

The **GSE** REPORT™

Contents of GSE Report™

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 - MBA's policy statement is similar to recent policy statements made by America's Community Bankers and the Fannie/Freddie watchdog group, FM WATCH – One source for an article noted that these recent policy statements show that “95% of Fannie & Freddie's customers are telling them that something is not right”
 - MBA believes GSEs should be limited to their narrowly defined chartered responsibilities of maintaining liquidity and stability in the secondary mortgage market and meeting affordable housing goals – Fannie & Freddie should not use their special GSE advantages to “expand into markets currently well-served by others”
 - MBA supports a clear separation between role of mortgage lenders and GSEs – MBA opposes any entry by Fannie & Freddie into direct lending to borrowers
 - MBA supports increased regulation and oversight of the GSEs, including particular attention to GSEs' activities that are displacing the private market and determining whether the GSEs' activities are consistent with the GSEs' narrowly defined mission
 - MBA believes guarantee fees should be appropriate to risk and set only at reasonable returns to shareholders
 - MBA takes an especially tough stance on technology – GSEs' technology systems should be open and transparent and should not bypass lenders or displace competing private technology systems – GSEs should not tie their technology to products or as a pre-condition for waivers of reps. and warranties and less documentation requirements – MBA supports a competitive open technology marketplace
 - MBA believes that capital for both GSEs and private institutions should be set at appropriate levels for safety and soundness, stability in the overall market, and taxpayer protection
 - MBA supports HUD's proposal to increase Fannie & Freddie's affordable housing goals – However, Fannie & Freddie should not transfer the cost and risk of meeting their affordable housing goals onto the primary mortgage market
 - Fannie & Freddie reportedly disagree with 90% of the policy statement
- American Bankers Association (ABA) Task Force issues a report with recommendations to help agricultural and small business operations (*p. 10*)
 - ABA Task Force believes that the GSEs should assist private sector institutions in closing capital market gaps, not compete with the private sector institutions in retail markets
 - ABA Task Force believes the GSEs, in general, can do more to assist rural capital markets
 - ABA recommends that Fannie & Freddie expand efforts to serve rural housing
 - ABA supports expanding banks' ability to access the FHLBank System for agricultural and small business loans
 - ABA supports revising the Farm Credit System to allow it to provide funds to commercial banks that make agricultural-related loans and direct more of the Farm Credit System resources to young, newer, low-income farmers rather than to larger, more established farms
 - ABA criticizes the Farm Credit System's controversial proposed rule that would allow Farm Credit System institutions to compete. “The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for segments of a government sponsored enterprise to compete with itself and other private sector institutions.” The report further stated that the Farm Credit System “is using its unique tax advantages and GSE agency market advantages to ‘cherry pick’ from private sector lenders”
 - ABA believes Farmer Mac should continue its important function in agricultural credit delivery

- *Washington Post* runs extensive news article by Kathleen Day reporting on the recent criticisms being expressed by the private industry and government about Fannie & Freddie – “*Fear of What Fannie May Do*” (p. 12)
 - Karen Shaw Petrou, a financial services consultant, states “Fannie Mae has found itself fighting a multi-front war, and even with the biggest lobbying guns and the best marksmen, it’s increasingly hard to assume it will win every battle.”
 - Cong. Richard Baker (R-LA), the Chairman of the House Banking subcommittee that oversees government-sponsored enterprises notes “The mood has changed...Members of Congress are now hearing publicly for the first time from other participants in the housing market about concerns over encroachment into free markets by government-sponsored enterprises such as Fannie Mae.”
 - Seven Eisman, an analyst for CIBC Oppenheimer & Co. notes, “for the first time in many years, political issues will dominate both Freddie Mac and Fannie Mae.” Eisman wrote this warning in his April report in which he downgraded the stock of both GSEs from a “buy” to a “hold,” and noted “these issues could plague the stock prices of both companies for all of 1999.”
 - According to Day, Fannie’s stock has dropped 13.8% and Freddie’s has fallen 17.4% since the beginning of the year. The S&P 500-stock index has risen 5.8% over the same period.
 - William Apgar, Assistant Secretary of HUD for Housing says, “there are two clear and indisputable facts...One, the number of Americans in need of affordable housing stands at an all-time high of 5.3 million families. Two, Fannie and Freddie are making record profits.”
 - Apgar adds, “We’re not over regulating or micromanaging. We’re just doing what the law requires...The GSEs are concerned with their shareholders. We’re concerned with their obligations to the public.”
- Fannie/Freddie watchdog group, FM WATCH, claims a small victory (p. 15)
 - A 22% budget increase for Fannie & Freddie’s safety and soundness regulator, OFHEO, is included in the VA-HUD Appropriations bill
 - OFHEO requested the budget increase because it needs greater resources due to Fannie & Freddie’s rapid growth and increasingly sophisticated activities, such as off-balance sheet financial derivatives, global debt issuances, and participation in the subprime mortgage markets
 - 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, Cong. 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.”
- FHLBank expansion that would have allowed the FHLBanks to guarantee up to \$500 million a year in tax-exempt school bonds was deleted from the Final Conference Report on the tax bill (p. 17)
 - Association of Financial Guaranty Insurers (AFGI) – the private bond insurers – opposed the provision because they did not see a market need for GSEs’ entrance into this highly competitive area that is well served by the private market
 - AFGI called the provision inefficient, ineffective, and counterproductive
 - A Congressional Research Service (CRS) economic analysis by Barbara Miles and Dennis Zimmerman concludes that unless it is more carefully targeted, the Senate Finance 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.”
 - 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.”
 - 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

All GSEs

- *National Mortgage News* runs editorial by Mark Fogarty on FHFB's proposal to limit the FHLBanks' arbitrage investments and HUD's proposal to increase Fannie & Freddie's affordable housing goals (p. 19)
 - The editorial supports both refocusing the FHLBanks' mission to home lending and increasing Fannie & Freddie's affordable housing goals, but believes the divestiture of the FHLBanks' mortgage-backed securities does not need to be as high as the FHFB proposal
 - The editorial notes that Fannie & Freddie should be "free to offer any product they think they can turn a profit with, just like any other firm – but only (and it's a big but) if they are willing to give up the implied government agency status they have that makes it cheaper for them to issue debt."

Fannie Mae and Freddie Mac

- *Euromoney Magazine* article by James Smalhout warns foreign investors that purchasing Fannie & Freddie's debt is not as safe as purchasing Treasuries (p. 20)
 - Washington, DC Attorney Tom Stanton states, "risk migrates to the place where the government is least equipped to deal with it...The failure of the S&L Industry and the imposition of the Basle capital standard on the remaining thrifts chased hundreds of billions of dollars of mortgages from the primary market to the secondary market...That's where we didn't have effective regulation or comparable capital standards under the Basle Accord."
 - Smalhout notes that the most important difference between GSE debt and Treasury debt is that the GSE debt is not government guarantee, but an implied government guarantee
 - Smalhout lists two situations where the implied government guarantee may not bail out investors. The first he says, was "straightforward." "Increased foreign holdings of agency debt will dilute US government resolve. In some future crisis, Congress might not be as willing to ride to the rescue if most of the investors at risk are overseas and not eligible to vote in US elections." The second situation is political. Smalhout notes, "the implicit guarantee enjoyed by the agencies is a political football and it is being kicked around."
 - A prime example of the GSEs expansion, in Smalhout's opinion, is in new technology, particularly in automated underwriting – of which, the GSEs control 90% of the market. "But Fannie and Freddie were hardly the first to enter this arena. Citibank and Norwest came up with systems much earlier. And most observers think that Fannie and Freddie rose to become the dominant players thanks to their implicit subsidy from the government and the resulting lower cost of funds."
 - Smalhout notes that the non-GSE subprime market is well established and competitive. So the case that they [GSEs] should move into this market to correct a market failure is weak. But anybody hoping to block Fannie and Freddie faces an uphill battle. Congress gave them the power to decide whether mortgages pass muster."
 - "[GSE] expansion into new markets may impose significant costs on society," observes Robert Seiler, an analyst at the Congressional Budget Office, "by making significant safety and soundness regulation more complex and potentially less effective, by increasing federal tax subsidies, by limiting competition, and by allowing the GSEs to set prices and earn profits above competitive levels."
 - Smalhout writes, "what's good for the GSEs seems less and less to be what's good for America...Buyer beware."
- Fannie & Freddie stock continues to drop (p. 24)
 - From the beginning of the year through August 13, Freddie's shares fell 18.5% and Fannie's 13.4%
 - Salomon Smith Barney Analyst Thomas O'Donnell expects Fannie & Freddie to increase their use of risk-based pricing and continue to expand into home equity, less-than-prime, immigrant, and minority markets
 - Freddie says its main areas of growth would be the A-minus and alternative-A
 - Raymond James Financial downgrades Freddie to "Accumulate" from "Buy"
 - Warren Buffet continues to sell off his Fannie & Freddie shares
- Senate confirmation of OFHEO's Director is postponed until after Congressional recess period (p. 26)
 - The safety and soundness regulator for Fannie & Freddie, OFHEO, has been without a permanent director since February 1997
- President Clinton intends to nominate Susan Wachter as Assistant Secretary for Policy Development and Research at HUD (p. 27)
 - Dr. Wachter has received research funds from Fannie in the past and has served on the Advisory Board of Fannie's Office of Housing Policy Research

- Fannie & Freddie’s loan purchase guidelines can prevent many renters from getting condo loan approvals (*p. 28*)
 - Article notes that “buyers purchasing in a condominium complex with a large population of tenants have little recourse other than shopping around for a lender that’s willing to bend the rules or keep the loan in its portfolio, rather than selling it through the secondary market to Freddie Mac or Fannie Mae.”
- Little Rock Mayor Jim Dailey asks Deloitte & Touche to audit/investigate the city’s financial procedures, in part, because the city has allegedly invested illegally in Fannie Mae bonds (*p. 29*)
 - Prior to a state law that was just recently passed, the city was prohibited by state law and Little Rock’s investment guidelines from investing in securities that are not backed by the full faith and credit of the federal government [Fannie’s bonds only carry an implied government guarantee]
 - Pulaski County Prosecuting Attorney issues seven subpoenas as part of the investigation
 - Arkansas Securities Department is questioning officials at local banks that sold Little Rock the Fannie bonds and investigating whether PaineWebber, which controls two Little Rock accounts, should have understood Arkansas law
- Community bank opens a new department to handle all aspects of its mortgage operations, from origination to closing (*p. 30*)
 - Valley of the Rogue Bank believes that consumers will benefit because consumers can deal personally with local loan officers and all decisions will be made by local employees rather than by secondary market lenders such as Fannie & Freddie
- Article asks “*Will Fannie or Freddie be Your Next Lender?*” (*p. 30*)
- Fannie/Freddie watchdog group – FM WATCH – modifies its website per request from Fannie Mae lawyer (*p. 31*)
 - FM WATCH also adds a whistleblower page to its website
- The Mortgage Insurance Companies of America (MICA) welcome Congressman James Hansen’s (R-UT) proposal for a GAO study on mortgage insurance and whether alternative, more efficient means of default loss protection exist (*p. 32*)
 - MICA says the proposed study will give insurers an opportunity to make the case that Fannie & Freddie’s insurance plans “circumvent the [private mortgage insurance] cancellation law”
- President and CEO of Ultraprise.com – a private-sector Web-based Internet secondary mortgage market exchange – advises the mortgage industry to use business-to-business Internet commerce to redirect the flow of its business to alternative engines, other than Fannie’s and Freddie’s propriety systems (*p. 32*)
- Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors, and consumers (*p. 33*)
 - 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
- Fannie’s recent developments
 - (1) Fannie supplies computers and software [presumably Fannie’s] to community non-profit groups
 - (2) Fannie announces that FiNet.com and Monument Mortgage were selected for Fannie’s Technology Leadership Award – Companies were selected based on their usage of Fannie’s technology

FiNet.com, owns iQualify, a Fannie/Freddie technology partnership that allows consumers direct access to Fannie’s automated underwriting system – FiNet.com also owns Monument Mortgage
- Freddie’s recent developments

Freddie establishes a new board to assist servicers in using Freddie’s technology including onsite visits from Freddie

[Due to the GSEs’ duopoly power in the secondary market, this new servicer arrangement makes it even more difficult for private sector technology to compete against the GSEs’ technology]
- Federal Trade Commission holds public forum on credit scoring (*p. 34*)
 - Fannie & Freddie use credit scoring in their automated underwriting systems (GSEs control 95% of the underwriting market share)
 - There were some criticisms of the GSEs’ automated underwriting systems
 - A study commissioned by HUD found that Fannie & Freddie’s automated underwriting systems of credit scoring may be discriminatory

Fannie Mae

- HomeStore.com has an initial public offering (IPO) on August 5 (*p. 37*)
 - Fannie has a 3.5% Equity Interest in HomeStore.com – owning 2.08 million shares in the company
 - HomeStore’s stock price opened at \$20 and has risen as high as \$44 15/16 in recent days, giving Fannie astronomical profits
 - Despite its public mission, Fannie refuses to discuss what it intends to do with the proceeds – Fannie Spokesman John Buckley stated that “The last thing we’d do in the world is discuss our intentions”
 - *Inman News Feature* notes that federal law requires anything that affects a public firm’s worth must be disclosed. [Fannie is exempt, however, from SEC registrations that normally protect investors.]
 - HomeStore.com owns Realtor.com (the largest home-listing site on the Internet and official site of the National Association of Realtors), HomeBuilder.com, SpringStreet.com (rental properties) and Commercial Source.com (commercial real estate)
 - HomeStore.com says it has plans to enter into home financing, repair, remodeling, and landscaping
 - Controversy surrounds HomeStore.com
 - The Federal Trade Commission has turned over an investigation of HomeStore.com to the US Department of Justice’s Antitrust Division over HomeStore.com’s practice of signing exclusive property listing arrangements with multiple listing services (Realtor.com lists 81% of the US’ MLS-listed properties)
 - [It is questionable how an investment in an Internet IPO meets Fannie’s public mission of providing liquidity to the secondary mortgage market.]
- Fannie starts a pilot program to automate B & C loans (*p. 40*)
- Mission creep – Fannie expands into construction loans (*p. 40*)
- Fannie announces it will purchase 4.99% of the voting shares of a savings bank in Buffalo, NY to assist the savings bank in opening for business (*p. 40*)
 - Fannie also purchases a \$300,000 certificate of deposit in another savings bank in Tennessee
 - [Investing in depository institutions appears to be outside Fannie & Freddie’s mission.]
- American Mortgage Acceptance announces \$250 million apartment loan venture with Fannie (*p. 41*)
- Fannie, like 68 other Fortune 500 companies, offers economic benefits to same-sex domestic partners (*p. 41*)
- 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 eight more are in the process of being organized) (*p. 41*)
 - Fannie said it plans to have 45 partnership offices opened by the end of the year
- Fannie selects 80 housing partners to participate in a Washington, DC Fannie Mae Partner Summit (*p. 43*)
 - Participants also met with Members of Congress to discuss the impact of housing legislation being considered in Congress
- Ex-Fannie VP is named Pedestal CEO (*p. 45*)

Freddie Mac

- Freddie had a \$1 billion writedown (*p. 46*)
 - Fannie/Freddie watchdog group, FM WATCH, says the writedown could prove harmful to taxpayers and shows the need to restrain Freddie
- Choctaw Nation, Washington Mutual, Freddie Mac, First Americans Mortgage and PMI Mortgage Insurance Co. announce a seven-state expansion of lending program (*p. 46*)
- Freddie announces \$1 million contribution to National Urban League (*p. 47*)
- Freddie names David Stevens as Senior Vice President of Sales in Single-Family Securitization Group (*p. 47*)
- Freddie names Patricia Dodson as Senior Vice President, Investor & Dealer Services (*p. 47*)
 - Freddie’s prior head of Investor & Dealer Services, Kevin Finnerty, left Freddie after only five months at the firm – Finnerty was reportedly hired at Freddie after a bidding war among a number of Wall Street firms

Federal Home Loan Banks

- PaineWebber says the FHFB's proposed rule requiring FHLBanks to phase out their non-mortgage investments and divest their mortgage-backed securities (MBS) is being misinterpreted and could slow MBS buying but wouldn't likely affect the level of MBS the FHLBanks currently hold (*p. 48*)
 - Disagreement among analysts whether this rule would have a significant impact on the mortgage-backed securities market
 - The FHFB issued the proposed rule in response to criticisms about the FHLBanks' arbitrage investment practices
 - 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
 - New York FHLBank President says FHFB proposal would transform the FHLBanks' role from a customer of Fannie & Freddie to a competitor of Fannie & Freddie
- FHFB is considering applications from three FHLBanks for a new pilot – the Mortgage Partnership Purchase (MPP) program – to purchase mortgages from members (*p. 51*)
 - The MPP proposal differs from the current FHLBanks System's Mortgage Partnership Finance (MPF) program, but is still designed as an alternative to selling loans into the secondary to Fannie & Freddie
- FHFB issues interim rule for public comment on the availability of unpublished FHFB information (*p. 52*)
- FHFB announces a proposed rule that would approve the sale of whole advances between FHLBanks without approval of the FHFB under limited circumstances (*p. 52*)
- Pittsburgh FHLBank names a new Chairman (*p. 52*)
- Status report of legislation containing FHLBank expansion provisions (*p. 52*)
 - Conference Committee will reconcile the House and Senate-passed versions of financial services modernization bills. Both versions contain FHLBank expansion provisions.

