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Legislative Bulletin……………………………….…..………May 17, 2007

Contents:

Summary of the Bill Under Consideration Today:

Total Number of New Government Programs: 1

Total Cost of Discretionary Authorizations: $22 decrease over five years

Effect on Revenue: $2.72 billion increase over five years

Total Change in Mandatory Spending: $2.72 billion increase over five years

Total New State & Local Government Mandates: Several

Total New Private Sector Mandates: Numerous

Number of *Bills* Without Committee Reports: 0

Number of *Reported* Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 1427—Federal Housing Finance Reform Act (*Frank, D-MA*)

Order of Business: The bill is scheduled to be considered on Thursday, May 17th, subject to a likely modified open rule, allowing all germane amendments that have been pre-filed in the *Congressional Record* by close of business on Wednesday, May 16th.

Background: The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are government-sponsored enterprises (GSEs) created to facilitate a *secondary* mortgage market. That is, GSEs are privately owned, congressionally chartered financial institutions created to enhance the availability of credit for home mortgages. Under their charter, they exist to buy mortgages from lenders in the *primary* mortgage market and package them into securities for sale to investors on Wall Street. With the old loans off their books, lenders in the primary market can then make additional loans to consumers. Currently, the GSEs are regulated by the Department of Housing and Urban Development's Office of Federal Housing Enterprise Oversight, commonly known as OFHEO.

However, Fannie Mae and Freddie Mac's charter came with significant government subsidies not enjoyed by their private sector competitors, including a $2.3 billion line of credit with the U.S. Treasury (i.e., borrowing at below-market rates), an exemption from state and local taxes, and an exemption from certain Securities and Exchange Commission (SEC) registration requirements (including fees as publicly traded companies). In addition, as a result of these government subsidies, Fannie Mae and Freddie Mac benefit from an *implicit* guarantee that the debt they issue is backed by the full-faith-and-credit of the U.S. Treasury, making GSE debt instruments almost as attractive to investors as government bonds.

Recent Accounting Failures: In 2003, Freddie Mac admitted that it had used improper accounting policies to create the appearance of steady earnings growth and issued a restatement of financial results. OFHEO imposed a $125 million fine and pursued civil actions against several former Freddie Mac executives. Similarly, in 2004, OFHEO issued a public report that was highly critical of accounting methods at Fannie Mae. OFHEO charged that Fannie Mae has not followed generally accepted accounting practices, allowing Fannie Mae to present investors with an artificial picture of steadily growing profits, and, in at least one case, to meet financial performance targets that triggered the payment of "cookie jar" bonuses to company executives.

In addition, Fannie Mae reported that it was unable to file a third-quarter earnings statement because its auditor refused to sign off on the accounting results. One month later, after finding similar inadequacies in Fannie Mae's accounting policies and methodologies, the SEC directed Fannie Mae to restate all of its accounting results since 2001. Shortly after this announcement, both Fannie Mae's CEO and CFO resigned their posts. Such recent accounting failures have led many lawmakers and commentators to conclude that current regulatory framework of OFHEO governing the GSEs is inadequate. H.R. 1427 is an attempt to provide a stronger such regulatory framework.

Note: This bill is similar—but not identical—to H.R. 1461 from the 109th Congress, which passed the House by a vote of 331-90. To see the RSC Legislative Bulletin on the bill from last Congress, go here: http://www.house.gov/hensarling/rsc/doc/GSE%20Legislative%20Bulletin.pdf.

Possible Conservative Concerns: Some conservatives may be concerned with the following provisions:

- The **Affordable Housing Fund** (see below);
- The increased conforming loan limits in **"high cost areas"** (see below);
- The **six-month delay** before the new regulator is up and running (see below); and
- The **new duty to "minimize the cost of housing finance"** (see below).

Last Congress, RSC Members sent the following letter expressing support for strong controls over the portfolios of GSEs: http://www.house.gov/hensarling/rsc/doc/Hensarling--GSE.pdf

Additionally, RSC Members sent the following letter opposing the Affordable Housing Fund: http://www.house.gov/hensarling/rsc/doc/GSE%20slush%20fund.pdf.

