

**FOR IMMEDIATE RELEASE
JULY 25, 1997**

**Contact: Jill Weide
(202)414-3813**

**STATEMENT OF
MARK KINSEY, ACTING DIRECTOR
OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT (OFHEO)
TO
SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES AND
GOVERNMENT-SPONSORED ENTERPRISES
U.S. HOUSE OF REPRESENTATIVES
JULY 24, 1997**

Thank you, Mr. Chairman. I appreciate the opportunity to appear here today and to provide the views of the Office of Federal Housing Enterprise Oversight (OFHEO) on the topic of creating a single regulator to oversee the three housing government-sponsored enterprises (GSEs). My testimony focuses on two areas. The first is OFHEO's mission and how it interacts with OFHEO's current structure within the Department of Housing and Urban Development (HUD). The second area sets out OFHEO's comments on the General Accounting Office's (GAO) July 9, 1997 report on the advantages and disadvantages of creating a single regulator for the housing GSEs.

OFHEO'S CURRENT STRUCTURE

OFHEO was established as an independent entity within HUD by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, (Title XIII of P.L. 102-550), (the 1992 Act). The Office is headed by a Director, appointed by the President and confirmed by the Senate for a five-year term. OFHEO's primary mission is to examine and regulate the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) for capital adequacy and safety and soundness. In carrying out this mission, OFHEO has regulatory authority similar to such other federal financial regulators as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, Office of Thrift Supervision, and the Board of Governors of the Federal Reserve System.

OFHEO's specific supervisory responsibilities include:

- Conducting examinations of Fannie Mae and Freddie Mac;

- Developing a risk-based capital standard, using a stress test, that simulates stressful interest rate and credit risk scenarios;
- Making quarterly findings of capital adequacy based on a minimum capital standard and, when complete, a risk-based capital standard;
- Prohibiting excessive executive compensation;
- Issuing regulations concerning capital standards and enforcement procedures; and
- Taking necessary enforcement actions.

It is important to note that these supervisory responsibilities are exclusive to OFHEO and are exercised without the review or approval of the HUD Secretary. OFHEO also has specific independent operational authorities. These include determining budget requests, managing operations, and reporting directly to Congress. While OFHEO's budget is subject to the Congressional appropriations process, the Office is fully funded through direct assessments on the GSEs.

General regulatory authority over the GSEs resides with HUD. This authority includes the power to make rules and regulations necessary to ensure that the public policy mission of the GSEs is carried out. Central to this public purpose is the setting, monitoring, and enforcing compliance with affordable housing goals.

OFHEO's independence from HUD, as presently structured, creates the environment of accountability and credibility required by OFHEO to do an effective job. OFHEO's relationship with HUD provides a broad avenue for coordination of HUD's programmatic operations with OFHEO's safety and soundness concerns.

Coordination between HUD and OFHEO occurs in a number of ways. OFHEO provides a quarterly operations report to the Secretary that highlights major activities and accomplishments. OFHEO also participates in HUD's Principal Staff meetings. Coordination with HUD on GSE regulations and new programs has also worked well. For example, communication and exchange of information on Fannie Mae's Mortgage Protection Plan played a major part in helping to expedite the evaluation and subsequent approval of that program.

OFHEO's relationship with HUD should also be measured in light of OFHEO's own significant accomplishments. Starting in 1993 with no personnel and no equipment, we have assembled a talented staff with outstanding regulatory and supervisory skills and a solid understanding of housing finance markets and the operations of the Enterprises.

In the examinations area, we developed, and will shortly have completed, a sequence of exams to assess each of the six core risks that represent significant risk exposures to the Enterprises. These were major and time-consuming undertakings. We had to learn the details of the Enterprises' structures, policies, procedures, and problem areas. For their part, the Enterprises

had to learn what kind of information we need and how to provide it efficiently. I note that during this period, we developed an off-site financial analysis function that permits us to routinely monitor both published Enterprise financial data and internal risk measures.

OFHEO has also made great progress in developing its capital regulations. Last year, we issued a Notice of Proposed Rulemaking containing major components of the risk-based capital standard, as well as a Final Rule on minimum capital. This year, we completed construction of the financial simulation model that will serve as the operating platform of the risk-based capital stress test. We are ready to discuss this model with OMB and other interested administration parties. Building this model has been an extremely complex task, unprecedented for a financial institution regulator. We have gathered, reformatted for comparability, and analyzed enormous amount of data from the two Enterprises. Over the next few months, we will complete decisions about stress test assumptions that will lead to publication next year of a Proposed Rule. When complete, we believe OFHEO's risk-based capital regulation will be a landmark in the field of financial regulation.

OFHEO'S COMMENTS ON GAO'S REPORT RECOMMENDING A SINGLE REGULATOR FOR HOUSING GSEs.

