

# The **GSE** REPORT

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## ***Fannie Mae and Freddie Mac***

- ***Fannie Mae is Bullying its Regulator not to Provide a Specific Amount of Capital in its Risk-Based Capital Proposal for Fannie and Freddie – Freddie Says It is Taking a "Wait-and-See" Approach to the Risk-Based Capital Proposal:***
  - Fannie Mae voiced "strong objection" to its regulator's (the Office of Federal Housing and Enterprise Oversight (OFHEO)) proposed risk-based capital proposal for Fannie and Freddie. Despite Fannie Mae's urging OFHEO not to include specific amounts of capital in its risk-based capital proposal, OFHEO submitted a proposal to the Office of Management and Budget (OMB) that includes specific amounts of capital. Fannie Mae then responded by launching a "frontal assault" complaining directly to the OMB about the proposed capital rule.

### Background:

- OFHEO, the safety and soundness regulator for Fannie and Freddie, was created in 1992 under the Federal Housing Enterprises Financial Safety and Soundness Act for which its chief job was to develop a risk-based capital standard for Fannie and Freddie. Under the act, the risk-based capital standards were to have been completed by December 1, 1994. The deadline for completion passed four years ago and OFHEO has been working on the risk-based capital standard for over five years now. Recently, however, OFHEO submitted a risk-based capital standard proposal to the OMB for its review on October 30<sup>th</sup>. OMB then has 90 days to review the proposal in concert with the Treasury Department and HUD. Congress will then have 15 days to review the proposal before it is published in the *Federal Register* for public comment (possibly in early March). A risk-based capital proposal would require Fannie and Freddie to use a risk-based approach to determine the level of capital they should maintain and could require Fannie and Freddie to raise additional capital.

### Fannie Mae's Objection:

- Three days prior to OFHEO's submission of its risk-based capital standard to the OMB on October 30<sup>th</sup>, Fannie's Vice Chair Jamie Gorelick wrote a letter to OFHEO. The letter voiced "strong objection" to OFHEO's intention to include "in the risk-based capital proposal "a calculated dollar or percentage amount of capital required to be held" by Fannie and Freddie. Fannie objected to disclosing a capital amount because it would create a misperception of capital inadequacy. "It would be unconscionable for OFHEO to actually create a perception of capital inadequacy where none occurs in fact, based on the misinterpretation of a number that OFHEO need not transmit in the first place," the company stated. Gorelick further stated that "In our view, there is nothing to be gained, and potentially much to lose, should a calculated capital shortfall be taken out of context and construed by a nervous public to mean that we are anything other than the rock-solid anchor of the mortgage finance system that we are."

### Despite Fannie's Opposition, OFHEO Submits Specific Capital Numbers for Fannie & Freddie

- Sources have noted that despite the Fannie Mae letter, the submission by OFHEO to the OMB included specific capital numbers for both Fannie and Freddie.

### Fannie Complains to OMB About OFHEO

#### Fannie Complains of Lack of Dialogue with OFHEO on Plan

- According to a *Dow Jones Newswire* article, Fannie Mae launched a “frontal assault” on OFHEO’s risk-based proposal by complaining to the OMB that the OFHEO hasn’t given Fannie Mae any opportunity to engage in a dialogue about the risk-based capital proposal. (It appears from earlier testimony by the GAO, however, that Fannie Mae did engage in dialogue with the OFHEO on the development of a stress test and a risk-based capital proposal, and the GSEs may have even played a part in delaying the rule.) Thomas McCool, Director of Financial Institutions and Market Issues, General Government Division at the GAO testified last year that one of the reasons the OFHEO cited for the delay in the capital proposal and stress test was the delays the OFHEO encountered from Fannie and Freddie in obtaining accurate financial data from their companies: According to the GAO testimony, “Beginning in 1994, OFHEO officials requested that the enterprises provide large amounts of historical and current financial data so it could do the work necessary to develop the stress test. According to OFHEO officials, the enterprises did not always provide all of the necessary data, or they provided data that may have been inaccurate. These problems persisted in 1996 and impeded development of the stress test, according to OFHEO officials. In response, Fannie Mae officials said that OFHEO’s data requests were burdensome and would have been less extensive if OFHEO had used a simpler approach to develop the stress test. The Fannie Mae officials said that a more simplified approach would have resulted in appropriate risk-based capital standards and could have been completed faster than OFHEO is currently taking to develop its stress test.” (*Testimony by Thomas McCool before the Subcommittee on Capital Markets, Securities, and GSEs of the House Banking Committee, 10/30/97*)

#### OFHEO Responds to Lack of Dialogue Criticism by Fannie Mae

- When questioned about Fannie’s criticism on for the lack of dialogue, *the Dow Jones Newswire* reported that OFEHO told Congress recently that “publishing a complete and concrete proposal is the most efficient way of eliciting focused and meaningful comments.” OFHEO stated that it would aggressively seek comments from Fannie and Freddie once the rule had been reviewed and published for comment in the *Federal Register*.

#### Fannie Believes OFHEO’s Approach to its Regulation is too “Heavy Handed”

- In a letter to the OMB on December 4<sup>th</sup>, Fannie Mae also stated that the “prescriptive” approach used by OFHEO to assess risk-based capital needs is inconsistent with the oversight mandate of the law that created OFHEO “because it effectively seeks to control

the operations of sound private companies.” Further, Fannie Mae stated that “We strongly believe that we are appropriately capitalized and that our risk-based capital models produce accurate assessments of the capital we need.”

- John Buckley, Senior Vice President for Communications at Fannie Mae, stated that a Presidential executive order issued several years ago directed that federal rules not be crafted in a prescriptive, heavy-handed fashion, but that OFHEO has developed a prescriptive rule that “weighs about the same as a Volkswagen Beetle.”

#### Fannie Recommends OFHEO Use a “Less Intrusive” Risk-Based Capital Standard Approach

- In its letter to OMB, Fannie Mae suggested OFHEO use “a less intrusive alternative” for determining risk-based capital, such as the more “supervisory approach” employed by other financial regulators. Fannie also presented materials to the OMB attesting to its role in helping keep the mortgage market liquid during the recent “liquidity crisis.”

#### Fannie Compares itself to Bank and Thrift Capital Regulation

- In its letter to the OMB, Fannie Mae stated that it had a stronger credit rating than any thrift and all but a few banks, stating “We doubt that the regulators of those institutions, which have government guaranteed deposits, would say that the industries they regulate are undercapitalized. Therefore, if OFHEO’s proposed model suggests the need for additional capital, serious questions should be raised about the model and its assumptions.” (*Dow Jones Newswire*, 12/3/98, 12/4/98, 12/8/98; *Fannie Mae Vice Chair Jamie Gorelick’s Letter to the OFHEO*, 10/27/98)

#### Freddie Says It is Taking a “Wait-and-See” Approach to the Risk-Based Capital Proposal

- According to a *Dow Jones Newswire* article, Freddie Mac is not voicing opposition or concern to the OFHEO over its proposed risk-based capital rule. Executive Vice President and CFO John Gibbons said the company expects to wait until the proposal is public before making any comments. “What can we say if we haven’t seen it?” he stated. Gibbons believes Freddie Mac is currently “strongly capitalized” and the company will make sure when the time is right to study the OFHEO proposal thoroughly to make sure “they get capital right.”
- Gibbons did not share the same concerns as Fannie over the lack of dialogue with OFHEO over the proposal. Gibbons stated that the rulemaking procedure now underway by OFHEO “is the way regulators operate in other financial institutions.”
- Gibbons professed his sympathy for OFHEO on the question of including specific capital numbers in the proposed rule, because absent specific figures, the OFHEO would have been criticized for “not being forthcoming.” (*Dow Jones Newswire*, 12/17/98)
- ***Fannie and Freddie are Snapping Up Non-Traditional and Subprime Mortgage Securitizations – Reducing Amount and Potentially the Quality of Products Available to Non-GSE Purchasers – One Investor Questioned What Was Next for Fannie & Freddie – Credit Cards?:***

As evidenced by recent articles, Fannie and Freddie's buying outside the conforming area has noticeably reduced the amount of securities available to other buyers.