Private Sector Items to Note

- Bank of America announces it will lend \$30 billion to low- to moderate-income homebuyers under new program that will require no down-payment, application fees or closing costs (*p. 53*)
- Wells Fargo, ahead of its goal to lend nearly \$1 billion to Latino businesses (*p. 53*)
- Norwest, Bank One, Countrywide, and several mortgage insurance companies are in opening stages of a broad mortgage lending initiative, aimed at creating 1,000 homeowners on Indian reservations (*p. 54*)

Farm Credit Administration

- Farm Credit Administration announces a direct final rule with opportunity to comment that would allow Farm Credit Banks to transfer certain capital to affiliated associations without having to obtain prior approval from the Farm Credit Administration (*p. 54*)
 - Farm Credit System Insurance Corporation Board announces plan to lower insurance rates
- Farm Credit Administration announces effective date for its new policies on leasing activities (*p. 55*)

Major Events

The Mortgage Bankers Association (MBA) stays tough on the GSE issue and MBA Board of Directors unanimously approves a strong GSE policy statement

Board Members include both small and large lenders

MBA policy statement takes a hard line on Fannie & Freddie's use of technology and charter creep

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MBA supports a clear separation between role of mortgage lenders and GSEs – MBA opposes any entry by Fannie & Freddie into direct lending to borrowers

MBA supports increased regulation and oversight of the GSEs, including particular attention to GSEs' activities that are displacing the private market and determining whether the GSEs' activities are consistent with the GSEs' narrowly defined mission

MBA believes guarantee fees should be appropriate to risk and set only at reasonable returns to shareholders

MBA takes an especially tough stance on technology – GSEs' technology systems should be open and transparent and should not bypass lenders or displace competing private technology systems – GSEs should not tie their technology to products or as a pre-condition for waivers of reps. and warranties and less documentation requirements – MBA supports a competitive open technology marketplace

MBA believes that capital for both GSEs and private institutions should be set at appropriate levels for safety and soundness, stability in the overall market, and taxpayer protection

MBA supports HUD's proposal to increase Fannie & Freddie's affordable housing goals – However, Fannie & Freddie should not transfer the cost and risk of meeting their affordable housing goals onto the primary mortgage market

Fannie & Freddie reportedly disagree with 90% of the policy statement

- The Mortgage Bankers Association (MBA) finalized its policy statement on Fannie and Freddie on August 10, following a two-day Board of Directors meeting. The Board of Directors, which includes both large and small mortgage bankers, unanimously approved the statement. The policy

position still takes a tough stance against the GSEs and according to Thomas Jacob, Chairman and Chief Executive Officer of Chase Manhattan Mortgage Corp, the MBA policy statement is “substantially similar” to those made by America’s Community Bankers and FM WATCH. According to Jacob, “This is the first time that the little guys and medium-sized guys united in their opposition.” Jacob told *National Mortgage News* that the industry “wants more competition in the secondary market. The problem is that private capital will not come into the market because they cannot compete against the borrowing advantage the two [Fannie & Freddie] enjoy.” Angelo Mozilo, Chairman and Chief Executive of Countrywide Home Loans said the policy statement was badly needed because, “There has been an ongoing attempt by the GSEs to disaggregate the business – and that’s what is at the core of the issues here.”

- **According to a *National Mortgage News* article, one source noted that the MBA policy statement and a similar ACB policy statement shows that “95% of Fannie and Freddie’s customers are telling them that something is not right here.”**

GSES should be limited to the narrowly defined chartered responsibilities of maintaining liquidity and stability in the secondary mortgage market and meeting affordable housing goals – Fannie and Freddie should not use their special GSE advantages to “expand into markets currently well-served by others”

- The policy statement continues to affirm the role Fannie and Freddie play in maintaining and improving liquidity and stability in the secondary mortgage market, however, the MBA believes that the GSEs should not use their special advantages to compete in the primary market or to expand into markets currently well-served by others. Rather, the GSEs should be focused exclusively on maintaining liquidity and stability in the secondary mortgage markets, as provided for in their charters, and on achieving their affordable housing goals.

Clear separation should be made between role of mortgage lenders and GSEs – MBA opposes any entry by Fannie and Freddie into direct lending to borrowers

- The MBA maintains that there should be a clear separation between the role of mortgage lenders and GSEs. MBA supports prohibition against participation by the GSEs in any primary mortgage market activities, including the current statutory prohibitions against the GSEs’ providing or engaging in direct lending to borrowers. Mortgage lenders, should, according to the statement, “continue to originate and service mortgage loans, maintaining the market contact with their customers and vendors, including, but not limited to consumers, owners/developers of housing, brokers and other real estate professionals.” MBA believes the GSEs should introduce new products and services only when they directly relate to their core functions of providing liquidity and stability in the secondary mortgage market, including activities related to mortgages on housing for low and moderate income families.

MBA supports increased regulation and oversight of the GSEs, including particular attention to GSEs’ activities that are displacing the private market and determining whether the GSEs’ activities are consistent with the GSEs’ narrowly defined mission

- The MBA supports regulation and oversight that pays particular attention to the issues of: (1) whether the activities of the GSEs have the effect of displacing or discouraging activities of private market entities that do not enjoy the special GSE advantages; and (2) whether their activities are consistent with the specific mandate of providing stability and liquidity in the secondary mortgage market

Guarantee fees should be appropriate to risk and set only at reasonable returns to shareholders

- MBA believes the GSEs' guarantee fees and other charges should be set at levels that are appropriate to protect the GSEs against the risks posed by the types of mortgages purchased, as well as guarantees and services provided, and to provide reasonable returns to shareholders in the context of their public mission

Tough stance on technology – GSEs' technology systems should be open and transparent and should not bypass lenders or displace competing private technology systems – GSEs should not tie their technology to products or as a pre-condition for waivers of reps and warranties and less documentation requirements – MBA supports a competitive open technology marketplace

- The MBA policy statement took an especially tough stance on the role of technology. The MBA continues to support an open, competitive marketplace for technology in order to achieve greater efficiencies and competition that benefits the entire marketplace. MBA's position was: (1) any underwriting technology used by the GSEs should be transparent so the lending criteria of the GSEs are understood by their seller/servicers and (2) performance data collected by the GSEs should be made available to their seller/servicers. The GSEs should not develop, distribute, or use technology in a way that: (1) bypasses their seller/servicers by going direct to the customers or vendors of those partners, including, but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals; (2) displaces or discourages innovation and development of competing systems by private enterprises; and (3) limits access to their programs or is a pre-condition for waivers of representations and warranties or waivers of program and documentation requirements.

Capital for both GSEs and private institutions should be set at appropriate levels for safety and soundness, stability in the overall market, and taxpayer protection

- The MBA supports expanded liquidity for the residential mortgage markets by achieving the lowest possible risk-based capital standards for the GSEs and other federally regulated financial institutions consistent with safety and soundness for participating institutions, stability for the overall market, and minimum exposure to the American taxpayers.

MBA supports HUD's proposal to increase Fannie & Freddie's affordable housing goals – However, Fannie & Freddie should not transfer the cost and risk of meeting their affordable housing goals onto the primary mortgage market

- The MBA believes that the Affordable Housing Goals for Fannie and Freddie should be set at the numeric levels proposed by HUD and these goals should be accomplished without cost or risk transfer to the primary mortgage market consistent with the GSEs' statutory goal of "leading the market."

Fannie & Freddie reportedly disagree with 90% of the policy statement

- According to *National Mortgage News*, mortgage officials reportedly showed the MBA policy statement to Fannie and Freddie and according to one top mortgage banker, the two GSEs "rejected about 90% of what was in there."
- Sharon McHale, a Spokeswoman for Freddie, said the technology section is "the most backward looking" part of the statement and that the MBA's policy statement takes a "narrow interpretation of our charter." She added that the policy statement demonstrates an effort to "basically block the tides of change that we think are benefiting consumers." Freddie believes that its mission,

particularly on the technology side, goes beyond merely providing liquidity. “They reject the idea that we should even be working to lower the cost of homeownership,” she stated, adding that the MBA is choosing “protectionism to the detriment of consumers.”

- David Jeffers, a Spokesman for Fannie stated that “We are pleased the MBA policy statement reaffirms the vital role Fannie Mae plays in the mortgage finance system. To the extent that it identifies issues of disagreement, we will continue to be available to resolve any current or future disagreements with our lender partners.” (*National Mortgage News*, Brian Collins & Paul Muolo, 8/16/99; *National Mortgage News website*, posted 8/11/99; *American Banker*, Joshua Brockman, 8/13/99; *BNA Daily Report for Executives*, 8/16/99; *MBA press release*, 8/10/99; *MBA GSE Policy Statement*, 8/10/99;; *Reuters*, 8/10/99)

American Bankers Association (ABA) Task Force issues a report with recommendations to help agricultural and small business operations

ABA Task Force believes that the GSEs should assist private sector institutions in closing capital market gaps, not for the GSEs to compete with the private sector institutions in retail markets

ABA Task Force believes the GSEs, in general, can do more to assist rural capital markets

ABA recommends that Fannie & Freddie expand efforts to serve rural housing

ABA supports expanding banks’ ability to access the FHLBank System for agricultural and small business loans

ABA supports revising the Farm Credit System to allow it to provide funds to commercial banks that make agricultural-related loans and direct more of the Farm Credit System resources to young, newer, low-income farmers rather than to larger, more established farms

ABA criticizes the Farm Credit System’s controversial proposed rule that would allow Farm Credit System institutions to compete. “The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for segments of a government sponsored enterprise to compete with itself and other private sector institutions.” The report further stated that the Farm Credit System “is using its unique tax advantages and GSE agency market advantages to ‘cherry pick’ loans from private sector lenders”

ABA believes Farmer Mac should continue its important function in agricultural credit delivery

- An ABA Task Force released a report, “*Positioning Agriculture and Rural America for the 21st Century*,” recommending initiatives to help farmers and rural businesses. The report, prepared by the 10-member ABA Task Force on 21st Century Agricultural Banking contains a series of recommendations. The task force includes bankers from several farm states.
- The ABA Task Force believes that the GSEs should assist private sector institutions, not compete with them. The report stated that “the public mandate and the appropriate role for the GSEs are to work with and assist private sector institutions in closing the identified gaps in capital markets - not to compete with private sector institutions in retail markets. Unfair competition, inefficient

resource use, and duplication of effort often result when GSEs compete directly with private sector institutions.”

- The Task force believes that the GSEs, as a whole, need to put more emphasis on rural capital markets, as the “benefits of GSEs have been disproportionately experienced in urban areas.”

Fannie & Freddie

- The Task Force recommends that Fannie and Freddie expand efforts to serve rural housing markets. The report notes that Fannie and Freddie have traditionally been less involved in rural housing markets. “Today, only a small part of the both GSE portfolios is based in rural America. Significant effort must be made to get Fannie Mae and Freddie Mac more involved in meeting the credit needs of rural home buyers.”

FHLBanks

- The ABA Task Force supports expanding banks’ ability to access the FHLBank System for agricultural and small business loans. The ABA Task Force believes that the FHLBanks need to make their underwriting standards more appropriate for community development by increasing their expertise in agriculture, rural business and infrastructure financing for rural communities. The report stated that expanding FHLBank authority and linkage with banking networks in rural communities would “help fill gaps in rural financial markets. The FHLB system has historically focused on underwriting home loans in urban markets. Expanding FHLB authority and linkage with banking networks would improve access to credit for business, housing and infrastructure for rural areas.” The Task Force suggests immediate action to expand access to the FHLBanks, which the report states would “permit banks in rural areas to match the maturity of the funding with that of a rural development project, reducing interest rate risk to the borrower and the lending institution.” The Task Force also recommends that the FHLBank expand its underwriting guidelines to maximize the value of rural collateral. The Task Force recommends educational efforts to develop rural capital market expertise in the FHLBank System. “Banks from rural communities that are addressing a gap in the local capital markets should be able to utilize collateral beyond the FHLB’s previous standards designed more for urban markets.” Finally, the report recommends that expanding FHLBank authority should not be limited to small business loans, as “[b]anks that serve rural community capital markets typically serve all market segments in the community.”

Farm Credit System

- ABA supports revising the Farm Credit System to allow it to provide funds to commercial banks that make agricultural-related loans and direct more of the Farm Credit System resources to young, beginning and low-income farmers rather than to larger, more established farms. The report concluded that the Farm Credit System has been afforded substantial subsidies from its GSE status. The report estimated that the Farm Credit Systems’ GSE advantages equals \$600 million to \$800 million per year, amounting to a pricing advantage of 150 basis points (or 1.5% APR) on the average Farm Credit System loan for agricultural purposes. The report notes that “government subsidies are going to larger, established farm families in strong financial position. Low income, small, beginning, and young farmers are less likely to receive FCS financing and therefore do not receive the benefit of the federal [GSE] subsidy.”
- The report also criticized the Farm Credit System’s controversial proposed rule that would allow Farm Credit System institutions to make loans outside their designated territories. “The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for

segments of a government sponsored enterprise to compete with itself and other private sector institutions.” The report further stated that the Farm Credit System “is using its unique tax advantages and GSE agency market advantages to ‘cherry pick’ loans from private sector lenders. The FCS was created by Congress to fulfill capital market gaps for farmers and cooperatives in areas where credit was not available. The Task Force concludes there are two long-term options for the FCS. The first option is for Congress and FCS to refocus their mission to work with rural private sector lenders. The second option is to allow FCS institutions to become privately owned and capitalized institutions and to surrender their GSE status. For those FCS institutions that wish to remain part of the FCS, Congress should review the mission of the FCS in order to make sure that a public policy objective is being met.”

Farmer Mac

- The Task Force believes that “Farmer Mac should continue its important function in the delivery of agricultural credit.”

(ABA press release, 8/5/99; Des Moines Register, 8/6/99; Wichita Eagle - Knight-Ridder Tribune Business News, 8/5/99; “Positioning Agriculture and Rural America for the 21st Century,” American Bankers Association, 1999)

Washington Post runs extensive news article by Kathleen Day reporting on the recent criticisms being expressed by the private industry and government about Fannie & Freddie – “Fear of What Fannie May Do”

Karen Shaw Petrou, a financial services consultant, states “Fannie Mae has found itself fighting a multi-front war, and even with the biggest lobbying guns and the best marksmen, it’s increasingly hard to assume it will win every battle.”

Congressman Richard Baker (R-LA), the Chairman of the House Banking subcommittee that oversees government-sponsored enterprises notes that “The mood has changed...Members of Congress are now hearing publicly for the first time from other participants in the housing market about concerns over encroachment into free markets by government-sponsored enterprises such as Fannie Mae.”

Steven Eisman, an analyst for CIBC Oppenheimer & Co. notes, “for the first time in many years, political issues will dominate both Freddie Mac and Fannie Mae.” Eisman wrote this warning in his April report in which he downgraded the stock of both GSEs from a “buy” to a “hold,” and noted “these issues could plague the stock prices of both companies for all of 1999.”

According to Day, Fannie’s stock has dropped 13.8% and Freddie’s has fallen 17.4% since the beginning of the year. The S&P 500-stock index has risen 5.8% over the same period.

William Apgar, Assistant Secretary of HUD for Housing says, “there are two clear and indisputable facts...One, the number of Americans in need of affordable housing stands at an all-time record high of 5.3 million families. Two, Fannie and Freddie are making record profits.”

Apgar adds, “We’re not over regulating or micromanaging. We’re just doing what the law requires... The GSEs are concerned with their shareholders. We’re concerned with their obligations to the public.”

- The Business section of the Sunday, August 8, 1999 *Washington Post* ran a front-page story on Fannie and the recent opposition Fannie and Freddie have been encountering from private industry and the federal government. The article, written by Kathleen Day, focused on the new coalition of mortgage-lending companies and mortgage insurance companies that have banded together to lobby against Fannie and Freddie. According to Day, “the coalition [FM WATCH], which includes such firms as Chase Manhattan Corp. and GE Capital Corp, has launched a lobbying campaign to convince Congress that Fannie Mae needs to be reined in. At the same time, Fannie is being criticized by regulators at the Department of Housing and Urban Development who say that the company is focusing too much on making profits for shareholders when it needs to beef up its cushion against financial losses and do more to encourage blacks and other minorities to become homeowners.”
- Day noted that Fannie’s CEO Franklin Raines disagrees with the critics of Fannie. Raines is quoted as saying, “We believe we have over the 20 years shown that you can pursue a public mission and have good returns to your shareholders... There are many theorists who say it is not possible, who would say that you have to be shorting one or the other. Indeed, I think we have found a healthy balance.”

Political pressure heats up

- **Despite Raines’ assurances, Day noted that the challenges that Fannie is facing from the government and private industry add up to Fannie’s “biggest political challenge in decades.” Karen Shaw Petrou, a financial services consultant, is quoted as saying, “Fannie Mae has found itself fighting a multi-front war, and even with the biggest lobbying guns and the best marksmen, it’s increasingly hard to assume it will win every battle.” Congressman Richard Baker (R, LA), the chairman of the House Banking subcommittee that oversees government-sponsored enterprises noted that “The mood has changed... Members of Congress are now hearing publicly for the first time from other participants in the housing market about concerns over encroachment into free markets by government-sponsored enterprises such as Fannie Mae.”**

Political pressure from private industry

- Day listed the multitude of benefits that Fannie and Freddie receive from their GSE status. These benefits include: the GSEs’ \$2.25 billion line of credit with the US; the GSEs’ exemption from state and local income taxes; the exemption from registering their securities with the Securities and Exchange Commission, which, Day noted, saves the GSEs about \$500 million a year; and, the implied federal guarantee of Fannie and Freddie, which allows the GSEs to borrow at rates substantially lower than other private companies. Day further noted, “Those advantages are part of what makes their competitors howl, especially now that they fear Fannie and Freddie have the capability to cut into their business as middlemen in providing mortgage loans. Both companies deny they want to go straight to the consumer to make loans -- indeed, their charters prohibit it -- but Wall Street analysts say Fannie and Freddie now have technology that would enable them to do it.”
- This technology is in the form of the Internet. Morgan Stanley Dean Witter & Co analyst Ken Posner said that opposition to the GSEs is fueled by Fannie and Freddie’s ability to use automated underwriting technology to correlate data that will “precisely pinpoint borrowers who might default on their mortgages, greatly improving the efficiency of evaluating the creditworthiness of home

buyers.” Day further noted that the GSEs use that information about the homebuyer to “streamline the mortgage application process in ways that many lenders could never hope to match.” Posner is quoted as saying, “The real issues are these competitive issues...The political controversy masks the re-shaping of the competitive landscape by technology.”

