, sound project, they will make the loans.

Mrs. Biggert. Thank you. And why is it that nonprofit social services in--this is in Illinois--who provide housing to

very-low-income people and families with disabilities can't qualify for lower refinancing rates? You know, these are multi-family houses or homes that are now considered commercial versus home-occupied properties. And why is that designation for them?

Mr. Lockhart. I am not sure about that. I am going to have to look into that. I really had not heard about that issue before.

Mrs. Biggert. Okay. Would you get back to me? Thank you. Then another Illinois issue is why is it that Fannie and Freddie still have a policy, for example--in the State of Illinois, they only permit a handful of law firms, and I think in Illinois it is two, to handle foreclosures? And this continues to bottleneck the system, it is anti-competitive and, I think, a disservice to lenders and sellers and borrowers.

Mr. Lockhart. I am not sure about the situation in Illinois. But I know in some other States, they are trying to expand their legal representation. Historically, there weren't a lot of foreclosures. Now that we are seeing, unfortunately, a pretty rapid growth in them, they too will be looking at how to more expeditiously work through the issue.

Mrs. Biggert. Is that something--is there any regulation on this, or is it just--

Mr. Lockhart. Not that I'm aware of. We will certainly go back to ask Fannie and Freddie about that issue.

Mrs. Biggert. Okay. Then why is it that the home valuation code of conduct has been implemented without the traditional public scrutiny and review? It seems like this new policy wasn't vetted through Congress, but only on a side deal made with the officials from the State of New York.

You know, I think it really is a dramatic policy that could severely impact many small businesses, in my district and elsewhere.

Mr. Lockhart. The new appraisal code actually is by Fannie and Freddie and they have historically had appraisal codes. This is a strengthening of that code and it was done after a lot of comment. They received many comments from a whole series of different groups and they made significant changes in the appraisal code from what they had originally agreed to.

It is really designed not to hurt small businesses. What it is designed to do is in many ways the opposite, that is, to take pressure off appraisers to do bad appraisals or to do too high an appraisal.

There were a lot of problems that went on in the last 3 or 4 years in the housing market, and one of them was appraisal fraud. This code was designed to help reduce that. Chairman Kanjorski has obviously been working on--

Mrs. Biggert. Right. He is head of--yes.

Mr. Lockhart. --a companion piece of legislation as well, and we applaud that effort. Certainly, Fannie and Freddie will comply with it.

Mrs. Biggert. Then just quickly, what is the compelling reason to increase consumer fees?

Mr. Lockhart. If you are talking about the fees related to guarantee fees that Fannie and Freddie have in place, they have a 25 basis point adverse market fee that they have had for a while. They were going to raise that another 25 basis points after the conservatorship. They decided not to.

They have also done some risk-based pricing. So where they have raised fees is because the risks are higher. This is the balance of trying to conserve assets versus helping the mortgage market. There are things that have to be done there.

We have watched what they have done, and certainly we have talked to them about what they have done. We are trying--and they are very much trying--to achieve balance between safety

and soundness and mission.

Mrs. Biggert. Well, thank you. There is no question that we need a GSE reform package. I don't know that we want to have the taxpayers eternally bailing out all of these various companies, including the mortgage giants. So thank you very much for being here.

Mr. Lockhart. I agree with you, Congresswoman.

Chairman Kanjorski. Thank you very much, Mrs. Biggert.

And now we will hear from Mr. Adler from New Jersey for 5 minutes.

Mr. Adler. Thank you, Mr. Chairman.

Mr. Lockhart, I want to follow up on some questions on some of the dialogue I heard earlier. My sense is that mortgage insurers lack the capital to underwriting new mortgages. I am wondering what you suggest the FHFA could do to solve that problem for America.

Mr. Lockhart. That is a good question. As you know, Fannie and Freddie cannot write mortgages above 80 percent loan to value so they have relied historically on mortgage insurers. In the more recent past, there was something called piggyback mortgages, but those have totally disappeared.

They have relied on mortgage insurers to make greater than 80 percent loan to value mortgages. The mortgage insurers, like many other players in the mortgage market, have suffered some very significant losses, and their capital has been depleted. And that has meant that they can do less mortgage insurance than they have in the past, and rightfully so. They have tightened their standards as a result.

And that has meant that Fannie and Freddie can make less loans in that space, which historically has been an affordable space. And we have been working with the mortgage insurers, ``we'' being FHFA. Fannie and Freddie have also worked with the mortgage insurers. FHFA in particular has been working with the Treasury Department, and we are looking at whether there is some mechanism under the TARP funding to help them get back into the marketplace and help bring some more liquidity to the mortgage market.

Mr. Adler. Do you think the TARP is a proper vehicle to achieve more--

Mr. Lockhart. It is certainly well within the philosophy of the TARP that was related to mortgages and housing as one of the key target markets for the TARP funds. We have been talking to Treasury to see how it is structured because it is different.

The TARP banks all have Federal regulators. The insurance companies, as you know, do not have Federal regulators. It was the Federal regulators that made the recommendations to the Treasury team. We are working our way through the various issues there.

Mr. Adler. Leaving aside TARP for a second, are there other governmental solutions, congressional solutions, you would seek for us to consider that would try to right the situation?

Mr. Lockhart. My view is that the better mechanism would be TARP. It is difficult to see, as these are State-regulated entities, what Congress could do to help.

Mr. Adler. I think there is enormous concern that Fannie and Freddie are big, and maybe too big. There is some discussion that maybe we need to have a few smaller entities to provide the GSE service that Fannie and Freddie have traditionally provided. Do you have any view on that?

Mr. Lockhart. I have always said that their portfolios are too big. One way to shrink them would be to shrink their portfolios over time, and that is part of the senior preferred agreement. I don't think it should be done right away. I think we need to get through this crisis first.

There are proposals on the table that say maybe there should be more GSEs or more players in the secondary mortgage market space. I think that is something that has to be looked at. I really have not formed an opinion one way or the other, but it definitely should be looked at.

Mr. Adler. I am sure we are going to look at it. Thank you very much. I yield back the balance of my time.

Chairman Kanjorski. Thank you very much, Mr. Adler.

And now we will hear from the gentleman from California, Mr. Royce.

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

I think when we look at the factors that created this economic catastrophe here, I don't think anybody says there was a sole cause.

I think most economists believe that one of the major causes--besides Fannie Mae and Freddie Mac--one of the major causes was the Fed funds rate in Europe and here in the United States, the central banks setting a negative interest rate when adjusted for inflation for 4 years running. There is no way that wouldn't cause a housing bubble.

But the question about the involvement in Fannie and Freddie purchasing subprime, purchasing Alt-A loans, purchasing the instruments that otherwise would not maybe find ready buyers out there, that is unique. And that is a part of their role as Government-Sponsored Enterprises, really, that they evolved into.

And as I said, originally in 1989, they wouldn't go near a lot of these practices, and especially wouldn't go near the idea of buying these things for their own portfolio. But then that process changed, and politics took over.

What I wanted to ask about--and I will mention a couple of other factors as well.

I don't think anybody says it was solely Fannie and Freddie. But a number of economists worry about the amount of bullying of the market that went with CRA in terms of the direction of loans to be made.

There is a lot of worrying about what we placed in statute in terms of the NRSROs, in terms of the credit-rating agencies, in the way in which we replaced by statute what otherwise would have been done by market discipline.

The implication there was that because these were government-sponsored, or because the government was engaged in setting up these standards, that it removed market discipline from the equation. And that helped compound the problem. This is the root of my question, and I wanted to ask this of Mr. Lockhart and Mr. Dickerson.

I think one of the most telling statements of the GSEs' impact on the entire mortgage market came, for me, from a former Freddie Mac employee, who mentioned that the executives at the company understood that when they began purchasing junk mortgage-backed securities, as he called them, based on subprime and Alt-A mortgages, they were sending a clear message to the market that these were in fact safe investments.

In other words, if the duopoly that controls most of the market is now going out and buying this from Countrywide, it is a message to the market that these have been analyzed as safe.

As you know, prior to that, Fannie and Freddie were exclusively known for buying more conserve conforming loans. So when they began purchasing junk mortgage-backed securities, it was a clear deviation from their prior endeavors.

Do you believe the executives at Fannie and Freddie understood the message they were sending when they began to invest in junk mortgages, and especially at such a large scale?

Mr. Lockhart. They were investing in these private label securities that had subprime, Alt-A, option ARMs, and other

higher risk mortgages that were nontraditional mortgages. There is no doubt about it. They stayed in the AAA space. As it turned out, they and the rating agencies' models failed dramatically.

Yes, they probably had some endorsement factor by buying them. There is no doubt about that. Whether the management realized it or not, I cannot speak for them. I can tell you, to pick up your other point, that they did get affordable housing goals credit from HUD for buying these securities. They thought they were profitable. They were buying them because they thought they were profitable. It also did help them to get those credits.

Mr. Royce. I wanted to go to something that the Treasury Secretary mentioned; former Secretary Paulson actually said this. And this has to do with the three objectives that he thought we should have in terms of a reformed GSE structure. I will ask Mr. Dickerson about this, too.

These three objectives are: no ambiguity as to government backing; a clear means of managing the conflict between public support and private profit; and a strong regulatory oversight of the resulting institution, taking politics out of the regulatory oversight function, and allowing the regulators to actually do their job.

Now, going forward, do you agree that these three objectives should be achieved? And what do we risk if we fail to meet that task in the future?

Mr. Lockhart. I definitely agree with the three objectives. I believe I incorporated them in my five principles as well. It is extremely important to get it right. The ambiguity between public and private and the ambiguity between mission and safety and soundness helped cause some of the problems we have today.

As we go forward, we are going to have to really concentrate on what I said were five principles and what he said were three, to make sure that we can recreate the secondary mortgage market in this country in a safe and sound fashion.

Chris, do you want to--

Mr. Dickerson. Right. I would agree with that. Certainly, the need for strong regulatory oversight is going to be a need that we will need to continue, with no ambiguity as far as the private/public.

Mr. Royce. Thank you very much.

Chairman Kanjorski. Mr. Manzullo, for 5 minutes, please.

Mr. Manzullo. Thank you, Mr. Chairman.

Mr. Lockhart, I personally want to thank you for the phone conversation that we had several weeks ago concerning the home valuation code of conduct. But I am very disappointed in the answer that I got to our letter dated April 30th under your pen on May 8, 2009.

The ostensible purpose of the home valuation code of conduct, as set forth in your news release of December 23, 2008, is to improve the reliability of a home appraisal. My question to you is: If a homeowner gets an appraisal that he doesn't like, what is his remedy?

Mr. Lockhart. If a homeowner gets an appraisal he doesn't like--

Mr. Manzullo. That is correct. What is his remedy?

Mr. Lockhart. His remedy is to try to get another appraisal.

Mr. Manzullo. That is not correct. If you take a look at page--

Mr. Lockhart. And a different lender.

Mr. Manzullo. Well, he would be forced to go to a different lender.

Mr. Lockhart. Yes.

Mr. Manzullo. Well, that--

Mr. Lockhart. The lender has the right to make the decision whether they want to make--

Mr. Manzullo. No. I understand that. But what if the lender is open to another appraisal?

Mr. Lockhart. What if the lender is open to another--

Mr. Manzullo. That is correct.

Mr. Lockhart. My view is that the lender cannot shop around for appraisals.

Mr. Manzullo. That is not--

Mr. Lockhart. That is one of the big problems we had in the last 2 or 3 years.

Mr. Manzullo. Right. I understand. The other problem is this: I would refer you to page 3, no. 9. We discussed this at length on the telephone and you gave me no answers in the written inquiry:

``If an appraisal comes back that is an error, the only way that you can get another appraisal, second or subsequent appraisal, is if there is a reasonable basis to believe that the initial appraisal was flawed or tainted, and such basis is clearly and appropriately noted in the loan file; or unless such appraisal or automated valuation model is done pursuant to written, pre-established, bona fide pre- or post-funded appraisal review or quality,' etc., etc.

Your inability to understand my question and the inability to answer is based upon the fact that I don't think that your organization knows anything about real estate closings.

You know, the people who came up with this rule--

Mr. Lockhart. The people who came up with this rule are the biggest mortgage lenders in this country.

Mr. Manzullo. Well, that is interesting.

Mr. Lockhart. It is Fannie and Freddie that came up with the rule.

Mr. Manzullo. I understand. I understand that. But my question--

Mr. Lockhart. The point is that if there is a mistake, the mistake can be--

Mr. Manzullo. Not under your rules. If you read--

Mr. Lockhart. If there is a problem, every State has an appraiser regulatory board. They can go to that.

Mr. Manzullo. So here we are. We are trying to close a real estate sale and there is a big problem with an appraisal. Let me give an example.

In a townhouse area that I know, end units are selling for \$500,000 and inside units for \$470,000. And an end unit just sold for \$350,000 because the party had died and it was out-of-State heirs and they were in a hurry in order to get that sale done.

So the appraisal comes in at \$350,000. And the guy who wants to sell a townhouse that is an end unit that should be selling for around \$500,000, under these rules--I mean, these are your own rules here--he has to either go to another lender, which is absurd under the circumstances, or he has to show a reasonable basis to believe that the original appraisal was flawed or tainted.

I mean, your rules can purposely devalue a home that somebody is trying to sell because you have so much bureaucracy tied up in it.

Mr. Lockhart. If the appraiser is a professional, he will have looked at the circumstances of that \$350,000 sale.

Mr. Manzullo. Ah, that is not correct. That is not correct because you may have somebody who may not know that the original owner died, and that it was a fire sale.

I mean, my whole point here is if your job is to come up with a fair appraisal, which you say to improve the reliability

of home appraisals, there is no recourse in here for the homeowner. And the homeowner doesn't choose who the mortgage company will be to say, let's get another appraisal. Somehow you think that is collusion. And I think that is just a lack of foresight on the part of the people who came up with the regulations.

Mr. Lockhart. A lot of this regulation is based on the USPAP, as you know, and that--

Mr. Manzullo. Based on the what?

Mr. Lockhart. The U.S. appraisal practices that have been--

Mr. Manzullo. Well, I understand that. But that is a methodology of doing it, in fairness. But I am just talking about--it is a very simple situation that I brought up.

Mr. Lockhart. I would be happy to see your proposal. We will certainly forward it to Fannie and Freddie.

Mr. Manzullo. I would like you to answer my letter, number one. And number two, we asked in there the number of banks that actually own these appraisal--

Mr. Lockhart. We tried to answer your questions in the letter. If there are some areas that you feel that we didn't--

Mr. Manzullo. I would like to submit this under the authority of the Chair, if it is okay with Mr. Kanjorski, and force you to answer my questions. I mean, one of the basic questions in there--

Mr. Lockhart. I think we tried to answer your questions.

Mr. Manzullo. If I may finish.

