

Consumer Bankers Association  
Consumer Mortgage Coalition  
The Financial Services Roundtable  
National Home Equity Mortgage Association

December 15, 1999

The Honorable Andrew M. Cuomo  
Secretary  
U.S. Department of Housing & Urban Development  
451 Seventh St., S.W.  
Washington, D.C. 20410

Dear Mr. Secretary:

We are writing to express our increasing concern over the efforts of Fannie Mae and Freddie Mac to expand their business activities into areas which are well beyond what Congress has directed as their “public mission.” By this letter, we are formally requesting the Department of Housing and Urban Development to exercise its existing statutory authority to adopt a stronger stance against this so-called “mission creep” by the secondary market agencies.

It has long been understood that the primary public mission of Fannie Mae and Freddie Mac has been to facilitate home acquisitions by providing liquidity to the conventional mortgage market.<sup>1</sup> They were to do so by helping to develop a healthy secondary market wherein lenders can sell conventional mortgages to investors and then have more capital to reinvest in additional mortgage lending. In recent years, Congress also expanded the mission of these Government Sponsored Enterprises (GSEs) to include the laudable goal of promoting affordable housing opportunities for women, minorities and lower-income consumers.

The GSEs have done a commendable job in helping to build and maintain a viable secondary market for conventional home mortgages. Accomplishment of their affordable housing targets has been less demonstrable<sup>2</sup>, and, in fact, the GSEs appear to have lagged behind the private sector in this important area. What is abundantly clear, however, is that Fannie Mae and Freddie Mac have been moving aggressively into new markets and utilizing the advantages of their government subsidies to crowd out existing market competitors.

For example, in 1998, Fannie Mae and Freddie Mac launched identical programs involving the payment of a delivery fee by consumers to the GSEs in lieu of standard private mortgage

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<sup>1</sup> *Report of the Secretary of the Treasury on Government Sponsored Enterprises*, (May 1990), p. A-1.

<sup>2</sup> *See, e.g.*, editorial of Martin Luther King, III, President & CEO, Southern Christian Leadership Conference, *Washington Times* (Nov. 17, 1999).

insurance coverage. Both the Fannie Mae program (called Flex) and the Freddie Mac counterpart (called Alt) incorporate, for the first time ever, a fee to the borrower that is paid over the life of the loan as an interest rate add-on or paid in full at closing. In either case, the net result is that the GSEs are self insuring rather than meeting the level of primary mortgage insurance contemplated by the Congress when it established minimum loan-to-value purchase requirements.<sup>1</sup>

Another example of the secondary mortgage agencies seeking to venture beyond the scope of their traditional mortgage purchase activity can be found in their recent forays into subprime lending. Fannie Mae's September 30, 1999 announcement of its subprime program specifically states that "Fannie Mae Offers *New Lower Cost Mortgage for Borrowers With Past Credit Problems.*"(Emphasis added.) Subprime lending is not just new, it is significantly different from traditional GSE mortgage purchase programs, as best evidenced by the Interagency Guidance on Subprime Lending published by the federal financial regulators which defines this loan product as "extending credit to borrowers who exhibit characteristics indicating a *significantly* higher risk of default than traditional bank lending customers."<sup>2</sup> (Emphasis added.)

Yet another illustration of questionable "mission creep" by the GSEs is the announced intention of Fannie Mae to expand more broadly into the home equity market. In remarks delivered before a Merrill Lynch Investor Conference on September 14, 1999, Fannie Mae Chairman & CEO, Franklin Raines, specifically identified home equity lending as one of four areas for future company expansion. By definition, home equity lending relates to existing homeowners, not home buyers which is the principal focus of the GSEs' charters.

It should also be noted that the GSEs have become active in the real estate disposition markets by bidding on and purchasing properties that do not involve mortgages owned, guaranteed or otherwise supported by the GSEs. In fact, Freddie Mac recently acquired a real estate disposition company as a separate line of business. It also owns and operates a real estate sales unit called the HomeSteps Buying Center.

We respectfully suggest that HUD has a statutory obligation to review and then rule on these new business ventures. The Federal Housing Enterprises Financial Safety & Soundness Act of 1992,<sup>3</sup> and the implementing regulations issued thereunder, specify that "The Secretary shall require each enterprise to obtain the approval of the Secretary for any new program of the enterprise

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<sup>1</sup> 12 U.S.C. § 1717(b)(2) [Fannie Mae]; 12 U.S.C. § 1454(a)(2) [Freddie Mac].

<sup>2</sup> Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision (March 1, 1999), p. 1.

<sup>3</sup> 12 U.S.C. § 4542(a).

before implementing the program.” A “new program” is defined in that same Act as any program for purchasing or otherwise dealing in conventional mortgages that is “significantly different” from programs that have been previously approved or engaged in prior to 1992,<sup>1</sup> or which “represents an expansion, in terms of the dollar volume or number of mortgages or securities involved, of programs above limits expressly contained in any prior approval.”<sup>2</sup>

Accordingly, we specifically ask that HUD exercise the authority as referenced above to require the GSEs to obtain the Department’s approval prior to conducting any further operations in these new areas.

In conclusion, the private-sector lenders constituting our association members are concerned that Fannie Mae and Freddie Mac are abusing their special charter powers to compete unfairly with non-GSEs. By utilizing their tax exemptions, government subsidies and other advantages, these GSEs can, and do, come to totally dominate markets which they enter because private industry simply cannot compete for long given all the advantages conferred by GSE status. It is precisely for this reason that we believe the Congress intended that Fannie Mae and Freddie Mac confine their activities to situations where market imperfections justify a GSE presence.

For Fannie Mae and Freddie Mac, that niche has historically been the secondary market for conventional home loans, particularly as it involves expanding affordable housing opportunities. It was never intended to be, nor should it include, expansion into programs like mortgage insurance, subprime and unrestricted home equity lending, third-party real estate disposition and even real estate brokerage. As well summarized by Ralph Nader in recent congressional testimony:

“Fannie and Freddie have become the dominant force in the housing finance market. It is obvious that some of the subsidy derived from their GSE status is being used, not for home buyers, but to increase corporate power and control over all facets of the mortgage business.”<sup>3</sup>

For all these reasons, we believe that the expansionist activities of Fannie Mae and Freddie Mac should be carefully scrutinized and allowed to proceed, if at all, only after HUD has conducted a thorough review of the new program as required by law and applicable Department regulations.

Thank you for taking our views under consideration.

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<sup>1</sup> 12 U.S.C. § 4502(13)(A).

<sup>2</sup> 12 U.S.C. § 4502(13)(B).

<sup>3</sup> *Hearings before the House Committee on the Budget*, 106<sup>th</sup> Cong., 1<sup>st</sup> Sess., (June 30, 1999).