Asset Sales Report Notes that Deals Are Going Directly to GSEs without Going Through Syndication Process:

- According to a recent *Asset Sales Report*, Freddie Mac stepped outside of the conforming area and purchased sizable portions of non-traditional mortgage securitizations – a further indication of increasing GSE interest in nonconforming mortgages. The transactions, a \$1 billion home equity asset-backed offering from ContiFinancial, and a \$315.5 million deal from Mid-State Homes Inc., attracted so much agency interest that they were nearly offered in the private market. “There were rumblings that some of these (home equity) issuers aren't going to bother coming to the market, but directly sell these passthroughs directly to the agencies,” said an MBS trader, adding that sales memos regarding the Mid-States deal timing were sent only to Freddie Mac. The article further noted that Fannie and Freddie also snapped up both mobile home deals and home equity deals. “The deal didn't go through the syndication process,” a source familiar with the deal stated. (*Asset Sales Report*, 12/7/98)

Reuters Notes Stealth Deals are Being Offered Straight to GSEs

- According to a *Reuters* story, there was confusion surrounding the \$1 billion home equity ContiFinancial deal with investors wondering if the deal had already been completed. Some market sources, including several ABS traders, believed that the deal had already been put away, and others said they heard the offering had been purchased nearly completely by one of the GSEs, most likely they believed in this article to be Fannie Mae. “If you see one of these stealth deals, where you see it priced but you see no details, and it's typically done as a pass-through without being tranced, then it's a pretty good clue that it's a Fannie or Freddie deal,” said an ABS analyst. (*Reuters*, 12/2/98)

Asset Sales Report Notes that Regular Investors are Getting Leftovers from GSEs

- According to another *Asset Sales Report* article, due to the GSEs' interest in recent mobile home offerings, regular investors “aren't getting a chance to hunt.” The article noted that Vanderbilt recently followed Oakwood's lead and placed its senior pieces on a reverse inquiry basis, said by market sources to be with Fannie and Freddie. Further Green Point and Bombardier have upcoming deals which remain to be seen as to whether the offerings will be marketed more widely. One source stated, “I can see why they're doing it. The agencies are a sure bet, they have the money, and they're not going to buy too far down... We get the leftovers.” Green Tree also recently priced a \$1.3 billion mobile home deal on the same reverse inquiry basis which prompted one investor to note their pleasure with a benchmark firm like Green Tree entering the sector, however this same investor “didn't really know how to read the tea leaves for the market going forward.” The source stated, “I would hate to see what (the agencies) leave behind.” (*Asset Sales Report*, 11/16/98)

Bloomberg Notes Less Securities Available to Other Investors and GSE Status Makes it Difficult for Other Investors to Compete

- A *Bloomberg* article noted that Fannie and Freddie's buying has noticeably reduced the amount of securities available to other buyers. Lisa Brown Premo, who helps manage more than \$16 billion of bonds at First Capitol Group, stated that she tried recently to buy

securities backed by home equity or trailer-home loans, but found few available for sale because Fannie and Freddie had purchased them. “I think they have snapped up everything that’s around.” Premo and other investors said they believe that Green Tree Financial Corp.’s recent \$1.13 billion sale of “AAA” bonds backed by loans on trailer homes was almost certainly arranged with Fannie and Freddie. “Green Tree disappeared,” said Scott Colbert, who manages \$4.4 billion of bonds at Commerce Bank Investment Group. “It came and went, I never saw it.” Officials at Green Tree declined to comment and officials at Fannie and Freddie declined to comment on specific purchases.

- Fannie Mae and Freddie Mac said they are increasing their purchases of other real estate loans – from commercial mortgages for apartment buildings to home equity loans – because they are lured by high yields as other buyers shun those markets. According to a *Bloomberg* article, Fannie and Freddie can afford to buy because their government charters help them borrow at low rates and they have enough capital to increase their investment portfolios. Because of the government charters, investors assume the federal government would prevent a default by either company. H.L. Van Varick, Vice President of Multifamily Negotiated Transactions at Freddie Mac said that Freddie Mac’s ability to finance its purchases at low rates allows it to offer better prices than are available from other buyers whose financing costs are higher. Fannie and Freddie’s guarantee of repayment on the securities they issue is another layer of protection lacking for like-rated “AAA” issues backed only by the underlying mortgage loans, said Richard Lawch, Vice President for Multifamily Capital Markets at Fannie Mae. The *Bloomberg* article noted that the “extra layer of safety” caused 10-year Fannie Mae multifamily bonds to trade earlier this year at yields about 15 basis points less than comparable “AAA”-rated commercial mortgage bonds and as the commercial bond market got “battered” last month, that gap widened to 70 basis points. (*Bloomberg News*, 11/9/98)

*Mortgage-Backed Securities Letter* Notes that 1999 Might be the Year Fannie and Freddie Expand Aggressively into Non-Agency Collateral

- A *Mortgage-Backed Securities Letter* article noted that Fannie’s commitment to buy \$30.2 billion of mortgages in November marked Fannie’s largest commitment rate ever. Sources noted that the gargantuan figure was due in part to an aggressive campaign by the GSEs to purchase tranches of commercial mortgage-backed deals, home-equity loans and manufactured housing securities. One analyst noted that “1999 could well be the year when the agencies begin to diversify their portfolios openly and aggressively into nonagency collateral.” Fannie Mae would not discuss its portfolio acquisitions, but added that rumors the GSE were purchasing mortgages directly from such sources as hedge funds were not accurate. (*Mortgage-Backed Securities Letter*, 11/16/98)

*National Mortgage News* Reports that Some Investors Welcome the GSEs Entrance into Subprime Market to Boost the Subprime Market– While Some Investors Report that GSEs are Purchasing Only the Least Risky Portion of Subprime Deals and that the GSEs are “Federalizing” the Market:

- *National Mortgage News* reported that Fannie and Freddie’s emergence in the past eight weeks as key buyers of “senior tranches” of subprime securitizations had some investors

believing that the GSEs' entrance into the market would help the battered subprime sector recover and caused other buyers to take a "me too" approach and get back into the market. By purchasing senior tranches, however, Fannie and Freddie are actually purchasing the least risky portion of a B&C deal. "They are not buying the first-loss piece or residuals," said one subprime executive.

- One mortgage investor described the GSEs' purchase of B&C tranches as a "Federalization" of the subprime market. "When there is no place left to turn to, you turn to the government," said the investor requesting anonymity. "Don't get me wrong, I don't blame them – they see value here. The question is what's next – credit cards?"
- The GSEs have reportedly been tight lipped about the specifics of their subprime purchases but sources cited recent securitizations by Delta Financial (\$400 million), ContiFinancial (\$1 billion), and Empire Funding (\$290 million) as GSE possibilities. The article reports that Freddie is said to be more active than Fannie Mae in subprime purchases. The article noted that Fannie and Freddie are placing the tranches in their long-term mortgage portfolios and not their short-term liquidity accounts. (*National Mortgage News*, 12/98)
- ***Fannie and Freddie Are Some of the Nation's Top Political Contributors and Spenders on Lobbying – Observers Question What are Quasi-Governmental GSEs Doing Playing Politics:***

Freddie is #5 Largest Soft Money Contributor; Fannie Mae is #50

- The Campaign Reform Project released a listing of the nation's top soft money contributors to the Republican and Democratic parties during the 1997-98 election cycle. Unlike contributions to candidates, soft money is not bound by any limitations on the amount that corporations can contribute. For the 1997-98 election cycle, Freddie Mac was # 5 in top soft money contributions with \$625,000 in donations and Fannie Mae was #50 with \$276,350 in soft money contributions. (*Campaign Reform Project – Top 500 Business Contributions in Soft Money*, <http://www.campaign-reform.org>, 12/98)

Observers Question What are Quasi-Governmental GSEs Doing Playing Politics?

- In the *National Center for Policy Analysis's (NCPA) Digest*, the NCPA notes that Fannie and Freddie are quasi-governmental institutions chartered by Congress and that these GSEs make loans implicitly guaranteed by the federal government. The NCPA noted the following about the GSEs' contribution to political campaigns:

“So what, observers ask, are they [GSEs] doing playing politics?”

- They have contributed more than \$100,000 to an ad campaign to attack presidential candidate Steve Forbes' flat tax plan
- The money was transferred to an organization called the Coalition to Preserve Home Ownership – whose other members are the National Association of Realtors and the National Association of Home Builders
- The Coalition has so far spent more than \$270,000 for what some critics call “hysterical” commercials in Iowa and New Hampshire attacking the flat tax because it would eliminate the tax deductibility of home mortgage interest

payments. According to a Heritage Foundation paper the ads weren't even accurate. For example, they over-estimated by 30 percent the average marginal tax rate that homeowners face. Observers are also calling attention to other questionable 'charitable donations.'

- In 1994, FNMA and FHLMC gave more than \$10.5 million to such public policy and advocacy organizations as the Brookings Institution, the Urban Institute and the Center for Policy Alternatives.
- They also gave nearly \$240,000 to the Children's Defense Fund – a favorite of first lady Hillary Rodham Clinton.

Many are questioning the propriety of such contributions by even quasi governmental institutions.”