Mr. Lockhart. If there are some that you feel we haven't answered as well as--

Mr. Manzullo. Well, you haven't answered. I mean, just take a look at my questions and your answers to them. One of my questions was very simple: How many banks actually own AMCs? And you said, well, we don't know. Well, would you consider--

Mr. Lockhart. We don't know, but we will try to find out for you.

Mr. Manzullo. Yes. Well, that is not what you told us in the letter.

Mr. Lockhart. Well, that is what I am telling you now.

Mr. Manzullo. Well, then, I would like--would you consider regulations forcing any bank that owns an AMC to disclose that so that you can avoid any collusion, which is the purpose of this document? Would you consider regulations to that effect?

Mr. Lockhart. We don't have powers over banks. We only have powers over Fannie and Freddie.

Mr. Manzullo. Oh, no. You could make the suggestion, or you could even put it into an amended rule if your whole purpose is to stop collusion. Wouldn't you agree with that?

Mr. Lockhart. Excuse me?

Mr. Manzullo. I mean, you could amend your rule here, couldn't you?

Mr. Lockhart. It is Fannie and Freddie's code, not--

Mr. Manzullo. No. I understand that. But you are the regulator for them.

Mr. Lockhart. As I said earlier, Congressman Kanjorski is working on legislation in this area. If there is something that you feel that Fannie and Freddie did not do properly, what Fannie and Freddie were trying to do, and I think it is an extremely important role that, frankly, they didn't do as well the last two or three, is set better standards in the marketplace.

Mr. Manzullo. No. I understand. But what--

Mr. Lockhart. And that is what we are really trying to do here. And to the extent--

Mr. Manzullo. But what you gave here was banks--you gave banks the sole authority to pick the appraisers. That is what you did.

Mr. Lockhart. No. I don't think that is what we did at all.

Mr. Manzullo. Well, that is what you did because it is the bank that chooses the appraiser either through an in-house appraisal company that the bank owns or through picking somebody else.

Mr. Lockhart. What we tried to do is definitely separate the lending officer from the person who was choosing the appraiser.

Mr. Manzullo. Well, that is like asking people to go to separate restrooms. I mean, that doesn't work. You know that doesn't work. I mean, if you had the opportunity to stop collusion, you would say, look, the banks cannot own these AMCs. Wouldn't you agree that would be the better way to do that?

Mr. Lockhart. Again, it is up to the bank regulators as to the ownership of AMCs.

Mr. Manzullo. No. I know. But you could have made that suggestion, could you not?

Mr. Lockhart. We can make suggestions, but it wouldn't have the power of a regulation.

Mr. Manzullo. No. I understand that. But I mean, do you understand what I am trying to get at here?

Mr. Lockhart. I certainly understand your concern in this area, and certainly will try to respond. We will be happy to have another meeting with you to go through these issues to figure out what you think should be changed in the code that would make it more responsive to your needs.

Mr. Manzullo. Fair enough. Thank you.

Chairman Kanjorski. Thank you very much, Mr. Manzullo.

And if I may recognize for a motion Mr. Royce.

Mr. Royce. Just for a second, Mr. Chairman. I would like to introduce for the record a highly confidential restricted report from 2005 that Fannie Mae staff presented to management at that time which showed the tradeoffs between staying the course and maintaining strong credit discipline in the company versus accepting higher risk, higher volatility, and higher credit losses in order to drive up profits for their shareholders.

Chairman Kanjorski. Without objection, it is so ordered.

And now we will recognize the gentleman from California, Mr. Miller.

Mr. Miller of California. Thank you, Mr. Kanjorski. And I have great respect for the chairman. We just happen to disagree on this one issue, which is very unusual.

I did write you a letter, and I appreciate your response. But I have read the letter several times, and it basically boils down to one sentence, your response: ``Business practices have been adjusted, and each market participant can adapt to a more responsible system that avoids coercion of appraisers and reduces the opportunity for fraud.''

And I guess the problem I have with this is I know a lot of Realtors and mortgage brokers and appraisers--I have been in the real estate business since I was in my early 20's--who are really good people. And it seems like we have struck a deal here between the attorney general of New York--and perhaps fraud is prevalent in New York; I don't know--and your Office that impacts 80 percent of all the loans made in this country, period.

It didn't go through the Administrative Procedures Act or the Regulatory Flexibility Act, which I think normally it should have. And I am really bothered that we are in a very difficult real estate market--I mean, most of the people I know are somewhat involved in development or real estate; I was a real estate broker and a developer since I was in my early 20's--and everybody I know is doing pretty badly out there.

I know banks are suffering out there because they are having to foreclose homes and they are having to shove them on the marketplace, which is further declining the value of homes out there that are for sale. And I think it is problematic and ever reaching a real bottom in the market so the market can somewhat recover.

And if we are going to look and say, what can we do that really helps consumers? What can we do that is really fair to business people and everybody in a broad base? It seems like we are going in the wrong direction. This is just my opinion.

You could have a mortgage broker who has a client, and they are really trying to shop for the best loan that they possibly can. But they can't even shop for the best loan and provide an appraisal associated with it that lenders can look at, and where they can determine where they can really get the best deal for their client because now we solely have to rely on the bank to do the appraisal.

Now, when I was a developer, building subdivisions, that was very common. You would go a bank and the bank would do their appraisal on your subdivision. But a subdivision is altogether different and much more complicated than making a loan on an existing single-family home or a new home that has just been completed and you can establish some reasonable fair market value.

One has much broader pitfalls and more areas that can go wrong for a lender when you are dealing with a subdivision than when you are dealing with an individual home.

And I just--I am really concerned that--we are dealing with a very difficult marketplace. We are dealing with consumers who are having very difficult times even getting loans today, as you know. They have to have stellar credit to get a good loan, and if GSEs weren't in the market, they would be making no loans in California, to be quite honest with you, because they are the only ones really willing to lend, especially in a jumbled marketplace. Most lenders can't make a fixed 30-year loan and sit on that loan for that period of time because they don't have the liquidity to do it.

So when you have consumers out there who go to their Realtor or they go to their local mortgage broker, who is trying to package a loan for them, and go out and shop that loan in the marketplace, it seems like we are making it much more difficult and hamstringing them in more ways by saying that an agreement that perhaps works in New York--and maybe it is the best thing for the State of New York; I don't know--but I can say it doesn't seem to be the best thing for the State of California and for many other parts of this Nation, to make it much more difficult and place much more control in the hands of one bank rather than having an individual being able to shop a loan with numerous banks.

Because the problem is, if you go approach a bank with a loan, they are going to do the appraisal. You can't take that to another bank because the appraisal is propriety property of the lender.

And I don't know why we are going in this direction. So maybe you can tell me--I mean, I understand fraud. But we can deal with fraud. If you have appraisals, writing improper or fraudulent appraisals, you can hold that appraiser accountable, and it is very easy to do. That is why we have laws in this country and there are laws against that.

And it seems like we have all these laws on the books that prohibit coercion and prohibit fraud, and yet we are saying, yes, that we might have laws, but that is not good enough. We are just going to make it illegal altogether.

Could you--I mean, I would like to understand the benefit of why we are doing this.

Mr. Lockhart. I certainly agree with you that we don't need to make life more difficult for the housing market at this point. I think you are right on there. On the other hand, we also want to make sure things are done on a safe and sound basis.

The mortgage broker can take an appraisal ordered by one bank and use it for the other banks. That is certainly--

Mr. Miller of California. It is a propriety appraisal in many cases, where they prohibit that package from being shopped.

Mr. Lockhart. As I understand it, the bank regulators do permit the transfer of that--

Mr. Miller of California. Well, they permit them, but the banks donate necessarily, is the problem. They paid for the appraisal, the bank did. That is like I am not allowed to go to use--I am not trying to interrupt you. I am saying I am not allowed to go--without authorization, I am not allowed to use somebody else's appraisal because somebody paid for the work product.

Mr. Lockhart. Yes, you will have to get another appraisal from another bank. There may be some occasions where more than one--another bank will order its own appraisal. Unfortunately, there is a little extra friction in the system that could happen.

The idea was that in too many cases, brokers were getting inflated appraisals during that period that so many things went wrong in the mortgage market. And I think it is--

Mr. Miller of California. Well, let me back up. What went wrong in the mortgage market was GSEs did a great job of bundling mortgage-backed securities for years. They really did.

Mr. Lockhart. Yes.

Mr. Miller of California. And if a loan that they bundled went bad, they would replace that loan. And then a lot of these other private sector lenders said, that is a really good idea because look at all the money coming from Wall Street.

And they started making loans, just forgoing normal underwriting standards and appraisals and to see if a person had a job. I mean, we can go back to predatory versus subprime and we can really define what went wrong in this marketplace. And I can blame the lenders who made that amount of business today who made a fortune bundling mortgage-backed securities, making loans that were not even junk bond quality because they never even confirmed the person had a job.

But I don't want to go back and blame my local mortgage broker and Realtor who didn't participate in that fraudulent act and say, perhaps there are a few bad apples out there, so let's overturn the entire bucket. And I am not trying to argue with you. I just--I don't think we have thought that particular process through.

I think we are lumping--and I agree there was a lot of fraud. But I can point to a few people out there who made it, that caused a lot of this problem, that I don't need to publicly point out because a lot of them are gone today. They have been bought by other groups.

But we know who bundled these, and we know who made a fortune bundling them and who left the investors holding the bag who bought the junk. But we seem to be going after a sector of the marketplace that was not responsible for that, and drawing--I would just ask you--I am not--I am trying to be polite in this.

Mr. Lockhart. I appreciate it.

Mr. Miller of California. I am not trying to argue with you, and I not trying to be rude and cut you off. I have the greatest respect for Mr. Kanjorski. I really do. We just don't agree on this one issue.

I would really hope that you would just take a moment and have somebody go back and review the process that normally took place, how we would deal with this. Look at the existing laws that are on the books if modifications need to be made as far as corrupt brokers and corrupt mortgage brokers and corrupt appraisers or whatever, that we deal with that effectively without taking and turning the entire cart over.

Because an agreement between one State and your Office that perhaps--maybe there is a real problem in the State of New York. I don't know. Maybe there is a real reason why the attorney general would come to you saying, there is such rampant fraud within our housing market here that we need to turn the laws over.

Perhaps they need to shine a light on their own problem. But I think we have done it nationally and impacting 80 percent of the marketplace in a very, I think, negative way at the worst time.

And I would just ask that you please take a moment and revisit this and say, did we really do the right thing? I understand what you were trying to get at, and I applaud you for that, for getting the bad apples out of the marketplace.

But what caused us to get in this problem we are in today are not the people I believe who are being impacted by it. I am just asking you if you would take time--and Mr. Kanjorski, you have been very generous with your time on something you hate for me to talk about.

So I want to thank you for being generous and granting me more time. But we are good friends, and I have great respect for the individual. And Mr. Lockhart, I have a great respect for you, and I am asking that--and you did mention something earlier that--for years, I think we sent five bills to the Senate that were really good, fighting a strong regulator over GSEs and changing the way they could do business.

We never accomplished that, but we tried hard. And I would just ask you to please revisit with earnestness what we have done here because I think we are going at the wrong people, trying to resolve a legitimate problem.

Mr. Lockhart. Yes. There is a legitimate problem there, and it is not just in New York State. Why the attorney general of New York got involved is all these securities, the ones you don't like--

Mr. Miller of California. I understand that.

Mr. Lockhart. --were sold in New York. Fannie and Freddie have put out the rule, and they are continuing to look at the impact. As they get impact back and they understand better what is happening out there, they certainly have the ability and will continue to--

Mr. Miller of California. And you will look at this?

Mr. Lockhart. We will look at the--I mean, we don't see it directly. We see it through--

Mr. Miller of California. That is what I am asking. But you responded to my letter, so I am going to you. You are the one who signed it, and I want to thank you for taking the time to respond.

Mr. Lockhart. There you go. We continue to dialogue. I have meetings now with both CEOs once a week.

Mr. Miller of California. Good.

Mr. Lockhart. Certainly, this issue has come up in the last month with both CEOs. And so we are continuing to dialogue as to what is happening out there in the marketplace, and we will continue to do so.

Mr. Miller of California. And I was elected to dialogue and have my picture taken. So let's continue this dialogue. Is that fair?

Mr. Lockhart. Yes, but the other point you have to realize,

too, is that the bank regulators are also looking at this issue at this point, and are looking at potentially making changes as well.

Mr. Miller of California. Yes. But see, I have a problem with--when you say bank regulators are looking into it, we are focusing on one sector. And I think I would like to look at all the people who are being impacted by this.

Mr. Lockhart. Right.

Mr. Miller of California. And I agree that bank regulators need to look at it. But if we just revisit it. And I thank you, sir, and I thank you, Mr. Chairman.

Mr. Lockhart. Thank you.

Chairman Kanjorski. Thank you very much, Mr. Miller.

Mr. Lockhart, I am sure we would have more questions from more members. We still have one left, the gentleman from Florida, Mr. Grayson, for 5 minutes.

Mr. Grayson. Thank you, Mr. Chairman.

I have here the Form 10-Q filed by Fannie Mae the month before it went broke. I actually went through it and read it myself personally, and I had some questions I want to ask you about that to try to get a sense of how this happened and what we can learn from it.

Specifically, on page 112, it says, ``Risk Management Derivatives,' and there is a table there, and it indicates that between December 1, 2007, and June 30, 2008, Fannie Mae increased its notional balances for derivatives by \$255 billion.

Can you give me some idea of the justification for a company like Fannie Mae increasing its exposure to derivatives at seemingly the worst possible time by a quarter of a trillion dollars?

Mr. Lockhart. Fannie and Freddie had many problems that surfaced over the last year. Certainly, in their June 10-K of last year, they mentioned many issues.

The derivatives have not been an issue that actually caused any significant problems at the two firms. The derivatives were used to hedge their mortgage portfolios.

What they do oftentimes as the market changes, is they add a derivative. Then rather than closing it out, they just buy one to counter the one that they had before. And so you get this piling up of derivatives. It is an issue that we have talked to them over the years about. Could they close these derivatives out rather than just buying a counter one?

Oftentimes, they buy it with the same counterparty, and so the actual exposure is not that large. It is an issue that we have been talking to them about before the conservatorship and after the conservatorship. As I think Congressman Garrett asked earlier, there are ways to lessen the exposure through exchanges and clearinghouses. And that is something we are looking at, at the moment.

Mr. Grayson. I wonder if it is really true that this had no effect on them. I mean, logically, having an exposure that as of June 30, 2008, totaled \$1,141,000,000,000 is something that could conceivably have some effect on your operations, particularly since we are talking about a time just 2 months before it went broke.

Mr. Lockhart. Right.

Mr. Grayson. Why would they have such an exposure like that unless it were for a purpose? And for that purpose, couldn't it easily have been something that went wrong?

