CQ Transcriptswire
Sep 15, 2010 15:01

HOUSE-HRG-GSES -00

HOUSE COMMITTEE ON FINANCIAL SERVICES, SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT-SPONSORED ENTERPRISES HOLDS A HEARING ON THE FUTURE OF HOUSING FINANCE

SEPTEMBER 15, 2010

SPEAKERS: REP. PAUL E. KANJORSKI, D-PA. CHAIRMAN REP. GARY L. ACKERMAN, D-N.Y. REP. BRAD SHERMAN, D-CALIF. REP. MICHAEL E. CAPUANO, D-MASS. REP. RUBEN HINOJOSA, D-TEXAS REP. CAROLYN MCCARTHY, D-N.Y. REP. JOE BACA, D-CALIF. REP. STEPHEN F. LYNCH, D-MASS. REP. BRAD MILLER, D-N.C. REP. DAVID SCOTT, D-GA. REP. NYDIA M. VELAZQUEZ, D-N.Y. REP. CAROLYN B. MALONEY, D-N.Y. REP. MELISSA BEAN, D-ILL. REP. GWEN MOORE, D-WIS. REP. PAUL W. HODES, D-N.H. REP. RON KLEIN, D-FLA. REP. ED PERLMUTTER, D-COLO. REP. JOE DONNELLY, D-IND. REP. ANDRE CARSON, D-IND. REP. JACKIE SPEIER, D-CALIF. REP. TRAVIS CHILDERS, D-MISS. REP. CHARLIE WILSON, D-OHIO REP. BILL FOSTER, D-ILL. REP. WALT MINNICK, D-IDAHO REP. JOHN ADLER, D-N.J. REP. MARY JO KILROY, D-OHIO REP. SUZANNE KOSMAS, D-FLA. REP. ALAN GRAYSON, D-FLA. REP. JIM HIMES, D-CONN. REP. GARY PETERS, D-MICH. REP. BARNEY FRANK, D-MASS. EX OFFICIO

REP. SCOTT GARRETT, R-N.J. RANKING MEMBER REP. JEB HENSARLING, R-TEXAS REP. TOM PRICE, R-GA. REP. MICHAEL N. CASTLE, R-DEL. REP. PETER T. KING, R-N.Y. REP. FRANK D. LUCAS, R-OKLA. REP. DONALD MANZULLO, R-ILL. REP. ED ROYCE, R-CALIF. REP. JUDY BIGGERT, R-ILL. REP. SHELLEY MOORE CAPITO, R-W.VA. REP. ADAM H. PUTNAM, R-FLA. REP. J. GRESHAM BARRETT, R-S.C. REP. JIM GERLACH, R-PA. REP. JOHN CAMPBELL, R-CALIF. REP. MICHELE BACHMANN, R-MINN. REP. THADDEUS MCCOTTER, R-MICH. REP. RANDY NEUGEBAUER, R-TEXAS REP. KEVIN MCCARTHY, R-CALIF. REP. BILL POSEY, R-FLA. REP. LYNN JENKINS, R-KAN. REP. SPENCER BACHUS, R-ALA. EX OFFICIO

REP. DENNIS MOORE, D-KAN.

WITNESSES: MICHAEL S. BARR, ASSISTANT SECRETARY, FINANCIAL INSTITUTIONS, TREASURY DEPARTMENT

EDWARD DEMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY

[*] (JOINED IN PROGRESS) KANJORSKI: ... capital markets, insurance, and government- sponsored enterprise will come to order.

Without objection all members' opening statements will be part of the record.

Pursuant to committee rules and prior discussions with the ranking member, each side will have 15 minutes for opening statements. Without objection all members' opening statements will be made part of the record.

I yield to myself five minutes.

Good morning. We meet today to focus on many strategies that Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency, and the Treasury Department have employed (inaudible).

This hearing is also the sixth in a series that we have so far convened in Congress to examine the future of housing finance.

(inaudible) years have passed since the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship under the procedures of the Housing and Economic Recovery Act of 2008.

At the request of then-Secretary -- Treasury Secretary Henry Paulson (inaudible) also provided the Treasury Department with emergency liquidity powers to support the (inaudible).

To stabilize the United States housing markets, the Treasury Department has to date purchased or announced plans to buy just under $150 billion in the senior preferred stock of the enterprises combined.

Moreover, according to a June report issued by the Federal Housing Finance Agency, the Treasury Department and the Federal Reserve have together purchased $1.36 trillion in the mortgage-backed securities of the two institutions.

At this hearing we will explore the many approaches used to protect taxpayers and limit the losses of Fannie Mae and Freddie Mac.

For example, in July the Federal Housing Finance Agency issued 64 subpoenas seeking documents related to private label securities in which the two enterprises invested to determine if issuers of these securities are liable for enterprise losses. Fannie Mae and Freddie Mac have also begun forcing underwriters of delinquent mortgages purchased or guaranteed by the enterprises to buy back the faulty loans if the loans violated the representations and warrants provided at the time of sale.

As a result, the four largest commercial banks have already incurred losses of $9.8 billion on the loans they have repurchased or expect to repurchase from Fannie Mae and Freddie Mac.

During the height of the housing bubble many players in our financial markets trusted what they buy (ph), but they did not verify that the loans lived up to the promises contained in representations and warrants (ph).

During the height of the Cold War, however, Ronald Reagan taught (inaudible) us better. For the housing finance system to regain its footing, we need the players in the market not only to trust, but also to verify. Any new housing finance system must do both.

While the enterprises, their regulators and the Treasury Department have acted to limit the losses of Fannie Mae and Freddie Mac in the aforementioned ways and through several other methods, we must also consider what more can and should be done to protect taxpayers both now, and going forward.

In particular, we must begin to think about approaches for recouping the taxpayers' money in the long run.

We found a way to pay for the savings and loan crisis, and we can surely find a way to recover the cost associated with this crisis.

Some of my colleagues may try to use today's hearing as an opportunity for political grandstanding. They, however, need to remember that people who live in glass houses should not cast stones.

KANJORSKI: Under the leadership of former Chairman Mike Oxley, we tried for several years to enact bipartisan legislation to improve the regulation and activities of Fannie Mae and Freddie Mac.

Unfortunately, many Republicans in Congress and officials in the Bush administration blocked these efforts. Their delays allowed the housing crisis to fester into an ulcer.

As we now consider the future of housing finance, we have a chance to proceed differently. The Dodd-Frank Wall Street Reform and Consumer Protection Act has already laid the foundation for change by adjusting securitization rules, better regulating rating agencies, modifying appraisal practices, and standardizing mortgage underwriting.

The adoption of these process reforms should simplify the debates about altering the housing finance system.

In sum, today's hearing brings us one step closer to figuring out what needs to be done to improve our housing finance system. As we previously said, my goals in these debates are to limit taxpayers' risks and to establish a more stable long-term funding source to help hard-working responsible middle-class American families to buy a home with an affordable mortgage.

I look forward to hearing the perspectives of our distinguished witnesses on these matters.

I would like to recognize the ranking member, Mr. Garrett, for four minutes for his opening statement.

Mr. Garrett?

GARRETT: Thank you.

Thank you, Chairman Kanjorski, for holding this very important hearing.

You know, when you review all of the material that's before us in preparation for the hearing, you could probably hold a GSE oversight hearing about once a month and still have enough important issues to deal with. I'm sure the director would agree with that.

You know, the current state and future of mortgage finance has really been a hot topic, continues to be a hot topic for the Financial Service Committee. And we're holding several hearings over the next several weeks to look at the current state of housing finance situation and discuss ideas on how to structure the market in the future.

When you think about it, unfortunately I believe the focus is happening much later than it really should be. It really should have been happening -- what? -- about two years ago, since Fannie and Freddie were put into conservatorship. And finally, now we're getting to formally and seriously look at the way to reshape that market.

Without the financial regulatory reform to date, my Republican colleagues and I continuously looked for opportunities to end the bailouts so that Fannie and Freddie wind down their businesses and accurately account for their losses to the American taxpayers.

But at each hearing, if you remember, when we did those amendments and such, the majority party and the White House have prevented those efforts from moving forward. So to my colleagues, including Chairman Frank, who had said specifically, and I quote, "There is no urgency. We've already abolished Fannie and Freddie" -- well, may I remind him, that just because you say something enough times doesn't actually mean that it's true.

Just because Fannie and Freddie have been into conservatorship that doesn't mean that they've been reformed. Fannie and Freddie are continuing to hemorrhage billions of dollars each and every quarter.

With the possibility now of a double-dip recession and further value declines in homes, really there's no end in sight.

So Fannie and Freddie have not been reformed. Rather, they're being used essentially as an experimental guinea pig, if you will, for the administration's home modifications programs.

Also, I've seen a quote by Chairman Frank when he said, quote, "The money is not being lost by anything that we're doing right now." Well, in '04 and '05, when this committee was pushing ahead to institute new regulatory oversight over these companies, supporters of these entities, including Chairman Frank, said, "All this was unnecessary then, because they were in such terrific shape." Well, we see where that led us.

So to say that Fannie and Freddie have already been reformed and everything is fine now, is really just making the same excuses that they made before, and the same mistakes as well.

You know, as any expert in the mortgage business will tell you, mortgage loans typically hit their peak default rates -- when? At five to seven years. So the loans written by Fannie and Freddie during '09 and this year, they're only one or two years old. So we have absolutely no idea what the market will be like in three, four or five years from now.

So we need to take concrete steps right now to reduce the ongoing financial risk that Fannie and Freddie pose to the American taxpayer.

And one of these steps is to more rapidly increase the wind-down of these entities' retained portfolio. Fannie and Freddie's combined portfolio is $1.6 trillion. With the current market demand for GSEs MBSs, there is absolutely no plausible reason they have to be this size. If they're so large, there's a significant amount of interest rate risk that continuously has to be hedged. And as the interest rates sometimes rise in the future, the hedging of these assets will become even more complicated and volatile and harder to manage.

So with the current market situation and the appetite for the GSEs MBSs, we should be requiring the entities right now to reduce their portfolio size and do it soon to reduce the risk before interest rates inevitably will rise, and when the conservator can actually make more money back for the taxpayer.

One closing note to the director. I thought it was a thoughtful decision that you made to shut down the PACE program during the summer. This was a scheme that was putting the taxpayer at further risk, while only really benefiting a few tax security firms that were offering these products.

Now we must need to make more hard decisions, as you did then, to protect the taxpayers and wind down the entities' portfolios in a more responsive manner, and finally abolish these two companies.

Thank you.

KANJORSKI: Thank you, Mr. Garrett.

Now we hear from the chairman of the full committee, the gentleman from Massachusetts, Mr. Frank, for five minutes.

FRANK: Mr. Chairman, I regret the fact that the ranking member has decided to continue a political debate, but if he was going to do it, I wish it had been done more fully.

Obviously, we have a problem here, because Fannie and Freddie bought loans that shouldn't have been made in the first place.

The point, though, is that beginning in the period that the gentleman from New Jersey alluded to in part, members of this committee, led by the gentleman from North Carolina, Mr. Miller, and the gentleman from North Carolina, Mr. Watt, tried to outlaw those loans. Congress had in fact previously asked the Federal Reserve to do that. They hadn't done it.

So in 2007, which was the first year in which we were in the majority, we did pass a bill in that year to prevent the kind of predatory loans from being made that Fannie and Freddie were buying.

And here's what the gentleman from New Jersey, Mr. Garrett, had to say in the committee vote on that bill to ban predatory loans: "The increasing availability and affordability of subprime mortgage credit is and has been an important factor leading to the increase in homeownership in recent years. This bill" -- the bill to restrict predatory lending -- "may well limit now the products available to subprime borrowers, particularly minority borrowers, and will deprive many of those consumers from owning or maintaining a home.

"What we need to do is to ensure that it does absolutely nothing to homeownership, particularly among minority communities who have benefited from the innovations that have occurred in the marketplace."

That is a song of praise to predatory loans which we tried to stop. And had loans not been made, they could not have been bought.

In fact, the gentleman was also incorrect when he said in 2004 and 2005 when Republicans were trying to restrain Fannie Mae and Freddie Mac, some of us were on the other side.

No, exactly the opposite is the case. In 2003, I said I didn't think Fannie Mae and Freddie Mac were in trouble. In 2004, when President Bush ordered them to go beyond 50 percent in the number of loans that they bought from people below median income -- the kind of loans the gentleman from New Jersey was defending when we tried to outlaw them -- I changed my opinion. I thought this was dangerous.

In 2005, Michael Oxley, the Republican chairman of the committee, put a bill through this committee to restrain Fannie Mae and Freddie Mac. I actually voted for it in committee -- many of my -- a couple of my Republican colleagues voted against it. I later found problems with an unrelated aspect of housing.

But the fact is that Mr. Oxley passed the bill through the House which he thought would restrain Fannie Mae and Freddie Mac, and the Republicans in the Senate and the Bush administration and some on this committee didn't like the bill.

So I have never heard a more inaccurate characterization.

And when the gentleman from New Jersey said, when Republicans were trying to get something through, we opposed it.

No. The Republican majority of this committee and the Republican majority of this House -- the gentleman from Texas, Mr. Neugebauer, supported it, the gentleman from Alabama, Mr. Bachus, supported it -- they put through the bill. We didn't stop them. They had a lot of cooperation. The gentleman from New Jersey didn't like the bill.

But this argument that the Democrats stopped it is just absolutely the opposite of the truth in 2004 and 2005. That broke down.

As Secretary of the Treasury Paulson points out in his book -- he became secretary of the Treasury in 2006 -- some in the Bush administration had given up on trying to reform Fannie and Freddie politically. He said no, he wanted to work (inaudible).

He approached me, and as he said in the book, we worked together. And when in the year 2006 the majority switched and 2007 came, this majority passed a tougher Fannie and Freddie regulatory bill in 2007 than the Republicans had passed in 2005. Things had moved beyond that. And then in 2008, when the Senate caught up to us, which they sometimes do, Secretary Paulson put them in a conservatorship.

