

**GAO**

Testimony  
Before the Committee on Banking,  
Housing, and Urban Affairs, U.S. Senate

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For Release on Delivery  
Expected at 10:00 a.m. EDT  
Thursday, April 21, 2005

# HOUSING GOVERNMENT- SPONSORED ENTERPRISES

## A New Oversight Structure Is Needed

Statement of David M. Walker,  
Comptroller General of the United States





Highlights of [GAO-05-576T](#), a testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

## Why GAO Did This Study

Serious concerns exist regarding the risk management practices and the federal oversight of the housing government-sponsored enterprises (GSE)—Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLBank System), which had combined obligations of \$4.6 trillion as of year-end 2003. In 2003, Freddie Mac disclosed significant accounting irregularities. In 2004, the Office of Federal Housing Enterprise Oversight (OFHEO) cited Fannie Mae for accounting irregularities and earnings manipulation. Fannie Mae has to restate its financial statements for 2001-2004 and OFHEO has required the GSE to develop a capital restoration plan. Also in 2004, the FHLBanks of Chicago and Seattle entered into written agreements with their regulator, the Federal Housing Finance Board (FHFB), to implement changes to enhance their risk management.

To assist Congress in its housing GSE oversight, this testimony provides information on GSEs' missions and risks, the current regulatory structure, and proposed regulatory reforms.

## What GAO Recommends

GAO recommends that Congress establish a single regulator with a board or hybrid board and director governance model. This single regulator should be equipped with adequate authorities to oversee all housing GSE activities.

[www.gao.gov/cgi-bin/getrpt?GAO-05-576T](http://www.gao.gov/cgi-bin/getrpt?GAO-05-576T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Thomas J. McCool at (202) 512-8678 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov).

# HOUSING GOVERNMENT-SPONSORED ENTERPRISES

## A New Oversight Structure Is Needed

### What GAO Found

While the GSEs provide certain public benefits, they also pose potential risks. Fannie Mae and Freddie Mac's primary activity involves purchasing mortgages from lenders and issuing mortgage-backed securities that are either sold to investors or held in the GSEs' retained portfolio. The 12 FHLBanks traditionally made loans to their members and more recently instituted programs to purchase mortgages from their members and hold such mortgages in their portfolios. While not obligated to do so, the federal government could provide financial assistance to the GSEs if one or more experienced financial difficulties that could result in significant costs to taxpayers. Due to the GSEs' large size, the potential also exists that financial problems at one or more of the GSEs could have destabilizing effects on financial markets.

The current housing GSE regulatory structure is fragmented and not well-equipped to oversee their financial soundness or mission achievement. For example, although all the GSEs face increasingly similar risks (particularly potential losses in their mortgage portfolios resulting from fluctuations in interest rates), OFHEO is responsible for Fannie Mae and Freddie Mac's safety and soundness oversight while FHFB is responsible for the safety and soundness and mission oversight of the FHLBanks. OFHEO also lacks key regulatory authorities necessary to fulfill its oversight responsibilities. Moreover, the Department of Housing and Urban Development (HUD), which has housing mission oversight responsibility for Fannie Mae and Freddie Mac, faces a number of challenges in carrying out its responsibilities. In particular, HUD may not have sufficient resources and technical expertise to review sophisticated financial products and issues.

Creating a single housing GSE regulator could better ensure consistency of regulation among the GSEs. With safety and soundness and mission oversight combined, a single regulator would be better positioned to consider potential trade-offs between these sometimes competing objectives. To ensure the independence and prominence of the regulator and allow it to act independently of the influence of the housing GSEs, this new GSE regulator should have a structure that consists of a board or a hybrid board and director model. To be effective, the single regulator must also have all the regulatory oversight and enforcement powers necessary to address unsafe and unsound practices, respond to financial emergencies, monitor corporate governance and compensation practices, assess the extent to which the GSEs' activities benefit home buyers and mortgage markets, and otherwise ensure that the GSEs comply with their public missions.