(NCPA website, <http://www.ncpa.org/pd/govern/govern8.html> – Policy Issues –Lobbying and Interest Groups - NCPA Source: Editorial, “Public Funds, Private Agendas,” *Investor's Business Daily*, 2/23/96)

- The Center for Responsive Politics (CRP) released a report on lobbyists spending in Washington based on data from the calendar year 1997. In its report, Fannie Mae was listed #42 in the list of top lobbying spenders for 1997. The spending includes all reporting payments that Fannie made to lobbying firms and in-house expenses for lobbying activities. The CRP reported the following about Fannie and Freddie:

<b>Company</b>	<b>Lobbying Expenditures</b>	<b>Campaign Contributions</b>	<b>Dem. %</b>	<b>GOP %</b>
42. Fannie Mae	\$4,960,000	\$323,028	33%	67%
Freddie Mac (not ranked in Top 100 – no other ranking offered by CRP)	\$1,560,000	? (not compiled by CRP)	? (not compiled by CRP)	? (not compiled by CRP)

- (Note: The total amounts of campaign contributions in this CRP report do not reflect the individual campaign contributions of Fannie Mae employees. Running a search on the CRP individual campaign contribution database of key Fannie Mae employees, there were significant amounts of personal contributions by Fannie Mae employees during the 1997-98 election cycle. For example, running a quick search of key Fannie Mae employees' individual contributions, more than \$88,000 in personal contributions were given personally. The amounts in the CRP study also do not reflect a group's ability to mobilize an active membership with includes many leading individual campaign contributions as well as a network of PACs around the country and hosting of fundraisers encouraging like-minded groups or persons to make contributions. Further, the contribution and lobbying expenditure amounts do not reflect the spending by groups in “astroturf” or grassroots “lobbying” which are not reportable as well as amounts spent by Fannie Mae's Partnership Offices which have been used for active public outreach to federal and state officeholders in their respective states – e.g., the hosting of numerous press conferences. The figures also do not represent the practice of hiring a number of influential lawmakers, public officials, and Congressional

and Administrative staff as employees or appointing them as members of the Board for these GSEs.) (*Center for Responsive Politics*, Influence Inc., <http://www.crp.org/lobbyist>, 12/98)

- ***Fannie and Freddie are in the Top 20 World Financial Institutions in Market Capitalization:***

- The *American Banker* ranked the Top 100 world financial institutions in market capitalizations. Fannie Mae ranked # 5, while Freddie Mac ranked # 16. The following is the *American Banker's* list of the Top 20 world financial institutions in market capitalization listed in order of market value of common stock on September 30, 1998:

1	BankAmerica Corp., Charlotte, NC
2	Citigroup, New York
3	American International Group Inc., New York
4	Allianz AG Holding, Munich
5	Fannie Mae, Washington, DC
6	Lloyds TSB Group Plc, London
7	Wells Fargo & Co., San Francisco
8	First Union Corp, Charlotte, NC
9	Bank One Corp., Chicago
10	ING Groep, Amsterdam
11	UBS, Zurich
12	Muenschner Rueckversicherungs AG, Munich
13	Chase Manhattan Corp, New York
14	American Express Co, New York
15	Allstate Corp, Northbrook, IL
16	Freddie Mac, McLean, VA
17	Assicurazioni Generali Group, Trieste
18	HSBC Holdings Plc., London
19	AXA, Paris
20	Fortis Group, Brussels

(*American Banker*, 11/16/98)

- ***Warren Buffet Reveals Holdings in Shares of Fannie and Freddie:***

- Warren Buffet's Berkshire Hathaway revealed holding 63,977,600 shares (reflecting no changes since second quarter 1997) in Freddie Mac and 6,558,000 (a selling of 206,200 shares since second quarter 1997) in Fannie Mae according to a confidential Form 13F covering the third quarter of 1997. (*Newstraders*, 12/17/98)

- ***Fannie & Freddie Requiring their Sellers and Servicers to be Year 2000 Compliant or Face Penalties:***

- Fannie and Freddie have both stated that customers servicing their loans must report compliance that meets a series of deadlines leading up to March 31, 1999--the day when all outside parties must have passed compliance testing. Fannie is requiring all customers to be compliant, however Freddie is requiring compliance testing by only those servicing 1,000 or more loans. According to the *American Banker*, the

consequences of Year 2000 non-compliance escalate for violating deadlines at either agency. For example, if a customer cannot become compliant, it will be expected to find a sub-servicer to take over its loans, then to sell the servicing, and ultimately to see the agencies force-place the servicing with a company in compliance. (*American Banker*, 12/1/98)

## ***Fannie Mae***

- ***While Fannie Mae Celebrates Thirty Years as a “Private” Company, an Investment Writer for the Cincinnati Post States that Fannie Mae Investments are, in effect, Backed by the Full Faith and Credit of the US:***

- Investment writer and commentator, Bruce Williams gave the following advice to an elderly investor:
- Dear Bruce: “We are well along in years, and our broker suggested we put a good deal of money into Fannie Maes. They are not FDIC insured, but supposedly have a high degree of safety. Is that true?” - P.B., Sun City
- Dear P.B.: “While Fannie Mae investments are not protected by the FDIC, they are, in effect, backed by the full faith and credit of the United States. Fannie Maes are sufficiently safe to warrant long-term investments by folks like yourself.”

(*Cincinnati Post*, 12/8/98; Note: Bruce Williams is the owner of a number of businesses and the host of a radio show on 55KRC)

- ***Continuing its Practice of Hiring Employees with Strong Political Ties, Fannie Hires and Creates a New Position in its Company for House Speaker Gingrich’s Chief of Staff:***

- Fannie Mae announced that the company intends to hire Arne Christenson, Chief of Staff to outgoing House Speaker Newt Gingrich as a Senior Vice President of Regulatory Policy at Fannie Mae. Among his duties will be managing the company’s relationships with its regulators, HUD and OFHEO, and to “ensure that there is a corporate-wide focus on meeting the mandates included by Congress in the company’s charter.” According to Kate Fralin, a Fannie Mae spokesperson, “This is a new position that we created at Fannie Mae.” Fralin noted that “Arne is expected to take over that position in early January pending approval by our board of directors.” Prior to Christenson’s position as Chief of Staff, he was a special assistant handling budget and appropriations issues and was the chief liaison from the House Leadership to the House Committees on Budget and Appropriations and was promoted to deputy chief of staff and then chief of staff. Prior to his work at the Speaker’s office, Christenson was Legislative Director for the American Israel Public Affairs Committee for two years, before which, he worked as Administrative Assistant to Congressman Vin Weber (R-MN) and Legislative Director for former Senator Rudy Boschwitz (R-MN). (*PR Newswire*, 12/7/98; *National Mortgage News website* posted 12/7/98)

- ***State Department Cancels Use of its Posh Reception Room for Fannie Mae Event After Criticism that Fannie Was Not Using the Room for Official Government Business:***

- Fannie Mae planned a gala goodbye bash for outgoing Fannie Mae Chairman Jim Johnson on December 15<sup>th</sup> in the US State Department's Benjamin Franklin Room. According to the *Washington Post*, groups outside the State Department can request the room through an agency official for official government functions. In this case, Fannie Mae asked the Treasury Department to submit the request. Fannie Mae had already sent out its invitations to the event with the Franklin Room listed as a site, however, a *Washington Post* "Loop" Fan asked whether a Fannie Mae goodbye party qualified as official government business for purposes of using the room, particularly since Fannie Mae wants to be seen as a private company. After the *Washington Post* made some calls, the State Department's lawyers denied Fannie's request to use the Franklin Room for the goodbye bash. The bash was held instead at the National Museum of Women in the Arts. Fannie Mae Spokesman John Buckley said the problem was "we made a mistake" in not putting Treasury Secretary Robert Rubin's name on the invitation. (*Washington Post*, 12/9/98)

- ***Fannie Mae Responds to Charges that the Company Does Not Pay Taxes:***

- The *Washington Post's* "Washington Business" section ran a two-page profile piece on Fannie Mae using an edited transcript of the *Washington Post's* conversation with incoming Fannie CEO Franklin Raines and outgoing CEO Jim Johnson. When asked to discuss Fannie's tax status and the controversy over the fact the company doesn't pay income taxes in the District, Raines and Johnson gave the following comments:

Raines:

"People will say, 'Well, why don't you guys make a payment in lieu of taxes?' I say we pay *taxes* in lieu of taxes. We pay all of our real estate taxes, which is the issue – always has been the issue with universities, hospitals. Anything dealing with our income is treated the same nationwide, so this isn't a District-being-discriminated against issue. I'd like to add I've also never had the question on Capitol Hill. Never once."

Johnson:

"I think there is this fundamental confusion because I think when people hear that we don't pay income taxes, they do assume we don't pay property taxes, which is just not true. We do, and it puts us at least in a different category than all the entities that are exempt from paying property taxes." (*Washington Post, Washington Business*, 12/14/98)

- ***Expanding its Automated Underwriting Share, Fannie Announces Automated Underwriting Pilot of Co-Op Loans:***

- Fannie Mae began an automated underwriting pilot on November 16<sup>th</sup> with 20 lenders in five regions with an updated version of its automated underwriting software that includes the ability to automatically underwrite co-op loans. Bank of New York is the only lender that is currently using the co-op option. Patrick McEnerney, President of New York Mortgage, noted that "Co-ops are a very small volume in the national market, which shows how advanced the agencies have gotten with automated underwriting if they've

gotten to the point where co-ops are part of their model.” McEnerney further noted that “A co-op is like a 51<sup>st</sup> state that has its own set of rules” and “Fannie has been very aggressive to modify their underwriting system.” Lenders often view co-ops as riskier than conventional single-family loans because corporation dues take precedence over the lender’s lien, and lenders could find themselves in the situation of paying maintenance dues on which the borrower has defaulted to protect the lender’s interest. Jeff Noe, a Spokesman for Freddie Mac, said Freddie had no plans to add automated co-op underwriting to its software. (*American Banker*, 12/9/98)

- ***Fannie is Working on a Pilot to Purchase CRA Loans on a Loan-by-Loan Flow Basis – The Private Sector’s Pilot to Purchase Loans on a Flow Basis is Set to Start at the Beginning of the Year:***

Private Sector’s CRA Pilot is Set to Start at the Beginning of the Year:

- Bear, Stearns – which has a 90% market share in CRA securitization has been chosen as the chief underwriter for a new program to begin soon after the New Year that will enable bank participants to sell CRA loans to the securitization market on a monthly basis, allowing banks to take risk off of their books much sooner. For the most part, prior to this program, in order to securitize CRA loans, banks had to sell them in bulk to Fannie or Freddie, causing the risk to remain on the bank’s books for long period of time. Sources stated that the underwriting guidelines for the new program include an emphasis on nonagency conforming loans, with no mortgage insurance. There are at least 10 banks set to participate in the new program but the program could grow to comprise up to 30 banks. (*CFO Alert-American Banker*, 11/16/98; *Mortgage-Backed Securities Letter-American Banker*, 11/16/98)

Fannie Mae is Working on a Similar CRA Pilot:

- Barry Zigas, a senior Fannie Mae official announced that Fannie is beginning a pilot program to buy CRA loans on a loan-by-loan “flow” rather than a bulk basis. So far, Fannie and Freddie have only purchased seasoned CRA loans on a bulk basis. “Flow” loans are bought as they are originated – straight from the source - without seasoning. Zigas noted that the lender has the option of choosing to either securitize or to go into the Fannie Mae portfolio. When securitized, these CRA loans will go into standard Fannie Mae MBS.
- Fannie partnered with the Ford Foundation and the Center for Community Self-Help “to create a new conduit to enable lenders to sell nonconforming product without mortgage insurance, through Self-Help directly into a secondary-market execution,” according to Zigas. The pilot is a 4-year \$2-billion initiative. Fannie is looking at five partners and \$100 million in loans in bulk purchases of seasoned portfolios so far, but “with the expertise and recourse capabilities of Self-Help, the program will be able to take lending directly on a flow basis,” Zigas stated. The program began with depositories in North Carolina, but now with the backing of Fannie Mae and a \$50 million Ford Foundation grant the program is growing nationwide. According to Fitch IBCA, seasoned CRA pools need a 13.50% credit enhancement to attain a triple-A rating, in comparison to unseasoned collateral which requires a 17% credit enhancement. (*Mortgage Marketplace-American Banker*, 11/9/98; *Regulatory Compliance Watch-American Banker*, 11/9/98)

- ***Reported Close Friend of President Clinton and Former TX Gubernatorial Candidate, Garry Mauro, Asked White House about Appointment to Fannie’s Board, so he Could Stay in “Public Policy”:***
  - According to an article in the *Star-Telegram*, outgoing Texas Land Commissioner Garry Mauro, has indicated his interest to the White House in serving on Fannie Mae’s Board of Directors. Mauro, who served as Texas Land Commissioner for 16 years, decided this year not to seek re-election to the office and instead ran unsuccessfully as the Democratic Party’s candidate against Republican Governor George W. Bush. While Mauro is leaving his office as Land Commissioner, Mauro doesn’t view his “political days as over. Mauro, reportedly a close friend of President Clinton, indicated that he had talked to the White House about joining the Board of Fannie Mae. According to the article, Mauro said the \$50,000-a-year part-time post would allow him to remain in Austin while “keeping my hands in public policy.” Mauro said he had not talked personally to President Clinton about the Board position but had discussed it with the President’s staff. (*Star-Telegram*, 12/15/98)
- ***Fannie Mae, Norwest, and the Native Council on Economic and Community Development help Family Celebrate in New Home on Omaha Tribe Reservation Under New Low Down Payment Program:***
  - A family purchased a new home on the Omaha Tribe Reservation with assistance from a low down payment program created by the Native Council on Economic and Community Development (NED) program and Fannie Mae. The loan was obtained through Norwest Mortgage. NED is a reservation-based, not-for-profit organization that lowers the construction costs of homes with funding from the Nebraska Department of Economic Development’s HOME program. The NED program, under Fannie Mae’s Community Seconds plan, uses HOME funds from HUD. (*Fannie Mae press release*, 12/7/98)
  - As we noted in the September 19<sup>th</sup> *GSE Report*, Norwest already announced a new pilot program earlier this year that provides home loans for Native Americans living on reservations in South Dakota, North Dakota, and Nebraska. Under this pilot, HUD is guaranteeing the mortgages that Norwest issued so that they can be sold in the secondary market, and the Bureau of Indian Affairs must give its stamp of approval when a potential borrower living on trust land wants a mortgage. (*American Banker*, 9/9/98)
- ***Fannie Provides \$150 Million Financing for Apartment Complex in NY with only 20% of Apartments Reserved for Low and Moderate-Income Tenants:***
  - Fannie Mae announced that that it completed a transaction to provide \$150 million in credit enhancements for New York City Housing Development Corporation (NYCHDC) bonds that provided financing for a 729-unit apartment complex on Manhattan’s West Side - One Columbus Place. Fannie credit-enhanced \$142.3 million of tax-exempt bonds and \$7.7 million of taxable bonds issued to refinance the mortgage on the apartment complex. Only twenty percent of the apartments in One Columbus Place are reserved for low- and moderate-income tenants. The two-building, 49-story complex includes four street level retail stores and approximately 76,000 square feet of professional office

space. The building is within walking distance of Lincoln Center and the Columbus Circle area. (*Fannie Mae press release, 12/1/98*)

- ***Outgoing Fannie Chairman Claims Fannie Mae Helped More Minorities become Homeowners than Any Other Institution:***

- In a recent speech, outgoing Fannie Mae Chairman and CEO Jim Johnson stated that “Today, Fannie Mae helps more minorities become homeowners than any other institution in the country.” Johnson noted that since 1994, Fannie Mae had provided \$130 billion in affordable housing finance to help 1.3 million minority families achieve homeownership. And, together with Freddie Mac, the companies purchased or securitized more than \$38 billion in loans for nearly 387,000 minority families in 1997. Johnson also stressed the community outreach and public education efforts of Fannie Mae in reaching the minority communities. Johnson cited the extensive advertising that Fannie Mae had entered into with Black Entertainment Television (BET) and noted that Fannie Mae had done enough advertising on BET this year that according to Johnson “90% of Black families in American will have seen 20 or more Fannie Mae commercials in the course of 1998.” (*Remarks by Jim Johnson to African American MBA Association – Wharton Women in Business Lecture Series, 11/2/98*)

- ***Housing Authority in North Dakota Finds Complications in its Dealings with Fannie:***

- The Grand Forks Housing Authority recently approved a \$605,000 loan in December to Grand Forks Home Inc. to meet cash-flow needs and pay contractors who have built houses in a planned subdivision. According to Terry Hanson, Finance Director for the Grand Fork’s Urban Development Department, the cash-flow was needed because Grand Forks Home Inc. is waiting to receive a \$3 million loan from Fannie Mae and US Bank and “It’s taking longer than we all expected.” John Snustad, representing US Bank of Grand Forks, said it’s been a complicated process to work with Fannie Mae to get all of the loan documents reviewed and approved. Duane Hafner, the City Council representative on the Housing Authority, noted that “This is just a paperwork issue,” and he thinks the contractors deserve to get paid because “It wasn’t fair for them to be holding the bag until the Fannie Mae money came through.” After the 1997 flood, a financing package was assembled to cover the costs of building 225 houses in Grand Forks. Snustad said the \$3 million loan is called a “participation” loan where “We sell a position of the loan to them (Fannie Mae),” Snustad said. (*Grand Folks Herald, 12/4/98*)

- ***Fannie Announces “Employer-Assisted Housing” Program Success – Critics of the Program are Worried About Long-Term Impact of Employers Providing Housing:***

- Many companies are starting to offer employer assisted housing plans. Fannie Mae issued a press release describing a family in Iowa who used the program to move into a larger home. One of the family members was employed with Oskaloosa-based Panel Components Corporation, which had a home purchase assistance program. The company offered employees the lesser of five percent or \$5,000 in the form of a forgivable loan for down payment or closing cost assistance toward the purchase of a home. If the employee stays with the company, 20% of the loan will be forgiven until the loan is completely

forgiven after the fifth year. According to the press release, the Panel Components Corp. and Fannie Mae created the program. (*Fannie Mae press release, 1/7/98*)

- According to an article in the *Washington Post*, Fannie created this loan program encouraging firms to donate money toward an employee's down payment and dozens of employers across the country are participating in the program. Fe Morales Marks, Vice President of Fannie's National Housing Impact Division stated that under this arrangement, "Everybody wins," because "it makes employees more stable, more loyal and boosts retention – and it makes them happy because they get to be homeowners, the American dream."
- The article notes that employer-assisted housing "carries specters that even its most enthusiastic adherents find troubling." Some note the company towns of the 1800s that were originally launched with fairly benevolent intentions, but gradually transformed immigrant workers into indentured servants when their expenses were inflated and deducted from their pay. When economic conditions weakened in company towns, the housing fell into disrepair and workers were abused. Further, company housing is contingent upon employment with the company, adding a layer of complexity when employees are terminated from their employment and must also be evicted. Another complication arises when company ownership is changed, leaving company housing in limbo. An example was given of Hudson Foods which spent \$3 million from 1995-97 to build 32 duplexes for its employees, only to be acquired in January by Tyson Foods which plans to sell the duplexes, displacing workers, because Tyson does not think "it's in our best interest or the best interest of our people to be in the housing business." (*Washington Post, 11/27/98*)
- ***Fannie Continues to Hold Numerous Press Conferences this Month with Influential Elected Officials:***

