



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

NEWS RELEASE

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**STATEMENT OF
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OFFICE OF FEDERAL
HOUSING ENTERPRISE OVERSIGHT
BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS,
SECURITIES AND GOVERNMENT-SPONSORED ENTERPRISES**

Mr. Chairman, Representative Kanjorski, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss H.R. 3703, the Housing Finance Regulatory Improvement Act. The bill takes a two-track approach at improving the regulation of government sponsored enterprises (GSEs). One track is consolidating the regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks into a new independent agency. The other track makes a number of amendments to the GSEs' charters addressing safety, soundness and systemic risk issues.

Mr. Chairman, first I want to commend you for your ongoing commitment to ensuring the best possible oversight of the GSEs and reiterate my support to achieving this end. You and Representative Kanjorski have brought real leadership to GSE issues in general and I look forward to working with you and your colleagues on the full Committee to ensure the best possible oversight structure.

As you know, since OFHEO began operating in 1993, Fannie Mae and Freddie Mac have doubled in size. The Enterprises' exposure to credit risk has doubled to over \$2 trillion. The bulk of this growth has occurred in their retained portfolio of mortgages and mortgage-backed securities, which grew by over 350 percent. The amount of mortgage assets on which they manage interest rate risk now exceeds \$846 billion. The need for strong oversight is more critical now than ever before.

As Congress considers the changes you have proposed, I want to assure you that there is a very strong regulatory system already in place. OFHEO works well as the safety and soundness regulator for Fannie Mae and Freddie Mac (the Enterprises). The only shortcoming, which I will address later in my testimony, is OFHEO's lack of financial independence.

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OFHEO's top-notch examination program is an annual, comprehensive, risk-based assessment of the health and management of the Enterprises. We recently completed our 1999 examinations of the Enterprises and will be reporting our results and conclusions to their respective Boards in the near future. The results and conclusions of these examinations will also be communicated to Congress in June in OFHEO's Annual Report.

Also, as I'm sure you are aware, the comment period on our risk-based capital proposal closed on March 10 and we are currently in a "comment on comment process" that will end in April. It is my intention to move expeditiously to a final risk-based capital rule that will truly be state-of-the-art. In the end, the rule will be dynamic so that it can evolve over time to reflect new products, innovations in risk management, and new techniques for measuring risk. This will provide the Enterprises with the flexibility to operate their businesses while closely matching capital to risk.

In order to understand how changes in the market impact the Enterprises and how changes in Enterprise operations impact the market, OFHEO also conducts sound and authoritative research and analysis. The information and insights gained from our research and analysis shop helps OFHEO — and Congress — become even more proactive in its oversight of the Enterprises. This is critical given today's rapidly changing markets.

Mr. Chairman, while the current system is working well, that doesn't mean it can't be improved. Consolidation of the safety and soundness regulation of the housing GSEs could lead to even stronger oversight, if done right. However, the consolidation of mission regulation with safety and soundness regulation is not essential for OFHEO or its successor to properly fulfill its safety and soundness responsibility. Any need OFHEO may have to be aware of developments in mission regulation is satisfied through the open lines of communication that exist between OFHEO and HUD. For example, OFHEO was fully consulted on the development of HUD's affordable housing rule regarding the safety and soundness implications of the new goals.

Nor has mission regulation suffered. Secretary Cuomo and Assistant Secretary Apgar have demonstrated their strong commitment to fulfilling HUD's mission oversight responsibility. I have several general comments to make on H.R. 3703. In addition, as the bill moves forward in the process, I will be happy to provide the Subcommittee with whatever technical assistance it needs.

Strong and Independent Safety and Soundness Oversight

The structure and authorities of the regulator created under H.R. 3703 would maintain and, in some ways, even improve the existing strong and independent regulatory framework for safety and soundness oversight of Fannie Mae and Freddie Mac. This is even more important, given the continued rapid growth of the Enterprises.

I am fully supportive of increasing the transparency of the Enterprises' operations to the public. More disclosure would serve to increase the efficiency of the secondary mortgage market. In addition, more complete and timely disclosure about the Enterprises' activities and risk exposures would also help to strengthen the ability of the market to better evaluate and price the Enterprises' securities.

OFHEO already contributes to this process by disclosing the results and conclusions of our comprehensive risk-based examinations. And while I recognize the need to protect proprietary Enterprise data from public disclosure, OFHEO will be looking for additional ways to increase the public's understanding of the Enterprises' activities and risk exposures.