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Mr. Chairman, Mr. Ranking Minority Member, and Members of the Committee:

I appreciate the opportunity to participate in today's hearing to discuss federal oversight of the housing government-sponsored enterprises (GSE), namely Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLBank System). When I testified before this committee in February 2004 on this same topic, it was shortly after Freddie Mac had disclosed significant financial problems associated with its accounting practices.<sup>1</sup> Freddie Mac's regulator—the Office of Federal Housing Enterprise Oversight (OFHEO)—did not detect the GSE's accounting irregularities at an early stage. At that hearing, I discussed the need for the establishment of a capable, credible, strong, and independent regulatory structure to help ensure that the housing GSEs operate safely and soundly. To accomplish this goal, GAO—and others—proposed that Congress replace the current fragmented regulatory structure for housing GSE oversight with a single regulator that would be responsible for safety and soundness and mission activities. Subsequently, this committee took the lead in approving a strong bill to create a single GSE regulator.

Over the past year, the need for fundamental regulatory reform of the housing GSEs has become even more clear and compelling. As you well know, Fannie Mae has been found to have engaged in the misapplication of accounting standards and earnings manipulation, and company staff even allegedly falsified signatures on documents. Fannie Mae will have to restate its financial statements for the past several years and OFHEO has required the GSE to develop a capital restoration plan. I am encouraged that OFHEO identified these deficiencies at Fannie Mae and has moved aggressively to correct them. I also note that the FHLBank System's regulator—the Federal Housing Finance Board (FHFb)—has identified risk management deficiencies at the Chicago and Seattle FHLBanks and entered into written agreements with these institutions to correct identified deficiencies. Nevertheless, I believe the evidence clearly shows that the current regulatory structure is not well-equipped to oversee the operations and effectively monitor the risks of the large and complex

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<sup>1</sup>See GAO, *Government Sponsored Enterprises: A Framework for Strengthening GSE Governance and Oversight*, [GAO-04-269T](#) (Washington, D.C.: Feb. 10, 2004).

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housing GSEs, which had combined financial obligations of about \$4.6 trillion at year-end 2003.<sup>2</sup>

To assist the committee in its oversight of the housing GSEs and their regulation, my testimony today is divided into two sections. First, I will provide an overview of the GSEs and their missions, identify the risks they pose to taxpayers and the financial system, and describe the current regulatory structure, which is divided among OFHEO, the Department of Housing and Urban Development (HUD), and FHFB. Second, I will identify deficiencies in the current regulatory structure and discuss how a single regulator that is governed by a board and endowed with adequate legal authorities is, in our view, the best potential means to help ensure that the GSEs meet their housing-related missions while doing so in a safe and sound manner.

To prepare for this testimony, we relied heavily on a substantial amount of work that we had done on the housing GSEs and their regulatory oversight in the past (see Related GAO Products), but we also reviewed our historical positions in light of recent events. We conducted our work in Washington, D.C., in April 2005 in accordance with generally accepted government auditing standards.

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## Overview of the Housing GSEs, Their Risks, and Regulatory Structure

I would like to begin my testimony by briefly describing the missions and activities of each of the GSEs, and the risks they pose to taxpayers. Then I will describe the current GSE regulatory structure.

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## The Housing GSEs Share Similar Missions

Fannie Mae and Freddie Mac's mission is to enhance the availability of mortgage credit across the nation during both good and bad economic times by purchasing mortgages from lenders (banks, thrifts, and mortgage lenders), which then use the proceeds to make additional mortgages available to home buyers. Most mortgages purchased by Fannie Mae and Freddie Mac are conventional mortgages, which have no federal insurance

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<sup>2</sup>The reported housing GSEs' financial data for financial obligations and retained mortgage portfolios identified in this testimony are subject to change. Both Fannie Mae and the FHLBank System are currently revising previous financial statements.

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or guarantee. The companies' mortgage purchases are subject to a conforming loan limit that currently stands at \$359,650 for a single-family home in most states. Although Fannie Mae and Freddie Mac hold some mortgages in their portfolios that they purchased, most mortgages are placed in mortgage pools to support mortgage-backed securities (MBS). MBS issued by Fannie Mae or Freddie Mac are either sold to investors (off-balance sheet obligations) or held in their retained portfolios (on-balance sheet obligations). Fannie Mae and Freddie Mac guarantee the timely payment of principal and interest on MBS that they issue.

The 12 FHLBanks that constitute the FHLBank System traditionally made loans—also known as advances—to their members (typically banks or thrifts) to facilitate housing finance and community and economic development. FHLBank members are required to collateralize advances with high-quality assets such as single-family mortgages. More recently, the FHLBanks initiated programs to purchase mortgages directly from their members and hold them in their retained portfolios. This process is similar to Fannie Mae and Freddie Mac's traditional business activities, although the FHLBanks do not currently have the authority to securitize mortgages.<sup>3</sup>

The housing GSEs' activities have generally been credited with enhancing the development of the U.S. housing finance market. For example, when Fannie Mae and the FHLBank System were created during the 1930s, the housing finance market was fragmented and characterized by regional shortages of mortgage credit.<sup>4</sup> It is widely accepted that the housing GSEs' activities helped develop a unified and liquid mortgage finance market in this country.

