
CONSUMER MORTGAGE COALITION

September 13, 2006

Ms. Susan S. Jacobs
Chief Strategic Planning Officer
Office of Federal Housing Enterprise Oversight
1700 G Street, NW, Fourth Floor
Washington, D.C. 20552

RE: Comments on OFHEO's Proposed Strategic Plan 2006-2011

Dear Ms. Jacobs:

Thank you for the opportunity to comment on OFHEO's Proposed Strategic Plan 2006-2011. The Consumer Mortgage Coalition ("CMC"), a trade association of national mortgage lenders, servicers, and service providers, wishes to commend you for the care with which you solicited comments on the plan update before publishing the draft plan for further comment.

It is our general observation that the Proposed Strategic Plan is a useful document that provides a clear basis by which to measure the performance of OFHEO in coming years. We would like to offer, however, a number of suggestions where further improvements are necessary.

Program Approval

The single most important issue that we would like to bring to your attention concerns a statement on page 20, about program approval, which states that, "...OFHEO is in the difficult position of considering only safety and soundness elements of activities that could be in violation of an Enterprise's charter."

In fact, OFHEO does have the authority and responsibility to address all violations of law by an Enterprise (unrelated to affordable housing goals), even when safety and soundness issues are not involved. Section 1371(a) (3) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act) authorizes OFHEO to take enforcement actions with respect to "...any conduct that violates – any provision of this title, the Federal National Mortgage Association Charter Act, the Federal Home Loan Mortgage Charter Act, or any order, rule, or regulation under any such title or Act...."

That authority is in addition to OFHEO's authority to take enforcement action with respect to safety and soundness, as is authorized by a number of provisions, including Section 1371(a)(1).

If an Enterprise were to violate both its charter act and the 1992 Act by engaging in programs that violate the prior approval provisions of law, OFHEO has the authority and responsibility to take enforcement action against the Enterprise, whether or not such unlawful programs also raise safety and soundness concerns. The text at the top of p. 20 should be revised to make this clear.

Indeed, OFHEO's substantial authority in the area of program approval was settled many years ago. Attached to this comment letter are two letters that OFHEO's then-General Counsel sent on October 10, 1996, and November 27, 1996, to the general counsels of Freddie Mac and Fannie Mae, respectively. In those letters, OFHEO reviewed the charter act authority of the Enterprises to use spread accounts with high LTV mortgages, and determined that use of spread accounts by the Enterprises is impermissible under their charter acts. Those letters refer only to an analysis of the Enterprises' legal authority; they do not reference safety-and-soundness considerations.

Of course, violation of a charter act or of the 1992 Act introduces reputation risk, which may itself be unsafe or unsound.

The following are two additional points with respect to program approval that we would like to make:

1. We would urge a change in terminology on p. 20 of the Proposed Strategic Plan: the 1992 Act requires the Enterprises to obtain prior approval for new *programs*, not merely products. A new program, for example, may involve services that do not include products. The prior approval discussion on p. 20 should refer to "programs" rather than "products."
2. In addition, we would urge that the last of the performance goals for Strategic Goal 3, on p. 17, be reworded to call for coordination with HUD (not mere meetings) and that program approval be added as one of the subjects of that coordination.

Strategic Goal 1

We urge that a second paragraph be added to the discussion of Strategic Goal. We recommend that the paragraph make the following points:

1. As a result of their direct and implied government subsidies, the Enterprises are not subject to the market discipline that is imposed on all other private financial institutions.
2. Market discipline is an important tool to supplement OFHEO's direct safety-and-soundness supervision.

3. OFHEO will promote increased market discipline and safety-and-soundness by publishing important information about the Enterprises. Most importantly, OFHEO will prescribe stress tests for the Enterprises to determine the scenarios under which they are at risk for depleting all of their capital. While OFHEO is limited to applying the rigid stress test prescribed by the 1992 Act, OFHEO will publish the results of these other stress tests as a means of alerting the public, including investors, as to possible safety-and-soundness vulnerabilities of the Enterprises, potentially increasing market sensitivity to these issues.