NOTE: Republican Leader John Boehner (R-OH) and Republican Whip Roy Blunt (R-MO) are urging a NO vote on H.R. 1427, if the Affordable Housing Fund is not removed before final passage.

Summary by Title:

Title I: Reform of Regulation of Enterprises and Federal Home Loan Banks

- **Definitions:** Defines a regulated entity as Fannie Mae, Freddie Mac, their affiliates, and each Federal Home Loan Bank. An affiliate includes: directors, employees, officers, controlling stockholders, agents, shareholders, consultants, independent contractors (an accountant or an attorney), or any not-for-profit entity "that receives its principal funding, on an ongoing basis, from any regulated entity."

- **New Regulator**: Establishes the Federal Housing Finance Agency (FHFA) to regulate Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs) and replace OFHEO. The new independent agency would be headed by a Director, appointed by the President and confirmed by the Senate, for a term of five years. In addition, the bill would require the appointment of three deputy directors; one to supervise the GSEs, one to oversee the FHLBs, and the other to focus on the affordable housing mission of the GSEs (see below).

- **Director Duties:** Requires the regulator to ensure that regulated entities operate in a "safe and sound manner," maintain adequate capital and internal controls, and contribute to "liquid, efficient, competitive, and resilient national housing finance markets **that minimize the cost of housing finance.**" Some conservatives may argue that this last new duty will inhibit the new regulator from restraining the GSEs and lend support to their arguments when they later attempt to engage in new business activities.

  In fulfilling these principal duties, the regulator would be instructed to propound regulations setting forth standards regarding the:
  (1) adequacy of internal controls and information systems;
  (2) independence and adequacy of internal audit systems;
  (3) management of interest rate and market risk;
  (4) adequacy and maintenance of liquidity and reserves;
  (5) management of asset and investment portfolio growth;
  (6) investments and acquisitions by an enterprise to ensure they are consistent with current law purposes;
  (7) maintenance of adequate accounting policies;
  (8) issuance of subordinated debt;
  (9) overall risk management processes (for example, ensuring adequate oversight from the Board of Directors); and
  (10) other operational and management standards deemed appropriate.

If a GSE failed to meet these standards, FHFA would issue a plan to correct the deficiency and would be charged with either freezing an entity's total assets or requiring an increase in its capital stocks, if the plan was not adhered to (in the case of a GSE being undercapitalized).

- **Federal Housing Enterprise Board**: Establishes a five-member Federal Housing Enterprise Board to advise the new Director on "overall strategies and policies" in carrying out the duties under the legislation. The Board would be comprised of the Director, the Secretary of the Treasury, the Secretary of Housing and Urban Development (HUD), and two other members appointed by the President with expertise in capital markets, secondary mortgage markets, mortgage financing, and the development of affordable housing.

- **Nonprofit Contributions:** Requires the GSEs to report annually the total amount of charitable contributions to nonprofit organizations made in the previous fiscal year. The report would have to identify the name of the nonprofit and the amount of the individual contribution if over a "designated amount" (to be set by the regulator). This information would have to be made publicly available.

- **Assessments:** Authorizes FHFA to collect annual assessments from the GSEs to provide for its costs and expenses and any enforcement proceedings against them and to punish them for being undercapitalized. These assessments are not to be construed as government funds (although the amounts collected and spent are recorded for federal budget purposes as receipts and outlays). This provision effectively frees the regulator from the appropriations process, ensuring a certain level of independence.

- **Withholding Executive Compensation**: Authorizes the regulator to require a regulated entity to withhold compensation to its executive officers for any fraudulent act or omission, breach of trust or fiduciary duty, insider abuse, or violation of any law, regulation, or order.

- **Minorities and Women**: Requires each regulated entity to establish or designate an Office of Minority and Women Inclusion to ensure, "to the maximum extent possible," the inclusion and utilization of minorities and women (and businesses owned by people in such wide categories) in the activities of the regulated entity.

- **Capital Requirements**: Allows the regulator to adjust the risk-based capital requirements and provide for minimum capital levels to ensure the safety and soundness of the GSEs. The Director could, by order, increase minimum capital levels on a temporary basis, if the regulated entity has violated prudential standards or if an unsafe or unsound condition exists.