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## Housing GSE Activities Involve Significant Risks

While the housing GSEs have generated public benefits, their large size and activities pose potentially significant risks to taxpayers. As a result of their activities, the GSEs' outstanding debt and off-balance sheet financial obligations were about \$4.6 trillion as of year-end 2003. The GSEs face the risk of losses primarily from credit risk, interest rate risk, and operational

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<sup>3</sup>Securitization is the process of aggregating similar financial instruments, such as loans or mortgages, into pools and selling investors securities that are backed by cash flows from these pools.

<sup>4</sup>Freddie Mac was established in 1970.

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risks.<sup>5</sup> Although the federal government explicitly does not guarantee the obligations of GSEs, it is generally assumed on Wall Street that assistance would be provided in a financial emergency. In fact, during the 1980s, the federal government provided financial assistance to both Fannie Mae and the Farm Credit System (another GSE) when they experienced difficulties due to sharply rising interest rates and declining agricultural land values, respectively. The potential exists that Congress and the executive branch would determine that such assistance was again necessary in the event that one or more of the GSEs experienced severe financial difficulties. Because the markets perceive that there is an implied federal guarantee on the GSEs' obligations, the GSEs are able to borrow at interest rates below that of private corporations.

The GSEs also pose potential risks to the stability of the U.S. financial system. In particular, if Fannie Mae, Freddie Mac, or the FHLBank System were unable to meet their financial obligations, other financial market participants depending on payments from these GSEs may in turn become unable to meet their financial obligations. To the extent that this risk, called systemic risk, is associated with the housing GSEs, it is primarily based on the sheer size of their financial obligations. For example, as discussed in OFHEO's 2003 report on systemic risk, if either Fannie Mae or Freddie Mac were to become insolvent, financial institutions holding the enterprise's MBS could be put into a situation where they could no longer rely on those securities as a ready source of liquidity.<sup>6</sup> Depending on the response of the federal government, the financial health of the banking segment of the financial services industry could decline rapidly, possibly leading to a decline in economic activity. As another example, derivatives counterparties holding contracts with a financially troubled GSE could realize large losses if the GSE were no longer able to meet its obligations. If such an event were to occur, widespread defaults could occur in derivatives markets.

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<sup>5</sup>Credit risk is the possibility of financial loss resulting from default by homeowners on housing assets that have lost value; interest rate risk is the risk of loss due to fluctuations in interest rates; and operational risk includes the possibility of financial loss resulting from inadequate or failed internal processes, people, and systems or from external events.

<sup>6</sup>Office of Federal Housing Enterprises Oversight, *Systemic Risk: Fannie Mae, Freddie Mac, and the Role of OFHEO* (Washington, D.C.; Feb. 4, 2003).

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## Housing GSE Regulatory Structure Is Divided among OFHEO, HUD, and FHFB

The current regulatory structure for the housing GSEs is divided among OFHEO, HUD, and FHFB, as described below:

- OFHEO is an independent office within HUD and is responsible for regulating Fannie Mae and Freddie Mac’s safety and soundness. OFHEO oversees the two GSEs through its authority to examine their operations, determine capital adequacy, adopt rules, and take enforcement actions. Although OFHEO’s financial plans and forecasts are included in the President’s budget and are subject to the appropriations process, the agency is not funded with tax dollars. Rather, Fannie Mae and Freddie Mac pay annual assessments to cover OFHEO’s costs.
- HUD is responsible for ensuring that Fannie Mae and Freddie Mac are accomplishing their housing missions. HUD is to accomplish this responsibility through its authority to set housing goals, and to review and approve new programs, and through its general regulatory authority. HUD is funded through appropriations.
- FHFB is responsible for regulating the FHLBank System’s safety and soundness as well as its mission activities. The agency has a five-member board, with the President of the United States appointing four members—each of whom serves a 7-year term—subject to Senate approval. The fifth member is the Secretary of HUD. The President also appoints FHFB’s chair subject to Senate approval. Like OFHEO, FHFB carries out its oversight authorities through examinations, establishing capital standards, rule making, and taking enforcement actions. FHFB is funded through assessments of the 12 Federal Home Loan Banks and is not subject to the appropriations process.

