**AEI Housing Center**

# American Enterprise Institute 1789 Massachusetts Ave NW Washington, DC 20036

January 4, 2021

Enterprise Regulatory Capital Framework

Federal Housing Finance Agency

Proposed: October 9, 2020

Comment Period Closes: January 8,2021

Submitted: January 4, 2021

Document No.: FR Doc 2020-23452

RIN-2590-AA17

Re.: New Enterprise Activities

Dear Sir/Madam:

Thank you for the opportunity to comment on FHFA’s proposed rulemaking for New Enterprise Activities. We recommend that FHFA make explicit reference to controlling provisions of the Enterprises’ charters.

It would be a pleasure to discuss this recommendation further with you at your convenience, should you so desire. Thank you again for the chance to participate in this timely rulemaking.

Yours respectfully,

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FHFA PROPOSED RULE FOR NEW ENTERPRISE ACTIVITIES

FHFA’s proposed rule would describe a new product as any new activity that FHFA determines merits public notice and comment on matters of compliance with the applicable sections of an Enterprise’s authorizing statute, safety and soundness, or public interest. The public interest factors that would be considered by FHFA include any activities that:

* Advance any of the purposes of the Enterprise under the applicable authorizing statute;
* Serve underserved markets or further fair housing and/or fair lending;
* Could be supplied by other market participants and/or promotes or stifles competition;
* Overcome natural market barriers or inefficiencies;
* Raise or mitigate systemic risks to the mortgage, mortgage finance, or other financial markets; and
* Involve other factors as determined appropriate by the Director.

The above definition should make explicit reference to relevant charter provisions. For example, Fannie Mae’s Charter (12 U.S.C. 1719) provides:

“… the operations of the corporation under this section shall be confined so far as practicable, to mortgages which are deemed by the corporation to be of such **quality**, type, and class as to meet, generally, the **purchase standards imposed by private institutional mortgage investors**. In the interest of assuring sound operation, the **prices to be paid** by the corporation for mortgages purchased in its secondary market operations under this section, should be established, from time to time, **within the range of market prices for the particular class of mortgages involved**, as determined by the corporation. **The volume of the corporation’s purchases** and sales, and **the establishment of the purchase prices, sale prices, and charges or fees**, in its secondary market operations under this section, should be determined by the corporation from time to time, and such determinations should be consistent with the objectives that such purchases and **sales should be effected only at such prices and on such terms as will reasonably prevent excessive use of the corporation’s facilities**,…” (**bolding added)**.

Over the last few decades Fannie Mae’s business operations have been designed and implemented so as to assure, rather than prevent, the excessive use of its facilities. This has been accomplished through liberal pricing and lending terms in direct contravention of its charter.

Rather than meeting, “generally, the purchase standards imposed by private institutional mortgage investors,” it has instead operated in a manner designed to maximize the use of its facilities. One result of this “excessive use” has been that it has operated pro-cyclically during housing booms, thereby helping to support unsustainable home price increases, particularly for entry-level buyers.

This constitutes a *prima facie* violation of the Fannie Mae Charter, one that FHFA has the regulatory power to address.

**Example: Comparison of GSE and Portfolio Lending Standards at Loan Limit**

The following analysis and fact pattern constitutes a *prima facie* Charter violation.

* The chart below shows that borrowers are actively bunching at the GSE loan limit.
* This continued bunching is a sign that many of these loans benefit from either underwriting quality or pricing liberality, both of which are Charter violations.
	+ A recent study found no pricing liberality. GSE prices paid for such loans are below the price paid by “private institutional mortgage investors” (meaning that GSE rates are higher).[[1]](#footnote-1) The GSE’s rate disadvantage since 2014 has been around a quarter basis point *after controlling* for borrower risk characteristics.[[2]](#footnote-2)
	+ This same study found that these GSE loans did not have the same quality as to meet “the purchase standards imposed by private institutional mortgage investors”.
* To assess this quality liberality, the table compares the credit characteristics of GSE loans at the conforming loan limit to jumbo portfolio loans. The table shows that the “credit box” for jumbo portfolio loans is indeed smaller than that for GSE loans at the loan limit. In particular, only 4 percent of jumbo portfolio loans have DTIs above 43 percent, compared with nearly one-fifth of GSE loans at the limit. The Qualified Mortgage (QM) rules implemented in 2014 by the Consumer Financial Protection Bureau provide lenders with a strong incentive to cap the DTIs on jumbo loans at 43 percent. Among other important risk factors, the table shows that GSE loans at the limit are substantially more likely than jumbo portfolio loans to have credit scores below 720 (6 percent for jumbo vs 23 percent for GSE at the limit) or LTVs above 90 percent (4 percent for jumbo vs 15 percent for GSE at the limit) or at least one of the 3 risk characteristics describe above (12 percent for jumbo vs 55 percent for GSE at the limit)
* This comparison implies that some GSE borrowers could not have obtained a jumbo portfolio loan, which helps explain continued bunching at the loan limit, but also is evidence of differential quality standards between the GSEs and the private sector.
* These findings explain the conundrum why on the one hand the GSE pricing is below the one provided by private institutional mortgage investors, yet on the other hand why so many borrowers are bunch together and pay the higher GSE rate. The reason is that the GSEs are offering the “**quality**, type, and class” of loans that DO NOT “meet, generally, the **purchase standards imposed by private institutional mortgage investors.”** This is evidenced by the fact that 55 percent of the GSE loans have one or more of the three characteristics described above and listed in the chart below, compared to only 12 percent for private institutional investors.
* Because the underwriting standards currently in use by the GSEs are not generally offered by private investors, the outcome is an unnatural result where the GSEs can outcompete the private sector despite offering higher rates. This is *prima facie* evidence of a Charter violation—Fannie is using quality reductions to allow for excessive use of its facilities.

*Distribution of 2014-2018 GSE loan amounts relative to the conforming loan limit*

Note: Distribution is for 1-unit, primary owner-occupied, 30-year fixed-rate home purchase loans. The right-most bar contains GSE loans larger than 98 percent of the applicable conforming loan limit.

*Distribution of 2014-2018 GSE loan amounts relative to the conforming loan limit*

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| --- |
| **Percent of 2014-2018 home purchase loans with:** |
|  | GSE at the loan limit | All jumbo portfolio |
| **DTI > 43%** | 19 | 4 |
| **Credit score < 720** | 23 | 6 |
| **LTV > 90%** | 15 | 4 |
| **At least one of the above 3** | 55 | 12 |

Note: Includes GSE loans have loan amounts greater than 98 percent of the applicable conforming loan limit. GSE and jumbo portfolio loans with missing data for a given risk factor are excluded.

Source for the chart and table: Lynn Fisher, Michael Fratantoni, Stephen Oliner, and Tobias Peter, “Jumbo Rates Are Below Conforming Rates: When Did This Happen and Why?” Data from CoreLogic and Black Knight, Inc.

1. Lynn Fisher, Michael Fratantoni, Stephen Oliner, and Tobias Peter, “Jumbo Rates Are Below Conforming Rates: When Did This Happen and Why?” [↑](#footnote-ref-1)
2. Perhaps around half, but not all, of the rate disadvantage for GSE borrowers may reflect a greater effort undertaken by borrowers with private institutional mortgage investors to lock-in attractive rates. [↑](#footnote-ref-2)