

The **GSE** REPORT™

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 - There are Concerns that an Increasingly Crowded GSE Market Might be Dangerous in a Weaker Market
 - Wall Street Source Suggests that the Treasury Department might need to Assume its Intermediary Role Again in Scheduling Fannie & Freddie's Debt Issuances
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- Following in Freddie's Footsteps, Fannie Revises Private Mortgage Insurance (PMI) Cancellation Guidelines to Comply with Homeowners Protection Act (*p. 18*)
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Fannie Mae

- "Yo Quiero Fannie Mae?" - Fannie hires Taco Bell's Advertising Executive who is Considered Largely Responsible for Taco Bell's Successful Chihuahua Commercials (*p. 20*)
 - (This Move Heightens Criticisms that Fannie is Building its Brand Name to Target Consumers)
 - One Mortgage Executive said the Hiring Makes Fannie's Loud Protests that they are Not Going Directly to Consumers "Hard to Believe"
 - Fannie reportedly Spent \$34.5 Million in Advertising in 1998
 - (Fannie's "Taxes on Homeownership" Funds Advertising Budget)
- While Fannie Downplays Political Risk to their Business at a Recent Biennial Investor Conference, the Company Makes Another Round of Politically Connected Staff Hires (*p. 21*)

Current Political Risks Facing Fannie include the Following:

 - (1) OFHEO introduced a risk-based capital proposal that would impose higher capital standards on Fannie and Freddie;
 - (2) CBO Suggested new fees on Fannie and Freddie's investment portfolio and requiring that Fannie and Freddie Register their Securities with the SEC;
 - (3) HUD is considering raising Fannie and Freddie's affordable housing goals;
 - (4) HUD is evaluating the fair lending impact of their automated underwriting systems and lending guidelines;

- (5) HUD is examining the non-mortgage investments of Fannie and Freddie;
- (6) HUD is retroactively reviewing Fannie and Freddie's "lower-cost" MI products;
- (7) Congress is Open to the Idea of Creating a Single GSE Regulator.
- (8) Increasing competition from the FHLBank System;
- (9) Increasing concerns raised by the private sector on Fannie and Freddie's expansion into their business; and
- (10) The risk-weighting assigned for all investment grade (AAA and AA-rated) private institution mortgage-backed securities (MBS) and asset-backed securities (ABS) might be lowered to 20% (same as for Fannie & Freddie)
- Fannie Announces that it has Provided More than \$5 Billion of Financing under its Multifamily Credit Facility (*p. 22*)
- Fannie Invests in First REIT to Focus on Affordable Housing and Community Development (*p. 23*)
- Fannie Announces Environmental Partnership with the National Association of Home Builders (*p. 23*)
- Garry Mauro, who President Clinton Announced he would Appoint to Fannie's Board of Directors, States that he Intends to Play a Big Role in Vice President Al Gore's Presidential Campaign and Intends to Move to New York to Work on First Lady Hillary Rodham Clinton's Senate Campaign (*p. 23*)
- 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 36 offices are officially opened and three more are in the process of being formed) (*p. 24*)
 - (Although Fannie Claimed Recently that its Advertisements were too "Fannie Mae-Centric" and Did Not Incorporate the Crucial Contribution of its Lender Partners in its Successful Projects – Fannie Continues To Only Incidentally Mention its Lender Partners in its Numerous Press Releases)

Freddie Mac

- Freddie Loses Two Senior Executives (*p. 25*)
 - After Only Five Months on the Job, Recently Hired High-Profile Wall Street Talent, Kevin Finnerty, Leaves Freddie Mac
 - SVP of Corporate Relations, Ann Schnare, is also Leaving
- Freddie Plans to Continue Using its Controversial MODERNs Derivative Program (*p. 26*)
 - Freddie is also Planning Catastrophe Bonds Like those Pioneered by Insurance Companies
- Freddie Wraps a \$400 Million Offering of Home Equity Loans (*p. 26*)
- Freddie Closes its Largest Senior Housing and Assisted Living Pilot Program Deal – an \$88 Million Commercial Mortgage Deal with GMAC (*p. 26*)
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- Freddie Announces New Senior Vice President for Investment Funding (*p. 28*)
- Freddie Designates Cincinnati, OH its "Fifth Alliance Community" (*p. 28*)
- Freddie Announces that it will Join Initiative to Help the Quad Cities Area – Rock Island and Moline, IL and Davenport and Bettendorf, IA (*p. 28*)
- Freddie and MBA Create Spanish Language Credit Education Brochure (*p. 28*)

Federal Home Loan Banks

- It Appears that Fannie's Warnings about the FHLBanks will go Unheeded by the FDIC (*p. 29*)
- Fannie Chairman Franklin Raines Threatens FHLBank System that they will Face More Regulation if they Continue with their Mortgage Partnership Finance (MPF) Program – a Program that is Competing with Fannie & Freddie in the Secondary Mortgage Market (*p. 30*)
 - FHLBank of Chicago President is Flattered at Fannie's Attention over the MPF Program
 - The MPF Program is Becoming a Real Competitor to Fannie & Freddie – Five FHLBanks are Now Offering the Program
- FHFB Approves a Temporary Capital Leverage Change to Enhance the FHLBanks' Liquidity in Preparation for the Year 2000 Computer Conversion (*p. 31*)
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 - President Clinton Intends to Nominate a New York State Senator and a Former Senate Aide to the Federal Housing Finance Board to Fill Two Vacancies on the Board
 - Since March of 1998, Only Three of the Five-Member Federal Housing Finance Board Director Slots have been Filled
- Status Report of Legislation Containing FHLBank Expansion Provisions (*p. 32*)
 - House Commerce Committee Passes H.R. 10 with FHLBank Expansion Provisions on June 10

- Administration Continues to Oppose FHLBank Expansion Provisions

Farm Credit Administration/Farm Credit Banks

- Farm Credit Administration issues a Rule that would Expand the Farm Credit System Banks into Non-Mission Related Investments (*p. 33*)

Major Events

GAO Releases a Study that Indicates that Farmer Mac is Largely Ineffective

GAO Reports Finds that Farmer Mac held \$1.18 Billion in Non-Mission Related-Investments, which accounts for 61% of Farmer Mac's Assets

GAO Reports Finds that Farmer Mac has a Small Market Presence – Overall Share of the Agricultural Mortgage Market is a Mere 1.2%

GAO Finds that Even if Farmer Mac Continued to be Economically Viable, it was Difficult to Determine whether the Public Benefits Created Justify Continued Government Sponsorship

GAO Recommends that Congress Consider All the Activities of Farmer Mac, the Farm Credit System, and the FHLBanks because of their Overlapping Mission Activities

Chairman of the House Banking Committee Jim Leach (R-IA) Stated that it was “unconscionable for a government-sponsored enterprise to have more than three-fifths of its assets in non-mission-related investments.” Leach further stated that “When a governmentally-privileged institution established to serve farmers abuses its status by investing disproportionately in arbitrated financial investments rather than agricultural loans, the Treasury and the Congress have an obligation to review its management practices.” (*House Banking Committee press release, 6/10/99*)

Chairman of the House Banking Subcommittee on Capital Markets and GSEs, Cong. Richard Baker (R-LA), Plans to Review the GAO Report and Determine whether Farmer Mac's Continued Government Sponsorship is Needed (*House Banking Subcommittee press release, 6/9/99*)

- (GAO Report, “*Farmer Mac: Revised Charter Enhances Secondary Market Activity, but Growth Depends on Various Factors,*” (GAO/GGD-99-85, May 1999))

Fannie is Playing a Major Role in Realtor.com - the largest home listing site on the Internet and Official Site of the National Association of Realtors

Fannie has a 4% Equity Investment in HomeStore.com (formerly RealSelect Inc.), the brains behind REALTOR.com

Fannie also has a Representative on HomeStore.com's Eight-Member Board of Directors

Lenders are concerned about the Investment

(Announcement Further Illustrates that Fannie & Freddie are Using their Duopoly Power Combined with Technology to Consolidate the Mortgage Industry and Expand into New Lines of Business (Jobs in the Private Sector are Threatened))

- According to *National Mortgage News*, Fannie Chairman Franklin Raines stated that he sees Fannie's ties to Realtors “getting deeper and deeper.” (While at the same time, Raines states

during a recent MBA meeting that “lenders are our only customers.”) *National Mortgage News* reported that Fannie had an equity ownership in RealSelect, Inc. (now HomeStore.com), the owner of the REALTOR.com website, the largest home listing site on the Internet and the official site of the National Association of Realtors. (Fannie had previously announced a “partnership” with RealSelect back in August of 1998, however, the company never mentioned an “equity partnership” and would not comment about the investment.) According to *National Mortgage News*, Fannie would not specify the dollar size of Fannie’s investment in the company, however, the investment was revealed when HomeStore.com filed papers on May 28 to announce an initial public offering of the company.