So yes, we have changed Fannie and Freddie. The Fannie and Freddie that have existed since Hank Paulson used the authority a Democratic Congress gave him, at his request, to put them into conservatorship, has been very different.

And yes, the PACE loans has -- have been a source controversy. And many people -- the governor of California, the Republican governor of California, the Democratic attorney general of California -- are suing Fannie and Freddie because they're being too tough.

FRANK: Joe Nocera in the New York Times had a column criticizing Fannie and Freddie because they are insisting on too high a level of credit score before they give loans.

The fact is undeniable. Fannie and Freddie, once they were put in a conservatorship, are very different. And that's why I say there was no urgency. There was no urgency because the pattern of abuse that they had been engaged in has changed.

It's also the case that over the objective of gentleman from New Jersey and others, we outlawed, finally in 2010, in the financial reform bill the kind of predatory loans that were getting people in trouble which the gentleman from New Jersey was so fond of, and a few others on his side.

And the Wall Street Journal, when we did finally pass the bill in the House to restrict subprime predatory loans, called it a "Sarbanes- Oxley for housing." And Sarbanes-Oxley is, of course, as nasty a set of words (inaudible) get from the Wall Street Journal.

So let's get back to where we are. Fannie and Freddie are behaving differently and are causing far less problems thanks to the action of the Democratic majority in Congress that gave the Republican administration the power to do conservatorship. There was bipartisanship there, and let's continue it.

KANJORSKI: Thank you, Mr. Frank.

And now, we'll hear from the gentleman from Alabama, Mr. Bachus.

BACHUS: Thank you.

I think we want to yield first to...

KANJORSKI: OK. We have a passover here to Mr. Neugebauer for 10 minutes.

NEUGEBAUER: Thank you, Mr. Chairman.

And I'll yield a few minutes to -- seconds to the distinguished ranking member...

(CROSSTALK)

GARRETT: So the gentleman just yield 10 seconds for me to respond to the chairman. It is odd that I am now put in the position, as I often am, to actually be (inaudible) member to defending minority interests. And that's exactly what that quote was doing, as you said (inaudible) in '04 and '05. I was defending the rights of minorities and the minority housing interest.

And I would like to enter into the record a letter of June 28th, '04, signed by 70 Republicans addressing that issue (inaudible) signed by 70 Democrats written to President George Bush which would have weakened those same (inaudible) regulations that the president -- that the ranking member -- or the chairman was talking about. Those were -- those regulations would've weakened the affordable housing standards that the chairman was talking about that they were trying to do at that period of time.

(UNKNOWN): (inaudible) objections?

KANJORSKI: Without objection so ordered.

Is there objections?

(UNKNOWN): No objections.

KANJORSKI: So ordered.

And now, the shortest 10 minutes in the world just yield (inaudible) allows 56 minutes (inaudible).

NEUGEBAUER: Thank you, Mr. Chairman.

And, you know -- two years and $148 billion later, we still have Freddie and Fannie basically operating like they were before -- maybe with a little bit better underwriting -- and that's a good thing.

But the bottom line is, is the taxpayers are still on the hook for these mortgages that are being originated today. And quite honestly one of the problems with that is that as long as we continue with Freddie and Fannie operating where they're primary guaranteeing these single-family mortgages -- which, by the way, is -- accounts for about 75 percent of the losses that they've sustained, this particular book of business -- we really don't -- are not going to see any private activity in the mortgage market at all.

And so I think what many of us feel like is two years, it's time to begin to do a model to wind this activity down, get the taxpayers off the hook, and to move in the direction that we will be able to encourage private activity in the mortgage market.

But quite honestly as long as Freddie and Fannie are the majority of the originations and the taxpayers pick up the tab, there's really no incentive for us to do that.

And Mr. Chairman and Ranking Member, I think it's time for this committee and this Congress to get the taxpayers off the hook and to get the -- a robust sustainable mortgage market that doesn't depend on the taxpayers to bail them out.

KANJORSKI: Thank you very much, Mr. Neugebauer. And now we'll hear for three minutes from the gentleman from Alabama, Mr. Bachus.

BACHUS: Thank you, Mr. Chairman.

You know, Mr. Chairman, I say to you and to Chairman Frank, I think it's time for President Obama to quit blaming President Bush for all the problems that are confronting us today.

And I really think it's time that Chairman Frank, for you and the Democrats to quit saying that some Republicans went along with you in watering down these affordable housing and underwriting standards.

You know, the American people aren't concerned with the history of how this happened. They're concerned with taking action now to see that it doesn't happen again.

And for two years now, Fannie and Freddie have been controlled by the federal government. They own 79.9 percent of those corporations. The only reason they don't own 80 percent is if they owned 80 percent, one-tenth of 1 percent, they'd have to be put on the federal -- on the books of the federal government. So they're just one-tenth of a 1 percent from there.

Now, we have released detailed proposals on what we want to do with Fannie and Freddie, and that's put them in receivership. They shouldn't be in conservatorship. No other corporation would be. They are failed corporations. We don't need to -- they're not too big to fail. There ought to be an orderly wind-down. They ought to be in receivership.

That would -- that would solve a lot of the uncertainty. The mortgage bankers have urged the administration to resolve with uncertainty, and the housing market needs it.

We in the Dodd-Frank bill pushed for something very reasonable, and that was for downpayments for loans. That's not a very outrageous proposal. That's simply Fannie and Freddie quit approving or buying mortgages without a downpayment and without good credit history.

Not only did the majority party reject our attempts to simply say in Dodd-Frank that you have to have a downpayment and you have to have a good credit history, they went beyond that. And the administration in Fannie and Freddie have actually now started this Affordable Advantage program, mortgage program that actually doesn't require downpayment and you don't have to have good credit history.

So we're laying the seeds for the next bubble. We're -- we're laying the seeds for the next failure.

Assistant Secretary, you know, in all respect, y'all have really done nothing but plan to do things. There's no proposals on the table. You've done nothing. You seem to be content, the administration, with doing nothing except for having progress hearings. Well, there's not been any progress. There have been planning sessions and -- but there has been no action taken. And you've got 10 percent unemployment. You've got 30 percent home price depreciation. And you've got these bailouts. And you're continuing -- what probably bothers me worse than anything, and I think the American people, we continue to make guarantees presently that taxpayers will have to meet in the future.

And it's time that we quit the slow walking and we started doing things. Well, this should be a legislative hearing, not another planning session.

And I've asked permission that my full statement be included in the record.

KANJORSKI: (OFF-MIKE) the opportunity to hear from our witnesses.

Next, the gentleman from California, Mr. Sherman, is recognized for three minutes.

SHERMAN: Thank you, Mr. Chairman.

Three points: First, we need to make -- to stabilize home prices and make sure they're stable.

If we see another precipitous drop in home prices even in some key markets, that could create a double-dip recession.

Key to that is extending the $729,750 limit in the roughly one dozen most expensive housing markets in the country. If we allow this to expire at the end of the year, it will be impossible to finance homes in most parts of Los Angeles and other -- and certain other major cities.

And even in areas where homes sell for less, if in the middle- class neighborhoods the price drops precipitously than in the working- class neighborhoods prices will drop precipitously as well and we will see a double-dip recession.

I hope that we get even more than the 74 co-sponsors we have for H.R. 2483, which I introduced along with Gary Miller, a fine Republican member from California.

Second, I want to commend Mr. DeMarco for his agency's efforts against these Wall Street transfer fees. These provisions indeed say that every time the property is transferred, somebody on Wall Street gets 1 percent of the gross purchase price. That undercuts the security of the lender. It disadvantages the homebuyer. It complicates the transaction. And it lowers comps for the entire neighborhood, thus impairing the value of the substantial investment that the federal government has in home prices nationwide.

SHERMAN: Finally, to set the record straight, I think the Chairman was eloquent in talking about H.R. 1461 which we passed in 2005. But the former chairman of this committee might've been even more eloquent in his article, which I would like to put in the record, without objection, of September 9th in the Financial Times.

He was quoted as describing that bill which we passed in May 2005, which would have prevented this bubble from occurring. And what did the -- Chairman Oxley said? "All the hand-wringing and bed-wetting is -- is going on without remembering that the House stepped up. What did we get from the Bush White House? We got a one-finger salute."

Mr. Oxley did not specify which finger, but he did make it clear that it was the Republican opposition in the Senate and the White House that prevented us from nipping this crisis in the bud by stopping it in 2005. And had we done so, in the opinion of Chairman Oxley, and I believe Chairman Frank as well, we would be in much better shape.

FRANK: Will the gentleman yield (ph)?

SHERMAN: I will yield.

FRANK: The chairman, I think, did make it clear that it was not a thumbs-up. He didn't say which finger it was, but he did say which finger it wasn't.

SHERMAN: It was clearly a finger, not a thumb. I yield back.

KANJORSKI: The gentleman's time has expired.

And we'll now recognize the gentleman from California, Mr. Royce, for two minutes.

Oh, he's gone?

OK. We'll recognize the gentlelady from Illinois, Ms. Biggert, for two minutes.

BIGGERT: Thank you, Mr. Chairman.

I think we put where's the plan, when will this administration or Congress wind down and put an end to these, what we could call Frankenstein-like mortgage giants, Fannie and Freddie. Fannie and Freddie edged out the private sector over a period of years. In September 2008 these GSEs entered into conservatorship (ph). Explicitly backed by taxpayers, the GSEs have received over $150 billion in taxpayer-backed funds, and are a significant taxpayer liability upwards of $6 million -- $6 trillion.

According to The Wall Street Journal, the GSEs were twice as leveraged as Bear Sterns.

In addition, aside from the regulator, the FHFA which runs them, Fannie and Freddie have no independent watchdog, no inspector general reviewing their activities and the many questionable actions of the -- of the GSEs that are directed by FHFA.

The Senate leadership should, without further delay, schedule a vote on approving a nomination of Steve Linick (ph) to be the FHA -- FHFA inspector general.

For the GSEs, we need transparency and accountability to end the bailouts and have reforms. We've needed this for a long time. The questions remain: Why were there no substantive provisions to address the GSEs included in the Dodd-Frank Act? When will the GSEs be addressed? What's the plan?

Look forward to hearing from the witnesses, and yield back.

KANJORSKI: Thank the gentleman -- gentlelady from Illinois.

And now we'll hear from the gentleman from North Carolina, Mr. Miller, for two minutes.

MILLER: Thank you, Mr. Chairman.

I agree, we need to think about a plan. We've got to reinvent our mortgage lending system.

And since there are something like $12 trillion to $14 trillion in outstanding mortgage debt right now, that's not a small -- a small matter. But it would be very helpful in knowing how to fix what went wrong to figure out what it was that went wrong. And it's particularly hard to take Republicans complaining about Democrats trying to place blame, because all I have heard from Republicans for two years is how this was somehow the Democrats' fault.

We had a financial crisis that happened seven years, eight months into a Republican administration because of mortgages made during 2004 and 2006, when Republicans were also in the majority in Congress.

And I know that the Republican ministry of information has hit upon Fannie and Freddie as the culprits in all this. But when Dick Fuld sat at that seat, and the Lehman Brothers bankruptcy appears to be what most immediately precipitated the crisis, I asked him, how -- after having heard several Republicans somehow work Fannie and Freddie into the conversation, ask him how in the world did Fannie and Freddie cause Lehman Brothers to go bankrupt? And the answer, of course, is he could not come up with any role that Fannie and Freddie played at all.

In fact, Fannie and Freddie was losing market share throughout that period through private label securitizers, the investment banks in New York. And all Republican criticisms of Fannie and Freddie were parroting all the criticisms of their competitors, who were not looking to have a more honest mortgage lending market. They were looking to make more money, and they were already making -- and they were making more money than God.

Thank you.

KANJORSKI: Thank you, Mr. Miller.

And we have two reservations, but I suspect it's neither Mr. Royce or Mr. Hensarling will appear. Is that correct? OK.

Well...

BACHUS: How much time do we have remaining on our side?

KANJORSKI: You have four minutes.

BACHUS: I'd like to claim that time.

KANJORSKI: The gentleman from Alabama wants to claim four minutes, and we think he should be allowed to claim the four minutes, and will so recognize.

BACHUS: Thank you. I appreciate that.

Secretary Barr -- and this is not a question -- but I note that you say, here private gains will no longer be subsidized by public losses. And that's what's happened in the past. I think you have acknowledged that.

But if the government is going to make guarantees, if the government is going to buy mortgages, and those mortgages fail, then there will be public losses. So I know your statement that you released last night says that -- but (ph) also if those capital and underwriting standards will be appropriate. And I -- they certainly need to be. I think that's a given. I think we would 100 percent agree with that.

But I am disturbed that we've had programs like Affordable Advantage, along with the state financing authority, but there's no downpayment required, and there is a -- good credit history is not required. In fact, people are getting those without any downpayment.

And I was on CNBC this morning, and Wilbur Ross, who was a guest, said, "You know, when you -- when you have no downpayment because of your closing costs and the realtor fees, you start 6 percent under water. You can't sell that -- can't turn around and sell that house for the same amount."

So if housing prices go down -- and who knows whether they will or not -- you're actually, in my mind, you're creating more mortgages that taxpayers may one day have to pick up. And I think that's something I'd like to hear.

You say excessive risk taking will be restrained. You know, I don't see that happening right now. When Republicans -- and I think the administration resisted our attempt to say that -- that if you -- if you have mortgages, you're going to have to have a downpayment or you have -- you need a good credit history at least if the government is going to stand behind them.

And finally, I'd say, you know, there's been a debate. I noticed that some of the statements out of the administration are whether or not there ought to be an explicit government guarantee or an implied government guarantee, whether it needs to be implied or explicit.

You know, I would say to you there's another option, and that's that taxpayers shouldn't guarantee any of it. I think the forgotten man here -- and Roosevelt used the term "forgotten man" -- I think the forgotten man is the taxpayer. I think we're all forgetting about the taxpayer.