- However, Day noted that homebuyers may save money if Fannie and Freddie could offer loans directly. Since their charter-related benefits have been documented as saving borrowers up to 1 percentage point on mortgage rates, the GSEs may be able to offer loans for lower costs. Fannie and Freddie already claim that their tools such as automated underwriting will make loans cheaper. Robert O’Toole, a senior executive at the Mortgage Bankers Association commented that the GSEs’ charters “mandate they make money available . . . nothing in it [says] they have to make mortgages as cheap as possible.” He further added, “It might be cheaper for government-sponsored enterprises to do lots of stuff --if they made cars or washing machines -- but that doesn’t mean they should do it.” O’Toole also said that the overriding concern in the industry is that Fannie and Freddie are pushing this line of business not to help consumers, but to “meet earning promises to their shareholders . . . which requires them to identify other business opportunities on the mortgage-lending food chain.”
- The creation of FM WATCH, the Fannie/Freddie watchdog group, was prompted by these technological concerns, said Day, as well as concerns of encroachment into the mortgage insurance business. Last October, Freddie attempted to amend its charter slipping language into the omnibus appropriations bill that would allow Freddie to offer mortgage insurance. This was halted by lobbyists who heavily lobbied Congress and attracted the attention of House Banking Committee Chairman Jim Leach (R, IA).
- FM WATCH addresses their concerns in their literature and on their web page, www.fmwatch.org, according to Day. FM WATCH’s ads state that “Fannie Mae and Freddie Mac have played an important role in providing access to quality housing for millions of Americans. What you might not know...[is that they] are moving beyond their unique charters, to benefit their investors at the risk of taxpayers and the expense of home buyers.” Meanwhile, Day notes that the Fannie Mae Foundation, which disperses gifts around the country, is trying to garner support for the company at the grass-roots level. Insiders believe that Fannie’s strategy is to discourage people, including members of Congress, from challenging the company.
- **While Fannie and Freddie both deny these charges, the political heat is beginning to rise, according to Day. She quoted Steven Eisman, an analyst for CIBC Oppenheimer & Co. as noting, “for the first time in many years, political issues will dominate both Freddie Mac and Fannie Mae.” Eisman wrote this warning in his April report in which he downgrades the stock of both GSEs from a “buy” to a “hold,” and noted “these issues could plague the stock prices of both companies for all of 1999.” According to Day, Fannie’s stock has dropped 13.8% and Freddie’s has fallen 17.4% since the beginning of the year. The S&P 500-stock index has risen 5.8% over the same period.**

Political pressure from government

- While Fannie has faced increasing heat from the mortgage industry, it has also been sparring with HUD. Day noted that the Office of Federal Housing Enterprise Oversight (OFHEO) unveiled its new guidelines for the GSEs that would force them to increase their capital to cushion against potential financial losses. Freddie’s capital met OFHEO’s standards, while Fannie’s did not.

Meanwhile, HUD Secretary Andrew Cuomo has been pushing Fannie and Freddie to invest in more loans to low and moderate-income homeowners. Last month, HUD announced that, starting in 2001, it wants the GSEs to ensure that 50% of the loans they buy are such. The current affordable housing goal is 42 percent. Day noted that Fannie initially fought the new target, but Raines recently pledged his support, cautioning that it would be a “stretch” to meet.

- Day remarked that government officials say that Fannie and Freddie will have no problem meeting these goals if they simply reduce earnings, still leaving a generous portion for shareholders. In recent years, Fannie Mae has been delivering returns of about 24%-25%, compared with the average 5%-10% returns for the rest of the financial services industry. **William Apgar, Assistant Secretary of HUD for Housing is quoted as saying, “there are two clear and indisputable facts...One, the number of Americans in need of affordable housing stands at an all-time record high of 5.3 million families. Two, Fannie and Freddie are making record profits.”**
- Raines has noted that new regulations will just hamper the company’s mission, not their earnings. “Lowering earning might benefit a few current customers ... by enabling the company to buy more low-income loans. But in the long run would hurt the company’s ability to attract new capital. That would therefore reduce our ability to provide benefits to many more customers.”
- HUD is also examining plans to restrict the amount of non-mortgage investments that Fannie and Freddie engage in. The GSEs have been criticized for arbitraging their GSE status by borrowing at a lower cost and then investing the proceeds in higher yielding securities, unrelated to their mission, while pocketing the difference.
- Raines wrote a letter to the editor to the *Washington Post* in the spring that expressed his concerns about extra regulations from HUD, said Day. The letter questioned HUD’s “heavy-handed regulation” and said it is unlikely to improve the functioning of the GSEs’ system. Day noted that “Apgar isn’t moved.” Apgar stated that **“We’re not over regulating or micromanaging. We’re just doing what the law requires...Congress has given us certain regulatory responsibilities, and we take our responsibilities seriously. We’re doing the best we can to protect the public interest, mindful of the GSEs private business interests. The GSEs are concerned with their shareholders. We’re concerned with their obligations to the public.”** (*The Washington Post*, Kathleen Day, 8/8/99)

Fannie/Freddie Watchdog group, FM WATCH, claims a small victory

A 22% budget increase for Fannie & Freddie’s safety and soundness regulator, OFHEO, is included in the VA-HUD Appropriations bill

OFHEO requested the budget increase because it needs greater resources due to Fannie & Freddie’s rapid growth and increasingly sophisticated activities, such as off-balance sheet financial derivatives, global debt issuances, and participation in subprime mortgage markets

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, Cong. 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”

- Fannie /Freddie Watchdog group, FM WATCH, is claiming a small victory in the VA-HUD Appropriations bill (H.R. 2684). Included in the VA-HUD spending bill that the House will consider after the August recess is \$19.49 million for the Office of Federal Housing Enterprise Oversight (OFHEO), a \$3.49 million increase from fiscal year 1999. OFHEO is the safety and soundness regulator for Fannie and Freddie. “We think that it’s important that people realize what a critical role the agency plays in regulating Fannie Mae and Freddie Mac,” stated FM WATCH Spokesperson, Beneva Schulte. (*Congressional Monitor*, 8/9/99)
- According to a statement by OFHEO, the 22% budget 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. 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)

FHLBank expansion provision that would have allowed the FHLBanks to guarantee up to \$500 million a year in tax-exempt school bonds was deleted from the final Conference Report on the tax bill

Association of Financial Guaranty Insurers (AFGI) – the private bond insurers - opposed the provision because they did not see a market need for GSEs’ entrance into this highly competitive area that is well served by the private market

AFGI called the provision inefficient, ineffective, and counterproductive

A Congressional Research Service (CRS) economic analysis by Barbara Miles and Dennis Zimmerman concludes that unless it is more carefully targeted, the Senate Finance 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.”

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.”

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

- The FHLBank expansion provision that would have allowed the FHLBanks to guarantee up to \$500 million a year in tax-exempt school bonds was deleted from the final Conference Report on the tax bill. The provision, backed by Senate Finance Committee Chairman William Roth (R-DE), was included in an education bill passed by the Senate Finance Committee earlier this year and then added to the overall tax package introduced by Roth and passed by the Senate. According to a *Bond Buyer* article by Amy Resnick, Senate Banking Committee Chairman Phil Gramm (R-TX) “effectively stopped the legislation” by asserting the Senate Banking Committee’s jurisdiction over the operations of the FHLBanks and inserting language in the Senate-passed tax bill stalling the implementation. According to Resnick, the effective-date section associated with the bond guarantee now states that it cannot occur until separate legislation makes specific reference to “this year’s Senate tax bill.” A spokesman for Senator Gramm, Christi Harlan, stated that “Considering the Banking Committee’s oversight role for the Federal Housing Finance Board, (Gramm) wants to make sure that they are sticking to their mandate, which is housing, and that the Federal Home Loan Banks are sticking to homes.” The provision was ultimately “killed” in the Conference Report. (*Bond Buyer-American Banker*, Amy Resnick, 7/28/99)

AFGI - private municipal bond insurers - do not see a market need for entrance of the GSEs into this highly competitive area that is well served by the private market

- The following were statements made by private municipal bond insurers on the FHLBank expansion proposal:
 - The proposal is “stunning” and “perfectly ridiculous,” stated Roger Taylor, President of FSA. “The Federal Home Loan Bank board should have better things to do than try to edge their way into an area of the market that is already well served by private industry,” stated Taylor, whose firm has insured more than 2,100 public school bond issues totaling almost \$20 billion since 1995.
 - The proposal is “counterproductive to our nation’s social and economic progress,” stated Ann Stern, President of FGIC and Chairman of the Association of Financial Guaranty Insurers. “The private sector, through the financial guaranty insurance companies, has done an outstanding job to date of insuring school construction and modernization bonds,” said Stern, whose firm has insured more than 1,550 school bond issues totaling \$26 billion since 1995.

AFGI calls the proposal inefficient, ineffective and counterproductive

- Ann Stern, Chairman of AFGI, wrote a letter to Senator Roth and the Finance Committee’s top Democrat Senator Daniel Patrick Moynihan (D-NY) on May 18 in opposition to the FHLBank expansion proposal. The letter stated that the proposal was “misguided” for the following reasons:
 - “It would be *ineffective*. It does not address the real problem of insufficient bonds to finance needed investments in school facilities. As new bond issues require local voter approval to make more bonds available for school construction, voters must be willing to borrow and to support property taxes at the levels needed for repayment.”
 - “It would be *inefficient*. Issuers of municipal bonds have ample access to a highly effective, intensely competitive market that is well-served by private bond insurers. The market for bond insurance has been highly effective without any government subsidy.”
 - “It might actually be *counterproductive* if the Federal Home Loan Banks (FHLBanks) were ultimately to deprive states and localities of the services of private bond insurers and other private experts in public finance by driving them out of the market. Given their federal subsidies, the FHLBanks entry into this market will undermine the private bond insurers and actually lessen competition over time. The final result will be to reduce, not increase the availability of low cost private insurance to those localities seeking to credit enhance their bonds. The financial guaranty industry, which was pioneered in the U.S. in the 1970s, insures the timely payment of all principal and interest due on an issue of debt securities. The principal benefit of the insurance is to upgrade the rating of the bonds based on the credit rating of the insurer. For example, an insured security that would otherwise carry an A-rating receives the AAA-rating of the insurer. The guaranty enhances the value and marketability of securities, thus allowing them to be brought to market at a lower cost to the issuer.” (*BNA Daily Report for Executives*, 5/19/99, 5/20/99; *Bond Buyer*, Amy Resnick, 5/18/99, 5/21/99; *Chairman of AFGI, Ann Stern, Letter to Senator Roth and Senator Moynihan*, 5/18/99)

CRS

- As reported in the July 30 *GSE Report*, a Congressional Research Service (CRS) economic analysis by Barbara Miles and Dennis Zimmerman concluded that unless it was more targeted, the 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 concluded 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 noted that the FHLBanks could harm the competitiveness of the private bond insurance and credit enhancement markets. The analysis also found 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 (*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; *Bond Buyer-American Banker*, Amy Resnick, 7/28/99)

All GSEs

***National Mortgage News* runs editorial by Mark Fogarty on FHFB’s proposal to limit the FHLBank’s arbitrage investments and HUD’s proposal to increase Fannie & Freddie’s affordable housing goals**

The editorial supports both refocusing the FHLBanks mission to home lending and increasing Fannie & Freddie’s affordable housing goals, but believes the divestiture of the FHLBanks’ mortgage-backed securities does not need to be as high as the FHFB proposal

The editorial notes that Fannie & Freddie should be “free to offer any product they think they can turn a profit with, just like any other firm – but only (and it’s a big but) if they are willing to give up the implied government agency status they have that makes it cheaper for them to issue debt.”

- *National Mortgage News* ran an editorial by Mark Fogarty, entitled “*Two Modest Proposals*” on two recent GSE-related proposals. The first is a recent proposal and request for public comment by the Federal Housing Finance Board (FHFB). The FHFB proposal calls for a \$100 billion divestiture of mortgage-backed securities and Treasuries in order to eliminate arbitrage activities and force the 12 FHLBanks to devote more resources for providing mortgage liquidity to their members. Fogarty writes that FHFB Chairman Bruce Morrison “gets our vote for the gutsiest move of the year.” However, Fogarty writes, “We endorse his [FHFB Chairman Morrison] to refocus the mission of the district banks to home lending, but with one caveat – we wouldn’t be so draconian on the amount of the unwinding.”
- The proposal, Fogarty noted, is “part of a broader risk-based capital regulation [and] obviously would spur development of member mortgage programs like the Mortgage Partnership Finance program of the Chicago district bank. Less obviously, it also fosters the nascent competition between the FHLBs and the other government-sponsored housing enterprises, since FHLBs currently are big investors in Freddie Mac and Fannie Mae securities. This rule would pull the plug

on that.” In addition, Fogarty notes that the proposal should not disrupt the MBS markets, since the FHFB proposal allows the assets to run off, rather than a sellout.

- Fogarty writes, “We favor some compromise in the middle ground between zero and \$100 billion. Setting a reasonable cap on non-mortgage investments would accomplish Mr. Morrison’s goal of keeping the district banks on target, while also bowing to the reality that, since the savings and loan crash, the FHLBs have been redesigned to act more like private financial institutions. They need some freedom to hedge their balance sheets against mortgage cyclicity.” However, said Fogarty, the FHLBs also need firm guidelines on their investments.
- The second “gutsy move” was HUD’s proposal to set Fannie and Freddie’s affordable housing goals at 50% within the next five years. **“We are in favor of expanding markets, and the 50% goal could expand the market in two directions at once. Obviously, the affordable housing market, but also the moderate-to high-income market as well, since new higher-income borrowers will be needed to match gains in affordable housing,”** said Fogarty. Fogarty noted that both GSEs are skeptical of HUD’s lofty goals, but noted that Fannie has agreed to comply.
- The GSEs have been expanding into more markets in the past decade, according to Fogarty. Their automated underwriting systems have allowed them to reach new borrowers, and Fannie’s promise to honor the 50% goal “would give them the impetus to keep that vast expanding markets engine humming along.” **In his conclusion, Fogarty compared the GSEs and their regulators to a tiny person walking a huge dog -- where the dog walks their owner not vice versa. “I’m sure GSE ‘regulators’ get that feeling sometime, as they try to rein in these mostly-private housing behemoths that have assets in the hundreds of billions of dollars. Not to mention powerful and well-financed lobbying machines. The GSEs have been straining on the leash for at least the past decade. A good philosophical question is, why not let them run free?”**
- Fogarty ended by stating, **“We’ve always said here that Fannie and Freddie should be free to offer any product they think they can turn a profit with, just like any other firm -- but only (and it’s a big but) if they are willing to give up the implied government agency status they have that makes it cheaper for them to issue debt. As long as they don’t want to give that up, they’re going to have to put up with the government watchdogs . . . The same is true for the FHLBs. The concern is that they are using their GSE status to get money cheaply and then arbitrage it into MBS. If they want to keep that access to cheap money, the price they pay is having a federal watchdog like the FHFB.”** (*National Mortgage News*, Mark Fogarty, 8/12/99)

Fannie Mae and Freddie Mac

***Euromoney Magazine* article by James Smalhout warns foreign investors that purchasing Fannie & Freddie’s debt is not as safe as purchasing Treasuries**

Washington, DC Attorney Tom Stanton states, “risk migrates to the place where the government is least equipped to deal with it . . . The failure of the S&L Industry and the imposition of the Basle capital standard on the remaining thrifts chased hundreds of billions of dollars of mortgages from the primary market to the secondary market...That’s where we didn’t have effective regulation or comparable capital standards under the Basle Accord.”

Smalhout notes that the most important difference between GSE debt and Treasury debt is that the GSE debt is not government guaranteed, but an implied government guarantee

Smalhout lists two situations where the implied government guarantee may not bail out investors. The first, he says, was “straightforward.” “Increased foreign holdings of agency debt will dilute US government resolve. In some future crisis, Congress might not be as willing to ride to the rescue if most of the investors at risk are overseas and not eligible to vote in US elections.” The second situation is political. Smalhout notes, “the implicit guarantee enjoyed by the agencies is a political football and it is being kicked around.”

A prime example of the GSEs’ expansion, in Smalhout’s opinion, is in new technology, particularly in automated underwriting, of which, the GSEs control about 90% of the automated market. “But Fannie and Freddie were hardly the first to enter this arena. Citibank and Norwest came up with systems much earlier. And most observers think that Fannie and Freddie rose to become the dominant players thanks to their implicit subsidy from the government and the resulting lower cost of funds.”

Smalhout notes that the non-GSE subprime market is now well-established and competitive. So the case that they [GSEs] should move into this market to correct a market failure is weak. But anybody hoping to block Fannie and Freddie faces an uphill battle. Congress gave them the power to decide whether mortgages pass muster.”

“[GSE] Expansion into new markets may impose significant costs on society,” observes Robert Seiler, an analyst at the Congressional Budget Office, “by making significant safety and soundness regulation more complex and potentially less effective, by increasing federal tax subsidies, by limiting competition, and by allowing the GSEs to set prices and earn profits above competitive levels.”

Smalhout writes, “what’s good for the GSEs seems less and less to be what’s good for America. . . Buyer beware.”

- In the July 1999 *Euromoney Magazine*, James Smalhout wrote an article, entitled “*Freddie and Fannie Aren’t Sovereign*,” warning foreign investors of the potential dangers in buying GSE debt. He notes that foreign investors are purchasing large amounts of Fannie and Freddie debt as a substitute for US Treasuries and Fannie and Freddie are expanding their balance sheets and pushing into new markets, but he cautions that Fannie and Freddie “are not treasury lookalikes.”
- He began the article by noting that foreign investors currently hold over 40% of the privately held, marketable U.S. Treasury debt, accounting for about 18% of America’s GDP. However, White House analysts have estimated that the US will be debt-free in 2015. According to Smalhout, investors will be forced to look to other venues to invest in. “Taking up the slack will be the country’s GSEs-- or government-sponsored enterprises -- which will overtake the US treasury for the first time next year in the amount of debt outstanding in the market.”
- Smalhout noted that both Fannie and Freddie are “confident that their securities provide a valid alternative to US government securities.” Smalhout also noted that the GSEs are pleased by the growing interest of European investors in their debt.

