

The **GSE** REPORT™

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ALL GSEs

- ***Washington Post Op-Ed Refers to GSEs' Arbitrage Investments as - "A U.S. Government Hedge Fund"***
 - In an op-ed appearing in the March 10, 1999 edition of the *Washington Post*, David Ignatius details the tremendous market advantage that government-sponsored enterprises enjoy over their private sector counterparts. In particular, Ignatius focuses on the "arbitrage" strategies that allow the GSEs to "profit from the spread between the cheap money they can borrow as government-backed institutions and the higher rates they receive in the commercial money market." **Ignatius likens this GSE arbitrage practice to a quasi-hedge fund operation.**
 - The news-wedge for this piece is rooted in a failed amendment offered during the House Banking Committee mark-up of H.R. 10, the Financial Services Modernization Act of 1999 that Ignatius noted would allow the FHLBank System to borrow even more money. Ironically, one of the primary opponents of this amendment was Fannie Mae, which was worried about so-called unfair competition. Fannie contends that since the FHLBank's stock is owned by its 6,800 members, most of which are federally insured, it doesn't have a normal "at risk" capital base. Fannie said it in contrast, raises capital by selling shares to the public.
 - The op-ed cites a letter from Treasury Secretary Robert Rubin to the House Banking Committee in which he is sharply critical of the Federal Home Loan Bank System's investment practices. In this letter forwarded during the week of March 1, 1999, Rubin states that the FHLBank system has "fundamental problems." Elaborating on this point, he adds "with a total of \$350 billion in government-subsidized debt outstanding, it (FHLBanks) uses little of this debt to further its public purpose of expanding homeownership." And he also calls for "curtailing the use of subsidized funds to make overnight money-market loans and hold a \$150 billion investment-arbitrage portfolio."

- Countering, Bruce Morrison, Chairman of the Federal Housing Finance Board, the regulator of the FHLBank System, noted that under his watch, he has reduced the system's money-market investments to about 20 percent, down from its previous mark of 40 percent. Building on this point, Morrison adds "the Treasury says glibly that we should act quicker...but that would be a mistake, since it would mean smaller dividends for the system's members, who might then withdraw their capital suddenly -- producing instability." (Note: Ignatius points out that this argument is similar to those put forward whenever additional regulations are suggested for the nation's hedge fund markets.)
- **Morrison concludes by stating that the FHLBank System just wants equal treatment between it and the other GSEs -- "...put (us) under the same microscope and measured by the same ruler."** Morrison offers a radical proposal – he says he agrees with analysts that a case could be made to privatize the FHLB System, Fannie Mae and Freddie Mac. Morrison notes, however, that politically, privatization will not happen. Ignatius writes, "he's probably right. This is a town where the dinosaurs live on forever." (*Washington Post*, Op-Ed, David Ignatius, 3/10/99)
- ***GSEs Issued a Record \$6.3 Trillion in Debt in 1998 (GSEs issued \$5.7 Trillion in 1997)- The Bulk of the Debt for Both Years was Short-Term Debts:***
 - According to John Connor at the *Dow Jones Newswire*, the GSEs issued a record \$6.3 trillion in debt in 1998. In comparison, in 1997, the GSEs issued \$5.7 trillion in debt, with the bulk of both 1997 and 1998 debt being short-term debt.

FHLBank System

- The FHLBank was the largest issuer of debt – issuing \$2.5 trillion in 1998 compared to \$2.1 trillion in 1997. Short-term debt accounted for the majority of the FHLBank's debt issuance: \$2.28 trillion in 1998 and \$1.9 trillion in 1997.

Freddie Mac

- Freddie issued over \$2.2 trillion in debt in 1998 (\$2.1 trillion of which was short-term).

Fannie Mae

- Fannie issued nearly \$843 billion of debt in 1998 (\$695 billion of which was short-term). (*Dow Jones Newswire*, John Connor, 3/9/99)

Fannie Mae and Freddie Mac

- ***HUD Increases Regulatory Scrutiny of Fannie & Freddie – HUD Plans to Examine: (1) Potentially Increasing the Affordable Housing Goals for Fannie & Freddie; (2) Regulating the Non-Mortgage Investments of Fannie & Freddie; (3) Retroactively Reviewing Fannie's (and now Freddie's) Controversial "Lower-Cost" MI Product (See***

Later Story in this GSE Report on Freddie's Introduction of a MI Product Similar to Fannie's) – HUD Warns that Fannie's Product Could be Retroactively Overruled by HUD; and (4) a Fair Lending Examination of Fannie & Freddie's Automated Underwriting Technology Systems (Which Control 95% of the Primary Usage Market Share):

- According to articles in the *Mortgage Marketplace-American Banker* and the *Mortgage-Backed Securities Letter-American Banker*, HUD is increasing its regulatory scrutiny of Fannie and Freddie's activities.

Affordable Housing Goals

- During an America's Community Bankers Conference, Commissioner William Apgar noted that HUD would introduce a proposed rule on Fannie and Freddie's affordable housing goals that would raise the current 42% level for affordable housing set back in 1992. Apgar said that the market for these mortgages has matured in recent years. "What was a stretch five years ago, has now become mainstream," he said. The law requires a final rule by the beginning of the year 2000.

Non-Mortgage Investments

- Apgar noted that HUD was also planning to introduce a proposed rule to regulate the non-mortgage investments of Fannie and Freddie. The rule could reportedly be unrolled with the affordable housing rule or on a separate timetable.

Retroactively Reviewing Fannie's (and now Freddie's) Controversial "Lower-Cost" MI Product

- As we noted in previous *GSE Reports*, Fannie introduced a new controversial "lower-cost" mortgage insurance product. Apgar noted that Fannie, because of "ambiguity in the law," did not seek regulatory approval for this change. Apgar said he intends to evaluate this mortgage insurance program after the fact and said the program could be overruled retroactively. He stated that when GSEs go forward with a new program without first requesting a review by HUD, they do so "at their peril." As we noted in the March 5 *GSE Report*, Apgar stated "To the extent new activities enhance their dominance in the marketplace, that is a concern." Apgar said he is "worried" about the impact that Fannie and Freddie would have on other businesses if they expanded into nontraditional activities, like self-insurance and subprime lending. **"I worry about the encroachment of Fannie Mae and Freddie Mac into other areas just to enhance their own business."**

Fair Lending Examination of Fannie & Freddie's Automated Underwriting Technology Systems

- Finally, HUD fair lending specialists plan to examine Fannie and Freddie's automated underwriting technology systems. (*Mortgage-Backed Securities Letter-American Banker*, 3/8/99; *Mortgage Marketplace-American Banker*, 3/8/99)
- ***Private Sector Concerned about Unfair Competition from Fannie & Freddie – Freddie's Chairman Notes that Freddie will Continue to "Push the Envelope" and that under Freddie's Charter, "Practically Anything that Increases the Availability of Mortgage Credit and Reduces Costs is Acceptable":***