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## Housing GSE Regulatory Reform Is Necessary to Better Ensure Safety and Soundness and Mission Achievement

As I stated previously, OFHEO has moved aggressively over the past year to identify and address risk management and accounting deficiencies at Fannie Mae and Freddie Mac, and FHFB has entered into written agreements with two FHLBanks to correct interest rate risk management deficiencies. Nevertheless, we continue to believe that the current fragmented regulatory structure for the housing GSEs is inadequate to monitor these large and complex financial institutions and their mission activities. Establishing a single housing GSE regulator with a board structure and equipping the agency with adequate authorities would better ensure that the GSEs operate in a safe and sound manner and fulfill their housing missions.

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## Current GSE Regulatory Structure Is Fragmented, OFHEO Lacks Key Authorities, and HUD's Mission Oversight Capacity Is Questionable

The current fragmented structure of federal housing GSE regulation does not provide for a comprehensive and effective approach to safety and soundness regulation. Although the housing GSEs operate differently, their business activities and risks are becoming increasingly similar. As I described previously, the FHLBank System has established mortgage purchase programs over the past several years and FHLBank System mortgage holdings were \$113 billion at year-end 2003. While still small compared with Fannie Mae and Freddie Mac's combined retained mortgage portfolios of \$1.3 trillion for the same time period, the FHLBank System now operates more like Fannie Mae and Freddie Mac and is increasingly incurring interest rate risks. Management of interest rate risk for mortgage holdings involves the application of sophisticated risk-management techniques, including the use of financial derivatives. Although such strategies are appropriate for risk management, they require specialized expertise, sophisticated information systems, and an understanding and application of sometimes complex accounting rules. In my view, it simply does not make sense for the federal government to entrust regulation of large and complex GSEs that are incurring similar risks to two different regulators, which have different approaches to examinations and setting capital standards.

Moreover, OFHEO, and FHFB to a lesser degree, lack key authorities to fulfill their safety and soundness responsibilities, as described below:

- Unlike with bank regulators and FHFB, (1) OFHEO's authority to issue cease and desist orders does not specifically list an unsafe and unsound practice as grounds for issuance and (2) OFHEO's powers do not include the same direct removal and prohibition authorities applicable to officers and directors.
- Bank regulators have prompt corrective action authorities that are arguably more robust and proactive than those of OFHEO and FHFB. These authorities require that bank regulators take specific supervisory actions when bank capital levels fall to specific levels or provide the regulators with the option of taking other actions when other specified unsafe and unsound actions occur.<sup>7</sup> Although OFHEO has statutory authority to take certain actions when Fannie Mae or Freddie Mac capital falls to predetermined levels, the authorities are not as proactive or broad

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<sup>7</sup>Capital can be a lagging indicator of unsafe and unsound conditions at financial institutions. Declining asset quality is an unsafe and unsound condition that may be identified months or years before capital declines.

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as those of the bank regulators.<sup>8</sup> OFHEO has also established regulations requiring specified supervisory actions when unsafe conditions are identified that do not include capital, but OFHEO's statute does not specifically mention these authorities. FHFBS's statute does not establish a prompt corrective action scheme that requires specified actions when unsafe conditions are identified. Although FHFBS officials believe they have all the authority necessary to carry out their safety and soundness responsibilities, the agency has significant discretion in resolving troubled FHLBanks. Consequently, there is limited assurance that FHFBS would act decisively to correct identified problems.

- Unlike bank regulators—which can place insolvent banks into receivership—and FHFBS, which can take actions to liquidate an FHLBank, OFHEO is limited to placing Fannie Mae or Freddie Mac into a conservatorship.<sup>9</sup> Thus, it is not clear that OFHEO has sufficient authority to fully resolve a situation in which Fannie Mae or Freddie Mac is unable to meet its financial obligations.