- However, Smalhout warned that **“GSE paper will never be the same as treasuries - and investors should beware the differences.”** He quoted Washington D.C. attorney Tom Stanton as stating, **“risk migrates to the place where the government is least equipped to deal with it . . . The failure of the S&L Industry and the imposition of the Basle capital standard on the remaining thrifts chased hundreds of billions of dollars of mortgages from the primary market to the secondary market...That’s where we didn’t have effective regulation or comparable capital standards under the Basle Accord.”**

Government guarantee v. implied government guarantee

- **Smalhout further noted that the most important difference between the GSE debt and US Treasury debt is that the GSE debt is not government guaranteed. “Investors take it as a given that the US government stands behind the GSEs,” says William Oliva, a managing director at Salomon Smith Barney, “even though they say in plain English that their securities are not backed by the full faith and credit of the United States.”** Smalhout noted that investors’ faith in the implied government guarantee stems from the S&L crisis of the 1980s, when Congress was forced to bail out the thrifts. But there is nothing in the GSEs’ charters that states that Congress will bail them out, said Smalhout. Instead, Stanton is quoted as saying, **“Fannie Mae and Freddie Mac . . . are too big to fail by an order of magnitude, in terms of the contingent liability of the federal government.”** **Francis Cavanaugh, a retired senior Treasury official, wonders whether foreign investors will be comfortable with the implicit guarantee concept. The idea that everybody knows that Fannie and Freddie are guaranteed by the government when US law specifically says that they are not can be a hard sell. “That’s going to be a bit of a problem,” he predicts, “as foreigners find that there aren’t enough treasury securities.”**

Implied guarantee may not be enough for investors

- **Smalhout listed two situations where the implied government guarantee may not bail out foreign investors. The first, he said, was “straightforward.” “Increased foreign holdings of agency debt will dilute US government resolve. In some future crisis, Congress might not be as willing to ride to the rescue if most of the investors at risk are overseas and not eligible to vote in US elections.”** The second situation is political. Smalhout noted, **“the implicit guarantee enjoyed by the agencies is a political football and it is being kicked around.”**

May be more efficient way for the government to subsidize housing than using GSEs

- Critics argue that the implicit government guarantee is inefficient and have long been critical of the GSEs’ ability to perform as a publicly traded company while serving their Congressional charters to enhance liquidity and efficiency of the market for home mortgages. With Fannie’s 25% return on equity last year and Freddie’s 23%, Smalhout noted that **“these profits depend on a raft of explicit special privileges from the government.”** He cited the Congressional Budget Office and US Treasury studies which both concluded that the GSEs’ receive over \$6.5 billion per year from their special subsidies. Out of this amount, the CBO concluded that the GSEs pass about \$4.4 billion onto the consumers. However, the remaining \$2.1 billion is retained by the GSEs. Smalhout noted that the CBO called the GSEs **“spongy conduits’** because they absorb so much of the subsidy.” **“Once we get to the point where we want to subsidize housing,” says Charles Calomiris, of the Columbia University Business school, “we know that this is not the way to do it.”** In Calomiris’ opinion, spending the same \$4 billion or \$5 billion a year on down-payment assistance would be more effective. **“The biggest problem for people who don’t qualify for a mortgage is saving up for the down payment,”** he stated. He prefers down

payment assistance because, unlike a guarantee program, there is no leakage. “When you give down-payment assistance, dollar for dollar, that all goes to the homeowner,” he stated. Peter Wallison of the American Enterprise Institute stated, “Is it worth having this gigantic apparatus of Fannie and Freddie dominating the conventional mortgage market for the purpose simply of reducing the conventional mortgage rate by something between 20 and 50 basis points? This is quite an expensive way to achieve that purpose.”

- According to Smalhout, critics also criticize the GSEs for their transparency in the federal budget and their lack of accountability. He further noted, “if these criticisms become sufficiently vocal, investors will have to price in the risk that the implicit guarantee is weakening.” Many critics advocate a complete privatization of Fannie Mae and Freddie Mac, where they are forced to stand completely on their own. Others believe that the mortgage market will best be served by pulling the GSEs back into the government. Another group of critics wants the GSEs to pay fees to the US Treasury for their charter. **Peter Wallison, of the American Enterprise Institute is quoted as stating, “the question about Fannie and Freddie ultimately comes down to whether it makes sense for the government to create companies that are private in structure but receive subsidies with which they are expected to perform public functions.”**

GSEs could fail

- **Smalhout notes that investors should also be worried that a GSE might fail.** He noted that Fannie almost failed in a period of high interest rates in the early 1980s, and had \$11 billion of negative net worth. Luckily for Fannie, said Smalhout; the US government ignored the problem. So Fannie Mae “gambled for redemption . . . Fannie bought up vast amounts of mortgages, paying for them with short-term borrowing. This was fine with lenders. They knew Uncle Sam was there - if need be - to pick up the pieces. And Fannie’s stockholders had nothing to lose.” Clearly, Fannie succeeded with their gamble.

GSEs are expanding into new markets

- Now, the GSEs are trying to find other ways to make more money, noted Smalhout. “As private companies GSEs face powerful incentives to push into new markets. They aim to price their products just below the levels for completely private companies. And tensions in the US mortgage industry recently boiled over as a result.” **Vern McKinley, a Washington lawyer, stated that “the GSEs construe their charters broadly...Private companies want a more narrow interpretation. They see GSEs as competitors with unfair advantages, courtesy of the US Congress.” A prime example of the GSEs’ expansion is in new technology, particularly in automated underwriting. Smalhout remarked that the GSEs control about 90% of the automated market. “But Fannie and Freddie were hardly the first to enter this arena. Citibank and Norwest came up with systems much earlier. And most observers think that Fannie and Freddie rose to become the dominant players thanks to their implicit subsidy from the government and the resulting lower cost of funds.”**
- Another area of expansion is in the sub-prime market, according to Smalhout. He noted that Fannie and Freddie will issue between \$10 billion and \$20 billion of nonconforming mortgages this year. But, **“the non-GSE sub-prime market is now well-established and competitive. So the case that they should move into this market to correct a market failure is weak. But anybody hoping to block Fannie and Freddie faces an uphill battle. Congress gave them the power to decide whether mortgages pass muster.”**

- Smalhout reported that Congress has been checking into the GSEs' non-mortgage investments. These investments, known as arbitrage, account for 15% of Fannie's assets and 9% of Freddie's. He noted that critics claim that these investments are just to make a fast dollar. The GSEs claim that in a changing market, they need to redefine their business. That is how Freddie Mac defends their attempt to enter the mortgage insurance business last fall. This attempt failed, but it resulted in a new coalition in the mortgage industry to begin a lobbying group, noted Smalhout.
- “[GSE] Expansion into new markets may impose significant costs on society,” observes Robert Seiler, an analyst at the Congressional Budget Office, “by making significant safety and soundness regulation more complex and potentially less effective, by increasing federal tax subsidies, by limiting competition, and by allowing the GSEs to set prices and earn profits above competitive levels.”
- Smalhout concluded his article by warning, “what’s good for the GSEs seems less and less to be what’s good for America. . . Fannie and Freddie dominate America’s home mortgage markets. And they also pack an impressive political wallop in Washington. America’s President appoints five members to their boards of directors. However, there is increasing pressure to re-examine Fannie and Freddie’s relationship with the US government if they continue to expend their balance sheets in response to demand for their securities. This could damage their earning and lower their credit rating. Combine that with an adverse interest rate environment, which would damage both their mortgage-backed and arbitrage business, and these agencies would begin to look less like the US government and more like a thrift, a gambling Pfandbrief issuer or the mortgage-backed book of a large commercial bank. Buyer beware.” (*Euromoney Magazine*, James Smalhout, July, 1999)

Fannie & Freddie stock continues to drop

From the beginning of the year through August 13, Freddie’s shares fell 18.5% and Fannie’s 13.4%

Salomon Smith Barney Analyst Thomas O’Donnell expects Fannie & Freddie to increase their use of risk-based pricing and continue to expand into home equity, less-than-prime, immigrant, and minority markets

Freddie says its main areas of growth would be the A-minus and alternative-A

Raymond James Financial downgrades Freddie to “Accumulate” from “Buy”

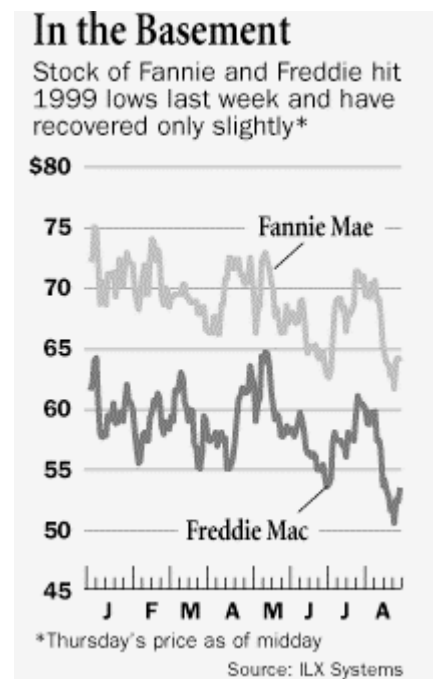
Warren Buffet continues to sell off his Fannie & Freddie shares

- Joshua Brockman with the *American Banker* wrote an article on August 9 reporting that Fannie and Freddie’s shares, which were already down from rising interest rates, lost more ground when the Treasury Department announced recently that it would reduce its issuance and buy back more of debt. “The possibility that the move would result in wider spreads between the yields on Treasuries and the yields on agencies’ debt was seen as another negative for the two companies.” On the day of Treasury’s announcement, Fannie’s stock fell \$2.50 to \$65.25 and Freddie’s fell \$3 to \$56.625. Brockman noted that the yield spread between Fannie and Freddie’s noncallable debt and Treasuries peaked at 88 basis points the week of August 2, from a low of 79 the previous week

and an average of 64 earlier this year. Salomon Smith Barney Analyst Thomas O'Donnell said the differential was enough to prompt investors to sell Fannie and Freddie stock. Investors are concerned that increased mortgage rates will "depress mortgage originations" and "the ability of Fannie and Freddie to grow their mortgage portfolios," O'Donnell stated. He further noted that it is more expensive for Fannie and Freddie to fund mortgage purchases with a wider spread on the agencies' debt. However, Treasury opened the door for Fannie and Freddie to play a more active role with Treasury reducing its role in the capital markets. (*American Banker*, Joshua Brockman, 8/9/99)

- In a follow-up article on August 20, Joshua Brockman with the *American Banker* reported that Fannie and Freddie's stock fell to its lowest levels of the year the week of August 9. According to a research report by Salomon Smith Barney Analyst Thomas O'Donnell, investors sold off shares of Fannie and Freddie, in response to rising interest rates and fears that the Fannie and Freddie are becoming too big. Brockman notes that from the beginning of the year through August 13, Freddie's shares fell 18.5% and Fannie's 13.4%. During the week of August 16, the shares regained some ground; at midday August 19, Fannie's stock was trading at \$63.9375 and Freddie's at \$53.4375.

- O'Donnell noted, however, that despite last week's Wall Street selling, Fannie and Freddie are the two biggest buyers of home loans and will be able to maintain profitable enterprises. "Over the next three to five years, EPS growth and profitability will not present serious problems for the GSEs," said O'Donnell. According to O'Donnell, analysts say they do not share investors' concerns that Fannie and Freddie are becoming too large to handle the impact of rising interest rates and reduced volume. "They have the resources and the innovations to be able to grow their portfolio," he stated. He noted that the two GSEs are developing "higher-yielding asset classes" to build their mortgage portfolios, adding that they will also increase their use of risk-based pricing as they continue to move into the home equity, less-than-prime, immigrant, and minority markets. He predicts that Fannie and Freddie will continue to focus on their balance-sheet business rather than their MBS business, and move more aggressively into underserved markets and risk-based pricing. (*American Banker*, Joshua Brockman, 8/20/99, Chart source: *American Banker*, 8/20/99)



- Vice President for Investor Relations at Fannie, Ellen Goldberg, said financial stocks, in general, are "somewhat out of favor." However, Fannie expects to have no problem expanding its mortgage portfolio over the next five years, without adverse effects on spreads or profitability. Vice President for Shareholder Relations at Freddie, Bill Stephens, said Freddie can "grow in all interest rate environments." He said Freddie's main areas of growth will be the A-minus and alternative-A markets. (*American Banker*, Joshua Brockman, 8/20/99)
- A *Reuters* article noted that investors have pointed out that the GSEs have tried to step into the void created by the shrinking Treasury supply but to little success so far, further highlighting the need of an active role for the Treasury. Fannie and Freddie have both issued large benchmark

securities that could be used by dealers and investors to borrowers, lend and hedge, instead of Treasuries. But so far, “the agencies have not replaced the need for Treasuries,” said Keith Anderson, Chief Investment Officer at BlackRock Financial Management. (*Reuters*, 8/4/99)

Freddie downgraded by Raymond James Financial

- Freddie was cut to “accumulate” from “buy” by Richard Bove at Raymond James Financial. (*Bloomberg News*, 8/10/99; *Dow Jones Newswire*, 8/10/99)

Warren Buffet continues to sell off his Fannie & Freddie shares

- *Federal Filings Business News* reported that according to the firm’s confidential 13F filing as of March 31, 1998, Berkshire Hathaway Inc. lowered its shares of Fannie and Freddie in the First Quarter of 1998. *Federal Filings Business News* reported on May 11, 1998 that Warren Buffet cut his Fannie Mae stake by 490,000 shares to 5.9 million shares and reduced his shares of Freddie Mac by 221,200 shares. (*Dow Jones Newswire*, 8/4/99)
- As reported in the April 2 *GSE Report*, in Warren Buffet’s annual letter to Berkshire Hathaway’s shareholders, Berkshire appeared to have slightly lowered its stake in Freddie Mac. “We trimmed or substantially cut” a number of the portfolio’s holdings, Buffet’s letter notes without elaboration. According to the shareholder letter, the company held 60,298,000 Freddie Mac shares as of 12/31/98. As reported in the December 18, 1998 *GSE Report*, Warren Buffet’s Berkshire Hathaway revealed holding 63,977,600 shares (reflecting no changes since second quarter 1997) in Freddie Mac and 6,558,000 (a reduction of 206,200 shares since second quarter 1997) in Fannie Mae according to a confidential Form 13F covering the third quarter of 1997. (*Newstraders*, 12/17/98; *Wall Street Journal Interactive Edition*, 3/15/99; *Warren Buffet’s Annual Letter to Berkshire Hathaway Shareholders*, 3/1/99)

Senate Confirmation of OFHEO’s Director is postponed until after Congressional recess period

The safety and soundness regulator for Fannie & Freddie, OFHEO, has been without a permanent director since February 1997

- The Senate confirmation of Armando Falcon to be the Director of the Office of Federal Housing Enterprise and Oversight (OFHEO) – the safety and soundness regulator for Fannie and Freddie – was postponed until after the Congressional recess period. The Senate Banking Committee was expected to send the nomination of Falcon to the full floor for a vote following a confirmation hearing on August 5. The nomination was not expected to be challenged, however, the Senators did not have time during the August 5 hearing as the Senators’ time was consumed by more controversial nominations. Senate Banking Committee staff expects the committee will take action on the Falcon nomination shortly after Congress returns from its August recess on September 8th. According to *Real Estate Finance Today* article, Falcon will be only the second director of OFHEO since the office was created in 1992.
- During the hearing on August 5, Falcon testified that his eight years of legal experience at the House Banking Committee, and three years as general counsel, made him qualified to head OFHEO. “Much of my time with the House Banking Committee was spent working on financial institution safety and soundness issues,” stated Falcon. He stated that he recognized the important role of Fannie and Freddie to the nation’s housing market and said the creation of OFHEO in itself

is an example of the federal government's recognition of the need to ensure the long-term financial health of the government-sponsored enterprises."

- Falcon believes that OFHEO is an important juncture in its development. "First, the agency has issued a risk-based capital standard for public comment. OFHEO needs to carefully consider all comments and move towards implementation of a final rule, as required by Congress," he stated. "Second, last year OFHEO completed a new, comprehensive approach to annual risk-based examination of the enterprises. The agency must now assess the need for any changes in the program," he stated. "And finally, OFHEO is developing a state-of-the-art surveillance and monitoring system as part of its examination program. This system needs to be fully integrated with the risk-based capital standard and OFHEO's research and analysis responsibilities. These are just some of the immediate challenges the next director will face."
- According to a *BNA* article, Falcon received praise from Senator Paul Sarbanes (D-MD), the Committee's ranking Democrat. Sarbanes stated that Falcon would bring an "impressive set of credentials to the job" and is "eminently qualified." Sarbanes further stated that Falcon's experience as a congressional aide "sort of alerts you to what our concerns are."
- Falcon has been serving as an expert consultant at OFHEO since September of 1998, while Mark Kinsey has served as OFHEO's acting director since February of 1997. (*BNA Daily Report for Executives*, Marc Selinger, 8/6/99; *Real Estate Finance Today*, Gwendolyn Glenn, 8/6/99) As reported in previous *GSE Reports*, OFHEO has been without a permanent director since February 1997 when Aida Alvarez left to head the Small Business Administration.