Consistent with this approach, the bill would require the regulator to obtain annual credit ratings for the Enterprises from nationally recognized statistical rating organizations. OFHEO exercised its existing authority to obtain such a rating in 1996. With adequate funding, regular updates of this type would provide more information to investors about the Enterprises' financial condition and would provide an additional source of information about the Enterprises' financial condition to the regulator.

The bill also reflects prudent public policy by providing for the appointment of a receiver for a GSE under certain circumstances, which is an important option for a regulator and one that does not exist in current law. Under some dire circumstances, receivership may be the most cost-effective and efficient resolution of an Enterprise's problems. Furthermore, the absence of such provisions serves to weaken market discipline by reinforcing the market's conviction that Enterprise securities are implicitly guaranteed by the government.

Finally, I am fully supportive of a transparent regulator. The regulator should report on all of its actions to Congress and to the public, and should be held accountable for its actions. Having comprehensive reporting requirements provides a means for Congress to have effective oversight of the regulator's activities. It also provides meaningful discipline to the regulator in the execution of its oversight responsibilities.

Now I would like to address the regulatory structure contained in the bill.

Board Structure

The bill consolidates the current safety and soundness and mission regulatory responsibilities of OFHEO, HUD, and the Federal Housing Finance Board into a new, independent agency. The new agency will be managed by a five-member Board comprised of a Chairman, two full-time Directors, and the Secretaries of Treasury and HUD.

Mr. Chairman, I believe that a single agency head is preferable to a Board. It is not unprecedented for independent agencies to be headed by a single individual. There are many examples of this structure, including the National Aeronautics and Space Administration (NASA) and the Environmental Protection Agency (EPA). This structure has proven to be effective and efficient.

First, a single agency head focuses accountability on one individual, rather than diffusing accountability among numerous Board members. Second, a single agency head unifies day-to-day management of the agency in one person, which avoids the confusion, dissension, and gridlock often associated with Boards. Also, a single agency head allows the agency to move nimbly in reacting to the risks of the companies it regulates.

Transition and Effective Date

Whatever Congress decides on the final structure of the new agency, I know you will agree that the bill should do everything possible to ensure success of the new agency.

To that end, I strongly believe that the bill's transition period needs amending. First, the 9-month period is far too short. Also, under the bill, until at least two members of the new Board are confirmed, authority is vested jointly in Treasury and HUD. This seems inconsistent with the intent of providing further independence.

I recommend that the bill include a longer, more practical transition period. During this transition period, the duties and functions of the existing agencies would be combined into one agency, allowing the integration of the agencies before the new agency assumes responsibility. This is especially crucial if the new agency is set up under a Board structure, because it would allow the new Board to inherit a fully integrated agency, rather than having to grapple with integration while also learning how to work together.

A longer transition period will also allow OFHEO and the Federal Housing Finance Board to conclude the major regulations which are already in process.

Finally, this longer transition would accommodate a more orderly merging of the technological and regulatory infrastructures of the three current agencies.

Agency Funding

Mr. Chairman, as you know, we share a view that safety and soundness regulators need to be free of the uncertainty of the annual appropriations process and have the flexibility to set resources in response to any rapid changes in the GSEs or the market. That is why I wholeheartedly and enthusiastically support the bill's funding mechanism.

I feel very strongly that the current situation of subjecting OFHEO to the appropriations process is bad public policy. That is why I have asked Congress to remove OFHEO from the annual process. This would put us on par with other safety and soundness regulators such as the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Housing Finance Board, the Federal Reserve Board and the National Credit Union Administration.

I want to be clear that this change would in no way remove OFHEO from appropriate congressional oversight. OFHEO would continue to be subject to the oversight of this Committee and would still have to meet all annual statutory reporting requirements. Removing OFHEO would simply provide me with the flexibility I need to respond quickly to changing conditions, especially a deteriorating one, of the Enterprises or the market.

I want to thank you for your support of our previous budget requests. I also want to thank you for taking the lead on the appropriations issue. I hope that our combined efforts will achieve this goal this session.

Conclusion

Mr. Chairman, I want to thank you again for the opportunity to testify this morning. As I stated in my testimony, the current regulatory system is working well, but that does not mean that improvements can't be made. I am committed to working with Congress to ensure that the system for regulating the GSEs is as strong as possible.

The following footnote appeared on the front page of the original testimony:

The views expressed herein are my own and do not necessarily represent the views of the Secretary of Housing and Urban Development or the President. The Office of Federal Housing Enterprise Oversight (OFHEO) is an independent office within the Department of Housing and Urban Development (HUD) charged with ensuring the safety and soundness of Fannie Mae and Freddie Mac (the Enterprises).