

Testimony of

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**On Behalf Of the
National Association of Home Builders**

**Before the
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Urban Affairs**

**Proposals for Improving the Regulation of the Housing
Government Sponsored Enterprises**

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Introduction

The 220,000 members of the National Association of Home Builders (NAHB) appreciate the opportunity to present their views to the Senate Committee on Banking, Housing and Urban Affairs on Proposals for Improving the Regulation of the Housing Government Sponsored Enterprises (GSEs) Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks). The GSEs are critical components of the nation's housing finance system and are largely responsible for the efficiency and resiliency of that system, as reflected in the tremendous advances recorded in the availability and affordability of mortgage products for home buyers and providers of rental housing. The success and value of our housing finance system has been clearly evident in recent years from both a human perspective, as demonstrated by the record homeownership rate, and from an economic perspective, with the housing sector continuing to be an engine of growth.

One of the reasons the GSE regulatory reform initiative is so challenging is because of the uniqueness of the U.S. housing finance system. This extremely efficient and liquid system is a blend of public and private components. The lynchpin is a sophisticated secondary market that facilitates the flow of credit to housing from investors in the domestic and international capital markets. The system has evolved to provide a reliable supply of housing credit at relatively low and affordable mortgage interest rates from coast-to-coast, and during rising and falling economic cycles.

The U.S. housing finance system's public-private partnership framework is particularly prominent in the secondary mortgage market arena. At the core of the secondary market are the GSEs. Fannie Mae, Freddie Mae and the Federal Home Loan Banks are private entities, each with a public mission to provide liquidity to the housing finance system and lower housing borrowing costs. Studies show that the GSEs lower mortgage rates by as much as 50 basis points, and NAHB estimates that this results in increased homeownership opportunities for approximately two million households.

To be sure, accounting scandals and corporate governance shortcomings paint a disturbing picture to those who placed their trust in these entities to serve an important public purpose. NAHB agrees that the current GSE regulatory system would benefit from renovation and enhanced supervisory powers. To that end, NAHB is pleased to assist the committee in exploring ways to improve the regulatory oversight of the GSEs to prevent similar problems, or worse, from occurring in the future.

Given the critical role of the housing GSEs in the nation's housing finance system, changes in how they are regulated could have a significant impact on that system. NAHB believes it is possible to enhance the safety and soundness of the key secondary market participants without adversely affecting the cost and availability of housing credit or diminishing affordable homeownership and rental housing opportunities. But such an outcome will not occur without careful deliberation throughout the process. NAHB commends the committee for providing extensive opportunities for discussion and debate of these important policy issues.

Although there is a myriad array of factors and ingredients to consider in the reform debate, NAHB believes the optimal approach to GSE reform incorporates four guiding principles: First, the advantages inuring to the GSEs through the public/private partnership of the housing finance system should be retained. Second, reform measures should reinforce the obligation of the GSEs to channel those advantages to the nation's home buyers and renters. Third, the most efficient and demonstrable method of accomplishing this objective is through enhanced safety and soundness regulation, stronger GSE affordable housing requirements and increased GSE competition. Fourth, there must be a balance between safety and soundness oversight and mission regulation so as not to impede the GSEs' housing mission.

The current phase of the GSE regulatory reform discussions can be effectively distilled down to six key components: (1) regulatory structure; (2) program oversight; (3) affordable housing requirements; (4) capital requirements; (5) portfolio limits; and, (6) receivership powers. The remainder of NAHB's statement addresses these components.

Regulatory Structure

An overriding issue in the GSE regulatory reform discussion is achieving the appropriate balance between safety and soundness and mission oversight in the structure and governance regime of the regulator. It is a priority for NAHB that Congress establishes a strong system for regulating the safety and soundness of the GSEs without displacing the focus on the housing mission of the GSEs.

Currently, the Department of Housing and Urban Development (HUD) oversees the mission of Fannie Mae and Freddie Mac, including approving new programs and establishing and enforcing affordable housing goals (annual mortgage purchase targets that Fannie Mae and Freddie Mac must reach). The Office of Federal Housing Enterprise Oversight (OFHEO), an independent agency within HUD, oversees the financial safety and soundness of Fannie Mae and Freddie Mac. For the FHLBanks, another independent agency, the Federal Housing Finance Board (FHFB) regulates both mission and financial safety and soundness.