President Clinton intends to nominate Susan Wachter as Assistant Secretary for Policy Development and Research at HUD

Dr. Wachter has received research funds from Fannie in the past and has served on the Advisory Board of Fannie's Office of Housing Policy Research

- According to a White House press release, President Clinton announced his intent to nominate Susan Wachter to serve as Assistant Secretary for Policy Development and Research at HUD. Dr. Wachter, of Newark, NJ, has been Chairperson of the Wharton Real Estate Department and Professor of Real Estate Finance at The Wharton School of the University of Pennsylvania since July 1997. The Assistant Secretary is the principal advisor to the Secretary and Deputy Secretary on overall Departmental policy, program, evaluation, economic analysis, research and regulation of housing financial institutions. The Assistant Secretary is also responsible for developing and revising policy and program proposals; evaluating and monitoring programs and information; and coordinating policy development and research within HUD. According to *National Mortgage News*, Wachter has been working at HUD as a consultant since January. (*White House press release*, 7/29/99; *National Mortgage News website*, posted 8/4/99)
- According to a Cato report by Vern McKinley, Dr. Wachter, who helped write a study commissioned by the agencies responsible for the Privatization Reports on Fannie and Freddie, has received more than \$100,000 of Fannie research funds. McKinley notes that in fact, the study she worked on had five authors, all five of whom had at that time, or in the past, received research funding from Fannie Mae. The study concluded that privatization of the GSEs would adversely affect housing markets. According to HUD's website, Dr. Wachter's study found that the social

costs of privatizing the GSEs would disproportionately fall upon African Americans, lower income households, and those living in central cities. McKinley notes that Fannie agreed with the bulk of the conclusions. McKinley concludes, however, that “Wachter notes all too truthfully that anyone would be hard-pressed to find ‘a single researcher in the country who hasn’t been paid to do work [on housing finance issues] by’ Fannie Mae.” (*“The Mounting Case for Privatizing Fannie Mae and Freddie Mac,”* Vern McKinley, 12/29/97; *Studies on Privatizing Fannie Mae and Freddie Mac*, www.huduser.org website)

- According to a biography of Dr. Wachter on the American Real Estate and Urban Economics Association (AREUEA) website, Dr. Wachter has served on the Advisory Board of Fannie Mae’s Office of Housing Policy Research. (Dr. Wachter served as a former President of AREUEA.)
- In testimony before the House Banking Committee’s Subcommittee on Capital Markets, Securities and GSEs on July 16, 1997, Dr. Wachter testified about Fannie and Freddie’s mission and affordable housing goals --

“Yes, I have no concerns about their [Fannie and Freddie] - putting it another way - I agree that they [Fannie and Freddie] should be profitable, so the 20 percent profit is not what I am concerned about. These are shareholder-based institutions and they should have profit incentives. But I am concerned that there be a continued focus and attention to their mission and that be discussed in the light of day, that there be set up various goals, that the goals that are set up be discussed in more detail, and that there be some very serious consideration about, not just the numerical goals, but what they serve.” (*Transcripts of House Banking Committee’s GSE Subcommittee hearing, 7/16/97*)

Fannie & Freddie’s loan purchase guidelines can prevent many renters from getting condo loan approvals

Article notes that “buyers purchasing in a condominium complex with a large population of tenants have little recourse other than shopping around for a lender that’s willing to bend the rules or keep the loan in its own portfolio, rather than selling it through the secondary market to Freddie Mac or Fannie Mae.”

- According to an article by Marcie Geffner in the *San Diego Union-Tribune*, many credit-worthy condominium buyers have a difficult time getting a mortgage because there are too many tenants living in the complex. Both Fannie and Freddie’s loan purchase guidelines for lenders call for 60% owner occupancy for established condominium complexes and 70% of the sold units for newer complexes still under the developer’s control. As Geffner points out, while lenders set their own standards for mortgage application approvals, yet many conform those standards to the guidelines dictated by Fannie and Freddie, since they purchase the bulk of the loans originated nationwide.
- Fannie and Freddie make certain exceptions to their guidelines. Freddie allows an exemption to the owner-occupancy guidelines for buyers who make a 25 percent down payment and intend to live in the condominium themselves. The company also reportedly grants waivers in some instances at the request of lenders. Fannie does not have specific exemptions to the guidelines but allows some flexibility if other requirements are met.

- Geffner notes, however, that “buyers purchasing a condominium complex with a large population of tenants have little recourse other than shopping around for a lender that’s willing to bend the rules or keep the loan in its own portfolio, rather than selling it through the secondary market to Freddie Mac or Fannie Mae.”
- Geffner further notes that the “bias among lenders against condominium complexes with large tenant populations has drawn some criticism for causing de facto discrimination that stifles an opportunity to create more ownership of affordable housing.” Realtor Ann Throckmorton, Executive Vice President of Century 21 Able, in San Diego, stated that “When someone buys a single-family home, the lender doesn’t drive up and down the street and find out how many of the houses on the block aren’t owner-occupied. (These lending guidelines) are very counter-productive to the (goal) of increasing affordable housing.” Throckmorton is also a member of the California Association of Realtors’ Affordable Housing Task Force. (*San Diego Union-Tribune*, Marcie Geffner, 8/8/99)

Little Rock Mayor Jim Dailey asks Deloitte & Touche to audit/investigate the city’s financial procedures, in part, because the city has allegedly invested illegally in Fannie Mae bonds

Prior to a state law that was just recently passed, the city was prohibited by state law and Little Rock’s investment guidelines from investing in securities that are not backed by the full faith and credit of the federal government. [Fannie’s bonds only carry an implied government guarantee.]

Pulaski County Prosecuting Attorney issues seven subpoenas as part of the investigation

Arkansas Securities Department is questioning officials at local banks that sold Little Rock the Fannie bonds and investigating whether PaineWebber, which controls two Little Rock accounts, should have understood Arkansas law

- According to an *Arkansas Democrat-Gazette* article, Little Rock Mayor Jim Dailey has asked Deloitte & Touche to audit/investigate the city’s financial procedures. His decision to request an investigation was made, in part, because the city had allegedly invested illegally in Fannie Mae bonds. Until July 30, when a new state law took effect, state law and Little Rock’s investment guidelines said it was illegal for the city to buy bonds not fully backed by the federal government, which Fannie is not. A state law that took effect on July 30 reportedly allows the city to invest in “government agency securities,” and the article notes that the state can now invest in Fannie securities. Despite the law, Little Rock has been investing since 1991 in Fannie bonds. The Deloitte & Touche report requested by Dailey is expected within 30 days. The Arkansas Securities Department is also investigating these allegedly illegal investments. (*Arkansas Democrat-Gazette*, 8/4/99)
- As part of the investigation, Pulaski County Prosecuting Attorney Larry Jegley issued seven subpoenas on August 18 – six were issued to Little Rock Finance Department employees and at least one was issued to a former worker. Jegley said “one of several” primary aspects of the investigation is the relationship between Finance Director Harold Boldt and the Princeton, NJ office of PaineWebber, Inc. where Little Rock has two accounts – a custodial account and a money market account. The money market account was allegedly established without a competitive

selection process. PaineWebber officials are reportedly cooperating with the investigation and have declined to answer specific questions about the business they do with Little Rock, saying such relationships must be confidential. The Arkansas Securities Department officials said that besides questioning officials at the local banks that sold Little Rock the illegal Fannie bonds, they are looking into whether PaineWebber should have understood Arkansas law. (*Arkansas Democrat-Gazette*, 8/19/99)

Community bank opens a new department to handle all aspects of its mortgage operations, from origination to closing

Valley of the Rogue Bank believes that consumers will benefit because consumers can deal personally with local loan officers and all decisions will be made by local employees rather than by secondary market lenders such as Fannie & Freddie

- Valley of the Rogue Bank (VRB), a community bank, in Rouge River, OR, opened a new department that brings real estate lending close to home. VRB Bankcorp President and Chief Executive Officer William Haden stated that “We are especially pleased to become responsible for the complete lending process, all the way from loan origination to closing. This personalizes our banking services even more and enhances our hometown philosophy.” VRB has been a real estate lender with loans primarily to conventional, non-conforming and subprime products. Loan decisions on non-portfolio products were typically made by secondary market lenders such as Fannie or Freddie or by private investors. VRB’s new department takes the entire real estate lending process in-house to include local processing, underwriting, and closing of residential real estate loans. VRB believes the hometown touch is paramount. “The most important benefit to customers is that they will deal with local loan officers and all decisions will be made by local VRB employees,” says Judi Hartmann, VRB Vice President and Manager of the new department. (*Business Wire*, 8/3/99)

Article asks “Will Fannie or Freddie be Your Next Lender?”

- Peter Miller, with OurBroker®, wrote an article on the dominance of Fannie and Freddie, the formation of FM WATCH, and their impact on consumers. Miller began his piece by listing some of the many benefits that Fannie and Freddie receive from their GSEs status -- their income tax exemptions, and the fact that the GSEs do not register shares with the SEC, which he estimates saves the GSEs about \$500 million a year.
- In addition, Miller noted that the GSEs seem to be moving closer to originating mortgages. He warned, “the looming problem is not who makes loans today, but who will make loans tomorrow. So far, Fannie Mae and Freddie Mac make no loans directly to the public, but lenders worry that with the Internet that may change.” Miller added that lenders sell “fungible” products -- with the same products as other lenders. As an example, Miller said that if a consumer needed an FHA loan, it didn’t matter if it came from an online lender, a bank down the street, or one across the country. So, if all FHA programs are the same, then the issue for consumers is price, not the lenders.
- Therefore, lenders have begun to worry that the GSEs are aiming to take advantage of the “efficiencies of the Internet and combine[ing] them with the size and advantages of the Fannie Mae and Freddie Mac.” That is why the new coalition, FM WATCH has been formed by

various lenders and mortgage insurers to keep the GSEs out of the primary market, noted Miller.

- Miller further noted that a debate has been brewing over who should benefit from the efficiencies and advantages enjoyed by the GSEs -- shareholder, borrowers, or tax collectors. He noted that consumer advocate Ralph Nader argues that Fannie and Freddie shareholders are receiving too much benefit for too little risk. He quoted the testimony of Nader, at a House Budget Committee Hearing this past June, as saying “according to the CBO, Fannie and Freddie pass only part of their subsidy [estimated at \$6.5 billion in 1995] on to homebuyers -- about \$4.4 billion -- with the remainder ... pocketed by private shareholders, the corporations’ executives and lobbyists. In other words, for every \$2 dollars delivered to homebuyers, Fannie and Freddie take \$1 of the subsidy for themselves.”
- An idea has been floated to tax the investment portfolios of Fannie and Freddie, however, Miller noted that Fannie Mae CEO Franklin Raines has said that by increasing mortgage costs by as little as .25 percent in fees and taxes would penalize almost 400,000 prospective homebuyers. “So far Fannie and Freddie have successfully defended their territory, and lenders have defended their turf as well. There are no new taxes on GSEs and Fannie and Freddie are not offering loans directly to consumers. But in any debate where hundreds of billions of dollars are at stake, you can safely bet that the discussion is far from over.”
- Miller believes that Fannie, Freddie and lenders are all at risk in the Internet era. “The Web makes all lenders ‘local,’ and online lenders have shown that mortgages by modem are both practical and competitive. If in the future we find an online lender who both makes mortgages and sells securities on Wall Street, then mortgage costs may be forced down and the home financing landscape will be entirely changed.” (Peter G. Miller, *OurBroker*®; www.realtimes.com, 8/10/99)

Fannie/Freddie watchdog group – FM WATCH – modifies its website per request from Fannie Mae lawyer

FM WATCH also adds a whistleblower page to its website

- FM WATCH has made cosmetic changes to its website (FMWatch.org) in response to a request from trademark lawyers for Fannie. According to FM WATCH Executive Director Mike House, “We received a letter from one of Fannie Mae’s lawyers asking for some minor changes to our website. In between the names ‘FM Watch’ and Fannie Mae and Freddie in the corner of each page of the website, we have now added the words ‘shining a spotlight on.’ In addition, the title tag has been changed to read ‘FM Watch’ instead of ‘Fannie Mae Watch.’”
- In the process of reviewing the website, FM WATCH also decided to modify its website and added a “whistleblower” page to make it easier for those with examples of Fannie Mae and Freddie Mac putting the interest of their investors above the interests of homebuyers and taxpayers to pass on information. “A careful review of our website following Fannie Mae’s request revealed a glaring oversight by FM Watch, the lack of a whistleblower page. Since our formation, we have received numerous calls from whistleblowers, and we decided this would be a convenient and confidential way that even more can contact us,” House said. (*FM WATCH press release, 8/3/99*)

The Mortgage Insurance Companies of America (MICA) welcomes Congressman James Hansen's (R-UT) proposal for a GAO study on mortgage insurance and whether alternative, more efficient, means of default loss protection exist

MICA says the proposed study will give insurers an opportunity to make the case that Fannie & Freddie's insurance plans "circumvent the [private mortgage insurance] cancellation law"

- In a "Dear Colleague" letter, Congressman James Hansen (R-UT) said he intends to request a GAO study "to take a comprehensive look at mortgage insurance, the mortgage insurance industry, and whether alternative, more efficient means of default loss protection exist." According to the letter, Congressman Hansen's GAO request was prompted by a mortgage insurance cancellation law that took effect recently and by insurance alternatives introduced this year by Fannie and Freddie. According to a *National Mortgage News* article by Brian Collins, the mortgage insurance companies suspect that Fannie suggested the idea of a GAO study to Cong. Hansen, but they see it as an opportunity to talk about the value of mortgage insurance. "In addition, we welcome GAO looking into these delivery fee programs that Fannie and Freddie are starting to use," said Suzanne Hutchinson, Executive Vice President of the Mortgage Insurance Companies of America."
- MICA claims that the GSEs charge delivery fees on their insurance alternative products that the consumer has to pay at closing or through a higher note rate. MICA claims that in most cases this actually raises mortgage insurance costs to consumers. "It will be interesting, from Mr. Hansen's perspective, because those fees circumvent his law," Ms. Hutchinson said. [Once a portion of the cost of the reduced mortgage insurance is added to the interest rate, it cannot be canceled.] According to an *American Banker* article by Marc Hochstein, Cong. Hansen's mortgage insurance cancellation law requires insurers to cancel mortgage insurance policies once a borrower's equity in a home has reached 22%, and to cancel upon request for borrowers who have build up 20% equity. MICA notes that unlike private mortgage insurance premiums, the delivery fees in the GSEs' structures may not be canceled. A Freddie spokeswoman disagreed, and said that consumers save more even if they pay the delivery fee. Fannie spokesman David Jeffers stated that "It is ridiculous, and it is a smoke screen to hide their desire to cost consumers more money." *National Mortgage News* reported that an aide to Congressman Hansen stated that a final decision has not been made yet and any request for a GAO study will not be finalized for at least a month. (*National Mortgage News*, Brian Collins, 8/9/99; *American Banker*, Marc Hochstein, 8/6/99; "Dear Colleague" Letter by Congressman James Hansen (R-UT), 7/22/99)

President and CEO of Ultraprise.com – a private-sector Web-based Internet secondary mortgage market exchange – advises the mortgage industry to use business-to-business Internet commerce to redirect the flow of its business to alternative engines, other than Fannie's and Freddie's proprietary systems

- According to *National Mortgage News*, Ultraprise.com President and Chief Operating Officer David Matthews had a message for attendees at a recent Western Secondary Market Conference: the untapped potential for changing the business model in mortgage banking lies in the business-to-business arena. "We know the GSEs have changed the rules with their proprietary systems," he stated. "And no matter how much they've helped the industry with LP [Freddie's automated underwriting system] and DU and DO [Fannie's automated underwriting system]...remember that they own that technology. By simply shifting the gears in their automated underwriting engines, they can increase the flow of Alt A and subprime business that flows into their portfolios. "By

using the Internet to redirect the flow of your business into the alternative...engines provided by large investors, that business can remain within the province of the mortgage banking industry. Business-to-business e-commerce exchanges will facilitate that process in the months to come. The open nature of the Internet eschews the proprietary networks provided by the agencies and the one-way data flows and will offer alternatives to the way we do business today.” (*National Mortgage News*, 8/2/99)

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

Fannie’s Recent Developments:

(1) Fannie supplies computers and software [presumably Fannie’s] to community non-profit groups

(2) Fannie announces that FiNet.com and Monument Mortgage were selected for Fannie’s Technology Leadership Award - Companies were selected based on their usage of Fannie’s technology

FiNet.com, owns iQualify, a Fannie/Finet technology partnership that allows consumers direct access to Fannie’s automated underwriting system - FiNet.com also owns Monument Mortgage

Freddie’s Recent Developments:

Freddie establishes a new board to assist servicers in using Freddie’s technology including onsite visits from Freddie

[Due to the GSEs’ duopoly power in the secondary market, this new servicer arrangement makes it even more difficult for private sector technology to compete against the GSEs’ technology]

Fannie’s Recent Developments:

(1) Fannie supplies computers and software [presumably Fannie’s] to community non-profit groups

- According to an article in *The Tennessean*, Fannie will supply computer software [presumably Fannie’s] and other support services for community-based organizations that help low- to moderate-income residents buy houses or find affordable rental housing. Roshun Austin-Wilson, the Orange Mound Development Corp, a non-profit group, said Fannie has supplied her group with computer software and other assistance to screen potential home buyers and help them qualify for loans. (*The Tennessean*, 8/3/99)

(2) Fannie announces that FiNet.com and Monument Mortgage were selected for Fannie’s

Technology Leadership Award - Companies were selected based on their usage of Fannie's technology

FiNet.com, owns iQualify, a Fannie/Finet technology partnership that allows consumers direct access to Fannie's automated underwriting system - FiNet.com also owns Monument Mortgage

- Fannie presented FiNet.com and Monument Mortgage with its Technology Leadership Award. The award selection is based on a lender's innovative use of Fannie's technology to streamline the mortgage process. FiNet.com and its Monument Mortgage subsidiary use Fannie's automated underwriting system, Desktop Underwriter, as an integral part of the loan origination system. FiNet.com, owns iQualify.com, the first website to allow consumers to directly access Fannie's automated underwriting system for a "Fannie-approved" loan. According to the press release, Monument Mortgage leads the Western Region in Fannie's Desktop Originator loan submissions and was the first lender in the region to adopt Desktop Originator technology. (Monument Mortgage is owned by Finet.) (*Business Wire*, 8/4/99) In related news, FiNet.com announced it has entered into a partnership with Forbes.com to create a multi-functional co-branded Mortgage Center providing visitors to the Forbes.com website with on-line financing services. Visitors to Forbes.com will have direct access to FiNet.com's mortgage information, rate comparison, and on-line loan application, power by FiNet.com's Interloan consumer-direct channel. Direct links to the Mortgage Center will be strategically placed throughout the entire Forbes.com website. (*TitleWeb.com Title News*, 8/5/99)

Freddie's Recent Developments

Freddie establishes a new board to assist servicers in using Freddie's technology including onsite visits from Freddie

- According to a *Real Estate Finance Today* article, Marcia Davies, Director of Servicing Relations at Freddie, noted that Freddie has established a new board that will work hand in hand to assist servicers in choosing the right [Freddie] technology in order to increase efficiency and eliminate redundancies. According to Davies, each servicer has a team from Freddie assigned to them to make sure that their needs are being met by Freddie which includes making onsite visits to servicers. (*Real Estate Finance Today*, 7/30/99)

Federal Trade Commission holds public forum on credit scoring

Fannie & Freddie use credit scoring in their automated underwriting systems (GSEs control 95% of the automated underwriting market share)

There were some criticisms of the GSEs' automated underwriting systems

A study commissioned by HUD found that Fannie & Freddie's automated underwriting systems and use of credit scoring may be discriminatory

- The FTC held a public forum on July 22, 1999 entitled "The Consumer and Credit Scoring." The forum touched on many aspects of credit scoring and automated underwriting. Topics included: Mechanics of Credit Scoring; Use of Credit Scoring in the Mortgage Industry (with presentations

from Fannie and Freddie); Consumers' Experiences with Credit Scoring; Is Credit Scoring Fair; and What Information Should Consumers Receive About Credit Scoring?