Fannie Hosts Press Conference with Newly Elected House Republican Conference Chairman J.C. Watts (R-OK) and Ron McCord, Immediate Past President of MBA:

- Fannie announced its \$4 billion five-year House Oklahoma program with incoming House Republican Chairman J.C. Watts, Jr. and Ron McCord, Chairman of Holliday American Mortgage Company and the immediate past president of the Mortgage Bankers Association of America. The program includes initiatives in the area of rural lending, Native American lending, seniors lending, affordable rental housing financing, and consumer home-buying education programs. McCord will serve as Chairman of Fannie's newly formed Oklahoma Partnership Office Advisory Council. As part of the program, Fannie Mae announced and recognized Oklahoma University graduate students who will help local non-profits develop affordable housing plans for rural communities. The Fannie Mae Foundation provided a \$15,000 corporate contribution fund (CCF) grant to the Oklahoma Housing Finance Agency to help fund the salaries of the Oklahoma graduate students. In November, Freddie Mac announced a \$100 million initiative to increase homeownership in Oklahoma City. (*Fannie Mae press release, 12/14/98; National Mortgage News website, posted 12/15/98*)

Fannie Holds Press Conference with Cong. Rick Lazio (R-NY) to Announce Results of "Living on Long Island" Initiative:

- Fannie held a press conference with Cong. Rick Lazio (R-NY) to announce that Fannie had provided \$1.7 billion in mortgage financing during the past year as part of its “Living on Long Island” initiative. “Fannie Mae’s substantial investment in the Long Island housing market has already had a significant impact on thousands of families who never dreamed they could afford to buy a home,” said Rep. Lazio. “I look forward to working closely with Fannie Mae in the coming years to ensure that Long Island families continue to have access to the most innovative and affordable home mortgage financing available.” (*Fannie Mae press release, 12/2/98*)

Fannie Holds Press Conference with Cong. Linder (R-GA) and Mayor of Athens, GA:

- Fannie held a press conference with Mayor Cardee Kilpatrick and Congressman John Linder (R-GA) to celebrate the first home purchase under a \$9.8 million bond purchase agreement between Fannie and the Athens Housing Authority (AHA). Fannie purchased the \$9.8 million tax-exempt, single-family mortgage revenue bond issued by the AHA. The bond proceeds are available from eight local mortgage lenders and one builder. (*Fannie Mae press release, 12/1/98*)

Fannie Holds Press Conference with Cong. Rodriguez (D-TX), Congressman-Elect Gonzalez (D-TX), and San Antonio Mayor Peak:

- Fannie held a press conference with Cong. Ciro Rodriguez (D-TX), Congressman-elect Charlie Gonzalez (D-TX) and San Antonio Mayor Howard Peak to tout the status of Fannie’s “House San Antonio” program. The press conference highlighted a couple who purchased a home in October through Fannie’s mortgage revenue bond program. Mayor Peak stated that “San Antonio has benefited greatly from Fannie Mae’s investments in our city.” Cong. Rodriguez stated that “Fannie Mae is an important presence in our city.” Congressman-elect Gonzalez noted that “Through its investment plan, Fannie Mae has helped to make the American dream a reality.” (*Fannie Mae press release, 12/14/98; San Antonio Express-News, 12/14/98*)

Fannie Holds Press Conference with Mayor of Columbus:

- Fannie held a press conference with Columbus, OH Mayor Gregory Lashutka with the P.M. Group to announce the renovation of a new Woodland Meadows apartment complex. According to the press release, the complex is the largest renovated affordable multifamily housing development in Columbus. The property will consist of 1,100 units of affordable rental housing. Fannie Mae, through Key Bank, provided credit enhancement for \$18 million in taxable and \$1 million tax-exempt bonds issued by Franklin County that will be used to purchase and renovate the property. Bank One also purchased 50% of the primary debt of the property which equaled \$9.5 million. (*Business Wire, 2/10/98; Columbus Dispatch, 12/11/98; Fannie Mae press release, 12/10/98*)

Fannie Holds Press Conference with Mayor of Portland

- Fannie held a press conference with Portland Mayor Vera Katz to announce the status of the second phase in a new mixed-income multifamily housing development. Katz stated that “I am thankful that Fannie Mae and the Union Station II Development Team have given us the assistance we need to make this development top notch.” The development, the Yards at Union Station Phase II, includes 321 mixed-income apartment units, and 56 condominium units. Fannie provided credit enhancement for \$23 million of bonds issued

by the city of Portland for Phase II and Green Park Financial helped arrange the financing on the development. (*Fannie Mae press release, 12/14/98*)

Fannie Holds Press Conference with Mayor of Natchez, Mississippi to Celebrate First Reverse Mortgage Loan by a Mississippi Lender:

- Fannie Mae, the Mayor of Natchez, Mississippi Butch Brown and the Deposit Guaranty Mortgage Services announced the availability of reverse mortgage products to Mississippi seniors. According to a Fannie press release, Deposit Guaranty Mortgage Services is the first Mississippi-based lender to close a reverse mortgage. The press conference highlighted an elderly Natchez homeowners who obtained a reverse mortgage from Deposit Guaranty, a loan that was subsequently purchased by Fannie. (*Fannie Mae press release, 12/10/98*)
- ***Fannie Mae Purchases \$20 Million of CRA Loans Made in Arizona by Norwest Bank:***
  - Fannie Mae purchased \$20 million of seasoned loans from Norwest Bank that meet Community Reinvestment Act (CRA) guidelines. All 370 loans were originated in Arizona through the Community Homeownership Program (CHP) – a program assisting first-time homebuyers who earn 80% or less of the area median income. (*Fannie Mae press release, 12/9/98*)
- ***Fannie and Fleet Financial Group Announce Purchase Rehab Program:***
  - Fleet Financial Group and its subsidiary, Fleet Mortgage announced a \$65 million purchase rehabilitation program, HouseWorks, in a joint initiative with Fannie Mae and NeighborWorks organizations (affiliated with the Neighborhood Reinvestment Corporation). The program is available to low- and moderate-income homebuyers who complete extensive homebuyer counseling programs offered by participating NeighborWorks Organizations. Under the HouseWorks program, eligible borrowers can obtain up to 95% financing for single- and two-family homes, and up to 90% for three-family homes. Under the NeighborWorks program, borrowers can purchase a single family home with a maximum sales price of \$80,000 with a down payment of only \$1,000. The remaining down payment and closing costs can come from the participating NeighborWorks Organization in the form of an unsecured loan. The borrower can also obtain an unsecured loan from Fleet Bank to cover closing costs. Fannie Mae will allow 50% of the appraised value to be financed for the cost of the rehabilitation. Commonwealth Mortgage Assurance Corporation (CMAC) will provide mortgage insurance. (*Business Wire, 12/15/98*)
- ***Fannie Announces “Your Home Columbus” Initiative Success:***
  - Fannie issued a press release describing a young college-educated couple who purchased a home thanks to a new “Your Home Columbus” program created by the city of Columbus, OH and Fannie. The City of Columbus is offering down payment loans up to \$4,000 for the purchase of a single-family, owner-occupied home in the Columbus Public School District. The loans, which can be used for down payment or closing costs, are fully amortizing second mortgages with an interest rate of 6.75%. The city generated the

funds for the loans by issuing a \$600,000 note that was purchased by Fannie. (*Fannie Mae press release, 12/7/98*)

- ***Fannie Mae Foundation Funds Study on Disabled Housing in Nevada – Rep. Ensign (R-NV) Issues Statement:***
  - The Fannie Mae Foundation funded a study for the Nevada Special Needs Housing Coalition to determine housing availability and affordability for disabled citizens in Nevada. According to the study, as many as 39,000 severely disabled Nevadans – or 85% of the state’s severely disabled adult population – can’t afford a decent place to live due to a combination of high rents, low wages, and an overall lack of affordable housing in the state. In a statement released with the study, Cong. John Ensign (R-NV) called the study “a call to action for government, private business and nonprofits to step up to the plate and begin fulfilling the demand for special needs housing in Nevada.” (*Las Vegas Review-Journal, 11/22/98*)
- ***Despite Basketball Lockout, Fannie Continues the “Home Team” Partnership with NBA:***
  - Despite the current NBA basketball lockout, Fannie has participated in “Home Team” partnership events during the last two weeks with management and coaches of the Milwaukee Bucks, Portland Trailblazers and Seattle SuperSonics. (*PR Newswire, 12/4/98, 12/8/98, 12/15/98*)

## ***Freddie Mac***

- ***Website Allows A Person to Vote on Whether Freddie Mac Should be Allowed to Enter the Mortgage Insurance Business:***
  - *National Mortgage News* included a survey question on its website where web viewers can vote on Freddie’s entrance into the mortgage insurance business. The following is the survey question and the vote tally as of 12/16/98:

*Should Freddie Mac be allowed to use self-insurance as a form of default protection?*

<i>Respondents Who Said Yes:</i>	<i>902</i>
<i>Respondents Who Said No:</i>	<i>962</i>

