

NHEMA's GSE Policy Statement

11/99

The National Home Equity Mortgage Association ("NHEMA") believes that:

- ❖ When granting special charters to the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), Congress intended that these quasi-governmental entities should stay focused on the specific, but limited public mission of facilitating home acquisitions by helping to develop and maintain liquidity and stability in the secondary conventional consumer mortgage market and of expanding affordable housing opportunities.
- ❖ No private lender can compete successfully against these government subsidized enterprises ("GSEs") due to the GSEs' special unfair benefits and advantages which include, for example: an implied government guaranty (which results in the GSEs having significantly lower borrowing costs than private lenders); exemptions from state and local taxes and various state filing, licensing and business laws; and from SEC registration requirements; \$2.25 billion lines of credit with the U.S. Treasury; relatively low capital requirements; and exclusive charters that essentially provide them duopoly market powers.
- ❖ Fannie Mae and Freddie Mac now are expanding into new lines of business, like home equity and subprime lending, that are well beyond what their public missions are, or should be.
- ❖ It is totally inappropriate and unfair, and an abuse of their charter privileges, for Fannie Mae and Freddie to use their government subsidies and special status to compete in such new lines of business with private sector companies that lack such government provided advantages.
- ❖ There is no marketplace need for Fannie Mae and Freddie Mac to expand into subprime and home equity lending or other areas currently served adequately by private firms.
- ❖ These GSEs' entry into such new markets will discourage innovation and competition and undermine and disrupt the viable and competitive primary and secondary markets that already exist as the GSEs use their government-subsidies and duopoly powers to undercut non-GSE market participants.
- ❖ Home equity and subprime lending are quite different from the conventional mortgage market involving home acquisitions that Congress intended these GSEs to focus on; home equity and subprime loans generally are not for home acquisition but are made to existing homeowners who use the funds to restructure family finances and for non-housing consumer credit purposes (e.g., to pay off higher cost credit cards).
- ❖ Fannie Mae and Freddie Mac, and ultimately the taxpayers, will be exposed to significantly more risk when these GSEs expand into new programs like subprime where borrowers generally have impaired credit.
- ❖ These GSEs are failing to disclose fully to lenders the lending criteria being used in the GSEs' automated underwriting systems for these new programs, and these "black box" systems may be unfairly discriminating against some home equity and subprime borrowers.

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- ❖ Fannie Mae and Freddie Mac are likely to drive many subprime lenders out of business, thereby lessening competition, and drive up the cost for borrowers in the lower subprime credit grades as they capture the more profitable higher grade subprime customers.
- ❖ Contrary to the public relations image these GSEs have fostered, Fannie Mae and Freddie Mac have tended to lag behind private sector firms in lending for affordable housing (yet the GSEs have consistently made record corporate profits).
- ❖ Fannie Mae and Freddie Mac, not surprisingly, have repeatedly resolved the inherent conflict between their public mission and private shareholders' interests by retaining a large portion of the value of their government subsidies (perhaps 1/3) to inflate their profits to record levels to enrich their shareholders and top executives instead of passing the full benefits on to borrowers.
- ❖ To increase their profitability, Fannie Mae and Freddie Mac have dramatically increased financial arbitrage activities to expand their portfolio holdings, thereby displacing private capital in the secondary market and increasing financial risks.
- ❖ These GSEs can only maintain their extraordinary profitability by continuing to skim off ---- instead of passing on to consumers----billions of dollars of their government subsidies and by expanding into new private sector markets because they have largely reached the limits of their traditional markets.
- ❖ The Department of Housing and Urban Development ("HUD") and Congress have failed to provide adequate regulation and oversight of Fannie Mae's and Freddie Mac's activities, especially these GSEs' expansion into new programs.

NHEMA therefore strongly urges that:

- HUD take immediate appropriate regulatory actions to confine these GSEs to the limited secondary market / affordable housing mission originally intended and to ensure that the GSEs' are not engaging in unfair competition with private firms.
- Congress initiate a comprehensive review of Fannie Mae's and Freddie Mac's charters and operations, including for example, considering how these GSEs may be going beyond the missions and activities that Congress intended; whether current and future market conditions---which are radically different than when these quasi-governmental entities were created---justify a change in their missions and special subsidies / benefits; and whether there is not a more efficient way than the current GSE model, which absorbs roughly one-third of the value of federal subsidies, to encourage home ownership.
- Congress should modify these GSEs' special charters and subsidies to ensure that they are not allowed to compete unfairly with private firms, that the GSEs do not continue to retain an undue part of the value of their governmental subsidies instead of passing on such benefits borrowers who are seeking to acquire homes, and that these GSEs are subject to better governmental regulation and oversight.