- During the daylong forum, there were several themes that resonated throughout. The first theme, presented by Peter McCorkell, a representative of Fair Isaac and Company, was that credit scoring and automated underwriting were useful tools. Not surprisingly, representatives of Fannie and Freddie repeated this theme. However, as the forum moved into topics centered around consumers, the themes shifted to the need for consumer education about their credit scores and the potential problems with credit reports and credit bureaus.
- As we have reported in previous *GSE Reports*, the GSEs currently control over 95% of the automated underwriting market with their underwriting systems -- Desktop Underwriter (Fannie) and Loan Prospector (Freddie). Both of their systems were built using the Fair Isaac model. Representatives from Fannie and Freddie gave presentations in the second panel of the morning, entitled, "The Use of Credit Scoring in the Mortgage Industry."
- Pamela Johnson, Vice President, Single Family Mortgage Business at Fannie, defended Fannie's use of credit scores by noting that Fannie has done extensive research, and concluded that credit scores are predictive and fair to all consumers. According to Johnson, Fannie does not use factors such as age, time in residence, or owning v. renting as part of their credit scoring. Instead, they use the factors that McCorkell described in his presentation: previous credit performances, current level of indebtedness, amount of time credit has been in use, the pursuit of new credit and types of credit available. She said that credit scores are predictive of defaults, and regardless of race, the lower the credit score, the more defaults.
- However, Johnson noted that Fannie does not turn away loans because of low credit scores. Fannie sends letters to lenders that "guide" lenders when a consumer's FICO score is below 620 -- the normal cutoff point. Fannie's automated underwriting system -- Desktop Underwriter -- issues three possible recommendations to brokers for loans: Approve, which gives lenders the green light; Refer, where a lender needs to review the application more carefully; and Refer with Caution, which means that Fannie probably will not buy the loan, but lenders should carefully examine the application. Johnson said that loans with receive a Refer with Caution flag from Desktop Underwriter are six times more likely to default than approved loans.
- Johnson concluded by saying that manual underwriting is much more likely to be prejudiced than objective scoring.
- Peter Mahoney, Associate General Counsel at Freddie, used his presentation to try to debunk "10 Myths of Credit Scoring," addressing issues he said were points of contention within the entire mortgage community. This included the "myth" that credit scores make lending decisions, which Mahoney said was false because the underwriting programs in computers are tools to guide lenders. He also addressed the myth that credit scores are unfair to low/moderate income borrowers, which he, like Johnson and McCorkell, said was false, and noted that distribution rates were very similar for all income levels in terms of defaults.
- Mahoney also discussed the myth that minority borrowers were unfairly treated with credit scores, saying that the mortgage industry has made great strides in the past ten years in terms of minority

borrowers, and while there may still be some lingering bias, the use of subjective credit scoring will reduce bias.

- Perhaps Mahoney's "myth" that received the most attention from participants later in the conference was his assertion that credit scores *are not* unknown "black boxes" of numbers and variables. Instead, he said the variables that go into credit scores are publicly available and common. Like Fannie, Freddie does not use variables such as renting v. owning, and age. The GSE uses debt to income ratio, the amount of cash reserves, and a consumer's credit reputation as factors to compute credit scores and to underwrite loans through Loan Prospector, Freddie's automated underwriting system.
- Mahoney also discussed the "myth" that credit scores were always predictive for everyone, which he said was false, but reiterated that credit scores improve odds that lenders will "get it right." Finally, Mahoney attempted to address the myth that credit scoring reduces the availability of low-cost mortgage credit, which he said was false. Mahoney's answer was very roundabout, stating first that credit scoring streamlines the mortgage process, bringing technology to the consumers, and allowing Freddie to purchase loans that were once considered A-

Criticisms of GSEs

- Despite their market dominance, the GSEs did not receive much criticism or attention from those participating in or attending the FTC forum. The lack of attention can be attributed to two things. First, the panel that Johnson and Mahoney participated in ran late, and to make up for time, the moderator did not ask for questions from the audience. Secondly, and probably more importantly, representatives from Fannie and Freddie did not stay for the entire forum, both leaving soon after their presentations.
- There was a slight amount of criticism of the GSEs from mortgage broker Caryl Iseman, a panelist. She criticized Freddie for portraying themselves as a "100% Low-Income Lender," while sending out instructions for certain loans to be run through Loan Prospector that required a minimum FICO score of 680 *just to be run through*. Richard Lefebvre, who runs a credit repository, was critical of the GSEs for not allowing third-party intervention into their automated systems to prevent problems with credit scores. He commented that he had seen many people receive lesser-quality loans because of incorrect information on their credit reports. He also was critical of the fees that the GSEs charge lenders to use their automated systems.
- Pamela Johnson of Fannie did stay at the forum long enough to respond to Caryl Iseman's concerns about the GSEs not accepting loans because of low FICO scores. She noted that Fannie does not approve or deny loans, they "recommend" whether a loan should be processed or not. She also said that Desktop Underwriter gives an automatic yes to 75-80% of loans, the rest of which go back to lenders for further review. "We do not have minimum credit scores in our system," said Johnson.
- However, Johnson left the forum after her brief comments and Peter McCorkell of Fair Isaac was left to defend automated underwriting and credit scores by himself throughout the afternoon.

(Public Forum, *The Federal Trade Commission*, July 22, 1999)

A recent study commissioned by HUD found that Fannie & Freddie's automated underwriting systems and use of credit scoring may be discriminatory

- As reported in a previous *GSE Report*, an independent study commissioned for HUD by the Urban Institute found that that Fannie and Freddie's underwriting guidelines may have an unintentional but adverse impact on borrowers with low incomes, limited wealth and poor credit histories which are "disproportionately minority." The report also noted that Fannie and Freddie "do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities." The report noted that "Primary lenders are making more aggressive efforts" to serve the lower income and minority home buyers "by offering loan products with underwriting guidelines that are more flexible than the GSEs' guidelines." The report also noted that the use of automated underwriting systems and credit scores may place lower-income borrowers at a disadvantage when applying for a loan, even when they are acceptable credit risks. Further, automated systems make it more difficult for "marginal applicants" to receive personalized attention from an underwriter, and some "informants" believe credit scores might not be accurate predictors of loan performance, despite contrary claims by the GSEs. According to the *Wall Street Journal*, **HUD Assistant Secretary William Apgar stated that the report raises serious questions about [the GSEs'] lending practices and the department will look into these immediately.** (*Wall Street Journal*, 4/30/99; HUD Study, "A Study of the GSEs' Single Family Underwriting Guidelines", April 1999)

Fannie Mae

HomeStore.com has an initial public offering (IPO) on August 5

Fannie has a 3.5% Equity Interest in HomeStore.com – owning 2.08 million shares in the company

HomeStore's stock price opened at \$20 and has risen as high as \$44 15/16 in recent days, giving Fannie astronomical profits

Despite its public mission, Fannie refuses to discuss what it intends to do with the proceeds – Fannie Spokesman John Buckley stated that "The last thing we'd do in the world is discuss our intentions"

***Inman News Feature* notes that federal law requires anything that affects a public firm's worth must be disclosed. [Fannie is exempt, however, from SEC registrations that normally protect investors.]**

HomeStore.com owns Realtor.com (the largest home-listing site on the Internet and official site of the National Association of Realtors), HomeBuilder.com, SpringStreet.com (rental properties) and Commercial Source.com (commercial real estate)

HomeStore.com says it has plans to enter into home financing, repair, remodeling, and landscaping

Controversy surrounds HomeStore.com

The Federal Trade Commission has turned over an investigation of HomeStore.com to the US Department of Justice's Antitrust Division over HomeStore.com's practice of signing exclusive

property listing agreements with multiple listing services (Realtor.com lists 81% of the US' MLS-listed properties)

[It is questionable how an investment in an Internet IPO meets Fannie's public mission of providing liquidity to the secondary mortgage market.]

Fannie has a significant equity stake in HomeStore.com

HomeStore.com - As we reported in the June 11 *GSE Report*, when HomeStore.com filed its official papers on May 28 to announce a public offering of the company, it was revealed that Fannie owned 833,354 shares or 4.5% of the company. The National Association of Realtors, for which Realtor.com is its official website (and major part of HomeStore.com), only owns 9% of the company. According to *Inman News Feature* on August 4, a more recent S-1 filing with the SEC by HomeStore reveals Fannie has 2.08 million shares with an aggregate purchase price of about \$10 million, accounting for a 3.5% stake of shares beneficially owned. According to *Inman*, the amended SEC report also noted that the National Association of Realtors will own a 6.8% share of HomeStore.com and GE will own 5.7%.

HomeStore.com owns the following websites:

Realtor.com – the largest home listing site on the Internet and official site of the National Association of Realtors

HomeBuilder.com – the web's leading provider information on newly built homes, with listings for more than 100,000 new homes and planned developments throughout the US;

SpringStreet.com – listing more than 6 million rental units in 6,000 cities nationwide; and

CommercialSource.com – the official commercial real estate site of the National Association of Realtors.

- HomeStore.com had an IPO on August 5, opening at \$20 a share. The stock only had a modest opening gain of 15%, and closed its first day of trading at \$22 ³/₄ per share. According to *Inman News Feature*, "With a modest opening gain, you can't really say HomeStore.com's IPO was a failure. But to many online realty professionals and industry observers, it may have been." The stock, however, has risen in recent days to as high as \$44 ¹⁵/₁₆.

HomeStore.com says it has plans to enter into home financing, repair, remodeling, and landscaping

- According to a *LA Times* article, HomeStore.com says it has plans to move into other ancillary home-related services and products, such as home financing, repair, remodeling, and landscaping.

Fannie refuses to discuss its investment in HomeStore

- Despite its public mission, Fannie refuses to discuss what it intends to do with the proceeds – Fannie Spokesman John Buckley stated that "**The last thing we'd do in the world is discuss our intentions**"
- "We're aware of (the HomeStore investment) said Fannie Board-Member Karen Hastie Williams, who is an attorney with Crowell & Moring, a Washington, DC-based law firm. "It's consistent

with the mission of Fannie Mae.” Hastie Williams, however, said she would not say what Fannie plans to do with its HomeStore.com shares, or whether Fannie would donate any proceeds to the Fannie Mae Foundation. She noted that Fannie executives have discussed the possibility. Other Board of Directors refused to comment. *Inman News Feature* reported that Fannie insiders say the company plans to sell the stock and donate all proceeds to the Fannie Mae Foundation.

- ***Inman News Feature* also noted that federal law requires anything that affects a public firm’s worth must be disclosed. [Fannie might argue that it’s a private company so it doesn’t have to meet that requirement, but unlike private companies, Fannie is exempt from SEC filings, so investors, taxpayers, and consumers really have no idea about Fannie’s material gains or losses.]** Fannie spokesman John Buckley said the \$10 million is so small in comparison to Fannie’s \$400 billion in mortgages in 1998 that Fannie is not required to notify investors of the investment. Buckley stated that HomeStore.com is the only public company in which Fannie owns shares.

Controversy surrounds HomeStore.com

Cendant files lawsuit

- Cendant Corp., whose real-estate division operates the Century 21, Coldwell Banker, and ERA franchises, filed a lawsuit against HomeStore.com prior to the Internet company’s IPO, alleging that HomeStore.com failed to honor a commitment to offer Cendant an equity stake in its IPO. Cendant filed suit against HomeStore.com and its subsidiary, RealSelect, for up to \$300 million in damages. Under the suit, filed in New York State Supreme Court, Cendant said it gave a unit of HomeStore.com – RealSelect - access to its real estate listing data in exchange for a cash fee and a written agreement saying HomeStore would make a good faith effort to issue Cendant \$7 million of private stock before it went public. HomeStore did offer certain Cendant executives a “personal opportunity” to participate in its IPO. However, the offer was not made to Cendant itself, and the executives turned down the offer as “inappropriate.” Cendant is seeking damages for breach of contract. The company noted that the \$300 million estimate is based on the fact that HomeStore’s value has “increased significantly” since 1998. The amount Cendant would have received when the agreement was made would be worth \$56 million today and could be worth more than \$300 million based on comparable Internet-sector IPOs, Cendant said. HomeStore has not responded to the specifics of the Cendant case, but said through a statement that the suit was “without merit.” In an S-1/A filing by HomeStore with the SEC on August 2, HomeStore said it was considering filing a counterclaim against Cendant.

Federal Trade Commission and Department of Justice examine HomeStore.com

- According to *Inman News Feature*, the Federal Trade Commission has turned over an investigation of HomeStore.com to the US Department of Justice’s Antitrust Division. HomeStore officials have so far said they are unaware of an investigation. Both the FTC and DOJ have said they are unable to confirm or deny the investigation. HomeStore’s practice of signing exclusive property listing agreements with multiple listing services has generated controversy among critics and competitors who view the deals as anti-competitive. Realtor.com reportedly lists 81% of the US’ MLS-listed properties. (*Inman News Feature*, 7/29/99,7/30/99,8/2/99, 8/4/99,8/5/99, 8/16/99; *LA Times*, 8/2/99; *Reuters*, 7/28/99; *Wall Street Journal*, 8/6/99)

Fannie starts a pilot program to automate B & C loans

- According to an article in the *Sacramento Bee* by Michele Dillingham, Fannie started a pilot program that reaches out to more borrowers by adjusting to credit problems. According to Dillingham, the Fannie pilot program is allowing borrowers who might normally have needed to go to the subprime or B & C market to now go to a regular lender instead.
- The pilot is a Fannie automated underwriting pilot program. Fannie's automated underwriting system is Desktop Underwriter (DU). The pilot DU allows for three levels beyond the standard Fannie A paper loans. The interest rate is higher and the points can be higher as well, but the borrower is getting a Fannie conventional loan with no prepayment penalty and the rate and points will usually still be less than with a subprime lender. The rate difference might be 1.5 to 2% higher than the regular Fannie loan. Dillingham says what level a borrower is approved at by DU depends on the risk involved with the loan. Level I loans are comparable to an A- loan, Level II comparable to a B loan, and Level III comparable to a C loan. Dillingham said the DU pilot is not available to all lenders at this time. (*Sacramento Bee*, Michele Dillingham (who is also a Senior Loan Consultant for Mission Hills Mortgage in Sacramento), 8/1/99)

Mission creep - Fannie expands into construction loans

- Fannie held a press conference with Cong. Cal Dooley (D-CA) to announce a \$10 million loan pilot to enable self-help non-profit developers in Central Valley and Southern California to finance construction and permanent phases of homes built through "sweat equity" with one fixed-rate mortgage. The program – the Mutual Self-Help Construction-to-Permanent Initiative – will provide resources to Self-Help Enterprises in Visalia, People's Self-Help Housing Corporation in San Luis Obispo, Coachella Valley Housing Coalition in Indio, and Rural California Housing Corporation in Sacramento. According to a Fannie press release, the borrower can lock-in the current interest rates for both the construction and the permanent phases of the loan, and finance the cost of the land and materials to build a single-unit, owner-occupied home. During the construction phase, the loan funds are disbursed to the borrower as each stage of the home is completed, with the borrower paying interest only on the funds disbursed. The construction phase can be up to twelve months, and once the home is built, the mortgage is automatically converted into a permanent loan. If participating families provide a total of 1,400 hours of sweat equity to help construct their home in a nine-month period, their down payment will be just \$1,000. In addition, according to Fannie, the initiative will save the self-help borrower an estimated \$1,500 in construction financing costs. The Mutual Self-Help Construction-to-Permanent Initiative is available through Dime/North American Mortgage and the four self-help non-profit developers to families earning 80% or less of the area median income. (*Fannie press release*, 8/18/99)

Fannie announces it will purchase 4.99% of the voting shares of a savings bank in Buffalo, NY to assist the savings bank in opening for business

Fannie also purchases a \$300,000 certificate of deposit in another savings bank in Tennessee

[Investing in depository institutions appears to be outside Fannie & Freddie's mission.]

- According to a Fannie press release, Fannie announced in a press conference that it has committed to purchase up to 4.99% of Greater Buffalo Savings Bank's (GBSB) total voting common shares.

