

The **GSE** REPORT TM

Contents of GSE Report TM

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 - Fannie participated in the press conference, stating that it would "stretch" to meet the new affordable housing goals [but told Wall Street analysts the increase was relatively meaningless – stock prices jumped as a result]
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 - Chairman of the House Banking Capital Markets Subcommittee, Richard Baker (R-LA) supports increasing OFHEO's budget, stating that because of Fannie & Freddie's exposure – over \$2 trillion in obligations – "failing to fund the office [OFHEO] at this level would diminish the agency's ability to fulfill its responsibilities and leave taxpayers exposed to greater risk."
- Despite efforts by Fannie to "kill" the FHLBanks' Mortgage Partnership Finance (MPF) program by convincing the regulators to issue an unfavorable capital ruling, the regulators issued a favorable capital ruling for the MPF program (*p. 11*)
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- Responding to criticisms about the FHLBanks' arbitrage investment practices, the FHFB votes to issue a proposed rule to restrict and gradually eliminate the FHLBanks' non-mission investments (*p. 12*)
 - After a five-year transition period, the FHLBanks would be required to have 100% of what the FHLBanks borrow in the capital markets to be used to finance core mission activities related to broad definitions and interpretations of their housing and community development mission
 - The proposal would force the FHLBanks to divest their mortgage-backed securities (MBS) over a five-year period – under the proposal, MBS would not qualify as mission investments
 - FHFB also announced plans to change the FHLBanks' capital requirements by announcing plans to establish a risk-based capital proposal requirement for the FHLBanks
 - FHFB will hold a public hearing on the proposals in October
 - In a separate report, it was announced that the FHLBank System's debt issuance increased to \$755 billion in the first quarter
- A new Congressional Research Service (CRS) economic analysis by Barbara Miles and Dennis Zimmerman concludes that unless it is more carefully targeted, a Senate Finance Committee proposal to allow the FHLBanks to guarantee up to \$500 million in tax-exempt school bonds each year could “accomplish little for those districts that actually need it.” (*p. 14*)
 - The CRS analysis concludes that “because FHLBs are [government] subsidized, introducing them as the new competitor into the [bond insurance] market would not be economically efficient.”
 - The CRS analysis notes that the FHLBanks' implied federal guarantee would result in a lower yield on FHLBank insured bonds than on bonds insured by private firms and commercial banks and would displace the private insurance market
 - CRS analysis states that GSEs face pressures to expand into riskier areas that are not part of their original missions as opportunities for profits in their assigned market area decline and whether or not any market failure exists
 - CRS analysis states that GSEs' expansion into new areas can cause market failure rather than corrections because GSE status allows an enterprise to reap greater-than-competitive returns, making federal taxpayers liable for some of the cost with no offsetting benefits.
 - CRS analysis states that “GSEs are not particularly good conduits for subsidies” – because they “have a profit motive and a fiduciary responsibility to their owners”

Fannie Mae and Freddie Mac

- OFHEO said that its proposed risk-based capital proposal for Fannie & Freddie will not create a level capital playing field between banks/thrifts and the GSEs (*p. 16*)
 - OFHEO said it would be on alert for attempts by Fannie & Freddie to “game” OFHEO's risk-based capital rule
- In a “Dear Colleague” letter, Congressman James Hansen (R-UT) applauds Fannie & Freddie's decision to expand the Homeowner's Protection Act's objectives to benefit existing homeowners and requests that GAO conduct a study on mortgage insurance and whether alternative means of default loss protection exist (*p. 16*)
- *National Mortgage News* Columnist Brian Collins writes about the formation of the Fannie/Freddie watchdog group, FM WATCH entitled: “*Watch Out, Fannie and Freddie*” (*p. 17*)
 - Collins states that the group should get “high marks” for taking up the challenge and if the group “can survive to see its first anniversary, there may be a chance to instill some restraint on the part of the GSEs”
- *National Mortgage News* reports that Fannie & Freddie's combined 1998 earnings accounted for almost 70% of the earnings of the 13 largest companies in mortgage banking (*p. 17*)
- Fannie & Freddie have record earnings for second quarter of 1999 (*p. 18*)
 - Fannie's net income increased 13% - Salomon Smith Barney analyst states that political risk is keeping Fannie's stock down
 - Fannie's loan purchases for June were down – Freddie's loan purchases in June increase
- Fannie/Freddie watchdog group, FM WATCH, notes that currently, Fannie & Freddie have more debt and guarantees outstanding than the total liabilities of the entire Savings and Loan industry when it failed (*p. 19*)
 - FM WATCH said this debt begs the question – “Who stands between the taxpayers and a staggering GSE debt if the GSEs miscalculate their risk?”
- Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors, and consumers (*p. 20*)
 - Despite Fannie's repeated pronouncements that lenders are their “only customers,” Fannie & Freddie continue to market and build their technology brand name directly to brokers, realtors and consumers
 - *Reuters* article on the future of mortgage technology states that Fannie could act as a central clearing house and central repository for information on homes and links to ancillary service providers

- Fannie’s recent developments
 - (1) Fannie makes its website a “one-stop-shopping” area for multifamily lenders – Fannie states that it wants to be the single point of entry for business-to-business e-commerce, starting with multifamily committing and delivery and delivery (putting Fannie in a position of being able to charge monopoly usage fees to businesses)
 - (2) Lender’s Interactive Online (LION) announce the creation of a new interface for Calyx Software to simplify the process for brokers submitting their loan applications via the Internet to wholesale lenders for automated underwriting using Fannie’s Desktop Originator system. LION provides Fannie approved lenders and their sponsored brokers Internet access to Fannie’s Desktop Originator system
 - (3) Mortgage Builder Software announces an interface to Fannie’s automated underwriting system
 - (4) Finet, the owner of the first website that allows consumers direct access to Fannie’s automated underwriting system, announced that its common stock has been incorporated into the Russell 2000 and Russell 3000 Indexes, the benchmark small stock and total market capitalization index published by the Frank Russell Co.
 - (5) Fannie’s Chief Information Officer joins Board of Directors of Viant Corporation, a leading builder of digital businesses

- Freddie’s recent developments
 - (1) Freddie will transmit credit reports online through its automated underwriting system
 - (2) Freddie launches a new Online Learning Center for its business partners on its website

Fannie Mae

- Fannie changes its pooling method (p. 23)
- Fannie exchanges its Medium-Term Notes for its Benchmarks (p. 23)
- Fannie closes three multifamily deals with AMI Capital (p. 23)
- Fannie directs a call of tax-exempt multifamily bonds after a developer fails to meet certain construction requirements (p. 24)
- Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its partnership offices in press events (currently 34 offices are officially open and operating and seven more are in the process of being organized) (p. 24)
 - Fannie said it plans to have 45 partnership offices opened by the end of the year

Freddie Mac

- Freddie had a \$1 billion writedown (p. 26)
 - Freddie spokesman said “It’s insignificant”
 - Fannie/Freddie watchdog group, FM WATCH, says the writedown is significant and is a “hint” of what can happen without adequate capital standards
- Freddie says it hired former Speaker Newt Gingrich as a consultant, not a lobbyist (p. 27)
 - CNN’s Robert Novak states that there really is no difference between a “consultant” and a “lobbyist”
 - Since Freddie is calling Gingrich a “consultant,” the company is not required to disclose its payment to Gingrich as an expenditure on its lobbying expenditure reports
 - *American Banker* article notes that Gingrich is one of a growing number of political heavyweights hired recently by Fannie & Freddie and that both companies are exploring electronic grassroots lobbying
 - Charles Lewis, Executive Director of the Center for Public Integrity, states that Fannie & Freddie’s hiring of high level government and political officials blur the line between public service and private enterprise. In his opinion, the recent hirings by Fannie & Freddie are an example of how “incestuous these quasi-governmental entities are with the people that ostensibly regulate them or have oversight over them.”
 - A spokeswoman for the Fannie/Freddie watchdog group, FM WATCH, states that “many of those hired by Fannie Mae and Freddie Mac are specifically assigned to oppose any legitimate debate on Capitol Hill, in the administration, in the White House and the industry, about Fannie Mae’s and Freddie Mac’s role.”
 - Consumer advocate Ralph Nader stated in June 30 testimony before the House Budget Committee that some of the GSEs’ government subsidies – intended to lower the costs for home buyers – are being diverted to build political and lobbying efforts “designed to make it difficult, if not impossible, for the Congress to provide (or the public to demand) proper oversight or regulatory improvements which would protect the public, increase support for affordable housing or ensure open competition in the mortgage market.”

- Freddie backs another Senior Housing facility (p. 28)
- Freddie closes a \$160 million multifamily Gold PC swap (p. 28)
- Freddie closes a \$62.8 million securities deal with Berkshire Mortgage Finance for an apartment REIT (p. 28)

Federal Home Loan Banks

- FHFB management and the FHFB's Inspector General are in disagreement over a policy statement recently approved by the FHFB (p. 29)
 - The Inspector General states that the policy statement adopted by the FHFB would allow FHFB managers to obstruct criminal investigations, could compromise the rights of FHFB employees, and was issued without the concurrence of the Inspector General's office
 - The Inspector General recommends that the policy statement be rescinded
- Justice Department urges a US Claims Court to dismiss a suit brought by a consulting firm accusing the FHFB of wrongful termination of its contract (p. 29)
- Status report of legislation containing FHLBank expansion provisions (p. 30)
 - Conference Committee will reconcile the House and Senate-passed versions of financial services modernization bills. Both versions contain FHLBank provisions.