As long as Fannie Mae and Freddie Mac exist as a government agency, you're going to have the risk of taxpayer subsidies, and you're going to be subsidizing those who get those mortgages or those mortgage guarantees by people who rent, by people who don't have a mortgage, or people who have a conventional mortgage that's not backed by the government.

And I think it's -- it's time for the government to get out of that business. As long as the government is in the business, they subsidize the business, that crowds out private investment and private capital. We've basically eliminated the private mortgage market by having a government guarantee. The government can, because of that, knowing the taxpayer stands behind it, the cost of capital for the government will be less.

And we have seen that Fannie and Freddie have been operated on many occasions as an extension of a (inaudible) social or public policy to allow people to own homes at less than -- than what the true cost would be.

And, finally, I would say who bails out the government? If the government has to bail out Fannie and Freddie, who bails out the government?

We just can't continue to rescue -- be in the rescue business or the lifeguard business. That's just not something -- I think the people are speaking out. In every election, they're saying...

KANJORSKI: The gentleman...

(CROSSTALK)

BACHUS: ... get the government out of my pocketbook.

KANJORSKI: The gentleman's time has expired.

And now we've completed everything but one remaining minute on our side, and recognize the gentleman from Georgia for one minute.

SCOTT (?): I'll take that minute, sir.

Joe Friday said, "Just the facts, ma'am. Just the facts." Remember him, the great Joe Friday, "Dragnet" series?

The facts are, without any questions -- so we can get this behind us.

SCOTT (?): It was Paulson, Hank Paulson, secretary of the Treasury, and he was not President Barack Obama's secretary of the Treasury. He was George Bush's secretary of the Treasury, who came from -- before this committee and laid out the dire consequences if we did not act.

So when you measure this deal, let's be honest. There's no -- you got to figure out how you got into a problem before we can figure out how you got out -- not a matter of calling names. It's a fact. This did not happen under President Barack Obama. Guy was out as a state senator trying to become president. This happened under Paulson's watch, who was the Treasury secretary for President Bush. Fact. Closed.

Now, there's still a need out here for help and assistance with middle- and moderate-income people to be able to get their homes.

But, Mr. Chairman, may I just add this one thing? I hope that when we pay attention here that we will to these community banks. Our community banks own 85 percent of the lenders who own stock in the GSEs. So when you start talking about dismantling and doing all of that, it ain't just as simple as that. This is a complicated area, and the need is still there.

KANJORSKI: The gentleman's time is expired.

All time is expired.

We will now hear from the panel of witnesses that we have.

And we want to thank you for appearing before this subcommittee today. And without objection your written statements will be made part of the record.

You will each be recognized for a five-minute summary of your testimony. I hope you will hold to that five minute better than the members of the committee (inaudible) did.

First we have the Honorable Michael S. Barr, assistant secretary of financial institutions, United States Department of Treasury.

Assistant Secretary Barr?

BARR: Thank you, Mr. Chairman, Ranking Member Garrett, Chairman Frank, Ranking Member Bachus, members of the subcommittee. Thank you for the opportunity to testify today about housing finance reform, and the progress made since the placement of Fannie Mae and Freddie Mac into conservatorship in September 2008.

Before I talk about the conservatorship it is important to remember how we got here. For too many years the GSEs were allowed to operate under an unacceptable heads I win, tails you lose system. They enjoyed the benefits of the perception of government support. They had inadequate oversight, and inadequate capital. The market did not instill appropriate discipline because the market assumed that they had a government backstop.

The events that lead to conservatorship were symptomatic of a range of regulatory management and oversight failures throughout our financial system. As the private, unregulated mortgage market grew and market players began to loosen mortgage credit standards to pursue ever-risky business -- ever-riskier business in the booming market, the GSEs which had initially stuck to their core business of guaranteeing well underwritten loans, saw their market shares fall precipitously.

Driven by profit motives in (ph) an effort to regain that market share, the GSEs purchased riskier mortgages without holding adequate capital or having appropriate risk management. These moves left them dangerously exposed.

As a result of the substantial deterioration in the housing market and Fannie and Freddie's inability to raise necessary new capital, FHFA placed the GSEs into conservatorship under the authority granted to them by Congress under the bipartisan Housing and Economic Recovery Act.

Since September 2008 FHFA has acted carefully to help ensure that Fannie Mae and Freddie Mac's assets are conserved while continuing to play a critical role in making mortgage credit available.

By facilitating the flow of credit for responsibly underwritten mortgages, the GSEs have served as a source of stability for the housing market, and helped to enable millions of Americans to continue to have the ability to take out a new mortgage, or to refinance.

The new loans being guaranteed by the GSEs are not contributing in any material way to the losses the GSEs now face. Quite the contrary. In fact it is the GSE's old book of loans -- those acquired before conservatorship -- which are the overwhelming source of losses.

The credit quality and risk profile of the post-conservatorship book of business has dramatically improved compared to pre- conservatorship levels. And less than 1 percent of losses have come from loans originated in 2009 and 2010.

Now some have suggested that taking time to get reform right will expose taxpayers to even greater losses. That is simply not the case. The losses that Fannie Mae and Freddie Mac face are the result of mistakes made in the years leading up to the crisis, not those made today.

The country is unfortunately stuck with the consequences of the poor choices the GSEs made prior to conservatorship. The GSEs today are working hard to minimize losses through loss mitigation. And the GSEs are continuing to promote overall stability in the housing finance system, which is the most important source of loss mitigation they can provide.

While we continue to bring stability to the mortgage market, we are also hard at the work on the business of reform. It is not tenable to leave in place the system that we have today.

The administration is committed to delivering a comprehensive proposal to Congress as called for under the Dodd-Frank Act by January 2011. Our proposal will call for a fundamental change. Congress began the process of reform with a package (inaudible) here in 2008. And FHFA continued to pass when it placed Fannie Mae and Freddie Mac into conservatorship.

The next phase of reform came with the passage of the Dodd-Frank Act, which includes fundamental reform of mortgage market rules, including important ability to pay requirements and risk retention standards for mortgages.

This act will help to ensure that homeowners are not sold products that they cannot afford, and that originators retain skin in the game when they originate risky mortgages.

As we move forward together toward responsible reform of our nation's housing finance system, we are committed to ensuring that the transition to a new system occurs in an orderly fashion that is minimally disruptive to the markets.

And in designing a new system for housing finance, we must ensure that the system is more stable, consumers are protected, sustainable credit is widely accessible, and low- and moderate-income families have access to affordable housing.

After reform the GSEs will not exist in the same form as they did in the past. Private gains will no longer be subsidized by public losses. Capital and underwriting standards will be appropriate. Consumer protection will be strengthened. And excessive risk-taking will be restrained.

Thank you.

KANJORSKI: Thank you very much, Mr. Barr.

And we'll now hear from Dr. Edward J. DeMarco, acting director of Federal Housing Finance Agency.

Dr. DeMarco?

DEMARCO: Thank you, Mr. Chairman.

Excuse me.

Chairman Kanjorski, Ranking Member Bachus, and members of the subcommittee, thank you for inviting me here today. My written testimony covers four topics: the status of the conservatorship, the current condition of the enterprises, projected losses by the enterprises, and considerations for the future of the housing finance system.

I will briefly summarize several key points from my written statement.

The enterprises have been operating in conservatorship for two years now, since September 2008. The principal focus of the conservatorship is to maintain the enterprises' secondary mortgage market role until legislation produces a resolution of their future.

FHFA's oversight is also directed toward minimizing losses, limiting risk exposure, and ensuring the enterprises price their services to adequately address their costs and risk. FHFA recognizes that losses by the enterprises translate into costs for the taxpayers, and we are doing everything in our power to minimize future losses.

Examples of these loss mitigation activities include loan modifications, both through the administrations HAMP program and through each enterprise's proprietary modification programs; repayment plans and forbearance plans; and short sales and deeds-in-lieu of foreclosure.

The foreclosure alternatives pursued by the enterprises not only serve the conservatorship goal of minimizing losses, but also fulfill FHFA's statutory mandate in EASA (ph) to maximize assistance to homeowners while minimizing losses to the enterprises.

FHFA reports every month to Congress on the full range of enterprise foreclosure prevention activities through our Federal Property Manager's Report. Since the first full quarter of the conservatorship the enterprises have completed more than one million foreclosure alternative transactions with borrowers.

As conservator, FHFA has also been clear that the enterprises should actively enforce lender compliance with their contractual obligations, which includes pursuing repurchases from those institutions whose loans did not meet the enterprises' underwriting and eligibility guidelines.

Separately, in July FHFA issued 64 subpoenas as part of an effort to determine whether other firms have legal responsibility for some of the enterprises' losses on private label mortgage-backed securities, which to date have been borne by the enterprises and taxpayers.

In February, I communicated to Congress my position that in conservatorship the enterprises will be limited to continuing their existing core business activities and taking actions necessary to advance the goals of conservatorship. We continue on that course today.

When I appeared before you in late May, I pledged that FHFA would expand its reporting on the enterprises in conservatorship.

DEMARCO: In fulfillment of that pledge, last month FHFA published the first of what will be a quarterly conservator's report on the enterprise's financial condition.

(inaudible) the findings presented in the report are, at the end of 2007, the enterprises had $71 billion of combined capital. From the end of 2007 through the second quarter of 2010, charges against capital totaled $226 billion. The largest contributor to these charges against capital has been the single-family credit guarantee segment, accounting for $166 billion or 73 percent of combined capital reductions over that period.

During conservatorship, the enterprises have made significant progress in improving the quality of new mortgages purchased. New enterprise mortgage guarantees have been for borrowers with higher credit scores and loans with lower loan-to-value ratios, two factors that affect expected default rates.

Also, when I appeared here in May, I was asked how much more money the enterprises may draw under the preferred stock purchase agreements. I said that, even across most severe stress scenarios modeled by the enterprises, combined Treasury draws appear to be less than $400 billion.

Based on the analysis available to me, that remains my view today. But to provide Congress and the public with a more defined sense of the enterprise's potential future Treasury draws, FHFA is working with the enterprises to develop forward-looking financial projections for public release.

Similar to the supervisory capital assessment program conducted by the federal banking agencies last year, the results of this exercise will not be forecast or expected outcomes, but rather modeled projections in response to what-if exercises that utilize various scenarios.

As we prepare for the future, legislation is needed to restructure and strengthen our housing finance system and resolve the conservatorships. Ensuring an orderly transition will be essential. The role of the government in housing finance going forward is the key decision point. And in my written statement, I offer some issues for consideration regarding government guarantees.

We look forward to working with the administration and Congress in this endeavor.

KANJORSKI: Thank you, Dr. DeMarco.

And now we'll move on to questioning by the committee members. Let me take our first crack at it. I -- not -- not that I apologize, but I think that, in some of the opening statements, we've had a little bit of revisionism of history, if we might, and that tends to confuse the problem. Let me try and move with what I see the problem being.

We're trying to get back to an active, responsible real estate market in this country and mortgage market. In order to accomplish that at the level that the country needs, it seems to me we need a methodology of having a secondary market that brings in and attracts more capital into the American market, not maybe to the exact level of pre-crisis stage, but certainly a great deal higher than today.

Have either of you given a great deal of thought to whether or not just having two institutions like Fannie and Freddie, that they obviously didn't compete very well to get the best price and both seem to rely on the same -- the same conditions and failed in the same way?

What if we broke up the mortgage market into 10 GSEs, and to carry it a little further and say we offered the license to be purchased as we do air time in the communications field and let the private sector get in, but if we had 10 GSEs, if any one of them failed, we would be able to allow the bankruptcy process to weed that out and clean it out and continue on?

We wouldn't insulate, however, against deflation. If across-the- board deflation occurs, I don't know how we can create any situation that's going to take that into consideration and protect against it.

But what are your thoughts, instead of having just the two GSEs that have handled this problem, that we spread it over to 10 or even 15, if you will? And is there a given number that makes it so inefficient that it's not worth doing it in those small proportions?

Mr. Barr?

BARR: Mr. Chairman, I think that the question of how many entities are involved in a system of housing finance in the secondary market is only one set of factors in the development of a new housing finance system.

And I think bringing it back to the fundamental level, what's the shape of that housing finance system; what do we want it to look like; how will it deliver widely available credit for sustainable mortgages; how will it deliver on financial stability goals; how will it deliver on affordability -- I think those broader and deeper sets of questions come into play, in a sense, first.

The question of whether you want one entity or multiple entities; if you want multiple entities, how many they have, relate to those broader sets of concerns.

And as you're thinking about the numbers of entities in the system, they involve a number of tradeoffs. And you've identified some of those -- a question of what part of the system is inside the new housing finance system we've created and what part is out; how do we insure a level playing field for different kinds of approaches to financial intermediation; how do we prevent races to the bottom in that sector; if we have multiple entities involved, does it deal with the basic question of correlation of risk in the system or just add to that?

And I think those are the kinds of fundamental questions we're going to need to address in the -- in the reform plan.

KANJORSKI: When do you anticipate the Treasury's reform plan to be available so it could be -- started to be considered?

And I ask this honestly, that I hear sometimes the beating of the chest up here on the Hill, at a point that it's going to take time, but we ought to have some time frame that we're looking at so we can inform the American people that this is not going to go on interminably, but, in fact, we have some constraints on time. When do you anticipate that?

BARR: Well, as required under the Dodd-Frank Act, we will be submitting a plan no later than January of 2011. So that's the time frame, and I think it'll give the Congress the opportunity to take up legislation in earnest in the next -- in the next year. And we would anticipate working very hard to get that done at that time.

KANJORSKI: What are your thoughts on this, Mr. -- Dr. DeMarco?

DEMARCO: Mr. Chairman, I'd add two things to what Secretary Barr said. First, with regard to the system we had, we were limited to two because of the way the enterprises were structured. That -- that model envisioned that there would be only two companies. They were given a number of advantages not otherwise available in the marketplace. And so we did not have freedom of entry and exit.

In terms of how many firms there might be in the future, if we're looking for a market model, I would think it's the market that should determine that, not a -- not a regulator or a -- or the government, generally.