In its report issued earlier this month, GAO lists five criteria that it believes are critical to effective housing GSE oversight. These criteria are: Independence and objectivity; prominence in government; economy and efficiency; consistency in regulation of similar markets; and separation of primary and secondary market regulation. Based on these criteria, GAO concludes that GSE regulation would be more effective if existing responsibilities at OFHEO, HUD, and FHFB were combined into a single entity. GAO further concludes that the best regulatory structure would be an independent, arm's length, stand-alone regulatory body headed by a board.

These conclusions are consistent with prior GAO reports and positions. In comparing the existing oversight arrangement to its preferred structure, GAO concludes that the preferred structure would: 1) be more independent and objective; 2) be potentially more prominent; 3) be better positioned to ensure consistency of regulation among the housing GSEs; and 4) provide better coordination and sharing of expertise.

I would like to comment on the analysis surrounding these conclusions.

Would a combined structure be more independent and objective?

OFHEO, as currently structured, has sufficient independence from HUD to do its job effectively. This independence is bolstered by OFHEO's exclusive authority over safety and soundness and capital matters as well as independent budget and management authority. GAO agrees: "The existing regulatory structure is one way to accomplish the objectives of maintaining a link with HUD and also having a safety and soundness regulator with sufficient independence."

Objectivity means operating in a manner that is perceived to be, and is in fact, independent of the regulated entities. Current law provides an explicit arm's-length framework for OFHEO's

operations. Reinforcing this independence is a prohibition against employment at a regulated GSE by any senior OFHEO official for two years after leaving the Office.

Would a combined structure be more prominent?

GAO concludes that a combined structure would provide the housing GSE regulator with more prominence. While a broader mission could increase OFHEO's prominence, it does not follow that increased prominence would significantly enhance our ability to regulate effectively.

A unified regulator, by virtue of its size and regulatory breadth, would likely be given more attention by industry, the media and Congress. Nonetheless, OFHEO has, we believe, done an estimable job of establishing its reputation as a strong, cost-efficient regulator, with a lean but highly skilled staff.

GAO says that a single more prominent regulatory agency could help attract and retain staff with a special mix of expertise and experience needed to examine and monitor the GSEs. As noted by GAO, hiring and retaining staff has been a concern for OFHEO, since the Office competes with other financial regulators and the private sector for the limited number of individuals with the required skills and experience. OFHEO believes that a combined structure might help attract staff in some areas, such as examinations, but not in the areas needed to develop the stress test.

Would a combined structure be better positioned to ensure consistency of regulation?

The importance of regulatory consistency depends on the extent to which the activities of one or more regulators overlap. So far, we have found relatively little overlap with HUD's GSE programmatic regulation and even less with FHFB's Home Loan Bank regulations. Programmatic rules for Fannie Mae and Freddie Mac have had only modest safety and soundness implications, and these Enterprises have, up to now, competed only tangentially with the Home Loan Banks.

This could change in the future. It is possible that HUD's future roles could make it difficult for the Enterprises to comply with our rules, or vice-versa. Similarly, new activities of Fannie Mae, Freddie Mac or the Home Loan Banks could result in more direct competition. The Chicago Home Loan Bank's pilot program is one possible example.

Would a combined structure provide better coordination and sharing of expertise?

In general, OFHEO agrees with GAO that a combined structure should provide for better coordination and sharing of expertise. But the key to an efficient combined structure is effective communication, not whether the regulatory components are housed under the same roof or report to the same person. In this regard, OFHEO's relationship with HUD has functioned well. There is ongoing communication and sharing of expertise, demonstrated in HUD's and OFHEO's recent review of Fannie Mae's Mortgage Protection Plan, and the development of HUD's affordable housing regulation.

Other Issues

I would like to comment on two other issues. First, GAO concludes that a stand-alone, independent agency governed by a board, as opposed to an independent office within an executive branch agency governed by a director, best meet its criteria. However, GAO notes that existing structures for financial institution regulators illustrate that either arrangement is plausible. We agree, and reemphasize our belief that the OFHEO-HUD structure works well. We believe that a director-run office is more efficient and accountable. A director may carry a higher profile than a combined board, making a director-led agency more prominent. GAO concedes that a board could be less efficient, and could lead to less accountability, than a single director.

Second, the process of combining the three housing GSE regulators could be disruptive to existing processes at a critical time. OFHEO agrees with GAO's observation that this disruption could be significant in terms OFHEO's development of the risk-based capital standard.

In conclusion Mr. Chairman, OFHEO finds theoretical merit in GAO's arguments for creating a single regulator for the housing GSEs and in combining safety and soundness and mission regulation. It is an option worthy of this Subcommittee's consideration. However, OFHEO believes that its current regulatory structure is equally valid and is working effectively.

Thank you. I would be pleased to answer any questions you may have.