Several questions have been raised as to how to better configure this oversight system. One area of inquiry with bearing on the mission/safety and soundness balance is the location and independence of the GSE regulator. An initial proposal was to house the regulator at Treasury. However, Treasury's reputation as an opponent of federal benefits for the housing sector has led almost all other parties in the debate to agree that the agency must have independence or autonomy in pursuing its regulatory duties. NAHB supports the 2004 Committee bill (S. 1508) which established a stand-alone structure outside any other cabinet or government unit. Further, NAHB supports granting the regulator the authority over Fannie Mae, Freddie Mac and the FHLBanks, as was also proposed in last year's Committee bill.

Perhaps the greatest concern for NAHB in this area is the governance of a new GSE regulatory agency. Some proposals would place control of the new regulator in the hands of a single director. These measures include an advisory board that includes the Treasury and HUD Secretaries and the Chairman of the Securities and Exchange Commission (SEC), which would

not have executive powers. NAHB opposes this approach because a regulator headed by a single individual or small board could be subject to political influence and might not exercise independent judgment. In addition, such a structure would open the door for the regulator to take actions of tremendous importance without adequate accountability for such actions.

NAHB asks the Committee to support governance by a board modeled on the Federal Deposit Insurance Corporation (FDIC), where the board seats are divided between government representatives and private individuals with appropriate regulatory expertise. In the case of the GSE regulator, the board would be made up of the Secretaries of HUD and Treasury and three private individuals, one of whom would serve as the board chair. The goal is to infuse additional expertise in and concern for housing and housing finance through the appointment of individuals with such credentials.

As an additional counterbalance between mission and safety and soundness regulatory objectives, NAHB supports the creation of deputy director positions to oversee the various regulatory elements. NAHB supports the three separate regulatory divisions contained in last year's Committee bill. One division would conduct mission oversight of Fannie Mae and Freddie Mac (including approval of new programs and enforcement of affordable housing requirements). A second division would conduct safety and soundness oversight of Fannie Mae and Freddie Mac (including establishment and enforcement of capital standards). A third and final division would oversee the regulation of the mission and financial safety and soundness of the FHLBank System. The FHLBank division should reflect the uniqueness of the system's mission, operating structure, charter type and other characteristics.

Program Approval

An important part of the mission oversight responsibilities of a GSE regulator is the review of activities to ensure conformance with a GSE's charter and public purpose. In addition to providing liquidity and lowering borrowing costs in the housing finance system, the housing-related GSEs support innovation in mortgage products and programs as well as technological improvements that address housing needs. In considering a new GSE regulatory regime, a key challenge involves developing a program review and approval process that is sufficiently rigorous to ensure charter compliance, support for achievement of affordable housing goals, and safety and soundness while facilitating the GSEs' ability to continue to engage in program, product and technological innovation to address market needs in a timely manner.

NAHB supports a strong program approval process that ensures the GSEs are operating within their charters and undertaking activities in a safe and sound manner. However, the program review process should be streamlined to foster innovation and prompt responses to market needs. To accomplish that, program oversight should focus on broad categories of programs and should not involve micromanagement of individual activities within an approved program area.

Prior approval should only be required for new "programs" that represent broad areas of "activities" and involve a range of activities not previously undertaken. New activities under previously approved programs should not require prior approval. However, the regulator should be notified in advance (30 days) before a new activity under an approved program is undertaken.

Review of previously approved programs and activities should occur only as a part of safety and soundness supervision. The regulator should be granted a reasonable, but limited period of time (45 days) for review of new programs submitted for prior approval, with latitude for an extension (an additional 15 days) if additional information is required. We support last year's Committee bill in this regard.

The key criteria in the program approval process should be whether a program is permitted under a GSE's charter and needed to facilitate achievement of mission, including affordable housing goals. Safety and soundness of new activities should be a factor only if it is determined that the nature or scope of the activity cannot be adequately addressed through risk-based capital requirements and that the proposed activity poses a significant threat to the financial health of the GSE.

NAHB opposes efforts to add language to Fannie Mae's and Freddie Mac's charters to define permissible activities. Their charters already clearly define their mission and functions. It is redundant to add language establishing a "bright line" boundary between primary and secondary market activities. More importantly, proposed bright line language such as that contained in S. 190, introduced in this congress, would be disruptive to the operation of the secondary market, stifle innovation and lead to higher mortgage costs.