Private Sector Items to Note

- GE Capital Mortgage Insurance introduces new insurance product that will assist lenders with their secondary market execution (p. 30)
 - No additional costs to consumers or lenders
 - Product does not require that lenders change their systems
- Republic Mortgage Insurance (RMIC) offers a new insurance product as an alternative to GSE pool insurance (p. 31)
 - No additional costs to consumers or lenders
 - Product does not require that lenders change their systems

Farmer Mac

- Farmer Mac reports higher earnings but anticipates higher delinquencies in the third quarter (p. 31)

Major Events

HUD proposes increasing Fannie & Freddie's affordable housing goals

President Clinton, the National Association of Home Builders, America's Community Bankers, the US Conference of Mayors, the Enterprise Foundation, the National Low-Income Housing Coalition and FM WATCH (Fannie/Freddie watchdog group) were among those who released statements in support of HUD's actions

Fannie participated in the press conference, stating that it would "stretch" to meet the new affordable housing goals [but told Wall Street analysts the increase was relatively meaningless – stock prices jumped as a result]

Freddie did not participate in the press conference

- HUD held a press conference on July 29 to announce that it was planning to implement a policy that would increase Fannie and Freddie's affordable housing goals. Fannie and Freddie would be required to increase the percentage of low-to-moderate income home loans they finance to 50% by 2001 from their current goal of 42%. The first percentage increase begins in 2000 – at 48%. Fannie participated in the press conference, stating that it was committed to meeting the goals and would "stretch" to meet the new affordable housing goals. "It is not going to be easy. But we are going to work very hard to meet the Secretary's new goals," said Fannie's Chairman Franklin Raines. Freddie did not participate in the press conference. A Freddie spokeswoman stated that company is still working with HUD on the matter. According to HUD Assistant Secretary for Housing and Federal Housing Administration Commissioner William C. Apgar, the department is still talking with Freddie about the soon-to-be proposed rule, but Freddie has not yet taken a position.
- On HUD's proposal, President Clinton stated: "Raising the GSEs goals will help us generate increased momentum in addressing the nation's housing needs. I congratulate HUD Secretary Andrew Cuomo and the entire HUD team on their efforts in this important area."
- Other comments in support of HUD's announcement:

Sheila Crowley, President, The National Low Income Housing Coalition – "The National Low Income Housing Coalition welcomes the news...The goals provide Fannie Mae and Freddie Mac the opportunity to join the resources and potential of the capital markets with the rental housing needs of the very poor...Raising the goals will help to narrow the homeownership gap for minorities, women, and lower income Americans as well as lead to continued innovation in single and multifamily housing finance."

Cushing N. Dolbeare, Housing Policy Consultant, Founder and Chair Emeritus, National Low Income Housing Coalition called the announcement "good news to everyone who cares about increasing rental housing production and broadening access to homeownership, particularly for people of color.... The goals that expire this year marked a major step toward broadening the benefits of the secondary market and increasing the current rate of home ownership to historic highs. It is heartening that the new goals will build on this experience and that this major commitment is now being made."

Jesse Norwood, President of the National Conference of Black Mayors - "The National Conference of Black Mayors clearly understands that there exists a major affordable housing crisis in America and stands with HUD and Fannie Mae in support of affordable housing goals."

J. Thomas Cochran, Executive Director, The U.S. Conference of Mayors -- "HUD and Fannie Mae have responded to our call to provide greater access to loans by Americans looking to own their first home."

Bart Harvey, Chairman & CEO, The Enterprise Foundation -- "All of this is good news for low- and moderate-income families and reaffirms Fannie Mae's aggressive outreach to those most in need. We salute the good news and most of all the hundreds of thousands of families that will be effected by having a decent, affordable place to live."

Mike House, Executive Director, FM WATCH, a GSE watchdog group -- "Secretary Cuomo has shown extraordinary leadership on this issue. This is an important and necessary step HUD has taken."

Gerald Friedman, Chairman, FM WATCH – “We will continue to work with HUD to ensure that these goals are meaningful and fulfill their intended purpose.”

Charlie Ruma, President, National Association of Home Builders – “HUD’s new affordable housing goals for Fannie and Freddie “represent a ‘significant step forward’ in the effort to expand homeownership and rental housing opportunities.” Ruma praised Cuomo and Raines for working together in raising the bar and developing ambitious affordable housing goals. He also singled-out Raines for committing Fannie’s resources in the effort to further penetrate the low- and moderate-income housing market.

Charlotte Bahin, Regulatory Counsel, America’s Community Bankers – “We are pleased that HUD has suggested that they are going to propose goals that are more ambitious, which is in line with our policy statement, and we are pleased that Fannie Mae said they will work hard to meet the new goals...[W]e will be interested in the new programs that they develop to make [the new goals].” ACB’s recent policy statement on the GSEs said that Congress and the administration should focus the GSEs on their affordable housing mission because they have not met the statutory goal in funding loans to minorities and low- and moderate-income borrowers. (More information on ACB’s policy statement is included in this *GSE Report*.)

When asked about Freddie’s delayed response to HUD’s announcement, Bahin, said, “Freddie Mac has always been more conservative, and it’s probably taking more time to analyze [the new goals]. Freddie has historically had a little more trouble meeting the goals...but I’m sure that they will make every effort to comply with the law.”

- HUD’s press release noted that if Fannie and Freddie fail to make a good faith effort to achieve their affordable housing goals, the Secretary of HUD has the authority to impose civil money penalties of up to \$10,000 each day the failure occurs. According to HUD’s Apgar, the rule will next be sent to the Office of Management and Budget for review, to Congress, and then released for a public comment period. Apgar said HUD plans to have the proposal in place by January 1, 2001. According to an *Associated Press* article, HUD could impose the new affordable housing

requirements on Fannie and Freddie unilaterally if it wished. Secretary Cuomo said HUD preferred to cooperate and negotiate with Fannie and Freddie. (*Associated Press*, 7/29/99; *BNA Daily Report for Executives*, Eileen Canning, 7/30/99; *Dow Jones Newswire*, Jerry Guidera, 7/29/99; *HUD press release*, 7/29/99; *National Mortgage News website*, posted 7/29/99; *PR Newswire*, 7/29/99)

American Financial Services Association (AFSA) joins Fannie/Freddie Watchdog group - FM WATCH

- The American Financial Services Association (AFSA) joined the Fannie/Freddie watchdog group, FM WATCH. AFSA is a trade association that represents consumer finance companies including companies such as Household Financial Services and Associates First Capital Corp. According to *National Mortgage News*, AFSA would like to contribute to FM WATCH's effort to educate Congress on the GSEs' history and operations and to identify public policy issues. (*National Mortgage News website*, posted 7/27/99) Other members of FM WATCH include the Appraisal Institute, the Association of Financial Guaranty Insurers (AFGI), the Consumer Bankers Association (CBA), the Consumer Mortgage Coalition (CMC), the Financial Services Roundtable, the Mortgage Insurance Companies of America (MICA) and the National Home Equity Mortgage Association (NHEMA).

America's Community Bankers (ACB) issues policy statement addressing concerns about Fannie & Freddie

ACB makes recommendations to keep the GSEs motivated by mission not profits

ACB says it will use the policy statement to become more active on the GSE issue

Fannie agrees with some of ACB's recommendations

ACB Policy Statement

- The America's Community Bankers (ACB) – a trade group representing thrifts and smaller banks - issued a strong policy statement on July 19 that addressed concerns about Fannie and Freddie. In a press release, the ACB stated that it recognizes that Fannie and Freddie have played “a constructive role in supporting homeownership, but should not be allowed to intrude in the primary market,” which they find “clearly inconsistent” with Fannie and Freddie's charters.
- According to an *BNA* article by Eileen Canning, ACB's Director of Government Relations Bob Davis stated that the policy statement would be used as a framework to become more engaged in “a constructive fashion about the future growth and direction of secondary market GSEs... We are going to become more active” on the secondary market issues. “This framework will be used for certain regulatory issues we know are on the horizon,” he stated. There is “ongoing creative tension between seller servicers and secondary market GSEs, and as their businesses become more intertwined, our effort is to maintain complementary business relations.”
- In its policy statement, the ACB recommended a number of items to keep Fannie and Freddie motivated by mission rather than profit. Among the recommendations:

- Fannie and Freddie not purchase loans with a loan-to-value ratio of more than 80% in a manner inconsistent with their charters, or move in on the subprime mortgage market, except in programs targeted for lower-income borrowers and the underserved;
- Fannie and Freddie should not use their “benefits as quasi-governmental” firms to weaken competition in the market;
- Fannie and Freddie should not use technology, such as artificial intelligence and automated underwriting systems, to enter the primary mortgage market;
- Congress and the Administration should consider whether to set new goals to focus Fannie and Freddie on their affordable housing mission because they have not met the statutory goal of “leading the market” in funding loans to minorities and low- and moderate-income borrowers;
- The capital requirements for Fannie and Freddie should reflect the risks facing each company, be consistent with the requirements set for other federally regulated entities, and should reduce taxpayer exposure; and
- HUD should adopt a regulation to keep Fannie and Freddie from engaging in pure arbitrage investments of any type, require annual reporting of all foreign instruments held, define permissible investments, and limit liquidity investments to US Treasuries or federal agency securities or domestic securities of investment grade.

Fannie agrees with some of ACB’s recommendations

- According to the *BNA* article by Eileen Canning, Fannie responded in agreement to some of the recommendations made by ACB, but a Fannie official called other criticisms from ACB and the new Fannie/Freddie watchdog group, FM WATCH, “100 percent wrong.”