- In HomeStore.com’s S-1 filing to the SEC, it was revealed that that **Fannie owns 833,354 shares or 4.5% of the company. The National Association of Realtors, for which Realtor.com is its official website, only owns 9% of the company.** Fannie IT Executive William Kelvie will be representing Fannie on the Board of HomeStore.com. The SEC documents indicate that HomeStore.com plans to raise \$100 million in its first-ever public sale of common stock. The company plans to trade on NASDAQ under the stock symbol HOMS.
- Besides its flagship website, Realtor.com, HomeStore.com also owns-
 - HomeBuilder.com** – the web’s leading provider of 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.
- In earlier stories, a Fannie spokesman reportedly stated that Fannie asked REALTOR.com to list all of its seller/servicers on the website, a move that potentially could link consumers directly to all Fannie-approved seller/servicers. Realtor.com also features consumer-friendly information about the mortgage shopping process from Fannie’s HomePath.com website and promotes the sale of Fannie REOs by Realtor brokerages.
- **According to *National Mortgage News*, some top-ranked lenders are not sure about the partnership. “What bothers me,” said one executive at a top-ten lender, “is that this is a site primarily for the consumer – so why is Fannie Mae involved?” Another origination lender stated, “What’s the motivation here? To make Realtors mortgage brokers?”** (*Inman News Feature*, 5/28/99; 5/29/99; 5/30/99; *National Mortgage News*, 5/24/99; *National Mortgage News website*, posted 5/24/99)

Further Controlling the Realtor side of the Homebuying Process - Fannie promotes software product, HomePath Adviser, for real estate agents to assist prospective homebuyers at any point in the homebuying process. The software provides a quick analysis of the buyer’s financial readiness to purchase a home, creating a seamless (Fannie-controlled) link between the real estate professional, mortgage lender and housing counselor.

- As we reported in the May 28 *GSE Report*, Fannie Chairman Franklin Raines is now promoting a new Fannie software product, HomePath Adviser, that will “enable real estate professionals to

assist prospective homebuyers at any point in the path to homeownership.” The software provides a quick analysis of the buyer’s financial readiness to purchase a home, creating a seamless (Fannie-controlled) link between the real estate professional, mortgage lender and housing counselor. “It is clear that real estate practitioners are key advisers to consumers as they approach the process of homeownership, and that is why we strive to build close relationships with you (real estate professionals),” Raines stated. (Where are lenders, Fannie’s “only customer,” in this homebuying advisor process between consumers and realtors?) Raines made his remarks during a National Association of Realtors forum during the association’s Midyear Governance Meetings and Trade Exposition. (*PR Newswire*, 5/24/99)

Responding to Criticisms about the FHLBanks’ Arbitrage Investment Practices, the FHFB Announces the Outline of a Plan to Restrict and Gradually Eliminate the FHLBanks’ Non-Mission Investments

The Plan would Reclassify the Types of Investments that the FHLBanks could make so that All Investments would Be Consistent with the System’s Mission

The Plan would Force the FHLBanks to Divest their Mortgage-Backed Securities Over a Five-Year Period

Under the Plan, Mortgage-Backed Securities would Not Qualify as Mission-Related Investments

The Proposed Rule will be Officially Released on July 14

- According to John Connor with *Dow Jones Newswire*, the Federal Housing Finance Board (FHFB) – the regulator for the FHLBank System - announced during a FHFB meeting on May 28 the broad outlines of a plan to gradually eliminate the FHLBanks’ non-mission investments. The Treasury Department, Congress, and others have criticized the FHLBanks for their arbitrage practices – borrowing at preferred rates due to its GSE status and then investing in higher-yielding obligations that are often unrelated to its housing mission. The FHLBanks have come under controversy for investing in such higher-yielding investments, rather than making advances to their members and sticking to their housing mission.
- According to Connor, the plan would effectively require the FHLBanks to take 100% of the money it raises in the capital markets and lend it through their members for housing and targeted economic development purposes. Housing would be considered “in the broadest sense.” The plan provides for a five-year transition period, and after 2005 consolidated obligations (debt issued by the FHLBanks) could be used only to finance advances, mission-related assets and qualifying investments, not MBS. After the transition period, each FHLBank would be required to have 100% of the proceeds of their debt obligation to finance core mission activities. According to the *BNA*, “core mission activities” consist of a business transaction between a FHLBank and a member that “assist and enhance” the FHLBank System’s housing finance mission.
- FHFB Chairman Bruce Morrison stated that MBS would not qualify as mission-related assets and the plan leaves the FHLBanks with enough investing alternatives to fund their activities. However, FHFB Member J. Timothy O’Neill stated that he was not certain whether MBS were not mission-related and he was concerned about the phase-out of MBS. According to the *American Banker*, of the FHLBank System’s \$137 billion investment portfolio, MBS represent \$56.5 billion, or 41%.

- According to Morrison, the actual proposed rule will be considered by the FHFB on July 14. Morrison stated that the proposal will be officially published in the *Federal Register* with a 90-day comment period and a public hearing would be held possibly in September. Morrison further stated that final approval of the rule should come early next year.
- Morrison stated that the political risk of not phasing out the System's arbitrage activities is "very high."
- The staff outline is available through the FHFB's website (<http://www.fhfb.gov>), in the "What's New" section. (*BNA Daily Report for Executives*, Eileen Canning, 6/1/99; *Dow Jones Capital Markets Report*, John Connor, 5/28/99; *American Banker*, 6/1/99; *Federal Register*, 6/7/99, page 30328; *National Mortgage News*, 5/31/99)

OFHEO Extends Comment Period on Proposed Risk-Based Capital Rule for Fannie & Freddie

November 10 is the New Deadline

Both Fannie & Freddie Requested Extensions on the Comment Period – It is Expected that the Companies May Request Another Extension

***National Mortgage News* Columnist Notes that OFHEO's Model is "Not Ready for Prime Time"**

- The Office of Federal Housing Enterprise Oversight (OFHEO) officially extended its comment period on its proposed risk-based capital rule for Fannie and Freddie. OFHEO originally set a comment deadline for August 11, 1999, however, the agency announced that it extended the deadline another 90 days to November 10, 1999. (*Federal Register*, 6/14/99, page 31756)

Fannie

- John Connor with *Dow Jones Newswire* reported that Fannie sent a letter to OFHEO last month requesting an extension because the company needs to replicate OFHEO's model to understand the rule. Fannie reportedly stated that the two consultants the company had retained estimated that it would take 10 to 13 months to replicate the model. "After we have replicated the model, we anticipate that we will need an additional three months to formulate our comments," the company stated. "Thus, this request for a 120-day extension is preliminary, and we may need to request additional time to complete our comments."

Freddie

- According to Jerry Guidera with *Dow Jones Newswire*, Freddie sent a letter on May 11 asking OFHEO to extend the 120-day comment period until December 9. The letter, written by Maud Mater, General Counsel of Freddie, noted that Freddie has begun working on the proposal but noted that would take substantially longer than the full comment period to digest the regulation. According to *National Mortgage News*' website, Freddie's Spokeswoman Sharon McHale stated that, "We are working to replicate and analyze both the individual and components of the stress test and the stress test as a whole" – a process she estimated would take at least six months. (*Dow Jones Newswire*, Jerry Guidera, 5/17/99, John Connor, 6/10/99; *National Mortgage News*, 5/10/99)

National Mortgage News Columnist Notes that OFHEO's Model is "Not Ready for Prime Time"

- Brian Collins, a columnist with *National Mortgage News*, noted that OFHEO's model "is not ready for prime time." The model, Collins notes, is "the key to a risk-based capital standard," but "unfortunately the computer model is still in the basement stage of development." He reveals that there is some difficulty replicating the OFHEO model because the model cannot produce the correct numbers unless proprietary data about Fannie and Freddie are fed into the model which cannot be released to the public. Further, he writes that "Even if OFHEO gave the GSEs the model, OFHEO doubts it would be much help to them in their efforts to replicate it." OFHEO at this point, he writes, cannot provide the computer code that makes the model work. He notes, however, that OFHEO is working with Fannie and Freddie on a daily basis as they attempt to replicate the model. "We are trying to provide them with as much information as we possibly can," stated OFHEO's Chief Economist Pat Lawler. Collins also notes that OFHEO is willing to run simulations for interested parties "to show how the model responds to changes in risk." (*National Mortgage News website*, Brian Collins, posted 6/2/99)

Background

- OFHEO, the safety and soundness regulator for Fannie and Freddie, was created by Congress in 1992 and was tasked by Congress to create a risk-based capital rule for Fannie and Freddie to be completed by December 1994. OFHEO has been working five years on the proposal. 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. OFHEO officially published the proposed risk-based capital rule for Fannie and Freddie in the *Federal Register* on April 13, 1999. It was previously estimated that the new rules would go into effect at the earliest 18 months following publication, after OFHEO heard public comments and gave Fannie and Freddie a year to comply with the new standards. With this newest extension, it will be even longer before the GSEs will have to come into compliance.