- Lew Sichelman from *United Feature Syndicate, Inc.* wrote a piece about recent private sector complaints that Fannie and Freddie are “intruding on what they see as their turf.” Sichelman writes that because of Fannie and Freddie’s government connection, either real or perceived, they can raise money more cheaply than total private concerns. Through the years, he notes that Fannie and Freddie have enjoyed a generally strong working relationship with mortgage lenders, insurers, title companies, and appraisers. However, that changed when Fannie decided several years ago to launch a big advertising campaign aimed directly at homebuyers. Sichelman notes that the advertising made lenders nervous that the GSEs would “bypass them completely.” The private sector concerns were further exasperated when Freddie unsuccessfully tried a year ago to revise their charter to insure low downpayment loans and when Fannie announced a couple of months ago that it was reducing mortgage insurance coverage. The catch, he notes, is that the loans must be approved – for a fee – by Fannie’s automated underwriting system. Sichelman writes **“Indeed, to sell loans to either GSE...these days, lenders are required to use the GSE’s technology, a condition that enforces a generally held belief that the two companies are trying to undermine electronic-approval platforms offered by some mortgage insurers and large primary lenders.”**
- Sichelman notes that many mortgage industry players are concerned about just how far Fannie and Freddie “intend to go to feed their bottom lines and keep their stockholders happy.” He noted that many fear the GSEs will get into loan administration, the lucrative back-end of the business in which “servicers” earn fees for collecting monthly payments, paying property taxes and insurance and distributing principal and interest payments to investors. Others worry that GSEs may simply start originating loans, bypassing the private sector completely. Fannie and Freddie believe these concerns are “ridiculous.” However, Sichelman notes that **Freddie Chairman Leland Brendsel stated that “he will continue to push the envelope,” and that “under the company’s charter, practically anything that increases the availability of mortgage credit and reduces costs is acceptable.”**
- The Mortgage Bankers Association of America notes that the GSEs “eat up a good portion of the profits,” and “after investors take their bite out of the mortgage food chain, the two GSEs gobble up about half of what’s left, and everyone else is left to divvy up the rest. And as the two companies continue to take a larger part of the pie, the MBA’s Paul Reid notes that even his smaller members are worried “about what’s going to be left for them.” (*United Feature Syndicate*, Lew Sichelman – article ran in the *Chicago Tribune*, 3/14/99 and the *Free Lance-Star*, Fredericksburg, VA, 3/12/99)
- ***Group of Realtors Concerned about Unfair Competition from Fannie & Freddie – Believe GSEs are Encroaching into Real Estate Brokerage Business:***
 - According to Brian Collins with *National Mortgage News*, a group of realtors is concerned about unfair competition from Fannie and Freddie over asset disposition sales. The realtors, who specialize in the management and sales of foreclosed or real estate owned (REO) properties, have formed a group called the Independent Realtor Coalition (made up of realtors and attorneys in California, Texas and Illinois). Coalition spokesman Bruce Koklich stated that the **“default real estate market which the GSEs**

have already infiltrated is only an avenue into the relocation and general estate market.”

- Reportedly Fannie and Freddie entered the REO business to control their losses on the loans they invest and guarantee. However Fannie began offering its REO services to lenders directly two years ago to assist them in disposing of their non-Fannie loans that had gone into foreclosure. Freddie began offering its REO services to third parties when it acquired Cendant Asset Services in September of 1998, which it later renamed HomeSteps. Collins noted that Fannie and Freddie claim the following: (1) their third-party business amounts to only 10% of their REO sales; (2) they depend on local real estate brokers; and (3) their REO activities are consistent with their charters. However, **Coalition Spokesman Koklich calls Fannie and Freddie’s activities “charter creep,” and the Coalition argues that the “GSEs represent unfair competition that is breaking established relationships between Realtors and lenders.”**
- The Coalition has asked the California Association of Realtors (CAR) to examine the issue and a working group is expected to present a report on Fannie and Freddie’s activities to CAR’s board of directors in June. Koklich stated that “All we can do is continue to point out the facts and we pray that CAR and NAR rise to the challenge to protect their members from further GSE encroachment into the real estate brokerage industry.”
- The GSEs deny that they are interested in getting into the relocation or general brokerage business, however, when it comes to REO activities, Fannie reportedly believes it can provide any service, even if it means purchasing REO from a customer.
- Collins reported that in November, Fannie unsuccessfully bid on an REO portfolio of 60 properties that was sold by the California lender for around \$8 million. Collins noted that generally, federally chartered banks and thrifts are not allowed to own real estate properties. “I was surprised to see Fannie Mae bidding,” said Mark Giltner, Vice President for West Coast operations at Fifth Eastern Holding Co, an affiliate of Eastern Savings Banks, Hunt Valley, MD. Fannie’s Vice President for Asset Disposition Services, declined to comment on the bid, but he commented that purchasing REO is just one of many options Fannie will use to help its customers with REO disposition. (*National Mortgage News*, Brian Collins, 3/8/99)
- ***Weeks After Fannie introduces its “Lower Cost” Mortgage Insurance Program, Freddie Introduces Virtually Identical Program – Mortgage Bankers Association is “Disappointed” with the GSEs’ New Programs (Is there True Competition in the Secondary Market or do Fannie & Freddie Simply Copy Each Other’s Products?):***
 - As we noted in the January 22nd *GSE Report*, Fannie further encroached into the mortgage insurance business by announcing two new low cost mortgage insurance options, angering lenders and private mortgage insurers. **Fannie’s new program would permit only high LTV loans (those with low down payments) that were underwritten through Fannie’s automated underwriting system, Desktop Underwriter, to have**

lower mortgage insurance costs. Despite many lender's and mortgage insurer's concerns with the new Fannie Mae program, Freddie announced virtually the same program as Fannie on March 15 - just weeks after Fannie's announcement.

- Like Fannie's program, **Freddie's new program would permit only high LTV loans that were underwritten through Freddie's automated underwriting system, Loan Prospector, to have lower mortgage insurance costs. Bob Ryan, Vice President of Marketing for Freddie, however, stated that Freddie plans to "work independently with our lenders on alternative solutions."**
- Joshua Brockman with the *American Banker* noted that the Mortgage Bankers Association criticized both the Fannie and Freddie programs and Donald Lange, President of the MBA, sent a letter on March 15 to Freddie's Chairman Leland Brendsel criticizing the program. "We are highly disappointed," stated Robert O'Toole, Senior Staff Vice President for Residential Finance at the MBA. O'Toole noted that the MBA had urged Freddie not to take the step. Brockman notes that according to O'Toole, the MBA's disagreement with Fannie and Freddie's programs is the up-front fee to Fannie and Freddie for lower mortgage insurance coverage. "That appears to us to be a function of the primary market and not the secondary market," he stated. The fee revenue might otherwise have gone to lenders and mortgage insurers in the primary market.
- As we noted in the February 19th *GSE Report*, however, the private sector (MGIC, United Guaranty, PMI and GE Capital Mortgage Insurance) introduced programs for high LTV loans that actually lower the mortgage insurance costs for consumers even more than Fannie's highly publicized program and without any of the disruptions to lender's operations and systems that Fannie's program causes by requiring lender's to reconfigure their systems to use the GSEs' automated underwriting systems. (*American Banker*, Joshua Brockman, 3/18/99; *PR Newswire*, 3/15/99)
- ***OFHEO's Risk-Based Capital Proposal for Fannie & Freddie is Expected to be Released Shortly***

OMB is Currently Still Reviewing the OFHEO Proposal

Senator Chuck Hagel (R-NE) Urges OMB to Finish its Review of the OFHEO Proposed Rule

Mortgage Bankers Association Urges OMB to Finish its Review of the OFHEO Proposed Rule "As Quickly as Possible"

Chairman of the House Banking Committee Jim Leach (R-IA) and Chairman of the House Banking GSE Oversight Subcommittee Richard Baker (R-LA) Criticize the OMB for Delaying the Release of the OFHEO Proposed Rule

