August 25, 2000

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets,
Securities, and GSEs
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Paul Kanjorski
Ranking Member
Subcommittee on Capital Markets,
Securities, and GSEs
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Baker and Ranking Member Kanjorski:

The Financial Services Roundtable appreciates the opportunity to submit formal comments on H.R. 3703, the Housing Finance Regulatory Improvement Act of 2000. The bill would create a single regulator of government sponsored enterprises with authority over both safety and soundness and mission regulation. The bill would also address certain aspects of the explicit and implied government guarantee that has been granted to the GSEs through their government charters.

The Financial Services Roundtable is a national association whose membership is reserved for 100 companies selected from the nation's 150 largest integrated financial services firms. The member companies of the Roundtable engage in a wide range of financial activities, including banking, securities, insurance, and other financial service activities. The mission of the Roundtable is to unify the leadership of large, integrated financial service companies in pursuit of three primary objectives:

$ To be the premier forum in which leaders of the United States financial services industry determine and influence the most critical public policy issues that shape a vibrant, competitive marketplace and a growing national economy;

$ To promote the interests of member companies in federal legislative, regulatory, and judicial forums; and

$ To effectively communicate the benefits of competitive and integrated financial services to the American public.

The Roundtable is a CEO-driven association that advocates the interests of integrated financial institutions primarily in the Congress, the federal agencies, and federal courts.

## General Comments

As indicated in our July 20, 2000 testimony before your Subcommittee, the Roundtable supports H.R. 3703. This letter outlines the basis of the Roundtable support and also suggests several changes to improve the bill so that the GSEs can continue to fulfill their core mission of providing liquidity to the secondary mortgage market. H.R 3703 establishes a framework that will provide regulators proper authority to control mission expansion by the government sponsored enterprises.

The Roundtable believes that the Federal National Mortgage Corporation (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) have helped to reduce the costs of mortgages and raised homeownership rates through their secondary-market first mortgage activities. Likewise, the Federal Home Loan Banks (FHLBanks) have contributed to lower mortgage costs and increased homeownership rates by assisting private market lenders in funding their mortgage activities. Recent innovations by the FHLBanks hold the promise of greater advances in homeownership. In particular, the Mortgage Partnership programs are designed to increase capital available for mortgage lending and provide commercial banks and thrifts competitive alternatives in the secondary mortgage market. Under these programs, private sector lenders retain the credit risk and customer relationship from mortgages, while the FHLBanks manage the liquidity, interest rate and prepayment risk. Because private sector financial institutions hold the credit risk from mortgages, rather than the FHLBanks, the risk to American taxpayers is limited.

The Roundtable commends the GSEs for their success in fulfilling their core missions. However, a number of recent activities by the GSEs, in particular Fannie Mae and Freddie Mac, go beyond their core mission. The Roundtable opposes such activities and supports H.R. 3703 as an important first step towards addressing these concerns.

**Specific Comments**

TITLE I, Subtitle A—Improvement of Supervision

*Single Regulatory Agency*

Title I of H.R. 3703 would establish a new regulatory framework for supervision and regulation of GSEs. Under this new approach, the newly created Housing Finance Oversight Board (Board) would have responsibility for overseeing the safety and soundness, and mission regulatory authority of the GSEs.

The Roundtable supports this approach. Under the existing regulatory structure, safety and soundness and mission regulation for Fannie Mae and Freddie Mac are split among the Office of Housing and Urban Development and the Office of Federal Housing Enterprise Oversight (OFHEO). Conversely, the Federal Housing Finance Board regulates both mission and safety and soundness of the Federal Home Loan Banks. The Roundtable believes that dividing mission and safety and soundness regulation between two regulators weakens the ability of regulatory agencies to fulfill their responsibilities. For example, investing in certain nonmission assets may have both safety and soundness and mission-related implications. By having authority to address both topics, the regulator will be better able to look at a GSE's activities in total and make appropriate judgements.

Under H.R. 3703, the board of directors of the new independent regulatory agency would consist of a representative of the Department of Housing and Urban Development and the Department of the Treasury, along with three private citizens. All of the board members would be subject to Senate approval. While there is some logic in associating HUD and Treasury with the new organization, the stature of these departments within the government might well accord them more leverage than two of five seats on the board would suggest. To ensure that the board would truly be independent, a five member board with staggered terms, no more than three of whom could represent more than one political party, should be created. Those members should be appointed by the President and confirmed by the Senate, and the President should determine who should chair the board. If the departmental knowledge of HUD and Treasury is important in the conduct of the affairs of the board, inter-governmental comity should permit the board to obtain whatever information is needed from those as well as other governmental agencies. Similarly, the board could notify those departments of the decisions of the agency in prompt fashion if that were desirable.