<p style="text-align: center;">Federal Reserve Responds to Joint Trade Association Letter Requesting that the Fed Lower the Risk Weighting Assigned to All Investment Grade (AAA and AA-rated) Private Institution Mortgage-Backed Securities (MBS) and Asset-Backed Securities (ABS) to 20% (Same as for Fannie & Freddie's MBS)</p>
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- As reported in the May 14th *GSE Report*, a joint financial services trade letter was sent to the Federal Reserve Board on May 11 requesting that the Federal Reserve and other bank regulators revise the risk-weightings so that all investment grade MBS be given a 20% risk-weighting to ensure that Fannie and Freddie MBS would not be treated more favorably under bank risk-based capital guidelines than private-label MBS with AAA and AA ratings. The letter notes that currently Fannie and Freddie's MBS have "support from an array of government-granted benefits" which provides preferential treatment to GSE-supported MBS over other private sector MBS. "In addition to being among the limited class of securities insured depositories may hold, the risk based capital regulations afford their MBS [Fannie and Freddie's] a favorable 20 percent risk weight, resulting in a 1.6 percent capital charge." On the other hand, "MBS guaranteed by private institutions are assigned a risk weight of either 50 percent (equal to a 4 percent capital charge) or 100 percent, depending on the 'prudential' nature of the underlying mortgages."
- The letter further notes that, "Since banks and thrifts need to hold less capital against government sponsored enterprise (GSE) securities than other comparable investments, their required hurdle is lower, thereby making investments in Fannie Mae or Freddie Mac MBS preferred over other investment alternatives, even when they have identical investment ratings." The letter concluded

by stating that “We urge the Federal Reserve and other bank regulators to revise the risk-weightings so that all investment grade mortgage backed securities should be given a 20 percent risk weighting. This would further the process of reform of the risk-based capital system to more closely align ratings with real risk.” The letter was signed by the Financial Services Roundtable, America’s Community Bankers, American Bankers Association, Consumer Mortgage Coalition, Mortgage Insurance Companies of America, and the National Home Equity Mortgage Association. (*Joint Bank Trade Letter to Federal Reserve Board, 5/11/99*)

- The Mortgage Bankers Association also sent a letter to the Fed on the issue. Paul Reid, Executive Vice President of the Mortgage Bankers Association, sent a letter to Federal Reserve Board Chairman Alan Greenspan requesting that a reduction be given for the risk-weighting for highly rated (AAA and AA) private label mortgage- and asset-backed securities (MBS/ABS) from 50 percent to 20 percent. Reid wrote that the “MBA feels strongly that by reducing the capital requirement for these types of securities, the agencies will have taken an important step toward meeting the goal stated in the rule’s preamble of adopting ‘capital requirements that more closely reflect a banking organization’s relative exposure to credit risk.’” Reid urged the regulatory agencies to carve out this section and rule on it separately “without waiting to include it in the final rule.” Reid wrote that “the current risk-based capital rule discourages a large number of potential investors (banks and thrifts) from investing in highly rated private label MBS. These investor groups face a significantly higher capital charge for investing in private label MBS than they do for other MBS of comparable credit quality which enjoy a 20 percent risk weighting.” Reid closed his letter by writing that “The MBA believes that remedial action *now* would clearly demonstrate that the Fed and the other regulators are truly committed to the goal of aligning risk ratings more closely to actual risk.” (*MBA Executive Vice President Paul Reid letter to the Federal Reserve Board, 5/24/99*)

Fed Responds

- The Federal Reserve responded to the joint trade association letter in a June 2 letter, stating that if federal banking agencies revise their risk-based capital standards to assess a lower capital requirement against highly rated asset-backed and mortgage-backed securities, “then privately issued mortgage-backed securities based on whole mortgage loans could be assigned to the 20 percent risk weight if they are rated in the highest investment grade category.” The letter also noted that if proposals to revise the Basle Accord are implemented, “highly rated claims on sovereigns, banks, and corporations, as well as high quality mortgage-and asset-backed securities could be eligible for assignment to a lower risk category.” (*Richard Spillenkothen, Director of Banking Supervision and Regulation, Federal Reserve Letter, 6/2/99*)

All GSEs

Debt Issuance by the GSEs is Up – Volume Totaling \$1.62 Trillion in First Quarter

- According to John Connor with *Dow Jones Newswire*, the Bond Market Association (BMA) reported that the GSEs, including Fannie, Freddie the FHLBank System, and the Farm Credit System, increased their debt issuance by a “modest” 5.7% in the first quarter of 1999, with volume totaling \$1.62 trillion compared with \$1.54 trillion in the first quarter of 1998.

- The BMA also noted that long-term debt issuance by agency issuers totaled \$195.4 billion in the first quarter of this year, up 39.8% over the \$139.7 billion issued in the comparable period last year. Short-term issuance rose 2.3% in the first quarter over last year's first quarter, with a volume of \$1.4 trillion in the first quarter of 1999.

FHLBank System

- According to the BMA, the FHLBank System's debt issuance was approximately \$776.9 billion the first quarter of 1999, up 26% from the \$613.7 billion in the first quarter last year. Short-term issuance totaled \$685 billion in the first quarter of 1999, a 26.3% increase over the \$542.3 billion in short-term debt issued in the first quarter of 1998. As Connor noted in his article, the FHLBank System has come under criticism by the Treasury Department for its borrowing practices and arbitrage activities – using its government ties to borrow at preferred rates and then making non-housing related investments. The regulator of the FHLBank System, the Federal Housing Finance Board, is currently considering a proposal to phase out these arbitrage investments. (See earlier story in this *GSE Report*.)

Fannie & Freddie

- Fannie and Freddie reportedly reduced their debt issuance in the first quarter of 1999, according to BMA. Fannie issued \$189.9 billion in debt securities in the first quarter, down 13.1% from the \$218.5 billion sold in the first quarter of 1998. Freddie reduced its debt issuance by 2.9% to \$462.8 billion in the first quarter of 1999, compared to \$476.5 billion in the first quarter last year.

Farm Credit System

- The Farm Credit System's debt issuance was reportedly \$84.9 billion in the first quarter of 1999, an increase of 23.2% from the \$68.9 billion it issued in the first quarter of last year. (*Dow Jones Newswire*, John Connor, 6/8/99)

Fannie Mae and Freddie Mac

Senator John Kerry (D-MA) Sends a Letter to Fannie & Freddie to Request their Assistance in Bringing Standardization and Price Competition into the Subprime Market

Freddie Indicates their Desire to Enter the B&C Market

- According to *National Mortgage News' website*, Senator John Kerry (D-MA) reportedly sent letters to Fannie and Freddie urging the companies to explore ways to bring standardization and competitive pricing to the subprime market. Freddie is reportedly drafting a letter in response to Senator Kerry's request, which will outline its efforts to enter the B&C markets. Freddie's Spokeswoman Sharon McHale stated that Freddie wants to enter the B&C market, and welcomes Senator Kerry's challenge. She noted that Freddie was already purchasing A-minus loans on a flow basis and is guaranteeing subprime securitizations to learn more about B&C credits. "Once we get comfortable we hope to be able to serve that segment more broadly," and start purchasing B&C paper, McHale stated. (*National Mortgage News website*, posted 6/3/99, 6/7/99)

The Market Share Battle between Fannie & Freddie Continues

Following in the Footsteps of the recent Freddie Agreements with Norwest (March) and Bank of America (May), Fannie counters by forming Agreements with Dime Bancorp., Resource BancShares, and Ohio Savings Bank

Mortgage Officials Caution that both Fannie & Freddie have Considered Financing Part of a Seller/Servicer's Balance Sheet and Warehouse Lending to Non-Depositories – a Business Dominated by Commercial Banks - to Increase their Market Share

Dime Bancorp.

- Dime Bancorp. announced that Dime's mortgage banking subsidiary, North American Mortgage Company, entered into a strategic partnership with Fannie. Under the terms of the partnership, North American will deliver all of its conforming loan originations to Fannie and will adopt Fannie's automated loan underwriting system, Desktop Underwriter, as its primary agency loan underwriting system. (*Business Wire*, 6/1/99) According to the Database Products Group, an affiliate of *MortgageWire*, North American sold an estimated \$6.6 billion to Fannie and \$2.0 billion to Freddie during 1998. (*National Mortgage News website, MortgageWire*, posted 6/2/99)

Resource BancShares

- Resource Bancshares Mortgage Group announced that it entered into a strategic alliance with Fannie. Under the alliance, the Company will allocate a substantial portion of its conforming conventional production to Fannie over the next two years. Under the agreement, Fannie agreed to accept the Company's RapidDecision™ automated underwriting system. (*PR Newswire*, 6/1/99) According to the Database Products Group, an affiliate of *MortgageWire*, only \$55 million of Resource's 1998 production and \$37 million of its 1997 production was sold to Fannie. Freddie purchased \$5.7 billion from Resources in 1998 and \$3.9 billion in 1997. (*National Mortgage News website, MortgageWire*, posted 6/2/99)

Ohio Savings Bank

- Fannie also reached an agreement with Ohio Savings Bank. Under the agreement, Ohio Savings agreed to sell all of its conforming loans to Fannie through 2000. According to the *American Banker*, Ohio Savings also agreed to sell the servicing rights on \$10 billion of future production, in what would be one of the largest "flow" servicing trades ever. According to the article, Ohio Savings is the largest user of Fannie's Desktop Originator. (*American Banker*, 6/10/99)