- **Assets and Liabilities**: Requires FHFA to review on a periodic basis the assets and liabilities of each GSE, and if necessary, to require by order the disposal or acquiring of an asset or liability.

- **Corporate Governance and Ethics**: Requires a majority of the board of directors of each regulated entity to be "independent," as defined by the New York Stock Exchange. In addition, the bill would require the board to meet at least eight times a year and prohibits a member from voting by proxy. Compensation of board members would be limited to what is "reasonable and appropriate" and "commensurate with the duties and responsibilities of such person" and shall take into account not just earnings but also risk management and legal and regulatory compliance. Each entity would have to establish and administer a written code of conduct and ethics. An enterprise could not (directly, indirectly, or through a subsidiary) make any personal loan to a board member or executive officer.

- **Compliance and Risk-Management Programs**: Each regulated entity would have to establish a compliance program "reasonably designed" to ensure that the enterprise complies with applicable laws, regulations, and internal controls. Additionally, each entity would have to establish a risk-management program "reasonably designed" to manage the risks of operation. Both programs would have to be led by designated officers who report directly to the CEO and regularly to the board.

- **SEC Registration**: Requires each GSE to register at least one class of its capital stock with the Securities and Exchange Commission (SEC) and to comply with sections 14 (proxy reporting) and 16 (transaction disclosure requirements for directors, officers, and principal stockholders) of the Securities Exchange Act.

- **Guarantee Fees**: Directs the Government Accountability Office (GAO) to study guarantee fees (the GSEs charge a fee for the risk involved with guaranteeing loans), including the factors used to determine their amount, the amount incurred by each enterprise to provide guarantees, and the total revenue earned from collecting such fees.

- **New Business Activity**: Requires the GSEs to receive approval from FHFA *before* undertaking any new programs or business activities *and grandfathers in any current ones* (some of which may be inconsistent with the GSEs charter). The regulator would be required to note such an application in the Federal Register and allow for a period of public comment. Approval would then be granted on the basis of whether the new activity is: consistent with the GSEs' chartering statutes, taking into consideration the definition of the terms "mortgage loan origination" and "secondary mortgage loan origination;" consistent with the safety and soundness of the enterprise; is in the public interest; and does not materially impair the efficiency of the mortgage finance system. Products and services "other than residential mortgage financing" or that create "significant new exposure to risk for the enterprise or holder of the mortgage" would have to be subject to the new business activity pre-approval requirements..

- **Automated Loan Underwriting:** Prohibits the regulator from preventing a GSE from offering the "automated loan underwriting system" in existence upon enactment or other education and counseling activities as a primary market activity. This software technology uses statistical models to determine objectively in a matter of minutes whether a borrower is likely to default on a loan. Fannie Mae and Freddie Mac have

- **Conforming Loan Limits:** Sets conforming loan limits (loans that are to be sold to Fannie Mae and Freddie Mac must "conform" with these limits) at:
  - $417,000 for a single-family residence,
  - $533,850 for a two-family residence,
  - $645,300 for a three-family residence, and
  - $801,950 for a four-family residence

  H.R. 1427 requires these limits to be increased or decreased each year depending on a new housing index the FHFA is directed to establish surveying the housing market.

  In addition, the bill would allow for the GSEs to further increase the loan limit in **"high cost areas"** where the median price for such size residences exceeds the conforming loan limit. The adjustment would be up to the lesser of 150% of the loan limit (in 2005, $540,000 was 150% of the single-family conforming loan limit) or the area median home price and would apply only to mortgages that are the basis for securities sold by the enterprises. H.R. 1427 would direct the FHFA to study whether restricting this increase in the conforming loan limits in high cost areas to such mortgages "will result in an increase in the cost to borrowers for mortgages on housing in such high-cost areas." If so, the regulator would be allowed to terminate the restriction. Some conservatives may be concerned that this provision will lead to an overly broad application of "high-cost area," lessening the cost (via federal subsidies) of housing for consumers who are not necessarily low- or middle-income and crowding out private competitors. Other conservatives have argued that the high-cost adjustments are needed in certain areas where real estate is extremely expensive and "middle class" is defined by higher incomes than in the rest of the country.