Fannie claims that they are not moving into the primary market – others question Fannie’s denials

- David Jeffers, Fannie’s Vice President for Corporate Relations, told *BNA* that he “absolutely agreed” that Fannie Mae should not encroach into the primary market. In fact, he said, “We have no interest in going to the primary market...[N]ot only is it not permitted by our charter, and not only do we have no interest in it, we don’t think we would be very good at it.”
- During an American Enterprise Institute (AEI) Seminar on March 24, 1999 on Fannie and Freddie, Vern McKinley, a policy contributor to CATO noted that Fannie and Freddie’s technology, including Fannie and Freddie’s automated underwriting systems and their direct marketing to consumers, raised questions about whether Fannie and Freddie are violating their charters by originating mortgages. It all depends on your definition of “originate.” McKinley stated that, “originate could be narrowly defined to simply include the funding of a loan. It could also be defined much more broadly to also include steps involved in the underwriting process.”
- James Hennessy, Jr. a Senior Vice President of Sales and Marketing for Hansen Loan Quality Service, recently wrote an article in *MortgageOriginator.com* analyzing the continued denial by the GSEs that they are in competition with the rest of the mortgage industry. He noted that Fannie Chairman Franklin Raines has made many appearances in front of lenders and trade associations saying things like “our job is to support your business -- not to do your business.” “He [Raines] has even gone so far as to say he would tattoo that message on his forehead if he thought it would allay lenders’ fears.” Hennessy also reported on Raines’ recent full-page “letter” to lenders (actually an advertisement, according to Hennessy) that pledged to open Fannie’s automated underwriting system to all, even Freddie Mac. The letter concluded with “Fannie Mae will not originate mortgages. Period.” Hennessy compared these statements to those of former President

George Bush when he famously said, “Read my lips. No new taxes.” Hennessy notes, **“The possibility remains that even if Fannie does not go after consumers, they are certainly paving the way to go after brokers and other originators. If this happens, where does that leave Fannie’s ‘only customers?’”** (*MortgageOriginator.com*, James L. Hennessy, Jr., July 1999)

Fannie says it has done more than any single institution to support underserved areas – GAO Report found that the GSEs lagged the primary market in serving the low- to moderate-income homebuyers

- Fannie’s Jeffers also stated to *BNA* that the ACB was “100 percent wrong” to say that Fannie and Freddie have not fulfilled their statutory mission of lending to minority, lower income, and underserved communities. “No single institution has done more to support housing for minority families and other underserved [communities] than Fannie Mae in the 1990s.” [In testimony before the House Banking Committee’s Capital Markets Subcommittee in July 1998, the GAO noted that the GSEs generally lag the private sector in serving low- and moderate-income homebuyers, while holding substantially more capital than the GSEs.]

Fannie says it a strong supporter of risk-based capital standards, however, Fannie strongly opposed OFHEO’s risk-based capital proposal prior to its release

- In addition, Jeffers said Fannie is a strong supporter of risk-based capital standards. “[O]ur regulator is coming out with risk-based capital standards that we are working hard to replicate at this point, [but] it will be several months before we can comment on the details of that proposal, but in principle, we have always been a very strong proponent of risk-based capital standards,” he said. [Despite Jeffers’ claim that Fannie is a strong supporter of risk-based capital standards, Fannie fought and strongly denounced OFHEO’s proposed risk-based capital rule prior to its release and before Fannie reportedly ever saw a copy of the proposed rule. See previous *GSE Reports* for specific criticisms by Fannie.] (*ACB press release and policy statement*, 7/19/99; *BNA Daily Report for Executives*, Eileen Canning, 7/22/99)

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Consumer advocate Ralph Nader urges Congress to fully fund OFHEO’s budget request

In fact, Nader supports even greater funding increases for OFHEO than the current budget request and would like to strengthen Fannie & Freddie’s regulator in the long term

Nader states: “At a minimum, OFHEO needs the full funding of the current budget request unless the oversight of Fannie and Freddie and the protection of taxpayers are to become a mockery. Longer range, Congress needs to consider a full-scale upgrading of OFHEO to keep pace with rapid expansion of Fannie and Freddie.”

Chairman of the House Banking Capital Markets Subcommittee, Richard Baker (R-LA) supports increasing OFHEO’s budget, stating that because of Fannie & Freddie’s exposure – over \$2 trillion in obligations – “failing to fund the office [OFHEO] at this level would diminish the agency’s ability to fulfill its responsibilities and leave taxpayers exposed to greater risk”

- According to a *BNA* article by Marc Selinger, OFHEO would receive a 22% budget increase under a FY 2000 appropriations bill passed by the House Appropriations VA-HUD Subcommittee on July 26. According to a statement by OFHEO, the increase from \$16 million to \$19.5 million was requested to “provide more depth in mission-related areas, particularly with respect to information technology.” OFHEO stated that \$2 million (57% of the increase) would fund regulatory infrastructure improvements and development of a state-of-the-art monitoring system for assessing the risk of Fannie and Freddie.
- According to the article, OFHEO said it needs greater resources due to Fannie and Freddie’s rapid growth and increasingly sophisticated activities, including off-balance sheet financial derivatives, global debt issuances, and participation in the subprime mortgage markets. (*BNA Daily Report for Executives*, Marc Selinger, 7/28/99)

Ralph Nader

- Consumer advocate Ralph Nader sent a letter on July 19 to VA-HUD Appropriations Subcommittee Chairman James Walsh (R-NY) supporting OFHEO’s budget increase. Because Fannie and Freddie represent large contingent liabilities for the federal government, Nader urged Congress to fully fund the pending budget request of \$19.5 million for OFHEO. “The increase in OFHEO’s FY 2000 budget (approximately \$3.5 million) is clearly needed if the office is to have any chance of monitoring the rapid asset growth and expanding activities of the GSEs...If Congress expects OFHEO to meet its statutory oversight responsibility, it must support the additional funding and the development of modern surveillance systems.”
- Nader wrote, “If anything...the size and funding of OFHEO is too small even with the increases requested for FY 2000. Fannie and Freddie are engaging in ever more sophisticated operations ranging from the use of off-balance sheet financial derivatives to global debt issuances to expansion into sub-prime markets.”
- Nader concluded by stating that “At a minimum, OFHEO needs the full funding of the current budget request unless the oversight of Fannie and Freddie and the protection of taxpayers are to become a mockery. Longer range, Congress needs to consider a full-scale upgrading of OFHEO to keep pace with rapid expansion of Fannie and Freddie.” (*Ralph Nader letter to Cong. James Walsh*, 7/19/99)

Cong. Richard Baker (R-LA)

- Chairman of the House Banking Capital Markets Subcommittee Richard Baker (R-LA) sent a letter on July 16 to VA-HUD Appropriations Subcommittee Chairman James Walsh (R-NY) endorsing the budget increase for OFHEO. “With over \$2 trillion in obligations, the enterprises are vitally important to the efficient operation of the US mortgage market,” he wrote. “Moreover, with that kind of exposure, I believe that failing to fund the office at this level would diminish the agency’s ability to fulfill its statutory responsibilities and leave taxpayers exposed to greater risk.” (*BNA Daily Report for Executives*, Marc Selinger, 7/28/99)

Despite efforts by Fannie to “kill” the FHLBanks’ Mortgage Partnership (MPF) program by convincing the regulators to issue an unfavorable capital ruling, the regulators issued a favorable joint capital ruling for the MPF program

The joint capital ruling is expected to stimulate the growth of the MPF program

The MPF program is becoming a real competitor to Fannie & Freddie – Half of the FHLBanks are now offering or planning to offer the program

- Federal bank and thrift regulators issued a new risk-based capital ruling that is expected to stimulate the growth of the FHLBank System’s Mortgage Partnership Finance (MPF) program. The MPF program, first developed by the FHLBank of Chicago provides thrift and commercial bank lenders with an alternative to selling fixed-rate home loans to Fannie and Freddie. By allowing FHLBanks to purchase mortgage loans originated by member financial institutions. The program provides new competition in the secondary mortgage market.
- The new capital ruling was issued jointly by the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corp. and the Office of Thrift Supervision. The ruling confirmed that MPF transactions would receive “direct credit substitute” treatment for risk-based capital purposes, given that the program has established an up-front 100 basis-point first-loss account replacing the previous monthly buildup before it can receive direct credit substitute treatment. The regulators said that they could revisit the risk-based capital and supervisory treatment if safety and soundness problems arise within the program at a later time.
- The FHLBank of Chicago called the ruling “a favorable outcome” for MPF lenders. “We expect the market demand for MPF will grow even faster now that this issue has been definitely resolved,” said FHLBank of Chicago President Alex Pollock. “This clarification of risk-based capital treatment is an important step toward improving the efficiency and competitiveness of the American mortgage finance system,” stated Federal Housing Finance Board Chairman Bruce Morrison.
- The MPF program is currently available to FHLBank member institutions in Chicago, Dallas, Atlanta, New York and Pittsburgh. As reported in a previous *GSE Report*, the FHLBank of Seattle has applied to the Federal Housing Finance Board (FHFB) for approval to offer the FHLBank System’s MPF program. (*Dow Jones Newswire*, John Connor, 7/22/99; *BNA Daily Report for Executives*, Eileen Canning, 7/26/99)

Fannie lobbied hard to convince regulators to issue an unfavorable ruling for the MPF program

- As reported in the April 2 and June 11 *GSE Reports*, Fannie lobbied hard to convince Congress and regulators that the FHLBanks had insufficient capital with most of the criticism focused on the FHLBanks’ MPF program. Fannie wrote a letter a letter to the FDIC comparing the risk of the FHLBanks’ new programs to the S&L crisis. According to a *National Mortgage News* article by Brian Collins, sources indicated that the FDIC summarily dismissed Fannie’s claims as a complaint filed by a competitor. (*Wall Street Journal*, John Connor, 3/29/99; *Dow Jones Newswire*, John Connor, 3/26/99; 3/29/99; *Washington Post*, Kathleen Day, 3/27/99; *Bloomberg News*, 3/29/99; *Mortgage-Backed Securities Letter – American Banker*, 3/22/99; *National Mortgage News website*, posted 3/29/99; *National Mortgage News*, Brian Collins, 5/31/99)

Responding to criticisms about the FHLBanks' arbitrage investment practices, the FHFB votes to issue a proposal to restrict and gradually eliminate the FHLBanks' non-mission investments

After a five-year transition period, the FHLBanks would be required to apply 100% of what the FHLBanks borrow in the capital markets to the financing of core mission activities related to broad definitions and interpretations of their housing and community development mission

FHFB also announced plans to change the FHLBanks' capital requirements by establishing a risk-based capital requirement proposal for the FHLBanks

FHFB will hold a public hearing on the proposal in October

In a separate report, it was announced that the FHLBank System's debt issuance increased to \$755.5 billion in the first quarter