Mortgage Officials Caution that both Fannie and Freddie have Considered Financing Part of a Seller/Servicer's Balance Sheet and Warehouse Lending to Increase their Market Share

- A *National Mortgage News* article by Paul Muolo reported that banking sources said that Fannie was considering several ways of gaining market share from Freddie after Freddie signed agreements with Norwest and Bank of America, including financing part of a seller/servicer's balance sheet. The mortgage officials, who requested that their names not be used, also cautioned that both Fannie and Freddie have considered such options – that would aid non-depository institutions – in the past. Muolo writes that details about how this would be done, and whether it would include elements of warehouse lending – a business dominated by commercial banks – were not known. (*National Mortgage News*, 5/24/99)

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

(Announcements Provide Further Evidence that Fannie & Freddie are Attempting to use their Technology to Vertically Integrate and Control the Mortgage Industry and Horizontally Expand into New Lines of Business)

Background:

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

Fannie's Recent Announcements:

- (1) Fannie Announced the Successful Completion of a Pilot Program with the Lenders Interactive Online Network (LION) that would Automate Transactions between Lenders, Brokers, and Fannie's Automated Technology, and Fannie's Desktop Originator Software by Using an Internet Access Portal – For First Time, Brokers have Access to Fannie's Desktop Originator Software through the Internet

Fannie Announces the Launching of a New "DO Center" to Provide On-Line Access to Information about Fannie's Desktop Originator Software to New and Existing Customers

- Fannie announced on June 3 that its test pilot program with the Lenders Interactive Online Network (LION) – a unit of Plenum Communications Inc. - to automate transactions between mortgage brokers, lenders, Fannie's automated underwriting system, and Fannie's Desktop Originator software – by using the LION's portal website (www.lioninc.com) was successfully

completed. The announcement was made during the National Association of Mortgage Broker's annual conference. (LION's website currently operates as a wholesale mortgage industry Internet portal used by wholesale lenders to provide daily product and rate information to thousands of mortgage brokers.) Under the pilot, lenders were able to offer sponsored brokers access to Fannie's automated underwriting system - Desktop Underwriter and Fannie's Desktop Originator Software System through the Lenders Interactive website. The pilot is now complete and LION will join Byte, Calyx, Contour, and Genesis as the fifth technology provider to integrate Fannie's Desktop Originator fully into its system. But unlike LION, lenders must install the other four origination systems onto their computers. With the LION pilot, Desktop Originator can be accessed over an Internet portal for the first time.

- **The alliance with LION puts Fannie “in closer touch with the broker,” said Richard Beidl, an Analyst at the Tower Group in Needham, MA. Traditionally, neither Fannie nor Freddie has had broker relationships as close as those with major lenders,” he stated. The partnership “allows Fannie Mae to move one step closer to the end-user, the customer,” Beidl stated. And it is also a way for Fannie to “really brand itself,” he added. (American Banker, Joshua Brockman, 3/31/99; Dow Jones Newswire, 3/26/99; Fannie press release, 3/22/99; PR Newswire, 3/26/99; Mortgage Marketplace-American Banker, 3/29/99; Seattle Post-Intelligencer, 3/23/99; Spokesman-Review, 3/30/99)**
- Fannie announced on June 4 that it is starting a “DO Center” on the LION's website to describe Fannie's Desktop Originator process and how brokers and lenders may sign up for Internet access to Desktop Originator. (Fannie press release, 6/3/99)

(2) Fannie Also Provides Brokers Access to Fannie's System over the Internet through OpenClose.com

- Fannie also provides broker's Internet access to its technology through OpenClose.com an Internet “meeting room” owned by mortgage.com that provides lenders with tools for delivering underwriting decisions to their brokers at point-of-sale. Participating mortgage originators can access Fannie's Desktop Underwriter recommendation after selecting a lender. (Fannie press release, 6/8/99)

Freddie's Announcement

Freddie Officially Launched its Automated Underwriting Technology, Loan Prospector, to Brokers over the Internet

- Freddie officially announced the launching of its automated underwriting technology on the Internet during a recent National Association of Mortgage Brokers Convention in Phoenix. Peter Marselli, Freddie's Senior Vice President of Business Development, said this service was dedicated to mortgage brokers. Under the program, brokers will be able to access Freddie's automated underwriting technology, Loan Prospector, on the Internet directly or use an interface from one of the four major broker origination software vendors: Contour, Calyx, Byte, and Genesis 2000. Freddie also announced that mortgage brokers who click onto Loan Prospector over the Internet could receive a Loan Prospector Customer Service Award, which includes a new Volkswagen Beetle. (National Mortgage News website, posted 6/7/99)
- **Morgan Stanley Dean Witter Analyst Kenneth 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.” (*Morgan Stanley Dean Witter- US and the Americas Investment Research, US Savings & Loans/GSEs & Mortgage Finance, The Internet Mortgage Report: New Models, New Opportunities*, Kenneth Posner, 2/4/99)

Small Software Technology Providers Believe that Fannie & Freddie are Reaching Too Far into the Technology Area –an Area they Feel is Outside the Scope of Fannie & Freddie’s Federal Charters

Small Software Technology Providers are Concerned they are being Cut out of the Market as Fannie & Freddie Reach Agreements with Larger Technology Providers

One Technology Provider Raises Concern about the GSEs’ Increasing Reach to Consumers and Questions the GSEs’ Motivation for Going There (Despite Fannie’s Repeated Pronouncements that they Do Not Market to Consumers)

- According to a *Real Estate Finance Today* article, Freddie’s recent announcement with Calyx Software has **many lenders and technology industry professionals concerned about Fannie and Freddie’s entrance into an industry that is outside the scope of their federal charters.** Freddie’s agreement with Calyx would allow users of Calyx’s origination software to integrate Freddie’s automated underwriting system, Loan Prospector, to directly access Loan Prospector over the Internet.
- **According to industry sources, Fannie and Freddie’s agreements with select technology partners could give those providers an unfair advantage over smaller software vendors. Although the technology industry is thankful for the contributions of Fannie and Freddie, providers agree that Fannie and Freddie are reaching too far into the technology arena, sources said. “They’ve developed their end. Lenders and software vendors can handle the other end,” said Jack Luhtanen, President and Chief Executive Officer at Dynatek Inc., Livonia, MI. “[GSEs] need to let us do what we need to do on our end.” He further stated that “small [software] companies like ourselves would get a little worried when we’re competing with Fannie Mae. I know what a big name can do.”**
- Luhtanen said that software vendors that cater to smaller lenders and mortgage brokers feel especially threatened by Fannie’s partnership with Calyx to develop its own software because of the big-name recognition of the company. Many technology providers were also reportedly concerned about Fannie partnership with Calyx announced in February. Under the partnership, Fannie and Calyx produced a Fannie Mae Technology Pak that bundled Fannie’s automated underwriting technology, Desktop Underwriter, with hardware and loan origination components. Fannie went so far as to sell computers with the software installed and no other technology company, other than Calyx, was offered the same opportunity to develop similar software packages with the GSEs. (*Real Estate Finance Today-Electronic Edition*, 6/4/99)

Waiting Six Months after his Initial Announcement, President Clinton Finally Sends OFHEO Director Nomination to the Senate

- As reported in the January 8th *GSE Report*, President Clinton announced in January his intention to nominate Armando Falcon, Jr. as Director of the OFHEO. According to John Connor with *Dow Jones Newswire*, the actual nomination, however, did not officially go to Capitol Hill until June 7. Falcon was formerly the Democratic minority general counsel to the House Banking Committee. Falcon served under Cong. Henry Gonzalez (D-TX), who retired during the last session of Congress. Falcon left the committee last fall to run for Gonzalez's seat in Congress but lost to Gonzalez's son in the Democratic primary. OFHEO has been without a permanent director since February 1997 when Aida Alvarez left to head the Small Business Administration. Mark Kinsey, a former Treasury Department official, has served as acting OFHEO director for the past two years. Earlier articles noted that Falcon was currently serving as a consultant at OFHEO, until completion of the clearance process. Falcon's nomination will be considered by the Senate Banking Committee. It is expected that Falcon will likely have to defend OFHEO's proposed risk-based capital rule on Fannie and Freddie. (*American Banker*, 8/10/98; *Dow Jones Newswire*, 9/30/98, 6/7/99; *National Mortgage News website*, posted 8/14/98, 1/6/99; *Wall Street Journal*, 1/6/99; *White House press release*, 1/5/99)

***National Mortgage News* reports that Conflicts on GSE Financing May Signal a Market Glut of GSE Debt Deals**

The Frequency of GSE Debt Offerings and the Competition between Fannie and Freddie Might be "straining Wall Street's capacity to handle them [GSE debt offerings] smoothly"

There are Concerns that an Increasingly Crowded GSE Market Might be Dangerous in a Weaker Market