- **Standards for Subprime Loans**: Directs the regulator to issue standards by which mortgages purchased would be considered subprime for the purpose of complying with the reporting requirement in Housing and Community Development Act of 1992.

- **Affordable Housing Goals:** Requires the FHFA to set annual single-family and multi-family goals for the GSEs to purchase mortgages benefiting low-income families and families living in low-income areas (defined in the bill). These targets would be a percentage of the three-year rolling average of publicly available data, as required under the Home Mortgage Disclosure Act of 1975, and could be increased or reduced at the discretion of the Director. In addition, H.R. 1427 would add a duty for the GSEs to serve "underserved markets," including in rural areas, by developing certain loan products and flexible underwriting guidelines. GSEs would be required to provide the regulator with sufficient information to determine if minorities are charged a different interest rate than are non-minorities.

The regulator could reduce a housing goal, if a GSE requests as such, only if market and economic conditions or the financial condition of the GSE require such action; or efforts to meet the goal would result in the constraint of liquidity, over-investment in certain market segments, or other consequences contrary to the intent of the law.

If a GSE fails (or there is a substantial probability that it will fail) to comply with the affordable housing goals, the regulator would be authorized to inform the enterprise of the reasons for such a determination and provide the data on which it is based. In addition, the regulator *may* require that the enterprise submit a housing plan for it to meet its housing goals. If the GSE refuses to submit such a plan, submits an unacceptable plan, or fails to comply with the plan, the regulator could issue a cease and desist order or impose civil monetary penalties.

Affordable housing goals are already a part of current law to ensure that the GSEs, which benefit from substantial federal subsidies, are not driven solely by profit but also a commitment to expand housing to low-income families in low-income areas. However, the GSEs have typically not met their goals, and the current regulatory structure has lacked the power to force compliance.

- **Affordable Housing Fund**: Requires the FHFA (in consultation with HUD Secretary) to establish and manage an Affordable Housing Fund, which would be funded by the GSEs. The Fund would provide formula grants to increase homeownership for extremely low- and very low-income families, increase investment in housing in low-income and chronically distressed areas, increase and preserve the supply of rental and owner-occupied hosing for extremely low- and very low-income families, increase investment in public infrastructure development related to this housing above, and leverage investments from other sources in affordable housing and in public infrastructure development.

  For fiscal years 2007 through 2011, each GSE would have allocate to the Fund 1.2 basis points of its average total mortgage portfolio (1.2 cents per $100 of the value of its mortgage portfolio, as defined in the bill) during the preceding year. The regulator would have to temporarily suspend the required allocation for a GSE to the Fund if he finds that such allocations would contribute to the financial instability of the GSE, cause the enterprise to be classified as undercapitalized, or prevent the GSE from successfully completing a capital restoration plan.

  The GSEs would not be required to make allocations to the Fund in 2012 or in any year thereafter. Not later than June 30, 2011, the regular would have to submit to Congress a report making recommendations on whether the Fund should be extended or modified.

  In FY2007, all Fund allocations would all be directed to disaster relief from Hurricanes Katrina and Rita (2005): 75% to the Louisiana Housing Finance Agency, and the remaining 25% to the Mississippi Development Authority. After FY2007, the HUD Secretary would have to establish a formula to allocate funds to states and Indian tribes based on specified factors, including population, housing affordability, percentage of extremely low- and very low-income families, and the extent of substandard housing.

The regulator would determine the formula amount for each grantee (states and Indian tribes) and publish in the *Federal Register* the available amounts.

Each grantee could then designate a state housing finance agency, housing and community development entity, tribally designated housing entity, or other qualified instrumentality of the grantee to receive grants. An annual allocation to a grantee would be reduced by the amount of misused funds that were not returned or reimbursed in the preceding year. Each grantee would have to create and publish a plan for distribution of grant amounts each year, including requirements for applicants to receive assistance.