Finally, we have significant concerns about HUD's capacity as the mission regulator for Fannie Mae and Freddie Mac. As I stated in my testimony last year, HUD officials we contacted said the department lacked sufficient staff and resources necessary to carry out its GSE mission oversight responsibilities. HUD officials said that although the GSEs' assets had increased nearly sixfold since 1992, HUD's staffing had declined by 4,200 positions and GSE oversight—which consisted of about 13 full-time positions—must compete with other department priorities for the limited resources available. While HUD's ability to ensure adequate resources for its GSE oversight responsibilities is limited, its mission oversight responsibilities are increasingly complex. For example, as we have noted in the past, it is not clear that HUD has the expertise necessary to review sophisticated financial products and issues, which may be associated with the department's program review and approval and general regulatory

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<sup>8</sup>For example, bank regulators are generally required to take specified regulatory actions at earlier stages of capital depletion than is OFHEO. Bank regulators are also required to initiate four supervisory actions against an undercapitalized institution—including restricting asset growth—while OFHEO is mandated to take only two actions (not including restricting asset growth).

<sup>9</sup>According to OFHEO officials, a receivership is empowered to take over the assets and operate an entity, assuming all of its powers and conducting all of its business as well as removing officers and directors. A receiver may place the failed institution into liquidation and sell its assets. While a conservator may also remove officers and directors of an entity, a conservator is typically appointed to conserve rather than dispose of assets.

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authorities.<sup>10</sup> In addition, without the authority to impose assessments on Fannie Mae and Freddie Mac to cover the costs associated with their mission oversight, it would appear that HUD will always be challenged to fulfill its GSE mission oversight responsibilities.

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### A Single Housing GSE Regulator with a Board or Hybrid Board/Director Governance Model and Equipped with Sufficient Authorities Is Critical

To address the deficiencies in the current GSE regulatory structure that I have just described, we have consistently supported and continue to believe in the need for the creation of a single regulator to oversee both safety and soundness and mission of the housing GSEs.<sup>11</sup> A single housing GSE regulator could be more independent, objective, efficient, and effective than separate regulatory bodies and could be more prominent than either one alone. We believe that valuable synergies could be achieved, and expertise in evaluating GSE risk management could be shared more easily, within one agency. In addition, we believe that a single regulator would be better positioned to oversee the GSEs' compliance with mission activities, such as special housing goals and any new programs or initiatives any of the GSEs might undertake. This single regulator should be better able to assess these activities' competitive effects on all three housing GSEs and better able to ensure consistency of regulation for GSEs that operate in similar markets.

Further, a single regulator would be better positioned to consider potential trade-offs between mission requirements and safety and soundness considerations, because such a regulator would develop a fuller understanding of the operations of these large and complex financial institutions. Some critics of combining safety and soundness and mission have voiced concerns that doing so could create regulatory conflict for the regulator. However, we believe that a healthy tension would be created that could lead to improved oversight. The trade-offs between safety and soundness and compliance with mission requirements could be best understood and accounted for by having a single regulator that has complete knowledge of the GSEs' financial condition, regulates the mission goals Congress sets, and assesses efforts to fulfill them.

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<sup>10</sup>See GAO, *Government Sponsored Enterprises: Federal Oversight Needed for Nonmortgage Investments*, [GAO/GGD-98-48](#) (Washington, D.C.: Mar. 11, 1998). HUD's general regulatory authority can be used to limit or disallow activities that are determined not to support the mission of Fannie Mae or Freddie Mac.

<sup>11</sup>See GAO, *Government-Sponsored Enterprises: Advantages and Disadvantages of Creating a Single Housing GSE Regulator*, [GAO/GGD-97-139](#) (Washington, D.C.: July 9, 1997).

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New GSE Regulator Should Have a Board or Hybrid Board/Director Governance Structure

In determining the appropriate structure for a new GSE regulator, I note that Congress has authorized two different structures for governing financial regulatory agencies: a single director and board. Among financial regulators, single directors head the Office of the Comptroller of the Currency, the Office of Thrift Supervision and OFHEO, while boards or commissions run FHFBS, the Securities and Exchange Commission, and the Board of Governors of the Federal Reserve, among others. The single director model has advantages over a board or commission; for example, the director can make decisions without the potential hindrance of having to consult with or obtain the approval of other board members.

In our previous work, however, we have stated that a “stand-alone” agency with a board of directors would better ensure the independence and prominence of the regulator and allow it to act independently of the influence of the housing GSEs, which are large and politically influential. A governing board may offer the advantage of allowing different perspectives, providing stability, and bringing prestige to the regulator. Moreover, including the secretaries of Treasury and HUD or their designees on the board would help ensure that GSE safety and soundness and housing mission compliance issues are considered.