- The Federal Housing Finance Board (FHFB), the regulator for the FHLBank System, unanimously agreed on July 28 to issue a risk-based capital proposal for public comment that would phase-out and eventually eliminate the FHLBanks' arbitrage activities. After a five-year transition period, the FHFB proposal - referred to as the "Financial Management and Mission Achievement (FMMA) Regulation" - requires that 100% of what the FHLBank System borrows in the capital markets must be used to finance core mission activities in support of broadly defined housing and community development missions. Under the proposal, the 100% standard would be effective January 1, 2005. The proposal will be open to a 90-day public comment period.
- The FHLBank System has been under criticism from the Treasury and Congress for its arbitrage activities and investments - specifically, using its implied government guarantee from its GSE status to borrow heavily at preferential rates and then investing the proceeds in higher yielding instruments that are often unrelated to the system's mission of assisting housing and community development.
- The FHFB also voted to change the FHLBanks' capital requirements with plans to create a risk-based capital requirement for the FHLBanks based on credit risk, market risk, and operations risk. The FHFB stated that the proposed requirements would be created from historical credit loss experience, stress tests using interest-rate scenarios over a 20-year period, and the stress test scenarios developed by OFHEO recently for Fannie and Freddie. The FHFB in the proposed regulation also defined risk-based capital to include all retained earnings and non-redeemable stock, and up to 50 percent of all other stock. According to a *BNA* article by Eileen Canning, the risk models under the regulation would require FHFB approval. The *BNA* article further noted that the proposal calls for a contingency liquidity requirement based on a seven-day lock-out from the consolidated obligations markets and credit concentration limits. In addition, the proposed regulation sets a minimum total capital requirement of 3 percent of assets instead of current liabilities-based leverage ratio, stating that consolidated obligations cannot exceed 20 times capital. According to the FHFB, the FHLBanks are overcapitalized. The FHFB stated that the proposed minimum capital to assets requirement of 3 percent is greater than required by statute for Fannie and Freddie (2.5%) and equals the minimum tier 1 capital required by primary bank regulators for banks without supervisory concerns.

- The FHFB proposal also allows the FHLBanks to acquire a broader range of assets than currently permitted. The proposal authorizes the FHLBanks to authorize the following broader range of assets: debt securities of investment grade, equities that count as core mission activities (e.g. SBICs), and Mortgage Market Assets (MMA). MMA would be considered mission assets because these assets would require risk-splitting between FHLBanks and their members. The FHFB considers the FHLBank Systems' Mortgage Partnership Finance (MPF) program – currently in pilot form - as a MMA. Prohibited investments under the proposal include equities other than those defined as core mission assets, foreign securities, non-rated or below investment grade debt, commodities and foreign currencies.
- Mortgage-backed securities are not prohibited by the proposal. However, most Fannie Mae and Freddie Mac MBS would not count as core mission activities. The proposal stated that the mortgage-backed securities of Fannie and Freddie – in which there is no member/FHLBank risk-sharing – would not count as core mission assets.
- The FHFB agreed to publish the regulation in the *Federal Register* for a 90-day comment period. In addition, Morrison stated that there would be a public hearing on the proposal in October.
- According to an *American Banker* article by Katharine Fraser, many of the critics of the FHFB's proposals believe that much of what the FHFB wants to accomplish would be required by the financial services modernization legislation pending in Congress. Critics suggested that the FHFB wait to see what Congress does. "This is a bit of the cart before the horse," said Robert Davis, Government Relations Director at America's Community Bankers. "It's hard to create a regulatory framework before you know what the statutory authority for capital structure will be, and we don't know that at this time." (*BNA Daily Report for Executives*, Eileen Canning, 7/29/99; *Dow Jones Newswire*, John Connor, 7/28/99; *FHFB Fact Sheet, Proposed Financial Management and Mission Achievement Regulation*, 7/28/99; *National Mortgage News website*, posted 7/28/99)

FHLBank System's debt issuance increases in first quarter

- In a new report, the FHLBank System stated that the aggregate issuance of FHLBank System bonds and discount notes increased to \$755.5 billion in the first quarter of 1999 from \$615.6 billion in the same period last year. The report also stated that discount note issuance increased to \$663.7 billion in the first three months of the year from \$546.1 billion in the first three months of 1998. Consolidated bond issuance also increased to \$91.8 billion in the first quarter of 1999 from \$69.5 billion during last year's first quarter. (*Dow Jones Newswire*, John Connor, 7/26/99)

A new Congressional Research Service (CRS) economic analysis by Barbara Miles and Dennis Zimmerman concludes that unless it is more carefully targeted, a Senate Finance Committee proposal to allow the FHLBanks to guarantee up to \$500 million in tax-exempt school bonds each year could “accomplish little for those districts that actually need it”

The CRS analysis concludes that “because FHLBs are [government] subsidized, introducing them as the new competitor into the [bond insurance] market would not be economically efficient”

The CRS analysis notes that the FHLBanks could harm the competitiveness of the private bond insurance and credit enhancement markets

The CRS analysis concludes that the FHLBanks’ implied federal guarantee would result in a lower yield on FHLBank insured bonds than on bonds insured by private firms and commercial banks and would displace the private insurance market

CRS analysis states that GSEs face pressures to expand into riskier areas that are not part of their original missions as opportunities for profits in their assigned market area decline and whether or not any market failure exists

CRS analysis states that GSEs’ expansion into new areas can cause market failure rather than corrections because GSE status allows an enterprise to reap greater-than-competitive returns, making federal taxpayers liable for some of the cost with no offsetting benefits

CRS analysis states that “GSEs are not particularly good conduits for subsidies” – because they “have a profit motive and a fiduciary responsibility to their owners”

- A *Bond Buyer* article by Amy Resnick reported on a recent CRS analysis that concluded that a Senate Finance Committee proposal allowing the FHLBanks to guarantee up to \$500 million in tax-exempt school bonds each year could “accomplish little for those districts that actually need it.” Barbara Miles and Dennis Zimmerman wrote the recent CRS analysis.
- Miles and Zimmerman concluded that “because the FHLBs are [federally] subsidized, introducing them as the new competitor into the [bond insurance] market would not be economically efficient.” A bond guarantee by the FHLBanks would constitute an indirect federal guarantee to those school bonds, because “the inference is drawn by investors in capital markets that the federal government would not allow the FHLBs...to fail such that investors would lose their money.”
- The CRS analysis notes that the FHLBanks could harm the competitiveness of the private bond insurance and credit enhancement markets. Miles and Zimmerman further note that the FHLBanks’ implied federal guarantee would result in a lower yield on FHLBank insured bonds than on bonds insured by private firms and commercial banks and would displace the private insurance market. “The clear implication...were they not constrained by the \$500 million limit, the FHLBs’ enhancements could displace currently offered private insurance completely, even though the FHLBs would be pricing their enhancements in a manner consistent with the risk they would be accepting.” (*Bond Buyer*, Amy Resnick, 7/15/99)

CRS analysis states that GSEs face pressures to expand into riskier areas that are not part of their original missions as opportunities for profits in their assigned market area decline and whether or not any market failure exists

- Miles and Zimmerman state:

“When a market failure has been corrected but the federal support for correcting it remains, economic analysis indicates over consumption is encouraged and economic efficiency is endangered. GSE charters confer benefits on shareholders that increase in value as business volume and investment risk increase. As opportunities for profit in the assigned market area decline, the GSE faces pressures to maintain dividends to shareholders or mutual members. This creates an incentive for the subsidized entity to expand into riskier areas not part of its original mission whether or not there is any market failure in the new area.”

CRS analysis states that GSEs’ expansion into new areas can cause market failure rather than corrections because GSE status allows an enterprise to reap greater-than-competitive returns, making federal taxpayers liable for some of the cost with no offsetting benefits

- Miles and Zimmerman write:

“GSE expansion into new areas can be detrimental to efficient competitors who do not have charters that convey similar economic benefits. Because its costs are lower than for non-favored companies, a GSE can reap greater-than-competitive returns, even while undercutting existing firms in the new area. The GSE need only price its products a little below what fully private companies charge, or offer a slightly improved product. Should this happen, the GSE becomes a source of market failure rather than a correction. Services are being provided at prices that do not reflect full resource costs, and over-consumption is encouraged. In effect, federal taxpayers end up potentially liable for some of the cost with no offsetting benefits.”

- Miles and Zimmerman conclude that **“GSEs are not particularly good conduits for subsidies – they do have a profit motive and a fiduciary responsibility to their owners.”** (*Congressional Research Service, An Economic Analysis of Allowing Federal Home Loan Banks to Guarantee Tax-exempt School Construction Bonds*, Barbara Miles and Dennis Zimmerman, 6/30/99)

Fannie Mae and Freddie Mac

OFHEO said that its proposed risk-based capital proposal for Fannie & Freddie will not create a level capital playing field between banks/thrifts and the GSEs

OFHEO said it would be on alert for attempts by Fannie & Freddie to “game” OFHEO’s risk-based capital rule

- During a recent briefing sponsored by ISD/Shaw, OFHEO’s Acting Director Mark Kinsey stated that its proposed risk-based capital proposal for Fannie and Freddie will not accomplish banks and thrifts getting capital parity with the GSEs. “The reason it will not is that our capital rule is designed to capture the credit and interest rate risk associated with mortgages held by Freddie Mac and Freddie Mae,” Kinsey stated. “These two companies are different from other investors in mortgages,” said Kinsey. “Namely, they are government-sponsored enterprises.” Because the firms have “unparalleled access to capital markets,” it enables them to match the cash flows of their liabilities to the cash flows associated with their mortgage investments inexpensively and the GSEs have more borrowing cost advantages than fully private firms.
- Kinsey stated that OFHEO would be alert to any attempts by Fannie or Freddie to “game” OFHEO’s risk-based capital rule. Kinsey stated that “one of the most important ongoing issues that OFHEO will face once the capital rule is final will be to make sure that the enterprises don’t alter their operations in a way that would effectively game the risk-based capital rule.” Kinsey stated that “One type of gaming that we will be watching for is related to the fact that we are using only one very specific economic scenario to determine capital requirements. In reality, the enterprises need to protect against a wide range of potentially bad situations.” Kinsey said they would find it unacceptable for an enterprise “to hedge against interest rate risk defined by the stress test environment, but would not be as well hedged for rate movements less than those applied in the stress test.” Kinsey also cited “window dressing” concerns that could occur because capital requirements are determined at a particular point in time, such as the last day of the quarter. Kinsey said OFHEO would find it unacceptable for the enterprises to make sure that they are hedged on that day and buy or sell Treasury futures and then reverse the transactions on the next day. OFHEO would also find it unacceptable for the enterprises to “minimize the level of outstanding commitments on the last day of each quarter.” (*Dow Jones Newswire*, John Connor, 7/20/99; *National Mortgage News website*, posted 7/20/99)