Grants could be used only for:
--the production, preservation, and rehabilitation of rental housing for extremely and very low-income families;
--the production, preservation, and rehabilitation of housing for homeownership (including downpayment assistance, closing cost assistance, and assistance for interest-rate buy-downs) for extremely and very low-income first-time home buyers; and
--public infrastructure development activities in connection with housing activities funded above.

Grant funds could be provided only to organizations, agencies, or entities (including for-profit, non-profit, or faith-based entities) with a demonstrated capacity for carrying out eligible housing activities, and that make assurances to the grantee (as required by the regulator) that they will comply with the requirements of the program. All funds would have to be used or committed within two years of the grant date, or be subject to recapture.

The regulator would have to set forth prohibited uses of grant amounts, which would have to include use for:
--political activities;
--advocacy;
--lobbying, whether directly or through other parties;
--counseling services;
--travel expenses;
--preparing or providing advice on tax returns;
--administrative, outreach, or other costs of the grantee or any recipient of such grant amounts (except those for carrying out the program required under this section).

The regulator would have to require each grantee to develop and maintain a system to ensure that all recipients of funds use those funds in accordance with the above provisions, and any applicable regulations, requirements, or conditions. The regulator would have to establish minimum requirements for grantees and recipients, including appropriate financial reporting, record retention, and audit requirements.

If the regulator or a grantee (subject to the regulator's review) determines that any recipient of assistance has used any amounts in a manner that is materially in violation of this program and its affiliated regulations, the grantee would have to require that, within 12 months after the determination of such misuse, the grant recipient would have to reimburse <u>the grantee</u> (not the Fund or the taxpayer) for misused amounts and return to the grantee any amounts that remain unused or uncommitted for use.

The regulator would have to require each grantee to submit an annual, publicly available report to the regulator that describes the activities funded under this program and the manner in which the grantee complied with the allocation plan established for the grantee.

If the regulator determines, after reasonable notice and opportunity for hearing, that a grantee (a state or Indian tribe) has failed to comply substantially with any provision of this program, and until the regulator is satisfied that there is no longer any such failure to comply, the regulator would have to either reduce the amount of assistance under this program to the grantee by an amount equal to the misused amounts; require the grantee to repay an amount equal to the misused amounts; limit the availability of Fund assistance to the grantee to activities or recipients not affected by such failure to comply; or terminate any Fund assistance to the grantee.

If a successor fund for affordable housing grants were to be established after the enactment of this legislation, but before FY2012, all remaining amounts in the Fund would have to be transferred to the successor fund.

The bill states that nothing in the housing goals or the Affordable Housing Fund should be regarded as authorizing a GSE to engage in any program or activity that contravenes or is inconsistent with its charter.

The Affordable Housing Fund in last year's bill (H.R. 1461) was different in two main ways: the assessment was 5% of annual revenues, and the grants were made directly by the GSEs to affordable housing entities.

<u>NOTE:</u> Many conservatives have regarded the required GSE contributions to the Fund as a tax on publicly-traded corporations. Arguably, since the GSEs constitute a duopoly, they have a heightened ability to pass this "contribution" on to consumers – thus making housing less affordable rather than more.

Furthermore, despite the provisions of the Affordable Housing Fund section that restrict the use of grants, many conservatives in the past have expressed concerns that the Fund could still be used by liberal entities to displace other funds. Money is fungible, so that if a group cannot use Fund grants for political activities, it could certainly have more money freed up for political activities because of the injection of Fund grants.

For example, if someone gives you $100 and says you can't use it to pay your electric bill, yet you deposit the money in your bank and then write a $100 check to your electric company, have you used the gift money to pay your electric bill? Maybe, or maybe not. More importantly, does it matter? The gift money unquestionably offset your other expenditures. Perhaps you didn't use the gifted $100 to pay your bill, but you now have $100 extra to buy other things.

The largest organizations (and thus the most able to commit resources to apply for federal grants) who work on affordable housing issues include, for example, ACORN (led voter registration efforts against Republicans, with allegations of voter fraud in Florida, Ohio, and North Carolina), National Council of La Raza (allegations of voter fraud in the Bob Dornan-Loretta Sanchez election of 1996), and Housing Works (led a demonstration against Senator Rick Santorum for his anti-needle exchange and pro-abstinence voting record). These entities unquestionably, and sometimes unabashedly, engage in partisan, leftist political activities.