Fannie Mae Chairman Raines Continues to Criticize the OFHEO Proposed Rule – Fannie Now Complains that a Combined Risk-Based Capital Rule that Applies to both Fannie & Freddie would Force Fannie & Freddie to Look and Act the Same Way, Stifling Competition

Background

- The Office of Federal Housing Enterprise Oversight (OFHEO) is expected to release its risk-based capital proposal for Fannie and Freddie for public comment shortly – reportedly within the next month. However, the Office of Management and Budget (OMB) is still in the process of reviewing the reportedly 700-page-long proposal. The *American Banker* reported that the Treasury Department, HUD, the OTS, and the Council of Economic Advisers have given the proposal a “green light,” but the process took the “unusual course, with the proposed rule landing on the desk of White House Chief of Staff John Podesta.” The article also noted that OFHEO Acting Director Mark Kinsey noted that the “600-700 page” proposal takes up about one-third as many pages – with the bulk of the proposal devoted to an “attempt to make people understand how the rule works.” (*American Banker*, 3/19/99)
- John Connor with *Dow Jones Newswire*, reported that Acting OFHEO Director Mark Kinsey, citing an executive order, appeared to hold open the possibility that OFHEO could try to advance the proposed rule at some point even if the rule hasn’t been formally cleared. Reportedly, Kinsey stated that “...it is our understanding that under the Executive Order, once the prescribed time period for review together with any extensions has expired an agency is authorized to proceed with publication of a rule. Notwithstanding this provision of the Executive Order, however, we have not moved forward with public dissemination of this rule because we have been informed by OMB that clearance was forthcoming.” Connor noted that an OFHEO spokeswoman declined to comment when asked if OFHEO might try to publish the rule if the delay at OMB persists. (*Dow Jones Newswire*, John Connor, 3/10/99)
- At issue, the risk-based capital proposal would determine the amount of capital Fannie and Freddie would be required to set aside to remain solvent during a 10-year period of severe credit and interest rate stresses. According to OFHEO’s Acting Director Mark Kinsey, “The risk-based capital requirement will be equal to the amount of capital needed to survive the stress test, plus an additional 30% to cover unspecified management and operations risk as specified by the law.” OFHEO sent the proposal to OMB for a 90-day review back in October but the plan has still not yet become public. Despite reportedly never seeing a copy of the proposal, Fannie “hit the streets” immediately denouncing and strongly objecting to the proposal. Even as early as three days prior to OFHEO’s submission to the OMB, Fannie’s Vice Chair Jamie Gorelick wrote a letter to OFHEO voicing strong objection to OFHEO’s inclusion of a specific capital number or percentage amount of capital required to be maintained by Fannie and Freddie. Fannie said that it objected to OFHEO disclosing a capital amount because it would create a misperception of capital inadequacy. Fannie also reportedly launched a “frontal assault” on the proposed rule by complaining to the OMB that OFHEO hadn’t given Fannie any opportunity to engage in a dialogue about the proposal. There have been reports that a leaked copy of the proposed rule revealed a capital shortfall at Fannie, while Freddie enjoyed a surplus. OFHEO was ordered by Congress to issue a risk-based capital rule for Fannie and Freddie to be completed by December 1994. OFHEO has been working five years on the proposal, and criticism by Fannie will only delay the process even longer.

Senator Chuck Hagel (R-NE) Urges OMB to Finish its Review of the Proposed Rule

- Senator Hagel sent a letter to the Director of the OMB, Jacob Lew, to request that the “OMB now release the rule and allow it to come before Congress for our 15-day review period.” Hagel’s letter noted that the size of Fannie and Freddie “clearly puts them in the ‘too big to fail’ category.” Hagel further noted that “Any capital insufficiencies need to be dealt with immediately. In order to know how well capitalized Fannie Mae and Freddie Mac are, they must be subjected to a risk-based capital standard. This can only occur if the process moves forward.” (*Senator Hagel letter to OMB Director Lew, 3/5/99*)

Mortgage Bankers Association Urges OMB to Finish its Review of the Proposed Rule “As Quickly as Possible”

- The Mortgage Bankers Association of America (MBA) sent a letter to the Director of the OMB Jacob Lew on March 11 requesting that the OMB “clear the proposed rule for publication and comment as quickly as possible.” In its letter, the MBA noted that the OFHEO risk-based capital rule is a matter of “significant public policy and the proper object of public scrutiny.” (*MBA Letter to OMB Director Jacob Lew, 3/11/99*)

Chairman of the House Banking Committee Jim Leach (R-IA) and Chairman of the House Banking GSE Oversight Subcommittee Richard Baker (R-LA) Criticized the OMB for Delaying the Release of the OFHEO Proposed Rule

- According to an article by John Connor of the *Dow Jones Newswire*, House Banking Committee Chairman Jim Leach (R-IA) and House Banking Capital Market and GSE Subcommittee Chairman Richard Baker (R-LA) criticized the OMB for delaying its release of the OFHEO proposed rule during a House Banking Committee mark-up on financial services modernization. Leach stated that “It is my impression the review under way is more political than substantive.” Baker reportedly proposed and then withdrew an amendment that would have cut OMB out of the process of reviewing OFHEO regulations. Baker called the delay “worrisome” and Connor noted that Baker left the impression that he was not through with the matter. (*Dow Jones Newswire, John Connor, 3/11/99; 3/12/99*)
- As we noted in the March 5th *GSE Report*, Congressman Baker sent a letter to OMB Director, Jacob Lew, urging the OMB to clear the rule “immediately,” saying he was eager to receive the rule for Congressional review and have the rule released to the public for comment. “OMB has had four months – including two, two-week extensions – to review the proposal,” Baker wrote. “Should the next step [Capitol Hill review] not occur, I believe further inquiry by this subcommittee might be merited in the form of hearings or otherwise to address issues associated with the inability of OMB to clear the proposal in a timely manner.” A group of trade associations also wrote OMB Director, Jacob Lew, noting that the OMB has had the regulation under review “significantly beyond the prescribed 90-day period, and we think it is in the public interest that it be cleared for public comment as soon as possible.” The trade associations signing the letter were the Bankers Roundtable, Consumer Bankers Association, American Bankers Association, America’s Community Bankers, and the Consumer Mortgage Coalition. (*Congressman Richard Baker Letter to OMB, 2/26/99; Trade Association Letter to OMB, 2/24/99*)

Fannie Mae Chairman Raines Continues to Criticize the OFHEO Proposed Rule - Newest Complaint is that a Combined Risk-Based Capital Rule that Applies to both Fannie & Freddie would Force Fannie & Freddie to Look and Act the Same Way, Stifling Competition