The true danger of this bright line proposal is that its overly broad approach would instantaneously preclude many of the GSEs' existing secondary market products and activities that were designed solely to increase access to mortgage credit, lower the costs of homeownership and foster innovations in home financing. For example, the bright line provision would undermine state-of-the-art mortgage underwriting technology that has contributed significantly to the vibrancy, competitiveness, and risk management that are vital to the contemporary housing finance system and would curtail the development of market-driven mortgage products and programs that meet lender and homebuyer needs.

Affordable Housing Requirements

NAHB believes the housing GSEs can and should do more to accomplish their affordable housing mission. The affordable housing requirements for Fannie Mae, Freddie Mac and the FHLBanks should be strengthened to ensure a more effective and targeted transfer of GSE benefits to the housing marketplace. Such changes, however, should not be undertaken in a manner that impairs the GSEs' ability to achieve their mission of providing liquidity to the mortgage markets.

Presently, Fannie Mae and Freddie Mac are required by law to meet annual housing goals established by the Department of Housing and Urban Development (HUD). The housing goals track Fannie Mae's and Freddie Mac's purchases of mortgages for low- and moderate-income people (the low/mod goal); loans in underserved geographically targeted areas (the underserved areas goal); and, mortgages for very-low income people and neighborhoods (the special affordable goal). Each of the 12 FHLBanks is required by law to contribute at least 10% of its annual net earnings to an Affordable Housing Program (AHP). The AHP subsidizes the cost of housing for very-low-income and low- or moderate-income owner-occupied and rental housing.

The subsidy may be in the form of a grant (“direct subsidy”) or a below-market interest rate on an advance (loan) from the FHLBank to a member lender.

NAHB supports creating comparable affordable housing requirements for all GSEs by combining components of the current statutory proscriptions. That is, affordable housing requirements for Fannie Mae and Freddie Mac should be supplemented with an AHP-like percent of profits set-aside. This is consistent with the approach embodied in the Committee’s bill last year and we appreciate the Committee’s support for these provisions. We ask the Committee to again include strong affordable housing requirements in this year’s bill. Further, in order to provide parity among the mission obligations of all the housing GSEs, NAHB would expand on last year’s affordable housing provisions to require the FHLBanks to meet affordable housing goals on their mortgage purchases, contingent on providing the FHLBanks mortgages securitization authority. NAHB’s specific recommendations in these areas are outlined below.

Fannie Mae and Freddie Mac Affordable Housing Requirements

Establish a Regulatory Affordable Housing Advisory Council

NAHB recommends that the legislation provide that the GSE regulator shall establish an Affordable Housing Advisory Council to advise the regulator on developing, implementing and monitoring housing goals and set-aside requirements. NAHB believes that this council should represent a broad spectrum of housing concerns and expertise, including representatives of housing-related nonprofit and for-profit organizations and government agencies. As noted below, NAHB also recommends that Fannie Mae and Freddie Mac be directed to establish an affordable housing advisory council charged with developing, implementing and overseeing their set-aside fund programs.

Enhance the Current Affordable Housing Goals for Fannie Mae and Freddie Mac

Retain, but Clarify Current Statutory Factors: Housing goals levels should continue to be established through regulations that incorporate general statutory criteria. The current statutory criteria should be preserved, but clarified in report language to make clear that the “ability of the enterprises to lead the industry” is a conditional criterion not an absolute requirement to “lead the market.” Technically, the enterprises cannot lead the market given that they are secondary market entities and can only purchase mortgages that are originated in the primary market. However, it is possible to judge the enterprises on their *ability* to lead the industry by creating mortgage products to encourage primary market lenders to reach down further to underserved markets.

In addition, Congress should specify in the legislation that single family refinancing activity should be eliminated from the market size estimates and goals calculations. The volatility of refinancing activity has a significant impact on market size estimates and on the ability of the enterprises to meet the housing goals without disrupting the secondary market. Refinancing volume is driven by interest rate fluctuations, not by enterprise outreach activities. Removing single family refinance transactions from the market estimates and goals calculations would

eliminate these negative effects and would focus Fannie Mae's and Freddie Mac's activities directly on supporting affordable housing home purchase transactions.