According to the press release, the investment will allow the bank, which will focus on community-focused lending, to open for business in the last quarter of 1999. "With Fannie Mae's participation, the existence of the bank is now assured," said Andrew Dorn, President of GBSB. "We have now exceeded the minimum required regulatory capital, and have directed the commencement of construction for our first branch in downtown Buffalo." Buffalo Mayor Anthony Masiello and Congressman Jack Quinn (R-NY) and Cong. Tom Reynolds (R-NY) were also at the press conference. (*Fannie press release, 8/16/99*)

Fannie purchases a \$300,000 certificate of deposit in another savings bank

- Fannie held a press conference with Cong. Harold Ford (D-TN) to announce a \$7 billion "HouseTennessee" investment plan. As part of the program, Fannie purchased a \$300,000 certificate of deposit in Citizens Savings Bank and Trust Company. (*Fannie press release, 8/2/99*)

American Mortgage Acceptance announces \$250 million apartment loan venture with Fannie

- American Mortgage Acceptance Company (AMAC) announced Fannie's approval of up to \$250 million of DUS loans for apartment properties that qualify for Low Income Housing Tax Credits under Section 42 of the Tax Code. Under the transaction, AMAC will originate and contract for individual loans of up to \$6 million each over a two-year period and will work with American Property Financing, which will underwrite and service the loans for Fannie. Each property in the transaction will benefit from 9% Low Income Housing Tax Credits for no less than 90% of the its units. (*PR Wire, 8/10/99*)

Fannie, like 68 other Fortune 500 companies, offers economic benefits to same-sex domestic partners

- According to a *Chicago Sun-Times* article, there are currently 68 Fortune 500 companies that offer economic benefits such as medical, dental and life insurance and pension survivor benefits to same-sex domestic partners. The list of 68 companies includes Fannie. (*Chicago Sun Times, 8/3/99*)

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 eight more are in the process of being organized)

Fannie announces it is opening a partnership office in Cheyenne, Wyoming and Nashville, TN

Fannie announces a director for its new Pittsburgh partnership office

Fannie expects to open Milwaukee office by September 1

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; Nashville, TN and Cheyenne, WY. 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*)

New Director for Pittsburgh partnership office

- Fannie announced that it has named Howard B. Slaughter, Jr., Director of its new Pittsburgh Partnership office. According to the press release, Slaughter most recently served as director of Preservation Services for the Pittsburgh History and Landmarks Foundation. (*Fannie press release, 8/12/99*)

Milwaukee office to be opened in September

- According to the *Milwaukee Journal*, Maureen Warren, Vice President of Housing and Community Development for Fannie's Midwest office, said Fannie is currently interviewing candidates for a three-person office in Milwaukee due to open September 1. (*Milwaukee Journal, 8/2/99*)

Senator Craig Thomas (R-WY), Senator Mike Enzi (R-WY), Cong. Barbara Cubin (R-WY), Cong. Mike Enzi (R-WY), WY Governor Jim Geringer, and Cheyenne Mayor Leon Pando

- Fannie held a press conference with the above officials to announce that Fannie had committed to opening a new partnership office in Cheyenne, WY. According to the press release, Governor Geringer and Senators Thomas and Enzi directly requested that Fannie open a partnership office in Wyoming. (*Fannie press release, 8/13/99*)

Senator Jeff Bingaman (D-NM) and the National Home Builders of Central New Mexico

- Fannie held a press conference with Senator Bingaman and the National Home Builders of Central New Mexico to announce a new \$5 million energy efficient mortgage product – DREEM Mortgage. Fannie has committed to purchase \$5 million in Albuquerque DREEM Mortgages from lenders. The DREEM Mortgage is a low down payment product to help lower-income families purchase a home with significant energy and utility savings. The new product is available for borrowers in Albuquerque whose incomes are at or below 80% of the area median income and are buying a new home with energy or other savings, such as (1) qualifies under the “Green Builder” program of Home Builders Association of Central New Mexico; (2) energy efficiency exceeds the requirements of model energy code; and (3) property is located within five miles of central business district and employs water savings and other resource conservation methods. (*Fannie press release, 8/18/99*)

Cong. Cal Dooley (D-CA) – Fannie expands into Construction Loan

- Fannie held a press conference with Cong. Cal Dooley (D-CA) to announce a \$10 million loan Mutual Self-Help Construction-to-Permanent Initiative. (*Fannie press release, 8/18/99*)

Cong. Edolphus Towns (D-NY) – Fannie gives \$40,000 grant to Faith Center for Community Development

- Fannie held a press conference with Cong. Towns to announce Fannie's grant of \$40,000 to the Faith Center for Community Development to fund the “Faith-Based Homeownership Project.”(*Fannie press release, 8/19/99*)

Cong. Jack Quinn (R-NY), Cong. Tom Reynolds (R-NY) and Buffalo, NY Mayor Anthony Masiello

- Fannie held a press conference with the above officials to announce that it has committed to purchasing up to 4.99% of Greater Buffalo Savings Bank's (GBSB) total voting common shares. (*Fannie press release, 8/16/99*)

Congressman Ed Pastor (D-AZ), Phoenix Mayor Skip Rimsza

- Fannie held a press conference with the above officials and representatives from Banc One and Irwin Mortgage to announce the second-year results of "HousePhoenix." As part of the announcement, new housing initiatives were unveiled for first-time homebuyers, homeownership assistance for the disabled and greater resources for home rehabilitation, as well as the formation of the Phoenix Affordable Housing Advisory Council to be chaired by Mayor Rimsza. (*Fannie press release, 8/9/99*)

Congressman Nick Lampson (D-TX) and Beaumont, TX Mayor David Moore

- Fannie held a press conference with the above officials and representatives from Beaumont Main Street, the National Development Council (NDC), Hibernia National Bank, First Bank & Trust, Community Bank and Trust, and HUD to announce the kick-off of a \$8.5 million restoration of the Historic Beaumont Hotel. Fannie invested \$1.45 million through its American Communities Fund (ACF) in the purchase of historic tax credits for Hotel Beaumont, an affordable senior living community. (*Fannie press release, 8/10/99*)

Cong. Harold Ford (D-TN) announce a \$7 billion "HouseTennessee" plan

- Fannie held a press conference with Cong. Harold Ford (D-TN) to announce a \$7 billion "HouseTennessee" investment plan. As part of the program, Fannie purchased a \$300,000 certificate of deposit in Citizens Savings Bank and Trust Company. In May 1999, Fannie announced the opening of its statewide Tennessee partnership office in downtown Nashville. A director for the Nashville office has still not be named. (*Fannie press release, 8/2/99; The Tennessean, 8/3/99*)

Fannie and Missouri State Treasurer Bob Holden announce a new 1% down-payment program for Missouri residents

- Fannie announced a new partnership with the Missouri Housing Development Commission (MHDC) to assist more first-time homebuyers purchase a home. The program, "First Home 1% Down" allows qualified, first-time homebuyers to obtain conventional mortgages with a down payment of as little as one percent from the borrower's own funds. Missouri State Treasurer Bob Holden, who is also commission of MHDC, issued a statement of support. As part of the program, MHDC will provide buyers with a grant of 4 percent to be used towards down payments and closing costs. A First Home 1% Down mortgage loan may be used for the balance of the home purchase, up to 97 percent of the price. All applicants must meet income guidelines established by the MHDC. Borrowers under this initiative will be required to participate in a home-buyer education session. (*Fannie press release, 8/9/99*)

Fannie selects 80 housing partners to participate in a Washington, DC Fannie Mae Partner Summit

Participants also met with Members of Congress to discuss the impact of housing legislation being considered in Congress

- Fannie announced that more than 80 housing partners were selected to attend the Washington, DC Fannie Mae Partner Summit on July 12-13. During the Summit, participants met with Members of Congress to discuss the impact of housing legislation being considered by the Congress. According to a Fannie press release, the following people were participants in the conference:

Brenda Weaver Ackinson, Lexington, KY, president and owner of Ackinson Financial Services Inc., and CredAbility, Inc.;

Herbert W. Appel, Jr., Houston, TX, president of the Greater Fort Bend Economic Development Council;

Darlys Baum, Pierre, SD, executive director of the South Dakota Housing Development Authority;

Gerald Beeson, Irving, TX, chief executive officer of CHM Satellite Communications, Inc.;

Pastor Gary E. Bender, Lawton, OK, pastor of Bethlehem Baptist Church;

Lorna Bourg, New Iberia, LA, co-founder, executive dir. & president of the Southern Mutual Help Association (SMHA);

Richard Brustad, Minneapolis, MN, partner of Brighton Development Corporation;

Robert J. Buchert, Cincinnati, OH, president of American Heritage Construction and Development Corporation;

Mary Frances Burleson, Dallas, TX, president of Ebby Halliday, REALTORS;

Leah K. Carter, Tallahassee, FL, interim exec. dir. of Tallahassee Lenders' Consortium, exec. dir. of FL Housing Trust;

Athan "Buster" F. Castiglia, Miami, FL, president of Continental National Bank;

Linda Chapin, Orlando, FL, clerk of the Courts for Orange County;

Brenda J. Clement, Providence, RI, executive director of the Housing Network of Rhode Island;

David W. Curtis, Wilmington, DE, executive vice president & chief financial officer of Leon N. Weiner & Associates, Inc.;

Gwendolyn B. Dawson, Gainesville, FL, leader of the "Cedar Grove" project;

Hayes Dent, Yazoo City, MS, president of The Avoca Company, Inc.;

Gary Dodge, Des Moines, IA, Neighborhood Finance Corporation (NFC);

Hattie B. Dorsey, Atlanta, GA, president and CEO of the Atlanta Neighborhood Development Partnership (ANDP);

Jay Epstein, Newport News, VA, president of Gabriel Enterprises;

Tommy Espinoza, Washington, DC, VP of community development & partnerships for Nat'l Council of La Raza (NCLR);

Leigh M. Ferguson, Chattanooga, TN, president and CEO of Chattanooga Neighborhood Enterprises, Inc., (CNE);

Richard C. D. Fleming, St. Louis, MO, chief executive officer of the St. Louis Chamber of Commerce;

The Honorable Maude Ford Lee, West Palm Beach, FL, chair of the Board of County Commissioners;

Peter A. Gagliardi, Springfield, MA, executive director of HAP, Inc., the Hampden Hampshire Housing Partnership;

Ron Garcia, Whittier, CA, vp for loan production & manag. of Retail Banking Division, Quaker City Fed. Savings & Loan;

Maria J. Garciaz, Salt Lake City, UT, executive director of Salt Lake Neighborhood Housing Services (NHS);

Kathryn "Kitty" George, Union Grove, WI, vice president of secondary marketing at Community State Bank;

Maria Gerwing, Louisville, KY, president of Housing Partnership, Inc., (HPI);

Bernard Gliberman, Novi, MI, owner and president of Crosswinds Communities, Inc., Affordable Mortgage Company, LLC, and Innovative Environmental Solutions, Inc.;

John J. Griffith, Omaha, NE, first vice president and community investment officer of Commercial Federal Bank and senior vice president for Commercial Federal Mortgage Corporation;

John Harvey, Kansas City, KS, convener of the Community Development Assoc. & exec. dir. of City Vision Ministries;

Joe W. Hatfield, Charleston, WV, chief administrative officer of the West Virginia Housing Development Fund;

Isaac Heard, Jr., Charlotte, NC, executive director of the Northwest Corridor Community Development Corporation;

Colleen Hernandez, Kansas City, MO, executive director of the Kansas City Neighborhood Alliance (KCNA);

Jacqueline D. Hill, Pittsburgh, PA, vice president of North Side Civic Development Council, the North Side Community Development Corp., (CDC);

Buz Hoffman, Hoffman Estates, IL, founder and president of Lakewood Homes, chairman of LHI Mortgage, Inc., and Northland Title Company;

Doug Hollyhand, Tuscaloosa, AL, president of Doug Hollyhand Realty, Inc.;

Dr. Francine Justa, New York, NY, executive director of Neighborhood Housing Services;

Stanley Keasling, Sacramento, CA, executive director of Rural California Housing Corporation (RCHC);

Michael S. Kennedy, Eastpointe, MI, executive director and co-founder of Housing Opportunities for Macomb, Inc.;

Don Kidd, Carlsbad, NM, president and chief executive officer of the Western Commerce Bank;

Sharon LaFleur, Baton Rouge, LA, executive director of the East Baton Rouge Council on Aging;

E.D. Latimer, Nashville, TN, executive director of Affordable Housing Resources, Inc., (AHR);

Dorothy L. Lengyel, Seattle, WA, executive director of HomeSight;

Diane Luther, Milwaukee, OR, executive director of Northwest Housing Alternatives;

Ronald Mason, Jr., New Orleans, LA, executive director of the Tulane-Xavier National Center for Urban Community;

Bernie Mazyck, Charleston, SC, leader of the Charleston Area Community Development Corp. & SC Association (CDC);

Marianne McCarty, Worthington, OH, vice president of mortgage lending, Republic Bank;

Ron J. McCord, Oklahoma City, OK, chairman of Holliday American Mortgage Company;
Ninette McDonald, Dallas, TX, owner Eighth Street Enterprises;
Tim McKenzie, Albuquerque, NM, founding director of the Burlington Community Land Trust (BCLT);
Kate Monter Durban, Cleveland, OH, assistant director of the Cleveland Housing Network (CHN);
Jim Morgo, Hauppauge, NY, president and chief executive officer of the Long Island Housing Partnership;
Dennis E. Nixon, Laredo, TX, chief executive officer for International Bancshares Corporation;
The Honorable Patricia Owens, Grand Forks, ND, mayor;
Mark Patton, Muscatine, IA, executive director of the Muscatine Center for Strategic Action (MCSA);
Dennis Penman, Amherst, NY, executive vice president & chief operating officer of M.J. Peterson Real Estate Corporation;
Phil Perry, Lincoln, NE, owner Perry and Associates;
Jack Quinn, Pueblo, CO, executive director of the Pueblo Housing Authority;
Will Randle, Jackson, MS, founding partner of Community Development Group;
John K. Rhodes, North Las Vegas, NV, councilman;
David Saffert, Spooner, WI, regional director of the United States Department of Agriculture, Rural Development;
Geoffrey W. Sager, Farmington, CT, president of The Metro Realty Group, Ltd., The Metro Construction Corporation and The Metro Realty Management Corporation;
Joseph Schmitz, Morris, IL, president of Exchange Bank;
Mary Schoen-Clark, Cedar Rapids, IA, president of MidAmerica Housing Partnership (MAHP);
Gregory Schwartz, Clearwater, FL, president & chief exec. officer of Tampa Bay Community Development Corporation;
The Honorable John Seymour, Rancho Cucamonga, CA, mayor;
Edward Shanks, Minneapolis, MN, president and chief executive officer of TCF Mortgage;
Mary Ann Shanley, Aurora, IL, director of real estate development & property management of Joseph Corporation (JoCo);
Linda Smith, Detroit, MI, executive director of U-SNAP-BAC, Inc., and U-SNAP-BAC Non-Profit Housing Corporation;
Tom Seth Smith, Durant, OK, executive director of Rural Enterprises of Oklahoma, Inc. (REI);
TK Somanath, Richmond, VA, executive director of Richmond Better Housing Coalition;
Carl William "Bill" Struever, Baltimore, MD, partner of Struever Bros., Eccles & Rouse;
Roni Strupat, Auburn, WA, director for the National Association of Realtors;
Lisa Sugino, Los Angeles, CA, executive director of Housing Services, Little Tokyo Service Center;
Marshall C. Tyndall, Houston, TX, senior program director for the Local Initiatives Support Corporation (LISC);
Douglas L. Ulery, Springfield, OH, president, chief executive officer, and director of Home City Federal Savings Bank;
Lisa Wageman, Waterloo, IA, leader of Operation Threshold;
Leon Weiner, Wilmington, DE, chairman and chief executive officer of Leon N. Weiner & Associates;
Frank Williams, Rancho Cucamonga, CA, executive officer of the Building Industry Association Southern California, Inc., Baldy View Chapter and chief executive officer of HomeAid San Bernadino County; and
Deborah C. Wright, New York, NY, president and chief executive officer of Carver Bancorp.

(Fannie press release, 7/30/99)

Ex-Fannie VP is named Pedestal CEO

- According to *National Mortgage News*, former Fannie Executive Stuart McFarland has been named President and Chief Financial Officer at Pedestal Capital in New York. McFarland was a former Executive Vice President and Chief Financial Officer at Fannie and a former Executive Vice President and General Manager of GE Capital Mortgage Services. McFarland will head Pedestal's expansion efforts into the online secondary mortgage trading market. Products traded on the Pedestal platform include nonconforming, subprime, and high loan-to-value mortgages. (National Mortgage News' website, posted 7/26/99)

Freddie Mac

Freddie had a \$1 billion writedown

Fannie/Freddie watchdog group, FM WATCH, says the writedown could prove harmful to taxpayers and shows the need to restrain Freddie

- According to an *American Banker* article by Joshua Brockman, the Fannie/Freddie watchdog group, FM WATCH, said that Freddie's second quarter earnings included a \$1 billion writedown that could prove harmful to taxpayers and shows the need to restrain Freddie. 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."
- Bill Stephens, Vice President for Shareholder Relations at Freddie stated that the writedown is "not a financial loss in any way." He noted that "When we buy any security, we hedge the security" using debt. Stephens stated that the writedown was an accounting issue resulting from \$1 billion of securities that underwent a "mark-to-market change in the value of the assets." Wall Street analysts reportedly agreed that this was an accounting issue. "Securities held for sale are marked to market, but the debt which funds these securities is not," said Jonathan Gray, an analyst at Sanford C. Bernstein & Co. Second-quarter writedowns of mortgage-backed securities were widespread among banks and thrifts, with 90% of these institutions taking some kind of writedown. "The mark-to-market equity account is only a one-sided rendering of the impact on the company's financial statements," Gray stated.
- **FM WATCH disagrees. "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 FM WATCH bulletin also noted that the GSEs' 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. (*American Banker*, Joshua Brockman, 8/18/99; *FM WATCH Bulletin*, 7/29/99)

Choctaw Nation, Washington Mutual, Freddie Mac, First Americans Mortgage and PMI Mortgage Insurance Co. announce a seven-state expansion of lending program

- The parties listed above announced a seven-state expansion of a lending program that has enabled members of the Choctaw Nation to buy their own home through mortgages that feature low down-payment requirements and customized qualification requirements. The \$10 million program,

which had been restricted to properties located in Oklahoma, is being increased to \$30 million as part of the geographic expansion. States being added include: Arizona, Arkansas, California, New Mexico, Oregon, Texas and Washington. The program permits down payments for as low as one percent on owner-occupied single-family homes and allows for borrowers to qualify for mortgages, using non-traditional credit sources. The program also allows for the rehabilitation of single-family properties, as well as the purchase of newly constructed homes. A three-percent down payment is standard, although in this program a borrower can take advantage of a special one percent down-payment option. The remaining two percent down-payment, along with closing costs, can be funded from a revolving loan fund offered by the Choctaw Nation, which features a low interest rate. Approximately \$2 million worth of loans have been originated to date. (*PR Newswire*, 8/4/99)

Freddie announces \$1 million contribution to National Urban League

- Freddie announced a \$1 million contribution to the National Urban League for general support, scholarships and consumer credit education over a two-year period. Freddie's press release stated that half the contribution (\$500,000) is intended to ensure the "organization [National Urban League] thrives into the new millenium," \$200,000 will provide \$10,000 scholarships for several young people to support their first two years of college, and the final \$300,000 will target consumer education. (*Freddie press release*, 7/28/99)

Freddie names David Stevens as Senior Vice President of Sales in Single-Family Securitization Group