- As we have noted in previous *GSE Reports*, despite the fact that Fannie reportedly has not seen a copy of the OFHEO proposed rule, Fannie is voicing “strong objections” to the proposal. Fannie first objected to the inclusion of a specific capital amount in the risk-based proposal because it might create a perception of capital inadequacy (resulting in pressure on Fannie’s stock). Fannie then objected to the proposed rule stating that a risk-based capital rule would hurt its ability to serve low- and moderate-income borrowers. (This despite the fact that the GAO and HUD have both noted in reports and testimony that the private sector serves the low- to moderate-income homebuyer community substantially better than do either Fannie and Freddie, while at the same time holding substantially more capital than Fannie and Freddie.) *Bloomberg News* is now reporting that Fannie Chairman Franklin Raines is worried that if regulators devise one rule for both Fannie and Freddie, the two GSEs would be forced to look and act the same way, stifling competition. Raines further noted that “We fear they [OFHEO] have gone off and created their own model,” and “No one there has ever bought a mortgage and held it in portfolio.” According to the article, Raines said he doesn’t dispute the notion that new capital standards are necessary, but he objects to the approach being taken. Regulators at OFEHO have said the new risk-based capital standards are needed because Fannie and Freddie now lack an incentive to hold adequate capital. (OFHEO’s Acting Director Mark Kinsey has also stated that government sponsorship of Fannie & Freddie “shields” them from “the type of market discipline faced by fully private firms.”) (*Bloomberg News*, Paul Nyhan and Rob Wells, 3/15/99)
- ***Mortgage Bankers Association (MBA) States that the Federal Reserve Board (Board) Agrees with the MBA and other Trade Associations that Commercial Mortgage Backed Securities (CMBS) Should be More Reflective of Risk and Warrant the Same 20% Risk-Weighting as Fannie & Freddie Mortgage Backed Securities (MBS) – However, the Board will Not Make a Quick Final Decision on the Risk-Weighting of CMBS – The Board will make the Determination when it rules on a Comprehensive Risk-Based Proposal:***

Background

- As we noted in the January 22nd *GSE Report*, a coalition of trade associations, called the Capital Consortium, urged the federal banking regulators to move quickly and give preferential risk-based capital treatment to AAA-rated commercial mortgage backed securities. The Capital Consortium consists of the Mortgage Bankers Association, the National Realty Committee, the National Association of Realtors, the Bond Market Association, and the Commercial Real Estate Secondary Market and Securitization Association. The Consortium sent a joint letter to the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision on January 12th. The Consortium proposal, if adopted, would lower the amount of capital institutions would be required to hold against top-rated CMBS and among other things, the proposal would lower from 100% to 20% the risk-weight for AAA-rated CMBS. Such risk weighting would give AAA-rated CMBS the same favorable treatment as Fannie and Freddie MBS.
- According to *National Mortgage News*, the Federal Reserve Board has decided not to make a final decision on the risk-weighting of CMBS until the Board rules on a comprehensive risk-based capital proposal. According to Debra McKinnon, Senior Director of Commercial Real Estate at the Mortgage Bankers Association, “They agreed

with us that it appears CMBS warrant a 20% risk weighting.” However, she explained that the Board decided to reject the idea of carving out the CMBS from the body of a comprehensive Risk Based Capital Proposal that deals with recourse and direct credit substitutes. “The regulators are waiting to move on a more comprehensive basis, so our piece will have to wait,” said George Green of the National Association of Realtors. (*National Mortgage News website*, posted 3/18/99)

- ***Fannie & Freddie Expected to Accumulate Considerable Fee Income and Competitive Advantage from Automated Underwriting Market Share Duopoly – GSEs Now Control 95% of the Automated Underwriting Primary Usage Market Share:***

- Joshua Brockman from the *American Banker* wrote an article on the recent Morgan Stanley Dean Witter report by Kenneth Posner on Fannie’s automated underwriting technology. Posner predicts that Fannie’s systems will gain market share and bring in more fee income. According to William Kelvie, Fannie Mae Chief Information Officer and Executive Vice President, Fannie obtained nearly \$55 million of its revenue in 1998 from its technology-related systems (including automated underwriting) and expects to obtain more than \$80 million of revenue this year. Posner predicts an even higher figure of nearly \$120 million and notes the fee income is only the “tip of the iceberg” in terms of the benefits of technology can provide. Fannie’s technology is helping Fannie gain competitive advantage and technological initiatives are playing a greater role in analysts’ assessment of Fannie and Freddie. Fannie’s technological initiatives include developing new products related to second mortgages and home equity lines of credit and expanding its Internet strategy. Brockman noted that large lenders have recently voiced concerns about the growth in market share and fee income for Fannie and Freddie’s technology systems noting that the private sector’s technology systems are overshadowed by Fannie and Freddie.
- *National Mortgage News* reported that Posner warned that residential loan brokers could account for fewer mortgage originations in the future if Fannie moves deeper into online mortgage lending. The Morgan Stanley report further noted that Fannie believes that 25% to 30% of all mortgage originations will take place over the Internet by 2003 – a forecast Morgan Stanley believes could severely handicap the mortgage broker industry if it comes true. “The losers in an Internet lending environment, in our view, are traditional, low value added brokers,” Posner stated

GSEs Now Control 95% of the Automated Underwriting Primary Usage Market Share

- Reportedly, Fannie bought nearly 50% of its loans through its automated underwriting systems in 1998 and expects to reach 100% in 1999. As we noted in the March 5th *GSE Report*, Posner noted that a recent MorTech survey showed that Fannie’s market share of automated underwriting system usage rose to 59% in 1998 from 40% in 1997 and 28% in 1996, whereas Freddie’s market share fell to 36% in 1998 from 44% in 1997 and 42% in 1996. The figures reflect answers of survey respondents to the question as to which system was used “primarily.” The only other system with any material market share was PMI Group’s Aura system whose share has declined in recent years to single digits (4% in 1997, 7% in 1996. Other systems were 12% in 1997, down from 21% in 1996.
(Looking at these figures, it appears that only 5% of the automated underwriting market primary usage is now coming from the private sector --- any other company

besides Fannie & Freddie -- down from 16% in 1997 and 28% in 1996.) (*American Banker*, Joshua Brockman, 3/12/99; *National Mortgage News* website, posted 3/12/99)

As we noted in the March 5 GSE Report, Posner wrote that “Fannie Mae and Freddie Mac will use the Internet to accelerate the use of their automated underwriting systems. In so doing, they will create a growing class of originators who are dependent on agency technology and thus less likely to negotiate pricing or hold back from selling loans.”

- ***Chairman Emeritus of Chase Manhattan Mortgage Corp. Urges More Communication between Lenders and Fannie & Freddie:***
 - *National Mortgage News* reported that Felix Beck, Chairman Emeritus of Chase Manhattan Mortgage Corp. noted that although some new initiatives of Fannie and Freddie have created anguish among lenders, both sides need to recognize the enormous progress and profit that their partnerships have provided. Beck made his remarks during a Regional Conference of the Mortgage Bankers Association. Beck suggested that when Fannie and Freddie begin new initiatives, they should discuss them with the MBA, which has the pulse of the industry. Beck reportedly advised MBA leaders not to constrain Fannie and Freddie by expecting them to discuss every single issue with the group. Beck reportedly admonished Fannie and Freddie for saying that changes in their policies are done to benefit consumers, calling this a “self serving” statement. He feels it is in the best interest to keep communication between the GSEs and the lenders open. (*National Mortgage News* website, posted 3/17/99)
- ***American Enterprise Institute (AEI) to Hold Conference on Fannie & Freddie to Discuss “Public Purposes and Private Interests”:***
 - AEI has scheduled a conference on March 24 to discuss Fannie and Freddie – “Public Purpose and Private Interests.” The conference, the first in a series, will discuss the following: (1) How do Fannie and Freddie balance their profit-making objectives with their public purposes?; (2) If the GSEs indeed operate with no cost to the government, should more GSEs be created to achieve other public goals?; (3) If not costless, how much of their government subsidies flows to their private shareholders and management?; and (4) If they are subsidized, to what extent should they be permitted to compete with private-sector entities that have no subsidy? The details of the conference are as follows:

Fannie Mae & Freddie Mac: Public Purposes & Private Interests

Wednesday, March 24 – 9:00 a.m. – 2:00 p.m.