To vote on the Freddie Mac issue, visit the following website,

<http://nmnews.fgray.com/welcome.htm>

- ***Bond Investors and Mortgage Bankers are “Skittish” about Freddie’s Entrance into A-Minus Market:***

- According to an article in the *American Banker*, mortgage bankers and bond investors are “skittish” and concerned about Freddie Mac’s entrance into the A-minus market - a market the *American Banker* describes as consumers with less than perfect credit. It is not credit risk, however, that is bothering investors and lenders, but rather Freddie’s decision to include A-minus loans with its regular collateral or pool of mortgages and not limiting how much of the pools can be A-minus loans nor disclosing the percentage of A-minus loans. Freddie Mac stated that the company has never disclosed any credit characteristics in the past and had no future plans to do so.
- Bond investors and mortgage bankers believe this decision will make it harder to measure prepayment risk to purchasers of bonds or of the servicing rights on the loans. Critics are concerned about the rate at which A-minus borrowers refinance their loans, which they feel is different from that of mainstream homeowners. Prepayments are a concern because if a borrower decides to refinance their loan faster than expected, mortgage securities holders get their principal back earlier than planned and fail to receive expected interest payments. Mortgage servicers, who collect payments and mail monthly statements to borrowers, are also affected when a borrower prepays and refinances. Additionally, A-minus loans cost more to service than regular loans. “Identifying such loans for servicing valuation purposes will be difficult and will add inefficiencies to the secondary market for [Freddie Mac] servicing rights,” stated a chief executive of a top-25 servicer who requested anonymity.
- John Queen, who helps manage \$2 billion of securities at Hotchkis & Wiley in Los Angeles, notes that this uncertainty could cause Freddie’s securities to trade at a steeper discount to Fannie Mae. Queen believes that Freddie’s non-disclosure of the breakdown of the pools, exacerbates the problem of developing good models of prepayments. The Bond Market Association is currently examining the issue, according to George Miller, the association’s Deputy Counsel. (*American Banker*, 12/3/98)
- ***Expanding its Reach into the Academic Community, Freddie Mac Appoints Top Economist to its Board:***
  - Freddie Mac announced that the company has appointed Stephen Ross, a top economist, to its Board of Directors. According to *National Mortgage News*, Ross is the Franco Modigliani Professor of Finance and Economics at MIT and Co-Chairman of Roll and Ross Asset Management Corp. Ross previously taught at Yale and the University of Pennsylvania’s Wharton School. Freddie noted in its press release, that Ross is known for developing pricing models that have become standard at several securities firms. (*Freddie Mac press release*, 12/7/98; *National Mortgage News press release*, 12/7/98)
- ***Freddie Mac Issues \$3 Billion Reference Note:***
  - Freddie Mac priced a \$3 billion, 3-year maturity Reference Note with a coupon of 4.75%. Similar to Fannie’s Benchmark Note program, Freddie’s Reference Notes are marketed as alternatives to Treasuries. According to a Freddie Mac press release, this transaction is Freddie’s fourth issue under the Reference Note program, and brings the total outstanding under this program to \$19 billion. Prior to this offering, Freddie issued a total of \$5

billion in 5-year and \$11 billion in 10-year Reference Notes. (*Freddie Mac press release, 23/3/98; PR Newswire, 12/3/98*)

- ***Freddie Mac's Senior Vice President for Multifamily Housing is Retiring:***
  - Freddie Mac's Senior Vice President for Multifamily Housing, Thomas Watt, announced his retirement at the end of 1999. Watts stated that he plans over the next year to work on "developing business strategies to continue to expand Freddie Mac's multifamily business and to position Freddie Mac securely at the top of the industry." In a related announcement, Freddie Mac promoted Daryl Hall to be Vice President for Multifamily Asset Management. (*National Mortgage News website, posted 12/15/98*)

### ***Private Sector Items to Note***

- ***Private Sector Prepares to Petition Regulators for MBS and ABS Capital Requirements that are More Reflective of Risk – Fannie & Freddie Likely to Oppose:***
  - According to a *Mortgage-Backed Securities Letter* article, an alliance of real estate and finance trade groups called the Capital Consortium are preparing to petition Federal banking regulators to use the credit ratings of mortgage- and asset-backed securities as the basis to determine how much capital must be held to support investing in these securities. Under the proposal, all triple-A rated ABS and MBS would receive a 20% risk-weighting, rather than the usual 100% risk-weighting currently. Right now, only Fannie and Freddie MBS receive a 20% risk-weighting, while Ginnie Mae MBS receives a zero risk-weighting. Fannie and Freddie have opposed lowering the risk weighting to 20% for triple-A rate tranches, arguing that a triple-A rating is not equal to their low levels of risk.
  - The current 100% risk-weighting method throws all securitizations regardless of credit quality into the same bag, according to a letter being developed by the Consortium – whose members include the National Association of Realtors, the Bond Market Association, the Mortgage Bankers Association, the National Realty Committee, and a commercial mortgage-backed securities group.
  - The article noted that sources indicate the letter is expected to state that MBS and ABS with high credit ratings have demonstrated such a high level of credit performance that these securities should be distinguished from securities not measuring up to the standard, and recommends that ratings be performed by a nationally recognized credit-rating company. Reportedly, the letter will also detail how credit risk is channeled away from the high-rated classes through the use of special structures and credit enhancements. Further, the Consortium will recommend that the use of ratings be adopted before banking regulators finish with some other long-term issues. (*Mortgage-Backed Securities Letter-American Banker, 12/7/98*)

## ***Federal Home Loan Banks***

- ***Incoming Fannie Mae CEO Raines Harshly Criticizes FHLBanks:***

- The *Washington Post's* "Washington Business" section ran a two-page profile piece on Fannie Mae using an edited transcript of the *Washington Post's* conversation with incoming Fannie CEO Franklin Raines and outgoing Fannie Mae CEO Jim Johnson. When asked to discuss the FHLBanks and the fact they are looking to compete with Fannie and Freddie, Raines gave the following statement:

"We keep our eye on what is beneficial to the consumer. It's going to be very hard for anybody to figure out easily from a dead start how they're going to do better for the consumer but if they have something to offer to consumers, God bless them. But, what they have to remember is they're getting into an entirely different business. They are in the business of making loans to banks. And that's what they do. They make loans to banks. Banks give them collateral. They're not in the business of measuring credit risk.

...So, if they want to get into this new business, the secondary mortgage market business, there's a variety of things out there they've got to do. First, they've got to become real entities and pay federal taxes like the others who are in it. They've got to get capital and they've got to get market discipline as we have. Our shares are owned by people who think our mission is an interesting mission, but if they think we're not running the company, well, they'll sell in a second. They'll vote us out if they think we're not running the company well. Their shares are held by the beneficiaries of their business. It's held by banks.

We have ongoing permanent examinations, unlike banks, who get examined once a year or once every two years.

The home loan banks have no safety and soundness regulator."

(*Washington Post, Washington Business, 12/14/98*)

- ***FHLBank of Chicago President Takes Aim at Fannie and Freddie:***

- In his remarks at a recent AEI conference on the FHLBanks, Alex Pollock, President and CEO of the FHLBank of Chicago recommended that all GSEs, including Fannie Mae and Freddie Mac, be sunsetted after 10 years.
- The *Mortgage Marketplace* reported on other comments made by Pollock during the AEI conference, referring to his comments as "the boldest public moves yet" toward "a full-blown GSE war" with Fannie and Freddie. (See December 4<sup>th</sup> *GSE Report* for more details on AEI Seminar.)
- Pollock believes that the FHLBanks are the only entities that would be able to effectively compete against Fannie and Freddie's duopoly in the secondary market because the FHLBanks like Fannie and Freddie enjoy special GSE privileges. The most beneficial of

the GSE status benefits is the “implicit” government backing of the GSEs, which allow the GSEs to borrow at cheaper rates than completely private companies. Pollock stated that “To compete with a GSE, it takes a GSE.”