Wall Street Source Suggests that the Treasury Department might need to Assume its Intermediary Role Again in Scheduling Fannie & Freddie's Debt Issuances

Despite the Crowded GSE Market, Fannie, Freddie and the FHLBanks continue to Flood the Market with Debt Offerings

- As reported in the May 28 *GSE Report*, controversy erupted when Merrill Lynch reportedly pulled out at the last minute from Freddie's inaugural multi-billion Reference Note deal last month. There were conflicting reports about why Merrill pulled out of the deal. *National Mortgage News* reported that sources stated that Merrill backed out of the deal because it realized that the deal conflicted with a competing Fannie deal to which the underwriter had previously committed. However, according to Jerry Guidera with the *Dow Jones Newswire*, HUD is looking into a report that Fannie pressured underwriters not to do business with Freddie. "This is a potentially serious issue and we will examine it thoroughly," said Assistant HUD Secretary William Apgar. According to Guidera, people familiar with the situation said Merrill backed out of the Freddie deal "because of pressure from Fannie Mae." Further, sources noted that J.P. Morgan Securities Inc. also found its business with Fannie curtailed because the company worked on Freddie's second callable debt offering – a \$3 billion Freddie issue that competed with Fannie's \$2.5 billion callable debt offering. Several sources reportedly described J.P. Morgan as having been "put in the penalty box" by Fannie – i.e., J.P. Morgan was removed from the lead underwriting group for future Fannie deals for an unspecified period of time. (*Dow Jones Newswire*, Jerry Guidera, 5/20/99, 5/21/99)

- Bonnie Sinnock with *National Mortgage News*, reported that Merrill dropped out of the Freddie deal, not because of pressure from Fannie, but after realizing that the deal conflicted with a competing Fannie deal to which Merrill had previously committed. She noted that the “conflict over the two deals may be a sign that the proliferation of government-sponsored enterprise financings is straining Wall Street’s capacity to handle them smoothly.” Sinnock reported that a Merrill Lynch source stated that both Fannie and Freddie’s large callable debt offerings performed well despite their near-simultaneous issuance, but said there are concerns that crowding the market with such offerings could be dangerous in a weaker market and that the proliferation of these offerings could lead to more scheduling conflicts. The source noted that that the incident has provoked concern that scheduling conflicts could potentially hurt the market. The source cautioned that if investor demand had not been strong or the market had suddenly slumped, the back-to-back Fannie and Freddie deals might have gone less favorably. “Demand exceeded supply in this case, but it could have been the other way around,” the Wall Street source said.
- Sinnock noted that the Treasury Department used to set a schedule for Fannie and Freddie’s debt issuance but Treasury ultimately decided it didn’t want to be an intermediary. **The source suggested that, with the introduction of Fannie’s Benchmark and Freddie’s Reference Note programs, the Treasury Department might want to consider the intermediary role again.** (*National Mortgage News*, Bonnie Sinnock, posted 5/24/99)

Despite the crowded market, Fannie, Freddie and the FHLBanks continue their proliferation of deals –

Fannie

- According to the *Dow Jones Capital Markets Report*, there is talk that Fannie is interested in doing a large callable debt deal in the near future. One trader said it would “most likely” be in the \$500 million range, but the trader hoped that deal would be held off a bit “and wait for Freddie” (which was expected to issue a deal the week of June 7). (*Dow Jones Capital Markets Report*, 6/7/99)
- Fannie launched a \$3 billion offering of 10-year global benchmark notes on June 2. The notes were priced at a yield margin of 64.5 basis points over Treasuries for a yield of 6.375%. The geographic distribution was 81% in the US, 13% in Europe, 4% in Asia, and 2% other. Reportedly, traders at first were worried about how the notes would be received. “The (Fannie) deal isn’t moving out, and there is even less anticipation for Freddie Mac’s deal next week,” said a trader, regarding Freddie’s planned reference note issue.

Freddie

- Freddie announced a new bullet Reference Note financing calendar in conjunction with its latest two issues – a \$2 billion reopening of the outstanding 5.75% issue due March 2009 and a new \$3 billion issue with a two-year maturity (see story below). Freddie announced it will follow a financing calendar for future Reference Notes transactions. New five-year Reference Note issues will not be offered in January and July. New ten-year Reference Note issues will be offered in March and September. In other months, Freddie will try to increase the size of the outstanding five and ten-year issues through reopenings, or sell Reference Notes issues with other maturities. (*Freddie press release*, 6/8/99)
- Freddie launched a \$5 billion two-part Reference Note on June 8. The first tranche is a \$3 billion of two-year notes and the second tranche is a \$2 billion reopening of Freddie’s 10-year issue. The deal marks the first time either Fannie or Freddie have done a two-tranche programmed offering. However, the Farm Credit Banks priced a \$1.5 billion two-part designated bond offering last April.

According to *Dow Jones Capital Markets Report*, Freddie's offering is believed to have the biggest tranches of any two- part deal ever done, including corporate deals. (*Dow Jones Capital Markets Report*, 6/7/99)

- Freddie also priced \$50 million worth of notes on June 2, including "an old favorite not seen in awhile – step up bonds." Freddie issued 25 million of 10-year step-up bonds that have a starting yield of 6.5%. "We haven't seen that structure in a while, and although it was a very small issue, it is worth looking at just because of the structure," said a trader. (*Dow Jones Capital Markets Report*, 6/2/99)

FHLBanks

- The FHLBank System announced that it had refined its procedures regarding FHLBank jumbo bullet bond issuance and it tripled the minimum size of its jumbo bullet bonds. So far in 1999, the FHLBank System has launched 11 jumbo bullet bonds and three reopenings of \$1 billion or more. According to *Dow Jones Capital Markets Report*, over \$31 billion has reportedly been issued through the global debt program in 1999, almost equal the total sales for the entire program from inception through 1998. The FHLBank System is changing the program to include a \$3 billion minimum size for new issues and \$1 billion in \$500 million increments for reopenings. Further changes include no jumbo reopenings until a new jumbo has settled in the quarter and jumbo issues of the same maturity may not be launched for five business days from the pricing date or 10 business days if at a wider spread. The FHLBank System also noted that different maturity jumbos may not be launched until the current when-issued jumbo settles and there will be a complete lockout on all identical domestic issues until the current when-issued jumbo settles. The changes are effective immediately. (*Dow Jones Capital Markets Report*, 5/28/99)
- *Bloomberg* reported that the FHLBanks' jumbo bonds sometimes trade approximately two to three basis points higher than the "Benchmark Notes" issued by Fannie. According to *Bloomberg*, investors blame the difference on the fact that the FHLBank issues are smaller than Fannie's (usually \$3 billion or over), and they are perceived to be less liquid or harder to trade. With larger offerings, the FHLBanks, "might be able to capture some of that" yield difference between its debt and Fannie's debt, sated Shrikant Ramamurthy, Co-Head of Fixed-Income Research at Prudential Securities. He noted that the FHLBanks new program might help narrow the gap between the FHLBank and Fannie debt by about one to two basis points. The article further noted that Freddie, whose issues range from \$3-\$5 billion, usually pays about one to two basis points higher in yield than Fannie. (*Bloomberg News*, 5/28/99)
- The FHLBank System priced \$1.15 billion worth of notes and bonds on June 2, including a \$500 million 10-year global issue, which reportedly worked its way into the swap market. (*Dow Jones Capital Markets Report*, 6/2/99)

<p style="text-align: center;">Following in Freddie's Footsteps, Fannie Revises Private Mortgage Insurance (PMI) Cancellation Guidelines to Comply with Homeowners Protection Act</p>
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<p style="text-align: center;">Appraisers are Concerned that the New Guidelines Leave them Out of the Process</p>
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- Fannie announced that it has changed its private mortgage insurance cancellation guidelines to bring the company into compliance with the Homeowners Protection Act that passed last year. Fannie's guidelines are reportedly similar to Freddie's recent announcement with a few differences. The Homeownership Protection Act mandated automatic mortgage insurance

cancellation by servicers once a loan reaches 78% of a property's original value and 80% when borrower-initiated cancellation is involved. While the law only applies to mortgages originated on or after July 29 of this year, Fannie and Freddie announced they are also adopting the automatic cancellation for all exiting mortgages when the loan reaches midpoint. Both Fannie and Freddie, however, agreed to delay the effective date on half-life cancellation until January 2, 2001 so that servicers are not overloaded with PMI system changes and Year 2000 readiness.