AEI, 1150 Seventeenth Street, NW, Wohlstetter Conference Center, 12th Floor

8:45 a.m. Registration

9:00 a.m. Introduction: Peter Wallison, AEI

9:15 a.m. From Public Agencies to Private Companies

The development of the housing GSEs: Why were they created and have they accomplished their purposes?

Speaker: John Weicher, Hudson Institute

9:45 a.m. Defining the Mission

What are the housing GSEs doing today, and how do these activities serve their public purposes?

Speaker: Vern McKinley, Policy Contributor to Cato Institute

Discussants: Lawrence White, New York University

Adolfo Marzol, Fannie Mae

Moderator: Peter Wallison, AEI

11:00 a.m. The Costs of Federal Support

How does the federal government subsidize Fannie Mae and Freddie Mac, what is the cost of those subsidies, and how are they allocated?

Speaker: Robert Seiler, Jr., Congressional Budget Office

The effect of Fannie Mae and Freddie Mac securities on the government securities markets

Speaker: Frank Cavanaugh, Economist & Former Senior Career Executive in charge of debt management, US Treasury Dept.

Discussant: Robert Van Order, Freddie Mac

Moderator: Charles Calomiris, AEI

12:30 p.m. Working Lunch

Open discussion between presenters, discussants and attendees.

Wrap-up and questions for further study.

Peter Wallison, AEI

2:00 p.m. Adjournment

- ***Freddie was the # 1 Top Corporate Philanthropist for the Washington, DC Area, Fannie was the #2 Contributor:***
 - The *Washington Post* published an article on the Second Annual Business Philanthropy Summit featuring a picture of First Lady Hillary Rodham Clinton seated next to Fannie Chairman Franklin Raines. The Fannie Mae Foundation, however, was not the number one contributor – the number one title for 1998 was Freddie Mac. In 1998, Freddie Mac contributed \$13.2 million, Fannie donated \$8.6 million – giving them the number one and number two spot on the top 25 listing of corporate philanthropists in the Washington, DC area. (*Washington Post*, 3/6/99)
- ***National Mortgage News Website Takes Informal Poll on Fannie & Freddie – Results are Running More than 3-1 in Favor of Confining Fannie & Freddie’s Activities to Providing Liquidity for Lenders:***
 - The *National Mortgage News* website (<http://nmnews.fgray.com>) included the following survey question on its website: “Should Congress confine the activities of Fannie Mae and Freddie Mac to those that provide liquidity for lenders?” As of 3/19/99, 3:00 p.m., the results for the poll were running more than 3-1 in favor of confining Fannie and Freddie’s activities. The results were 150 people voting “Yes” and 47 people voting “No.”

Fannie Mae

- ***Fannie Continues to Use its Technology to Expand and Build its Brand Name Directly to Consumers – Fannie Announces it has Added Renovation Information to its Consumer Website:***
 - Further expanding its reach to consumers through technology, Fannie announced that it has added renovation information to HomePath.com (its consumer website). The site now provides information on Fannie Mae home improvement mortgage products and a list of home improvement lenders. (*Fannie press release, 3/16/99*)
- ***Fannie Expands into Pension Funds – Fannie Approved its First Two Credit Facilities for Pension Funds (Seems to be Outside the Scope of their Original Mission):***
 - Fannie announced that it approved its first two credit facilities that will provide capital to pension funds that invest in multifamily properties. The facilities include an \$85 million credit facility for SSR Western Multifamily, LLC and a \$75 million credit facility to DOC Investors, LLC. Berkshire Mortgage Finance is the lender for the SSR credit facility and ARCS Commercial Mortgage, LLP is the lender for the DOC facility. The SSR facility is expandable to \$170 million, and the DOC facility is expandable to \$100 million. Financing for both can include a combination of short-term floating rate and long-term fixed rate mortgage-backed securities. “Our credit facility has become a preferred source of financing for many Real Estate Investment Trusts (REITs), and it’s gratifying to see that pension fund managers also recognize the superior flexibility and ease of execution offered by our credit facility,” said Richard Lawch, Vice President for Multifamily Capital Markets. (*Fannie press release, 3/4/99; National Mortgage News website, posted 3/5/99*)
- ***Fannie Allows Holders of Fannie’s Non-Benchmark Debt to Swap \$15 Billion of Non-Benchmark Debt for Fannie’s Benchmark Notes – Fannie has issued \$53.25 Billion in Benchmark Debt Since it Began the Program in 1998 – In Related News, Fannie Launches a New Three-Year Benchmark Note which Reportedly Wall Street is Having Trouble Selling:***
 - Fannie announced that it has offered holders of its non-benchmark debt the option of swapping their holdings for its five-year Benchmark Note. (Benchmark Notes are marketed as alternative to Treasuries.) The swap applies to holders of just over \$15.06 billion of Fannie’s non-callable, US dollar medium-term notes, global bonds and debentures. Investors taking part in the swap will receive holdings of 5.125% Benchmark Notes maturing in February 2004. Fannie has \$4 billion outstanding in Benchmark Notes and in addition to the exchange, it said it would reopen the issue to add at least another \$2 billion. The exchange offer applies to 71 specific issues of Fannie’s outstanding debt with maturities ranging between June 2002 and March 2006. According to *Euroweek*, a success rate of 30% (\$4.5 billion of bonds exchanged) would create a new Benchmark of around at least \$10.5 billion, the largest Fannie Mae Benchmark Note to date. Fannie reportedly has two outstanding lines – the April 2003 and May 2008 bonds – which currently stand at \$9 billion. *Euroweek* noted that “Such bonds dwarf the size of other jumbo deals in the international markets, and come close to matching the size of US Treasuries – which on average total around \$15bn-\$16 bn.” *Euroweek* notes that the swap offer is confirmation by Fannie to the market that all of its non-callable term

funding in the dollar market will from now on be concentrated on its Benchmark Notes. The swap is reportedly tax neutral for both Fannie and investors. *Euroweek* reports that the IRS recently clarified the guidelines on tax treatment of exchange offers, and the terms of the Fannie offer mean that investors will not have to book a tax gain or loss from the swap.

- Fannie has issued \$53.25 billion in Benchmark Notes since they were introduced last year in maturities ranging from three to ten years. (*Bloomberg News*, 3/10/99; *Euroweek*, 3/12/99; *Fannie press release*, 3/10/99; *Financial Times*, Vincent Boland, 3/11/99; *National Mortgage News website*, posted 3/10/99)

In Related News, Fannie Launches a New Three-Year Benchmark Note which Reportedly Wall Street is Having Trouble Selling

- On March 2nd, Fannie announced that it launched a new \$3 billion three-year Benchmark Note. According to the *Dow Jones-Capital Markets Report*, Wall Street dealers had some trouble selling the Benchmark Note. The article by Joe Niedzielski noted that a slow final day of marketing might have led to Wall Street being long the bonds and the issue trading weaker in the secondary market. Reportedly numerous sources said the deal was not well placed and that the market's tone had been weaker, citing movement in interest-rate swap spreads. There was also the sense that the deal's lead managers may have engage in aggressive swaps with accounts out of other agency issues to further push the sale. (*Dow Jones-Capital Markets Report*, Joe Niedzielski, 3/4/99)
- ***Fannie Commits to Buying \$26.5 Billion of Mortgages in February:***
 - Fannie stated that it committed to purchase \$26.5 billion of mortgages in February, the second highest month on record and up from \$20.8 billion in January. Fannie also created \$33.4 billion of mortgage-backed securities in February, down from \$40.8 billion in January. The net mortgage portfolio grew by \$13.5 billion to \$432.5 billion, an annualized growth rate of 38.6%, compared with 11% in January. Fannie also stated that the year-to-date annualized net mortgage portfolio growth rate was 25%. (*Bloomberg News*, 3/10/99; *Reuters*, 3/10/99)

Freddie Mac

- ***Home Equity Lenders Concerned about Freddie's Entrance into Subprime Market – Believe Freddie has an Unfair Competitive Advantage over Private Sector:***
 - According to an article by Heather Timmons for the *American Banker*, home equity lenders are concerned about Freddie's involvement in the subprime market. Laura Borrelli, President of the National Home Equity Mortgage Association (NHEMA) noted that Freddie's involvement in the subprime market is threatening the margins and could squeeze out players that concentrate on more creditworthy but less-than-prime customers.