So I would look for a market model in which there was licensing of firms to do certain things, but -- if they met certain requirements -- but other than that, we should be having a model that lets the market determine that through entry and exit. And that would help to spread and diversify risk.

KANJORSKI: Thank you very much. My time is obviously expired. We'll now recognize the gentleman from Alabama, Mr. Bachus.

BACHUS: Thank you. And let me say this. The subcommittee chairman said, "How do we keep the housing market going," and I think that is what people are asking. I'm not sure that that ought to be the question. I think the question should be, should the government keep the housing market going?

I mean, is it up to the government, through subsidies and guarantees, to do that, or is that -- is that the proper role of government?

Secretary Barr, you said the government is committed to ensuring that the GSEs have sufficient capital to perform under any guarantees issued now or in the future. So you obviously envision Fannie and Freddie continuing to make guarantees, I suppose. Is that correct?

BARR: The -- the basic goal of the provisions that the prior administration put into place and that we have continued under the preferred stock purchase agreements is to ensure that the GSEs can meet their obligations now and into the future, until such time as the Congress enacts reform.

And when Congress enacts reform, the future state of the system will decide, after that point, do we have guarantees; do we not have guarantees; do we have GSEs; do we not have GSEs?

BACHUS: But you're continuing...

BARR: But in terms of obligations that are being issued today, absolutely, standing behind those is essential to market stability, to the continued ability of our housing finance system to function and to not creating an environment of great instability that will harm -- harm taxpayers.

BACHUS: I need a -- let me ask this -- and I'll ask Mr. DeMarco. This idea of the government guaranteeing in the future -- I'm -- not the past, but the future guarantees.

You have said that -- and this is an answer to some that have called for -- particularly some on the other side -- an explicit government guarantee for home mortgages as one option.

You said replacing the enterprises' implicit guarantee with an explicit one does not resolve all the shortcomings and inherent conflicts in that model, and it can produce its own problem. The -- that was your statement I think today. I read it on your website yesterday.

DEMARCO (?): Yes, sir.

BACHUS: What -- what are some of the shortcomings with a government guarantee, and what are some of the possible consequences for taxpayers?

DEMARCO (?): I think that, Congressman, what I tried to articulate there was that while there are a number of -- of industry representatives and others that have been advancing the cause of having explicit government guarantees backing a wide array of mortgages in the future housing finance system, my testimony says that I think that some of the -- you know, there are definitely some positives to that, but that some of the negatives have not been fully explored.

And so I've tried to identify several matters that I would think lawmakers would want to consider in determining whether and the extent to which to provide explicit government guarantees, you know, in the -- in the future housing finance system. And that goes to the ability and capacity of the government to be able to adequately price the risk that's there.

It goes to the question of to the extent that there's, you know, government support for an activity that provides a subsidy -- you get more of that activity. And that comes as an opportunity cost of funds not going elsewhere. It's a matter for lawmakers to weigh.

And I believe that if the government is involved in -- in providing guarantees on a broad portion of the mortgage market, that it seems likely -- and past experience would suggest the government would want to say to some degree in how the mortgage market is working, pricing, what segments are being served. And, you know, that -- that -- how that gets done and how that might affect the proper pricing of mortgage credit risk or challenges that would need to be considered in a model that's relying upon government guarantees.

BACHUS: All right. Let me say -- and I'm reading -- read part of what you said, and I -- I would agree with it. You said, "The premise for an explicit guarantee is that the private markets are not able to price the risk of the mortgage default at reasonable levels."

"But we must ask," and I agree with you, "whether the government could do a better job." And I think the whole debate here is whether the private market or the government can do a better job. And I think most of my colleagues on this side say the private market can.

(inaudible) going to say if a government backstop is underpriced -- in other words, if the government underprices the risk, taxpayers eventually may foot the bill again. And we -- I know the minority party at -- at all cost wants to -- to see that -- that the taxpayers don't foot that bill.

DEMARCO (?): Mr. Chairman, may I respond?

KANJORSKI: Please.

DEMARCO (?): One other thing to note here, though, is that you know there can be a -- you know, it's for you all to decide, you know, what sort of multiplicity of guarantees there are.

We -- we still have, and you know, I would expect we're going to continue to have the FHA program. That's a form of -- that's a government guarantee program. It's one that's targeted. It's one, you know, that has certain transparencies about it.

I'm getting to the larger question of, you know, going to the full -- you know, what we know today is the conventional market. You know, to what degree is the government going to get involved there? But there is -- you know, may well be a role. And that's for -- you know, the public benefits of that to be -- to be weighed by lawmakers.

BACHUS: OK. Thank you.

KANJORSKI: Thank you very much.

Now we'll hear from the gentleman from California, Mr. Sherman?

SHERMAN: Thank you.

First as to conforming loan limits for the high-cost areas. The Federal Housing Finance Agency has determined that the loans originated since the temporary loan limit went into effect have consistently outperformed the smaller conforming loans -- at least that's what I've been told -- and have dramatically lower delinquency rates.

One issue that comes up is will Congress, even if we do extend the $729,000 (ph), do it late in December?

Mr. DeMarco, if Congress waits until the very end of the year to extend the current increased conforming loan limits, what do you think will be the impact of not doing it earlier? Will homes be able to open escrow in November and December without the borrower knowing whether he can get a conforming -- or she can get a conforming loan during that escrow period, and Congress perhaps not extending? How important is it for Congress to act expeditiously?

DEMARCO: Congressman, if -- if you say just to give this rough justice, there's 90 days from purchase to closing on a mortgage, then you would expect that, you know, from mortgages for -- for home purchases that begin in October, that you know, certainty for both potential borrowers as well as lenders would be -- would be helpful in that regard.

SHERMAN: So if we don't act before we adjourn for the election or for October, then people won't be able to open an escrow in November because they don't know whether they can close in January?

DEMARCO: Well, Congressman, won't be able to is a -- is a -- is a -- is a much higher hurdle. I mean, there -- the -- the -- the jumbo market is in fact performing. And it is -- it is actually coming back.

The -- the spreads on mortgages above $729,000 (ph) relative to those below have been coming down. And so there would be mortgage credit presumably available. You know, so I wouldn't say...

(CROSSTALK)

SHERMAN: I -- I would hope you go back and look at statistics. What I see in the Los Angeles area is yes, the jumbo market's working well for the homes in Malibu. Every one of -- anybody buying a home in Malibu has a banker on speed dial, probably the CEO.

But for those homes selling for $600,000, $700,000, $800,000, 99 percent of them are FHA, Fannie or Freddie. And the idea that the -- the private market to step in, I -- I certainly don't see it.

Do -- do you -- and I would -- I look forward to -- to working with you to see what the statistics are not in the most expensive home markets, but places where the $417,000 (ph) level applies to see whether, and under what circumstances, people can get loans in the $700,000 or $600,000 range.

Let's move to these private resale fees. Last month your agency proposed guidance for Fannie and Freddie, and the federal home loan banks; that they should not deal in mortgages on properties encumbered by these private transfer fees. I want to commend you for moving in that direction.

We discussed these fees last time you appeared before this committee. And as you know, they typically involve a circumstance where hidden in the documents is a statement that when the homebuyer sells, 1 percent of the purchase price goes to a designee -- usually an investor on Wall Street.

And the New York Times expose, which I'd like to add to the record without objection...

KANJORSKI: (OFF-MIKE)

SHERMAN: ... dated September 11, 2010, details a case where this fee is in a separate document that wasn't even included in the documents for signature at closing.

Do you expect that this proposed guidance will become guidance? And do you expect it to become adhered to by the -- by the relevant lenders?

DEMARCO: I expect that we will finalize the guidance in some fashion, Congressman. It is currently in a public comment period. And we are looking forward to receiving public comment on this.

We cast a wide net in this proposed guidance. And I think it's very important for us to take the time to -- to get public comment on this, and to consider it, so that we make sure that whatever would (ph) come out in final form is fashioned appropriately.

SHERMAN: And I would hope you would take this as an additional public comment especially as the -- it affects the lender and the prudential standards applied. When I said the lender -- the lender or guarantor of these loans.

DEMARCO: Yes, sir.

Thank you.

KANJORSKI: The gentleman's time is expired.

The gentleman from California, Mr. Royce, you're recognized for five minutes?

ROYCE: Thank you, Mr. Chairman. I'm -- I am going to ask Mr. DeMarco a question. Would you -- would you agree with this notion that the goals, at least in part, led the GSEs into the junk loan market?

DEMARCO: I believe that the enterprises began acquiring subprime and Alt-A loans and lowered their home credit standards for three reasons, Congressman. They did it to make money. They did it so that they would stem their growing loss of market share. And they did it because of housing goals.

ROYCE: OK.

(CROSSTALK)

ROYCE: One of the three goals -- and certainly, I mean, for me, at the time, in '05, I remember discussions I had and we had with the Federal Reserve chairman where he told us where these goals would -- would lead and, in particular, with the fact that, unless Congress allowed us -- allowed the regulators to deleverage the portfolios -- I mean, over the years, we watched those portfolios grow to $1.5 trillion. We watched, what, about $11 trillion, I think, in subprime loans go through securitization or end up in those portfolios.

And the Federal Reserve actually became frantic. And their worry was that we'd created, kind of, a political beast here that was half -- half politics and half private. And it became the most influential lobby here, at least in financial services, on The Hill. It was very hard for congressmen to stand up against it.

President Clinton did. I remember one of the -- one of the quotes he made. He said, "I think the responsibility that the Democrats have may rest more in resisting any efforts by Republicans in the Congress or by me, when I was president, to put some standards and tighten up a little on Fannie Mae and Freddie Mac."

And that was the fact. I mean, in the Senate, we had a good bill. In the House, we had the congressional bill. And the congressional bill would have made the problem worse, and that's why it was opposed by economists and by the Treasury and by the Fed, because, frankly, it would not have allowed the regulators to step in and regulate and deleverage those huge portfolios.

But here's the concern I have: having watched, in the -- in the past exactly what the Fed warned about, the systemic risk and how we're going to create this political beast that would eventually bring down the housing market and then on top of it the financial services sector -- we're talking about reconstituting them.

And at the same time, we've got these further goals that your office has put out that will lead -- at least the economists that look at this tell us that it's going to lead to these new minimum downpayments -- that there's going to be, sort of, again this road toward lower downpayments -- at least that's one interpretation under this -- that there's -- that there is going to be a purchase of high LTV loans, junk loans, to meet these goals, potentially, again.

And my worry is, how do we -- if we end up reconstituting this institution, how do we constrain it?

Because I guarantee it to you, they're not regulated by market discipline. They become an instant monopoly because they -- they knock their competition out of business because of the government backstop that they have behind them. And at the same time, with the rate at which they influence members of Congress, they've basically dictated terms and said they would not be regulated by the regulators.

So why would we go down this quasi-socialist road again of reconstituting these institutions?

Couldn't we eventually phase -- pull back towards sort of a market, a private market?

And, you know, I know it'll take time to do. But wouldn't that be the wiser course, in your opinion, rather than the kind of involvement we've seen Congress put into this with the goals -- in '92, with the act that Congress passed, with the leverage on trying to get to zero downpayment loans and all the rest of it?

Wouldn't we be smarter in the long term, rather than this boom- bust cycle in housing we seem to contribute to?

DEMARCO: Congressman, I think that there's widespread agreement that reconstituting the GSEs as they were would be a very bad idea. And I would agree that one of the quite possible outcomes, one of the (inaudible) options that's available to Congress, is one that is far more market-based.

ROYCE: Thank you, Mr. DeMarco. I appreciate it.

KANJORSKI: The gentleman from Massachusetts, Mr. Lynch, for five minutes.

LYNCH: Thank you, Mr. Chairman. First of all, I want to thank Mr. Barr and Mr. DeMarco for your willingness to come before the committee and help us with our work.

Mr. Barr, you mentioned in your opening testimony that only 1 percent of the losses that we're seeing are related to the post- conservatorship book of loans and that, I assume, the rest is from the, as you call it, the old book of loans.

Now, just before the -- the break, the August break, I know, Mr. DeMarco, your office issued 64 subpoenas in connection with private- label mortgage bank securities that were sold to Fannie and Freddie.

DEMARCO: Yes, sir.

LYNCH: So what -- where are -- I know that was just before the break, well, maybe mid-July, that you sent those subpoenas out. Could I ask you where are we now?

I know that there were some questions about the valuation of those securities, whether some misrepresentations were made. I know you asked for a lot of documents. I didn't go through all of the subpoenas, but I went through some of them. And where are we now with that whole process?

DEMARCO: The information that we've requested is in the process of coming in. And we are initiating, you know, our process and reviewing those documents for the purposes of doing a financial review.

The purpose here is to review the records, the mortgages underlying these securities, to see if -- to make a determination as to whether there's a breach of warranty or some other misrepresentation that would suggest that the losses the enterprises have incurred are the legal obligation of someone else.

That process is going to take some time, Congressman. But we are hard at work at it now. And the records are beginning to come in.

LYNCH: Do you have a time frame, Mr. DeMarco?

DEMARCO: I'm afraid not, sir.

LYNCH: So it's open-ended?

DEMARCO: Well, I mean, not open-ended in terms of responding to the subpoenas, but the time frame to go through all of these records and so forth is very hard to say.

LYNCH: Is there any opportunity that you might share with Congress, with this oversight committee on financial services, your progress or lack thereof?

DEMARCO: Congressman, I would be happy to try to find an appropriate method to periodically update the committee on the progress we are making here, recognizing, sort of, some of the privacy and, you know, legal sensibilities that need to be respected. I would be -- I would be pleased to find a way of providing periodic updates.

LYNCH: I would really like that. I think that, just as some of these mortgage-backed securities were foisted on others, I think -- I think that Fannie and Freddie, for various reasons, bought into these as well, and that misrepresentation resulted in major losses for the taxpayer.

Let me ask you another angle on this. While you're going after some of these private-label issuers and trying to hold them accountable for selling bad product, mortgage-backed securities, to Fannie and

Freddie, Treasury and the Fed are pumping in, at last count, $1.36 trillion into some of these same companies by purchasing their -- their securities.

