



# U.S. Senate Committee on Banking, Housing, and Urban Affairs

U.S. SENATOR RICHARD C. SHELBY, AL, RANKING MEMBER

---

EMBARGOED UNTIL BEGINNING OF HEARING

Contact: Jonathan Graffeo at (202) 224-0894  
Jonathan\_Graffeo@banking.senate.gov

## **OPENING STATEMENT OF SENATOR RICHARD C. SHELBY**

*“Reforming the Regulation of the Government Sponsored Enterprises”*

February 7, 2008

“Thank you, Mr. Chairman, for calling today’s hearing on reforming the regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks. I remain committed to seeing this Committee create a new regulator with the authority and independence necessary to ensure that these institutions carry out their mission in a safe and sound manner.”

“While it is easy to recognize the role the GSEs play in providing liquidity to our home mortgage markets, I believe it is also important for us to recognize the size and scope of their operations. The combined obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks exceed SIX TRILLION dollars. That is over one trillion dollars more than the 4.4 trillion dollar publicly held debt of the United States Government. Additionally, Fannie Mae and Freddie Mac are among the largest participants in the derivatives market, arising from their need to hedge the risks associated with their combined 1.4 trillion dollar portfolios.”

“Through their debt exposure and derivative contracts, the GSEs affect an extensive network of financial institutions. Clearly these are large organizations with a tremendous influence on our financial markets. Should a GSE be unable to meet its obligations, the ramifications for our mortgage market and our financial system could be devastating. The current difficulties in the subprime market would be small in comparison if one of the GSEs were to falter.”

“Mr. Chairman, you have heard me say many times that an institution which is well-managed, well-regulated and well-capitalized is not only likely to be safe and sound, but is also best positioned to weather bad economic conditions. Both Fannie and Freddie have had significant management problems as evidenced by a string of disturbing accounting scandals which are not yet entirely resolved. They are not well-regulated because the structure and authorities of the current regulator are grossly inadequate to ensure the safe and sound operation of institutions the size of both Fannie and Freddie. Finally, Fannie Mae and Freddie Mac are not well-capitalized. Roughly three years ago, OFHEO placed a 30 percent excess capital requirement on the GSEs’ statutory minimum capital requirements because of serious operational deficiencies. While a 30 percent

surcharge may sound like a significant increase, the practical effect is that their capital went from 2.5 percent to 3.25 percent for assets. In the wake of their combined losses of over eight billion dollars this year, representing almost 20 percent of their capital, both Fannie Mae and Freddie Mac are leveraged over 80-to-1 on a fair value basis.”

“These margins leave little, if any, room for error. Even a minor decline in the value of their assets or higher than anticipated losses on guaranteed Mortgage Backed Securities could leave Fannie and Freddie ill-equipped to perform the necessary liquidity role in today’s troubled housing market. Considering that housing market analysts are uniformly forecasting further price declines, and some are even suggesting home values may decrease by as much as 25 percent next year, I believe it is only prudent to ensure that the GSEs are properly capitalized.”

“While we ask the GSEs to perform the critical task of adding liquidity to the market, we must also be cognizant of the fact that the GSEs face the same heightened risks as every other participant in the mortgage market. We have already seen some of the effects in the GSEs’ bottom lines. In four of the last five quarters, Freddie has reported losses. Fannie has had two losses in the last five quarters. For the third quarter – the most recent public data – Freddie Mac reported a two billion dollar loss while Fannie Mae reported a 1.4 billion dollar loss. The fourth quarter is not likely to be any better and 2008 promises to continue this trend for the GSEs and other market participants.”

“As we find ourselves surrounded by waving red flags, what is the first thing we do? Do we look for ways to shore up the safety and soundness of these massive institutions by creating a strong and independent regulator? Do we look for ways to focus them on their original mission of facilitating affordable housing? Do we look for ways to decrease the risk profile of the GSEs so that we first, and foremost, protect the American taxpayer from another costly bailout?”

“The answer to all of these questions is NO. We do none of these. In fact, we do quite the opposite.”

“As part of the stimulus package, the Congress is considering an increase in the GSE conforming loan limit from \$417,000 to over \$700,000. Let me repeat that so there is no confusion. The Congress is considering an increase in the GSE conforming loan limit from \$417,000 to over \$700,000.”

“This represents nearly a 75 percent increase in the loan limit despite the fact that this Committee has not held one hearing, has built no record and has no clear picture as to the status of the jumbo market and whether it really needs this kind of help at this time. Just so we are clear, an individual would need a yearly income in excess of \$150,000 to even qualify for a \$700,000 home loan. Once again, instead of thinking of ways to further protect the American taxpayer, we are actually considering ways to further expose them for the benefit of those making healthy six-figure salaries. As one member of this Committee who lived through the savings and loan crisis and its aftermath, the move is

reminiscent of the 1980 behind-closed-doors increase in the deposit insurance limit from \$40,000 to \$100,000.”

“Mr. Chairman, we must ask ourselves why the GSEs are regulated in the first place, and let the answers drive the structure of their regulation. Fannie Mae and Freddie Mac are not regulated for the sake of protecting their shareholders or their debt-holders from loss. They are regulated to protect the taxpayer and to protect the stability of our financial system.”

“I commend the hard work of Director Lockhart and his agency in making use of the limited tools at their disposal to monitor the GSEs. I believe, however, that the OFHEO lacks the necessary authority to protect both our financial system and the American taxpayer from significant loss in the event of a GSE insolvency. This deficiency becomes all the more striking as we consider increasing the conforming loan limits by nearly 75 percent without even entertaining some added protections.”

“The role played by the GSEs in our mortgage and financial markets is necessary. But, what is equally necessary is the need to ensure the safety and soundness of their operations so that they continue to be a vital and dependable source of liquidity in our mortgage market. Therefore, we must craft strong legislation that will address the very real risks posed by the GSEs while at the same time facilitating and strengthening their core mission.”

“Thank you Mr. Chairman.”