Borrelli is concerned that Freddie's involvement could create two secondary markets for the loans, which could eventually drive up costs for consumers with the worst credit history. Borrelli further noted that Freddie enjoys an implicit government guarantee that gives Freddie an unfair competitive advantage. "It certainly isn't a level playing field," she said. "Their cost of funds is much lower, and they don't pay taxes." Freddie noted that its activities bring liquidity into the market. (*American Banker*, 3/15/99)

- ***Freddie Increases Quarterly Shareholder Dividend by 25%:***
 - Freddie announced that it increased its quarterly dividend by 25%. Freddie will increase to 15 cents a common share from 12 cents. It will be paid to shareholders of record as of March 15 on March 31. It was the first increase in four quarters. (*Bloomberg News*, 3/5/99; *Freddie press release*, 3/5/99)
- ***Freddie Launches \$3 Billion Reference Note (Similar to Fannie's Benchmark Notes – Marketed as Alternatives to Treasuries):***
 - Freddie announced that it priced a \$3 billion, 10-year maturity Reference Note with a coupon of 5.75% and an issue price of 99.518% or 62.5 basis points over the comparable Treasury security. Bankers said they expect the securities to be popular with Asia-based investors seeking safety amid Asia's financial crisis. This Reference Note sale increases the total outstanding balance of Reference Notes to \$30 billion and 1999 issuance volume to \$10 billion. To date, Freddie has issued Reference Notes with maturities ranging from three to ten years. Freddie anticipates issuing a total of \$40 billion of Reference Notes in 1999. (*Freddie press release*, 3/10/99; *Bloomberg News*, 3/8/99)
- ***Freddie Increases Total MBS Outstanding in February:***
 - Freddie's total MBS outstanding increased by \$10.4 billion in February to \$674 billion, a 15.6% annualized growth rate, up from 14.1% in January. Mortgage purchases were \$993 million in February, compared to \$384 million in January, while portfolio liquidations were \$4.5 billion in February, down from \$4.8 billion in January. Net commitments to purchase mortgages were \$14.0 billion, compared with \$7.4 billion the month before. Freddie's net mortgage portfolio grew by \$5.9 billion in February to \$262.9 billion, a 2.3% rise from January, and a 41.4% rise in portfolio from a year earlier. (*Dow Jones Newswire*, 3/16/99)

Private Sector Items to Note

- ***BankAmerica Increases its Commitment to Two Low-Income Mortgage Products and Will Make Those Loans Available in the old NationsBank's Market – Company Notes that these BankAmerica Low-Income Products were Needed because NationsBank's Current Affordable Lending Products -- Fannie & Freddie Loans – Didn't Allow the Company to "Reach Down Deep Enough" with their Lower-Income Borrowers:***
 - According to an *American Banker* article by Marc Hochstein, BankAmerica increased its commitments to two mortgage products targeted at low-income borrowers. One of the

products allows borrowers to purchase a home with no money down and the second product accepts borrowers with no credit scores who can prove their creditworthiness through nontraditional means. BankAmerica raised its commitments from \$500 million and \$600 million, respectively, to \$1 billion for each product.

- According to the article, Stephanie Smith, National Manager of Community Lending at the merged company of BankAmerica and NationsBank, stated that the two BankAmerica products were developed by the old BankAmerica but will now be offered in the old NationsBank markets. Smith stated that NationsBank's affordable lending products were Fannie and Freddie loans that "weren't letting us reach deep enough with our lower-income loans to low-income families and people of color in low-income neighborhoods." The article further noted that BankAmerica is planning to hold the loans it originates under these two products in its portfolio, though Smith stated that the bank expects a secondary market to develop. (*American Banker*, Marc Hochstein, 3/8/99)
- ***United Guaranty is Able to Secure a Secondary Market in the Private Sector for its New Mortgage Insurance Product for High LTV Loans- Fannie & Freddie Have Said they are Not Interested in Purchasing Loans Insured with the Mortgage Insurance Product Despite 120 Lenders Signing Up to Offer the Product to Consumers:***
- According to *National Mortgage News*, Regions Mortgage, Montgomery, AL and Ohio Savings Bank, Cleveland, will create a secondary market for United Guaranty Mortgage Indemnity Co.'s Borrower Advantage high LTV mortgage insurance product. Borrower Advantage reportedly provides mortgage insurance on loans that have 103% LTVs, including closing costs. The product is designed to attract borrowers who otherwise would have to secure second mortgage financings to finance high LTV loans and closing costs. To date, 120 lenders have signed the master agreement to offer the MI product. However, Fannie and Freddie have stated that they are not interested in purchasing loans insured with the product. Andy May, Vice President for Product and Corporate Development at United said the Borrower Advantage product is comparable to the FHA program, but is more flexible for lenders. Under the program, borrowers receive a conventional no down-payment option, without increased interest rates. Borrowers must have a FICO score of 700 or better. (*National Mortgage News website*, posted 3/5/99)

Federal Home Loan Banks

- ***A Third FHLBank (FHLBank of Atlanta) Begins Offering the Mortgage Partnership Finance Program (MPF) – Two Other FHLBanks are Close to Offering the Program - The MPF is Becoming a Real Competitor to Fannie & Freddie:***
- The FHLBank of Atlanta is now offering the Mortgage Partnership Finance Program (MPF)- the secondary mortgage market competitor to Fannie and Freddie. The MPF program, first developed by the FHLBank of Chicago, is increasingly providing new competition in the secondary mortgage market by providing thrift and commercial bank lenders with an alternative to selling fixed-rate home loans to Fannie and Freddie. The

FHLBank of Atlanta joins the Dallas and Chicago FHLBanks in offering the MPF program.