DEMARCO: Congressman, I'd correct that just -- just -- just a bit. Two -- two things, just to clarify. First, we're not yet pursuing anyone. We're just gathering information. We have made no determination that there's been misrepresentations or breaches of warranty. We're gathering information through the subpoenas to see if that is, in fact, the case.

Second, with respect to what the Federal Reserve and the Treasury have been purchasing, their purchases of mortgage-backed securities are those securities that have been issued by Fannie Mae, Freddie Mac and Ginnie Mae. They're not issued...

(CROSSTALK)

LYNCH: I realize that. But I'm just looking at the numbers here. We're looking at -- at losses, you know, the valuations on these things, since -- since they were sold to Fannie and Freddie. They just went in the toilet, you know, in a very brief period of time. So at one point they were AAA and then the next -- next thing we know, they're worth nothing.

DEMARCO: Yes, sir.

LYNCH: So as...

(CROSSTALK)

LYNCH: ... I'm just looking at the losses you've got here, you know, one-quarter -- $266 billion, you know, it's just a -- a whole litany of losses here. You're hemorrhaging value.

So I'm -- I just making a deduction that we've made everywhere else in the industry with their mortgage-backed securities, that there were -- there were misrepresentations made here at -- to some degree, whether it's...

DEMARCO: Well, we're going to...

LYNCH: ... malfeasance or (inaudible), I'm not going to go there, but...

DEMARCO: We're going to find out. I mean, I think that this is important for the American taxpayer. The American taxpayer is now, you know, backing Fannie and Freddie so that the mortgage market in this country can continue. The losses are extraordinary, and I think that we owe it to the American taxpayer to -- to find out, as part of our responsibility to conserve assets, to see where these losses are coming from and whether they're the legal responsibility of others.

DEMARCO: And we...

LYNCH: We sure do.

All I'm saying -- in closing, Mr. Chairman, all I'm saying is that there's -- there's -- it's counterintuitive that we're going to hold them accountable but we're also going to -- we're going to pump them full of money to, you know, try to prop up the values here. That's all I'm saying.

I yield back. Thank you, Mr. Chairman.

KANJORSKI: The gentleman from New Jersey, Mr. Garrett.

GARRETT: Thank you.

So, Director, my colleague, Mr. Campbell, and I sent a letter to you -- actually with 40 other members of Congress -- back during the summer. And it came about actually because of media reports, as a lot of these things are driven as far as coming out with the information, that mortgage bonds have reached an all-time high in price of 106.3 cents (ph) on the dollar, which (inaudible) when you think about it is really an incredible number for the purchase of bond and -- for an investment purpose.

And nonetheless, that's where it was or is, and the media reports indicated that Fannie and Freddie didn't want to sell a larger percentage of the securities even though they could, and they could do so and obviously get a good value for them, a great value for them.

And it also suggested that the GSAs (sic) didn't want to sell more because it would more rapidly shrink your portfolios, and then with a smaller portfolio would be more difficult to eventually free those entities from conservatorship, and then potentially put them back the way they were and lose (inaudible) capital markets.

So you sent a formal response (inaudible) got it late yesterday and -- for the first time. And you say that, quote, "Enterprises hedge their portfolios so gains in asset prices may be offset by losses on derivatives." That's true.

Well, if that's the case, then couldn't you actually lose less money or no money if you sold off those assets now, so then they wouldn't have to be hedged in any other way? They'd be off your books. In your letter then you go on to talk about how you're living up to your commitment to their current agreements with Treasury and everything is on schedule.

So in all -- we've had discussions and what have you, and every time you come here to testify you state that you're trying to fulfill your mission, and I know you are, of maintaining values of the entities and reducing losses to the taxpayers.

But if we're really trying to do that, preserve that value and get money back to the taxpayers, shouldn't we be selling them today when they're at these prices and not have to deal with the hedging of the risks down the road a year or two, or whenever that may be, when inflation kicks in and then that problem of hedging that would be -- just be astronomically harder than it is today?

DEMARCO: This is a challenging question, Congressman, and I would point out that there's more to this than just the hedging. So the enterprises are funding long-term assets by issuing long-term liabilities. If we start rapidly shrinking the asset side of the balance sheet, I'm left with long-term liabilities that need to be -- need to be funding something. So it has more to do than just hedging.

I would also say that they are...

(CROSSTALK)

DEMARCO: ... substantial holders of...

GARRETT: Let me just stop you there so I understand what you're saying. But can't you take care -- can't you take care of that better today? I mean, if you can sell them at 106 (ph) today -- who knows what they would be worth, say, five years from now if the interest rate goes up, and what have you. So you can take of those -- of other underfunded assets that are on your books if you basically sell them and then you put that money aside to take care of that.

DEMARCO: Managing $1.5 trillion worth of retained portfolio has lots of complexities to it.

Let me just simply say that part of that is -- that's so large that that is substantial relative to what's trading in the marketplace. And I think that the enterprises also have a responsibility to market stability with their sales and the unwinding of their portfolio be done in a stable and predictable way in order to, you know, ensure greater market stability.

With that said, my letter to you also pointed out that as a result of these market movements this summer -- we have been in discussions with Treasury as required by the senior preferred agreement. And we are making some adjustments to how we approach, you know, the question of disposition of assets in normal business order, in order to take greater advantage of market prices.

But I think we have a responsibility to do so in a way that does not invoke market instability, and also looks -- is cognizant of the fact that there's -- that there's hedging in long-term funding here as well.

GARRETT: OK.

DEMARCO: But we do want to -- look, the basic point, Congressman, is I do agree. We want these portfolios to be run down, and we are working very much to that end.

GARRETT: OK.

And my comments -- moving quicker than I would like, but particularly with our -- you made at your opening comment -- I think it was in your opening comment -- with regard to the purchase by Treasury of the GSEs -- of mortgage-backed securities. And I wanted to go into some more detail -- but in 30 seconds here.

So I asked the same question to Chairman Bernanke. When you were purchasing these things today, up until they are guaranteed by the good faith and credit effectively of the taxpayers until -- when? -- 2012, right? After that, that guarantee in essence is no longer there.

So what actually are you purchasing? And what is the value of those securities that you're purchasing today after 2012 if there's not the backing in the funding by the Treasury for the GSEs operations going forward?

DEMARCO: There's not a sharp distinction between the activities before and after 2012. The preferred stock purchase agreements that backs up the Treasury's support for Fannie and Freddie continue into force after that date, with respect to the obligation to the GSEs and with respect to the mortgage-backed securities.

Mortgage-backed securities that the Federal Reserve purchased and that in small part -- smaller part the Treasury purchased have their value that they have intrinsic to the asset, and that also continues after 2012. So there's not -- there's not a sharp break. Those obligations are obligations that will be supported in either event.

GARRETT: And that's where I actually wanted my question to go, is that from reading the Treasury's agreement with Fannie and Freddie it seems that there is no deadline on that, and that this can go on infinitum.

Is there any deadline?

KANJORSKI: The gentleman's time...

(CROSSTALK)

DEMARCO: May I just briefly answer, Mr. Chairman?

KANJORSKI: Very briefly.

DEMARCO: Under the preferred stock purchase agreement those were designed to put in place support for Fannie Mae and Freddie Mac such that the obligations that they're incurring today or have incurred in the past...

GARRETT: Right.

DEMARCO: ... are supported.

And the obligations are designed so that as the Congress considers reform of the housing finance system, it's not driven to instability in the housing finance system during the transition.

So whatever Congress decides about the future in Fannie Mae and Freddie Mac can be done on the basis of sound policy and good choices. Whether one wants a guarantee or doesn't want a guarantee, whether the size and the shape of the government's role in the market can all be made independently of disturbing any existing arrangement.

So they're designed really to free the Congress to develop a plan that is good for the country going forward in the future.

KANJORSKI: The gentleman's time has expired.

The gentleman from Massachusetts, the chairman of the committee, Mr. Frank, is recognized for five minutes.

(CROSSTALK)

FRANK: Thank you, Mr. Chairman.

I'd hoped we could focus on going forward -- but my Republican colleagues seem to (inaudible) discussion of history, while others engage in distorted versions of that history.

The gentleman from California, Mr. Royce, continues to misstate what has happened. He talks about a congressional bill in 2005. He meant the bill passed by the House Republicans.

The House Republicans brought that bill out. That was the bill that Mr. Oxley brought forward that most of the Republican members of the committee voted for.

The gentleman from California (inaudible) -- as he's pointed out, didn't like the bill. He offered amendments both in the floor and others -- and in committee. No amendment was even close to supported by a majority of Republicans. They all walked (ph).

He mentioned that President Clinton said, "Well (ph), the Democrats fought (ph) this." President Clinton's a great guy; he's not infallible.

From the time President Clinton said that the Republicans controlled Congress. It is extraordinary -- the Republicans controlled Congress from 1995 to 2006, December, and did nothing -- nothing legislatively.

We took office in 2007 and worked with Hank Paulson and put it into conservatorship. Now those are the clear facts.

We also tried to block the subprime lending. And that was somewhat controversial.

I will note, the gentleman from Alabama, to his credit, in my mind, in 2007, joined the Democratic majority in supporting the subprime lending restriction bill and almost lost his ranking membership. That was widely reported in the press.

Other members of this committee said, "Oh, no, you can't do that."

So the Republicans for 12 years did nothing to regulate Fannie and Freddie. We did it when we took the majority -- working with Mr. Paulson. And that's why they're now in conservatorship.

Secondly, the Republicans have consistently, still, opposed any efforts to stop the predatory lending. Because as the gentleman from North Carolina pointed out, it wasn't simply Fannie and Freddie buying those loans, it was others. And that's the facts.

Now Mr. DeMarco, I just want to be very clear. You were appointed originally when President Bush was president, correct, into the FHFA?

DEMARCO: I was not appointed, Mr. Chairman. I'm a career civil servant.

FRANK: Right...

(CROSSTALK)

DEMARCO: I was hired by...

(CROSSTALK)

FRANK: Yes, you were there, and when Mr. Lockhart left you took over and -- I don't mean to (inaudible) it just shows you are totally nonpartisan in this.

DEMARCO: Yes, sir.

FRANK: An argument has been made that Fannie and Freddie are still terrible problems and a source of losses. The view I got -- and I will say, by the way, from the standpoint of Fannie and Freddie, Mr. Paulson points out in his book that when he got ready to put them into conservatorship, knowing what a drastic change that would be for them, he was afraid they would appeal to Congress to block him. And he called myself and Senator Dodd and we said please go ahead.

FRANK: Now, I'll have to ask you, did the -- did putting them into conservatorship make a significant difference in the way in which they operate? Are Fannie and Freddie as they have operated since the conservatorship operating essentially similarly to the way they were before or have there been improvements from the taxpayers' standpoint?

DEMARCO: There have been many changes and improvements since conservatorship began.

FRANK: Would you elaborate some?

DEMARCO: Certainly. They've limited their activities to their existing core of business activities, their underwriting standards have improved substantially. And without having gone into conservatorship and having to backstop of the U.S. Treasury Department, they would've been rapidly receiving from the marketplace which meant we would've lost our secondary market and the housing finance crisis would've been...

(CROSSTALK)

FRANK: Mr. DeMarco, I appreciate that.

Let me ask -- because we are concerned about the losses. Is it correct, if not, you know -- I have full confidence in your bipartisan approaches. Is it correct that the great bulk of the losses predates the conservatorship and that since the conservatorship, losses, if any, that we could expect are severely curtailed?

DEMARCO: Yes, sir.

FRANK: Thank you for that, because I think that ought to be clear.

Now, the question is where do we go from there? And that's why I said there wasn't urgency.

Because we acted, the Democratic Congress when the Republican Congress wouldn't, had put them into conservatorship, or allowed Mr. Paulson to do that, we have made drastic changes. And as you say, we would lose the secondary markets.

I tend to agree more with, Mr. DeMarco, than some in the administration; I want it to be more purely private. But you simply can't go from A to Z without making sure you have done it right. Mr. DeMarco, you're going to hear, I think, from some of my Florida colleagues. They're concerned that what's going on in Florida has -- Gretchen Morgenson documented this in the New York Times -- a kind of foreclosure mill without any true notice to the people being foreclosed. And there was concern that Fannie Mae in particular has not been as helpful as it could be in protecting people's rights.

We have written you before. I hope you read that article. I believe there's a role for you through Fannie Mae, and I think you may hear about this from Mr. Klein. I will be joining that.

Finally, let me just say, I appreciated your comment about the federal homeowned (ph) banks. One of the best things we did in the financial reform bill was not bother the federal homeowned (ph) banks model and leave them essentially as they were.

When they no longer have to pay off the ref corp (ph), which is $300 million -- however much it is a year -- I saw your comments that you think they should not have to continue to send that in to the Treasury, but it should be used to enhance the mission of those agencies. I appreciate that, and I hope we can work together to do that.

Thank you.

DEMARCO: Thank you, Mr. Chairman.

KANJORSKI: Thank you, Mr. Chairman.

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

HENSARLING: Thank you, Mr. Chairman.

Gentlemen, forgive me. I missed part of this hearing, so we may be plowing a little bit of old ground here.

Secretary Barr, in your testimony you speak about the events leading up to conservatorship. And I read your testimony. I didn't hear it. Assuming that it was the same testimony, I didn't see any mention of Fannie and Freddie's affordable housing goals, which as you well know, the low- and moderate-income housing goals ratcheted up from 2000 and 42 percent, to 56 percent in '08; underserved areas from 24 percent in 2000, to 39 percent in '08; special affordable from 14 percent in 2000, to 27 percent in '08.

We've had testimony before in this committee about Fannie and Freddie having to take on lower quality of loans that were connected to these affordable housing goals. Again, I saw no mention in your testimony. Should I conclude that you believe there is no nexus?

BARR: Mr. Hensarling, I think that primarily if you look at what happened in the lead-up to the financial crisis and the conservatorship, primarily what happened was that Fannie Mae and Freddie Mac were chasing the private markets. The private market in the boom went out and did, frankly...