Revise Statutory Income Definitions: NAHB believes that the current statutory income definitions in the affordable housing goals are too generous. Each income level should be lowered to focus Fannie Mae and Freddie Mac more directly on lower-income populations. NAHB believes that more narrowly tailored income definitions will result in more concentrated efforts by the GSEs and expand homeownership and economic opportunities to people and areas most in need. Specifically, NAHB suggests that the goals definitions should be redefined as follows:

- Change low/mod goal to a low-income goal and reduce the qualifying income percentage to 80% AMI from the current 100% AMI.
- Change special affordable goal to a very-low-income goal, deleting the 80% AMI qualifying criterion and leaving the 60% AMI ceiling.
- Codify definition of "underserved area" in statute to include only those census tracts that do not exceed 80% AMI (100% AMI in census tracts with a minority population of 30%).

Establish Mission Incentives: NAHB recommends a revision in the housing goals statute that directs the regulator to establish "mission incentives" that would give extra credit to the GSEs for developing products to reach the most difficult underserved housing markets. Such incentives would be similar to the bonus point system under HUD's 2001-2003 housing goals rule. HUD eliminated the bonus points for the current rule on the grounds that these distort the goals measurement system and are no longer needed. NAHB submits that mission incentives, such as bonus points, work and should continue as a means to direct GSE purchases toward specific market segments.

Mission incentives should be structured on a sliding scale to provide more goals credit for purchases of loans from market sectors that are more difficult to reach and less credit for less challenging loans. This would encourage Fannie Mae and Freddie Mac to expand benefits beyond the better-served markets. NAHB suggests that the following underserved market segments be identified in statute as candidates for mission incentives:

- Units serving families below 60 percent AMI, with increasing goals credit as borrower income declines.
- First-time and minority home buyers.
- Small multifamily (5-50-unit) and 2- to 4-unit owner-occupied and investor-owned rental properties.
- Rural areas, with higher credit for loans on properties that are in remote rural areas and less credit for loans in rural areas that are adjacent to highly-populated metropolitan areas, close-in suburbs or cities.
- Purchases of mortgages on new production meeting the goals definitions.

New Percent-of-Profits Set-Aside for Fannie Mae and Freddie Mac

NAHB suggests that a direct method of focusing the mission-oriented obligations of Fannie Mae and Freddie Mac is to require these GSEs to use a portion of their profits to support affordable

housing programs. This “Housing Outreach Fund” (HOF) would be a complement to the affordable housing goals obligations of the GSEs and modeled after the statutorily prescribed Affordable Housing Program (AHP) of the FHLBank System. HOF-funded activities should ultimately stimulate the affordable housing environment and produce additional goals-eligible transactions. NAHB’s specific recommendations for the HOF include:

- Fannie Mae and Freddie Mac would each establish a separate set-aside fund equal to five percent of net after-tax profits which would be available for a range of specified eligible uses. This is in contrast to the approach in the 2004 Committee bill that created two funds per GSE – a loss reserve fund for new mortgage products, and another pool for grants and subsidies – each funded with 2.5 percent of net earnings.
- To address potential volatility in net, after-tax profits, Fannie Mae’s and Freddie Mac’s set-aside obligations should be subject to a minimum statutory floor of \$100 million each.
- The statutory language establishing the fund should not be overly prescriptive so that the enterprises’ abilities to innovate and respond to market dynamics and demographic trends are preserved. The statutory language should outline broad, general principles for the regulator to consider in crafting implementing regulations. Likewise, the statutory language should instruct the regulator to establish regulatory guidelines, rather than detailed criteria, in setting the parameters of the fund.
- Uses of the fund should be open to a broad range of techniques and activities to give sufficient flexibility to Fannie Mae and Freddie Mac for the development of innovative products to meet evolving housing needs. Types of activities eligible for HOF funding should include:
 - construction or substantial rehabilitation of owner-occupied or rental housing;
 - site acquisition, demolition, improvements and other related costs of producing developed lots for affordable housing;
 - downpayment and closing cost assistance; and
 - reserves for funding affordable housing loan losses over and above loans or losses reasonably anticipated as part of Fannie Mae’s or Freddie Mac’s business profile.
- As mentioned previously, each of the GSEs should be required to convene a set-aside advisory council charged with developing a set-aside fund distribution program based on the regulatory guidelines. The program would be subject to approval by the GSE Mission Regulator with input from the regulator’s Affordable Housing Advisory Council. Advisory council members should include a representative cross-section of affordable housing industry professionals. Statutory and regulatory language establishing the parameters of advisory council membership should not establish a bias towards any specific industry segment (e.g. not-for-profit vs. for-profit).
- The advisory council would also be charged with overseeing the fund distribution process, including the system for evaluating and scoring fund applicants. Funds should be broadly distributed throughout the nation, without undue concentration in any geographic area. Distribution of funds would be on a competitive basis according to the framework established by each enterprise’s HOF Advisory Council and approved by the GSE Mission regulator. Awarding of funds would be based on a set of objective scoring criteria incorporating the range of eligible activities. Scoring criteria should emphasize housing production and providing funding opportunities that are not currently available.

