

**Hearing Before the U.S. Senate Committee on Banking, Housing, and Urban  
Affairs “Reforming the Regulation of the Government Sponsored Enterprises”**

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**February 7, 2008**

**Washington, D.C.**

Chairman Dodd, Ranking Member Shelby, and members of the Committee, I appreciate the opportunity to speak today, and thank you for again taking up the issue of GSE regulatory reform. Fannie Mae is committed to supporting your efforts to pass reform legislation in 2008.

Before I offer my comments on regulatory reform, I'd like to provide the Committee with a brief update. Fannie Mae has undergone significant change during a time when the mortgage and housing markets have themselves undergone significant change.

Fannie Mae has new management, and a completely revamped corporate governance and internal control environment. Only one hurdle remains for us to fully comply with the 81 remediation measures called for in our 2006 consent order with the Office of Federal Housing Enterprise Oversight. That hurdle is the filing of our fully audited 2007 results with the Securities and Exchange Commission, which will be done at the end of this month.

We believe the internal improvements we have made since 2005 have helped us meet an external challenge: Maintaining liquidity, stability and affordability in the prime, conventional, conforming mortgage market during a period of extraordinary market stress. While subprime, jumbo and other non-conforming markets have shrunk or shut down completely, the center of the market where the GSEs have a large presence has performed relatively well. Credit remains readily available and rates have fallen for GSE-eligible loans.

Having said that, we are not immune from the disruptions in the market and we will take our lumps. In fact, we had a GAAP loss in the third quarter and we saw more difficult headwinds in the fourth quarter. But our business is meeting the increased demand for liquidity and our overall credit book has held up relatively well. Yes, these are tough times, but that is when you want a Fannie Mae.

The mortgage crisis in this country is widespread and growing. Economically distressed communities are being ravaged by foreclosures, and waves of subprime teaser rate “resets” are crashing over thousands of homeowners every month. The GSEs have an important role to play in helping the market through these problems. Both companies are doing loan workout and foreclosure prevention programs on a large scale. Through its HomeStay initiative, Fannie Mae successfully refinanced 68,000 subprime borrowers into prime, fixed-rate loans in 2007. In addition, we worked with more than 43,000 delinquent borrowers to help them stay in their homes. We’ve contributed nearly \$9

million to non-profit mortgage counselors so they have the capacity to meet the growing demand for help. And, most importantly, we continue to maintain a stable, liquid center of the mortgage market so that credit-worthy borrowers can access affordable mortgages.

Such efforts on the part of Fannie Mae are worth considering as Congress and the administration take up the issue of reforming the regulatory regime of the GSEs. The choices you make now should be durable and stand the test of time. We support the creation of a strong, independent and bank-like regulator that can not only provide proper oversight, but can ensure the GSEs are able to respond to the changing – and sometimes volatile — housing and mortgage markets.

We recognize the tensions at the very heart of the GSE charter — the tension between the interests of a private enterprise and the public interest; the tension between avoiding risk for safety's sake and embracing risk for the sake of expanding homeownership and affordable housing. Regulatory reform calls for that same balance: The need for a nimble, responsive, creative housing enterprise balanced with sound, professional regulatory oversight.

Mr. Chairman, you have asked me to comment on proposed legislation to strengthen that oversight. Our view of the principles that should guide regulatory reform has remained unchanged since I first testified before this committee on April 20, 2005. But the dramatic changes in the housing market that began last year only reinforce our views of key elements of regulatory reform. These views focus on:

- Our capital.
- The role of our mortgage portfolio.
- The products and programs we pursue.
- And our performance in funding affordable housing.

## **Capital**

With respect to capital, the current housing crisis has reinforced two things. First, financial institutions need to have enough capital to weather a downturn, and second, in times like these, it is critical that they have enough capital to continue delivering liquidity to the market.

This is the balance we have been trying to strike. We presently have more capital than at any time in our existence as a public company. This will protect us from the downside impact of the housing crisis. It will also permit us to provide service to the market in its time of need and ultimately to generate earnings to maintain and build capital. That is the balance struck in banking regulation, and the balance we seek in GSE regulation.

Congress has established a statutory minimum capital standard for Fannie Mae and Freddie Mac that reflects the unique role of the government sponsored enterprises and the importance of capital in meeting their liquidity, stability and affordability mission. We support this Committee's re-affirmation of our minimum statutory capital requirement in S. 190, in the 109<sup>th</sup> Congress, and the House's more recent re-affirmation in H.R. 1427.

As I have said before, the normal capital levels established by Congress for normal times should be the norm.

We also support the regulator's ability to increase our capital requirements when necessary to meet a clearly articulated safety and soundness concern. But when such concerns are absent, legislation should ensure that our capital requirements return to the levels established by Congress.