In addition the performance goal on p. 9 should be strengthened by calling for OFHEO not only to conduct applied research, but also to publish the results of that research, including the results of applying a range of robust stress tests on the capital strength of the Enterprises.

Strategic Goal 3

Strategic Goal 3, with its emphasis on an efficient mortgage market, is very important. The opening discussion of Strategic Goal 3, found on p. 12, should be expanded to note that an efficient mortgage market means one in which there is active competition, without being impeded by shared monopoly and excessive market power. A useful reference could be made to Section 304(a)(2) of Fannie Mae's charter which states that the Enterprise's "...lending activities should be conducted on such terms as will reasonably prevent excessive use of the corporation's facilities..." There is a similar, albeit narrower, provision in Freddie Mac's charter, at Section 305(a)(5).

Similarly, in the second bullet on p. 13, the performance goal should be revised to state that OFHEO will make consistent and transparent disclosures of the Enterprises' market position, as well as the other listed topics.

External Factors: Enterprise Capacity and Management

The last part of the discussion at the top of p. 21 addresses a possible "Failure of Enterprise management that cannot be detected through regulatory oversight..." The proposed Strategic Plan then concludes the section with a weak statement that, "OFHEO can mitigate these events through the use of its enforcement authorities, if necessary." While that statement is true, it is too limited.

It is true that information asymmetries do exist between the Enterprises and their regulator. The lesson of the two OFHEO special examinations, however, is that constant improvement of OFHEO's methods of detection, both internally through examination and externally through analysis of apparent anomalies in reported data, is the necessary first response to shortcomings in detection.

OFHEO needs to commit itself to constantly improve the quality of its examination and its openness to sources of information from and about the marketplace, and find other ways to reduce the asymmetries.

Conclusion

Thank you for the opportunity to submit these comments. We would reiterate that the proposed Strategic Plan is a very useful document with many positive aspects. We would ask you to accept our recommended improvements with this context in mind.

Sincerely,

A handwritten signature in black ink, appearing to read "Anne C. Canfield", enclosed within a thin black rectangular border.

Anne C. Canfield
Executive Director

Attachments (2)

Spencer Azzano



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

1700 G STREET NW WASHINGTON, DC 20552 (202) 414-3800

November 27, 1996

Anastasia D. Kelly
General Counsel
Federal National Mortgage Association
3900 Wisconsin Avenue, NW
Washington, D.C. 20016-2899

Dear Ms. *Azzano*

As you may know, we have been reviewing the use of spread accounts by the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) (collectively, the "Enterprises") in connection with the securitization or purchase of single-family conventional mortgages with loan-to-value (LTV) ratios in excess of 80%. Based on a thorough analysis of section 302(b)(2) of the Federal National Mortgage Association Act (Charter Act), a similar provision in the Federal Home Loan Mortgage Corporation Act (Corporation Act), and the relevant legislative history, it is our view that Congress did not envision that spread accounts would qualify as one of the types of credit enhancements that must be used in connection with high LTV loans.

Our conclusion is based on the following analysis. The Charter Act prohibits Fannie Mae from dealing in a high LTV loan unless the loan includes one of the credit enhancements enumerated in section 302(b)(2). This section lists three types of credit enhancements: (1) the retention of at least a 10% participation by the seller; (2) an agreement with the seller, for such period and under such circumstances as Fannie Mae may require, to repurchase or replace the mortgage upon demand in the event of a default; and (3) the existence of a mortgage guarantee or insurance covering that portion of the unpaid principal balance of the mortgage in excess of 80%. The Charter Act does not expressly address the use of spread accounts as an exception to the prohibition on purchasing high LTV conventional single-family mortgages. In addition, since spread account agreements generally do not provide for insurance on individual loans or constitute agreements to repurchase or replace individual loans, they cannot be considered the legal equivalent of either private mortgage insurance or recourse agreements.