In a “Dear Colleague” letter, Congressman James Hansen (R-UT) applauds Fannie & Freddie’s decision to expand the Homeowner’s Protection Act’s objectives to benefit existing homeowners and requests that GAO conduct a study on mortgage insurance and whether alternative means of default loss protection exist

- In a “Dear Colleague” letter, Congressman James Hansen (R-UT) applauded Fannie and Freddie’s recent decision to expand the new Homebuyer Protection Act’s objectives to benefit existing loans and Fannie and Freddie’s announcements earlier in the year that they would reduce the level of mortgage insurance required on home loans. Hansen wrote that “I believe the evolution of mortgage insurance’s role in the housing finance system - as illustrated by the Homebuyers Protection Act and by the recent initiatives of Fannie Mae and Freddie Mac to lower home buyers’ mortgage insurance costs - points out a need for us to take a comprehensive look at mortgage insurance, the mortgage insurance industry, and whether alternative, more efficient means of

default loss protection exist. In this regard, I plan to ask the GAO to conduct just such a study.”
(“Dear Colleague” Letter by Congressman James Hansen (R-UT), 7/22/99)

***National Mortgage News* Columnist Brian Collins writes about the formation of the Fannie/Freddie watchdog group, FM WATCH entitled: “Watch Out, Fannie and Freddie”**

Collins states that the group should get “high marks” for taking up the challenge and if the group “can survive to see its first anniversary, there may be a chance to instill some restraint on the part of the GSEs”

- *National Mortgage News* columnist Brian Collins wrote a piece about the recent formation of the Fannie/Freddie watchdog group, FM WATCH. Collins stated, “Like most crusaders, the coalition [FM WATCH] gets high marks for taking up the challenge. Everyone knows it will not be easy to stand up to the two giants [Fannie and Freddie], which set the pricing and standards for the “A” paper market. And everyone knows that the two FMs are solidly entrenched in Washington, and neither Congress nor the Clinton administration is going to take any bold action against them.”
- Collins notes that Fannie and Freddie’s claims that the discontent of the industry stemmed solely from the mortgage insurers are not accurate. Collins writes, **“Mortgage lenders would have to be mules to let the GSEs extend their control over the industry by tying access to the secondary market to Loan Prospector or Desktop Underwriter [Freddie and Fannie’s automated underwriting systems]. Lenders have also witnessed Fannie’s and Freddie’s assault on the MIs and they can easily see how it would affect their captive insurance arrangements if the GSEs succeed.”**
- **“Mortgage lenders also know that Fannie Mae and Freddie Mac shareholders expect double-digit earnings growth, and the chairmen of the two enterprises encourage these expectations. For the CEO of any mortgage company, this has to be a threat - in their bones they know that part of that growth will come at lenders’ expense.**
- Collins concludes that “If FM WATCH can survive to see its first anniversary, there may be a chance to instill some restraint on the part of the GSEs.” (*National Mortgage News website*, Brian Collins, posted 7/15/99)

***National Mortgage News* reports that Fannie & Freddie’s combined 1998 earnings accounted for almost 70% of the earnings of the 13 largest companies in mortgage banking**

- *National Mortgage News* reported that according to the new 2000 Mortgage Industry Directory, Fannie – with \$3.41 billion in 1998 earnings – accounted for almost 47% of the earnings of the 13 largest players in mortgage banking. Freddie’s earnings market share was 23% with 1998 earnings of \$1.7 billion. The following chart was published in the *National Mortgage News*:

Earnings of Giant “Conventional” Mortgage Industry Players (Dollars in Millions)					
Company	1998 Profit	1997 Profit	Percent Change	Earnings Market Share	Industry/Sector
Fannie Mae	\$3,413	\$3,056	12%	46.73%	Investor/Sec't'zer
Freddie Mac	\$1,700	\$1,395	22%	23.28%	Investor/Sec't'zer
Golden West Fin.	\$435	\$384	13%	5.96%	Lender/Service
MGIC	\$386	\$324	19%	5.29%	Mortgage insurer
Countrywide	\$345	\$257	34%	4.73%	Lender/Service
GE Mortgage Ins. (e)	\$225	\$220	13%	3.08%	Mortgage insurer
Norwest Mortgage	\$217	\$151	44%	2.97%	Lender/Service
PMI	\$192	\$175	10%	2.63%	Mortgage insurer
Washington Mutual	\$133	(\$44)	na	1.82%	Lender/service
Commonwealth MAS	\$91	\$75	21%	1.25%	Mortgage insurer
Chase Manhattan Mort.	\$76	\$47	62%	1.04%	Lender/service
GMAC Mortgage	\$57	\$46	23%	0.78%	Lender/Service
Indy Mac	\$34	\$24	39%	0.47%	Investor/lender/ serv.
Totals:	\$7,304	\$6,090	20%	100%	

Notes: Companies were picked based on their size and their prominence in the industry either as a lender/service, an MI, or an investor. Some mortgage giants, such as HomeSide and BankAmerica Mortgage were excluded because it was not possible to estimate their earnings based on statements released by the parent. HomeSide's earnings could be as large as \$300 million. Subprime firms are excluded.

Source: 2000 MID/Database Products Group

Fannie & Freddie have record earnings for second quarter of 1999

Fannie's net income increased 13% - Salomon Smith Barney analyst states that political risk is keeping Fannie's stock down

Fannie's loan purchases for June were down - Freddie's loan purchases in June increase

- According to the *Wall Street Journal*, Salomon Smith Barney Analyst Thomas O'Donnell stated that "It's not rates - they [Fannie] can handle rates," he stated. "I think political risk is what's keeping the stock down." The article specifically cited the Fannie/Freddie watchdog group, FM WATCH. (*Wall Street Journal*, 7/14/99) Joshua Brockman with the *American Banker* also wrote that uncertainty about recent deals between lenders and the GSEs, along with concerns about the creation of FM WATCH, "have reined in Fannie's and Freddie's shares in recent months." (*American Banker*, Joshua Brockman, 7/13/99)

Fannie's net income increased 13%

- Fannie stated that its net income increased 13% for the second quarter, rising to \$957.6 million, or 91 cents a diluted share, from \$848 million, or 80 cents a share, from last year. Fannie's net

mortgage portfolio increased to \$473.46 billion, a 36% increase from \$348.28 billion last year. The annualized mortgage portfolio growth increased to 29.7% in the quarter, up from 27.4%.

- According to *National Mortgage News*, Fannie's loan purchases "took a June swoon," falling to their lowest level in a year. Fannie acquired \$40.86 billion, down 19% from May and 8% from June of 1998.
- In a separate announcement, Fannie announced that it would pay shareholders a dividend of 27 cents a share for the second quarter- the same dividend Fannie paid out in the first-quarter when Fannie increased it by 12.5%. (*Bloomberg News*, 7/20/99; *National Mortgage News*, 7/19/99)

Freddie reports earnings increase 33%; revenues surpass \$1 billion

- Freddie reported that second-quarter net income grew 33.3% to \$552 million, and earnings per share rose 32% to 74 cents. Freddie's holdings of mortgages and mortgage-backed securities also increased in the quarter. The net retained portfolio of investments increased by \$101 billion from last year's period of \$297 billion. Total assets grew \$112 billion to \$341 billion. The company's revenue grew to \$1 billion, surpassing the billion mark for the first time, up 24% from last year and from \$997 million in the first quarter. (*American Banker*, 7/28/99; *Bloomberg News*, 7/15/99)
- According to *National Mortgage News*, Freddie's loan purchases increased to \$25.51 billion in June, a 8.8% increase from June of last year, and a 9.1% increase from May. (*National Mortgage News*, 7/19/99)

Fannie/Freddie watchdog group, FM WATCH, notes that currently, Fannie & Freddie have more debt and guarantees outstanding than the total liabilities of the entire Savings and Loan industry when it failed.

FM WATCH said this debt begs the question – "Who stands between the taxpayers and a staggering GSE debt if the GSEs miscalculate their risk?"

- A FM WATCH bulletin noted that in 1987, Fannie reported total assets of \$100 billion in mortgage backed securities (MBS). That same year, Freddie's total assets were \$23 billion and they issued \$100 billion in MBS. Today, Fannie and Freddie now have \$868 billion in assets and have \$1.2 trillion in MBS outstanding with private investors. At this pace, FM WATCH states that by the year 2005, Fannie and Freddie's debts and guarantees will exceed the entire national debt.
- "Right now, Fannie Mae and Freddie Mac have more debt and guarantees outstanding than the total liabilities of the entire Savings and Loan industry when it failed. All this debt begs the question - who stands between the taxpayers and a staggering GSE debt if the GSE's miscalculate their risk?"
- FM WATCH states that the GSEs are issuing MBS and then buying them back for their own investment portfolios. "When the GSEs buy their own securities, they are not expanding homeownership opportunities. They are buying securities comprised of mortgage loans that have already been closed and are priced at rates to attract private investors. This strategy can be summarized as borrow and buy, then keep the spread."