The reason I am asking this question is because if you look at page 78 of this same 10-Q, what you see is that for nonperforming single family and multi-family loans together in their portfolio, which was almost a trillion dollars by itself, the amount of interest income that they lost because of

nonperforming loans was only \$192 million and going down--\$192 million versus \$255 billion--isn't it more likely that they got into trouble over the \$255 billion than they did over the \$197 million?

Mr. Lockhart. I can tell you, in retrospect, they haven't lost significant money in the derivatives area. They are using derivatives to hedge their mortgage-backed exposure.

The vast majority of those losses, the over \$100 billion in combined losses in the two companies, has been not on their interest rate risk and their interest rate risk management, although there has been some there. Most of it has been in credit losses. And it is credit losses related to the private label securities, and credit losses related to their books.

When we did a very extensive look at the two companies in August, we worked with the OCC and the Fed. Also, Treasury had hired an investment bank as an advisor.

As we looked through all the issues in these two companies, the derivatives was an issue but nowhere near the top. The key issues really were they had a deferred tax asset and they had credit exposures in their private label securities. The three quarterly reports since then have shown that is where the big losses were.

Mr. Grayson. Well, again, let's look at the information I just provided to you. If in fact the interest income that was lost--and interest income is defined in the 10-Q as, ``the amount of interest income that would have been recorded during the period for on-balance sheet nonperforming loans had the loans performed according to their contractual terms.''

If those losses are only \$192 million, how could a \$192 million loss result in a \$100-billion-plus loss to the taxpayers? How is that possible?

Mr. Lockhart. What has happened since then is they have had to put up reserves for loans that are in default. And they have also had to take other-than-temporary impairments on their private label securities. And they booked a lot of losses related to the credit.

The interest give-up is a very small issue. Under proper GAAP accounting, if you think you cannot recover, you have to take an other-than-temporary impairment. Or if it is a loan, you have to write it down to the value that you expect to recover. And that is what has happened.

Mr. Grayson. Well, I see my time is up. But let me just ask you this last follow-up question, and thank you, Mr. Chairman, for your indulgence.

I still don't have a clear understanding from you about how a relatively tiny amount, like \$192 million in unpaid mortgage interest on what is a trillion-dollar portfolio, how that possibly lead to the taxpayers having to shell out \$100 billion plus.

Mr. Lockhart. They have had a lot more missed payments since then. It has spread throughout not only their lower quality book, but even to some of their prime loans. They have had to put up reserves. They have built the reserves very dramatically since June because of the deterioration in the mortgage market and the deterioration in the economy.

We would be happy to go through those numbers with you, and meet with you and show you what really happened, and go through not only the June numbers but the September, December, and March numbers, and how these losses have unfortunately marched through their financial statements.

Mr. Grayson. Well, that would be great. Thank you very much for doing that because, as we know, those who don't understand history are doomed to repeat it.

Mr. Lockhart. Yes, sir.

Mr. Grayson. Thank you, Mr. Chairman.

Chairman Kanjorski. Thank you very much, Mr. Grayson.

Mr. Lockhart, I want to thank you very much for appearing. And gentlemen, I am sorry that we had two interruptions and have taken such a long time. But I am actually sorrier to the next panel because you are going to--but thank you very much.

And we may ask your indulgence again to appear, because I think this is an important area where we want to spend a little more time on it.

Mr. Lockhart. Thank you for having the hearing, and we would be happy to come back.

Chairman Kanjorski. Okay. Thank you, Mr. Lockhart.

I am pleased to welcome our second panel. Each of you will have 5 minutes to verbally summarize your written statement. First, we have the Honorable Bruce Morrison, chairman of the Morrison Public Affairs Group, a former member of our committee, and the former head of the Federal Housing Finance Board.

Mr. Morrison, welcome.

STATEMENT OF THE HONORABLE BRUCE A. MORRISON, CHAIRMAN,
MORRISON PUBLIC AFFAIRS GROUP

Mr. Morrison. Thank you, Mr. Chairman, and members of the committee. I appreciate the opportunity to be here, and I commend you on starting this process. You have correctly said that it is not something that can be done in a sprint.

These institutions were built over a long period of time. Our mortgage industry and our secondary market have been built over a substantial period of time. Repairing what has gone wrong needs to be done carefully.

When you are talking about an industry of \$11- to \$12 trillion of assets, you are talking about real money. And it is important that the future of housing opportunity in the country not suffer as it has suffered in the last several years because of mistakes, misjudgments, that have been made historically.

I think it is important to acknowledge that the Federal role is not going away and cannot go away. We can pretend that this entire industry could be operated without Federal risk, without government risk, and then wait until the calamity comes.

But you can ask, where was the Federal role in AIG? And yet there are all those credit default swaps which related to the housing market, among others, resulted in huge Federal intervention, nothing that anybody really anticipated before it happens.

With respect to the mortgage industry, we have used the Federal Government to facilitate liquidity on a broad international basis for a very long time, and on an increasing basis.

I think our challenge is not to try to privatize our way away from that, but to narrow and focus what the Federal role is, and to make sure that the guarantees that are being given are paid for and are priced up front so that the system really insures itself, rather than wait for the calamity and go out looking for the taxpayer money for the bailout.

We have gained a lot in this country by a broad liquidity function that the secondary market provides. We need to preserve that. We don't have to preserve the precise institutional structures that provided it in the past, but we have to protect the function.

It is important when we talk about this subject to separate who bears the credit risk and other risks involved in the mortgage industry, and who owns which entities that participate. A lot of the discussion that goes on on this subject tends to fuzz up which is it that the Federal

Government is going to do and the private sector is going to do. Who is going to own the GSEs?

The most important question is who is going to take which risks? And I think that the Federal Government should take a very narrow and catastrophic risk, that is, the risk of catastrophic failures, and that the private sector should take as broad and extensive a risk position as possible, as we are able to define.

And I think in the past that the GSEs have taken more risk than they needed to take; that their role in the market, their limitations and their size, both of which led to the growth of the private label securities market in a way that undermined the entire structure.

And it wasn't Fannie and Freddie who led the way, but it was Fannie and Freddie who followed along and become part of the problem. I don't think we should be drawing those lines. I think we need a broader structure that brings the entire mortgage industry under one structural scheme.

And we can do that without implicating the Federal Government more. We can actually implicate the Federal Government less. But we are going to have the Federal Government as the ultimate guarantor, not as the guarantor of all risks but of the catastrophic risk.

So that goes in the credit risk and the scope of the guarantee. And I think if you think about all of the credit risk that can be and will be covered by a securitization model--a first loss protection that mortgage insurers and others carry; a general expected loss coverage; the kind of structured debt that parcels out different levels of credit, but which requires a rating agency system that is not corrupted in the way that the system we currently have was during the crisis.

You can design a model that has a narrow Federal guarantee that will give the kinds of liquidity, the international access to funding that we have had, but have the Federal Government very rarely if ever have to step up to the plate. And you can pay for it through guarantee fees from the beginning if you design it that way. And I think that is what we ought do.

I think other attempts to carve up the market, that leaves the Federal Government's role not that broad, will lead to regulatory arbitrage, as we have already had, will lead to the situation in which the private market brings down the whole system because it is not part of the scheme.

With respect to ownership of the entities, as I say in my testimony, I really think that a serious look ought to be given to cooperative ownership of Fannie and Freddie or whatever comes after Fannie and Freddie.

I think that the Federal Home Loan Bank system is a success in terms of its ownership structure; that it is better than the GSEs have been at aligning the interests of the public sector and the interests of the capital providers; that it doesn't require government capital; that it is able to scale its capital to the needs of the people who are the customers of the entity; and that you don't hear people saying, the Federal Home Loan Banks are displacing us out of the marketplace, as you always heard about Fannie and Freddie from other players in the mortgage business.

Because the people in the mortgage business own the Federal Home Loan Banks, and in the same way the people in the mortgage business can own the secondary market outlet and get an advantage in terms of an overall Federal catastrophic guarantee, but can provide both the capital and the risk-taking to make the system run. And in routine times, there will be no calling forth of any Federal participation beyond that.

Finally, I would say that in thinking about your regulatory

restructuring that you are going to be thinking about across a broad range of financial institutions, think about the mortgage industry as a subject for functional regulation.

Right now you just heard from FHFA, and you have heard when certain issues were being raised about appraisals, about how they don't regulate this or that, they would have to go to the bank regulators. The mortgage industry should not have its regulatory structure divided into so many pieces because looking just at the GSEs as a regulator doesn't give you the authority nor the perspective to see that the mortgage industry is properly regulated.

So think of mortgage industry regulation as a functional regulation subject. And maybe when you overall change the financial institution regulatory structure, that will mean a specialization within one agency, a coordination among several agencies. But there ought to be a mortgage regulator. There ought not to be just a GSE regulator. Thank you very much.

[The prepared statement of Mr. Morrison can be found on page 158 of the appendix.]

Chairman Kanjorski. Thank you very much, Mr. Morrison.

And now we will hear from the Honorable Susan Wachter, the Richard B. Worley Professor of Financial Management of the Wharton School at the University of Pennsylvania. Professor Wachter?

STATEMENT OF THE HONORABLE SUSAN M. WACHTER, RICHARD B. WORLEY
PROFESSOR OF FINANCIAL MANAGEMENT, THE WHARTON SCHOOL, THE
UNIVERSITY OF PENNSYLVANIA

Ms. Wachter. Chairman Kanjorski, members of the committee, thank you for the invitation to testify at today's hearing on the present condition and future status of Fannie Mae and Freddie Mac. It is my honor to be here today to discuss the role of secondary mortgage market institutions in contributing to the crisis, and what form these institutions should take going forward.

The Government-Sponsored Enterprises, Fannie Mae and Freddie Mac, have historically provided a secondary market for mortgages. But in considering their future role, today it is most important to consider how we may develop and maintain a housing finance framework that supports homeownership that is sustainable and contributes to overall financial stability.

Broadly speaking, there are three options for the future of GSEs: first, privatization; second, nationalization; and third, a return to their original Federal charter as hybrid public/private entities. I will outline here the pros and cons of these three approaches and the facts that can be and should be considered as the subcommittee, and indeed, the Nation, weigh the options.

Privatization of the GSEs in theory could have the benefit of desocializing the risk involved with secondary market housing finance. Critics argue that the GSEs' special access to cheap credit and high leverage expose the taxpayer to large liabilities. However, as we have seen with the socialization of private entities' losses, privatization does not exempt the taxpayer from such liabilities.

A second option is to nationalize the GSEs and have a solely public secondary market--essentially, FHA/Ginnie Mae for everyone. Taxpayer exposure to large liabilities is still a risk in a solely public sector approach. There is automatic socialization of risk and no market check on underwriting because of the U.S. Government guarantee.

The third possibility is a hybrid public/private secondary market. Hybrid public/private base financing worked fairly well until private label securitization arose. The GSEs found

themselves losing market share, and shareholders pressured the GSEs to lower underwriting standards to compete while Federal regulators did not stop it.

In fact, it is useful to think of privatization and nationalization as one choice and not two choices because nationalization effectively means that the existing FHA function is augmented with a larger sphere for lending, and the private sector of course would originate and securitize mortgages much as it did in the run-up to the crisis. Thus, a private label mortgage securitization would take off again.

Within the hybrid public/private approach, there are various options such as cooperative versus shareholder ownership, and choices on regulation such as public utility approach versus a larger role for the Federal Government in governance.

These choices are not inconsequential in system design. But today I will focus on the larger pros and cons of this middle ground versus the alternative of a Federal Government entity and GSE privatization, that is, a private label mortgage-backed securities market, which it would lead to.

While this issue is complex and multi-faceted, the overriding question is: Which of these two alternatives best serves the interests of the public? The public has an interest in systemic stability in the financial system. Individual households are the least well-equipped to weather instability in the financial system.

In addition to financial stability, a key public interest in mortgage finance is consumer protection. Moreover, from a household portfolio perspective, the long-term fixed-rate mortgage supports the goal of most families to at least have the option of continuing to live in their homes and neighborhoods. And the availability of this mortgage and this option depends on securitization.

To understand why and to understand the importance of the secondary mortgage market, it is only necessary to note that historically in the United States, housing finance was provided through banking systems funded by demand deposits.

In most countries today, deposit-funded banks remain the predominant, if not the sole source of funding, for mortgage borrowing. In countries with bank-provided mortgages, adjustable rate mortgages predominate, and the long-term fixed-rate mortgage is largely absent.

As colleagues and I have shown, real estate, including residential real estate, has been linked to banking and financial crisis, not just once but many times. Real estate crashes and banking crises tend to occur together. In our own recent history, the savings and loan crisis of the 1980's both contributed to the recession of 1990/1991 and destabilized the financial system, requiring a Federal bailout.

Securitization was the answer to this crisis. With the recognition that the stability of the banking system depended upon banks not lending long, financed by short-term demand deposit liabilities. Securitization enabled the housing finance system to continue to offer the long-term fixed-rate mortgage to America's homeowners without endangering banks' stability.

Elsewhere, in the absence of secondary market institutions, banks provide borrowers with adjustable rate mortgages. As I noted, the long-term fixed-rate mortgage is essentially absent. The exceptions to this, besides the United States, are Denmark, and to a lesser extent, Germany. Both of these countries, also historically, had in place extensive secondary market institutions which, while they differ from those of the United States, do in fact link long-term funders to long-term borrowers.

Fannie Mae and Freddie Mac grew with banks' continued

securitization of long-term mortgages originating and securitizing. The growth occurred both in the GSEs' guarantee business, in which they guaranteed mortgages, bundled into pass-through securities, and sold to investors, and in their portfolio purchases.

The growth of the secondary market coincided with a period of financial and economic calm in the United States known as the Great Moderation. Nonetheless, controversy arose over the GSEs' continued growth, to a great extent focused on the growth of their portfolios.

Ultimately, it was viewed that these institutions were implicitly guaranteed by the Federal Government. Thus, with the growth of their portfolios, taxpayers were liable for interest rate risk taken on by these institutions. Interest rate risk was and is an unnecessary risk for the GSEs to take on.

Importantly, however, the GSEs' Federal charters did and does require them to set standards for default risk, to minimize default risk, and to monitor and standardize contracts to do so.

The current crisis originated not with the growth of GSEs, but rather with the growth of private label mortgage securitization. In an era of deregulation, private label securitization drove the supply of risky mortgages. The demand for scrutinized mortgages fed the demand for recklessly underwritten loans.

As private label MBS grew in market share, so did nonstandard mortgages, from only 15 percent of market origination in 2002 to almost half of market origination in 2006.

Lending standards were not monitored by private label securitization, and declined over time. Surprisingly, so did risk premiums, and Wall Street encouraged such lending despite growing risk. Home prices were artificially inflated due to the willingness of institutional investors across the world to buy these subprime mortgages in the form of complex securities created by investment banks.