Statutory language should establish parity between non-profit and for-profit housing sponsors in the competitive selection criteria.

Federal Home Loan Bank Affordable Housing Requirements

New Mortgage Purchase Goals for the FHLBanks

In order to provide parity among the mission obligations of all the housing GSEs, NAHB recommends that the FHLBanks should be subject to regulations requiring them to meet specific affordable housing goals on their mortgage purchases. The goals framework would parallel what Fannie Mae and Freddie Mac are required to do, although the establishment of mortgage purchase goals should accommodate the unique organizational and operating structure of the FHLBanks and be contingent on the establishment of FHLBank securitization authority.

Revisions to the FHLBank Affordable Housing Program

NAHB recommends revising the statute creating the Federal Home Loan Bank Affordable Housing Program (AHP) in order to remove the priority to non-profit housing sponsors in the competitive selection criteria. The exclusion of for-profit sponsors needlessly works against the AHP's goal of providing housing most efficiently in markets where the need is greatest.

Capital Requirements

Capital requirements for financial institutions establish the level of reserves that these organizations must maintain to protect against their exposure to various types of risks, including credit risk of loans and guarantees, interest rate risk of the balance sheet, and management and other operational risk. Capital requirements also limit the degree to which financial institutions can leverage their sources of funds in pursuing business opportunities. Generally, financial institutions are held to two separate capital standards: a risk-based requirement that is driven by the composition of an institution's loan portfolio and other operating characteristics, and a minimum capital requirement that ensures some capital cushion regardless of the outcome of the risk-based standard. This is the case for Fannie Mae, Freddie Mac and the FHLBanks, where risk-based and minimum capital requirements are established by law.

The Committee should be mindful that changes in the GSEs' capital requirements have a direct impact on the availability and cost of mortgages in the housing finance system. Higher capital requirements limit GSE activity, reduce the range of GSE products and programs (impairing the ability to serve low- and moderate-income borrowers) and increase the cost of mortgage borrowing. Capital requirements that exceed those dictated by the risk of GSE activities and operations unnecessarily reduce the flow of capital to the housing finance system and add unnecessarily to the cost of those funds. The result would be a major setback to current efforts to expand homeownership opportunities.

There is fairly widespread agreement that the new GSE regulator must have much greater authority to adjust capital requirements than the current regulators possess. Concepts and systems for determining risk-based capital requirements have evolved significantly since

statutory requirements for Fannie Mae and Freddie Mac were established and it is argued that the current specificity of the statute in this area makes it difficult, if not impossible, for the regulator to adopt and maintain a state-of-the-art risk-based capital framework. The most debated policy questions, however, appear to be whether the minimum capital requirements should remain unchanged in statute and what degree of authority should be granted the new regulator to adjust the minimum requirements.

NAHB agrees with the approach taken in last year's Committee bill that would give the GSE regulator full authority to establish and adjust the risk-based capital system as the state of the art evolves. NAHB supports the removal of the current statutory criteria governing risk-based capital requirements for Fannie Mae and Freddie Mac to allow the new regulator full freedom to establish and adjust such standards through regulation. Comparable authority should be granted to the regulator with regard to the risk-based capital requirements of the FHLBanks.

The minimum capital requirement is intended to function as a backstop to the risk-based system and NAHB believes the minimum standard should continue to serve that purpose. NAHB does not support the imposition of bank minimum capital requirements on the GSEs, since the portfolios of the GSEs contain primarily residential mortgage-related assets that, historically, have proven to be low-risk. NAHB also believes that the GSE capital requirements should address only risks that are internal to the GSEs, not external risks such as systemic risk in the financial sector.