*Funding*

The bill would also change the manner in which the regulators are funded. Fannie and Freddie's current regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), is subject to a highly politicized appropriations process, unlike virtually any other federal financial regulator. The political strength of the regulated entities makes it difficult for OFHEO to obtain the funds it needs to do its job. Conversely, the new regulatory agency would fund itself through the common practice of assessing entities it regulates and its funding is separate from the appropriations process. The Roundtable believes that financial independence is critical to the stability and independence of any regulatory agency. By ensuring that adequate and timely funding is available by allowing the newly established oversight board to directly assess the institutions it regulates, H.R. 3703 ensures that the new agency and the job it does will be free from the problems presented by unpredictable funding or political interference.

While many features of H.R. 3703 are desirable and supported by the Roundtable, non-politicized funding for any GSE agency is sufficiently important that the Roundtable believes that an immediate change in the funding provisions of OFHEO should be adopted in the current session of Congress.

*Approval of New Activities*

The bill would put in place a process for Board approval of new activities that the GSEs wish to undertake. H.R. 3703 would require that new activities be published in the Federal Register, to allow for public comment. We would go further and require a clear bright-line statutory statement of the mission of the GSEs against which new activities could be measured. The Roundtable recognizes that this is a process that will place obstacles in the way of rapid implementation of new ideas by Fannie Mae and Freddie Mac. We believe that is good. Because of the size and strength of these GSEs, even modest implementation of new programs by them dramatically affects the housing market and complicates any potential withdrawal of such programs. To permit even pilot programs without first including a full consideration of the long-run implications of the programs and their relation to the mission of Fannie Mae and Freddie Mac would create a risk of the agencies being able to define their mission regardless of what others might say. In effect that is what they are now doing.

The current system for ensuring compliance with the GSE mission in essence leaves that process to the GSEs alone and simply does not work. In our July 20th testimony, the Roundtable highlighted the following two activities:

- Home Depot Program. Fannie Mae has developed a program where it will purchase home equity loans originated at Home Depot stores. Ostensibly, these funds are then used for home improvement purposes. However, the

Roundtable questions whether home equity loans in general, and loans originated through this program in particular, are within the scope of Fannie Mae's mission. Over 70 percent of home equity loans are used for general consumer credit purposes, including credit card consolidation, purchasing new automobiles or boats, financing education, or purchasing other goods. Such loans do not further Fannie's mission, not even when the loan proceeds are used solely to purchase goods from Home Depot.

- Home Steps Home Buying Center. Freddie Mac sells REO property directly to consumers through their Home Steps program. As part of this program, Freddie operates a storefront in a California strip mall where consumers can view pictures of property, pre-qualify for a loan, visit the homes with a Home Steps buying counselor, purchase the home, apply for a loan, have the home inspected, and close on the home. Such consumers can even choose to have certain appliances and types of carpet installed. An earlier version of the marketing material for this program promotes this "new way to buy a home." According to this brochure, "most home purchases require visiting several locations in different parts of town: a real estate office, a lending institution, and an escrow company. At HomeSteps, each of these steps can be taken care of under one roof—the HomeSteps Home Buying Center." The implication of this statement is clear: it is no longer necessary to go to a bank, a thrift or another lender to get a mortgage loan because Freddie Mac can provide them at their store. Perhaps most troubling, Freddie emphasizes its close relationship to the federal government by stating clearly on the front of the brochure that Freddie Mac is a "Congressionally Chartered United States Corporation." While Freddie's and Fannie's charters expressly prohibit them from engaging in primary market activities, Freddie obviously does not believe that using a retail storefront to sell homes and issue loans is a primary market activity.

These are clear examples of the GSEs creating their own definition of their mission. There is no practical process by which the introduction of these activities can be challenged or prohibited. There should be, and the challenges should come in advance of the introduction of new activities; in fact, it should come in advance of the initiation of research into the development of the systems for the new activities.

TITLE I, Subtitle B—Required Capital Levels, Enforcement Powers and Non-Mission-Related Assets

*Nonmission-Related Assets*

H.R. 3703 would place limits on the non-mission related assets of the GSEs. The Roundtable supports this provision. As discussed previously, the GSEs often undertake actions that go far beyond the original intent of their mission. Providing the regulatory agency with sufficient authority to control GSEs' use and ownership of nonmission-related assets is an important step toward addressing this issue.

As an integral part of that authority and as we stated earlier in this letter, the Roundtable supports the establishment of a clear bright-line statutory definition of the mission. While this will require thoughtful debate by all concerned parties, it is essential if the agency is to understand the scope of its regulatory responsibilities.

The Roundtable supports the provisions of this bill that properly leave the exact nature of such regulations up to the regulatory agency. This support comes despite that fact that the Roundtable has not always agreed with the decisions made by the GSE regulators in this area. For example, the Roundtable filed a comment letter on June 15, 2000 with the Federal Housing Finance Board objecting to several of the proposed provisions regarding the definition of "acquired mission assets" and "core mission assets." In the comment letter, the Roundtable expressed concerns that the provisions put forth by the Board in this area are overly restrictive.