As lending standards deteriorated, the demand for homes and the price buyers were willing and could pay was artificially driven up. There was no and is no regulation in place to stop the deterioration of lending standards over time, driven by the competition for market share for private label securitized loans.

This lending was not sustainable, and resulted in a credit bubble that burst, bringing down not only poorly underwritten nontraditional loans, but carefully underwritten traditional loans as well.

The private label securities backing these loans were not liquid, nor did they bear risk premium based on their issuers and the underlying loans' originators' balance sheets. Because these securities were not backed by standardized assets, they generally did not trade.

Even if short sellers knew of the heightened risk and mispricing of securities, they could not easily trade on this knowledge. Private label securities were marked to model with the imprimatur of rating agencies and not to market. Thus, market discipline was absent and could not work.

While it is clear that systemic risk derives from the procyclical erosion of lending standards, there is not yet a consensus on how to avoid this going forward. While no system is perfect, securitized, fixed-rate, long-term mortgages are critical for a stable mortgage system. And that robust standardized securitization is unlikely to be accomplished by an FHA-like entity alone.

Chairman Kanjorski. Professor, could we wrap it up?

Ms. Wachter. I will finish up now.

In any event, standardization need not only apply to securitized mortgages. Financial institutions could still originate nonstandard mortgage products and hold onto them on their books or resell them to each other. This means that financial institutions could continue to serve as a laboratory for product innovation. But they would be required to retain the risk on those products. This is the proper niche for niche products.

And in closing, the GSEs should not be removed from conservatorship until the economy is on a stable recovery path. They are currently helping to stabilize the economy through their support of the housing market. This effort is especially critical in light of recent discussion over government purchase of toxic assets that may be difficult to price and liquidate.

In the future, the benefits for long-run stability and consumer protection point to the need for strongly regulated and private market disciplined entities to support the U.S. housing finance system. Thank you.

[The prepared statement of Professor Wachter can be found on page 179 of the appendix.]

Chairman Kanjorski. Thank you very much, Professor.

And next we will hear from Ms. Frances Martinez Myers, senior vice president, Fox & Roach/Trident, LP, on behalf of the National Association of Realtors. Ms. Myers?

STATEMENT OF FRANCES MARTINEZ MYERS, SENIOR VICE PRESIDENT, FOX & ROACH/TRIDENT, LP, ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS (NAR)

Ms. Martinez Myers. Chairman Kanjorski, Ranking Member Garrett, and members of the committee, thank you for inviting me to testify today on the current condition and future status of Fannie Mae and Freddie Mac.

I am a senior vice president for Fox & Roach/Trident LP, the holding company of six home services financial and relocation-related companies located in southeastern Pennsylvania. I am here to testify on behalf of more than 1.1 million Realtors, who are involved in all aspects of the real estate industry.

Realtors believe that the GSEs' housing mission and the benefits that are derived from it continue to play a vital role in our Nation's real estate market. Had no government entity existed when private mortgage capital dried up in 2008, America's housing market would have come to a complete halt, throwing our Nation into a deeper recession.

We need only look at the current status of the affairs in the commercial and jumbo residential mortgage market to see how different things might be today in the traditional residential mortgage market without Fannie Mae and Freddie Mac.

For those reasons, Realtors believe that pure privatization of the GSEs is unacceptable. Rather, NAR supports a secondary mortgage market model that includes some level of government participation, protects the taxpayers, and ensures that all creditworthy consumers have reasonable access to affordable mortgage capital.

NAR is currently conducting research to determine what model for the secondary mortgage market would best achieve these goals. We will share that information with you as soon as it is complete. For now, I would like to briefly outline a set of nine principles that NAR's board of directors has adopted, and that we are using to guide in our research:

1. Capital must flow into the mortgage market in all market conditions.
2. Qualified borrowers should have access to affordable mortgage rates.

3. Affordable housing goals should ensure that all qualified borrowers, including low- and moderate-income households, have an opportunity to realize the dream of homeownership. However, such goals must also promote sustainable homeownership.

4. Financial institutions should be required to pass on the advantage of lower borrowing costs and other costs of raising capital by making mortgages with lower rates and fees available to qualified borrowers.

5. Conforming loan limits should be based on increases in median sale prices, including higher index limits for areas with high housing cost.

6. Sound underwriting standards must be implemented and adhered to.

7. Institutions must uphold the highest standards of transparency and soundness with respect to the disclosure and structuring of mortgage-related securities.

8. There must be sufficient capital to support mortgage lending in all types of markets.

9. The government must provide rigorous oversight. Simply stated, the housing market must work in all economic conditions at all times, and mortgage capital needs to be available to all potential qualified housing consumers.

In conclusion, NAR respectfully asks that Congress and our partners in the industry carefully consider these nine principles when discussing a new secondary mortgage model. Working together, I believe we can create a solution that will serve our best interests now and become a model for the global real estate and financial markets well into the future.

I thank you for this opportunity to present our thoughts on the current and future status of Fannie Mae and Freddie Mac. And as always, the National Association of Realtors is at the call of Congress and our industry partners to help facilitate a housing and national economic recovery.

Thank you.

[The prepared statement of Ms. Martinez Myers can be found on page 163 of the appendix.]

Chairman Kanjorski. Thank you very much, Ms. Martinez Myers.

Next we have Dr. Lawrence J. White, the Arthur Imperatore Professor of Economics at the Leonard Stern School of Business at New York University. Dr. White?

STATEMENT OF LAWRENCE J. WHITE, ARTHUR E. IMPERATORE PROFESSOR OF ECONOMICS, LEONARD N. STERN SCHOOL OF BUSINESS, NEW YORK UNIVERSITY

Mr. White. Thank you, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee. My name is Lawrence J. White. I am a professor of economics at the NYU Stern School of Business. During 1986 to 1989, I served as a board member on the Federal Home Loan Bank Board, and in that capacity, I also served as a board member of Freddie Mac. Thank you for the opportunity to present my views on the present condition and future status of Fannie Mae and Freddie Mac.

The hybrid private/public model that is and was and continues to be at the heart of the operation of the two companies is broken and should not be reconstructed. Before addressing what should be done, however, it is important to step back and remember that Fannie and Freddie have been just one part of a much larger mosaic of government policies to encourage the construction and consumption of housing.

Much of this encouragement is broad-brush, unfocused. It mostly just encourages people who would otherwise buy a home anyway, so it is really not encouraging homeownership but just

encouraging them to buy a bigger, better-appointed house on a large lot. I don't see a big social purpose in that kind of encouragement, instead of doing what social policy should be doing, which is focusing on encouraging homeownership itself.

Now, Fannie and Freddie's structure was just part of and still is just part of this broad brush approach through the implicit and now somewhat more explicit support for their debt by the United States Government. It looked like a free lunch, something for nothing, but we have now found out just how costly this meal has been.

So what is to be done? For the short term, it is clear. Fannie Mae and Freddie Mac need to continue to be wards of the United States Government, wards of the FHFA. The financial markets are simply too fragile to support anything else.

However, for the longer term, because the model is broken, Fannie and Freddie should be really, truly privatized. To replace their implicit broad brush, off-budget effects in housing finance, there should instead be an explicit, on-budget, adequately funded, targeted program to encourage--and of course, including appropriate counseling--low- and moderate-income households who might not otherwise be homeowners to become homeowners, focusing on the first-time home buyer in the low- and moderate-income household category through targeted help on downpayments and targeting help on monthly payments.

This is an appropriate function for government to really deal with that important spillover effect that yields benefits when a neighborhood is more stable, with more homeowners.

Finally, there are some other things that the Congress could do that could lower the real costs of housing, make housing more affordable, that would improve the efficiency of markets and benefit consumers. I would hope all of the people at this table as well as the people on your side of the table could support these measures.

They would include: making sure that there aren't impediments to shipments of timber from Canada so that we can keep the costs of construction of housing lower; making sure that there aren't impediments to shipments of cement from Mexico so that we can keep the costs of constructing housing lower; leaning on the States and localities to relax unduly restrictive zoning that would otherwise keep the costs of property higher and make it hard to build lower cost housing; and leaning on the States and localities to undo restrictive building codes that inefficiently cause the costs of constructing housing to be higher. These are all things that could really make housing more affordable.

Thank you again for the opportunity to appear here before the subcommittee. And I will be happy, of course, to answer questions.

[The prepared statement of Dr. White can be found on page 186 of the appendix.]

Chairman Kanjorski. Thank you, Dr. White.

Next we have Mr. Michael Berman, vice chairman of the Mortgage Bankers Association. Mr. Berman.

STATEMENT OF MICHAEL D. BERMAN, CMB, VICE CHAIRMAN, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. Berman. Thank you, Mr. Chairman.

Every part of the real estate finance industry was deeply impacted by the financial crisis which led to the conservatorship of Fannie Mae and Freddie Mac--large and small lenders, servicers, investors, multi-family lenders, and most importantly, consumers. A smoothly functioning secondary mortgage market is not only important for our industry but for the entire economy.

Despite their financial situation, the GSEs currently participate in over two-thirds of single family mortgage transactions and about 75 percent of all multi-family mortgage transactions. While the FHA also facilitates a significant share of residential mortgages, the GSEs currently are the prevailing force in the mortgage market.

In addition to falling housing prices and an unprecedented foreclosure crisis, the GSEs face severe management challenges. At the same time, they are being used as instruments of public policy.

While MBA supports the temporary use of the GSEs in this manner, this is an unsustainable and artificial business model. We are committed to working with you to create a new structure for the future.

Before we discuss the future, we must ensure that the current market works as efficiently as possible. For example, the credit facilities established by Treasury for the GSEs expire at the end of this year, as does Treasury's authority to purchase GSE mortgage-backed securities in the open market. We must ensure that these important programs are extended at least until the East Coast recovers.

Congress should also help make mortgage credit more available and affordable by permanently raising the GSE loan limits. The higher loan limits have benefitted consumers, but because they are temporary, investors have been hesitant to purchase high-balance loans.

This dilutes the full benefit of higher loan limits because liquidity has artificially restricted them. Ultimately, consumers are forced to pay higher interest rates on their loans.

After the conservatorship was announced, MBA convened a council of mortgage finance experts from every part of the real estate finance industry to examine these issues. The Council on Ensuring Mortgage Liquidity, which I am privileged to share, has identified the key ingredients of a functioning security market and established a set of principles for you and the policy community to consider when debating how to rebuild the secondary mortgage market in the future.

Our approach has been to examine the issues so that stakeholders could assess options in a measured and thoughtful way. We agreed early to avoid an overly prescriptive approach, and instead to assess the market and present alternatives, which we plan to refine in the coming weeks and months.

I have attached to my testimony a white paper on this issue that has been cited as one of the more helpful compilations of options available today. This paper presents a set of building blocks to aid in understanding and discussing the merits of various market structures. It also lists and begins to describe nine alternative models for channeling government support to the housing finance system.

I have also attached to my testimony a set of guiding principles based on the key considerations mentioned in the white paper. The scope of these principles is the entire secondary market, including responsibilities of the private market participants as well as the role of the Federal Government.

I hope to address our principles at greater length during the question-and-answer period. But let me close with a few thoughts to help guide the policy discussion moving forward.

First, secondary market transactions should be funded by private investors seeking market returns who understand, accept, and are held accountable for the risks that they take.

Next, in order to attract consistent levels of private capital from a wide range of investors, the MBA believes that there is a role for an explicit Federal Government credit

guarantee on mortgage-related investments in the core single family and multi-family products. There is also a clear government role as a liquidity backstop in times of market distress.

Finally, a careful, measured approach should be adopted so that current markets are not further destabilized. Safeguards should be established to ensure a smooth transition from the present to whatever future model is developed.

Thank you for the opportunity to appear before you today, and I am happy to answer questions that any of you may have.

[The prepared statement of Mr. Berman can be found on page 85 of the appendix.]

Chairman Kanjorski. Thank you very much, Mr. Berman.

And next, and last, we will hear from Mr. Robson of the Robson Companies and chairman of the board of the National Association of Home Builders. Mr. Robson?

STATEMENT OF JOE ROBSON, ROBSON COMPANIES, AND CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

Mr. Robson. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, I too am thankful for the opportunity to be here and testify today.

The housing GSEs, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are viable components of the housing finance system, providing liquidity to the mortgage markets and supporting the flow of credit to meet affordable housing needs.

Fannie Mae and Freddie Mac recently have encountered severe problems, and are currently operating under conservatorship under their new regulator, the Federal Housing Finance Agency.

The Federal Home Loan Bank system has also experienced stresses which, while considerably less intense, have affected its capacity for mission pursuit.

NAHB believes that the housing benefits that the GSEs have provided in the past, and their significant roles in dealing with the current financial system's problem, clearly demonstrate the need for Federal Government support for the secondary mortgage markets. There is broad agreement, however, that Fannie Mae and Freddie Mac will not be able to emerge from conservatorship without alteration in their current structure.

While NAHB believes the liquidity and affordable housing mission must continue with Federal Government backing, the primary objective is a system that assures that the continued availability of affordable housing credit, that facilitates healthy housing markets and consistency in satisfying community housing needs. Therefore, NAHB looks forward to discussing different models for achieving that objective.

As the credit crisis has worsened, Fannie Mae and Freddie Mac have tightened underwriting standards and increased loan delivery fees at the same time their combined market share has increased, and now represents nearly 75 percent of the single family market.

The continual ratcheting up of delivery fees and tightening of underwriting standards has swung the pendulum too far, denying credit to viable buyers. NAHB urges the repeal of these obstacles to help to increase mortgage affordability, enhance policymakers' attempts to reduce foreclosures, and help the country get back on the road to economic recovery.

Last year, NAHB housing finance task force recommended a permanent Federal backstop to the housing finance system in order to ensure a consistent specialty of mortgage liquidity as well as to allow rapid and effective responses to market dislocations and crises.

The current crisis has clearly demonstrated that the private sector, unaided, is not capable of consistently

fulfilling this role. The task force concluded that the Enterprises should not be transformed into fully private companies because such companies could not be counted on to provide liquidity in times of crisis or to consistently address affordable housing needs.

And they should not be converted to Federal Government agencies because such entities would be burdened by government red tape and would lack the resources and ability to respond effectively to market developments and housing finance needs.

NAHB's task force recommended that Fannie Mae and Freddie Mac be recast, retaining Federal backing but limited primarily to providing credit enhancement of mortgage-backed securities. Some portfolio capacity should be permitted to accommodate mortgages and housing-related investments that do not have a secondary outlet, although Fannie Mae and Freddie Mac should have the flexibility to support the mortgage market under the types of conditions we are currently experiencing.

Specific principles for restructuring the housing finance system are outlined in my written testimony.

In closing, NAHB urges that any changes to the role and structure of the GSEs not proceed until the current financial turmoil passes, and that the markets return to more normal conditions. It would be extremely difficult, if not impossible, to restructure Fannie Mae and Freddie Mac when they are so intertwined in ongoing efforts to address the deepening financial morass.