- Unlike Fannie and Freddie’s program, the MPF program “would disperse the \$2 trillion in credit risk concentrated in Washington, DC (at Fannie Mae and Freddie Mac).” Further the MPF program is limited to depositories and is said to undercut Fannie and Freddie’s current program by 12 to 13 basis points. Depositories would benefit from this program while mortgage bankers would have to continue to pay the higher costs at Fannie and Freddie. An official with the Mortgage Bankers Association stated that the association opposes the MPF program unless mortgage bankers are allowed to join the system. Pollock believes that consumers would benefit from the MPF program because the consumer would get cheaper mortgage rates and the increased competition would make Fannie and Freddie operate more efficiently and pass on greater savings. (*Mortgage-Backed Securities Letter-American Banker*, 12/7/98; *Mortgage Marketplace-American Banker*, 12/7/98; *Regulatory Compliance Watch – American Banker*, 12/7/98)
- ***Indianapolis FHLBank Plans New Secondary Market Product to Compete Against Fannie and Freddie:***
  - According to a *Mortgage Marketplace* article, the Indianapolis FHLBank is discussing whether to ask the Federal Housing Finance Board (FHFB) for permission to offer a new secondary market product – different from the Chicago FHLBank’s Mortgage Partnership Finance (MPF) program. The new Indianapolis “mortgage purchase program” would allow the FHLBank to assume both the credit and interest-rate risk from the member financial institutions. The Chicago MPF program is structured to divest the credit decision from the interest-rate risk, leaving the credit risk with the depository, while the Chicago FHLBank manages the interest-rate risk. According to Jonathan West, General Counsel of the Indianapolis FHLBank, “a final decision has not been made” on whether to go forward with the program but hopefully a decision will be reached sometime early next year. West noted that the program is still in the research and development phase and that the Indianapolis FHLBank may decide to adopt the Chicago MPF, or go ahead with its own variant and adopt the Chicago approach too. West further noted that the fact that the Indianapolis Bank is considering this new program does “not reflect any criticism” of Chicago’s MPF or any of the other approaches – an apparent reference to Fannie and Freddie. At this point, the Indianapolis FHLBank has invested in the Chicago MPF, but it has not participated as one of the six FHLBanks that now have authorized their members to originate mortgages for the MPF. (*Mortgage Marketplace*, 12/14/98)
- ***In Response to the FHLBanks’ Increased Competition Against Fannie and Freddie in the Secondary Mortgage Market – A National Mortgage News Columnist Argues “Who Can Argue Against Competition?”:***
  - Brian Collins, a columnist with *National Mortgage News*, wrote a recent column on the FHLBanks’ increased competition against Fannie and Freddie with its FHLBank MPF program. Collins noted FHLBank of Chicago President Alex Pollock’s comments during a recent AEI conference in which Pollock espoused the benefits of the Chicago MPF program and how the FHLBanks are uniquely positioned to compete against Fannie and

Freddie due to their shared GSE status. Collins reported that the Chicago MPF program offers better pricing than Fannie and Freddie because it is willing to accept a lower margin and because the originator retains a portion of the risk.

- Collins acknowledged the Chicago MPF program is still a “fledging program” - the Chicago program just passed the \$1 billion commitment level, while Fannie purchased \$39 billion in residential loans just in the month of September.
- Collins noted that although Treasury Assistant Secretary Richard Carnell is critical of “piecemeal” reforms of the FHLBanks and believes that the FHLBanks are conducting massive arbitrage operations unrelated to its housing mission, Carnell remained silent on the MPF program during the recent AEI Seminar. According to Collins, “This silence is telling, Washington insiders now believe that Treasury officials are beginning to see the MPF program as a way to discipline Fannie and Freddie’s duopoly.”
- Collins noted that the MPF program may “only be a flea on the back of the secondary market,” but Fannie and Freddie are “becoming annoyed that lenders find the MPF program attractive.” Collins reported that Pollock told *National Mortgage News* that some lenders have stated that they are once again making money in the conventional market thanks to the profit margins available through MPF. During the AEI Seminar, Fannie’s Chief Lobbyist William Maloney argued that if the FHLBanks want to enter the secondary market, they must meet the same requirements as Fannie and Freddie – they should have real capital, real regulation, and real housing goals. “In other words, the FHLBanks should be shackled with new requirements even before they have any market share,” Collins wrote. Collins believes these requirements “may come in time, but first the MPF program has to prove itself. More FHLBs have to offer this program and more FHLB members have to use it.” (*National Mortgage News* column by Brian Collins, posted on *National Mortgage News* website, 12/9/98)
- ***FHFB Commissions \$745,000 Cost-Benefit Study of the FHLBank System – Study will Attempt to Quantify GSE Status, Extent to Which Members Pass On Benefits, Extent to Which Member Engage in Mission-Related Lending, and Desirability and Feasibility of Privatizing FHLBank System:***
  - The Federal Housing Finance Board (FHFB), the regulator of the FHLBank System, commissioned Furash & Co., a Washington, DC firm to conduct a “cost-benefit” analysis of the FHLBank System. The study is expected to be presented to the FHFB by January 31, 1999. The study seeks to do the following: (1) identify quantitative value to the System of its GSE status; (2) how member institutions pass on the benefits they receive from membership in the System; (3) the extent to which members that borrow from a FHLBank engage in housing finance or community development lending; and (4) addresses the desirability and feasibility of privatizing the FHLBank System. (*Dow Jones Newswire*, 12/4/98)

- ***House Banking Committee Chairman Jim Leach (R-IA) Indicates he will Introduce FHLBank Expansion Legislation – Leach Proposes to Expand GSE (FHLBank) to Compete Against Another GSE (Farm Credit System):***
  - House Banking Committee Chairman Jim Leach (R-IA) announced at a recent Illinois Bankers Association meeting that he would introduce a comprehensive financial services reform bill in the next session of Congress that would be his committee’s “top priority.” He indicated that a provision in the financial services bill would let banks with less than \$500 million of assets finance agricultural and rural economic development projects with FHLBank advances, so that according to Leach, “community bankers will be able to offer more products and bring more choices to their customers.” Currently, FHLBanks only provide advances or loans to financial institutions for housing finance. Leach stated that “In the future they will be able, as a Government-Sponsored Enterprise with access, like the Farm Credit System to capital tied to Federal-agency rates, to assist community banks in bringing lower interest rates to agricultural and small business clients.” He believes that his proposal will improve community banks’ access to the FHLBank System so that commercial banks have a source of cheaper funds to lend to their customers. He further argued that the proposal would assist rural banks. In his opinion, rural banks do not have enough local deposits to keep up with loan demand and rural banks face stiff price competition from large banks and the government-sponsored Farm Credit System, which is able to tap capital markets at advantageous, government-agency rates. (*American Banker*, 12/11/98)
- ***FHFB Increases Salary Cap 9.5% for FHLBank Presidents – Treasury Assistant Secretary Carnell States that FHLBank Presidents have Personal Financial Incentives to Arbitrage FHLBank Investments:***
  - The FHFB recently approved new base salary caps for the FHLBank Presidents, increasing many of their salaries by 9.5%. The 1999 base salary cap for 11 of the 12 FHLBank Presidents will be \$345,000, while the San Francisco FHLBank will increase to \$375,000 due to the larger aggregate asset size of the member financial institutions in that district. According to an article in the *Dow Jones Newswire*, base salaries for the FHLBank Presidents cannot exceed the specified amounts, however, Presidents are eligible for performance-based bonuses. (*Dow Jones Newswire*, 12/4/98)
  - In an article in *Barron’s Online*, Assistant Treasury Secretary for Financial Institutions Richard Carnell noted that the FHLBank System borrows from the capital markets at low rates because of its government backing and then invests those sums in higher-yielding investments that Carnell says serve no public purpose. FHLBank Presidents, who are paid approximately \$300,000 in annual salaries, receive five-figure incentive bonuses based in part on the returns of that arbitrage portfolio, which, Carnell says, equals 36% of the FHLBank System’s total assets. The *Barron’s* article also noted that the FHLBank System may be more vulnerable to attack since the departure of former Senate Banking Committee Chairman Alfonse D’Amato - who was considered a protector of the 12 FHLBanks. (*Barron’s Online*, 12/14/98)

- ***FHLBank of Pittsburgh Disputes Treasury’s Position on FHLBank Reform:***
  - The FHLBank of Pittsburgh included a commentary on their *Porch Light*® website that disputed the Treasury Department’s recent comments on FHLBank reform, specifically Deputy Assistant Secretary of the Treasury Richard Carnell’s recent comments during an AEI seminar on December 2<sup>nd</sup> on the future of the FHLBank System. During the seminar, Carnell noted that the Treasury Department did not support “piecemeal” reform of the FHLBank System, such as language that was included during the last session of Congress in the financial services modernization bill (H.R. 10), because “piecemeal” reform would not go far enough to limit the investment authority of the FHLBank System.
  - The FHLBank of Pittsburgh argued that the FHLBank System is “not broken, nor does it need to be fixed.” Further, they argued that the “far-reaching reforms that Mr. Carnell and the Treasury advocate would limit the Banks’ investment authority. Hence, making it more difficult for the Banks to fulfill their mission to affordable housing.” In the FHLBank of Pittsburgh’s opinion, the FHLBank provisions that were added to the financial services modernization bill (H.R. 10) were narrow in scope, were supported by the Banks, the Federal Housing Finance Board, and Members of Congress, and would have helped the Banks better fulfill their mission of housing finance. The FHLBank of Pittsburgh contends that Treasury’s reform of limiting the amount of debt that could be issued by the Banks “would not only deplete the capital available in the affordable housing market, but also jeopardize the safety and soundness of the entire Federal Home Loan Bank System.” (*FHLBank of Pittsburgh’s Porch Light website*, posted 12/14/98)
- ***FHFB Proposes Rule on Collateral Eligible to Secure FHLBank Advances:***
  - The Federal Housing Finance Board (FHFB) issued a proposed rule amending its regulation governing eligible collateral for FHLBank advances to clarify that certain assets, including the insured or guaranteed portions of federally insured or guaranteed loans, securities representing an equity interest in eligible collateral, and mortgage assets or government securities held by members’ wholly owned investment subsidiaries, qualify as eligible collateral to secure FHLBank advances. Comments on the proposal are due to the FHFB by February 8, 1999. (*Federal Register*, 12/8/98, pages 67625-67629)
- ***Bank United CEO Elected to the Board of the FHLBank of Dallas:***
  - Barry Burkholder, the Chairman, President, and CEO of Bank United was elected to the Board of the FHLBank of Dallas. Burkholder is also President and CEO of Bank United Corp, Bank United’s parent. (*National Mortgage News website*, posted 12/15/98)
- ***FHLBank President of Atlanta is Resigning:***
  - Paul Hill, President and CEO of the FHLBank of Atlanta is resigning for personal reasons and will vacate the post by the end of January. Executive Vice President and COO, Carol Jackson, will begin serving as acting President effective February 1, 1999. (*National Mortgage News*, 12/7/98)