Quite possibly we may at other times feel the Board's decisions are too permissive. Nevertheless, we believe that a fully independent Board, operating with proper non-politicized funding, under a Congressionally defined mission for the GSEs will be well-suited to address concerns of nonmission-related assets.

*Conforming Loan Limits*

The Roundtable believes that the section governing conforming loan limits should be revised to clarify that such limits should be adjusted downward in the event that the Housing Price Index exhibits lower average home prices. It should also be made clear that the conventional loan limit is inclusive of first and subsequent mortgages.

TITLE I, Subtitle B—Reduction of Systemic Risk

*Yearly Review of Enterprises by Rating Organizations and Annual Reports*

The Roundtable supports provisions to require the GSEs to be rated by two nationally recognized rating agencies on an annual basis. Likewise, the Roundtable supports the provisions of this bill requiring annual reports by the regulatory agency that provide appropriate details related to the rating, enforcement actions and certain other relevant information analogous with the safety and soundness of the government sponsored enterprises. Evidence supports the assertion that GSEs have an implicit government guarantee beyond the explicit benefits afforded to the enterprises from the federal government. Requiring this thorough analysis will help to quantify this benefit for policymakers and the public and promote greater transparency in debt markets.

*Risk-Based Capital*

The Roundtable agrees with the changes to the statutory requirements for risk-based capital that this bill proposes. The proposed standard allows the regulatory agency, at its discretion, to "make any assumptions... appropriate regarding interest rates, home prices, and new business" in establishing capital requirements. The existing statutory standards for OFHEO's risk-based capital requirements are overly complicated and have contributed to the eight-year delay in promulgating final regulations. Capital regulations are one of the major tools that financial regulators use in regulating safety and soundness. This proposal provides the regulators with greater flexibility to establish appropriate capital regulations.

The Roundtable would also suggest that the bill include provisions that any final capital standards for GSEs be consistent with those of other major financial institutions. U.S. banks, for example, are subject to standards similar to those established by the 1988 Basle Accord as subsequently amended. Fannie Mae and Freddie Mac, which are among the world's largest financial services firms, and which sell their debt on a global basis, should be subject to the same standards as other globally active U.S. financial institutions.

*Repeal of the Treasury Lines of Credit*

Given the size of Fannie Mae's, Freddie Mac's and the Federal Home Loan Bank's balance sheets, repealing the lines of credit with the U.S. Treasury is not likely to have a major effect on the actual operations of these organizations. Nevertheless, it would be a symbolic action, which would help establish an atmosphere for compromise between all parties in that thereafter no explicit federal government guarantee of GSE credit would exist.

*Membership of Board in FFIEC*

The bill adds the Board to the Federal Financial Institutions Examination Council. While there is benefit in providing the Board with the cumulative experience of the present members of FFIEC, care should be taken to consider whether the underpinnings of the Board, namely institutions with large and measurable government subsidies, is an appropriate basis for joining the regulators of those institutions with regulators who regulate non-subsidized institutions. Implicit in the addition of the Board to FFIEC is an assumption that there is a similarity both between the Board and the other regulators and between the regulated entities which the FFIEC members regulate. The differences are very large, perhaps greater than the differences between current members and the SEC, a federal financial institutions regulator which is not a member of FFIEC.

*FHLB Finance Corporation*

The Roundtable supports the joint and several liability of consolidated debt obligations of the FHLBs made possible through the establishment of the FHLB Finance Corporation. We encourage the development of such obligations. Centralization of this function will lead to efficiencies and the creation of additional strength in the marketplace, all of which will help develop an additional strong competitor for the other housing GSEs.

*Study of Impact of GSEs on Insured Depository Institutions*

Much speculation has arisen over the relationship between insured depository institutions and the GSEs, particularly with respect to the debt held by depository institutions and the risk implicit in such holdings. The Roundtable supports the provisions in H.R. 3703 which mandate a systematic study by the FDIC and the Board of Governors of these relationships and the possible consequences of them in different financial scenarios.

TITLE II, Transfer of Functions, Personnel and Property

The Roundtable does not currently have a position on the provisions in this subtitle.

## Additional Comment

The Roundtable notes that OFHEO is the only federal financial safety and soundness regulator that is currently subject to the appropriations process. The federal regulators that oversee our companies, including the SEC, OCC, Federal Reserve, OTS, FDIC and FTC are not subject to the appropriations process as is OFHEO. The Roundtable would support immediate action to remove OFHEO from the appropriations process now. The strength provided by such action will ensure adequate resources while this bill is debated further.

## Conclusion

The Roundtable greatly appreciates the invitation to submit these comments in support of H.R. 3703, the Housing Finance Regulatory Improvement Act.

If the Roundtable or any of our member companies can provide you with further information on this topic, please do not hesitate to contact me or the Roundtable's Director of Government Affairs Lisa McGreevy at (202) 289-4322. Thank you for all of your hard work on this topic.

Best regards,

Steve Bartlett