NAHB looks forward to working with you to develop an effective, safe and sound, and reliable flow of housing credit under all economic and financial market conditions.

Again, I thank you for the opportunity to testify today, and I would be happy to answer any questions.

[The prepared statement of Mr. Robson can be found on page 169 of the appendix.]

Chairman Kanjorski. Thank you very much, Mr. Robson.

Listening to all this testimony here today, I have sort of come to the conclusion that maybe we should go back to basics. I want to pose just some basic questions, if I may.

Who says that the government should have a role in ownership of real estate? I mean, I hear some arguments posed and form sometimes questions or opinions, that the private sector and the private marketplace can take care of it. Is there anybody on this panel who agrees that we do not need government involvement in real estate?

[no response]

Chairman Kanjorski. Unanimous consent. I do not know if I am going to ask for party registration.

It seems to me that there is a little bit of an analogy-- not clear, but a little bit--of what happened in the late 1920's and what happened most recently in the real estate bubble and burst, and that is that greed, to an extent, caused people to overinflate and create a false value that kept on feeding on itself, to the extent that just as the boiler shops did in the 1920's with securities that did not have the financial worth behind them in the ultimate end, the real estate did not have the ultimate end.

Fortunately or unfortunately, I sat here and watched this fever. And I remember quite well having Alan Greenspan before us not too many years ago, about 5 years ago, and I posed a direct question to him. I think we have a tape of that; I think I will play that at my retirement party.

[laughter]

Chairman Kanjorski. And I asked him whether or not he had any fear whatsoever of the real estate bubble, and he said, ``Absolutely not.'' This was in 2005. And it could not cause a problem. They had it all handled and managed and analyzed.

Now, I have a lot of respect for Mr. Greenspan's economic capacity and ability to calculate economics. But he certainly missed that one. And it seems to be the story today that we always miss the one at hand.

And then somebody in their testimony used those horrible words, ``So this will never happen again.'' Could we knock those words out of our vocabulary? It is going to happen again regardless of what we do. It is just in another form or another method.

Now, the question is: Do we owe some loyalty to the private market, that government should stand behind these things? And if, in fact, it is necessary--you know, one of the methods I was thinking about here, if we pay the average people just a few percentage, maybe 10 or 20 percent more, in wages and income in this country, we would not have a problem. You would think that because it is a difficulty in some of these people in honoring their commitments.

Now, on the other hand, we do know that some people, regardless of the amount of money they have, they always overbuy, overshoot. But what is the role of government? Are we to put a label of teaching responsibility through government action? Yes, Dr. White?

Mr. White. Yes, Mr. Chairman. I have been thinking about your earlier question as well as this one. And I didn't raise my hand before because there is a role for government in housing. But I think it is a much more limited role than in fact we see government playing. It ought to be dealing with the true social spillover effects, the positive externalities, to use an economist's term, that comes with homeownership.

There is a role for encouraging innovation. After all, it was Ginnie Mae, an arm of the Department of Housing and Urban Development, that was the first securitizer of home mortgages. Freddie Mac was a fast second a year later, but it was Ginnie Mae that was first. So there is a role for government to play.

But markets can be terrifically efficient in allocating resources. I think we are all appreciative of that. And I believe that there is--yes, there is room for government, but it is a much more limited role. We ought to--

Chairman Kanjorski. I did not ask whether there is room for it. That seems to say that we want to compete. As a member of the government, I do not want to compete. The only reason I vote for housing is I want people to have good housing to live in. And if they cannot otherwise do it, I would not give them a penny. I mean, I would not support any--

Mr. White. There are better ways: by funding direct transfers rather than trying to lean on housing markets. By broadly subsidizing housing, all we do is encourage inefficiency in housing markets. We end up investing too much of our income, too much of our total capital stock in housing, not enough in productive physical capital, not enough in social capital, not enough in human capital, that could help people earn higher income.

Chairman Kanjorski. We have two more activists here, so we want to get to them.

Mr. Morrison. Mr. Chairman, you will always get the answer from the economists that, you know, if you appropriate the money directly and you target it most narrowly, that will be the best outcome. And yet our political system doesn't really work that way. And we have been much more successful in providing fundamental benefits that work for the society as a whole when they work for the whole society.

And it is really that you can just compare how successful our Social Security program is compared to targeted income support that only goes to the worthy, or those things that are most needy. And the fact is that we gain public support for a

broadly successful intervention and a necessity like housing when it is broadly shared.

And that doesn't mean that the targeted interventions that Dr. White is suggesting aren't good ideas. But our basic access to housing for individuals, both multi-family and single family, need an ultimate liquidity backstop to make it most affordable and most broadly available.

And that can be done with a minimal government risk and a maximum private sector operation and risk-taking. It is not the system we have because certainly Fannie and Freddie took on much more risk and much more power than they needed to take on. But it can be redesigned so that you get minimal government, but something that is broadly available and has broad political support, as the system has had.

So I think we should be careful of not facing up to the political realities of how we get the best overall result. You and I both have worked for years on what goes on in the committee on specific targeted matters. We have limited success. The broadly available benefits have broad political support.

Chairman Kanjorski. Thank you, Mr. Morrison.

Doctor, and then I have to get to my friend. But we are going to get a lot of time because I do not see a heavy population here. Doctor?

Ms. Wachter. We need mortgages for homeownership. I think that is obvious. People can't put down \$200,000 or \$300,000. We need mortgages. We need government to set the rules for a mortgage market. If we don't have a secondary market, we will have short-term variable rate mortgages. Many crises in other countries have come from that system. And of course, our savings and loan crisis came from that system.

Thus, we need a secondary market. If we have a secondary market without standards, we have a private label securitized system. I am not calling it a market because it is not a market. Rather we actually did not have a mortgage market. In order to have a market that works, you need to have the structure, the rules of the game, set out for the market players.

In the private label securitized market, heterogeneous mortgage securities were not traded. Thus we did not have the discipline of a market. The heterogeneity itself was a way of hiding the true costs and prices, both to investors and to borrowers.

Chairman Kanjorski. Thank you, Doctor. I have another couple of questions myself, but I am going to allow my friends here on the other side to be heard. Mr. Garrett?

Mr. Garrett. Mr. Chairman, thank you. Thank you to the panel. And I appreciate your opening comments as far as some basic questions. When you said, is there a role for the government here, I thought your next was going to go--and everybody concurred.

Is there a constitutional basis for the Federal Government here? I know we have a professor. Anybody want to cite the constitutional basis for the Federal Government intervening directly or indirectly in assisting someone to buy a House?

Mr. White. I am not a lawyer, and I never try to practice law without a license.

Mr. Morrison. It is the commerce clause.

Mr. Garrett. That commerce clause, we can do just about everything. I am not exactly sure why we have 50 States any more, actually, since we had that.

But also on a broader note, is there--we sort of had this discussion back when things were going well in the housing market, and the past Administration would oftentimes be championing the fact that things are going well in the housing

market, and the percentage of homeownership was always going up?

And some of us who would hear from those in the rental community and construction trades and what have you would say, well, you know, there is another trade out there as well. And how about us?

And so the question would be: Is there a target number that we should be looking at and saying, this is what we are trying to get to in homeownership, that when we reach 65 or 68 or 69 or 70 percent--we are never going to get a 100 percent homeownership rate--that we have reached the approximate number that we should be striving for in homeownership, realizing that there will always be some people who have to rent and there will always be some construction guys out there and investors who say, we should be building multi-family housing?

Ms. Martinez Myers. Our view on that, I think, would be that if you limit--if you decide that once we get to a 75 percent homeownership rate, we should stop pushing that button, also says that you would stop pushing the button that allows people to create wealth through homeownership.

And homeownership creates so many other opportunities for people and families and the government because there is a higher paying of taxes, there is greater investment in the community, and all those things that you would sort of limit its capability.

So in my view, if you are going to limit the homeownership rate by saying, oh, once we get there, that is good enough, you are also saying you would limit the possibilities of what it could mean to the--

Mr. Garrett. Now, I am not going to put words in his mouth. But Dr. White might say that there are other ways to create wealth in this country other than homeownership--is that something we are--we might go down that road?

Mr. White. I was going to say that in the last 3 years, it hasn't been a creator of wealth, among other things.

Mr. Garrett. Yes. There you go.

Mr. White. Yes, it was, for previous decades. Look, I don't know what that number is. It can't be 100 percent because it is clear: Homeownership is not for everyone. It requires a relatively steady income. It requires budgetary discipline. It requires an understanding of the obligations you are taking on.

There are, as Ms. Martinez Myers just indicated, positive consequences for communities. That is why we want to be encouraging it. But, you know, within limitations, and for sure the very broad brush approach mostly doesn't encourage homeownership. It mostly just encourages people who would otherwise buy anyway to just buy a bigger house with five bedrooms rather than four, four bathrooms rather than three, on a bigger lot. Where is the social value in that?

Mr. Garrett. Right.

Ms. Wachter. This deregulated environment did not encourage homeownership. Contrary to what Dr. White said, homeownership rates have declined in the last 3 years. Homeownership rates were at the maximum in 2004. And since 2004, homeownership rates have declined in this country.

What is important is a mortgage market that works, not only for homeownership but also for multi-family housing. A mortgage market that works supports multi-family options as well.

Mr. Garrett. Did you comment on recourse loans in your testimony with regard to--I guess you talked about the Danish system?

Ms. Wachter. I would be pleased to talk about that.

Mr. Garrett. Just a sentence because I don't have much time. Their system has recourse loans. Right?

Ms. Wachter. That is correct.

Mr. Garrett. We generally don't.

Ms. Wachter. That is correct.

Mr. Garrett. Which is better? Which works better?

Ms. Wachter. Well, certainly recourse is decided by the States. And I do think we can have a viable system that is consistent with financial stability with non-recourse. We had it for decades. It is only with the growth of the private label mortgage-backed securities that we have had the financial instability that we have seen the last few years.

Mr. Garrett. Okay. I will go to Mr. Morrison. Really quick, though, with regard to the private label, what I hear is it didn't work because, in part, we didn't have all the rules and regulations in place so you would have all those problems.

But if we come up here with all the right rules and regulations in place for the private label marketplace, could we see that with one of my pet projects, which you heard before, the covered Bond situation? Could we see those combined to basically expand the level that we need for a secondary market and the--

Ms. Wachter. I am sorry, Congressman. I may not be understanding your question completely.

Mr. Garrett. Sure.

Ms. Wachter. But my understanding of the Danish mortgage system is actually it is not that different than our GSEs.

Mr. Garrett. Mr. Morrison?

Mr. Morrison. Yes. Mr. Garrett, I am a proponent of recourse. I think recourse is an important part of a good system. And there is no reason you can't have recourse of various structures.

Recourse is actually wrung out of our system by Basel I capital rules, which made a transferred asset with recourse look exactly the same as a retained asset in terms of capitalization. And that is really why we have a non-recourse market.

And we could have a recourse market if we designed the capital rules sensibly to measure the risk. So you can have a recourse market, and it is one option for ways for the private sector to bear the risk. And it is not the only model; it can be a part of a model. It can be a mixed model.

So I would support your notion. Covered bonds are no magic--

Mr. Garrett. Right.

Mr. Morrison. --vehicle. It is another way of putting certain amounts of collateral behind your credit guarantee. So it is a way for the originating institution to stand behind it.

The question at the end of the day still is: Where does the liquidity come from? The system as a whole. And what kind of liquidity do you get for those bonds versus bonds which have some kind of guarantee on them?

And you can do both. I don't think we are really at war with each other on the options. I think it is a question of maximizing the benefit in the end.

Mr. Garrett. Right. And I will close on this, then, is that we are hopefully coming up with a solution. And in light of your comments on the political realities, some great sage one said, ``Don't let any great crisis go to no good use.''

Mr. Morrison. Right.

Mr. Garrett. We are going to try to use this crisis to come up with something that actually works.

And one last comment is is that I know you made a comment to Mr. White's comment as far as--and I appreciate your thought as far as targeting the money. And you are suggesting you can't always target, and you gave the example of Social Security being the broader system that really works, as an example, of course.

But we know that within a decade or so, Social Security is broke. And so that may not be the best example of saying-- giving us a system that is really working well across-the-board. And targeting health care systems or targeting things might actually be--

Mr. Morrison. Whatever system you have, you have to pay for it.

Mr. Garrett. Yes.

Mr. Berman. If I may respond to an earlier part of your question, with respect to multi-family--

Mr. Garrett. Yes?

Mr. Berman. --in that instance, and I happen to be a multi-family lender, Fannie, Freddie, FHA--that system today as well has become totally reliant on the GSEs. Over 75 percent of lending today in the multi-family sector in through the GSEs.

And so it in part points to another role of the government, which is to smooth out times--certainly times like this, when we are in crisis. But also it is not just when there is a 100-year flood. But between those times, to create a stable system where there is always liquidity in those markets for both multi-family and for single family.

Ms. Martinez Myers. I wanted to add to that as well. And I guess to go back to some of the original questions around the role and why the government should continue to play a role, I guess when you look at real estate in general, the industry, and we looked at it honestly and said all the various sectors of the industry combined represent, what would you say, 20 to 25 percent of our GDP?

I would think the government would have an interest in preserving and keeping a healthy industry because it is so much of our GDP.

Chairman Kanjorski. Mr. Manzullo. And after you get your reservation, if you guys do not mind, we will open it up to the three of us to throw questions back and forth and sort of make it a roundtable panel because I think we could get some interesting responses that way.

Mr. Manzullo?

Mr. Manzullo. Well, I want to thank you guys for sticking around. I had some other things to do, but I called my wife and I said, these people have been here all day, and it is a very interesting and tremendously important topic.

I have been listening to the testimony going on here, and this is very interesting. Ms. Martinez Myers, on behalf of the National Association of Realtors, you want to have this hybrid. And Dr. White, you say no hybrid. Let's let the market forces determine everything.

But the real mess has to do with the fact that people bought homes who couldn't afford them in the first place. Isn't that correct?

Mr. White. Certainly. In many instances, that has to have been true.

Mr. Manzullo. I mean, that is what made the loans go bad, is they closed on these loans, the so-called cheater loans, and the--

Mr. White. But it is because everybody was drinking the Kool-Aid that housing prices can only go up. And if housing prices can only go up, it is never going to be a problem.

Mr. Manzullo. Right. But even under the Fed, the Fed had the authority, has the authority, to do, among other things, two things. Number one, the Fed can govern the instruments. And number two, it can set forth underwriting requirements. Okay?

So the regulator that could have stopped all of this was already in place. And it wasn't until December of 2007 that the Fed did this top to bottom review and came to the incredible decision that you can't buy a house unless you can afford to

buy it.

I was stunned when the testimony came forth. And then again, that testimony came forth in October of last year. But the requirement is not effective until October of this year.