- FM WATCH suggests that the government require that Fannie and Freddie put up capital similar to the capital required of other well-capitalized financial institutions, so that Fannie and Freddie can remain in business in the event their investments sour. “Without adequate capital, the U.S. Treasury could have to pay off some portion of Fannie Mae and Freddie Mac's \$1.9 trillion in debt and guarantees outstanding.”
- **“Washington policy makers are predicting that recent economic good news will persist and that the federal surplus has increased to the point of wiping out the federal debt by 2013. Their predictions may prove wrong if these highly leveraged institutions make a mistake. Their size and market dominance will be used to justify a government bailout if the need should arise. Fannie Mae and Freddie Mac's mounting debt may make the Washington policymakers' predictions of ongoing budget surpluses look absurd as taxpayers realize that the nation's leaders forgot to look at the other part of the government's balance sheet.”** (*FM WATCH Bulletin*, 7/27/99)

Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors and consumers

Despite Fannie’s repeated pronouncements that lenders are their “only customers,” Fannie & Freddie continue to market and build their technology brand name directly to brokers, realtors, and consumers

***Reuters* article on the future of mortgage technology states that Fannie could act as a central clearing house and central repository for information on homes and links to ancillary service providers**

Fannie & Freddie are giving huge hiring and recruiting incentives for high-tech employees

Fannie’s Recent Developments:

- (1) Fannie makes its website a “one-stop-shopping” area for multifamily lenders – Fannie states that it wants to be the single point of entry for business-to-business e-commerce, starting with multifamily committing and delivery [putting Fannie in a position of being able to charge monopoly usage fees to businesses]
- (2) Lenders Interactive Online Network (LION) announce the creation of a new interface for Calyx Software to simplify the process for brokers submitting their loan applications via the Internet to wholesale lenders for automated underwriting using Fannie’s Desktop Originator system. LION provides Fannie approved lenders and their sponsored brokers Internet access to Fannie’s Desktop Originator system.
- (3) Mortgage Builder Software announces an interface to Fannie’s automated underwriting system
- (4) Finet, the owner of the first website that allows consumers direct access to Fannie’s automated underwriting system, announced that its common stock has been incorporated into the Russell 2000 and Russell 3000 Indexes, the benchmark small stock and total market capitalization index published by the Frank Russell Co.

(5) Fannie's Chief Information Officer joins Board of Directors of Viant Corporation, a leading builder of digital businesses

Freddie's Recent Developments:

- (1) Freddie will transmit credit reports online through its automated underwriting system
- (2) Freddie launches a new Online Learning Center for its business partners on its website

Background:

- According to *Web Finance*, **Fannie is “using the Internet to strengthen its already dominant position in the mortgage industry.”** The article cites Fannie's Openclose.com website through which mortgage brokers and lenders can use Fannie's automated underwriting system as one example. Another example is Fannie's recent announcement to let four mortgage lenders offer designated mortgage brokers access to its Desktop Originator software through the Lenders Interactive Online Network (LION), a mortgage industry website providing products and rate information to mortgage brokers. **The article notes that the announcements are significant because companies like Fannie and Freddie have traditionally played the role of mortgage buyers in the industry, while banks and consumer finance companies have dominated the area of origination, working with mortgage brokers to secure and complete mortgage loan applications. However, now that Fannie is trying to establish itself as a source of Internet-based underwriting technology for mortgage brokers, the company can exert more control over the origination process. The article references Morgan Stanley Dean Witter analyst Kenneth Posner's report, “The Internet Mortgage Report: New Models, New Opportunities,” that notes that “as the Internet grows as a sales channel for mortgages, Fannie has the potential to create a growing class of brokers who depend on the company for technology.” As a result, Fannie will have more bargaining power over banks and consumer finance companies because its software will be widely used, wrote Posner. Fannie will therefore have more power to dictate prices at which the company buys loans, he wrote.** (*Web Finance*, 4/26/99)

Reuters article on the future of mortgage technology states that Fannie could act as a central clearing house and central repository for information on homes and links to ancillary service providers

- A *Reuters* news article noted that Fannie “has been a heavy user of technology in its operations,” and Chief Technology Officer Mike Williams stated that it's a matter of “connecting all of the databases of information at one place.” “There's a big push right now for one-stop shopping for real estate online,” said Williams, “and the Internet can do a lot to give consumers more control of the process.” The article further noted that “Ultimately, that might mean that lenders like Fannie Mae, as a central clearing house, could play a role as the central repository for information on homes, and with links to the necessary service providers, like mortgage insurers or lawyers.” “We should think about turning the process around,” stated Williams. “Instead of going through 20 to 30 days of building up a huge file to provide to the underwriter who then magically tells you that you're approved or you need another piece of documentation, you kick off the process in which many can be pre-approved. Then you go back to the borrower and say what pieces are still needed.” (*Reuters*, 7/20/99)

Fannie & Freddie giving huge hiring and recruiting incentives for high-tech employees

- According to an *American Banker* article by Joshua Brockman, Fannie and Freddie are offering huge incentives for high-tech workers to join their companies. Reportedly, Freddie is offering employees a Volkswagen Beetle for successful job referrals. Those employees who refer a successful candidate get a cash award of \$2,000 for high-tech jobs and \$1,000 for others and are entered into the drawing for the car. Fannie is offering awards as high as \$5,000 for high-tech employee referrals and expects to hire approximately 2000 high-tech employees this year. Fannie notes that its information technology staff has tripled since 1990 and now has 1,200 people. Freddie has almost 900 information technology employees. (*American Banker*, Joshua Brockman, 7/16/99)

Fannie's Recent Developments:

- (1) Fannie makes its website a "one-stop-shopping" area for multifamily lenders - Fannie states that it wants to be the single point of entry for business-to-business commerce, starting with multifamily committing and delivery [putting Fannie in a position of being able to charge monopoly usage fees to businesses]
 - Fannie announced that it had enhanced its website, fanniema.com, to allow multi-family lenders to conduct their business via the Internet [Fannie's website] as the company moves its transaction applications to its website, "providing a single point of entry [Fannie] for business-to-business e-commerce, starting with multifamily committing and delivery." Based on annual business volumes, Fannie said it estimates that over \$10 billion in multifamily business transactions will flow through its website. Fannie said it will also provide multifamily product and service information and document distribution. "Our goal is to provide one place for lenders to log-on and have access to cutting edge business applications and information, according to Louis Hoyes, Fannie's Senior Vice President for Multifamily Lending and Investment. "We're hoping that through our investment in technology, we're making it easier for our lenders to do business with Fannie Mae while at the same time having a competitive advantage [technology monopoly with monopoly fees] for conducting business into the next millennium." (*Fannie press release*, 7/12/99; *PR Newswire*, 7/12/99)
- (2) Lenders Interactive Online Network (LION) announced the creation of a new interface for Calyx Software to simplify the process for brokers submitting their loan applications via the Internet to wholesale lenders for automated underwriting using Fannie's Desktop Originator system. LION provides Fannie approved lenders and their sponsored brokers Internet access to Fannie's Desktop Originator system. (*Inman News Feature*, 7/23/99)
- (3) Mortgage Builder Software announces an interface to Fannie's automated underwriting system
 - Mortgage Builder Software, Inc. announced the development of an interface of its loan origination system, Mortgage Builder to Fannie's Desktop Originator and Desktop Underwriter. (*Business Wire*, 7/28/99)
- (5) Finet, the first website that allows consumers to directly access Fannie's automated underwriting System, announced that its common stock has been incorporated into the Russell 2000 and Russell 3000 Indexes, the benchmark small stock and total market capitalization index published by the

Frank Russell Co. (*Inman News Feature*, 7/23/99)

(5) Fannie's Chief Information Officer joins Board of Directors of Viant Corporation, a leading builder of digital businesses

- Viant Corporation, a leading builder of digital businesses, announced the addition of Bill Kelvie to its Board of Directors. Kelvie is Executive Vice President and Chief Information Officer at Fannie Mae. (*PR Newswire*, 7/14/99)

Freddie's Recent Developments

(1) Freddie will transmit credit reports online through its automated underwriting system

- Freddie announced that its automated underwriting system, Loan Prospector, on the Internet is the first automated underwriting system to transmit credit decisions over the Internet. Freddie has gained the approval of Equifax, Experian, and Trans Union. (*National Mortgage News website*, posted 7/15/99; *Freddie press release*, 7/14/99)

(6) Freddie has launched a new Online Learning Center for its business partners that offers training courses and other tools on its website, www.freddiemac.com. (*National Mortgage News website*, posted 7/23/99)

Fannie Mae

Fannie changes its pooling method

- According to *National Mortgage News*, Fannie has introduced a new way of pooling its securities backed by mortgage loans with prepayment penalties. Reportedly, effective with its July 1999 mortgage-backed security issues, loans with a three-year and five-year penalty period will no longer be lumped into one pool. Rather, MBS will be pooled under four penalty-structure categories to notify investors of the penalty period and the original loan term. (*National Mortgage News website*, posted 7/15/99)

Fannie exchanges its Medium-Term Notes for its Benchmarks

- Fannie announced that it was offering to exchange 34 specific issues of its noncallable Medium-Term Notes for 6.375% 10-year Benchmark Notes due June 15, 2009. The eligible Medium-Term Notes have an aggregate principal balance of \$6.12 billion, with maturities ranging from April 2006 to December 2007. (*National Mortgage News website*, posted 7/14/99)

Fannie closes three multifamily deals with AMI Capital

- AMI Capital, Inc. recently closed three loans using Fannie as a funding source. Cherry Hill Apartments, a 27-unit apartment building located in Hayward, CA, was an acquisition financed through a Fannie MBS/DUS program for \$1,778,000 at 7.40%. The gated property has two picnic areas with playgrounds. Park Terrace Apartments, ten 3-story apartments in Mesa, AZ, was funded with a Fannie DUS second mortgage for \$2,753,500 at 8.113%. The 10-year loan has a 30-year

amortization. The loan to value, combining the first and second mortgages was 78% and the debt service coverage was 1.30. Towne Oaks South Apartments, a 470 unit complex with townhouses and apartments in Shreveport, LA was financed with a Fannie DUS third mortgage for \$1,500,000 at 8.558%. The 63-month term loan is co-terminus with the property's first and second mortgages. The loan-to-value, combining the first and second mortgages, was 75% with debt service coverage of 1.30. (*Business Wire*, 7/19/99)