NAHB supports maintaining the current statutory minimum capital requirements as in last year's Committee bill. Further, we support authority for the GSE regulator to adjust minimum capital requirements, as long as such adjustments are justified by changes in actual or perceived risk to a GSE and do not unnecessarily impair the GSEs' ability to achieve their mission. This in fact was the approach taken in last year's Committee bill. Consistent with the Committee's concern about the possible impact of capital provisions on mission, NAHB believes that capital requirements should be enhanced by providing for a process where such increases would be regularly reviewed and returned to the statutory level. This should be done once the "triggering" issue or issues are resolved. Minimum capital requirements must be temporary; let the regulator deal with longer-term risks through the risk-based system.

All changes to GSE capital – risk-based and minimum – should be undertaken through proposed regulation that provides public notice and comment, except in emergency situations, where increases could be instituted and then reevaluated in a subsequent review and comment protocol.

Portfolio Limits

Proposals to limit or reduce the portfolios of Fannie Mae and Freddie Mac are misguided and would have significant adverse effects on the housing finance system. Both Fannie Mae and Freddie Mac hold sizeable portfolios of mortgages and mortgage-backed securities, which play an important role in stabilizing the supply and reducing the cost of housing credit.

First, the portfolios support the provision of mortgage credit through instruments, such as multifamily mortgages and various homeownership loans designed for lower-income borrowers

that are not attractive to secondary market investors and, therefore, cannot be packaged and sold in mortgage-backed securities. Such products are expanding as more focus and requirements are placed on the GSEs to address the housing finance needs of more difficult to reach segments of the population.

Second, the GSE portfolios have served as an important shock absorber for housing borrowers in times of economic crisis. This is evidenced by the relative stability in mortgage availability and interest rates as other sectors of the financial markets were experiencing severe volatility in credit availability and cost during the 1998 international debt crisis and again following the 9/11 terrorist attacks in 2001. Fannie Mae and Freddie Mac stepped up their portfolio purchases to stabilize the mortgage markets in both of these periods and mortgage credit remained available at affordable rates.

Third, the added demand from Fannie Mae's and Freddie Mac's portfolio purchases helps to lower yields on mortgage-backed securities which flows through to lower rates on the underlying mortgages. Some have argued that removing Fannie Mae and Freddie Mac as buyers in this market would have no impact on mortgage borrowing costs. NAHB believes that such a position ignores the basic economic principle of supply and demand. Cutting GSE portfolio holdings by more than a trillion dollars, as some have proposed, would certainly have a major adverse impact on mortgage rates, even if the reduction were phased in over a number of years.

Finally, GSE portfolio operations have facilitated an expansion of investors in the U.S. housing markets. Foreign investors are supplying increasing amounts of capital for residential mortgages in this country through purchases of GSE debt and currently account for a significant portion of such holdings. Foreign investors are reluctant to invest in mortgage-backed securities, primarily due to unfamiliarity with fixed-rate, long-term mortgage collateral and concern over prepayment risk on such loans. The GSEs have successfully negotiated this obstacle by purchasing and holding mortgage-backed securities through funding provided by sales of their debt to foreign investors. GSE portfolio restrictions, therefore, would constitute a major setback to successful efforts to broaden the sources of capital for the U.S. housing markets.

NAHB recognizes that Fannie Mae and Freddie Mac also are able to generate profits through their portfolio operations by virtue of the spread between their advantaged borrowing costs and market yields on mortgage-backed securities. NAHB shares the concern that has been expressed that such profits are directed too extensively to GSE shareholders and executives. However, NAHB believes the best way to address this is not through restricting and shrinking GSE portfolios, as Federal Reserve Chairman Alan Greenspan and Treasury Secretary John Snow have suggested. Such actions would undercut the GSEs' ability to continue the pursuit of the valuable results outlined above. Instead, NAHB believes that the recommendations contained elsewhere in this statement to toughen GSE affordable housing requirements, including a percent-of-profits set-aside for Fannie Mae and Freddie Mac, and increased competition among GSEs, would succeed in more effectively directing GSEs' portfolio profits to mission purposes.

With regard to safety and soundness, the new regulator should hold each GSE accountable to have the strategies, systems, personnel and capital that are adequate to fully mitigate any risk associated with the holding of mortgages and mortgage-backed securities as well as other

portfolio investments. This would include the establishment of risk-based capital requirements to provide appropriate capital coverage for all portfolio-related activities. In addition, review of portfolio functions and operations should be an integral part of the regular safety and soundness examinations conducted by the regulator. Specific limits on the GSEs' portfolios therefore are overreaching and unnecessary in addressing their safety and soundness.