## ***Farm Credit System***

- ***Farm Credit Administration Extends Comment Period on Controversial Proposed Rule that Would allow Farm Credit System Lenders to Compete - Proposed Rule Increases Worries of Community Banks about Competition from this GSE:***

- The Farm Credit Administration (FCA) extended the comment period on the proposed rule that would allow Farm Credit System Lenders to compete against one another for customers. Comments were originally due on February 8, 1999, however, the FCA has extended the deadline 90 days to May 10, 1999. The FCA first published the proposed rule in the *Federal Register* on November 9<sup>th</sup>.
- Currently, the FCA assigns geographic boundaries or restricts banks' products to prevent internal competition. The proposed rule permits eligible farmers, ranchers, aquatic producers or harvesters, farm-related businesses, and rural homeowners to seek financing and related services from any association or Farm Credit Bank authorized to serve these customers. It also allows a Bank or association to extend credit, participate in loans, and provide related services to any eligible applicant. (*FCA News Release*, 12/10/98; *Federal Register*, 11/9/98, pages 60219-60222; *Federal Register*, 12/16/98, pages 69229-69230)

### Proposed Rule Worries Community Banks about Competition

- As we noted in previous *GSE Reports*, community bankers are worried about competition from the Farm Credit Banks partly due to this proposed rule – a proposed rule that is opposed by the ABA and the IBAA. The pending rule was partly the driving force in the announcement of a pending farm credit bank merger between two Farm Credit Banks that has community bankers worried that this GSE is becoming an even tougher competitor. (*American Banker*, 10/30/98)
- ***Farm Credit Administration Issues Policy Statement on Interest Rate Risk Management and Capital Adequacy for Farm Credit System Institutions:***
  - The Farm Credit Administration (FCA) issued a final policy statement on interest rate risk management to provide additional guidance regarding sound interest rate risk management practices and the basis by which FCA will evaluate a Farm Credit System institution's capital adequacy for interest rate risk. The final policy statement does not apply to Farmer Mac because a risk-based capital regulation that explicitly addresses interest rate risk management for Farmer Mac is being developed. (*FCA News Release*, 12/10/98; *Federal Register*, 12/16/98, pages 69285-69288)

## ***International GSEs***

- ***Germany's GSE-Like Institutions May Be Forced to Privatize as German Private Sector Banks Battle with these "GSE-Like" Banks Over State Guarantee and Market Share:***

- Background – Europe has “GSE-like” banks that are largely owned by the governments and savings banks they represent, and are government-backed, thus having a cost of funds advantage over truly private lenders. These entities are expanding their markets beyond the 30% - 40% share they currently control in many European countries. There are currently 13 “GSE-like” banks, called Landesbanks, in Germany which operate both as banks to Germany's Lander (states) and as wholesale – commercial banks.

Like the American GSEs, the German Landesbanks enjoy Special Privileges that their Fully Private Sector Competitors Do Not Enjoy

- Landesbanks enjoy special privileges much like their American GSEs that other fully private sector competitors do not enjoy. For example, Landesbanks by law enjoy an unlimited guarantee from the German state and can never go bankrupt. As a result, these entities receive higher credit ratings and pay lower rates of interest than might otherwise be justified. The *Financial Times* calls this “no small matter,” as “some Landesbanken are developing commercial activities such as trading and investment banking, in which particularly good credit ratings can lead to a crucial competitive edge.” In addition, the article notes that “these banks have increased their capital and reserves by accepting assets transferred by their state backers and paying only minimal interest on them.”

Private Sector Companies in Germany Argue they Cannot Compete Against Landesbanks

- Due to increased competition from the Landesbanks and their competitive advantages, private lenders in Germany are starting to voice their opposition to the expansionist plans of these state-owned and backed entities. The big four private banks in Germany – Deutsche, HypoVereinsbank, Dresdner Bank and Commerzbank – hold only a mere 15% of the domestic market for assets and deposits, and have never had much hope for increasing that market share, because of what they view as the political protection and privileges afforded to their Landesbank rivals.

Landesbanks have Grown to be the Largest Financial Institutions in Germany

- The lightning rod reportedly for Germany's private sector banks' anger is Friedel Neuber, CEO of Westdeutsch Landesbank Girozentrale (WestLB) – the largest of the 12 Landesbanks in Germany. Over the past five years, Mr. Neuber has turned what was once a regional lender into a global goliath with assets of 520 billion marks. According to the Wall Street Journal, it is now the fourth-largest bank in Germany and the 24<sup>th</sup> largest in the world. After fortifying itself domestically in the early-1990s, in part through alliances with other Landesbanks and establishing new subsidiaries in eastern Germany, WestLB dedicated much of the past two years to expanding internationally and in different business lines, primarily investment banking. A Frankfurt investment banker cautioned that the Landesbanks could be more vulnerable as they grow larger. The Landesbanks respond that they have no choice but to expand, claiming that in today's increasingly globalized economy they need an international presence in order to serve the needs of their corporate customers.

### Private Sector Banks Want to Level the Playing Field in Order to Compete Against Landesbanks

- The private sector's main complaint is the state guarantee that the Landesbanks enjoy gives them pristine credit ratings and a cheaper source of funds. The result is the ability to borrow and lend funds more cheaply than any private bank, therefore giving them a competitive advantage. Private banks say "if landesbanks are going to play with the big boys, they have to play by big boy rules without maternal coddling from their state governments."
- Bank observers believe that European "GSE-like" banks will have to learn to fly on their own or have their wings cut. In the increasingly borderless Europe of unlimited competition, state subsidies and backing does not fit with global banking competition.

### European Commission is Investigating Landesbanks and May Recommend Privatization of these Entities

- A European Commission began investigating the Landesbanks and Dieter Hein of Commerzbank, Germany's fourth largest commercial bank, reported that the Landesbanks may be forced into partial privatization, if the European Commission rules next year that the Landesbanks have breached European Union competition laws by receiving certain types of subsidies from their state owners. The European Commission launched the investigation after a formal complaint was submitted in December 1994 by Germany's commercial banks about a case involving the Westdeutsche Landesbank. The banks charged that the Westdeutsche Landesbank increased its share capital and reserves by accepting only minimal interest on them.
- After researching a preliminary European Commission Report, Hein believes the Commission will surprise everyone by focusing on the fundamental question of the legality of state aid to public sector banks. "The Commission is unequivocal that public sector companies which are in competition with other players in their markets may not under any circumstances receive any subsidies," Hein said.
- Hein believes the Landesbanks will have three options as a result of the European Commission's Report: (1) give up their commercial competitive business and confine themselves to regional development; (2) Landesbanks may merge with each other; and (3) Landesbanks may decide to become wholly commercial banks through privatization. (*Financial Times*, 12/9/98; *Wall Street Journal*, 11/19/97)
- ***Hong Kong Mortgage Corp., Similar to Fannie Mae, Increases Its Mortgage Portfolio and Allows Homebuyers to Borrow 85% of Home Value by Providing the Mortgage Insurance:***

#### Hong Kong Mortgage Corp. Increases its Portfolio

- The Hong Kong Mortgage Corp. (HKMC) announced that it purchased 2.3 billion of Hong Kong dollars (approximately \$297 million) of residential mortgages in October. This purchase increased its total loan portfolio to \$7.5 billion of Hong Kong dollars (approximately \$968 million) at the end of the month. The HKMC also reported that none of the loans in its portfolio were overdue for more than three months at the end of

October and only 0.16% were overdue for more than one month. (*National Mortgage News website*, posted 12/15/98)

Hong Kong Mortgage Company Allows Homebuyers to Borrow 85% of Home Value by Providing the Mortgage Insurance

- According to a *Mortgage-Backed Securities Letter*, the HKMC announced that it would allow homebuyers to borrow up to 85% of the value of their homes, up from the current 70% under a new insurance plan. Under the plan, the HKMC will provide a guaranty for up to 15% of the property and the HKMC will hedge the exposure of the guaranty via mortgage insurance. (*Mortgage-Backed Securities Letter-American Banker*, 12/7/98)

While Similar to Fannie Mae, the Hong Kong Mortgage Corp., Does Have Some Differences

- As we noted in the May 8<sup>th</sup> *GSE Report*, Fannie Mae consulted with Hong Kong over the past few years in its creation of a secondary market, which according to Fannie's managing director for internal housing finance services, Martin Levine, is the "closest to fully mirroring the US" mortgage system (of all the nations Fannie has advised). Levine further noted that Fannie Mae's international consulting business is a marketing opportunity for Fannie Mae debt sales. While the HKMC is similar to Fannie Mae, there are some differences. According to a January article in *Mortgage Banking*, the HKMC is 100% government-owned (as opposed to Fannie's implicit guarantee from the government) and the HKMC is expected to be privatized eventually. (*Mortgage Banking*, 1/98)

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