



July 18, 2008

Taxpayers Agree: No Blank Checks for Fannie & Freddie Bailouts!

Dear Member of Congress:

On behalf of the National Taxpayers Union's (NTU) 362,000 members, I urge you to reconsider the rash proposals that would saddle taxpayers with potentially more than half a trillion dollars in liabilities from Government-Sponsored Enterprises (GSEs) and the Federal Housing Administration (FHA). This week's hearing in the Senate should be only the first step of a deliberative process that involves hard questions about oversight, the federal balance sheet, and the role of GSEs in the financial markets. NTU believes these considerations **must be addressed before the very first taxpayer dollar is put on the line.**

For the better part of 20 years, successive Congresses and Administrations have failed to address fundamental issues surrounding the structure and operations of GSEs. NTU Founder and Chairman Emeritus James Davidson testified before the House Ways and Means Committee on this topic in September 1989, at what was then billed as the first oversight hearing on GSEs in recent memory. At the time he noted, "One of the unfortunate lessons of the Savings and Loan debacle is that off-budget activities, loan guarantees, and quasi-government functions can have a tremendous impact on the federal budget. ... Should a similar fiscal catastrophe hit GSEs, bailout costs could multiply to levels that would not currently seem credible." Amid assurances from GSE executives that their entities were well-capitalized, and not coincidentally, amid multimillion-dollar GSE lobbying operations, this warning was ignored.

Any lawmaker claiming the mantle of fiscal responsibility or generational equity should be reluctant to vote for legislation that seems certain to repudiate both of those qualities. At the very least, however, Congress must enact reforms that will end incentives for risky behavior in mortgage markets and shrink the undue influence that GSEs have exerted on politics and finance. Taxpayer advocates have offered the following as examples:

- The new GSE regulator should be required to consider systemic risks, as well as design appropriate capital standards and portfolio limits, whenever taxpayer funds are released to prop up the entities.
- Any infusion of taxpayer funds should be delivered to the least-risky level of capital held by GSEs. This would mean making the taxpayer investment a form of senior subordinated debt that could be converted to shares of GSE stock, but only at a below-market price for common stock and at an above-market interest rate.
- Junior unsubordinated debt should bear the brunt of GSEs' losses. This would mean, wherever possible, suspending common and preferred dividends as well as interest rate payments related to these holdings for as long as the "investment" of tax dollars is in place.
- A "hard" cap (of far less than the reported \$300 billion being sought) should be placed

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on the Treasury's line of credit for Fannie Mae and Freddie Mac as well as the purchasing authority for GSE stock. Both provisions should be limited to the shortest duration possible to encourage regular Congressional review and speedy repeal.

- Once any loans or share purchases involving tax dollars take place, GSEs should be prohibited from conducting any kind of political or lobbying activity.
- For the duration of any unpaid Treasury loans held by GSEs, or conversely, for the duration of the period in which the Treasury holds GSE shares of stock, the Treasury, in consultation with other regulators, ought to have decision-making power over GSE executive compensation. Some have suggested tying GSE salaries and benefits to the Executive Schedule as established by Congress and the Office of Personnel Management.
- The Treasury and/or other regulators should also have a defined role in the selection process for GSE Board Members and executives.
- A targeted housing finance tax credit should replace the lender-of-last-resort practices of GSEs, thereby preventing much of their housing market price distortions.
- Finally, in the longer term, competing housing finance franchises should be created by breaking up GSEs and auctioning off the new private entities in a manner similar to FCC spectrum auctions.

None of these recommendations will be easy to implement, but neither should putting taxpayers on the hook for what could potentially be huge, precedent-setting commitments. Many in the Administration and Congress contend that the stability of international markets and the U.S. housing sector call for immediate action before most of the steps mentioned above can be deliberated. We disagree. Of equal importance to forestalling an economic meltdown in the present is ensuring that government policies don't create conditions for similar meltdowns in the future. Otherwise, taxpayers will bear witness to these spectacles for years to come, as a host of "too big to fail" institutions become wards of the Treasury.

In the coming days, Congress may be reenacting the financial industry policy equivalent of crossing the Rubicon. What was once an implicit taxpayer guarantee will be wholly explicit, and the government could for the first time be involved in both owning shares of and lending to GSEs. Other quasi-federal entities, such as the Home Loan Banks, could be in for a bailout as well, while FHA could be left holding up to \$300 billion of risky mortgage paper, billions of which could be total losses.

All told, policymakers could be contemplating the largest socialization of risk (and reward for bad actors) in the history of finance. Few decisions are as fraught with future consequences for our free-market economy. Accordingly, **roll call votes on the housing/GSE bailout plan, including "yes" votes on amendments to protect taxpayers and "no" votes on amendments to increase the government's exposure, will be among the most heavily weighted in NTU's 2008 Rating of Congress.**

Sincerely,



Pete Sepp

Vice President for Policy and Communications