And I am listening to your testimony and see the tremendous angst that goes on from the builders, with Mr. Robson, to the Realtors and the mortgage folks in between. But, I mean, if somebody had just--if the Fed had said, look, you can't sell a house to somebody who can't afford it--I mean, the regulatory agency was in place. Don't you think that would have stopped this? Yes?

Ms. Martinez Myers. If I may comment, because your comment that says that all of this is only because people got loans they couldn't afford to pay. And I know that in the light of our conversation around the GSEs, I think that we need to kind of step back a moment and say, okay. For many, many years, decades, the GSEs did a really great job at providing affordable product that was sustainable.

And in fact, their foreclosure rate was something less than 1 percent. So for years they did a very good job at helping to grow homeownership, particularly among low- to moderate-income folks.

Now, their biggest crime is probably diverting from that and buying those bulk loans with some assets and loans that were not the kind of loans--

Mr. Manzullo. Under pressure from both parties.

Ms. Martinez Myers. That's right. They diverted from what they normally would do. So I think when we are sort of using the hammer to sort of hit them over the head for that action, I think everybody has to take a little responsibility for that.

And I think the industry has to take some responsibility because there is no doubt--and I think Chairman Kanjorski said--there is a lot of greed out there. The fuel got hotter. People kept selling. People kept pushing. People thought it would continue. People took loans thinking that they could flip the house or sell it and make a profit. And when it stopped, it was not a good story.

So I think there are lots of different factors that contributed to that. Some people themselves--I mean, a lot of people who have been homeowners for years refinanced their house, took out that equity, used it for things unrelated to their home, and the market changed, and guess what? Now their house is worth less.

Mr. Manzullo. But, you know, there are--there have been, in the past 20 years, periods of time when people paid ``X'' amount for their house, and then the houses have fallen in value. You have seen it happen here in northern Virginia.

But they just hang on, and then 5, 6, 7 years later they recover. And, you know, that is a lot different than whether or not they could afford the house when they bought it in the first place.

But what I don't understand, and maybe somebody here can clue me in, why did the Fed sit back and do nothing? Does anybody want to take a stab at that?

Mr. Morrison. I think it is a very good question. I think the Federal Reserve fed this crisis in two ways. They fed this crisis by keeping interest rates low for an excessive period of time, and they didn't discharge their regulatory responsibility with respect to the subprime market.

Those things I think you are absolutely right about, although it doesn't do us much good to be right about that.

Chairman Kanjorski. Whoa, whoa, whoa. Let me break in here a second. What obligation does the Federal Government have to do anything? You are the guys on that side saying, stay out of our bedroom. Now why do you want us to get into all your

business?

Mr. Manzullo. No, no, Mr. Chairman. What I was saying is that we are looking for a new regulatory system that will--

Chairman Kanjorski. Not really. Not really. We are looking really for the answer of why do we get ourselves so involved, create systems that fail--

Mr. Manzullo. Right.

Chairman Kanjorski. --and then we end up blaming the person who was not originally part of the transaction?

Mr. Manzullo. Well, no. But--

Chairman Kanjorski. Your indication here is the Federal Government had a responsibility to see that prices were not too high or--

Mr. Manzullo. No, no, no.

Chairman Kanjorski. What was the Fed supposed to do?

Mr. Manzullo. No, no. The Federal Reserve has the authority to--they could have stopped the 2/28 mortgages and the 3/27 mortgages. And the Federal Reserve could have said, look, we have some very basic underwriting requirements that when you buy a house, you have to have, you know, a minimum of 5 percent down or some other type of mortgage insurance, etc.

I am just saying that those--that the means by which these subprime mortgages could have been stopped--because they were too easy; the credit was too easy--that regulatory process was already there. It just wasn't used. That is what Mr. Morrison just said.

Chairman Kanjorski. You know, I think you all convinced me at this point we have to prevail upon the Speaker and the Leader of the Senate to convene a committee to determine what caused this thing. If we think 2/28 mortgages caused this thing, no wonder we cannot solve this thing.

It has nothing to do with it. It is minuscule. Who testified earlier, Mr. Lockhart, about the \$200 million in lost interest on a \$100 billion loss. It is minuscule. Our problem is why are we accepting the presumptions that we have a role to play, a committed role, a have to play? And why are we blind to what really happened?

And I have a suggestion. I did the--got here a little earlier. You know, our severeness in the real estate breakup occurred in the last 4 years.

Mr. Manzullo. Right.

Chairman Kanjorski. And it is when securitized mortgaging left government-regulated entities, went to Wall Street, and Wall Street discovered a way to sell crap for a AAA rating, and did. And they sold it all around the world.

And the only reason we felt obliged to go in and buy that crap from around the world is it looked like it had a Good Housekeeping seal of approval of the United States of America. And we were too embarrassed to recognize we stole this money all around the world with crap.

Mr. Manzullo. No. I agree. I mean, crap is crap. But the--

Chairman Kanjorski. Well, then, why do we not identify who put that crap together? It was the private--

Mr. Manzullo. Mr. Robson wants to clear up this crap.

Mr. Robson. Well, I wish I could.

[laughter]

Chairman Kanjorski. It helps things grow.

Mr. Manzullo. Mr. Chairman, are we in the informal portion of the hearing now? All right. Okay.

Mr. Robson. There are a number of issues, and I don't want to claim that I am the expert on how what is whole crisis came. But I think it goes to the point of--I think if you have too much government or too much private side, there can be a problem.

There needs to be checks and balances. And I am not going

to get into whether the Fed could have stopped it, or whether they could or would have or anything else. But I think there are a number of issues.

If you look back where the private sector, the private mortgage security started, it was really because there was a failure of FHA to a certain extent, that they had not monetized. They had not kept up with a number of--really, kind of providing mortgages on the low end of the market.

The private sector stepped in and started offering a lot of things that FHA was not able to do because of government red tape and a lot of bureaucracy that was there. That kind of started the whole ball rolling. Certainly--

Chairman Kanjorski. We can cut that red tape real fast by taking away any tax consequences of letting interest be deducted from income. Would you recommend we do that?

Mr. Robson. No, I wouldn't.

Chairman Kanjorski. Why not?

Mr. Robson. As far as what?

Chairman Kanjorski. I will bet I can identify three people at that table who would disagree with doing that because you get an advantage in your business with it. You have bought interest an advantage.

I am not castigating it. I vote for it. I think it is a good principle to get private housing out there. But everybody sitting at that table and everybody in this country is pushing their own self-interest, and have extended to the point it took the system down.

Now the question is: How do we get out of it? I am trying to suggest that let us not get out of it by redoing what we did before.

Mr. Robson. And that is to my point. I mean, GSEs were-- their primary responsibility was liquidity. I mean, it wasn't necessarily guaranteeing. It was providing liquidity because those of us who remember the days when you had a savings and loan, you couldn't get a new loan until they either sold them or you got new deposits in.

The whole liquidity question changed the mortgage finance system of this country. And the new system, whatever way-- forget about how we are going forward. A joint private government system--and I would say start with the Federal Home Loan Bank, is a good place to start.

Mr. Manzullo. Well, that is because the banks are shareholders in it. They eventually would be the losers if their loans went bad.

Mr. Robson. And they have skin in the game as owners of that bank system.

Mr. Manzullo. No, but Dr. White, you were on the board for that, weren't you?

Mr. White. It was a different time, but that's right. Part of the responsibility of being a board member of the Federal Home Loan Bank board was overseeing the Federal Home Loan Bank system, as well as Freddie Mac, as well as regulating the savings and loan industry.

Mr. Garrett. But would that give us the problem that you were talking about before, of a subsidization that just is even more obscure than what we have today?

Mr. White. Well, I mean, it is the same implicit guarantee that supports the Federal Home Loan Bank debt as is supporting the Fannie and Freddie debt. It is the same--the Federal Home Loan Bank system is a GSE as well.

The mutual ownership hasn't prevented a number of the banks from having their financial difficulties--not as serious as Fannie and Freddie, but still, they are suffering their difficulties as well.

Chairman Kanjorski. That gets you in trouble. Good

regulation and open regulation will tend to subside excess. Is that correct? I mean, I am a great supporter of the Home Loan Bank system. Mr. Morrison knows. But we know a few Federal Home Loan Banks that started to really get into serious trouble. If they had not been reined in by the regulator at the time, we would have been bailing them out, if we are not already.

And we have seen that in all of our financial institutions. But the problem really goes to excess, is the argument I am trying to make, that--you know, if you went back to the values that you are not trying to get a free lunch--not you but we, the American people.

If we are not trying to get a free lunch, if we are not trying to find pie in the sky over something that does not cost us anything, we will start evaluating things at their real value, and that is all we are going to pay. And if you are going to be a cosigner or a supporter of that, that is all you are going to support or cosign for. But we are always pushing the envelope.

There was a great gentlemen, this morning on the Secretary of the Treasury. It went through his purchase of his home in Westchester County, New York. Did anyone hear that, by any chance? You know, he bought a \$1.7 million McMansion and in a very short period of time had to sell it. And it showed what the drop of value was and how it went underwater very quickly for him.

But drive out in Virginia and look at the McMansions that are out there. And I think we need to start asking the question: Where are these people making all this money to buy all these McMansions? And they are not. They are getting it from institutions that government-supported or underwritten, are they not?

Unless there are an incredible amount of millionaires that I am not aware of in this country, it seems to me they are expending a great deal more for a piece of real estate than they should in rational terms.

Do you find that to be the case, Mr. Robson?

Mr. Robson. Those sorts of homes, I mean, if they are the McMansions, wouldn't be part of Fannie and Freddie anyway.

Chairman Kanjorski. I agree. I agree. I am not--

Mr. Robson. Those are going to be the private label mortgages.

Chairman Kanjorski. And are some of those underwater or not?

Mr. Robson. Sure.

Chairman Kanjorski. And why should they be under? You know, here is a question I really--going to the private sector, I am very impressed with all of the home builders, the Realtors, all of--but I have to ask the question: Did you, any of you, see this happening 3, 4, 5 years ago as some of us did?

And some of us fought the question that--you know, I remember with embarrassment this committee passing an amendment to reduce the requirement--I think it was the FHA requirement, reducing it from 3 percent to 1 percent or zero on the downpayment. Does anybody remember that just recently? Actually doing it at the time, the market was starting to collapse because of these ``crap mortgages'' that were out there?

Now, some saw it here and some made a question about it. Did any of you in the industry see that, and did it not bother you? Okay. What did you--did it bother you?

Ms. Martinez Myers. Actually, the Realtors testified before this committee about predatory lending in 2004.

Chairman Kanjorski. Yes. But I am not talking about predatory lending. That is not necessarily predatory lending. Predatory lending is a much higher price on a piece of real estate than it is worth according to a legitimate appraisal;

and then a high price of interest to be paid that should not finance a piece of property that expensive.

I am talking about just a simple question: Did you not see the real estate excesses that occurred in this country in probably the last 4 or 5 years?

Ms. Martinez Myers. We put out brochures in 2005 and 2004 to help the industry and the consumers understand how to buy mortgages, and to prevent them from buying unsuitable loans. We talked about--

Chairman Kanjorski. So all the smart people did not buy the loans, and all the stupid ones did?

Ms. Martinez Myers. No, no. I mean, at the end of the day, we have to face it. Whether people buy homes--well, people only buy homes once every 7 years, on average, I think, in this country. And they never become experts in the process.

And we know that as people in the industry. And we constantly have to educate them around what is available, what they should be watching for, and to watch out for predators who are out there giving them more mortgage and more promises than they probably should have been involved in.

We also tried to push for FHA reform, as Mr. Robson said earlier, in 2004.

Mr. Garrett. But you also pushed for higher conforming loan limits. And so for those people who were buying those McMansions, and even though a \$700,000 house is still a McMansion in most parts of the country.

Ms. Martinez Myers. Well, except only in high-market areas because affordability was outpacing the ability for a buyer to get into a starter home at that point. Incomes weren't increasing at the rate that housing was increasing. But--

Mr. Garrett. A \$700,000 house, even in New Jersey, I mean, they are still pretty darned nice houses.

Chairman Kanjorski. That is not a starter home.

Mr. Garrett. It is not a starter home.

Ms. Martinez Myers. Well, it is not. But in the State of California, it would be a starter home--\$500,000. People could not get into the State of--not today, but--

Chairman Kanjorski. That is economic discrimination. Maybe they should not be living in California if they cannot afford it.

[laughter]

Ms. Martinez Myers. But I think that the industry knew. The industry started--I can tell you at the National Association of Hispanic Real Estate Professionals, we started to talk to them about the changes that were coming on as well. So the Realtors have been very involved in trying to alert the brokers to protect their customers and to push for reforms.

Chairman Kanjorski. How about the home builders? What do they do? They stopped building.

Mr. Manzullo. I have a question.

Mr. Robson. You know, the private--it was really the private label mortgages that funded the McMansions and a lot of this, and the exotic stuff. I mean, Fannie and Freddie didn't fund exotic mortgages.

Chairman Kanjorski. No. Quite frankly, they did not. They ended up buying the private stuff, and they ended up, you know, helping--

Mr. Robson. Unfortunately, yes.

Chairman Kanjorski. Right.

Mr. Robson. I mean, they bought the stuff they wouldn't underwrite.

Mr. Garrett. So should the FHA be raising its downpayments, then?

Mr. Robson. Down payment? From 3\1/2\ percent?

Mr. Garrett. Yes.

Mr. Robson. I think in order to promote people to get into a home, I think they ought to pay something.

Mr. Garrett. Should they be tightening up--you made the comment before that part of the reason why we--part of the reason people weren't going FHA before was because of the darned red tape, which some people could construe that as being underwriting.

Mr. Robson. Well, it was red tape and not keeping up with technology. I had a meeting with former Commissioner Montgomery last year. They were still hiring people who knew Fortran. And this was last year.

Chairman Kanjorski. Were doing what?

Mr. Robson. Fortran. This is a 40-year-old computer programs. And as of last summer, they were still using Fortran computers.

Mr. Garrett. So just as to the underwriting, I mean, Director Lockhart was here before, and I think he mentioned it yesterday, that--and I guess you probably know the numbers--is that the default rate on FHA loans is beginning to spike up as well.

So some might say, hey, that is like our first warning sign that we might have some problems over there that we all should be looking at. And so call it red tape or--I understand the computer stuff and what have you. But we should be tightening these things up over there before we create a whole new problem. Anybody agree?

Mr. Manzullo. I have a legitimate question down here.

Mr. Garrett. That's a legitimate question. Should we be tightening things up with the FHA despite the fact that it may have a dampening effect--right? I mean, if you tighten things up, it may have a dampening effect on what you guys do. But would that be a prudent thing to do?

Ms. Martinez Myers. Well, I am not sure it would be a prudent thing to do at this time since we are trying to absorb as much of those foreclosed properties and the inventory that is in the market to get things going again.