(CROSSTALK)

HENSARLING: I understand that, Mr. Secretary, but do you believe there is a nexus or not a nexus?

BARR: I think primarily the cause of the conservatorship and the cause of the failure of the two GSEs is fundamentally driven by profit motive and a desire to regain the market share.

(CROSSTALK)

HENSARLING: ... some nexus but not a significant nexus?

BARR: I think that the argument with respect to the goals if they -- if they contributed was rather minor in relation to those two other factors, which is why I would not put it at the top of the -- of the set of problems.

I should say, going forward, that I think that if Congress is considering affordability going forward that it ought to have a clear delineation between that objective and other objectives in the housing finance system.

HENSARLING: Well, throughout -- I see the chairman of the full committee is here. Throughout most of his career, he encouraged Fannie and Freddie to get more deeply involved in affordable housing and encouraged them to do more in affordable housing.

On December 11th, Chairman Frank went to the House floor and said, quote, "In 2004, President Bush" -- and yes, the affordable goals came in in 1992 -- "President Bush raised them from 42 to 54 percent over my objections. I thought it was imprudent and said so at the time."

You don't want to take the opportunity and try to blame President Bush for one more problem here?

BARR: Sir, I don't think it really helps to blame one or another party or a member with respect to any activity. I think what we want to do is look at the (inaudible) problems in the housing finance system. We had a race to the bottom in mortgage standards. We had a lack of uniform level playing field in the system. We had a system in which there was an implicit government backing for this GSE...

(CROSSTALK)

BARR: ... private sector benefit and the public sector take the losses. I don't think...

(CROSSTALK)

HENSARLING: Mr. Secretary, we're move on to a new question, then.

In your testimony, you list four objectives and goals for housing finance and reform, I believe, on page four and five of your testimony. I did not see any mention whatsoever of taxpayer protection.

As you well know, we already have $150 billion of taxpayer loss in Fannie and Freddie. We have, as you well know, taxpayers on the hook -- the Fed, their MBS, over $1 trillion.

I assume that was not an accident that you did not consider -- the administration did not consider taxpayer protection among the lead objectives and goals for housing finance reform. Is that a fair assumption?

(CROSSTALK)

BARR: I think taxpayer protection is absolutely critical, and that's why I talked about not having private gains and public losses. Perhaps the colloquialism did not translate effectively, but it is absolutely designed to protect the taxpayers.

I don't think we can have a system in the future in which we had these private gains that are -- that are subsidized by the taxpayer which the taxpayers' on the hook for -- and which shareholders or private entities get the upside and taxpayers get the downside...

(CROSSTALK)

HENSARLING: I think you mentioned in your -- I think you mentioned in your testimony that part of the lack of desire to achieve reform today is, I believe, you testified, that most of the losses that resulted from the underwritings of '05, '06, '07.

But isn't it true that the loans that are being underwritten today, albeit with the new underwriting standard -- one, we have a limited track record as opposed to the longer track record. Also, do we know how these loans would perform if they became under water? And isn't the bottom line the taxpayer is still on the hook?

BARR: With respect to the losses that are being incurred today, there is a shortened time period, you're absolutely correct, on an age-adjusted basis. Those loans are performing significantly better than they would on an age-adjusted basis to the old book of loans. So we do have an apples to apples comparison in a -- in the conservator's report from August.

With respect to reform, we're strongly in favor or reform. I do believe that Congress took the important first step in passing here in 2008 the important second step of placing these entities into conservatorship, the important third step of passing the Dodd-Frank act, which fundamentally transforms the regulation of mortgage market, creates a level playing field, has ability pay requirements, has risk retention with respect to risky mortgages; has a whole set of reforms that are designed to prevent the market from blowing up the way it did in the past.

And now we need to take the last step in that process which is the housing finance (inaudible) reform that I think the Congress should take up in this -- in this coming year.

KANJORSKI: The gentleman's time is expired.

We'll now here from the gentleman from California, Mr. Baca, for five minutes.

FRANK: Would the gentleman yield me 15 seconds?

BACA: Yes, I -- excuse me.

I -- thank you very much for recognizing me. I yield the balance of my time to Chairman Frank.

FRANK: Well, thank you. I won't take all, but I did want to say -- and I appreciate the accurate quotations by the gentleman from Texas seriously.

But the one thing I should clarify, yes, I have been a strong advocate for affordable housing. I wasn't making the distinction at the time. By affordable housing, I was always talking about rental housing. I am, in fact, probably like a lot of people, I missed a lot of it (ph). But I have always been critical of what I thought was an excessive push into homeownership.

And when I talked about the affordable housing goals, I was focusing on the multi-family housing, which, in fact, did not cause nearly as many problems. And I believe what we should be doing is affordable rental housing.

I was and continue to be skeptical to the notion that we do people a favor when we push them into homeownership beyond what they can -- what they can sustain.

And I would just state further, to elaborate a little bit more, Mr. DeMarco, on that Florida situation -- it was troubling me. I'd heard some complaints, and then, frankly, the article by Gretchen Morgenson was really quite troubling about decisions being made in Florida where people were getting foreclosed without notice, et cetera.

FRANK: And Fannie could play a role in that. And we have been asking Fannie, to the extent that they're involved in that process, even if the court system isn't doing it, Fannie could take steps to make sure that notices get to people. And we have learned that there were problems with the papers. So we have written you before. We're going to renew that.

And I -- I -- I would ask you to look at that, and work with us to make sure that, to the extent that there's a -- a federal conservatorship there, Fannie in particular, but maybe Freddie -- that we do everything to protect the rights of the -- of the -- of the people who are there.

I thank you, and I thank the gentleman. And I would yield back.

BACA: Well, thank you very much.

Along the same lines, I guess we're all very much concerned with what's going on right now with a lot of the foreclosures that are pending before us. And it seems like the -- the institutions, though -- and I -- either one of you can answer it. A lot of the institutions right now are foreclosing. And there seems to be a lot of problems in the documentation and losing of the documentation within the banking industry, too, as well.

And I don't know if the Treasury and others can be involved in part of that process, because the consumer who is being foreclosed right now gets a notice. And in that process, they fill out the documents, and they are -- and then they don't tell us specifically what those documents should be. And then what happens is, during that whole process, they're losing their homes because they're not complying.

It seems like now it's another gimmick that is being used by some of the banking institutes to foreclose on individuals.

What can be done in that area? Or how are we addressing that?

BARR: Let me just try and address a -- a bit of that. I do think there were serious problems in the documentation process, and the -- and the foreclosure process. Treasury, through the lever of our home affordable mortgage program, has been putting pressure on services to do a better job in that.

I think they have made significant progress over the last number of months in reducing documentation problems. We have engaged, both with Fannie Mae and Freddie Mac as compliance agents and directly with the servicers, to deal with the lost documentation process and require additional reviews.

I still think there are problems out there in -- in the market. And -- and homeowners are having difficulty in that way. And I -- I think that it's -- we need to continue to focus on making better improvements.

BACA: Right, because they're still being penalized, and they're being foreclosed, and they shouldn't be because of the deadline that they said. Yet they're the ones that are late to responding back, and yet the homeowner is the one that ends up penalizing. I yield the...

(CROSSTALK)

FRANK: I thank (inaudible). One other point I wanted to make in support of my colleague from California, Mr. Sherman, although he's -- he's echoed here -- not echoed, but -- but joined by the gentleman from California, Mr. Miller, on the other side. And that is on the conforming loan limit being raised -- two points that are relevant. First, we had a vote on that in the House. We had some language in there in the FHA bill.

And I thought it was best -- I'd like to -- my -- my argument to the (inaudible) is let's have votes. The vote on that was more than 300 members of the House; three quarters of the House voted in favor of the higher loan limits, not just those of us in the affected area.

Secondly, I did note that, in a very good paper written by Alan Blinder and Mark Zandi -- kind of bipartisan -- about how we ended the great recession, they specifically credited the increase in the conforming loan limit as one of the factors that had helped the -- the -- the private market in -- in a good way.

So I would just add to what the gentleman from California said. And I hope we do do it before we adjourn. I thank the gentleman from California.

BACA: I yield back the remaining balance of my time.

KANJORSKI: Your time has expired.

And we'll now hear from the gentlelady from Illinois, Ms. Biggert.

BIGGERT: Thank -- thank you, Mr. Chairman.

Mr. DeMarco, on page eight of your testimony, you talk about work that's under way to develop projections that are comparable between the enterprises and say that there's some differences between the enterprise-generated results and results from FHFA-directed exercises.

But -- but you say that that's consistent with what you said in the past, even under severe stress scenarios, that the Treasury draws remain under $400 billion.

Would you support legislation to set a cap for Fannie and Freddie at $400 billion so that they can't borrow any more from the taxpayers?

I know that that cap was taken off around Christmas.

DEMARCO: Congresswoman Biggert, I believe that we owe investors in these securities and we owe the financial system clarity and certainty with regard to what the government is doing here with respect to Fannie and Freddie. And we have been clear about the securities that they are issuing today so that our mortgage market continues to function, will have the backing of the Treasury Department under the terms of the senior preferred agreement.

Those terms are public. People are trading billions of dollars in securities based on that. I don't think that we should come back in and alter the terms of that at this time.

BIGGERT: OK. Well, I -- I'm hearing from constituents about this fact. They're saying that -- that Fannie and Freddie are -- to the states -- are providing mortgages, just as in the past, where there's no downpayment.

DEMARCO: Yes. I'd very much like to -- to respond to that if I may, because Congressman Bachus raised it as well. There have been some news reports recently about a so-called affordable advantage program. I would like to explain this and -- and provide some clarity around this.

This program is with -- is an agreement between Fannie Mae and several state housing finance agencies. It's a limited term agreement. It is a -- think of it as an addendum to an ongoing purchase agreement that Fannie has with the HFAs. Under the terms of this, with the several HFAs, apparently Fannie has agreed to buy certain mortgages with little or no money down that involves recourse back to the HFA and that has a great deal of underwriting and -- and reviewed by the HFA.

I've had great communication with both Fannie Mae and Freddie Mac during the -- the period of this conservatorship. And any significant actions that's been taken by these companies have been reviewed and approved by a conservator. This one got away from us. It was a miscommunication, and this agreement with these HFAs was signed without my knowledge.

When I learned about it after the fact, I reviewed what has been done. I saw that there was now a legal contract with the HFAs, and I made clear to Fannie Mae a couple things. We were going to honor and respect that contract for its duration. It ends next March. And, two, we were not doing this in the future.

So there were several other requests that had come into Fannie Mae from other parties for similar no-downpayment or very-little- downpayment mortgages. And I said absolutely not. And so we've had nothing further on this. And when this particular program with these HFAs expire, it will not be renewed.

BIGGERT: But -- but how much is -- is the value of that? I mean, how many... DEMARCO: The -- the amount of loans that have been made under this program, I believe, is less than $10 million.

BIGGERT: Well, I -- I guess it's -- you know, it seems pretty risky, going back to -- to where we were before...

DEMARCO: Congresswoman, I -- I -- the basic premise here is that I believe borrowers should have a downpayment if they're going to purchase a house.

BIGGERT: OK.

DEMARCO: And I found that the terms of this program did not fit with the -- what we're trying to accomplish here in conservatorship, and that's why you won't be hearing about additional programs such as this.

BIGGERT: I'm not sure that -- I don't think you answered my previous question. Would you support legislation for a cap on the amount of money -- that $400 billion?

DEMARCO: Congresswoman Biggert, as I understand the way you've represented it, I would not, because I believe that that would change the terms of the agreement under which investors today are purchasing securities issued by Fannie Mae and Freddie Mac.

BIGGERT: OK. Thank you.

I yield the -- the remainder of my time to Mr. Royce of California.

ROYCE: I -- I appreciate the gentlelady from -- for yielding.

In point of fact, Chairman Frank said, in September of '03, "I do think I do not want the same kind of focus on safety and soundness that we have in OCC and OTS. I want to roll the dice, a little bit more, in this situation, toward subsidizing housing."

Now, that's -- that's frankly the fact. And I do think that President Clinton was -- was right in terms of his observation that "The responsibility that the Democrats may have rests more in resisting any efforts by Republicans in the Congress or by me when I was president to put some standards and tighten up a little bit on Fannie Mae and Freddie Mac."

For those of us that were involved in trying to put those standards on, and watching the Senate Republicans succeed in putting a bill out to deleverage those portfolios, it is a rewrite of history today not to acknowledge that we might be going down the same road again.

Thank you, Mr. Chairman.

KANJORSKI: The gentleman's time is expired.

I will now hear from the gentleman from North Carolina, Mr. Miller.

MILLER: Thank you, Mr. Chairman.

I joined this committee in 2003. And it was like walking into Harlan, Kentucky. And I didn't know the Hatfields. I didn't know the McCoys. But I knew they didn't get along with -- with each other.

What -- what Republicans on this committee now remember -- apparently remember was that they were voices in the wilderness years ago, saying that subprime lending was the road to ruin, and Fannie and Freddie were -- were -- were hugely responsible. And they -- and they warned us about Fannie and Freddie. And that's not what I remember at all.

MILLER: And fortunately these meetings are transcribed, and they live on in videotape. And I've gone back and checked. And that's not what they said at all, just as I remembered.

In fact, they praised subprime lending as being just the triumph of the kind of innovation that can come unfettered -- unfettered capitalism. It was leading to this huge spike in homeownership by people who could never go to -- would have qualified for mortgages under some stultifying set of regulations like what Democrats might propose.

And they did criticize Fannie and Freddie, but the criticisms of Fannie and Freddie were almost entirely repeating the talking points of Feddie -- Fannie and Freddie's bitter rivals, the companies that were almost entirely without government regulation, the private label securitizers -- such worthy companies as Goldman Sachs, Merrill Lynch, Bear Stearns, Lehman Brothers, AIG -- which was in competition with Fannie and Freddie, as well, because you all essentially insure your own -- your own securities.

The -- and the criticism was that those private label securitizers, those unregulated companies, were running rings around Fannie and Freddie in affordable housing; and that Fannie and Freddie were not doing nearly enough for affordable housing.