For example, ACORN, the Association of Community Organizations for Reform Now, is actually an umbrella organization for more than 75 entities, most of which are run out of a single office in New Orleans. Among these entities are unions, schools, radio stations, home mortgage counseling centers, tax advising centers, voter-mobilization organizations, lobbying firms, and even a furniture company. For example, the Service Employees International Union Local 880 once listed its contact email as seiu880@acorn.org (it changed its email address when the Employment Policies Institute highlighted this address in a report).

Estimates of ACORN's annual operation budget range from 30 to 40 million dollars. The Employment Policies Institute reports that large amounts of money move back and forth from various elements of the ACORN network all the time.

For more information on ACORN, including a map of where ACORN has been accused of election fraud, go here: http://www.rottenacorn.com/.

- **GSE Enforcement**: The regulator could issue cease-and desist orders and/or impose civil monetary penalties (as detailed in the bill) against GSEs in violation of their charters.

- **Capital Classifications**: Requires the regulator to classify the capital levels of the GSEs and the Federal Home Loan Banks as either adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. The regulator could reclassify a GSE for deficient capitalization if it is "engaging in conduct that could result in a rapid depletion of core or total capital," if after notice and a hearing, it is determined the GSE is "engaging in an unsafe or unsound practice" or in "an unsafe and unsound condition." In addition, H.R. 1427 would prohibit a GSE from making a capital distribution that would cause it to be undercapitalized.

  Some conservatives may be concerned that H.R. 1427 does not improve substantially on the powers of the current regulator. According to a study by American Enterprise Institute (AEI), "the regulator will lack the authority and leverage against a GSE to increase capital temporarily to address a problem such as the recent accounting and internal control failures…unless it can make the case that these tie directly to safety and soundness." Source: http://www.aei.org/publications/pubID.22705/pub_detail.asp

- **Capital Restoration**: Requires the regulator to closely monitor the condition of undercapitalized enterprises and whether they are complying with a capital restoration plan. If a GSE lacked such sufficient capital levels, its total assets would be frozen at the level of the preceding calendar quarter unless the regulator accepted its capital restoration plan (and an increase in assets is consistent with that plan) or the ratio of total capital to assets would enable it to become adequately capitalized in a reasonable amount of time. In addition, H.R. 1427 would prohibit an undercapitalized GSE from acquiring any new entities or engaging in any new business activity unless it is similarly consistent with an approved capital restoration plan.

- **Significantly Undercapitalized Measures**: Directs the regulator to take action against a significantly undercapitalized GSE to improve its management by: (1) ordering the election of a new board of directors, (2) dismissing any board member or executive officer who held office for more than 180 days prior to the entity becoming undercapitalized, and (3) employing qualified executives. In addition, H.R. 1427 would prohibit a significantly undercapitalized entity from paying out a bonus to any executive if in the last year the entity has became significantly undercapitalized.

- **Appointment of a Conservator**: Allows (but does not require) the regulator to appoint FHFA as conservator to manage the financial affairs of a critically undercapitalized GSE if:

    - the entity's assets are less than its obligation to its creditors;
    - there has been substantial dissipation of assets resulting from either a violation of the law or an unsafe and unsound business practice;
    - the entity willfully violated a cease-and-desist order or concealed its records from the regulator;
    - the entity sustained a substantial loss to its capital and there is no "reasonable prospect" of becoming adequately capitalized; or
    - the entity either fails to submit or to implement a capital restoration plan.

  The conservator would have the power to restore the entity to a sound and solvent condition, including through liquidating the entity (with due regard to the housing finance market) and winding up its affairs.

- **Cease and Desist Orders**: Allows the regulator to issue cease-and-desist orders to a regulated entity that is about to engage in an unsafe or unsound business practice or has violated a law or regulation. Unsound and unsound business practice is defined as a less-than-satisfactory rating for asset quality, management, earnings, or liquidity. Temporary cease-and-desist orders may be issued if such activities or violations is likely to cause insolvency or a significant dissipation of assets. If a cease and desist order is not obeyed, the regulator could seek an injunction to enforce the order in federal district court.