- According to *Real Estate Finance Today*, Fannie also changed its cancellation guidelines by allowing termination of mortgage insurance on all its loans based on the current property value, in order to allow for a home's appreciation. The Homeownership Protection Act permits this for loans closed by the act's effective date of July 29, 1999. According to the article, Freddie's rules cover primary residences only when permitting a property's current value to be used in determining the mortgage insurance cancellation date, and not all loans. Homeowners will have to have new appraisals to prove that the value of their property has increased since the original closing. Fannie and Freddie also reportedly differ in terms of borrower-initiated cancellation. Fannie allows a 70% loan-to-value borrower-initiated cancellation and Freddie a 65% loan-to-value borrower-initiated cancellation, based on the original property value, on 2-4 family principal residences and most 1-4 investment properties.
- Neither Fannie or Freddie decided to use the "high risk loan" classification in the Homeowners Protection Act that would allow them to define "high risk loans" and exempt new loans from the automatic cancellation at 78% LTV. "It just became very difficult and messy to define what is high risk. And we were getting MI on 80% LT loans so rarely anyway we decided to do without it," a Fannie official said. (*Real Estate Finance Today-Electronic Edition*, 5/28/99; *National Mortgage News*, 6/7/99)
- According to a *Sun-Sentinel* article, **the new PMI cancellation guidelines have sparked some controversy because the Freddie plan reportedly leaves appraisers out of the process. Reportedly Fannie and Freddie said it would accept home appraisals by real estate brokers. Real estate appraisers, however, say valuations done by anyone other than a trained and licensed appraiser should be unacceptable. "You need someone that has the training, the education to give that valuation," stated Michael Cibene, a Senior Residential Appraiser at Michael's Appraiser in Fort Lauderdale. "Otherwise you're just pulling a number out of the sky." Cibene worried that the guidelines could create avenues for potential miscalculations and fraud and that many states, including Florida, have passed laws requiring real estate valuations to be conducted by licensed appraisers.**
- Freddie responded that they do not foresee any problems with inaccurate or imprecise appraisers and noted that since they do not deal with consumers but instead with lenders, it was up to lenders to decide who is to prepare appraisals. (*Sun-Sentinel – Fort Lauderdale*, 5/27/99)

Fannie Mae

“Yo Quiero Fannie Mae?” - Fannie hires Taco Bell’s Advertising Executive who is Considered Largely Responsible for Taco Bell’s Successful Chihuahua Commercials

(This Move Heightens Criticisms that Fannie is Building its Brand Name to Target Consumers)

One Mortgage Executive said the Hiring Makes Fannie’s Loud Protests that they are Not Going Directly to Consumers “Hard to Believe”

Fannie reportedly spent \$34.5 Million in Advertising in 1998

(Fannie’s “Taxes on Homeownership” Funds Advertising Budget

- Fannie announced that the company had hired the advertising executive – Vada Hill – who is considered largely responsible for the popular Taco Bell talking Chihuahua commercials. Hill had been Taco Bell’s chief marketing officer since 1997. Hill was also named one of *Advertising Age’s* Power 50 marketers last year. In keeping with Fannie’s policy of hiring politically connected employees, Hill also once worked for former US Education Secretary and current Presidential candidate Lamar Alexander on education reform. While Hill is leaving Taco Bell for Fannie, the popular Chihuahua dog will reportedly stay at Taco Bell.
- Fannie Spokesman John Buckley denies that Hill will be developing marketing targeted at consumers, but instead “will be developing more sophisticated business to business marketing efforts.” A Fannie press release also noted that Hill will be responsible for the company’s marketing of products and services to lenders. Fannie’s statements however will not alleviate concerns expressed in the mortgage industry that Fannie is targeting its brand name to consumers and thus, bypassing its congressionally mandated customers – private sector lenders. Hill even stated that consumers are indeed part of Fannie’s focus. In a press statement, Hill reportedly said that he was “looking forward to the challenges of bringing marketing, branding, and a consumer orientation” to Fannie Mae. **Patrick McEnerney, the President of Bank of New York Mortgage Co., said the “hiring makes Fannie’s loud protestations that they are not going direct-to-consumer hard to believe.”** (*Advertising Age*, 6/99; *American Banker*, Hala Habal, 6/7/99; *Fannie press release*, 6/4/99; *Washington Business*, 6/7/99)
- According to Competitive Media Reporting, the Fannie Mae Foundation spent \$32 million on measured media last year and the Fannie Mae corporation spent \$2.5 million. (*Advertising Age*, 6/99)

While Fannie Downplays Its Political Risk to Investors, the Company Makes Another Round of Politically Connected Staff Hires

(Current Political Risks Facing Fannie include the Following:

- (1) OFHEO introduced a risk-based capital proposal that would impose higher capital standards on Fannie and Freddie;**
- (2) CBO suggested new fees on Fannie and Freddie's investment portfolio and requiring that Fannie and Freddie register their securities with the SEC;**
- (3) HUD is considering raising Fannie and Freddie's affordable housing goals;**
- (4) HUD is evaluating the fair lending impact of their automated underwriting systems and lending guidelines;**
- (5) HUD is examining the non-mortgage investments of Fannie and Freddie;**
- (6) HUD is retroactively reviewing Fannie and Freddie's "lower-cost" MI products;**
- (7) Congress is Open to the Idea of Creating a Single GSE Regulator.**
- (8) Increasing competition from the FHLBank System;**
- (9) Increasing concerns raised by the private sector on Fannie and Freddie's expansion into their business; and**
- (10) The risk-weighting assigned for all investment grade (AAA and AA-rated) private institution mortgage-backed securities (MBS) and asset-backed securities (ABS) might be lowered to 20% (same as for Fannie & Freddie)**

- Fannie made a number of recent political appointment/hires at its organization:
 - Thomas E. Donilon – Senior Vice President and General Counsel – Donilon was a partner at O'Melveny and Myers where he specialized in domestic and international litigation, antitrust transaction counseling, and internal investigations. Prior to that he served as Assistant Secretary of State for Public Affairs and Chief of Staff to former Secretary of State Warren Christopher. Donilon will manage legal activities and serve as secretary to the board of directors for Fannie.
 - Theodore Maness III – Vice President for Industry Relations – Maness was a former Executive Director of the National Republican Congressional Campaign Committee through the 1998 election cycle and before that was Chief of Staff to Senator Jon Kyl (R-AZ)

Other Hires:

- Earl Thomas Booker III – Vice President for Technology Marketing – Booker had been a Senior Vice President at Amerix Corp. and was Director of Technology Sales and Consulting at Fannie before joining Amerix
- Terri Davis – Vice President for Technology Sales and Consulting – Prior to Fannie, Davis was Director of Marketing and Product Development for PMI Mortgage Insurance Company
- Roger Williams – Vice President for Community-Based Lending – Prior to Fannie, Williams was Senior Vice President, Director of Program Development for First Union National Bank
- Jaynie Studenmund – Senior Vice President of the Company's Western Regional Office – Prior to joining Fannie, Studenmund was Executive Vice President of Home Savings of

America's retail banking division, where she was responsible for telebanking, business lending, alternative delivery, product management, and branch support services.

- Geoffrey Smith – Vice President for Marketing in the Company's Northeastern Regional Office

According to the *American Banker*, all of the appointments, including the Vada Hill appointment, are subject to the approval of Fannie's Board of Directors.

(*American Banker*, 6/9/99; *Fannie Press release*, 6/4/99; *Washington Business*, 6/7/99)

- Al Kamen, columnist for "In the Loop" of the *Washington Post*, wrote the following:

"Some folks speculate that if Vice President Gore wins the presidency, some lucrative jobs would open up at Fannie Mae. For example: Chairman James A. Johnson [past Chairman of Fannie] becomes Treasury secretary, Vice Chair Jamie S. Gorelick takes over the Justice Department and Donilon...runs his own agency or becomes deputy secretary of state to...Secretary Richard C. Holbrooke." (*Washington Post* – "In the Loop," 6/7/99)

- According to the *American Banker*, Fannie also hired Nathan J. Gatten, Senator Robert Bennett's (R-UT) Legislative Aide for three years, as Director of Government Relations to focus primarily on the Senate. The article noted that Fannie created the post to assist Duane Duncan, who is Vice President of Government and Industry Relations. (*American Banker*, 6/2/99)

Fannie Downplays the Political Risk that its Company is Facing at a Recent Investor Conference

- According to the *Wall Street Journal*, during the recent biennial investor conference, "Fannie Mae executives played down the significance of political risk to their operations, predicted that creeping political pressure to increase regulatory oversight of the company's lending practices won't materialize." Reportedly, Fannie "vowed to continue its lobbying efforts to maintain the regulatory status quo." According to a *Bloomberg* article, Fannie Vice Chairman Jamie Gorelick stated that "Political risk is something we manage and we manage it quite well." "Those who doubt it will miss out on a truly remarkable performance," she added. "There is more on the plate this year than any typical year," in terms of political risk, stated Jonathan Adams, an analyst with Prudential Securities Inc. at the conference. (*Dow Jones Newswire*, Jerry Guidera, 5/6/99; *Wall Street Journal*, 5/7/99; *Bloomberg News*, 5/6/99; *American Banker*, Joshua Brockman, 5/7/99)

Fannie Announces that it has Provided More than \$5 Billion of Financing under its Multifamily Credit Facility

- Fannie announced that it had surpassed the \$5 billion mark in lending under its multifamily credit facility, which was first introduced in 1995. The credit facility has been used by real estate investment trusts, pension funds, and other qualified borrowers, Fannie said. According to a release by Fannie, the company has provided financing to more than 20 REITs or qualified borrowers, with holdings of thousands of apartment dwellings. The company noted that the facility allows borrowers to use the funding for any business purpose, including purchase of new properties or funding of capital improvements as needed. (*Fannie press release*, 6/8/99)

