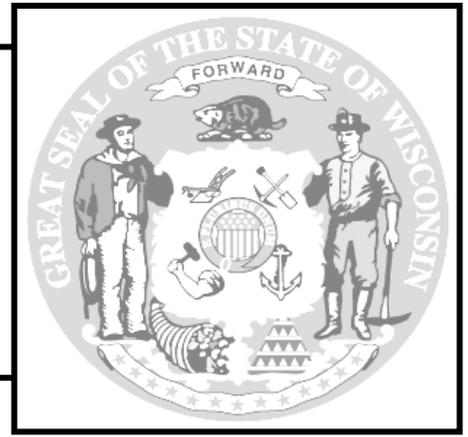


*Congressman*

**Paul Ryan**

*Serving Wisconsin's First District*



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## **PAUL RYAN: CONSISTENT VOICE FOR GSE REFORM**

**WASHINGTON** – Wisconsin's First District Congressman Paul Ryan has long been a critic of the flawed Congressional oversight of Fannie Mae and Freddie Mac. As a freshman member in the House Committee on Banking and Financial Services, Ryan foresaw our current crisis, advocated on behalf of the taxpayer, and called for clarity in the contradictory shareholder and Congressional mandates for Fannie and Freddie.

The following are excerpts from two separate hearings before the Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises, within the Committee on Banking and Financial Services, from the summer of 2000:

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**THURSDAY, JUNE 15, 2000**

Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises

Committee on Banking and Financial Services

U.S. House of Representatives – Washington, D.C.

**Mr. PAUL RYAN:** Mr. Chairman, as we found out at the last hearing, it is difficult to obtain an admission from the GSEs that they enjoy an implicit subsidy from their Government-sponsored enterprise status.

However, I firmly believe, as does the Congressional Budget Office, the GAO, the Treasury, the Federal Reserve, and Wall Street that there is an implicit subsidy.

As a result, Fannie and Freddie are able to use their GSE status to grow and profit by issuing debt at near Treasury rates while making money by taking on greater risk, such as repurchasing the mortgage-backed securities.

In a statement last September, Franklin Raines, the Chairman of Fannie Mae, said that they would achieve an annual earnings growth of 15 percent over the next four years, which is commendable.

The problem I see with this is that in order to maintain a double-digit earnings growth as they have over the last decade, Fannie Mae will have to take on more and more risk.

Taking into consideration that Fannie and Freddie have already guaranteed practically three-quarters of the conventional and conforming mortgage market, I do not see any other way to continue the

prodigious growth without breaking their congressionally mandated charters or by repurchasing greater amounts of mortgage-backed securities and thus concentrating their risk.

***To this end, I am concerned about taxpayer liability as Fannie and Freddie take on greater risk to increase profitability to shareholders, something that is clearly within their realm, which is their prerogative as a private company, but not the mission as a function of public policy.***

I still remain convinced that the retaining of mortgage-backed securities at this rapid pace is not the core to the GSE mission and is merely taking on more of an unnecessary interest rate risk for greater return on equity regardless of the new hedging devices that may be employed to offset the possible losses.

Further, I would like to point out that an important statement from Chairman Greenspan in his May 19th letter to you, Mr. Chairman, is noteworthy. It is a point that is often taken for granted in this debate.

But Greenspan writes, quote: "The Federal Government guarantees, implicit or explicit, are one way, along with Government outlays and mandates in the private sector, that the Federal Government makes claims on the real resources of the private sector. Subsidies accorded to GSEs are of necessity at the expense of other Federal or private-sector initiatives and hence are ultimately financed by households either through taxes or through reduced accumulation of wealth."

We often hear about the outright benefits that the GSEs get that accrue to Americans to lower mortgage rates, but in many ways we rarely discuss the hidden costs. And that is why I am pleased that we are having these hearings and we are going into these issues.

I am also concerned that Fannie and Freddie may seek to expand into areas outside of the conventional conforming housing market, things we just heard from Ms. Roukema.

Aside from moving into Jumble loans and sub-prime loans, Fannie and Freddie could use their special status and cheap bonds to move into general financial services such as home equity loans or other consumer credit markets.

Unfortunately, this implicit Government subsidy would give them an unfair advantage over their would-be competitors.

I believe that Fannie and Freddie have played a very important role. They are playing a very important role in securitizing the secondary market, and I do not think anybody here is really rejecting that.