But I believe Secretary Donovan has just said that FHA is doing great, and that they expect to see a profit of \$1.6 million this year. So--

Chairman Kanjorski. That is only because we made the mark-to-market rule.

Mr. Morrison. Mr. Garrett, I think you are right to ask questions about where FHA is going. So you had better look at FHA for sure.

Chairman Kanjorski. Let me ask you this: Are we just going to be putting a patch on a tire as we come out of this? Or are we going to get the opportunity to focus and really make fundamental corrections to the system? And is that possible?

Now, Professor, you had mentioned non-recourse loans? I am not quite up on my real estate law. Are you talking about the principle that you cannot go back for excess assets against the owner? The Pennsylvania rule.

Ms. Wachter. Yes. That is what I understood the Congressman to be asking. I don't know if that is what he is asking.

Chairman Kanjorski. Right. Well, let me ask you about that principle. Where did that come from, that you can throw the keys in and walk away? In my State, you cannot do that. You throw the keys in and they say, okay, where is your car, your firstborn, and everything else you own?

Ms. Wachter. It does vary by State.

Chairman Kanjorski. Yes. It varies by State. And did anybody do a comparison as to the foreclosure rate in Pennsylvania, relative to California or almost any other State that has a recourse rule? It is very low. When I sat on a bank board, a foreclosure of $\frac{1}{2}$ of 1 percent was huge because

people did not want to give up their trucks or their guns. They like guns in Pennsylvania.

Mr. Garrett. But that is when you were patching tires, too.

[laughter]

Mr. Manzullo. I have a question that I would like to ask Ms. Martinez Myers.

I looked at your testimony, along with the testimony of everybody else, including the Libertarian to your left. And you talk about wanting this hybrid. Okay? Well, apparently in today's economy in the United States, any business is subject to being taken over by the Federal Government.

We have had several hearings here on systemic risk, and when Mr. Geithner testified before this committee--I believe it was in--gosh, I am not sure when it was. It was in January--and he talked about this great super-regulator that would be over all the companies that could pose a systemic risk or perhaps a moral hazard. And a moral hazard really is a teetotaler who drinks a beer, because nobody could define these terms.

But I guess what bothers me is, you know, in the old days, you got a mortgage, you went to the bank, and the bank held it. And the mortgage was securitized by an appropriate ratio of demand deposits. And the money was simply set aside to cover the mortgage in case there was a problem on it.

And then we lost that great personal contact. But my question to Ms. Martinez Myers is: You talk about having a system that is fluid and liquid and that works. But you also make the statement that you want to make sure that money is available during tough times, and only the government can make that possible, as Dr. White gives us his big smile on that.

Would you explain that? And Dr. White, could you respond to that?

Ms. Martinez Myers. I guess you are asking me to explain why we feel that way. Well, the government has proven, through the experience with the GSEs, that through their existence, we were able to have liquidity in the market in good times and bad times. When things are tough in bad situations, they pull their money back, they don't make it available, and the market gets unstable.

We are looking to make sure that we can continue to help people sell their homes, help people buy homes in any kind of market because people are going to have housing needs regardless of what the market is doing at any given time.

I mean, we have situations. If you look at the example in the commercial mortgage scenario and the jumbo residential mortgage scenario, those are not guaranteed by the U.S. Government.

Mr. Manzullo. That is true.

Ms. Martinez Myers. Those folks, right now there are people who are in trouble, say, in the jumbo market who are looking to refinance their house. So let me give you an example.

You are somebody who has made a good living. You have a partner who loses a job. Suddenly you can't make this big payment anymore. You have one of those exotic loans. You want to go and try and refinance it. Now your house is worth less. And it is not guaranteed, and you don't fit into the program that the President has put out there. And there is no guarantee, and you can't refinance it because there is no money available.

So now you are going to be delinquent, when you have been trying to avoid that, and you are going to lose your house. And the likelihood is you are going to go into foreclosure. And there are lots and lots of stories like that, commercial folks who are looking to--their debt is coming due.

They are trying to get them refinanced. They can't get any liquidity in the market. There is no funding for them. And they

are in the same boat. We are seeing delinquencies rise, and we are seeing them go into foreclosure.

Mr. Manzullo. So that--

Ms. Martinez Myers. That would happen to the whole market.

Mr. Manzullo. Okay. That is a good answer.

Dr. White, what is wrong with her answer?

Mr. White. Look, we do have a Federal Reserve. They are a lender of last resort. They are a provider of liquidity. We have seen just how creative Mr. Bernanke has been able to be over these past few years, and I applaud his creativity. I really do. I think he has done a spectacular job.

At the same time, we saw that the GSEs weren't able to step up when hard times hit, and in fact, they went into the ditch. And it is only because the FHFA now is steering them and trying to get them out of a ditch that now they are part of the solution. But they weren't part of the solution, and were going into the ditch themselves.

And so we do have--back to my point. We have a Federal Reserve. They are the lender of last resort.

Mr. Manzullo. Yes. But so you are substituting the private/public partnership that is advocated by Ms. Martinez Myers by saying privatize the GSEs but have Federal Reserve on a standby?

Mr. White. I do believe in there being a lender of last resort in the financial system. I think that is terrifically important.

Mr. Manzullo. Then you believe the same way she does.

Mr. White. Well--

Mr. Manzullo. That is okay.

Mr. White. --I think by lending--

Ms. Martinez Myers. That is not a bad thing.

Mr. White. Well, thank you.

Chairman Kanjorski. Dr. White--

Mr. White. You focus it in a single entity. You don't spread it out.

Mr. Manzullo. I have always wanted to ask a professor questions like that. And thank you, Mr. Chairman, for the opportunity.

Mr. White. I am happy to help.

Chairman Kanjorski. Doctor, you are just switching insurance companies, are you not? You are changing--making the Federal Reserve the insurance company to the system.

Mr. White. Well, I would--

Chairman Kanjorski. I mean, to be sort of consistent with the free market system, you all should be pressing not to have the Federal Reserve as the lender of last resort.

Mr. White. Oh, no. I'm sorry. But when we do have financial crises, that is exactly when we do need a lender of last resort.

Chairman Kanjorski. So you do need the government?

Mr. White. Oh, for sure. For sure. And I said that before. We need a Federal Deposit Insurance Corporation.

Chairman Kanjorski. Why did you not say that when some of our members were here?

Mr. White. Well, and we need a Federal--

Chairman Kanjorski. These guys are telling me every day they do not need the government. We are interfering with them.

Mr. White. All right. I am with you on this. And let me say for the record, we need a Federal Deposit Insurance Corporation.

Chairman Kanjorski. Mr. Manzullo, did you hear that, that you guys are wrong on that side?

Mr. Manzullo. This hearing started out pretty boring, but it has really picked up in the last hour or so.

Mr. Berman. Mr. Chairman? Mr. Chairman, if I may, you know,

we have a situation today where we have a 100-year flood about every 10 years.

Chairman Kanjorski. And the government causes it.

Mr. Berman. Well, no. What I would suggest is that the government can play a role in helping to smooth out those kinds of crises. And there is not only a role for the government as a lender of last resort, but there is also a role in providing ongoing liquidity for a core set of products for both single family and for multi-family that can really be the central nervous system, if you will, for the secondary mortgage market and providing that liquidity; stable pricing, which is also important for homeownership; and a stable set of mortgage products that the economy can be built on.

Chairman Kanjorski. No. I agree with you. And of course I sound terribly radical up here. I mean to because I want to excite you people. But the reality is I am getting very tired of having witnesses come in and testify, and some of my friends on both sides of the aisle say, ``We are going to pass this special law so this will never happen again.''

Now, none of these people are that stupid. Okay? So they know it is going to happen again. It has happened all the way through our history. The fact of the matter is, if you really look at our present situation, we went 50 years minimally without having a financial crisis.

That was the first time in our history as a nation that we went that long; or we perhaps went 75 years. And I think everybody would have to admit the reason was we had good regulation until it went awry.

Now, our problem is we have to get back to ``good regulation.''. Maybe we even have to go a little beyond that and say, we need to get back to good values. And that is what I am sort of digging you all on.

You and I have a responsibility, it seems to me, that when we see somebody who is hedging the system, feeding the system, hurting the whole system, we have to realize it hurts us, too, because if they destabilize this system, all of us are going to get hurt.

And the question is: What are we doing about it? And I don't think for the last 5 years, we did a lot; certainly not enough. And if we go right back into repairing this, correcting some of our regulation, but we allow all these people to function out there in the system until they can find another way to escape responsible regulation in capitalism and it goes critical, and it has in the last 5 years, what have we gained?

We have gained very little. All we are doing is chasing our tail around the block. Maybe that is not wrong. Maybe that is how the system is intended to be. But I would hope after--there is a lot of pain, an awful lot of pain. And we don't see it down here.

You know, quite frankly, all of you are probably wearing suits that exceed the cost of most Americans' suits. You are driving cars that exceed the cost of most Americans' cars. Your kids are going to universities, and it is not--no, seriously. In Washington, you do not see the pain that you see when you go back to my district or you go back to Mr. Manzullo's district.

There are people living in this country for whom a sickness is a disaster. Just meals, just food, a disaster. It is a worrisome thing. It is not a question of educating your children; the need to actually not have them in school because you cannot even afford to have them there.

Now, we are not making accommodation for that. Oh, we are passing goody acts and we are, you know, doing nice things that are covering it up with whitewash, if you will. But this time, my friend Rahm is right. A disaster should not go unused. We can fundamentally change some of this system to make it fairer,

better, and more equitable. And in some respects, all of us are going to have to give a little.

I am going to ask a question, and we have to wrap this up. Do not worry, though, we checked. The airplanes are not flying because of the thunderstorm, so you are all safe.

But take a shot at us now. Republican, Democrat, Banking Committee. Give me the worst criticism you can of our failures as a government and as people. And do not pull any punches.

Ms. Martinez Myers. May I?

Chairman Kanjorski. You may start. You seem to like to do that, Ms. Myers. Go.

Ms. Martinez Myers. I am going to give you two.

Chairman Kanjorski. Yes.

Ms. Martinez Myers. Okay. I think that--and I am actually going to do one better. I am going to say, we are going to take some responsibility for this, too. The FHA piece, and we have talked about this and have alluded to this before.

Industry probably wasn't pushing the FHA reform soon enough. We should have been talking about this in 2001, maybe when we started to see changes, and we didn't. We got around to it in 2003/2004. We presented it to Congress. And it sat around and sat around.

And we have to ask ourselves: If we had the FHA program that we have today that was relevant in the marketplace, would we ever have had the need for subprime mortgages, and would we be here today? I think we all have to take responsibility for that.

The second area that I would point out to you is we have seen a lot of moratoriums on these foreclosed properties. We need to rip the band-aid off so we can start the how long because right now, if we keep those moratoriums--and now they are released, and we are going to see a big flood of real estate in the marketplace over the summer. There are something like 800,000 foreclosed properties that are going to hit the street.

That is going to have an impact on our market. We have to get those absorbed. If we are ever going to right this market, we have to get those absorbed. And the only shining light on that foreclosed property--and it saddens me and breaks my heart; like, you know, I am involved in some of that business myself--that people are losing their homes.

But the bright spot is there are a lot of first-time home buyers buying those homes. People who didn't jump into that subprime market, people who sat on the sidelines because they couldn't afford it, and are in there. And maybe our homeownership rate will get back to normal in the process.

But we have to get that--blow that inventory through here and out of here for those that we cannot save instead of dragging our feet. No good is going to come of that.

Mr. Robson. Mr. Chairman, could I--

Chairman Kanjorski. Mr. Robson, do you have something to add? I just happen to know you have a pressing engagement.

Mr. Robson. I appreciate that.

Well, two things. I think I would just follow up to--

Chairman Kanjorski. This is hate mail, now. You are supposed to give us the worst you have.

Mr. Robson. One, the whole credit problem, I mean, there is a whole credit problem in this country. It is not just mortgages. It is AD&C loans on the construction side. It is commercial. It is--credit has completely frozen up.

And what sprouts we are seeing in the economy, especially in housing, hopefully that it looks like we are maybe reaching a bottom on--at least as far as home sales are concerned, both new and existing.

But if we don't get credit flowing throughout this

country--whether it is small business, whether it is construction of development loans or anything else--we will not have a recovery.

And then I just echo--and some of the other things that have been said today earlier that--some of the questions with Mr. Lockhart, the appraisal problems are a very, very big issue. If we don't correct some of the abuses on the appraisal problems, we will never recover, either.

Chairman Kanjorski. Very good.

Mr. Berman. Mr. Chairman?

Mr. Robson. If I could, Mr. Chairman?

Chairman Kanjorski. Yes. You are excused.

Mr. Robson. Thank you very much.

Mr. Berman. Two issues that I put out there that I think maybe we could have done better on. One is taking a more holistic approach. And there have been a number of comments about not only the GSEs today but FHA, the banks, the private label market, and the rating agencies. I think if we are too focused on just one piece of the regulatory puzzle, it is unlikely that we will be successful in solving and preventing this from happening again.

Secondly, it has troubled me a little bit that some of the members are eager to latch onto a label of a solution. I think that at this stage of the debate, it is absolutely critical that we focused on principles and that we drill down on: What kind of ownership do we want for the entity?

What kind of regulation do we want? What kind of products do we want? Where do we want the interest rate risk to be? Where do we want the credit risk to be? What do we need to do for liquidity? And jumping ahead and trying to put a label on that, whether it is a public utility model or a coop model or a bond model I think is a serious mistake.

And rather, I think, if we have a principled approach and we start building up with building blocks from the ground up, we will end up with a model that--we will figure out what the name of it is after we create it, as opposed to trying to latch onto a model and say, that is a good one or that is a bad one.

So I would encourage us to use that ground-up principled approach.

Chairman Kanjorski. Very good. Shall we save Mr. Morrison or the professor for last?

Ms. Wachter. Well, thank you. If I were to criticize, going backwards, one, the consideration of lowering the FHA mortgage downpayment to zero at that moment to me was just a 13th gong of the clock.

And related to that, although I have no evidence but this is hearsay, it is out there that the GSEs were being encouraged, by Congress as well, to move into Alt-A and to subprime to help support that market.

Going forward, I think that Congress has to be farsighted in understanding the problems with asset bubbles. Asset bubbles are just as lethal as inflation and recessions. Japan was brought to its knees for 10 years. The Asian financial crisis affected many of the tiger countries for more than 10 years.

We have seen one. We can see more. We have had a housing market for decades in the United States, more than that, hundreds of years, even, in part because we have a very elastic supply of housing historically. We do not have an elastic supply of housing any more.