Fannie Invests in First REIT to Focus on Affordable Housing and Community Development

- Fannie is reportedly one of 17 financial institutions investing in a new REIT (real-estate investment trust) by the Local Initiatives Support Corp. According to Local Initiatives, the new REIT, called the Community Development Trust, is the first REIT to focus on affordable housing and community development. “This is one of the largest equity investments of this type we have made,” stated Kenneth Bacon, a Director of the REIT and a Senior Vice President at Fannie. (*American Banker*, 6/7/99; *Bloomberg News*, 6/1/99)

Fannie Announces Environmental Partnership with the National Association of Home Builders

- Fannie announced an environmental partnership with the National Association of Home Builders to work with home builders, lenders, and other community partners to develop mortgage financing products based on environmentally efficient “green building” criteria. Six cities have been identified as part of the pilot – Atlanta, GA; Columbus, OH; Albuquerque, NM; Denver, CO Los Angeles, CA; and Seattle, WA. (*PR Newswire*, 6/10/99)

Garry Mauro, who President Clinton Announced he would Appoint to Fannie’s Board of Directors, States that he intends to Play a Big Role in Vice President Al Gore’s Presidential Campaign and Intends to Move to New York to Work on First Lady Hillary Rodham Clinton’s Senate Campaign

- As reported in the May 28 *GSE Report*, President Clinton announced his intention to appoint Garry Mauro as a member of the Fannie Board of Directors.
- Garry Mauro is a reported close friend of President Clinton and ran President Clinton’s 1992 and 1996 campaigns in Texas. In 1998, Mauro ran unsuccessfully against Governor George W. Bush for Governor of Texas. Mauro, who served as Texas Land Commissioner for 16 years, decided in 1998 not to seek re-election to the office and instead ran unsuccessfully as the Democratic Party’s candidate for Governor. While Mauro left his office as Land Commissioner, Mauro did not view his “political days as over.” Mauro indicated that he had talked to the White House about joining the Board of Fannie Mae. Mauro reportedly said that the **\$50,000-a-year part-time post** would allow him to remain in Austin while “keeping my hands in public policy.” Since Mauro had served as Chair of President Clinton’s 1992 and 1996 Presidential campaign, it had been widely speculated that Mauro would receive a Clinton appointment, but one never came – until now. Mauro reportedly filed for personal bankruptcy in December 1992, only a few weeks after President Clinton’s first presidential election. Most of Mauro’s \$4 million in debt was reportedly owed to the federal government on real estate investments that went bust with the Texas economy in the 1980s. After his bankruptcy, Mauro stated that he took himself out of consideration for a Cabinet post in Clinton’s first term because he didn’t want his business dealings and financial problems subjected to national media coverage. Regarding his new appointment to the Fannie Board of Directors, Mauro stated that “I’m very pleased that the president saw fit to appoint me to the board that has the most to do with affordable housing in America.” (*Houston Chronicle*, 5/21/99; *Star-Telegram*, 12/15/98)
- According to the *Dallas Morning News*, Mauro indicated that he expects to play a big role in Vice President Al Gore’s Presidential campaign next year and that he intended to rent a home in New York next year for several months to work either as a paid staffer or a volunteer for First Lady

Hillary Rodham Clinton's US Senate campaign. "I always wanted to live in New York," he stated. (*Dallas Morning News*, 6/6/99)

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 36 offices are officially opened and three more are in the process of being formed)

(Although Fannie Claimed Recently that its Advertisements were too "Fannie Mae-Centric" and Did Not Incorporate the Crucial Contribution of its Lender Partners in its Successful Projects - Fannie Continues to Only Incidentally Mention its Lender Partners in its Numerous Press Releases)

- Fannie opened its 36th official Partnership Office in Nashville, TN. Fannie made its announcement during a press conference at the State Capitol with Governor Don Sundquist and Senator Bill Frist (R-TN). (*Fannie press release*, 5/17/99) As reported in previous *GSE Reports*, Fannie is also in the process of opening up at least three more Partnership Offices. According to a *Pittsburgh Post-Gazette* article, Fannie will be opening a Fannie Mae partnership office in Pittsburgh. The article further noted that Fannie officials were not sure when or in what neighborhood the Pittsburgh office would open. (*Pittsburgh Post-Gazette*, 5/8/99). According to *Bloomberg News*, the *Star Ledger of Newark* reported that Fannie is planning to open a Partnership Office in downtown Newark, NJ and the *Associated Press* is reporting that Senators Craig Thomas (R-WY) and Michael Enzi (R-WY) were urging Fannie to open a Partnership Office in Wyoming. (*Associated Press*, 4/28/99; *Bloomberg News*, 4/20/99)

Senator Dianne Feinstein (D-CA) and San Francisco Mayor Willie Brown

- Fannie held a press conference at City Hall with the above officials to announce a \$16 billion "House Bay Area" Investment plan. As part of the program, Fannie is making more investments in depository institutions. Fannie said it would make a \$50,000 deposit in the Bethel A.M.E. Church Federal Credit Union. Fannie also said it would be providing assistance for seismic upgrades, such as installations of foundation bolts or cripple walls. The Disaster Prevention Loan Program will provide financing for loans of up to \$20,000 with repayment terms of up to 10 years. (*Fannie press release*, 6/1/99)

Florida Governor Jeb Bush – Fannie Moving Further into Construction Loans

- Fannie announced at Florida Governor Jeb Bush's Hurricane Conference that it committed to purchase \$50 million of Project Impact Prevention Loans in Florida. Project Impact is a national public-private partnership initiative sponsored by the Federal Emergency Management Agency that operates in over 188 communities nationwide. Project Impact Prevention Loans in Florida provide homeowners with funds to strengthen and retrofit their homes to minimize damage from hurricanes. The loans are provided through Volt VIEWtech, Inc. The loans are unsecured and are available in amounts up to \$20,000, with terms up to 10 years. Interest is fixed for the life of the loan. (*National Mortgage News website*, posted 6/9/99; *PR Wire*, 6/9/99)

Cong. Doug Bereuter (R-NE), State Senator Connealy, Tekamah, NE Mayor McViegh – Further Moves into Commercial Property

- Fannie held a press conference with the above named participants to announce a pre-opening tour of a new affordable housing apartment building for seniors. Fannie made a \$163,000 equity

investment in the Equity Fund of Nebraska's estimated \$520,000 investment in the apartment building. The Washington County Bank is providing approximately \$210,000 in long-term loans that will be purchased by Fannie. (Although, Fannie claims it is trying to ensure that its crucial partners (the lenders) are given credit for their contributions, Fannie has not given much credit to lenders in its press releases. For example, the lender's contribution in this instance was not mentioned until the fourth paragraph of the press release.) (*Fannie press release, 6/4/99*)

Cong. John Lewis (D-GA), Cong. Cynthia McKinney (D-GA), Cong. Johnny Isakson (R-GA), and Atlanta Mayor Bill Campbell – Fannie Makes More Equity Investments in Depository Institutions

- Fannie held a press conference with the above named officials to announce the results of Fannie's "HouseAtlanta" initiative. Fannie mentions the lenders' contribution to the project in the 20th paragraph of the press release. The lender's involved in the project include Citizens Trust Bank Mortgage Services, Wachovia Mortgage, and Sun Trust. As part of the program, Fannie invests in more depository institutions. Including a \$280,000 equity investment in Citizens Trust Bank and a \$100,000 deposit investment in Mutual Federal Savings Bank of Atlanta. (*Fannie press release, 5/24/99*)

Cong Ernest Istook (R-OK)

- Fannie held a press conference with Cong. Istook to announce a "wall-raising" for a senior living community. Fannie said it invested \$3.365 million through the American Communities Fund (*Fannie press release, 6/3/99*)

Cong. Jerry Kleczka (D-WI) and Cong. Tom Barrett (D-WI) and Milwaukee Mayor John Norquist

- Freddie held a press conference with the above officials to announce the results of Fannie's "HouseWisconsin" initiative. (*Fannie press release, 6/3/99*)

Freddie Mac

Freddie Loses Two Senior Executives

After Only Five Months on the Job, Recently Hired High-Profile Wall Street Talent, Kevin Finnerty, Leaves Freddie Mac

SVP of Corporate Relations, Ann Schnare, is also Leaving

- According to *Bloomberg News*, Freddie's 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. When Finnerty was first hired, it was reported that Finnerty's hiring meant that Freddie would be expected to move more aggressively into subprime and higher risk mortgages. (See March 5th *GSE Report*.) Finnerty reported directly to John Fisk, Executive Vice President of Freddie's Single-Family

Securitization Group. Freddie Spokesman Douglas Robinson confirmed Finnerty's departure but declined to give further details. (*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)