We understand that an argument can be made that the language "for such period and under such circumstances as the corporation may require" in section 302(b)(2) provides Fannie Mae with sufficient flexibility to accept alternate credit enhancements so long as the sellers

Anastasia D. Kelly
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provide the Enterprise with protection against loss which is "economically equivalent" to full recourse. However, while the use of spread accounts under some circumstances may provide equivalent or, in some cases, superior economic protection to an Enterprise than recourse agreements, that does not make them the legal equivalent of recourse agreements within the meaning of section 302(b)(2). The Charter Act lists only three exceptions to the prohibition on dealing in high LTV single-family conventional loans and does not provide the express flexibility for Fannie Mae to use other types of credit enhancements, such as spread accounts, in connection with such loans.

If you have any questions about the foregoing, we would be pleased to meet with you at our earliest mutual convenience.

Sincerely,

A handwritten signature in cursive script, appearing to read "Anne", written in dark ink.

Anne E. Dewey
General Counsel

Charter Act - LTV Act



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800
Office of General Counsel

October 10, 1996

Maud Mater
General Counsel
Federal Home Loan Mortgage Corporation
8250 Jones Branch Drive
McLean, Virginia 22102

Dear Ms. Mater:

As you know, we have been reviewing the use of spread accounts by the Federal Home Loan Mortgage Corporation (Freddie Mac) in connection with the securitization or purchase of single-family conventional mortgages with loan-to-value (LTV) ratios in excess of 80%. In connection with that review we have also analyzed the opinion of Freddie Mac counsel regarding the legal issues involved. Based on a thorough analysis of these issues, it is our view that Congress did not envision that spread accounts would qualify as one of the types of credit enhancements that must be used in connection with high LTV loans.

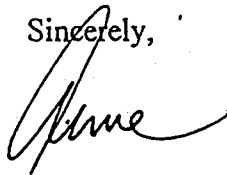
Our conclusion is based on the following analysis. The Federal Home Loan Mortgage Corporation Act (Corporation Act) prohibits Freddie Mac from dealing in a high LTV loan unless the loan includes one of the credit enhancements enumerated in section 305(a)(2). This section lists three types of credit enhancements: (1) the retention of at least a 10% participation by the seller; (2) an agreement with the seller, for such period and under such circumstances as Freddie Mac may require, to repurchase or replace the mortgage upon demand in the event of a default; and (3) the existence of a mortgage guarantee or insurance covering that portion of the unpaid principal balance of the mortgage in excess of 80%. The Corporation Act does not expressly address the use of spread accounts as an exception to the prohibition on purchasing high LTV conventional single-family mortgages. In addition, since spread account agreements do not provide for insurance on individual loans or constitute agreements to repurchase or replace individual loans, they cannot be considered the legal equivalent of either private mortgage insurance or recourse agreements.

We understand that Freddie Mac has taken the position that the language "for such period and under such circumstances as the Corporation may require" in section 305(a)(2) provides Freddie Mac with sufficient flexibility to accept alternate credit enhancements so long as the sellers provide Freddie Mac with protection against loss which is "economically equivalent" to full recourse. For instance, Freddie Mac's ability to tap into a spread account funded by a seller to cover its losses on a pool of mortgages may provide better overall loss

protection to Freddie Mac on its portfolio of purchased mortgages than an agreement by the same seller to repurchase a particular mortgage for a limited period of time. While it can be demonstrated that the use of spread accounts under some circumstances provides equivalent or, in some cases, superior economic protection to Freddie Mac than recourse agreements, that does not make them the legal equivalent of recourse agreements within the meaning of section 305(a)(2). The Corporation Act lists only three exceptions to the prohibition on dealing in high LTV single-family conventional loans and does not provide the express flexibility for Freddie Mac to use other types of credit enhancements, such as spread accounts, in connection with such loans.

In light of our conclusions, a meeting to discuss implementation might be appropriate. We would be pleased to meet with you at our earliest mutual convenience.

Sincerely,

A handwritten signature in cursive script, appearing to read "Anne", written in black ink.

Anne E. Dewey
General Counsel