And the Bush administration kept raising the affordable housing goals, but then said that Fannie and Freddie could meet that goal when Fannie and Freddie were saying, "We don't buy mortgages like the mortgages they're buying." Said that HUD, under the Bush administration, said that Fannie and Freddie could meet that goal by buying the private label mortgage-backed securities -- what we now call toxic assets -- from -- from those companies.

Mr. DeMarco, to what extent did the $255 billion in private label mortgage -- subprime mortgage-backed securities -- how much of a loss is -- are -- was a result of those -- those securities?

DEMARCO: Let me pause for just a minute, Congressman.

It is -- it's less than 10 percent of the total, Congressman. I'll get the exact number for you.

MILLER: OK. You've -- you've said most of it has come from non- traditional mortgages that Fannie and Freddie did begin to buy in the last decade. Now "non-traditional" covers a lot of ground.

DEMARCO: There's non-traditional and traditional. They've taken a huge hit on their -- on their credit guarantee book.

MILLER: Well, but I assume that the non-traditional led -- led and then traditional have...

(CROSSTALK)

DEMARCO: Outweigh...

MILLER: ... more recently become -- it's only when the housing crisis really hit that the -- that the traditional became a problem, is that correct?

DEMARCO: I suppose so. I mean, certainly, as house prices and as unemployment has risen, it's affected quite a broad range of home buyers.

MILLER: OK. Of the non-traditional, how much of that was -- was Alt-A, which is -- did not really include predatory terms, but certainly would benefit from hindsight and certainly at the time, should have appeared foolish, poorly underwritten loans, loans that required little documentation, stated income. But the terms were not, you know, the interest rate may have been higher, but the terms were not terribly different from prime loans.

How much were Alt-A and how much -- did -- did Fannie and Freddie buy any of the kind of 228s, 327s, with a 30 to 50 percent increase in mortgage -- monthly mortgage payment and a -- and a 3 percent prepayment penalty? What -- those kind of subprime mortgage lending in the last decade that I consider predatory?

DEMARCO: I'm sorry, Congressman, you asked a lot of different questions rolled up into that. I'd -- if you would indulge me, I'd prefer to be able to prepare that in an orderly fashion for you in writing...

(CROSSTALK)

MILLER: If you could provide that for me, that would be fine...

DEMARCO: ... I'd give accurate answers.

MILLER: And, Mr. DeMarco, I think you probably know that I have praised you for beginning to pursue claims against the mortgage-backed securitizers that sold Fannie and Freddie $255 billion in subprime mortgage-backed securities in issuing subpoenas in -- in July.

I don't think it should be the federal government's role to take sides in private litigation, but your claims are almost identical to those of many private litigants, pension funds, that feel cheated in the very same way, who had -- have been stymied so far in their litigation.

It's not uncommon for litigants with similar claims to kind of compare notes, compare -- share information. Are you in contact with those private -- with those private litigants, the pension funds and insurance companies that bought the same kind of securities you bought?

DEMARCO: Congressman, we'll -- we've issued the subpoenas. We're gathering this information. At this point we're simply gathering information and determining what it -- what it tells us. Whatever our path is from there is yet to be determined, and I will certainly rely upon the advice of counsel in that process.

KANJORSKI: Gentleman's time has expired.

Now recognize the gentleman from Texas, Mr. Neugebauer.

NEUGEBAUER: Thank you.

You know, I think -- and I apologize, I haven't been able to stay for the whole hearing. But I think one of the fundamental questions that I've been asking and been talking to a lot of folks about -- and Mr. DeMarco, you and I have actually had this discussion as well -- is Congress is considering GSE reform and the fate of Freddie and Fannie.

At one time, you know, we had a functioning private market in this country. And there are other countries that have mortgage financing that doesn't necessarily have government backing.

Can you see in the future the ability for, if Congress decides to get the taxpayers out of the bailout business, of having a functioning private mortgage market where the government's not on the hook?

DEMARCO: Yes, sir, I can envision such an environment. I believe this country has, despite the incredible difficulties it's had the last few years and the losses suffered, we have a strong and robust financial system. It is every day getting stronger. Congress took a lot of action this summer to enhance regulatory oversight. That will contribute to it.

I can envision a market system for a good chunk of the U.S. mortgage market, yes, sir.

NEUGEBAUER: Mr. Barr?

BARR: I would -- I would agree with Director DeMarco that we have a -- have a long history of a vibrant and innovative financial sector that has played a strong role in housing finance and business finance and commercial finance all across the market. We do need to attract private capital back into the market.

I think that as Congress considers the future shape of reform, as I said just a few moments ago, I do think it's important that we not go back to the system that we had in the past where there were basically private gains and public losses. We can't have that kind of system in the future.

I do think there is a question to what extent there should be a government guarantee in the mix of ways that we are approaching revitalizing and having a strong and robust housing system. What the role of that guarantee should be, when it should come into play, if it exists, how it's priced, I think, are important questions for the Congress.

As Director DeMarco suggested, it -- it's hard to imagine not having some kind of role similar to the role FHA plays, for example. So I do think that there needs to be a mix of strategies used to bring the private capital back into the system and ensure we have a strong and vibrant system into the future.

NEUGEBAUER: Are you familiar with the Canadian system?

BARR: I am. I'm not an expert on Canada, but I am familiar with their...

(CROSSTALK)

NEUGEBAUER: ... I don't think the -- they have a guarantee on those mortgages, do they?

BARR: Their -- the Canadian system is quite different from ours. In part, they have a quite tightly regulated but also highly concentrated banking system. They rely not on a 30-year fixed rate mortgage but on a shorter term adjustable rate mortgage. It's possible to create a system similar to that. Other countries have -- have used the covered bond market as an approach.

I think in each instance, when you look at the international examples, it's important to look not just at what's on the books but what may also be implicitly there. A number of countries with concentrated banking sectors, where there doesn't appear to be a government guarantee involved, there's an implicit backing for the financial institutions which, I think, we don't want to recreate.

So I do think international examples can help. But we have to go a couple layers deeper to know whether that's the kind of system we want or not.

NEUGEBAUER: And so the question I have is -- is -- is there any incentive for the private market to -- to get back into this -- this market, given the fact that Freddie and Fannie are in existence and we're -- we're continuing this -- I don't know what this is called, but I mean, it's -- it's this -- this freeze in time where we're just continuing to let Freddie and Fannie to do what they were doing before the crisis.

BARR: Let me just echo a little bit what Director DeMarco said before, which is that Fannie and Freddie are not doing what they did before the conservatorship. That is they have fundamentally changed the nature of their underwriting. They are operating under the strictures (ph) of the conservatorship. They are -- underwriting standards of change. They are not involved, for example, in purchasing Alt-A loans as they were so significantly in 2006 and 2007.

BARR: I do think that Congress now needs to turn to the task of reforming the housing finance system, including Fannie Mae and Freddie Mac, and deciding what kind of system we want to have in the future. And I think very strongly, I now the Treasury believes, we should not return to the system we had in the past. We can't recreate these entities the way they were.

NEUGEBAUER: But hasn't the administration -- I mean, just basically said whatever capital a company needs, we're going to keep putting it into it. So why would -- why would the private sector securitize outside of Freddie and Fannie as long as Freddie and Fannie are still there? And as long as you all are committed to keep just throwing money at (inaudible) companies?

BARR: Well, I think I'd like to -- to separate out the steps that we took and that the prior administration took to bring stability to the housing finance system. I think those were absolutely critical as the Congress decides what the future system should look like. It's not a statement that the future system should look like the past. Quite the opposite. It's a statement that says as we figure out what the new system should look like, we can't disrupt the market. We can't disrupt the ability of homeowners to get mortgages. And that's absolutely critical to maintain so that Congress can decide what the right system is for the future.

KANJORSKI: The gentleman's time is expired.

Now, the gentleman from Indiana, Mr. Carson, for five minutes.

CARSON: Thank you, Mr. Chairman.

Thank you, (inaudible).

The Basel III rule agreed to on September the 12th include the liquidity requirement for banks that will encourage them effectively to buy the debt of Fannie and Freddie, as well as mortgage-backed securities that they backed. Specifically, those banks will be required to have enough high-quality liquid assets, and Fannie and Freddie debt counts as a high-quality debt.

How will you ensure that Fannie and Freddie will not inadvertently take on more risk than they can effectively handle?

BARR: Let me just say a little bit about the capital rules and then maybe turn it over to Director DeMarco. I think the capital rules are an important step in bringing greater stability now and in the future to our -- to our financial system; significantly increase the capital requirements for our firms, as well as going forward will improve their ability to withstand liquidity crises.

I do think that as Congress takes up the question of the future of Fannie Mae and Freddie Mac, we're going to need to address the way in which other participants in the financial system interact with those institutions if they continue in the future; or if they don't continue in the future, what the role of financial intermediation is with respect to the link between the housing finance entities and the rest of our financial sector so that we're not increasing systemic risk, but rather reducing it.

DEMARCO: In terms of what was done just a few days ago among the international bank regulators -- I'm sorry, Congressman, I'm not familiar with what exactly it might -- it might say, so I'd be happy to take a look at that. But I would note obviously that the debt- and mortgage-backed securities being issued by Fannie and Freddie today are both, you know, issued with the backstop of the (inaudible) preferred agreement with the Treasury Department, and in fact the Federal Reserve and the Treasury Department themselves hold those securities in large volume.

CARSON: Thank you, Mr. Chairman. I yield back.

KANJORSKI: The gentleman from Illinois, Mr. Manzullo, is recognized for five minutes.

MANZULLO: Thank you, Chairman.

The -- the frustration level with the American people has exceeded to be the boiling point. And I'm not saying that the two of you here are responsible for that. I just want to share that with you. Here -- here's the whole point. I'll bet you're glad I made that caveat.

(LAUGHTER)

BARR: We appreciate it. Thank you.

(CROSSTALK)

MANZULLO: We -- we just got -- I just got another e-mail from a world-class manufacturer in my congressional district. He has orders. The Institute for Supply Management is up I think nine or 10 months in a row. He has orders -- O-R-D-E-R-S -- to manufacture. He has people that he wants to hire. He's gone to eight banks. Every one says the same things. The banks say it's the examiners. Examiners say it's the regulators. The regulators say -- regulators are saying "We've changed nothing."

And so we're at -- we can recover right now, but the federal government is stopping the recovery in manufacturing. I've got 25 percent unemployment back home, one out of four people works in manufacturing. Effectively, it's at 25 percent, if not more.

Then I (inaudible) with the realtors. For every 10 applications that go to a bank, nine are turned down -- nine. And of those nine, four to five normally would be given. And many of those are on the stuff that you have on your hands, what's in foreclosure and in short sales.

So here we are now. Even a city with that amount -- Rockford, Illinois -- with that amount of unemployment, people are ready to buy. They're ready to move this stuff. They're ready to re-start the supply chains of manufacturing not only in traditional manufacturing, but in the housing market. And the clog to the entire recovery for this recession is here with the regulators.

I've talked to them and they've said, "We've changed nothing." I want to know what you, Mr. DeMarco, can do, or anybody else, to stop -- to unplug that clog? The recovery is here. Washington is stopping it.

DEMARCO: Congressman, I appreciate the, you know, the challenge and the frustration and the real impact this has on -- on individual families and communities. I regulate, as you know, the entities involved in the secondary market for mortgages. I believe, in fact -- I would not as a regulator say nothing has changed. I think a lot has changed with respect with mortgages, the change that needed to happen; the change that's still underway.

We needed to improve the underwriting standards...

(CROSSTALK)

MANZULLO: But the standards are being met by the people that are applying.

DEMARCO: If I may, Congressman, yes -- so I mean I think that those changes have been made. But I think that if the enterprise is operating in conservatorship, awaiting congressional action on housing finance reform, we have a functioning secondary mortgage market, so there is a secondary mortgage market outlet for creditworthy borrowers seeking a mortgage. So I can't explain what might be a particular problem for a particular constituent of yours, but we have a functioning mortgage market right now.

MANZULLO: This is not a particular constituent. I'm talking about hundreds of thousands of people across America.

DEMARCO: I understand. Forgive me for saying it that way, Congressman. But yes, all I can tell you is that the secondary mortgage market is open and operating to purchase these mortgages. And so I think that creditworthy borrowers...

(CROSSTALK)

MANZULLO: No, I understand that, and obviously 80 percent or 90 percent of the homes financed today are going through Fannie Mae or Freddie Mac.

I mean, this has got to be resolved. It's not an issue of dishonest people or incompetent people in the different areas that I mentioned. But the problem is this, I mean, we could have all the mortgage foreclosure help programs we want. Nothing's going to happen. We can't buy our way out of this recession. We have to work or manufacture our way out of it, but now people want to buy homes. I mean, arbitrarily, even coming in with the whole deal on the appraisal they get, at the last minute, "Well, we need another appraisal."

Another closing was stopped because somebody couldn't explain a $17 charge on their credit report. I mean, this is a real problem. We are there, Mr. DeMarco, we're there. And there was a summit in this city -- What? -- two weeks ago dealing with the lack of credit and with foreclosures in the home market. But there is nothing more that government can do except to unfreeze this credit and make sure that people who deserve the credit get it.

(CROSSTALK)

BARR (?): If I could just add to the comment before.

MANZULLO: Yes, sir.

BARR (?): With respect to business credit, I do think that there has been an excessive tightening. It's common in any downturn. It's been much more pronounced in this downturn. It's been I know frustrating to businesses around the country. It's frustrating to us. I do think there are steps that we can take to help on the regulatory front, but also with -- with the pending small business and jobs bill, I think...

(CROSSTALK)

MANZULLO: That bill's not going to do it because it doesn't change the underlying -- the underlying standard for lending the money. Banks have money. They're -- the community banks have money. They don't need more money from the federal government. They don't need another program. They -- they're not lending the money out because they're being hammered by the regulators because the examiners will come in and just arbitrarily classify a loan.

Don't talk to me about another federal program.

