Opening Statement as Submitted to the U.S. House Committee on Financial Services
by
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Chairman Frank, Ranking Member Bachus, members of the Committee, thank you for the opportunity to testify today.

These are tough times for the housing and mortgage markets, for families trying to buy homes or struggling to stay in them, and for companies and employees that serve these economically important industries. Many investors have fled the mortgage market, drying up the flow of financing – the liquidity – for subprime, jumbo and even affordable conventional, conforming loans.

While most of the prime, conventional, conforming market we serve is working and remains relatively liquid, borrowers who don't qualify for or can't afford a standard long-term, fixed-rate prime loan have dwindling options. According to one recent estimate, subprime and Alt-A originations will drop from $700 billion in the first half of this year to $300 billion in the second half. With about $600 billion in subprime loans slated to reset by the end of 2008, this precipitous drop in subprime lending means that many subprime borrowers who could otherwise refinance into better loans could be out of luck. The mortgage markets are not going to be there for these borrowers, unless there is a boost of liquidity and long-term mortgage investors regain confidence.

For the broader housing market, and the economy in general, this lack of liquidity could have far-reaching effects. The credit markets tend not to operate in distinct buckets, despite labels such as prime, jumbo or Alt-A. History shows that a lack of liquidity in one part of the market has a ripple effect on the entire market. Borrowing costs increase for everyone.

Congress chartered Fannie Mae, and I quote from page one of that Charter, to "provide stability in the secondary market for residential mortgages"; to "respond appropriately to the private capital market"; to "provide ongoing assistance to the secondary market for residential mortgages by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing"; and to "promote access to mortgage credit throughout the Nation."

We shorthand that to "liquidity, affordability and stability." That is all we do, and we do it only in the U.S. mortgage market.

As a number of observers have pointed out, the mortgage market operated smoothly through financial crunches before, such as in 1998, and in other times of distress. But not so this time. Liquidity is not returning.

We think more can be done, and we want to do our part to help provide stability and liquidity across the mortgage market. Some steps we've taken already include the following:

- Since the beginning of the year we have helped lenders refinance about $6.5 billion of subprime ARMs into prime loans through our HomeStay initiative, helping more than 33,000 homeowners avoid subprime payment shock. We've also significantly increased our funding and technical support to qualified counseling agencies that are helping struggling homeowners get into the right loan or avoid problems with their current loan. We offer our Home Counselor Online service free to these organizations as well as lenders.

- We have committed to fund $450 million in mortgage rescue packages from housing finance agencies in Ohio, Massachusetts and New York. With more and more lenders exiting the subprime business, these packages serve as a vital escape hatch. These programs can offer a way of keeping people in their homes with a loan they can manage.

- As you know, many borrowers are already in trouble. Through August, our loan servicers have renegotiated loans for more than 27,000 seriously delinquent borrowers — more than 750 loan workouts a week — to keep them in their homes. These loss mitigation efforts keep about half of our seriously delinquent borrowers out of foreclosure. But while we do all we can to prevent the loss of a home, we don't always succeed. Should it come to that, we and our servicer partners work with the borrower to sell the home to recover some of the value, or at least avoid having a foreclosure on record.

- For the secondary market we serve, our mortgage-backed security business is currently operating at record volumes as demand for conforming product increases. Holdings by other investors of our mortgage-backed securities have grown $170 billion so far this year. But packaging loans into securities isn't a cure for all parts of the conforming market and it can't address all the liquidity needs. So, where possible, under the limits of our portfolio ceiling, we have sought to fund affordable multifamily housing mortgages and affordable single-family loans in instances where other buyers have exited the market.

We think the President's foreclosure prevention initiative is an important step, and we look forward to working with the Administration to make it successful by continuing to work with our lending partners and our loan servicers to identify potentially troubled borrowers and avert defaults.

But as I said, we'd like to do more to fulfill our mission to provide liquidity, stability and affordability. One of our primary tools, since our creation in 1938, has been buying and holding mortgages and mortgage-backed securities in our portfolio. However, as you know, our portfolio has been capped since May of 2006 under a consent agreement with our regulator, OFHEO, while we fixed our accounting and internal control weaknesses and caught up on our financial reports with the SEC.

