



July 15, 2008  
HP-1080

**Testimony by Secretary Henry M. Paulson, Jr.  
on GSE Initiatives  
before the Senate Banking Committee**

**Washington--** Good morning. Thank you Chairman Dodd, Senator Shelby and committee members for your leadership and for the opportunity to discuss these important issues.

As you know, our financial markets have been experiencing turmoil since last August. It will take additional time to work through challenges and progress has not come in a straight line. However, our financial institutions are repricing risk, de-leveraging, recognizing losses, raising capital and seeking to improve their financial positions. And policy makers and regulators are vigilant in their efforts to address the current challenges.

Fannie Mae and Freddie Mac, two of the government-sponsored enterprises (GSEs), are also working through this challenging period. Fannie and Freddie play a central role in our housing finance system and must continue to do so in their current form as shareholder-owned companies. Their role in the housing market is particularly important as we work through the current housing correction. The GSEs now touch 70 percent of new mortgages and represent the only functioning secondary mortgage market. The GSEs are central to the availability of housing finance, which will determine the pace at which we emerge from this housing correction.

In addition, debt and other securities issued by the GSEs are held by financial institutions around the world. Continued confidence in the GSEs is important to maintaining financial system and market stability.

Market stability and support for housing finance are among my highest priorities during this time of stress in our markets. Therefore, after consultations with the Federal Reserve, the Office of Federal Housing Enterprise Oversight (OFHEO), the Securities and Exchange Commission (SEC) and Congressional leaders we are asking Congress, as it completes its work on a stronger GSE regulatory structure, to also enact a three-part plan to address the current situation. Our plan is aimed at supporting the stability of financial markets, not just these two enterprises. This is consistent with Treasury's mission to promote the market stability, orderliness and liquidity necessary to support our economy.

Our proposal was not prompted by any sudden deterioration in conditions at Fannie Mae or Freddie Mac. OFHEO has reaffirmed that both GSEs remain adequately capitalized. At the same time, recent developments convinced policymakers and the GSEs that steps are needed to respond to market concerns and increase confidence by providing assurances of access to liquidity and capital on a temporary basis if necessary.

The plan we announced will strengthen our financial system as we weather this housing correction and establish a new world class regulator for the GSEs; it has three parts.

First, as a liquidity backstop, the plan includes an 18-month temporary increase in Treasury's existing authority to make credit available for the GSEs. Given the difficulty in determining the appropriate size of the credit line we are not proposing a

particular dollar amount. Flexibility is the best means of increasing market confidence in the GSEs, and also the best means of minimizing taxpayer risk.

Second, to ensure the GSEs have access to sufficient capital to continue to fulfill their mission, the plan gives Treasury an 18-month temporary authority to purchase – only if necessary – equity in either of the two GSEs.

Let me stress that there are no immediate plans to access either the proposed liquidity or the proposed capital backstop. If either of these authorities is used, it would be done so only at Treasury's discretion, under terms and conditions that protect the U.S. taxpayer and are agreed to by both Treasury and the GSE. I have for some time urged a broad range of financial institutions to raise capital and at Treasury we have constantly encouraged the GSEs to do just that. In March, at my request, both the Chairman and Ranking Member of this Committee hosted a meeting with me and the CEOs of the two GSEs where they agreed to raise capital and you began the effort to move your GSE reform bill, which is now hopefully about to be enacted with the modifications we are recommending today.

Third, to help protect the financial system from future systemic risk, the plan strengthens the GSE regulatory reform legislation currently moving through Congress by providing the Federal Reserve authority to access information and perform a consultative role in the new GSE regulator's process for setting capital requirements and other prudential standards. Let me be clear, the Federal Reserve would not be the primary regulator. As I have said for some time, the Fed already plays the role of de-facto market stability regulator and we must give it the authorities to carry out that role. This role for the Federal Reserve with respect to the GSEs is consistent with the recommendation made in Treasury's Blueprint for a Modernized Financial Regulatory Structure. Clearly, given the scope of the GSEs' operations in world financial markets, a market stability regulator must have some line of sight into their operations.

We have long maintained that the GSEs have the potential to pose a systemic risk and worked with Congress on legislation to create a GSE regulator with authorities appropriate to the task and on par with other financial regulators. We must complete this work. The Senate passed GSE reform legislation last Friday, and we urge the House to act quickly to advance this process.

As I have said, we support the current shareholder-owned structure of these enterprises. Our plan addresses current market challenges by ensuring, on a temporary basis, access to both liquidity and capital, while also ensuring that the GSEs can fulfill their mission – a mission that remains critical to homeowners and homebuyers across the country, especially during this housing correction.

I look forward to working closely with you, your colleagues in the House, and Congressional leadership in both chambers to enact this plan as part of a complete legislative package, as soon as possible. Thank you.