The point is, this relationship is an odd one. It is an odd relationship where there are two mandates or two bosses, so to speak.

***There is a shareholder mandate, and there is a Government mission mandate. And in many ways, those two mandates are contradictory toward one another.***

***That is why I think it is important that we in this Committee reveal and look into these conflicting mandates to see if we are moving beyond the best interests of the taxpayer or whether we are still within those confines.***

And that is why I am pleased that we are having these hearings, and I look forward to hearing the witness testimony later on today.

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**TUESDAY, SEPTEMBER 12, 2000**

Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises

Committee on Banking and Financial Services

U.S. House of Representatives – Washington, D.C.

**Mr. PAUL RYAN:** The goal here is to strengthen the GSEs, focus on the goals of securitizing the secondary market, making homeownership more affordable for all Americans and ensuring taxpayer safety and soundness.

I will limit my concerns and remarks to just two areas, new products and the risk associated with the growing debt that the GSEs are creating.

I toured the Board of Trade in Chicago, and they walked me over to the corner and they said "This is going to be our new Fannie and Freddie pit where we are going to be marketing this debt, and the market is very promising for this area." I said, "Well, that is interesting. Is this going to become the new benchmark debt?" They said, "Well, the jury is still out on that, but it seems to be clear that is where the train is headed." That is happening.

Now that poses a lot of interesting questions, but what cannot be answered adequately, in my opinion, is the fact that you have gone from 1994 to year 2000, holding about 4.2 percent of your mortgage-backed securities on your books, to holding about 30 percent of your mortgage-backed securities on your books. Clearly it seems that it is derived from a stockholder or a shareholder mandate to get a profit incentive.

*It is very difficult to understand why repurchasing that magnitude of your own mortgage-backed securities—and I use the term "repurchase" because that's what Freddie Mac uses in their annual report—repurchasing that magnitude of mortgage-backed securities is far more above and beyond than what you did in 1998 to try and settle the market disruptions. It is far more than simply stabilizing and creating a market. That has gone to a point where it is an arbitrage endeavor for profit-making that does nothing to further the securitization of the secondary mortgage market, and it poses a new risk. It just does.*

And the problem is that we hear you tell us that you are hedging better, you have different types of debt, you have bullet debt, you have callable debt, you have better hedging mechanisms than we had ten or twenty years ago. We are simply taking your word for that right now, no one else's.

That, in my opinion, is the greatest case for a stronger regulator that can clearly and unequivocally explain to us that there is not unnecessary risk being posed to the taxpayer. It is a new type of interest rate risk, not a credit risk, and the notion that repurchasing more mortgage-backed securities lowers interest rates. I just don't see the evidence there.

I see the econometrics studies that have been employed by Fannie Mae, and those are econometrics studies that have low R-squares, and those are econometrics studies that measure the effects of the secondary market and the mortgage-backed security markets. So I just don't think there is a case to be made that, in and of itself, repurchasing 30 percent of your mortgage-backed securities actually lowers homeowners' rates by that practice—in and of itself.

So I think that is a real issue. It is a real issue that shows us that the debt being raised by the GSEs is higher than it needs to be to fulfill the critical and core mission of the GSEs.

It then basically goes down to the fact that it is not your fault. It is a structural problem. There are two mandates that unfortunately, at times, are at tug-of-wars with one another, that are contradictory to one

another, a mandate of homeownership, a mandate of a return on profit which is something we clearly would not—I would not want to deny you, but they are contradictory; and in this case I think it is fairly clear.

The second warning—and I would like to congratulate Mr. Kanjorski for the concept of this roundtable. It is something I can clearly be—something that—a result that could and should come out of this, and that is new products. It is very understanding—it is extraordinarily clear to me that people who perceive themselves as your competitors are concerned about a—whether you call it a taxpayer-subsidized business, a GSE, one that receives preferential treatment, regardless of the points, you get your capital at cheaper rates than your competitors. Going into their markets, crowding them out is something that is absolutely a legitimate fear by other private sector companies.

It seems to me that a bright line can and should be defined that is accessible to both parties whereby we know what is your charter, what is not your charter, what is your market, what is not your market, where those lines are. That, to me, is something that hopefully this legislation can accommodate, and I do think that we ought to be able to find and come to an agreement on that kind of an acceptable definition.

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