OFHEO's decision yesterday to change the formula for the portfolio cap is directionally helpful because it provides us some limited flexibility. However, given the extent of the disruption, the market needs a broader, more comprehensive approach so that we can more fully address the ongoing turmoil and bring liquidity to the mortgage market.

We believe having the flexibility to increase our portfolio by at least 10 percent would make a meaningful difference. For instance, it would allow us to be a more active long-term investor in subprime refinance loans, affordable multifamily loans and other critical sectors of the mortgage market where investment capital has dried up.

We are fast closing in on the time when the terms of the OFHEO consent agreement will be satisfied. The fact is we have made enormous progress, and we have put in place procedures designed to ensure continued compliance with the requirements of the agreement. We have issued audited financials up through 2006. We have vastly reduced our material control weaknesses. A key item is to get caught up on our SEC filings, and we are close to doing that. Our 2006 10K report is filed, and we expect to file our 2007 quarterly SEC reports by year-end. At that time, we would anticipate the cap being removed, thus allowing us full flexibility to respond to the needs of the market and fulfill our mission.

Our mortgage portfolio provides liquidity by raising capital from investors, and then using the money to buy residential mortgages from lenders. We earn an investment return from holding the loans. By providing a stable, long-term home for mortgage assets, we free up lenders to make more loans. This increases the availability and lowers the costs of mortgages. Yes, we're only one of many investors in the market competing to buy mortgages. But when others pull out, the funds effectively dry up and it becomes more difficult and more costly for lenders to make loans. When that happens, our mandate is to step in, keep liquidity flowing and the market stable.

We have done so many times in the past, including the recent past. During the liquidity crisis in 1998, our portfolio grew by about $100 billion, or more than 30 percent, to provide secondary market support when others withdrew it. Our portfolio has had periods of expansion and contraction in response to market demands. For instance, our portfolio reached an all-time high of $917 billion in September 2003, another year when liquidity tightened. In 2005, demand for mortgage assets from other mortgage investors increased substantially. The market had plenty of liquidity. Our portfolio declined.

I am confident we could provide more liquidity help to the home finance market today without taking risks we are not capable of managing. Our purchases would comply with all relevant regulatory guidance, and be consistent with the internal controls framework we have established with OFHEO. We are not the only answer to the liquidity crunch, but we can play a part in a measured, safe and sound way.

Some have suggested an increase in the GSE conforming loan limit above the current $417,000 to address liquidity issues beyond the conforming market. We leave it to Congress to determine our proper loan limit, but I want to be clear – we would support such an increase, and we would be prepared to act.

Looking ahead, I am confident we can get through this critical chapter for housing, and I believe the best years for housing are still ahead. The mortgage market is returning to its senses, with products, prices, underwriting and investing that serve homebuyers for the long run.

To be sure, while I have spoken mostly about Fannie Mae and the role we should play, I want to emphasize that there are important roles for many institutions in this crisis. Turning to the industry broadly, a number of steps can be taken now to improve the long-term health of the home finance system. The bad actors — individuals and institutions that have broken rules or violated the consumer's trust — should be prosecuted. More sources of liquidity should be tapped. Transparency and clear disclosures can be put into place for both consumers and investors. On that note, the Mortgage Bankers Association's "Project Clarity" is a laudable effort. And a return to credit fundamentals seems to be underway. My fear is that amidst all the change, reform and improvement, we will lose sight of what brought us so far — a commitment to decent, affordable housing for all Americans.

The need for safe, affordable mortgage lending will only grow with this growing nation. Affordable housing is beyond the reach of two-thirds of the low- to moderate-income families in America, and the difference between what families can afford and what a home costs is growing, not shrinking. Our affordable products for lower-income and credit-blemished borrowers help bridge this gap, offering fixed-rate loans on manageable terms. We've already helped our lender customers make almost $53 billion of such loans so far this year.

Affordable lending will drive the growth of homeownership in this country, if we can minimize the long-term impact of the current crisis. The turbulence in subprime should not derail the effort to provide flexible, affordable and sustainable mortgages, now or in the years ahead. The need is great, and through this period and in the years ahead, Fannie Mae is committed to doing our part.

Thank you.