Fannie directs a call of tax-exempt multifamily bonds after a developer fails to meet certain construction requirements

- According to the *Bond Buyer*, Cuyahoga County, OH is planning to call \$14.4 million of tax-exempt multifamily housing bonds on July 27 after the developer failed to meet certain construction requirements. Fannie provided credit enhancement on the issue, which funded the conversion of a warehouse into housing units. The deal required that by July 1, 1999, Fannie had to be satisfied with the status of the construction or it could exercise a special redemption feature to call the bonds at par. On July 2, Fannie directed the trustee for the original issue, Bank One, to call the bonds under the redemption clause. (*Bond Buyer*, 7/16/99)

Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its partnership offices in press events (currently 34 offices are officially open and operating and seven more are in the process of being organized)

Fannie said it plans to have 45 partnership offices opened by the end of the year

- Fannie currently has 34 partnership offices “officially” operating. Fannie has announced plans to open or commitments to open partnership offices in the following areas: Columbia, SC; South Dakota; Milwaukee, WI; Bismarck, ND; Pittsburgh, PA; Newark, NJ; and an office in Wyoming. In a speech before the Long Island Housing Partnership’s Annual Meeting, Fannie Chairman Franklin Raines stated that Fannie hopes to expand to 45 partnership offices around the country by the end of the year. (*Fannie Chairman Franklin Raines speech before the Long Island Housing Partnership Annual Meeting*, 6/18/99)

Congressional Black Caucus

- Fannie awarded a \$500,000 grant to the Congressional Black Caucus Foundation to support a five-year minority homeownership campaign. According to Fannie, the grant will be used for a news service on affordable housing and community development (including a website and monthly newsletter) for policymakers, housing developers, lenders, and community groups. Fannie also agreed to be the lead sponsor for 10 Congressional Black Caucus Foundation summits over the next five years on affordable housing for minorities. (*National Mortgage News website*, posted 7/23/99; *Fannie press release*, 7/23/99)

NAACP – Austin Mayor Kirk Watson

- Fannie issued a press release to announce a five-year partnership with the NAACP Community Development Resource Center to provide expanded low down payment mortgage financing and information for first-time homebuyers. A statement by Austin Mayor Kirk Watson was included in the press release. (*Fannie press release*, 7/23/99)

Fannie awards grants to community fellows

- Fannie has named six James Johnson Community Fellows. The new program awards the Fellows a \$70,000 grant, plus an additional \$20,000 travel stipend, in order to pursue a self-designed course of study for new affordable housing and community development solutions. The fellows are: Robert Boulter of Jubilee Enterprise, Washington, DC; Lorna Bourg of Southern Mutual Help Association, Inc., New Iberia, LA; James Buckley of University Neighborhood Housing Program, The Bronx, NY; Gordon Chin of Chinatown Community Development Center, San Francisco, CA; Rodney Fernandez of Cabriloe Economic Development Corporation, Saticoy, CA; and H. Lewis Kellom of Homes in Partnership, Inc., Apopka, FL. (*Memo to Members - National Low Income Housing Coalition, 7/16/99*)

Fannie awards grant to the Consortium for Citizens with Disabilities Housing Task Force

- Fannie awarded a \$25,000 corporate grant to the Consortium for Citizens with Disabilities Housing Task Force. (*Fannie press release, 7/14/99*)

Fannie awards grant to the Congress of National Black Churches - Congresswoman Sheila Jackson Lee (D-TX)

- Fannie awarded a \$35,000 grant to the Congress of National Black Churches for a Houston homebuyer counseling initiative. A statement by Congresswoman Sheila Jackson Lee (D-TX) was included in the press release. (*Fannie press release, 7/19/99*)

Cong. Robert Ehrlich (R-MD)

- Fannie held a press conference with Cong. Ehrlich at a home recently purchased and renovated by a family made possible through a Fannie HomeStyle mortgage. (*Fannie press release, 7/26/99*)

Congresswoman Marcy Kaptur (D-OH) and Toledo Mayor Carleton Finkbeiner

- Fannie held a press conference with the above officials to announce "House Northern Ohio," a five-year \$8.5 billion investment plan to finance affordable housing for Northern Ohio. (*Fannie press release, 7/26/99*)

Congresswoman Connie Morella (R-MD) and Gaithersburg Mayor Sidney Katz

- Fannie held a press conference with the above officials to announce the grand opening of the Park Station Apartment Community, a new 386 unit apartment complex. Fannie made a \$31.5 million investment in Park Station. (*Fannie press release, 7/19/99*)

Freddie Mac

Freddie had a \$1 billion writedown

Freddie spokesman said “It’s insignificant”

Fannie/Freddie watchdog group, FM WATCH, says the writedown is significant and is a “hint” of what can happen without adequate capital standards

- According to *National Mortgage News*, Freddie had a “blowout quarter in terms of earnings” but it also took a \$748 million [after-tax] writedown on its “available for sale account” mostly due to its investments in asset-backed securities. The article by Brian Collins and Paul Muolo noted that because Freddie was hedged, the loss did not result in any “hit” against the \$552 million Freddie earned in the quarter. “It’s insignificant,” said a Freddie spokesman. However, the article noted that the writedown on the investments is huge compared to recent quarters. In the previous quarter, Freddie took a \$178 million writedown and in the fourth quarter of 1998, Freddie booked an increase. The writedown caused Freddie’s shareholder equity to decline by \$333 million to \$11.323 billion. Freddie’s Vice President of Investor Relations, Bill Stephens, acknowledged the market decline of \$748 million in an analysts conference call but stated that “This does not represent a financial loss. But it affects the (shareholder) equity because only the asset side, and not the liability side of the position is marked to market.” Stephens stated that the “bulk of this value decrease” was caused by asset-backed securities, which are a “significant portion” of Freddie’s “available for sale” portfolio. A spokesman at stated that “We do not see this as a safety and soundness concern.” (*National Mortgage News*, Brian Collins and Paul Muolo, 7/19/99)

FM WATCH

- FM WATCH issued a bulletin stating that Freddie’s writedown is “not insignificant.” “A \$1 billion write-down in one quarter that reduces reported shareholder’s equity by 3% gives only a hint of the potential taxpayer risk the GSEs pose and reaffirms that critical important of adequate risk-based capital requirements. Because Freddie Mac is leveraged 30 to 1 (\$330 billion in liabilities supported by only \$10.6 billion of equity) the \$1 billion unrealized loss reduced their shareholder equity by 3% in just 3 months.”
- **The bulletin further noted that it was reported that the “unrealized loss was not related to Freddie Mac’s MBS’s but to other asset-backed investments – perhaps home equity securities – that are not part of the GSE’s core mission. It appears that Freddie Mac has moved outside of its core mission of providing liquidity in the secondary market in pursuit of higher returns for their investors. In such pursuit, they had to mark down shareholder equity by a full 3%”**
- **“The only thing standing between Freddie Mac and a taxpayer bailout is Freddie Mac’s shareholder equity. The net result of the \$1 billion write-down, factoring in both net income and dividend, was a \$331 million reduction in shareholder’s equity. This shows the potential loss that can accrue first to shareholders – and then taxpayers – if markets move against a GSE. If Freddie Mac (and Fannie Mae) had higher capital requirements, similar to other financial institutions, Freddie Mac’s percentage loss of shareholder equity would have been much lower. Shareholder equity is what stands between taxpayers and a bailout of the Government-Subsidized Enterprises.”**

- The bulletin also noted that the GSE's current minimum capital standards do not take into consideration unrealized losses. If they did, FM WATCH states that Freddie would be below their minimum regulatory capital. Falling below minimum capital could have OFHEO to take extraordinary steps. (*FM WATCH Bulletin*, 7/29/99)

Freddie says it hired former Speaker Newt Gingrich as a consultant, not a lobbyist

CNN's Robert Novak states that there really is no difference between a "consultant" and a "lobbyist"

Since Freddie is calling Gingrich a "consultant," the company is not required to disclose its payment to Gingrich as an expenditure on its lobbying expenditure reports

***American Banker* article notes that Gingrich is one of a growing number of political heavyweights hired recently by Fannie & Freddie and that both companies are exploring electronic grassroots lobbying**

Charles Lewis, Executive Director of the Center for Public Integrity, states that Fannie & Freddie's hiring of high level government and political officials blurs the line between public service and private enterprise. In his opinion, the recent hirings by Fannie & Freddie are an example of how "incestuous these quasi-governmental entities are with the people that ostensibly regulate them or have oversight over them."

A spokeswoman for the Fannie/Freddie watchdog group, FM WATCH, states that "many of those hired by Fannie Mae and Freddie Mac are specifically assigned to oppose any legitimate debate on Capitol Hill, in the administration, in the White House and the industry, about Fannie Mae's and Freddie Mac's role."

Consumer advocate Ralph Nader stated in June 30 testimony before the House Budget Committee that some of the GSEs' government subsidies – intended to lower the costs for home buyers – are being diverted to build political and lobbying efforts "designed to make it difficult, if not impossible, for the Congress to provide (or the public to demand) proper oversight or regulatory improvements which would protect the public, increase support for affordable housing or ensure open competition in the mortgage market."

