Testimony Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs
"Housing Finance Reform: Next Steps"
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Chairman Crapo, Ranking Member Brown, and distinguished members of the Committee, thank you for the invitation to appear at this morning's hearing. I can think of few issues in our financial system more in need of our attention.

Our nation's housing finance system is in urgent need of reform. The status quo poses significant risk to taxpayers, homeowners, renters, and the entire financial system.

I want to thank Secretary Mnuchin and Secretary Carson for their efforts to develop comprehensive housing finance reform plans. They lay out a responsible roadmap to build a more resilient housing finance system that protects taxpayers and mortgage access. I also thank Secretary Mnuchin for the opportunity to have offered commentary on Treasury's plan during its development.

These plans are broadly consistent with my top priorities, which are to cement FHFA as a world-class regulator and to restore Fannie Mae and Freddie Mac ("the Enterprises") to safe and sound condition by building capital to match their risk profiles. Building capital would also begin the process to end the Enterprise conservatorships, which have lasted more than 11 years, far longer than any other conservatorship.

A root cause of the 2008 financial crisis was imprudent mortgage credit risk backed by insufficient capital. This fundamental problem remains unresolved today. While borrower average credit scores have modestly improved, the Enterprises' shares of low-down-payment and high debt-to-income mortgages are back to 2004 levels. Fueling rapidly rising home prices with easy mortgage credit from under-capitalized entities is a mistake. We should not repeat it.

In their current financial condition, the Enterprises are not equipped to withstand a downturn in the housing market. The Enterprises own or guarantee a combined $5.5 trillion in single and multifamily mortgages out of a $12 trillion combined market. Yet with just $6 billion in allowable capital reserves, the Enterprises' combined leverage ratio is nearly a thousand to one.

In comparison, the nation's largest financial institutions have an average leverage ratio of roughly ten to one.[1]

The 2019 Dodd-Frank Act Stress Test (DFAST) demonstrated the consequences of inaction. In the last crisis, from the market peak in the summer of 2006 to the bottom in 2012, housing prices declined by 27 percent. The 2019 DFAST modeled a scenario where residential

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[1] See Exhibit 1 on page 4.

real estate prices decline by 25 percent. Under such conditions, the Enterprises forecasted combined total losses of $43.3 billion during the stress-test period.

Given that housing supply appears to have become more inelastic since the crisis, we should expect greater price volatility going forward.

Our housing finance system also undercuts sustainable homeownership. The Enterprises have expanded with the economy recently yet maintained risk and capital levels that ensure they will fail in a downturn. This pro-cyclical pattern harms low-income borrowers, making it easier to buy homes beyond their means when the economy is strong and harder to keep those homes when the economy is weak.

Our housing finance system is supposed to serve homeowners and renters while protecting taxpayers. Currently, it fails on both counts. The Administration's plans aim to address these problems.

Only Congress, however, can enact the structural reforms needed to fix today's broken model.

Compared to the duopoly of the Enterprises, a fair and competitive secondary mortgage market would better serve borrowers and renters and promote long-term stability by ensuring that inefficient firms do not survive and that no institution is "too big to fail." We have witnessed in one industry after another that the best guarantee for delivering lower prices to consumers is an open, competitive market, not a monopoly or duopoly.

Some argue reform should wait for a crisis. This shortsighted thinking fueled the last housing market collapse. As we learned then, it is impossible to solve complex problems in the middle of a crisis.

To paraphrase President Kennedy, the time to repair the roof is when the sun is shining. Now is the time for bold reforms because our economy and housing market are strong. This will not always be the case.

I am not forecasting a downturn. Rather, as a prudential regulator, I believe my job is to hope for the best and prepare for the worst.

Therefore, I intend, fulfilling my statutory duties, to strengthen FHFA, enable the Enterprises to build capital to match their risk profiles, and end the Enterprise conservatorships.