And my colleague Dr. White argues for reducing restrictions locally so we would have a more elastic housing supply. But I just don't think that is in the cards for a variety of reasons, including concerns over the environment. And local control is simply in our blood

So I don't think that is going to happen. Therefore, like

Europe, like Asia, we are in a different world now. We are in a world where housing supply is inelastic. That means we are in bubble-potential world. But I don't think we can do anything about that from the basic regulation side. I think that means that we have to be attentive when housing bubbles are being formed.

There were those of us in academe--I was one of them--who said, in the real estate academe, in the real estate department at the Wharton School, we were in a bubble in 2006. And I wasn't alone.

And paying attention to this, and therefore to the potential for a major crisis when even reasonable loans are being priced at a point where prices aren't going to decline 20 percent; a 20 percent downpayment gives you no protection under those circumstances--we will need to pay attention.

Chairman Kanjorski. Let me stop you there for a moment because I am from Pennsylvania and I have a great deal of respect for the Wharton School. My father, my brother, my nephew, they are all Wharton people.

They do have telephones, do they not?

Ms. Wachter. Excuse me?

Chairman Kanjorski. You do have telephones at the Wharton School?

Ms. Wachter. I was not at Wharton. I did put my papers out there. But why wasn't it picked up? And my understanding--and this is a question to which I do not know the answer; this is an historian kind of a question. It is not empirical. I can't do econometrics, to answer your question.

But my understanding is there were good models out there. There were people saying this. But the models were not being purchased because there was no money in purchasing those models. Where the money was was continuing to get the deals done.

Chairman Kanjorski. Did you have absolutely no faith in government, either the congressional--

Ms. Wachter. No. I absolutely have faith in government.

Chairman Kanjorski. Why did you not take the time and the effort as an academic? You know, when a professor of your standing calls my office, you would probably get a priority because I assume that you would not waste your time or my time by calling. So I am going to talk to you about it, whatever the issue is.

Why did you not do that? We have a lot of lonely people on the committee. They would have been--

Ms. Wachter. Well, that is wonderful. I am thrilled to hear that is an option. We did publish our papers. We gave our papers at all of these meetings. They were in newspapers.

There were models out there. You know, Case-Schiller had his models out there. Mark Zandi was out there. Mark Zandi's company was purchased by Moody's. But prior to that, Moody's did not use Mark Zandi's models, which were excellent models.

Chairman Kanjorski. Well, going forward, use the telephone.

Ms. Wachter. I will. Thank you very much for the offer.

Chairman Kanjorski. Thank you.

Mr. Morrison? You know, I just want to blame you. You were here. Why did you not cure this problem? It is your fault.

[laughter]

Mr. Morrison. Well, I thought I fixed the savings and loan problem, so then I left.

Well, I think that just to go back to the GSE question, Fannie Mae and Freddie Mac were a wonderful symbolic battleground in the Congress. They either were the devil incarnate, and needed to be dismantled and got rid of so that the private market could function; or they were the best thing

that was ever done for affordable housing. Without them, we would have no housing at all.

And they were allowed to run a model which was totally unsustainable, a portfolio model of chasing growth stock status in the markets, and whatever they had to do to get there. After the years and years of the regulatory debate, what was most surprising to all the participants was that they were both wrong.

Those people who wanted to take Freddie and Fannie down apparently thought that Freddie and Fannie were so powerful that they would never be taken down. And on the other hand, there were those who thought they were so powerful that they would be the cash cow forever for affordable housing.

And what really turned out is they were a house of cards that collapsed because of the very model that made them appear strong, the growth stock model: ``We can get this capital from the marketplace. We can give them portfolios, whatever it takes.''

I think everybody was blind to the reality behind that. It was parties warring over symbols. And I think by missing that, yes, they were not the ones who created the private market securities. But they in fact created that marketplace in many ways by funding the AAA tranche of subprime securities early on and made that market go, and then everybody else followed on.

So I think that if the debate had been more honest--in 1995, I had a conversation with Alan Greenspan about huge portfolios and the impact that they would have. And he was very concerned about the Federal Home Loan Banks, but not at all concerned about Fannie and Freddie because he said, ``Jim Johnson is the smartest man in town.''

Well, he might have been. But his legacy we see. So we should be watching out for smart people and maybe do our own research.

Ms. Wachter. But Bruce, if I may, it wasn't that they bought these early on. They bought them--

Mr. Morrison. They did.

Ms. Wachter. What year did they start buying them?

Mr. Morrison. No. They started buying them--they funded Ameriquest and others in 2002/2003 by buying their AAAs.

Chairman Kanjorski. Well, now, Mr. Johnson was gone by that period.

Mr. Morrison. Oh, yes. No, I am not blaming Mr. Johnson. I am just saying that we had a lot of people who were blind to a model that was not sustainable, including Mr. Greenspan in 1995.

Chairman Kanjorski. No question about it.

Mr. Manzullo, are you going to wind us up? I think Dr. White should get a crack at us, too.

Mr. Manzullo. No. You know, the district I represent, in 1980 and 1981, we had 25 percent unemployment. And there were more people unemployed in Rockford, Illinois, during the early 1980's than there were proportionally during the so-called Great Depression.

And Americans worked their way through that. A lot of it had to do with the inversion of the dollar and the collapse of the ability to sell manufactured items overseas, including machine tools, etc., because your district is very much like mine.

But, you know, maybe I am thinking too simplistically here, is that we would not be in this problem, in this trouble, had not people bought homes that they couldn't afford in the first place.

And Mr. Chairman, do you know who some of the people were that were waving a red flag 5 years ago? It was the National Association of Realtors. They would come in the office, and of

course they were thrilled to sell real estate and make everything.

But I was questioning all the easy money going on, and you know that, and so were a lot of your Realtor colleagues, saying, this is great, but you just can't keep on going on like this because somewhere along the line something is going to happen.

Chairman Kanjorski. I held hearings on it.

Mr. Manzullo. Pardon?

Chairman Kanjorski. I held hearings in my district.

Mr. Manzullo. That's correct.

Chairman Kanjorski. In 2004.

Mr. Manzullo. That's correct. And these are the types of signals that were being sent out that people like myself and you were saying, there is something wrong here. It started with the laundering of the books by Fannie Mae in 1990--no, in 2003 and 2004, with Franklin Raines and those characters taking those incredibly high salaries.

And their bonuses were predicated upon the fact that they had to get to a certain point of profit, and they got down to the mill. Do you remember that, Mr. Chairman? It was mills, just so they could get that extra amount of money squeezed out. And we were screaming here.

In fact, Fannie Mae had hired 17 lobbyist firms that were out there getting bogus postcards from 2,500 of my constituents saying, don't change anything at Fannie Mae. We don't want any reforms. And then the reforms that we wanted really were to tighten up the lending standards.

But I guess we were just like John the Baptist, just crying out in the wilderness and no one was listening.

Mr. White. All right. I will try to be brief. It is getting late.

If I were to offer the criticism that you invited, I would say you let us get way too deep into the whole housing issue. Again, there is a role for government. Bruce, you and I differ on this, but I have to speak truth to power. It ought to be a focused, targeted role.

The broad brush role just gets us with a far too large stock of housing, and a far too small stock of human capital, of physical capital, as a consequence. That is a big cost that we have paid. We are paying it now in the current crisis as well.

Let's see. Some other things. Some small things--

Chairman Kanjorski. How could that have been--

Mr. White. There is RESPA.

Chairman Kanjorski. Yes. But how could that have been prevented?

Mr. White. Sorry?

Chairman Kanjorski. How could that have been prevented?

Mr. White. Well, okay. You asked. The rating agencies.

Chairman Kanjorski. They are the buggers.

Mr. White. They are--you know, there is lots of blame to go around. But clearly they were one of the central parties here. And it was no accident that they became a central party. They were a central party because of financial regulation.

Had that whole structure, and again, you could see each step made sense. But by the time you went down the road, you had a handful, a literal handful of rating agencies--

Chairman Kanjorski. I have to ask you: Should they have been federally regulated?

Mr. White. Say again?

Chairman Kanjorski. Should the rating agencies have been federally regulated?

Mr. White. I would argue no. But they also should not have been thrust into the center of the bond markets the way the

bank regulators, the insurance regulators, the pension fund regulators, the Securities and Exchange Commission, all forced them into the center of the bond markets. And when the securitization process started--

Chairman Kanjorski. No. I am trying to figure out, then. You would have had us not have a rating agency in any way giving indications of--

Mr. White. Oh, no. No. I would have the rating agencies still there, but not as a mandated source of information. I want banks to have safe bonds. I want the regulator to work with the banks to have safe bonds. But it should be the responsibility of the bank to either demonstrate the bonds' safety to the regulator or have an advisor that it can demonstrate to the regulator.

Chairman Kanjorski. Something like AIG Financial Products in London? A small operation of 400 people who have a bank, and have a regulator come over for a couple of weeks every year to look them over. And they get involved in transact counterparty positions of \$2.7 trillion. That is what you would like that unregulated--

Mr. White. Oh, no. Heavens, no. Heavens, no.

Chairman Kanjorski. Well, is that not what--

Mr. White. They were running a big insurance operation and--

Chairman Kanjorski. Is that not what an unregulated system brings us?

Mr. White. If we are going to let entities get so big with so many counterparties, then we have to have a regulator.

Chairman Kanjorski. So, now, that is a good point. Then you would have liked us not to have repealed Glass-Steagall?

Mr. White. Say again?

Chairman Kanjorski. Glass-Steagall should not have been repeated?

Mr. White. No. No. The repeal of Glass-Steagall had absolutely nothing to do with the debacle--everything that has happened could have happened.

Chairman Kanjorski. Well, that is what allows entities to become huge.

Mr. White. Well, Merrill and Bear Stearns and Lehman and Morgan Stanley were all going to--and Goldman--were going to get huge regardless, and Citi. Citi got a little bit bigger because the repeal of Glass-Steagall allowed it to buy an insurance operation.

Chairman Kanjorski. Well, I am not sure I catch your drift, though. Do you think the government should have had more or less regulation?

Mr. White. It needed to be smarter regulation. In some places it needed to be less, and in other places it needed to be more. For sure it needed to be smarter.

Chairman Kanjorski. That sounds like Monday morning quarterbacking. I am on the field on Saturday. We are calling the plays on Saturday.

Mr. White. Well, okay. In the case of the credit rating agencies, I have been there for about 8 years now. So I could have told you basically this story 8 years ago, and did--well, sorry. I was publishing it.

Chairman Kanjorski. Well, should they be allowed to be paid by their users?

Mr. White. That is something that the institutional bond market could figure out on their own. I don't trust this guy because I am worried about his conflicts of interest. I am going to trust somebody else who's business model I think is a more solid model.

The bond market is fundamentally an institutional market, and those institutions can figure that out.

Chairman Kanjorski. For some reason I think--I am sensing you are putting a foot on two icebergs here. You are not being straight with us. Give me an image of what you want the government to do.

We are the big government that you have a right to hack at us. So tell us what the right direction is, in your opinion, and then you are going to be held responsible for it.

[laughter]

Mr. White. Okay. As I said, we cannot do anything radical at the moment. The financial markets are far too fragile.

Chairman Kanjorski. So you would clearly give advice to us to go easy. Do not speed through this and have unintended consequences. Let us get back on the recovery stage, and then be very serious about reforming some of these institutions.

Mr. White. For sure. And then I would privatize Fannie and Freddie. I would have a targeted program to be encouraging first-time homeownership.

Chairman Kanjorski. So if we privatize Fannie and Freddie, they can do exactly what Wall Street did with their special securities that they privatized. Is that--

Mr. Manzullo. Well, given the size and the systemic risk, like it or not, we need a systemic regulator.

Chairman Kanjorski. Well, then you do not. You mean you want Fannie and Freddie privatized, but with a very stiff systemic risk regulator?

Mr. White. For sure. For sure. Yes. Yes.

Chairman Kanjorski. Well, then, all you are doing is where the money flows. You want--

Mr. Manzullo. Well, no. I think it makes a difference.

Chairman Kanjorski. You want the wealthy institutions to be making more money off mortgage securitization than they are now. Is that not the only difference?

Mr. White. I don't--Congressman, I don't see it that way. But, you know, I think it makes--I think it makes a difference. Also, I would not have the kind of implicit guarantees that were--where everybody knew that Fannie and Freddie were--

Chairman Kanjorski. You think if we have a private institution the size of \$5.6 trillion, that there is not an implicit statement that the United States Government has to come in and rescue it when it fails or else it brings the entire system down?

You don't think we made that hard vote, going back to September of last year, because we wanted to ``bail out'' Wall Street? You do know the circumstances of that vote, don't you? You remember what--you know what the Secretary of the Treasury and Chairman Bernanke told us that famous meeting or several meetings that we had?

That we were 24 hours away from a total meltdown of the American economy, and 72 hours away from a total meltdown of the world economy, that it would take us back several hundred years, that we did not have even the security to feed America at the time if it happened. I could go on to other scary things. I am not about to do it now.

But you do not think we did that because we just did not want some rich people on Wall Street to lose their banks?

Mr. White. For sure. For sure.

Mr. Manzullo. I didn't do that.

Chairman Kanjorski. What?

Mr. Manzullo. I didn't believe it.

Chairman Kanjorski. You did not believe him?

Mr. Manzullo. It was \$700 billion was supposed to buy up the bad assets. They still haven't been bought up.

Mr. White. Anyway, I would be happy to expand on these. And I hope I can take up the invitation you offered to Professor Wachter.

Chairman Kanjorski. Absolutely. All of you. The other two left already, and we will send them a letter. No, do not-- really. If you have ideas on the subject, regardless of how wacky they may sound or out of the normal configuration of things, do not hesitate to tell us.

We are going to try and do the best we can to do some management of what has been a relatively disturbing, unstabilized system that we now have. And we are going to do our best.

We are looking for the best thought process in the world, and that is why we asked you all to testify today, so that, one, we could harass you, two, we could keep you here until 7:30 at night and get you--you know, I am actually leading a seminar for divorce lawyers. Anybody has spouses you are going to get into potential catastrophes with at home? No. We are going to close it up now.

I do want to thank you all very much. I hope you did not mind going informal like this.

Mr. White. Thank you, Mr. Chairman.

Mr. Manzullo. Thank you, Mr. Chairman.

Chairman Kanjorski. Thank you for appearing. And I am supposed to read something into the record now.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Before we adjourn, the following items and statements will be made part of the record for this hearing: a statement from the Manufactured Housing Association for Regulatory Reform; a statement of the Independent Community Bankers of America; a letter from the National Association of Federal Credit Unions; the letter requested by Congressman Campbell from Mr. Cox to Mr. Lockhart; and an article by David Goldstein entitled, ``Private sector loans, not Fannie or Freddie, triggered crisis.''

Without objection, it is so ordered.

The panel is dismissed, and the hearing is adjourned.

[Whereupon, at 7:28 p.m., the hearing was adjourned.]

A P P E N D I X

June 3, 2009

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