- **Enforcement and Jurisdiction:** Authorizes the regulator or the Attorney General, upon request, to seek enforcement of orders in federal district court.

- **Civil Penalties:** Establishes three tiers of civil penalties: (1) $10,000 for each day for violating orders and regulations; (2) $50,000 for each day for any violation that "recklessly engages in an unsafe or unsound practice," breaches a fiduciary duty, and is part of a pattern of misconduct; and (3) a maximum $2 million for each day when such misconduct is done knowingly.

- **Management Removal:** Authorizes the removal of any official from his post (with fair notice and hearing) who violates an order, engages in unsafe or unsound activity, breaches a fiduciary duty, *and* such action involves personal dishonesty or a willful disregard for the safety and soundness of the entity. Anyone who knowingly participates in the business of the enterprises after being suspended or removed shall be liable for a fine of up $1 million or five years of imprisonment.

- **Criminal Penalties**: Assesses criminal penalties of up to $1 million and/or five years in prison on anyone who participates, directly or indirectly, in the affairs of a regulated entity while under suspension or order of removal.

- **Presidentially-Appointed Board Members:** Eliminates the current requirement that five of the members of each GSE's Board of Directors be appointed by the President and reduces the size of the board from 18 to between 7 and 15.

- **Portfolio Operations Report**: Requires the FHFA to report to Congress with: (1) a description of each GSE's portfolio holdings, including mortgages, mortgage-backed securities, non-mortgages and any other assets; (2) a description of the risk involved with such holdings (including the use of derivatives to hedge against such risk); (3) an analysis of whether such holdings are safe and sound and consistent with the mission of the GSEs; and (4) an assessment of the risk such portfolios pose for the housing and capital markets as a whole.

- **Alternative Secondary Market System Study**: Requires FHFA to study alternatives to the current secondary market system if the GSEs were privatized and how it would impact taxpayers.

- **Effective Date**: The underlying bill does not include a section (Section 185) setting the effective date for this title, however, despite their being numerous references to Section 185 throughout the bill. It is expected that the Manager's Amendment will add Section 185 to the bill, making Title I (i.e. the implementation of the new regulator) effective six months after this bill's enactment. Some conservatives may be concerned that this **six-month gap** may allow or encourage GSEs to expand into new activities before the new regulations take effect.

Title II: Federal Home Loan Banks

- **Boards of Directors**: Reduces the number of directors for each Federal Home Loan Bank (FHLB) from 14 to 13 – none of whom will be appointed – and increases the term of service from three to four years. In addition, H.R. 1427 would repeal the cap on director compensation and allow pay to be based on what is reasonable and appropriate. Requires that two-fifths of each FHLB's directors be "independent" (i.e. have no conflicts of interest, such as being an officer of the FHLB).

- **FHFA Oversight:** Replaces the Finance Board with the FHFA as the overseer of FHLBs.

- **Joint Activities:** Permits two or more FHLBs to establish a joint office for the purpose of performing common or collective functions.

- **Information Sharing:** Directs the regulator to prescribe regulations ensuring that each FHLB has access to information that it needs to determine the nature and extent of its liability.

- **Voluntary Mergers:** Permits the FHLBs to merge with each other upon the approval of their own Boards of Directors and the new regulator.

- **SEC Disclosure Requirements:** Exempts the FHLBs from certain SEC disclosure and reporting requirements, with respect to their ownership of capital stock and transactions in the ordinary course of business.

- **Community Financial Institution Members:** Allows insured depository institutions with less than $1 billion in total assets (increasing the threshold from $500 million) to receive advances from the FHLBs for lending. In addition, the bill adds community development lending to the list of allowable uses of such advances.

- **Affordable Housing Program Study:** Requires GAO to study the extent to which the FHLBs' current affordable housing programs are being used to assist long-term care facilities for low- and moderate-income individuals.

- **Effective Date:** Makes the provisions of this title effective six months after enactment of the legislation.