Receivership Powers

The powers and procedures for taking over (conservatorship) or liquidating (receivership) a financially troubled GSE are important issues within the context of reform of the regulatory oversight of the GSEs. It has been argued that the GSEs' safety and soundness regulator must have powers comparable to those of the federal banking regulators to be viewed as a credible and effective force. The authority to place a GSE in receivership has been identified as a leading item on the list of such powers.

OFHEO currently has the authority to place Fannie Mae and Freddie Mac in conservatorship, but lacks receivership powers. In other words, if circumstances become dire enough, OFHEO can order a takeover of Fannie Mae or Freddie Mac with the objective of revitalizing the GSE, but cannot liquidate the GSE.

The Federal Housing Finance Board has broad statutory authority to close, liquidate, or otherwise dispense with an individual FHLBank for any reason, although the extent of this authority appears to be limited by other statutory language that requires that there be no fewer than eight FHLBanks.

The issue of receivership powers raises questions about how the addition of such authority would affect investors' view of the GSEs and their relationship with the U.S. government. While GSE securities are not *explicitly* backed by the government, the capital markets have traditionally viewed these obligations as *implicitly* guaranteed since it is believed that the government would back up a GSE in the event of a financial problem.

Last year, some, including Standard and Poor's (S&P), speculated that giving receivership powers to the new GSE regulator would cause investors to abandon their notion of an implicit guarantee and, as a result, increase their yield requirements on GSE mortgage-backed securities and debt. In fact, such an outcome was a stated goal of some receivership proponents, including Federal Reserve Chairman Greenspan and Treasury Secretary Snow. Because of the obvious impact such a change would have in increasing mortgage borrowing costs, NAHB was a strong opponent of receivership proposals.

This year, S&P reversed its position and joined its peers in taking the position that receivership provisions will not in fact alter investors' perception of an implicit federal government guarantee on GSE obligations and, therefore, will not raise the cost of GSE borrowings or mortgage credit. As a result, NAHB has dropped its opposition to the inclusion of receivership provisions in GSE legislation. However, NAHB is extremely apprehensive and believes extreme care should be exercised in crafting such legislative language.

In particular, NAHB asks this Committee to consistently recognize the differences between GSEs and banks by crafting receivership language that reflects the GSEs' structure and operations. The provisions providing triggers for receivership action by the GSE regulator should be related to GSE characteristics and activities, and should focus primarily on situations where a GSE is critically undercapitalized. Also, the actions of the regulator should be guided by the circumstances under which a GSE encounters problems of a scale that would require the appointment of a receiver. For example, the regulator should take a much different approach if the problems are a result of a crisis in the U.S. or world economy than would be taken in response to difficulties that are internal to a GSE.

It should also be noted that, while it is true that many regulators of U.S. financial institutions possess receivership powers, a close reading of the actual statutory authority of these regulators reveals several limitations. For example, the FDIC must confer with the other banking agencies if shutting down a bank would pose a risk to the banking system. NAHB suggests that if the policy objective is to achieve parity with the oversight authority of other banking regulators, true parity entails establishing similar restrictions as well as powers on the new GSE regulator.

The bottom line is that the liquidation of a GSE would have a huge impact on the housing sector, the financial markets and the economy as well as many other domestic and international entities. Placing a housing GSE into receivership should be approached through careful and thorough consideration of those effects.

Conclusion

NAHB appreciates the opportunity to share our views on world-class regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks, the GSEs. It goes without saying that the GSEs have been and continue to be critical components of the nation's housing system; a system without equal anywhere in the world and one that contributes so much to the national economy. These entities were chartered to uphold an important public purpose and must be held accountable for actions that violate that public purpose or erode confidence in the GSEs or their mission.

NAHB is pleased to be part of the process to improve a clearly lacking oversight system, establish a world class regulator and ensure that the GSEs continue to expand housing opportunities for American families. We also believe that this process can be a success without undercutting the GSEs' housing mission if several core principles are followed. One, balance housing with safety and soundness concerns; two, maintain a smooth and steady flow of mortgage products to the market; three, focus and enhance GSE benefits to expand affordable housing opportunities; four, employ capital as a precise instrument of risk management; five, preserve GSE portfolios as tools for expanding investment in housing; and, six, tailor receivership provisions to GSE activities and mission. NAHB looks forward to working with the Congress to use these principles to achieve our mutual goals as the legislative process moves forward.