- The MPF program, launched in 1997, now has more than \$1 billion in outstanding loans and master commitments for another \$1 billion. Under the MPF, participating members of the FHLBanks (banks and thrifts) service, underwrite, and originate mortgage loans, which the FHLBank can fund directly or which can be funded by the member and then sold to the FHLBank. The member banks and thrifts share a portion of the credit risk in a limited, second loss position, while the FHLBank manages the funding, interest rate, liquidity and prepayment risk of the loans. For MPF loans originated in the Atlanta District, the FHLBank of Chicago will handle back-office functions and share in a participation.
- FHLBank of Atlanta Acting President Carol Jackson said, “MPF represents another opportunity to provide service to the institutions that rely on us to assist in mortgage lending initiatives in their markets.” Alex Pollock, President and CEO of the FHLBank of Chicago, stated that the Atlanta FHLBank’s involvement “demonstrates the growing demand for the MPF program among financial institutions across the country.” Pollock also noted that the New York and Pittsburgh FHLBanks were close to joining the MPF program. Bruce Morrison, Chairman of the Federal Housing Finance Board, stated, “The addition of the Atlanta FHLB increases competition in the mortgage market – and American homebuyers should benefit as a result.” (*FHLBank of Atlanta and FHLBank of Chicago Joint Press Release, 3/10/99; Dow Jones Newswire, John Connor, 3/11/99; American Banker, Joshua Brockman, 3/16/99*)
- ***Fannie’s Chairman Raines Criticizes FHLBank’s Mortgage Partnership Finance Program (MPF) – the Growing Secondary Mortgage Market Competitor to Fannie & Freddie:***
 - Fannie Mae Chairman Franklin Raines for the first time publicly criticized the FHLBank’s MPF program, the secondary mortgage market competitor to Fannie and Freddie. Raines stated that it wasn’t clear whether the FHLBank has the proper capital and experience to manage the program. “The jury is out,” he stated. A FHLBank system spokesman told *MortgageWire* that the 12 FHLBanks hold a combined \$9 billion in permanent capital. “That is more than enough capital to offset any risks associated with the program.” He further added that the system member originating the loan, not the FHLBank, handles credit risk associated with each MPF loan. (*Bloomberg News, Paul Nyhan and Rob Wells, 3/15/99; National Mortgage News website, 3/16/99*)
- ***House and Senate Banking Committees Approve Bills with FHLBank Expansion Language - Treasury Department Does Not Support this Piecemeal Reform, Would Prefer Comprehensive Reform and a Limit on the Arbitrage Activities of the FHLBanks***
 - The Senate Banking Committee passed its version of financial services modernization bill on March 4 on a party-line vote of 11-9. As we noted in the February 19th *GSE Report*, when Senate Banking Committee Chairman Phil Gramm (R-TX) introduced his original draft financial services modernization bill, he was still considering whether to include FHLBank provisions in the bill. In the updated version of the bill, approved by the Senate Banking Committee, Senator Gramm included FHLBank language making

thrift membership voluntary, allowing collateralized advances for institutions with less than \$500 million in assets, converting the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank earnings, and instructing the General Accounting Office (GAO) to conduct a study of the FHLBank System capital structure. (*National Mortgage News website*, posted 3/2/99)

House Banking Committee Approved a Modified Amendment Establishing New Capital Requirements for the FHLBanks

- The House Banking Committee held mark-ups of its financial services modernization bill on March 4 and March 10-11 and cleared the bill by a 51-8 bipartisan vote. The House version (H.R. 10) contained language making FHLBank membership voluntary, allowing collateralized advances for institutions with less than \$500 million in assets, and changing financing from a fee-based system to a flat rate. According to an article by R. Christian Bruce at the *BNA Daily Report for Executives*, during the House Banking mark-up on March 4, a modified amendment establishing new capital requirements for the FHLBanks was approved. The amendment, as originally offered by Congressman Richard Baker (R-LA) and Congressman Paul Kanjorski (D-PA), would have set the FHLBank leverage capital requirement as low as 2.5% and would have set the credit risk for certain collateralized advances at zero. However, the Banking Committee then approved by voice vote an amendment by House Banking Committee Chairman Jim Leach (R-IA) that changed the Baker-Kanjorski FHLBank amendment to require a 5% FHLBank leverage requirement. Further, Leach's amendment also struck the zero credit-risk feature. According to the *BNA* article, Leach stated that "I believe Mr. Morrison [Federal Housing Finance Board Chairman Bruce Morrison] is wrong to believe that the system is wildly overcapitalized." According to the *BNA* article, the Treasury Department opposed the Baker-Kanjorski amendment as originally offered. (*BNA Daily Report for Executives*, 3/4/99; *BNA Daily Report for Executives*, R. Christian Bruce, 3/5/99; *National Mortgage News website*, posted 3/2/99)
- According to the *BNA Daily Report for Executives*, during the March 10 House Banking mark-up, the Committee modified the FHLBank provisions passed during the March 4 mark-up and approved an amendment by Congressman Richard Baker (R-LA) and Congressman Paul Kanjorski (D-PA) that allows the FHLBank capital requirement to be met using two classes of stock. The new Baker-Kanjorski amendment reportedly has the effect of reducing the 5% leverage capital requirement that the House Banking Committee imposed on FHLBanks during the mark-up on March 4 under the amendment by House Banking Committee Chairman Jim Leach (R-IA). The amendment reads, "In determining compliance with the minimum leverage ratio established under section 6, the paid-in value of the outstanding Class B stock shall be multiplied by 1.5, the paid-in value of the outstanding Class C stock and the amount of retained earnings shall be multiplied by 2.0, and such higher amounts shall be deemed to be capital for purposes of meeting the 5 percent minimum leverage ratio." According to *National Mortgage News*, the amendment cuts in half the amount of capital that members have to hold against their FHLBank advances, if they purchase permanent stock. The *American Banker* reported that Leach objected to the modified amendment, arguing that members would flock to the class of stock with the lowest capital requirement but Congressmen Baker successfully defended the plan as a way to promote stability by using lower minimum capital requirements to encourage banks to buy nonredeemable, or permanent, form of stock.

- The *BNA* article noted that Congressman Baker stated that the proposal would encourage a more permanent capital base for the system, and Congressman Kanjorski stated that it would ensure more access to capital for smaller banks and community development corporations. Congressman Doug Ose (R-CA), however, warned that the change could backfire in an economic downturn. “We’re in sweet times now, but it’s not going to last,” he reportedly stated. (*American Banker*, 3/11/99; *BNA Daily Report for Executives*, R. Christina Bruce, 3/15/99; *National Mortgage News website*, posted 3/11/99)

Treasury Department Does Not Support FHLBank Provisions and Cites the FHLBank Expansion Provisions in both Financial Services Modernization Bills as One of the Three Reasons it Cannot Support the Bills

- The House Banking Committee held hearings on their version of the financial services modernization bill (H.R. 10) on February 10, 11, and 12. US Treasury Secretary Robert Rubin testified on February 12 to the House Banking Committee that the Treasury Department did not support the FHLBank provisions included in H.R. 10. Rubin testified that “the Administration would have vetoed H.R. 10 had it passed in the last Congress, and we continue to oppose H.R. 10 in its current form. We have three basis objections to this bill – its prohibition of the use of subsidiaries by banks, its weakening of the effects of the Community Reinvestment Act (CRA), and its expansion without reform of the Federal Home Loan Bank System.” Regarding the FHLBank System, Rubin testified that “The FHLBank System is currently the largest issuer of debt in the world. Last year, it issued approximately \$2.2 trillion in debt, and it currently has \$350 billion in debt outstanding. Yet the System uses little of its government-subsidized debt to further the System’s home ownership purposes. We recognize the desire of many Members to see the System lend more to community banks. Indeed, we believe that the System should focus on such lending, not on using taxpayer funds for arbitrage activities and overnight lending which currently constitute so much of its activities. Changing this important System perhaps should be done separately. But if it is to be addressed in this legislation, we believe changes in the FHLB System should occur only in the context of comprehensive reform.” (*Testimony of Treasury Secretary Robert Rubin to House Banking Committee*, 2/12/99; *Dow Jones Newswire*, 2/12/99)
- In a letter to Ranking Committee Democrat John LaFalce (D-NY), Treasury Secretary Robert Rubin said he supported the House financial services modernization bill (Leach/LaFalce compromise), however, Rubin noted that that some portions of the bill concerned him -- particularly the provisions expanding the FHLBank System. (*BNA Daily Report for Executives*, 3/4/99)
- Senate Majority Leader Trent Lott (R-MS) announced that he would like the Senate to vote on its version of financial services modernization during the first two weeks of May. The House version will be sent to the House Commerce Committee for its consideration. The House Banking Committee hopes to have a referral to the Commerce Committee shortly. (*BNA Daily Report for Executives*, 3/18/99)
- ***FHLBanks Increase their Political Muscle – Former New Jersey Governor James Florio Elected New Chairman of FHLBank of New York – Florio Advocates Creating Competition with Fannie & Freddie through the FHLBanks’ MPF Program:***