- According to *Bloomberg News*, Freddie's spokeswoman, Sharon McHale, confirmed that the company had hired former Speaker Newt Gingrich as a consultant. "He's not going to be lobbying or serving as a representative to the company in any way," she stated. "He's going to serve an internal role, providing advice for Freddie Mac staff." According to *National Mortgage News*, Gingrich is not allowed to lobby his former colleagues until he has been out of office for at least a year. (*Bloomberg News*, 7/16/99; *National Mortgage News website*, posted 7/14/99) [Note: Since Freddie considers Newt Gingrich a "consultant," the company does not have to report his retainer as part of the company's lobbying expenditure report.]
- According to *Hotline*, CNN's Robert Novak stated the following about Former Speaker of the House Newt Gingrich's "new gig as a government consultant": "Freddie Mac, which is a government-backed outfit, has hired as a consultant Newt Gingrich. Now it means he doesn't have

to register as a lobbyist, but, you know, if it looks like a duck and walks like a duck, it is a duck. And I think Newt Gingrich is now going to be a high-paid lobbyist – I mean, consultant.” (*Hotline*, 7/2/99 – “IP,” *CNN*, 7/1/99)

- According to an *American Banker* article by Joshua Brockman, Gingrich is one of a growing number of political heavyweights recently hired by Fannie and Freddie. The article further notes that both companies are exploring electronic lobbying – using e-mail and the Internet to sway Congress with public opinion.
- Charles Lewis, Executive Director of the Center for Public Integrity, stated that Fannie and Freddie’s hiring of high level government and political officials blurs the line between public service and private enterprise. In his opinion, the recent hirings by Fannie and Freddie are an example of how “incestuous these quasi-governmental entities are with the people that ostensibly regulate them or have oversight over them.”
- A spokeswoman for the Fannie/Freddie watchdog group, FM WATCH, stated that “many of those hired by Fannie Mae and Freddie Mac are specifically assigned to oppose any legitimate debate on Capitol Hill, in the administration, in the White House and the industry, about Fannie Mae’s and Freddie Mac’s role.” (*American Banker*, Joshua Brockman, 7/16/99)

Freddie backs another Senior housing facility

- According to *National Mortgage News*, Freddie and Glaser Financial have provided \$65 million in credit enhancement financing for two seniors housing facilities in Illinois. The credit enhancement replaced original letters of credit on \$33 million of bonds issued by the Illinois Development Finance Authority for The Heritage in Des Plaines, and on \$32 million of bonds issued by the Housing and Redevelopment Authority of the Village of Lisle for The Devonshire in Lisle. Brookdale Living Communities own the properties. (*National Mortgage News website*, posted 7/14/99)

Freddie closes a \$160 million multifamily Gold PC swap

- According to *National Mortgage News*, Freddie closed a \$160 million Multifamily Gold PC swap with Column Financial. The security was reportedly backed by 17 multifamily properties owned by Southern Management. The Gold PCs were repackaged into a Freddie Mac real estate mortgage investment conduit security. (*National Mortgage News website*, posted 7/28/99)

Freddie closes a \$62.8 million securities deal with Berkshire Mortgage Finance for an apartment REIT

- Freddie announced that its Negotiated Transactions unit has closed a \$62.8 million multifamily Gold PC swap with Berkshire Mortgage Finance. The transaction involved the exchange of four fixed-rate mortgages originated by Berkshire for Equity Residential Properties Trust - a Chicago-based REIT. (*Freddie press release*, 7/12/99)

Federal Home Loan Banks

FHFB management and the FHFB's Inspector General are in disagreement over a policy statement recently approved by the FHFB

The Inspector General states that the policy statement adopted by the FHFB would allow FHFB managers to obstruct criminal investigations, could compromise the rights of FHFB employees, and was issued without the concurrence of the Inspector General's office

The Inspector General recommends that the policy statement be rescinded

- According to an article by John Connor with *Dow Jones Newswire*, the FHFB's Inspector General has accused the FHFB management of adopting a policy statement that could compromise the rights of FHFB employees and allow managers to obstruct criminal investigations. FHFB Inspector General Edward Kelley stated that his office had worked with the FHFB on the policy statement but that the FHFB management last December issued its policy statement without concurrence from his office. "After completing a legal review of the policy, OIG has identified a number of deficiencies which could result in employees' rights being compromised," stated Kelley. "For example, the policy makes no mention of the Whistleblowers Protection Act and it directs employees to advise management of all matters reported to OIG," Kelley stated in a recent semiannual report. In an interview, Kelley stated that the report's references to "management" essentially refer to FHFB Chairman Bruce Morrison. Kelley's report stated that "The policy permits managers to obstruct criminal investigations and contravene the IG Act by not requiring that managers immediately involve OIG in decisions on whether actions observed are criminal in nature." "For example, a recent case involving falsifying time and attendance records was not referred to OIG by management," stated Kelley. Kelley has recommended that the policy statement be rescinded. Morrison denied Kelley's allegations, and stated that he would not rescind the policy statement. (*Dow Jones Newswire*, John Connor, 7/16/99)

Justice Department urges a US Claims Court to dismiss a suit brought by a consulting firm accusing the FHFB of wrongful termination of its contract

- According to a *Dow Jones Newswire* article by John Connor, the Justice Department is urging the US Claims Court to dismiss a complaint against the US by a former consultant to the Federal Housing Finance Board. The suit, brought by the consulting firm of Furash & Co, is challenging the termination by the FHFB and is seeking to retain nearly \$400,000 in payments for its work from the FHFB. The FHFB reportedly terminated Furash for allegedly failing to fulfill the contractual terms of a study it was commissioned to do by the FHFB on the FHLBank System. Furash argues that the FHFB terminated its contract because "it was dissatisfied with the draft final report from a political and policy standpoint, not for any substantive reason related to Furash's performance." The Justice Department stated that the Claims Court "should conclude that it lacks jurisdiction to entertain this case and, consequently, that Furash's complaint should be dismissed." (*Dow Jones Newswire*, 7/22/99)

Status report of legislation containing FHLBank expansion provisions

Conference Committee will reconcile the House and Senate-passed versions of financial services modernization bills. Both versions contain FHLBank expansion provisions

House:

- The financial services modernization bill (H.R. 10) passed the full House on July 1 by a vote of 343-86. H.R. 10 contains the following FHLBank expansion provisions: (1) makes thrift membership voluntary; (2) makes access to FHLBanks easier for small banks with less than \$500 million in assets; (3) converts the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank; (4) reduces FHFB control of day-to-day FHLBank operations; and (5) establishes new capital structure based on two classes of stock.

Senate:

- The Senate passed its version of financial services modernization (S. 900) on May 6 by a mostly party-line vote of 55-44. The bill contains the following five FHLBank provisions: (1) makes thrift membership voluntary; (2) makes access to FHLBanks easier for small banks with less than \$500 million in assets; (3) converts the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank earnings; (4) reduces FHFB control of day-to-day operations; and (5) instructs the General Accounting Office (GAO) to conduct a study of the FHLBank System capital structure. A provision was also included just minutes before the legislation passed the Senate on May 6 that would allow community development groups to tap directly into the FHLBank System, virtually free of charge.
- A Conference Committee will reconcile the House and Senate-passed versions of the financial services modernization bills. The Senate appointed all 20 Members of the Senate Banking Committee as its conferees. The House appointed 28 conferees, split evenly between the House Banking and House Commerce Committees. The reconciled bill will carry the S. 900 Senate designation.

Private Sector Items to Note

GE Capital Mortgage Insurance introduces new insurance product that will assist lenders with their secondary market execution

No additional costs to consumers or lenders

Product does not require that lenders change their systems

- GE Capital Mortgage Insurance announced a new insurance product, Advanced Primary™ to improve lenders' secondary market executions while providing enhanced risk management benefits to investors. Advance Primary™ loans are originated by the lender and delivered to Fannie using existing processes and normal mortgage insurance coverage and pricing. Lenders do not need to alter their origination or underwriting processes. Further, no systems changes are necessary. With delivery of the loans to Fannie, the insurance coverage is restructured into combined primary and supplemental coverage. There is no additional cost to the lender or consumer.

- The restructured loss protection provided by GE Capital Mortgage Insurance allows Fannie to obtain capital relief and lenders to receive a superior secondary market execution. The product will be available on Fannie loans with loan-to-value ratios of up to 97%. According to *National Mortgage News*, the lender stands to benefit because if Fannie can reduce its risk it should be able to reduce its guarantee fees. (*PR Newswire*, 7/26/99; *National Mortgage News website*, posted 7/26/99)

Republic Mortgage Insurance (RMIC) offers a new insurance product as an alternative to GSE pool insurance

No additional costs to consumers or lenders

Product does not require that lenders change their systems

- Republic Mortgage Insurance (RMIC) announced that it is offering lenders a new insurance product called Primary Plus[®], designed to be an alternative to GSE pool insurance and is available in conjunction with loans sold to Freddie. Primary Plus[®] converts normal Freddie required mortgage insurance coverages into two levels of insurance coverage for the investor. The program does not incur any additional premiums on lenders or borrowers and does not require modifications of a lender's system.
- When Freddie purchases an eligible RMIC-insured loan from a participating lender, the mortgage insurance will automatically convert to Primary Plus[®] coverage and the lenders will receive a more favorable Freddie Mac execution for loans with the coverage. (*PR Newswire*, 7/15/99)

Farmer Mac

Farmer Mac reports higher earnings but anticipates higher delinquencies in the third quarter

- Farmer Mac announced net income of \$1.7 million for the second quarter, up 74% from \$970,000 reported in 1998 on a fully taxable equivalent basis. Diluted earnings per share were \$0.15 for class A and B common stock and \$0.45 for class C common stock., compared with \$0.09 and \$0.26, respectively, a year ago. Farmer Mac President and CEO Henry Edelman stated that adverse economic conditions from low commodity prices and weak export markets were likely to continue throughout the year. "While we anticipate higher delinquencies in the third quarter due in part to these conditions, we believe that Farmer Mac's exposure to potential credit losses is limited by the sound credit underwriting standards applied to loans in our programs and the adequacy of the corporation's loss reserves," Edelman stated. (*National Mortgage News website*, posted 7/22/99)

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Canfield & Associates, Inc.
 801 Pennsylvania Ave., NW, Suite 625
 Washington, DC 20004
 Phone: (202) 661-2100
 Fax: (202) 661-2101
www.canfieldassoc.com