



**National Home Equity Mortgage
Association**

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August 22, 2000

Hon. Richard Baker
Chairman
Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises
2129 Rayburn Building
U. S. House of Representatives
Washington, DC 20515

Dear Chairman Baker:

On behalf of the member companies of the National Home Equity Mortgage Association ("NHEMA"), I want to commend you for your initiative and persistence in examining the activities and regulation of the housing government-subsidized enterprises ("GSEs"), especially Fannie Mae and Freddie Mac. We also applaud your willingness to adopt the suggestion of Congressman Kanjorski to conduct roundtable discussions this Fall on these issues and would welcome the opportunity to participate.

Like most national housing finance industry trade associations, NHEMA has serious concerns over how Fannie Mae and Freddie Mac are continuing to exploit the advantages provided by their government charters to unduly enrich their shareholders and stifle competition in the private sector¹.

Fannie's and Freddie's expanding activities and the fundamental changes that have occurred in the housing finance marketplace since these GSEs were created clearly make your Subcommittee's inquiry both timely and appropriate. We urge that you thoroughly reexamine how the GSEs can be best regulated to ensure safety and soundness, lessen taxpayer risks and remain focused on the mission intended by Congress. And, with regard to Fannie's and Freddie's mission, we feel that Congress must reevaluate both how well the GSEs are performing their acknowledged mission of providing liquidity in the secondary market and facilitating affordable housing and what these GSEs' mission should be in the changed circumstances of the 21st Century.

In recent years, Fannie and Freddie have come to totally dominate the so-called conventional housing finance market and have begun to move aggressively into new program activities, including home equity lending programs that do not involve home

¹ NHEMA has adopted a Policy Statement on GSEs, a copy of which is attached, expressing our members' concerns.

purchases or home improvement. HUD's oversight of the GSEs' expansion into new programs has been virtually non-existent².

Fannie and Freddie have a host of unmatched special advantages over non-GSE companies---including, exemptions from state and local taxes and SEC filing requirements, lines of credit to the U.S. Treasury and an implicit government guarantee of their debt that enables them to borrow funds at below market interest rates. Fannie and Freddie have used these special benefits to become among the most profitable companies in the country and to pay out high returns to their private shareholders. Although we have no doubt that these GSEs have competent management, we think that their extraordinary shareholder returns are based in no small part on their special government subsidies. As you know, government studies have concluded that Fannie and Freddie retain roughly 1/3 of their government subsidies, amounting to several billion dollars, instead of passing on these benefits to consumers as Congress intended in the form of lower housing costs.

Even with their unmatched subsidies, however, these GSEs have found that that they can not continue to pay shareholders such exceptional returns unless they expand further into new market segments, and they must squeeze more profits from the traditional markets they dominate by forcing their proprietary automated underwriting programs on lenders. Fannie and Freddie also have exploited the funding advantages provided by their charters to make money through arbitrage activities in buying back their own mortgage-backed securities. In doing so, they have incurred a staggering amount of debt that is implicitly guaranteed by the federal government and that places taxpayers at far greater risk. At the same time, as HUD has confirmed, these GSEs have lagged behind the market in lending to African-Americans and others who are most in need of affordable housing assistance.

Fannie's and Freddie's activities, and HUD's timid regulatory approach, raise extremely important and troubling public policy questions that virtually cry out for Congressional examination. What these GSEs have been doing and what they are planning to do is now obvious and relatively transparent, but until your Subcommittee's hearings, had clouded from public scrutiny by these GSEs' extensive public relations programs and political activities.

As you examine how Fannie and Freddie can be more effectively regulated and the more fundamental questions of what their mission now should be, we believe that it is imperative that you determine how to best resolve the inherent conflict that presently exists between these GSEs' public mission and their corporate obligation to maximize profits for their shareholders. Clearly, Fannie and Freddie should not be retaining billions in government subsidies and making record profits every year instead of passing

² Last year, NHEMA and several other trade associations asked HUD to fulfill its statutory obligation to review Fannie's and Freddie's expansion into home equity and subprime lending activities. A copy of relevant correspondence is attached. HUD has failed to act in response to this plea. *[Note: After sending this letter to Chairman Baker, NHEMA received essentially a non-responsive letter from HUD, a copy of which is attached, illustrating further that HUD is failing to properly fulfill its statutory review duties.]*

on all the special benefits as Congress intended to millions of Americans who need more help in securing more affordable housing. And, private sector competition should be encouraged instead of being stifled. These GSEs should not be allowed to engage in activities using the unfair competitive advantages of their government subsidies, where the private sector can adequately serve marketplace needs.

Chairman Baker, like the boy in the old story of *"The Emperor Has No Clothes!"*, your willingness this year to say *"Look At What Fannie and Freddie Are Doing!"* has pierced much of the political and PR cloud that has covered these GSEs. Public debate has now begun on these important issues, and we look forward to this debate's continuation in the upcoming Roundtable discussions and in further hearings and legislative actions in the next Congress. NHEMA wishes to be an active and constructive participant in this debate as you and your Banking Committee colleagues determine what "clothes" these imperial duopolies should wear to better serve the public interest.

We again commend you and Congressman Kanjorski for your leadership efforts in spotlighting these critical public policy questions and for your thoughtful, measured manner in exploring the many complex issues involved.

Sincerely,

A handwritten signature in black ink that reads "Charlie Coudriet". The signature is written in a cursive, slightly slanted style.

Charlie Coudriet
President
National Home Equity Mortgage Association

cc: Rep. Paul Kanjorski