### **Portfolio**

On portfolio oversight, we believe the bank regulation approach strikes the right balance of ensuring safety and soundness and market responsiveness, and would work for the GSEs as well.

During times of illiquidity, Fannie Mae's mortgage portfolio has grown to replace capital that flees the mortgage market. This happened during past real estate and liquidity crises in the 1980s, 1990s and early this decade. More recently, even though our portfolio growth is presently limited by our consent order, Fannie Mae has allocated increased investment to affordable rental housing, a market that other investors have abandoned.

We support regulation ensuring that the GSEs' mortgage portfolios are managed in a safe and sound manner. But regulation should not impose arbitrary limits, including a so-called "systemic risk" standard, on the GSEs' portfolios. Particularly when markets are

weak, the GSEs need flexibility to expand their portfolios in order to achieve their mission of providing the liquidity the markets need. Indeed, bank regulators have consistently taken the approach that asset growth, by itself, does not cause a safety and soundness risk – only unplanned or poorly managed asset growth.

I dispute the notion that our portfolio is somehow exempted from the laws of gravity, or supply and demand, or conditions in the capital markets. That is why you see month-to-month growth and contraction in the size of our portfolio. Conditions change. When they do, and it makes sense, we grow, shrink or hold our investments.

To that end, we therefore support legislation clearly identifying the bank-like safety and soundness factors that would guide regulatory oversight of our portfolio.

### **New Product Approval**

Another area that would improve and strengthen regulation is the consolidation of product approval with safety and soundness regulation. We believe our regulator should have oversight of the products and business initiatives we pursue, to make sure they are within our charter and are subject to safety and soundness controls, just like other financial institutions.

It is also important that the regulatory oversight process be efficient. Imposing a cumbersome pre-approval process or public notice and comment period would only impede our ability to serve the modern mortgage market.

A public notice and comment process would be contrary to any bank regulatory process of which we are aware. No other regulatory regime requires public disclosure of most new business initiatives.

Particularly during times of extraordinary disruption and change, like today, the GSEs must move quickly to address the pressing needs of the primary mortgage market.

HomeStay, our initiative responding to the subprime crisis that I mentioned earlier, is an example. Our customers and partners in the lending community asked for a solution, and we provided one, in a matter of days. Our regulator, of course, reviewed it, and encouraged us to move ahead.

Another example is our quick response to hurricanes Katrina and Rita. Among the many targeted initiatives were:

- Underwriting flexibilities on new loans for borrowers affected by the hurricanes.
- Servicing flexibilities with respect to existing borrowers affected by the hurricanes.
- Providing 1,500 Fannie Mae properties to families displaced by the hurricanes.

Any of these business decisions could be considered “new products.”

In this area as well, the bank regulation model offers what we believe is the best guide. Banks keep regulators apprised of new business initiatives through the examination process and by regular communication with their examiners. So should the GSEs. In

practice, banks consult their regulators routinely on significant business plans and developments without public notice and approval for every product innovation or new activity, except for a few exceptions, such as bank mergers or acquisitions. Well-capitalized, well-managed banks are able to offer new products and innovate to meet market demands without a burdensome pre-approval process. Subjecting every new initiative to a public inquiry through notice and comment periods would be unworkable for any bank. The GSEs are no different.

### **Affordable Housing**

Lastly, any new regulatory regime should reinforce the GSEs' mission to provide capital for affordable housing. Today, this responsibility is enforced by the Department of Housing and Urban Development under a complex and outdated system of goals that neither reflect the most current market data nor adapt to changing market conditions. These goals were established during a prolonged period of home price growth, and they assume that the primary mortgage lending market, which the GSEs do not control, will be able to deliver an increasing level of affordable housing mortgages steadily, through every market cycle. But the market has its own logic, as do home prices.

We support a different approach, with two key components. First, the GSEs' regulator should set and oversee streamlined affordable housing goals that reflect current market data and adapt to changing market conditions. The regulator should evaluate the totality of our results at expanding affordable housing.



Second, Fannie Mae supports the creation of an Affordable Housing Fund, to be funded from the GSEs' net income and integrated into a new affordable housing goals regime. We believe the GSEs to manage the fund in regular consultation with Congress and our regulator, including filing an annual plan and report on our efforts. We should manage the fund, and we should be held accountable for the results.

### **Conclusion**

Mr. Chairman, you've asked me to come to this hearing to express Fannie Mae's views on GSE regulatory reform. We believe H.R. 1427, which was passed by the House last year with bipartisan support, offers a sound basis upon which to build a lasting regulatory regime for Fannie Mae and Freddie Mac. The housing and mortgage markets need certainty and stability at this time, and strengthening oversight will provide an additional measure of confidence that the GSEs will be here doing our job the right way for the long run.

Thank you for the opportunity to be here today.