- Freddie announced the appointment of David Stevens to the position of Senior Vice President of Sales in the Single-Family Securitization Group. Stevens will now be responsible for managing the single-family mortgage business and sales force, leading and coordinating customer relationship efforts and overseeing affordable housing initiatives. Stevens will report to Pat Sheehy, Senior Vice President of Marketing, Sales and Production. Stevens had been working at World Savings, where he held several senior executive positions over a 16-year span. Most recently, he was group senior Vice President/Quadrant Manager at World Savings headquarters in Oakland, CA, where he managed all loan functions and personnel for 25% of the company. (*Freddie press release*, 8/17/99)

Freddie names Patricia Dodson as Senior Vice President , Investor & Dealer Services

Freddie's prior head of Investor & Dealer Services, Kevin Finnerty, left Freddie after only five months at the firm – Finnerty was reportedly hired at Freddie after a bidding war among a number of Wall Street firms

- Freddie announced the appointment of Patricia Dodson to the position of Senior Vice President, Investor & Dealer Services. Dodson will report to John Fisk, Executive Vice President of Freddie's Single-Family Securitization Group. The appointment is effective August 16. Dodson will be responsible for managing all of Freddie's mortgage-backed securities programs, including direct oversight of the following areas: the mortgage securities marketing function, the REMIC process, the whole-loan purchase process, the credit trading function, and the Freddie Securities Sales and Trading Group. According to Freddie's press release, Dodson will direct the company's strategy for mortgage security financing and revenue generation and will oversee the relationships

with mortgage investors and dealers. Dodson had served as Freddie's interim Senior Vice President, Investor & Dealer Services, during much of 1998, before being asked by the company to join the Corporate Finance Division. (Freddie press release, 8/12/99)

- As reported in the June 11 *GSE Report*, Freddie's prior head of investor and dealer services, Kevin Finnerty, left Freddie after joining the firm only five months earlier. Joining Freddie in January, Finnerty was responsible for Freddie's relationships with securities firms, marketing its securities and overseeing its internal sales and trading group. Prior to Freddie, Finnerty was managing director and head of mortgage trading, sales and research for UBS Securities. Before his position at UBS, Finnerty was Managing Director and Head of Trading at Bear Stearns for nearly 10 years starting in the 1980s and he held positions at Merrill Lynch and Dean Witter. Surprising Wall Street followers, Finnerty was reportedly hired (after a bidding war among a number of Wall Street firms) by Freddie to be Senior Vice President of Investor and Dealer Services at Freddie. (*Asset-Sales Report-American Banker*, 1/25/99; *Bloomberg News*, 6/7/99; *Mortgage-Backed Securities Letter-American Banker*, 1/25/99, 2/1/99)

Federal Home Loan Banks

PaineWebber says the FHFBS's proposed rule requiring FHLBanks to phase out their non-mortgage investments and divest their mortgage-backed securities is being misinterpreted and could slow MBS buying but wouldn't likely affect the level of MBS the FHLBanks currently hold

Disagreement among analysts whether this rule would have a significant impact on the mortgage-backed securities market

The FHFBS issued the proposed rule in response to criticisms about the FHLBanks' arbitrage investment practices

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

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

New York FHLBank President says FHFBS proposal would transform the FHLBanks' role from a customer of Fannie & Freddie to a competitor of Fannie & Freddie

- The Federal Housing Finance Board (FHFBS), 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. The proposal was likely made in response to criticisms from the Treasury and Congress for the FHLBanks' 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. After a five-year transition period, the FHFBS 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 FHFB agreed to publish the regulation in the *Federal Register* for a 90-day comment period. In addition, FHFB Chairman Bruce Morrison stated that there would be a public hearing on the proposal in October.

- 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. (*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)

PaineWebber says the FHFB rule is being misinterpreted and could slow MBS buying but wouldn’t likely affect the level of MBS the FHLBanks currently hold

- 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.
- According to *National Mortgage News*, the PaineWebber *Mortgage Strategist* contends that the FHFB proposal “is being interpreted as preventing Federal Home Loan Banks from buying mortgage-related securities, as well as forcing them to sell existing mortgage-backed assets... That is far too narrow an interpretation.” The PaineWebber publication believes that the proposal would discourage the FHLBanks from using borrowings to fund their MBS purchases, could quell future MBS buying but likely will not affect the level of MBS current held. PaineWebber notes the

proposal only limits the mix of assets funded by so-called consolidated obligations (debt raised by a FHLBank in the capital markets), the publication said, adding that such obligations represented \$376.7 billion of the FHLBank System's \$411.25 billion in liabilities as of year-end 1998. "FHLBs could still hold MBS funded by the \$34.53 billion in deposits and other liabilities, as well as the \$22.75 billion of capital," for a total of \$57.3 billion in non-mission-related securities, the *Mortgage Strategist* said.

- According to the PaineWebber publication, mortgage-related securities currently total \$56.3 billion and "[a]ssuming another billion in asset-backed securities gives a total of just over \$57 billion." The *Mortgage Strategist* admitted that the FHFB proposed rule might curtail the growth of MBS holdings by FHLBanks, but noted that the proposal would allow the FHLBanks to hold any MBS with an investment-grade rating. Paine Webber noted that current regulations limit such holdings to securities with AAA and AA ratings. "FHLBanks might be encouraged to move down in credit quality on new purchases, thus becoming a new buyer for lower-rated paper," the PaineWebber publication said. (*National Mortgage News*, Bonnie Sinnock, 8/9/99; *National Mortgage News website*, Terry Peters, posted 8/10/99)
- In an *American Banker* article by Joshua Brockman, entitled "*Little Harm Seen in Limiting Home Loan Banks*," Brockman reports that experts say the FHFB proposed rule would have minimal impact on the secondary market for mortgages. The article notes that market experts said the proposal would eventually take a large buyer out of the market, but that there was little danger of a fast sell-off that would hurt mortgage security values. One trader reportedly noted that most of the FHLBanks own short-duration securities rather than the usual 30-year pass-through securities, so "It's not going to produce any selling pressure, because these things will come due," in under five years. Inna Koren, Senior Vice President for fixed-income research at Prudential Securities stated in a research note that the \$57 billion currently held by the FHLBanks makes them significant investors, but the amount represents only 25% of outstanding mortgages. Therefore, the proposal would have "minimal effect on mortgage spreads, due to the lengthy divesting period and the seasoned nature of the FHLBs' mortgage holdings." (*American Banker*, Joshua Brockman, 8/3/99)

Disagreement among analysts whether this rule would have a significant impact on the mortgage-backed securities market

- According to a *Mortgage-Backed Securities Letter* article, the FHFB proposal has "turned many heads in the MBS community." Market players generally viewed the proposal as a significant event, possibly impacting both spread product and buy-side activity down the road due to the FHLBanks' status as one of the largest purchasers of MBS. "This has already had an impact," said Michael Hoeh, Head Portfolio Manager at Dreyfus Corp. "This type of liquidation is definitely a concern. The FHLB is one of the major forces in pushing spreads tighter, and now, one of the largest buyers will no longer be a buyer at all." "[This decision] hurts spread product, making it more difficult, at these levels, to recover. This definitely puts a little bit of a wet blanket on the market." "This will cut off buying right away," added Art Frank, Director of Mortgage Research at Nomura Securities. "Though I wouldn't jump to conclusions that there will be a wholesale liquidation, the Federal Home Loan Banks were significant short-term CMO buyers." (*Mortgage-Backed Securities Letter-American Banker*, 8/2/99)
- "The FHLBs have become an important investor in mortgage securities and we think that their elimination as an investor group is clearly a long-term negative for our market," said Michael Youngblood, Managing Director of Real Estate Capital Markets for Banc of America Securities. (*Investment Dealer Digest*, 8/2/99)

Critics of the FHFB proposal

- 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." (*American Banker*, 7/29/99)

New York FHLBank President says FHFB proposal would transform the FHLBanks' role from a customer of Fannie & Freddie to a competitor of Fannie & Freddie

- New York FHLBank President Alfred DelliBovi reportedly stated that the FHFB proposal would do little to harm the secondary market for loans but would change the FHLBanks' role. "The rule transforms us from a customer of Fannie Mae and Freddie Mac to a competitor," he said. He said the rule would give the 12 FHLBanks the opportunity to create alternative ways to serve the member institutions. (*American Banker*, 8/3/99)
- According to *National Mortgage News*, DelliBovi also said the proposal is a "good kick" for institutions that have not heard FHFB Chairman Bruce Morrison's call to develop new mortgage products such as MPF. "I think the challenge of this proposed regulation, when it is adopted, is for the banks to find new assets that are mission-related," DelliBovi said. And he expects that many comment letters will be filed concerning the definition of mission-related assets. (*National Mortgage News*, Brian Collins, 8/2/99)

FHFB is considering applications from three FHLBanks for a new pilot – the Mortgage Partnership Purchase (MPP) program - to purchase mortgages from members

The MPP proposal differs from the current FHLBank System's Mortgage Partnership Finance (MPF) program, but is still designed as an alternative to selling loans into the secondary to Fannie & Freddie

- The Federal Housing Finance Board (FHFB), the regulator for the FHLBank System, announced that it was considering applications from the FHLBanks of Cincinnati, Indianapolis, and Seattle requesting to begin a new pilot for the FHLBank System's new Mortgage Partnership Purchase (MPP) program. The FHFB is requesting comments on the request for a new pilot. According to the notice in the *Federal Register*, the FHFB said it would not act on the applications during the 30-day comment notice period and would consider any comments received during the notice period before taking action. According to the FHFB, the new pilot would allow the FHLBanks to purchase mortgage loans from member financial institutions under a credit risk sharing arrangement. Under the proposed MPP, the FHLBanks could purchase fixed-rate, single family mortgages from member financial institutions subject to the establishment of a risk-sharing account designed to transfer a substantial portion of the credit risk to the member financial institution. In addition, to the risk-sharing account, the member would further credit enhance the mortgage loans by providing supplemental mortgage insurance. In the notice, the FHFB said the MPP was designed to provide an alternative to selling mortgages on the secondary market and to increase mission-related investments for the FHLBanks. (*Federal Register*, 8/12/99, page 44016; *BNA Daily Report for Executives*, 8/16/99)

- According to *National Mortgage News*, the MPP differs from the FHLBank's MPF program (started by the FHLBank of Chicago) as it is completely independent of the FHLBank of Chicago, unlike other district banks, which have ties to Chicago as they implemented the MPF-like structures. MPP is reportedly still in the planning stages and once the three FHLBanks receive preliminary approval from the FHFB, they will begin development. (*National Mortgage News*, 8/16/99)

FHFB issues interim rule for public comment on the availability of unpublished FHFB information

- The FHFB added a new part to its regulations governing the availability of unpublished information. The rule describes the procedures a person or entity must follow when requesting unpublished FHFB information either by document or by testimony of current or former Finance Board employees or agents and the practices and procedures the FHFB will use in responding to such requests. According to the interim final rule, the FHFB considers all unpublished information to be confidential and any use or disclosure of such information without the express authorization of the FHFB is prohibited. Any persons or entities using unpublished information without authorization may be subject to criminal penalties. The interim final rule became effective on August 13, 1999 and the FHFB will accept comments on the interim final rule in writing on or before October 12, 1999. (*Federal Register*, 8/13/99, pages 44103-44109)

FHFB announces a proposed rule that would approve the sale of whole advances between FHLBanks without the approval of the FHFB under limited circumstances

- The FHFB issued a proposed rule that would approve the sale of whole advances between FHLBanks under certain limited circumstances. The FHFB said the change was consistent with the FHFB's efforts to devolve ministerial and routine business matters to the FHLBanks. The FHFB will accept comments on or before September 15, 1999. (*Federal Register*, 8/16/99, pages 44444-44446)

Pittsburgh FHLBank names a new Chairman

- According to *National Mortgage News*, David Curtis has been appointed Chairman of the Board of the Directors. Curtis, Executive Vice President and Chief Financial Officer of Leon N. Weiner & Associates Inc. in Wilmington, DE will succeed Raymond Christman as the Pittsburgh FHLBank Chairman. Christman resigned to become President of the FHLBank of Atlanta. In addition to his position at Weiner & Associates, Curtis was also President of Arbor Management LLP, which manages East Coast rental communities. (*National Mortgage News website*, posted 8/16/99)

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 FHFBC 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 FHFBC 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 is currently reconciling 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. During the August Congressional recess, staffers are meeting to narrow the differences between the two bills until lawmakers return to Washington in September.

Private Sector Items to Note

Bank of America announces it will lend \$30 billion to low- to moderate-income homebuyers under new program that will require no down-payment, application fees or closing costs

- Bank of America announced plans to fund \$3 billion in mortgage loans for low- to moderate-income homebuyers over 10 years through an arrangement with the Neighborhood Assistance Corporation of America (NACA) – a nonprofit housing group. As part of the program, the 30-year mortgages will require no down payments, closing costs, or application fees, and will carry fixed-rates from three-eighths to one percentage point below market rates. The \$3 billion commitment will probably be divided into about 30,000 loans of \$100,000 each, said officials from Bank of America and NACA. The mortgages will be available in cities across the US. (*American Banker*, 8/11/99; *Inman News Feature*, 8/11/99)

Wells Fargo, ahead of its goal to lend nearly \$1 billion to Latino businesses

- According to an *American Banker* article, Wells Fargo's Latino Loan Program, in only its second year of operation, is outpacing its target of \$1 billion in placed loans by 2003. Working with the Hispanic Chamber of Commerce, the bank was at last count about \$200,000 over the billion-dollar pace, with \$184 million lent to 8,900 businesses. The loans range from \$5,000 to \$100,000,

although credit in larger amounts is available in the 21 states where Wells Fargo and Norwest have banking stores. (*American Banker*, 8/17/99)

Norwest, Bank One, Countrywide, and several mortgage insurance companies are in opening stages of a broad mortgage lending initiative, aimed at creating 1,000 new homeowners on Indian reservations

- According to an *American Banker* article, Norwest, Bank One, Countrywide Home Loans Inc. are in the opening stages of a broad mortgage initiative, aimed at creating 1,000 new Indian homeowners on native lands over the next three years. President Clinton's recent visit to the Pine Ridge Reservation served as a kickoff to the mortgage lending initiative. According to HUD and bank officials, Bank One Capital Markets and George K. Baum of Kansas City will bring a series of \$300 million bond issues to market, raising \$1.5 billion to be loaned to tribes, tribal housing authorities and homeowners. Baum reportedly already has four lending projects underway: 20 homes in central California, 50 homes in Cook Inlet in Alaska, 100 homes in New Mexico, and an \$8 million deal with the Cherokee Nation. The mortgages for these homes will be placed in Ginnie Mae securitizations, ensuring the government-backed rating and lower interest rates. Most of the mortgages will be 30-year fixed-rate loans and range from 8.12% APR for 30-year fixed with no points and 3% down, to 7.68% APR with two points and 3% down. According to Sydney Lenz, a Managing Director at Countrywide Mortgage, the company has agreed to run a wholesale conduit program and buy the mortgages from lenders on the ground level. The mortgages will then be co-mingled with other FHA loans and then resold as securities. Private lenders are also in the process of setting up lending centers – One-stop Mortgage Centers in the case of the Navajo Reservation in Arizona and Pine Ridge Reservation in South Dakota to track the number of new mortgages and provide counseling. HUD is also examining how to streamline regulations.
- Other initiatives include Mortgage Guaranty Insurance Col's work with the Oglala Sioux. Mortgage Guaranty will endow a full-time director of Homeownership Counseling, create homeowner education courses for Oglala Lakota College, and develop financing tools specifically for the Oglala program. PMI Mortgage Insurance has also pledged to more than double its Native American mortgage insurance initiative, and GE Capital says it will launch a pilot with mortgage lenders to insure \$2 million in mortgage loans. (*American Banker*, 8/17/99)

Farm Credit Administration

Farm Credit Administration announces a direct final rule with opportunity to comment that would allow Farm Credit Banks to transfer certain capital to affiliated associations without having to obtain prior approval from the Farm Credit Administration

Farm Credit System Insurance Corporation Board announces plans to lower insurance rates

- The Farm Credit Administration issued a direct final rule with opportunity for public comment that would the FCA said would reduce regulatory burdens on the Farm Credit System by repealing or amending 16 regulations. The FCA said the revisions would provide Farm Credit System banks and associations greater flexibility concerning loan sales, agricultural secondary market activities, loans to insiders, letters of credit, information programs, travel expenses, and disclosing borrower information during litigation. According to a *BNA* article by Eileen Canning, the FCA stated that the rule would allow Farm Credit Banks to transfer certain capital to affiliated associations without

obtaining prior approval from the Farm Credit Administration Board. The rule would remove the approval requirement, defining a transfer of capital as a payment by a bank to an affiliated association. However, the rule requires 30 days notice to the bank's shareholders for specific "nonroutine" and "preferential" transfers of capital. "The final rule benefits Farm Credit banks and their affiliate associations because it provides clear guidance and streamlined procedures for banks to follow when transferring capital to associations. It also enables banks to transfer capital more quickly," FCA Board Chairman Marsha Pyle Martin said in a statement. "Our adoption of this final rule is part of our commitment to keep regulatory prior approvals only when required by the Farm Credit Act or when safety and soundness concerns exist," she said.

- The FCA announced that unless the agency receives significant adverse comments by September 8, 1999, the regulations would be effective 30 days after publication in the *Federal Register* during which either or both Houses of Congress are in session. The FCA said it would publish notice of the effective date in the *Federal Register*. (*BNA Daily Report for Executives*, Eileen Canning, 8/17/99; *Federal Register*, 8/9/99, pages 43046-43049)

Lower insurance rates

- The Farm Credit System Insurance Corporation Board also announced plans to reduce by half the rate of insurance premiums on accruing loans held by member institutions. The Board will reduce the rate of insurance premiums charged on accruing loans held by member institutions from 9 basis points to 4.5 basis points for July 1 through December 31, 1999. (*BNA Daily Report for Executives*, Eileen Canning, 8/17/99)

Farm Credit Administration announces effective date for its new policies on leasing activities

- The Farm Credit Administration published a final rule on June 28, 1999 clarifying existing regulation and providing Farm Credit System institutions with more regulatory guidance about leasing activities. The rule reflects comments received from two public comment periods. The FCA announced that the effective date of the final rule is 30 days from the publication in the *Federal Register* during which either or both Houses of Congress are in session. Based on the records of the sessions of Congress, the effective date of the regulation is August 6, 1999. (*Federal Register*, 8/9/99, page 43049)

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