- Former New Jersey Governor James Florio was approved by the Federal Housing Finance Board as Chairman of the FHLBank of New York. Florio was also reelected to a four-year term as Public Interest Director of the Bank. Reportedly, Florio is enthusiastic about the FHLBank System's MPF program and is "keen on the idea of creating competition for Fannie and Freddie." "One of the things we've advocated is a level playing field for the GSEs," he said. Florio is a Senior Partner at the law firm of Florio & Perrucci in Piscataway, NJ. According to the *Star-Ledger* of Newark, NJ, Florio is also considering a potential run for the US Senate in 2000. When questioned whether he was considering running for Senate, Florio stated that "I'm giving some serious thought to it." (*American Banker*, 3/11/99, 3/16/99; *Star-Ledger*, Newark, NJ, 3/3/99)
- ***New President and CEO for FHLBank of Seattle:***
 - Norman Rice was named President and CEO of the FHLBank of Seattle. (*The Seattle Times*, 3/8/99)
- ***Federal Housing Finance Board Releases Staff Interpretation of Affordable Housing Program Regulation for FHLBank System:***
 - The Federal Housing Finance Board published Questions and Answers regarding the FHLBank System's affordable housing program (AHP) in the *Federal Register* on March 11. The Questions and Answers were prepared by the staff of the Finance Board in response to questions about changes in the Finance Board's regulation governing the AHP that went into effect on January 1, 1998. (*Federal Register*, 3/11/99, pages 12079-12084)

Farm Credit System

- ***Community Bankers Concerned and Angry about Unfair Competition from Farm Credit Banks – Regulator for Farm Credit System asks Community Banks to Write their Office to Report Farm Credit System Lenders that are Unfairly Offering Below-Market Interest Rates – Many Bankers are Advocating the Privatization of the Farm Credit System:***
 - An *American Banker* article by Laura Pavlenko Lutton focused on community banker's increasing concern and anger over unfair competition from Farm Credit banks. **Bankers believe the Farm Credit System is able to offer lower interest rates on loans because it does not pay income taxes and has cheaper access to funds than commercial banks.** Dennis Utter, President of Adams County Bank in Nebraska, complained that he had lost three of his best customers to Farm Credit in the past two years after lenders from the Farm Credit System allegedly underpriced his bank on loans to farmers. Utter stated that "They [Farm Credit System lenders] want the really good customers, and they use predatory pricing to get them."
 - Lutton noted that bankers and industry experts are asking Congress to intervene and prohibit Farm Credit lenders from underpricing banks or at least give bankers access to the same low-cost funding sources. Lutton noted that "To say bankers are frustrated with Farm Credit's expansion is an understatement." According to her article, the Farm Credit Administration, the regulator for the Farm Credit System, received 25 letters complaining

about unfair competition from Farm Credit lenders – more letters than it received in the previous eight years combined. Michael Edelman, CEO of First National Bank in Ogallala, NE reportedly wrote a letter complaining that a Farm Credit lender was offering 15-year fixed-rate loans at 75 to 100 basis points below the lowest rates at First National. Edelman believes those low loan rates cost him several customers, including one that took a loan from Farm Credit to expand its feedlot operation. **“We as taxpayers don’t need to be subsidizing loans at 6.35%,” He stated. “It’s hard enough for us to compete.”** Marsha Pyle Martin, Chairman and CEO of the Farm Credit Administration, explained that Edelman’s complaint was investigated but found no evidence of wrongdoing. Martin reportedly stated that the Farm Credit Administration has only disciplined one lender since 1987 for underpricing its loans, which in that case, the Farm Credit Administration was concerned that the bank wasn’t earning enough income on its loans to keep its capital at an acceptable level.

- **Lutton noted that many bankers want Congress to privatize the Farm Credit System so those lenders are subject to the same taxes and have the same funding sources as commercial banks. Lutton further noted that “The Farm Credit Act of 1971 prohibits its lenders from offering interest rates ‘below competitive market rates for similar loans made by private lenders.’” Martin suggested that bankers send letters complaining of Farm Credit System lenders offering below-market interest rates directly to the Farm Credit Administration for investigation.** (*American Banker*, Laura Pavlenko Lutton, 3/15/99)

Ginnie Mae

- ***Mortgage Bankers Association Vows to Fight Ginnie Mae Privatization Proposal in Senate Budget Resolution - Since a Privatized Ginnie Mae would No Longer Carry the Full Faith & Credit of the US Government, or Have the Implied Backing Provided other GSEs, there was a Question as to whether a Privatized Ginnie Mae would Actually be able to Compete with Existing GSEs:***
- According to *National Mortgage News*, Mortgage Bankers Association (MBA) Executive Vice President Paul Reid vowed to fight the proposed privatization of Ginnie Mae included in a Senate Budget Resolution approved by the Senate Budget Committee on March 17. Reid said the proposal to privatize Ginnie Mae would weaken the FHA and VA loan programs because it would remove them from the full faith and credit guarantee of the federal government. Reid also noted that the industry would fight user fees (“taxes on homeownership”) which he stated have been part of budget discussions. According to the *Dow Jones Newswire*, the Senate Budget Resolution assumes \$2.8 billion in revenue from the privatization of Ginnie Mae. The *Dow Jones* article also noted that a Senate aide stated that the budget resolution plan leaves open the door for congressional banking committees to impose registration fees on securities issued by Fannie and Freddie. As we noted in previous *GSE Reports*, earlier this year, the OMB considered, but decided not to include, the privatization of Ginnie Mae, the imposition of user fees on Fannie and Freddie and an increase the Ginnie Mae guaranty fee in the President’s FY 2000 Budget. (*Dow Jones Newswire*, Mark Anderson, 3/16/99, *National Mortgage News* website, posted 3/18/99)

- ***Senators Rod Grams (R-MN) and Slade Gorton (R-WA) Introduce a Senate Concurrent Resolution Expressing a Sense of the Senate that Ginnie Mae Guaranty Fee Should Not be Increased:***
 - According to *National Mortgage News*, Senators Rod Grams (R-MN) and Slade Gorton (R-WA) introduced a Sense of the Senate Resolution that Congress should not increase Ginnie Mae guaranty fees. “This resolution serves notice that taxes on American homebuyers – in this case through higher fees on the securities used to fund the loans – should not be used to fund general government,” Senate Grams reportedly said in introducing the Resolution – Senate Concurrent Resolution 16. The Mortgage Bankers Association would like Congress to repeal the 3 basis point Ginnie Mae fee increase that goes into effect in fiscal year 2004 (passed in Higher Education bill last year). As we noted in the February 19 *GSE Report*, Assistant Majority Whip Jerry Weller (R-IL) introduced a similar Resolution on the House side – H. Con. Res. 10. In a “Dear Colleague” letter to other Congressional Members, Congressman Weller requested that other Members co-sponsor the resolution because “any increase in the Ginnie Mae guaranty fee is an unnecessary tax on homeownership that would cost homebuyers hundreds of dollars in additional expense at closing and prevent thousands of families from achieving the dream of homeownership.” (*National Mortgage News* website, posted 3/9/99)

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