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Statement of the Shadow Financial Regulatory Committee

On

Statement on Shays-Markey Bill on GSE Disclosure

May 6, 2002

In late March, Congressmen Christopher Shays and Edward J. Markey introduced H.R. 4071, which would eliminate Fannie Mae and Freddie Mac's exemption from SEC registration under both the Securities Act of 1933 and the Securities Exchange Act of 1934. If the bill were to become law, Fannie Mae and Freddie Mac, in common with all other publicly traded firms, would be required to register their equity, debt, and mortgage backed securities (MBSs) with the SEC prior to offering these securities to the public and to file with the SEC: proxy statements, annual and quarterly reports, and reports on material events that would be of interest to investors.

The Shadow Committee believes the bill is in the public interest, deserves support in Congress, and should be promptly adopted. Fannie Mae and Freddie Mac have objected to the elimination of their exemption because it would be costly to them to register and file with the SEC, arguing that such a requirement would in effect be "a tax on housing." The objection that requiring registration and reporting is a tax on housing is worth considering only if Congress believes that requiring pharmaceutical companies to register their securities is a tax on drugs.

Fannie Mae and Freddie Mac continue to take the position that as government sponsored enterprises (GSEs), the United States government does not back their securities. If true, there would be no basis whatever for exempting their securities from the full disclosure that SEC registration would produce. As long as Fannie and Freddie retain this exemption, it fuels the perception that they have special protection from the government. If not true, the Committee still believes that, for a variety of reasons, full disclosure of investor risks is warranted even if the GSEs are government-backed.

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For one thing, Fannie and Freddie are active participants in purchasing MBSs issued with respect to pools of securities they have previously assembled, securitized, guaranteed and sold to investors. Current estimates are that they hold 34 percent of all MBSs they have previously sold. Some market participants believe that the GSEs' disclosures concerning the constituents of the underlying mortgage pools are not sufficiently detailed to permit investors to differentiate among the pools in order to price the interest rate risk associated with these securities. In that event, when Fannie and Freddie repurchase these securities they would be able to use their superior information about these pools to purchase those MBSs that have the best prices in relation to the true interest rate risk they represent. The disclosures required by SEC registration will provide more information to investors in these securities, allowing them to better understand the risk and value of the MBSs they buy and sell.

Even the GSEs' debt securities could cause losses to investors who do not receive adequate disclosure. Recently, Fannie Mae was compelled to cancel a proposed repurchase of callable debt because investors—many of them small banks and thrifts—claimed that they were unaware at the time of acquisition that these securities could be called by Fannie Mae at any time. The early repurchase of the debt securities would have caused substantial losses among these institutions. Formal SEC disclosure might have avoided any misunderstanding.

Finally, the Committee sees other reasons for requiring the GSEs to register with the SEC. Although Fannie Mae has recently agreed voluntarily to disclose insider trading by its directors and officers and has begun to publish its proxy statement on its website, these voluntary steps could be rescinded if the current pressure for disclosure eases. These minimal steps were taken only after the media called attention to the failure to disclose insider trading and after their proxy statement was posted on the website of the American Enterprise Institute last year. In addition, the financial statements of Fannie and Freddie are not fully comparable with one another. Since they are supposed to be competitors, investors should be able to compare their financial results as an indicator of the quality of their managements. SEC registration and disclosure would likely result in more comparable financial statements.