BARR (?): I do think that -- that with respect to examinations, you do find again on any downturn a tightening and an excessive tightening that is in a sense the mirror image of excessive loosening...

MANZULLO: Well, what are you going to do to stop the excessive tightening?

BARR (?): I -- you know, we obviously don't have regulatory ourselves over this sector, but we do have the ability to talk to other regulators, which we do on a regular basis, Treasury has.

KANJORSKI: The gentleman's time has expired.

MANZULLO: Thank you.

KANJORSKI: We have the gentleman from Kansas waiting anxiously by, and we recognize Mr. Moore for five minutes.

D. MOORE: Thank you, Mr. Chairman.

Mr. Barr and Mr. DeMarco, thank you for your public service.

D. MOORE: And, Mr. Barr, I understand that Treasury has been collecting comments from all stakeholders in what the government should do to replace Fannie Mae and Freddie Mac and create a stronger housing finance system, but I've heard one suggestion that concerns me, and that's simply to end Freddie and Fannie, privatize the entire housing finance system.

Is Treasury receiving comments from private industry stakeholders that full privatization would be a good idea?

And is it a good idea?

BARR: Representative Moore, we've received a range of public comment on privatization, on nationalization, on a wide variety of different strategies, looking at the housing finance system in the future.

As with any topic this complex, there are conflicting views on each of the suggested approaches. The potential downsides of having a system in which there is no government involvement include the lack of standardization, a potential lack of consumer protection, a potential lack of key products that the country has become reliant on such as the 30-year fixed rate mortgage with a to-be-announced market, the potential for lack of standardization and liquidity.

The potential upsides of having a full privatization include removing some element of direct taxpayer risk, increasing the ability for private-sector capital to flow into the market, potentially reducing the relative amount of capital flowing into housing vis-a-vis business, to the extent that there's a mismatch in subsidy rates.

And we are looking at those tradeoffs. As with -- again, as with any area this complex, choosing an approach that sounds pure in advance is usually less satisfying once one gets into the details of it.

D. MOORE: Thank you, sir.

Mr. DeMarco, the other side has raised several concerns that the GSEs are taking a lot of risks with respect to low downpayment loans.

Is that really the case, and how many home purchase loans have Fannie and Freddie bought in the past 12 months in which the downpayment was below 5 percent and below 10 percent, respectively?

If you don't have the exact numbers, could you please give us those numbers in writing as soon as you can, and can you at least give us a general sense whether the volume is high or low, sir?

DEMARCO: I will certainly provide the precise numbers to you and to the committee, but I can assure you the numbers are quite low. Particularly with respect to less than 5 percent down, it's -- it's very low. It's almost virtually non-existent.

D. MOORE: Thank you. And Mr. DeMarco, at a capital market...

DEMARCO: I have to -- you know what? Can I clarify one thing?

D. MOORE: I'm sorry. Sure. Sure.

DEMARCO: This may -- I don't want there to be a misunderstanding here.

The one exception to this is that we do have a refinance program operating, the Home Affordable Refinance Program or HARP. And so there are refinances going on in the HARP program where we have allowed for refinances of existing mortgages that Fannie and Freddie owned up to a current loan-to-value of 125 percent.

And the purpose of doing that is that that benefits the homeowner, enabling them to take advantage of lower mortgage rates, but it also benefits the credit risk of Fannie and Freddie by having improved pricing on that mortgage and a homeowner with an improved balance sheet. So it reduces the credit risk.

That's -- whenever we go over these data, I've got to be careful about, you know, carving out that assumption for the HARP program.

D. MOORE: OK. And Mr. DeMarco, at a capital market subcommittee hearing in July, John Taylor from the National Community Reinvestment Coalition indicated his strong concerns about fees being charged by Fannie and Freddie.

His response to why he was concerned, quote, "Because we think it's unfair. I mean, you know, the notion that because somebody lives in a declining market, that somehow they have to pay a premium seems fairly anti-American to me. You ought to be able to judge the person on their capabilities, their individual financial status, their creditworthiness and so on, not by the neighborhood they necessarily live in," end quote.

These fees that are charged in lieu of adequate private mortgage insurance seem to be driving mortgages away from the GSEs into FHA. This seems to be in large part because these fees can't be financed. Mr. DeMarco, is this true, and if so, what are these fees being used for?

DEMARCO: I think we've -- the pricing on mortgages prior to this housing finance debacle we've had -- we clearly were underpricing credit risk.

I believe the typical conversation about Fannie and Freddie pricing today is regarding what are called loan level price adjustments. But I think the Congress needs to understand that Fannie and Freddie have base guarantee fees that they -- that they apply, and then the loan level price adjustment is essentially, you know, the risk-based pricing that gets placed on a mortgage that allows for pricing for the particular risk characteristics provided by that mortgage.

I have a responsibility as conservator, and I've certainly heard it in the last few hours in front of this committee, that we are supposed to be operating in conservatorship so that we are pricing to the risk that mortgages have.

And so I think, with respect to the pricing that's going on today, that's what I would say we are -- we are doing. We are pricing -- the enterprises are pricing their guarantee fees to cover expected losses, operating expenses, and to be able to have a measured rate of return that is certainly reflective of their responsibility to make dividend payments to the Treasury Department on the (inaudible) preferred...

(CROSSTALK)

D. MOORE: My thanks to the witnesses. I yield back, Mr. Chairman.

DEMARCO: ... not a question of fairness, Congressman.

KANJORSKI: The gentleman...

(CROSSTALK)

DEMARCO: It's a question of being economic and being risk-based pricing in the business that we're doing today in conservatorship.

D. MOORE: Thank you, sir.

KANJORSKI: We're going to wind this hearing up, hearing from our two members from Kansas. And we'll now recognize the gentlelady from Kansas, Mrs. Jenkins.

JENKINS: Thank you, Mr. Chairman. And I would like to yield my time to the gentleman from California, Mr. Royce.

ROYCE: I thank the gentlelady.

You know, the -- Mr. Chairman, the talking points did not come from Fannie and Freddie's competitors in '05. It came from the Federal Reserve that came down here -- the chairman of the Federal Reserve -- and spoke to us. And I just pulled out the quote he gave us in '05 as a warning, in terms of the pending problem if we did not -- if we did not address this problem with Fannie and Freddie.

He said -- he said, "If legislation does not limit GSE portfolios, we run the risk of solidifying investors' perceptions that the GSEs are instruments of the government, that their debt is equivalent to government debt. GSEs will continue to grow faster than the overall home mortgage market; they can grow virtually without limit and without restrictions on the size of the GSE balance sheets. We put at risk our ability to preserve safe and sound financial markets in the United States."

Now, this is what caught Jim Leach's attention and, frankly, the attention of Richard Baker, myself, Mr. Garrett, Mr. Hensarling, Chris Shays, others on this committee that took the Fed seriously and took the Treasury Department, both under the Clinton administration and under the Bush administration, seriously, when they looked at what we had done in the 1992 passage of the GSE Act to set up this house of cards that would eventually lead to two-thirds of the mortgage market -- subprime mortgage market -- being handled by Fannie, Freddie and FHA, 65 percent in '01, 68 percent in '02, 67 percent in '03.

This is who were -- who were making the -- these were making the purchases of the junk put out by Countrywide, right, and convincing the rest of the market that they should get into this line of business as well.

Now, the testimony that Mr. DeMarco gave, I thought, was very -- a very strong case. And the question I would ask him is, do you believe that the private market eventually can handle the vast majority of this market, down the road, if we properly handle the phase-in?

Because, right now, we've got a real problem in terms of how we sustain this. But long-term, I would like to see us get away from a situation where there's so much political pull replacing market discipline and where the biggest lobby on the Hill is a GSE.

And I'd make one other quick observation, and that goes to the issue made by Pinto, the former Chief Credit Officer of Fannie Mae. He said the new goals put out on September 2nd are, quote, "likely to prove more risky than those that led to Fannie and Freddie's taxpayer bailout. Meeting these goals will necessitate a return to dangerous minimal downpayment lending, along with other imprudent lending standards."

So, you know, to what extent will the GSEs be allowed to purchase again high LTV loans and junk loans to meet these goals?

I mean, that's my second concern, but let me go to my first question to you. Long-term, do you think we can get back to a private market here?

DEMARCO: With respect to the first question, Congressman, I believe that, if Congress decides that it would like to see the bulk of the conventional mortgage market be handled in purely private hands, I believe that that is achievable.

DEMARCO: It's not the only option. I believe it is achievable.

With respect to the second question regarding housing goals, I'm not familiar with the full extent of that -- of that quote.

I will say that FHFA did issue the final housing goals for Fannie and Freddie for 2010 and 2011. We're required to by statute.

And I believe that continuing the housing goal regime is important, because one of the things we're doing in conservator (ph) (inaudible) that they meet their existing core mission responsibilities under the statute. And I believe that the housing goals are one reflection or one set of metrics as to whether they are accomplishing that congressional mandate or not.

We have substantially changed the goal. Congress did in HERA. And so this rule that we just finalized is a substantially different set of housing goals than existed prior. And we also, in setting the final goal levels for Fannie and Freddie, have tied them to what the primary market is actually producing.

And, to put it simply, the goals are that Fannie and Freddie keep up with or be proportionate to what the primary market produces, not to have to exceed it.

ROYCE: I understand that. But remember also, in the '92 act -- and I think the '92 act was a disaster -- but there was a provision in there on the need to maintain the sound financial condition of the enterprise.

And what the former chief credit officer of Fannie Mae is now saying is that you're -- you're actually like to put at risk sort of this going concern concept for the -- for the GSEs, given the fact that you're headed down that road again, toward minimal downpayment lending and so forth.

And I think that has to be considered, because we know that Congress is reluctant to address this issue, but...

(CROSSTALK)

DEMARCO (?): ... important consideration, Congressman. And I tried to be clear to the committee in response to the question from Congresswoman Biggert that I am not looking for the enterprises to engage in very low or no downpayment lending. And I also as part of the final rule made absolutely clear that we expect them to not undertake bad mortgages or to (inaudible) or anything of the sort with regard to satisfying the housing goals.

ROYCE: Thank you, Mr. DeMarco.

Thank you, Mr. Chairman.

KANJORSKI: The gentleman's time has expired.

Mr. DeMarco, I, before we close, just have to ask one thing. It follows Mr. Manzullo's question. I'm acutely aware -- and you responded by letter on Friday about the inadequate Federal Home Loan Bank system responding to commercial loans and encouraging and priming that market.

Is there anything you can do to get out there and start encouraging the Federal Home Loan Banks to get involved in commercial loan activity in the country? And are you intending to do so?

DEMARCO: Well, Congressman -- or Mr. Chairman -- only with respect to what is authorized in the -- in the statute. I mean, I believe with any government-sponsored enterprise, their activity should be limited to the specific areas that Congress has targeted for them.

So general support of commercial lending is not part of the charter of the Federal Home Loan Bank system. But there are provisions and you have certainly been a proponent of it, I'm well aware of that, sir, with regard to certain of the programs they have -- the Community Investment Program, their (ph) community financial institution members. There's a broadened set of eligible collateral, because it's been clearly stated the intent of Congress is that the community financial institutions, they be able to take down advances for a broader set of community development purposes. And there's a -- there's a broader set of eligible collateral for that.

(inaudible) the letter that I sent you on Friday made clear -- I reiterated my commitment that I made in the comment letter to the GAO in response to their study this summer that we were going to go back and look at how we were examining each of the home loan banks with respect to their implementation of these authorities under the statute.

And so we will do so, but we will do so consistent with what the statutory mandate and limits are, yes, sir.

KANJORSKI: I appreciate that, Mr. DeMarco. Maybe we can -- I think -- I think I heard an undertone from the whole committee in terms of commercial lending and business activity that after every one of these events, as Mr. Barr well pointed out, there seems to be a slow response (inaudible) the banking community, and the regulators get hesitant in what they'll approve.

And I can see that happening. I mean, I'm hearing it from community banks, from the regional banks. I'm hearing it from a cross-section of lenders. They'd like to do more, but they're being constrained by their regulators.

Maybe you all can have a couple of summit meetings yourselves down here and get together. And make sure -- it's not only your decision here in Washington, but you send that out into the field. And maybe -- I know in one of our past recessions, the Washington regulators actually went out and convened meetings in the regions to encourage it. And maybe it's time we start doing that.

(CROSSTALK)

KANJORSKI: Because I agree with Mr. Manzullo, there's a lot of jobs out there that can be and will be created, but there is a need for money -- operating capital.

DEMARCO: Mr. Chairman, if I may, because I think that's an excellent suggestion. I'd like to point out something that the -- that the FHFA is, in fact, doing. Congress, in establishing FHFA, said we shall have a Division of Housing Mission and Goals. And we have such a division, sir.

And, in fact, the team in that -- in that division that works on these matters is, in fact, going out into the field and is holding field hearings, is meeting with community development participants out in the field.

They're going around the country and actually seeing what's going on, and trying to hear in local markets what are the needs, what are the concerns.

And with respect to the Federal Home Loan Bank system, they're trying to better understand how the programs available through the bank system are working or not working, how they could be improved.

And we are in the process of refreshing the regulatory framework we inherited from the Federal Housing Finance Board regarding those programs. We are in the process of refreshing them to make them more responsive to the needs of local communities.

But an important input of that has been sending my staff out across the country to gather this input.

KANJORSKI: I appreciate that.

I want to thank you, Mr. DeMarco, for your activities and certainly that new initiative that you're talking about.

Mr. Barr, I want to thank you for your participation in the hearing. I think it's been informative.

We've rewritten history to some extent, but that's always the case when you're seven weeks out from an election. We hope that ultimately that history will be written in the years ahead and be -- have a little more truth to it, on both sides, if I may say so.

That being the case, and no further activity before the committee, the chair notes that some members may have additional questions for this panel, which they may wish to submit in writing.

And 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.

Without objection, it is so ordered.

And without objection, all other things having been empaneled, the panel is dismissed and this hearing is adjourned.

END

.ETX

Sep 15, 2010 15:01 ET .EOF
Source: CQ Transcriptions