I would note that in other regulatory sectors—besides financial regulation—Congress has established alternative board structures that could be considered as potential models for the new GSE regulator. One such alternative structure would be the hybrid board/director governance model. Under such an approach, there would be a presidentially appointed and Senate-confirmed agency head who would report to a board of directors composed of secretaries from key executive branch agencies, such as Treasury and HUD. Having board members from the same political party could lessen some of the tensions and conflicts observed at boards purposefully structured to have a split in membership along party lines. A board composed of members from the same political party, however, may not benefit from different perspectives to the same extent as a board with members from different political parties. Therefore, an advisory committee to the regulator could be formed to include representatives of financial markets, housing, and the general public. This advisory committee could be required to have some reasonable representation from different political parties.

Adequate Regulatory Authorities Are Essential

It is also essential that the new GSE regulator have adequate powers and authorities to address unsafe and unsound practices, respond to financial emergencies, and ensure that the GSEs comply with their public missions. These authorities include (1) cease and desist authority related to unsound

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practices, (2) removal and prohibition authority related to officers and directors, (3) prompt corrective action authority, and (4) authority to resolve a critically undercapitalized GSE, which may include placing it into receivership. Additionally, the new housing GSE regulator should have the authority to adjust as necessary the housing enterprises' minimum and risk-based capital requirements to help ensure their continued safety and soundness.

I would also like to comment on an area of recent debate concerning discussions of GSE regulatory reform, i.e., restrictions on Fannie Mae's and Freddie Mac's retained mortgage portfolios, which were approximately \$1.3 trillion as of year-end 2003. In testimony before this committee on April 6, 2005, Federal Reserve Chairman Greenspan stated that the GSEs' large retained mortgage portfolios do not necessarily benefit housing finance, are primarily intended to increase the GSEs' profitability, and increase the potential for systemic financial risks. To address these concerns, Chairman Greenspan called for limits on the GSEs' mortgage portfolios to be phased in over time. Moreover, Treasury Secretary Snow also expressed concern about the GSEs' mortgage portfolios and called for limits on their size. We also have commented that the GSEs' housing portfolios raise potential risks, and their benefits to housing finance markets are not clear. In my view, providing the new regulator with strong criteria to evaluate the costs and benefits of the GSEs' mortgage portfolios and the authority to limit them, if necessary, is essential. The criteria could include the extent to which the mortgage portfolios enhance the GSEs' housing mission, increase financial risks, and raise financial stability concerns.

Further, the new housing GSE regulatory agency should be provided with explicit authority to oversee the GSEs' corporate governance and management compensation practices. As I stated in my previous testimony, while the GSEs should have been leaders with respect to corporate governance, in many respects they were not. For example, unlike leading organizations, the chairman of Fannie Mae's board also served as the GSE's chief executive officer (CEO). I note that both Fannie Mae and Freddie Mac have formally agreed with OFHEO to separate the positions of chairperson of the board and CEO, thereby helping to ensure that the GSE boards independently establish company policies that their CEOs are responsible for carrying out. OFHEO also found that Fannie Mae's compensation system provided managers with financial incentives to take actions—such as accounting irregularities—that increased the GSE's reported short-term profitability. Without the authority to police

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such practices, the new regulator would not be able to fully carry out its oversight responsibilities.

I also believe that the new GSE regulator should be tasked with the responsibility to conduct research on the extent to which the housing GSEs are fulfilling their housing and community development missions. As I described earlier, there are already questions about the extent to which the housing GSEs' mortgage holdings benefit housing finance markets. Moreover, federal agencies, academics, and the GSEs have initiated studies that have estimated the extent to which Fannie Mae's and Freddie Mac's activities generate savings to home buyers, which have reached differing conclusions. Additional studies may be needed to more precisely estimate the extent to which the GSEs' activities benefit home buyers. Further, there is virtually no empirical information on the extent to which FHLBank advances lower mortgage costs for home buyers or encourage lenders to expand their commitment to housing finance. Without better information, Congress and the public cannot judge the effectiveness of the GSEs in meeting their missions or whether the benefits provided by the GSEs' various activities are in the public interest and outweigh their financial and systemic risks.

