

Federal Home Loan Bank of San Francisco  
Housing GSE Regulatory Restructuring Proposals  
House Committee on Financial Services  
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Good morning. My name is Dean Schultz, and I am the President of the Federal Home Loan Bank of San Francisco. I am here today on behalf of the San Francisco Bank to support regulatory restructuring of the two housing GSE regulators: the Federal Housing Finance Board, the regulator of the 12 regional Federal Home Loan Banks; and OFHEO, the regulator of Fannie Mae and Freddie Mac. The board of the San Francisco Bank strongly believes that a new independent agency under Treasury, with one director regulating the Federal Home Loan Banks, Fannie Mae, and Freddie Mac, and with appropriate language recognizing the mission of the Banks, is the best way to ensure continued safe and sound operation of these institutions, a robust housing finance market, and in the words of Secretary Snow, “world-class regulation.”

In 1932, Congress established the Federal Home Loan Bank System of 12 cooperatively-owned regional Banks to promote housing, and the Banks take that housing finance mission seriously. Since its inception, the System has developed a high level of expertise in providing housing finance to housing lenders, and has created a very effective and efficient delivery system. The Banks do so by providing liquidity for home mortgage loans that would otherwise be illiquid because such loans do not meet the underwriting criteria of the secondary market. The members in our Bank – California, Nevada, and Arizona banks, savings institutions, and credit unions — range in size from some of the nation’s largest housing lenders to single office institutions. Our diverse membership base has a common interest: using the Bank to provide funds for housing loans. Access to the Bank’s advances provides lenders the confidence that they will be able to hold loans that they cannot sell easily in the secondary market and still meet either the seasonal or cyclical demands of the borrowing public. In effect, access to Bank advances takes the liquidity risk out of lending to families with the fewest financial options.

During the past 15 years, Congress has broadened the membership and mission of the Federal Home Loan Bank System, in addition to establishing a separate regulator, the Federal Housing Finance Board. In 1989, Congress established the Finance Board as a regulator that would focus on the unique cooperative structure and mission of the Federal Home Loan Banks. As such, the Finance Board has established rules and policies designed to ensure that the Banks provide liquidity for housing loans in a safe and sound manner. In 1992, Congress established OFHEO under HUD as the regulator of Fannie Mae and Freddie Mac. In doing so, Congress did not combine the Finance Board with OFHEO, and recognized that the GSEs each possessed different structures and missions.

While the Federal Home Loan Banks principal business is making advances to member institutions, Fannie Mae and Freddie Mac are in the business of purchasing conventional loans and either holding them in portfolio, or securitizing them for sale in the secondary market. By their nature, Fannie Mae and Freddie Mac must have uniform national underwriting criteria, and deal with homogenous mortgage loans to permit the secondary market to function effectively. As national, publicly traded companies, Fannie Mae and Freddie Mac are structurally different from the regional, cooperatively owned Federal Home Loan Banks. So it made sense over ten years ago to create regulators that focused on their different missions and operations.

There has been some convergence of the activities of the Banks and Fannie Mae and Freddie Mac during the past several years, and therefore, in the risks posed by each of the entities. To serve the needs of their members and to assure the availability of reasonably priced funds for housing, the Banks have developed programs under which they purchase mortgages from members, but the selling members retain the credit risk. Over the past dozen years, the business strategies of Fannie Mae and Freddie Mac have evolved, and the enterprises have been holding more loans in their portfolios. These similarities make some of the operational distinctions between the Banks and the Fannie Mae and Freddie Mac less significant. In addition, both are in the business for one principal purpose — to provide funding and liquidity to ensure the continued stability and growth of affordable housing finance. Recognizing the increasing commonalities among these housing GSEs, we believe that any consideration of regulatory restructuring must include not only Fannie Mae and Freddie Mac, but also the Federal Home Loan Banks.

We understand that the Committee will consider legislation, based on Congressman Baker's bill, to replace OFHEO with a new agency under the Treasury Department in order to provide enhanced regulation of Fannie Mae and Freddie Mac. The Federal Home Loan Bank of San Francisco supports replacing the Finance Board, the regulator of the 12 regional Federal Home Loan Banks, with the same new independent agency under Treasury. This would provide consistent, enhanced and vigorous regulation for all housing GSEs, and would be a strong statement in the marketplace that regulation of housing GSEs is a priority of the Congress and the Administration. An independent regulator also assures the marketplace that regulation, examination, and policy development will occur in an apolitical framework.

The San Francisco Bank believes that Congress has a unique opportunity to consolidate housing GSE regulation in one independent agency under Treasury. Like other financial regulators, the Finance Board and OFHEO were established at different times to deal with different GSE structures, and little consideration was given to the fact that each of the regulated entities involved housing finance. Today, there is no need for two separate housing GSE regulators when one could do the job more effectively.

To recognize and preserve the separate statutory structures and operations of the Federal Home Loan Banks and Fannie Mae and Freddie Mac, we recommend that Congress establish the new independent agency under Treasury with two deputy directors: one for the cooperatively-owned regional Federal Home Loan Banks; and one

for the publicly-held Fannie Mae and Freddie Mac. The deputy director for the Federal Home Loan Banks would implement and enforce the Federal Home Loan Bank Act, and the deputy director for Fannie Mae and Freddie Mac would implement and enforce the Federal Housing Enterprise Financial Safety and Soundness Act. Alignment with Treasury, the principal advocate for the Administration's financial policies and its primary link to the financial markets, would deliver a strong message to the financial markets that the new agency will provide enhanced, vigorous regulation of the housing GSEs. Such legislation would also make the new agency a peer of other financial institution regulators, especially the Office of Thrift Supervision and the Office of the Comptroller of the Currency, both independent agencies under Treasury.

Combining the Finance Board and OFHEO was mentioned by Chairman Oxley and Secretary Snow at this Committee's September 10<sup>th</sup> hearing. Both recognized the significance of housing finance to our economy and home buyers, and the need for a "strong world-class regulatory agency to oversee the potential operations of the GSEs and the safety and soundness of their financial activities." As Secretary Snow indicated, legislation should maintain healthy national markets for housing finance, and not merely be an exercise in moving existing agencies from one part of the government to another. He said that an agency under Treasury would be a "value added proposal" that would provide the agency with more significance, more expertise. We agree wholeheartedly.

The General Accounting Office has considered the issue of establishing a single housing GSE regulator. In its July 1997 report to Congress, it indicated that such a regulator would have several advantages. Affirming its 1991 and 1993 reports on these GSEs, the GAO indicated that a single regulatory agency would best fit its criteria of being: (1) independent and objective; (2) prominent in government; (3) economically efficient; and (4) consistent in its approach to regulation. GAO indicated in 1997 that it found no evidence that would cause it to alter its previous positions, and its ongoing work "has strengthened our belief that OFHEO and FHFB would be more effective if combined." It went on to say that a single regulator would create valuable synergies among regulatory staff, even if as GAO suggested, the regulation of the two entities be separated within a single regulator.

We appreciate very much the opportunity to present these views today. We also appreciate the substantial work of both Congressman Baker and Congressman Royce in proposing legislation dealing with GSE regulatory restructuring. We urge the Committee to include a proposal to combine the Finance Board and OFHEO into a new independent agency under the Treasury Department in any legislation that the Committee adopts.

Thank you.