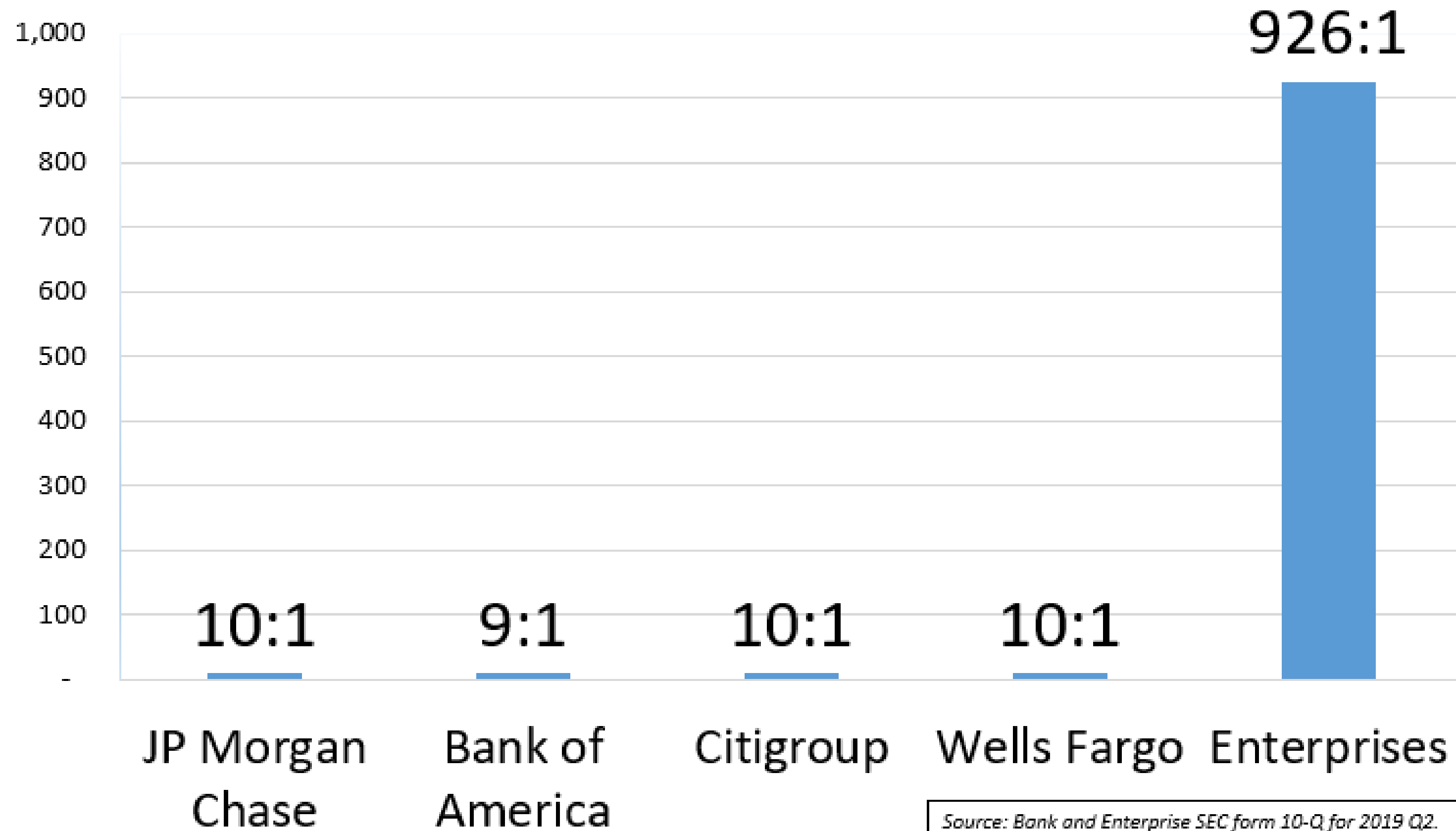
These reforms are critical to building a resilient mortgage finance system that protects taxpayers and delivers a diverse range of housing options at market-affordable prices. In the interim, modest reforms can improve FHFA's ability to do its job.

For example, in June, I asked Congress for the authority, similar to other financial regulators, to develop capital standards for the Enterprises and to charter new enterprises. This common-sense proposal need not wait for broader reform.

In far too many areas of our Nation, we face a housing affordability crisis. Too often this has been the result of misguided local land-use and building regulations. In other areas, housing supply remains limited due to a lack of construction labor. For the Enterprises to play an important role in addressing this crisis, they themselves must be fixed. Adding more weight to an already cracked foundation is to invite collapse.

Thank you again for the opportunity to testify today. I look forward to answering your questions.

Exhibit 1[2]



[2] Large U.S. banks and the Enterprises are subject to separate leverage ratio requirements that use differing components, both in terms of what each firm can use to meet its respective requirements and which balance sheet measures the requirements are based on. To provide a simplified version of the actual requirements for the purposes of comparison, this graph uses Stockholders' Equity for the banks and Total Consolidated Assets (Total Capital) for the Enterprises.