<u>Title III: Transfer of Functions, Personnel, and Property of OFHEO, the Federal Housing Finance Board, and HUD</u>

- **Abolishment of OFHEO:** Abolishes the Office of Federal Housing Enterprise Oversight (OFHEO) six months after this bill's enactment and provides for the transfer of its functions to FHFA. All regulations, orders, resolutions, and determinations made by OFHEO or a court would remain in force, and become enforceable by FHFA. During the six-month period beginning on the date of enactment, the OFHEO director would be instructed to manage the office "solely for the purpose of winding up the affairs." Some conservatives may be concerned that this six-month gap may allow or encourage GSEs to expand into new activities before the new regulations take effect.

- **Employee Rights:** Guarantees that each OFHEO employee is transferred to FHFA for employment with the same status, tenure, grade, and pay as held immediately prior to the transfer and will retain their benefits for at least one year.

- **Abolishment of the Federal Housing Finance Board:** Abolishes the Federal Housing Finance Board (FHFB) six months after this bill's enactment and provides for the transfer of its functions to FHFA. All regulations, orders, resolutions, and determinations made by FHFB or a court would remain in force, and become enforceable by FHFA. During the six-month period beginning on the date of enactment, the FHFB director would be instructed to manage the office "solely for the purpose of winding up the affairs." Some conservatives may be concerned that this six-month gap may allow or encourage FHLBs to expand into new activities before the new regulations take effect.

  - **Employee Rights:** Guarantees that each FHFB employee is transferred to FHFA for employment with the same status, tenure, grade, and pay as held immediately prior to the transfer and will retain their benefits for at least one year.

  - **Abolishment of Enterprise-Related Functions at HUD:** Directs the HUD Secretary to determine, within three months of this bill's enactment, which employees to transfer to the FHFA to maintain oversight of the regulated enterprises. Six months from enactment, all such oversight functions would have to be transferred to FHFA. Provides for continuity of employee status, regulations, use of property, and agency services, in much the same way as does the abolishment language earlier in this title. Provides for transfer from HUD of enterprise-related unexpended appropriations, assets, liabilities, contracts, property, records, authorizations, and facilities.

Committee Action: On March 9, 2007, the bill was referred to the Financial Services Committee, which, on March 29th, marked up the bill and ordered it reported to the full House by voice vote.

Administration Position: The Statement of Administration Policy (SAP) for H.R. 1427 expresses support for the overall legislation, but expresses concerns about the Affordable Housing Fund and the increased loan limits for high-cost areas. To read the full SAP, click here: http://www.whitehouse.gov/omb/legislative/sap/110-1/hr1427sap-h.pdf.

Cost to Taxpayers: CBO estimates that H.R. 1427 would increase revenues by $850 million in FY2008 and by $2.72 billion over the FY2008-FY2012 period. The bill would also increase mandatory spending by $570 million in FY2008 and by $2.72 billion over the FY2008-FY2012 period. These revenue and spending figures are due largely to the Affordable Housing Fund. H.R. 1427 would also reduce authorizations by $1 million in FY2008 and by $22 million over the FY2008-FY2012 period (due largely to the elimination of certain HUD responsibilities).

Does the Bill Expand the Size and Scope of the Federal Government?: Yes, the bill includes a new tax on the secondary mortgage market (stemming from the GSEs' contributions to the affordable housing fund) and increases the conforming loan limits in "high-cost" areas which expands the reach of federal subsidies further into the private sector.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: Yes, the bill would impose numerous private-sector mandates on Fannie Mae, Freddie Mac, and the FHLBs. Additionally, the bill would impose certain intergovernmental mandates in the form of state preemptions. Such preemption would allow FHFA to act outside the authority of state law in some circumstances and would preempt state statute-of-limitations and contract laws, primarily in the instance that FHFA serves as the receiver or conservator of a regulated entity.

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: The Financial Services Committee, in House Report 110-142, asserts that, "H.R. 1427 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI."

Constitutional Authority: The Financial Services Committee, in House Report 110-142, cites constitutional authority in Article I, Section 8, Clause 1 (the congressional power to promote the general welfare of the United States) and Clause 3 (the congressional power to regulate interstate commerce).

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