#### Regulatory Funding Structure

Finally, I would now like to comment on issues surrounding the potential funding arrangements for a new housing GSE regulator. Exempting the new GSE regulator from the appropriations process would provide the agency with the financial independence necessary to carry out its responsibilities. More importantly, without the timing constraints of the appropriations process, the regulator could more quickly respond to budgetary needs created by any crisis at the GSEs. However, being outside the appropriations process can create trade-offs. First, while the regulator will have more control over its own budget and funding level, it will lose the checks and balances provided by the federal budget and appropriations processes or the potential reliance on increased appropriations during revenue shortfalls. As a result, the regulator would need to establish a system of budgetary controls to ensure fiscal restraint. Second, removing the regulator from the appropriations process could diminish congressional oversight of the agency's operations. This trade-off could be mitigated through increased oversight by the regulator's congressional authorizing committees, such as a process of regular congressional hearings on the new GSE regulator's operations and activities.

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Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions that you or other Members of the Committee may have.

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Acknowledgments**

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# Related GAO Products

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*Federal Home Loan Bank System: An Overview of Changes and Current Issues Affecting the System.* [GAO-05-489T](#). Washington, D.C.: April 13, 2005.

*Government-Sponsored Enterprises: A Framework for Strengthening GSE Governance and Oversight.* [GAO-04-269T](#). Washington, D.C.: February 10, 2004.

*Federal Home Loan Bank System: Key Loan Pricing Terms Can Differ Significantly.* [GAO-03-973](#). Washington, D.C.: September 8, 2003.

*Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board.* [GAO-03-364](#). Washington, D.C.: February 28, 2003.

*OFHEO's Risk Based Capital Stress Test: Incorporating New Business Is Not Advisable.* [GAO-02-521](#). Washington, D.C.: June 28, 2002.

*Federal Home Loan Bank System: Establishment of a New Capital Structure.* [GAO-01-873](#). Washington, D.C.: July 20, 2001.

*Comparison of Financial Institution Regulators' Enforcement and Prompt Corrective Action Authorities.* [GAO-01-322R](#). Washington, D.C.: January 31, 2001.

*Capital Structure of the Federal Home Loan Bank System.* [GAO/GGD-99-177R](#). Washington, D.C.: August 31, 1999.

*Federal Housing Finance Board: Actions Needed to Improve Regulatory Oversight.* [GAO/GGD-98-203](#). Washington, D.C.: September 18, 1998.

*Federal Housing Enterprises: HUD's Mission Oversight Needs to Be Strengthened.* [GAO/GGD-98-173](#). Washington, D.C.: July 28, 1998.

*Risk-Based Capital: Regulatory and Industry Approaches to Capital and Risk.* [GAO/GGD-98-153](#). Washington, D.C.: July 20, 1998.

*Government-Sponsored Enterprises: Federal Oversight Needed for Nonmortgage Investments.* [GAO/GGD-98-48](#). Washington, D.C.: March 11, 1998.

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*Federal Housing Enterprises: OFHEO Faces Challenges in Implementing a Comprehensive Oversight Program.* [GAO/GGD-98-6](#). Washington, D.C.: October 22, 1997.

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*Housing Enterprises: Investment, Authority, Policies, and Practices.* [GAO/GGD-91-137R](#). Washington, D.C.: June 27, 1997.

Comments on “*The Enterprise Resource Bank Act of 1996.*” [GAO/GGD-96-140R](#). Washington, D.C.: June 27, 1996.

*Housing Enterprises: Potential Impacts of Severing Government Sponsorship.* [GAO/GGD-96-120](#). Washington, D.C.: May 13, 1996.

Letter from James L. Bothwell, Director, Financial Institutions and Markets Issues, GAO, to the Honorable James A. Leach, Chairman, Committee on Banking and Financial Services, U.S. House of Representatives, Re: GAO’s views on the “Federal Home Loan Bank System Modernization Act of 1995.” B-260498. Washington, D.C.: October 11, 1995.

*FHLBank System: Reforms Needed to Promote Its Safety, Soundness, and Effectiveness.* [GAO/T-GGD-95-244](#). Washington, D.C.: September 27, 1995.

*Housing Finance: Improving the Federal Home Loan Bank System’s Affordable Housing Program.* [GAO/RCED-95-82](#). Washington, D.C.: June 9, 1995.

*Government-Sponsored Enterprises: Development of the Federal Housing Enterprise Financial Regulator.* [GAO/GGD-95-123](#). Washington, D.C.: May 30, 1995.

*Federal Home Loan Bank System: Reforms Needed to Promote Its Safety, Soundness, and Effectiveness.* [GAO/GGD-94-38](#). Washington, D.C.: December 8, 1993.

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