- According to *National Mortgage News*' website, Ann Schnare, Senior Vice President of Corporate Relations at Freddie, is also leaving Freddie. According to the website, no reasons were given for either of the executives' departure. Reportedly, Schnare has agreed to stay at Freddie until a replacement has been made, however, Finnerty is leaving immediately. (*National Mortgage News website*, posted 6/10/99)

Freddie Plans to Continue Using its Controversial MODERNs Derivative Program

Freddie is also Planning Catastrophe Bonds Like those Pioneered by Insurance Companies

- According to *Bloomberg News*, Freddie plans to sell MODERNs securities to reduce its exposure to mortgage defaults. According to Kevin Finnerty, head of Investor and Dealer Services for Freddie (now left the company – see above story), the bonds would resemble a \$186 million issue the company sold in April of 1998. The MODERNs securities on that deal was tied to the default rate on a pool of \$20 billion of mortgages that Freddie bought in 1996. MODERNs, which stands for Mortgage Recourse Default Notes, pays investors principal and a floating rate of interest, so long as defaults don't exceed given thresholds. The article noted that investors initially applauded the MODERNs sale when it was first introduced as a breakthrough derivatives transaction that would be copied by mortgage lenders and private mortgage insurers. However, that has not happened. *Bloomberg* speculated that Asia's financial turmoil and Russia's default last year made investors wary of all but the safest and simplest of fixed-income securities. A Fannie spokesman declined to comment as to whether Fannie was working on a similar transaction.
- Freddie also announced that it was working on catastrophe bonds – securities whose performance is linked to earthquakes or hurricanes. Finnerty noted that Freddie might sell an issue this year, but more likely it would be introduced in the years to come. According to the article, insurance companies pioneered the market in catastrophe bonds and have sold almost \$4 billion of securities to reduce their exposure to disasters. According to Finnerty, Freddie is in talks with firms including Bear, Stearns & Co. to manage its sales. (*Bloomberg News*, 5/25/99)

Freddie Wraps a \$400 Million Offering of Home Equity Loans

- According to *Dow Jones Capital Markets Report*, a \$400 million offering of home equity loan asset-backed securities from BankBoston were sold through FSCP (Freddie) T-017, a special purpose vehicle. Delivery is scheduled for July 25, 1999. All classes of certificates were rated AAA by Moody's Investor Service Inc. and Standard & Poor's, based on a 100% insurance guarantee provided by Freddie. (*Dow Jones Capital Markets Report*, 6/3/99)

Freddie Closes its Largest Senior Housing and Assisted Living Pilot Program Deal – an \$88 Million Commercial Mortgage Deal with GMAC

- Freddie announced that it closed an \$88 million purchase of senior housing mortgages, originated by GMAC Commercial Mortgage Corp. for Sunrise Assisted Living Inc. The purchase consists of eight cross-defaulted and cross-collateralized mortgages on properties in New Jersey, Virginia, and

Pennsylvania that financed more than 660 units of housing. Including this transaction, Freddie has financed more than \$322 million of seniors housing mortgages since launching its Seniors Housing and Assisted Living Pilot program in 1998. (*Freddie press release, 6/1/99; Reuters, 6/1/99*)

Freddie Does its First “Clean-Up Call” on a Collateralized Mortgage Obligation

- According to *Bloomberg News*, Freddie announced that it is repaying the principal amount and interest accrued on a collateralized obligation early for the first time, reducing the return for investors. The article noted that the securities were so-called “Z” bonds or accrual bonds that collect interest on the original value until they start paying back the principal or are redeemed (as this case). By redeeming the securities, the company can avoid paying interest payments when the balance left is a small percent of the securities’ original value – which in this case could be repaid when 1% or less of the original value remained.
- The securities were reportedly sold in 1985 at an original value of \$18 million with an 11% interest rate and a 30-year maturity. The securities were however redeemed on June 1, 1999 for \$62 million, after the securities had collected interest for 14 years.
- “You know about it and hear about it, but nobody thinks they’re going to do it,” said Barry Rosner, Director of Mortgage and Asset-Backed Trading at Fimat USA Inc. The article noted that because this is the first time this has happened, most investors do not include this risk in their pricing models on Freddie CMOs. Fannie reportedly does not have these provisions in its CMOs. According to a Freddie spokesman, there are nine other Freddie CMOs outstanding. (*Bloomberg 5/28/99, 6/1/99*)

Freddie Establishes Multifamily Second Mortgage Program

- According to *National Real Estate Investor*, Freddie established a second mortgage program for multifamily projects in which the company also finances the first mortgage. Project owners can reportedly receive a separate second mortgage with a term that matches the term of the first mortgage, a separate noncoterminous second mortgage that exceeds the term of the first mortgage by up to 24 months, or a split mortgage where the first and second mortgages are originated simultaneously. The second mortgage can range from \$1 million to \$10 million, subject to a limit of 50% of the original loan balance. (*National Real Estate Investor, 5/30/99*)

MGIC Announces that it is Transferring to Freddie the Exclusive Marketing Rights to MGIC/Freddie’s Early Indicator Default Management System

- Freddie and Mortgage Guaranty Insurance Corp. announced that effective October 1, Freddie will have exclusive rights to market Early Indicator from MGIC. Early Indicator is a popular loan default management program that was introduced by MGIC and Freddie in 1997. The system determines the probability that late-paying borrowers will fall further behind and eventually require foreclosure. More than two-thirds of Freddie’s portfolio of nearly eight million loans is managed by servicers reportedly using the system. MGIC said it would be transferring sole rights to the system to Freddie. The agreement, however, will not affect existing licensing agreements through Fiserv, Alltel, or Excelis. MGIC said transferring Freddie sole rights to Early Indicator was part of MGIC’s decision to refocus the company systems and personnel on other technology initiatives.

(*American Banker*, 6/9/99; *Freddie press release*, 6/3/99; *National Mortgage News website*, posted 6/4/99)

Freddie Announces New Senior Vice President for Investment Funding

- Freddie announced that it had appointed Jerome Lienhard to the position of Senior Vice President, Investment Funding, in the Corporate Finance division. Lienhard will report to Gregory Parseghian, Senior Vice President, Corporate Finance. According to a Freddie press release, he will be responsible for creating and executing debt strategies to minimize the after-tax cost of Freddie funding and for managing the Treasury and Liability function relationships with key external constituencies, including Wall Street dealers, banks, relevant trade groups, and regulators. Lienhard was Corporate Treasury Manager for Toyota Motor Credit Corporation. (*Freddie press release*, 6/4/99)

Freddie Designates Cincinnati, OH its “Fifth Alliance Community”

- Freddie, Cincinnati Mayor Roxanne Qualls, and the Cincinnati Homeownership Partnership announced during a recent city council meeting that they have begun a \$125 million housing program for the city. Freddie also designated Cincinnati as its fifth metropolitan “alliance community” and committed to purchase approximately \$125 million of loans over three years. (*Freddie press release*, 6/11/99)

Freddie Announces that it will Join Initiative to Help the Quad Cities Area - Rock Island and Moline, IL and Davenport and Bettendorf, IA

- Freddie announced that it joined a coalition to provide \$60 million of new mortgage credits to fund low- to moderate-income homeownership and revitalize the Quad Cities area in Iowa and Illinois. (*Freddie press release*, 6/8/99; *Reuters*, 6/8/99)

Freddie and MBA Create Spanish Language Credit Education Brochure

- Freddie and the MBA introduced a Spanish language version of their brochure, “Get a Running Start on Good Credit,” detailing the importance of credit scores and credit management. (*Freddie press release*, 5/28/99)

Federal Home Loan Banks

It Appears that Fannie's Warnings about the FHLBanks will go Unheeded by the FDIC

Fannie Sends Letter to FDIC Warning about the Risk of the FHLBanks' New Programs

- In a March 18 letter to Peter Knight, Director of Legislative Affairs at the Federal Deposit Insurance Corp. (FDIC), Arne Christenson, Fannie's Senior Vice President for Regulatory Policy, wrote that new ventures in which FHLBanks invest directly for portfolio and provide letters of credit have injected a new risk into their operations. Christenson wrote: "We think the current situation bears some disturbing similarities to the S&L crisis of the late 1980s," which cost taxpayers several hundred billion dollars. "Institutions with thin capital are expanding into areas of higher risk, when they have little experience managing such risk." John Connor at the *Wall Street Journal* and *Dow Jones Newswire* reported that over 20 pages of material elaborating on Fannie's arguments were attached to the letter and were a sequel to a meeting between senior Fannie and FDIC officials.
- Most of the criticism of the FHLBanks by Fannie was aimed at the FHLBank's MPF Program – the new direct competitor to Fannie and Freddie in the secondary market. The MPF program, first developed by the FHLBank of Chicago provides thrift and commercial bank lenders with an alternative to selling fixed-rate home loans to Fannie and Freddie. The program allows FHLBanks to purchase mortgage loans originated by member financial institutions.
- John Connor with the *Wall Street Journal* and *Dow Jones Newswire* wrote extensively about Fannie's letter to the FDIC. Reportedly, Fannie's Christenson wrote in his letter that traditionally the FHLBank's main functions have been to provide low-cost loans, called advances, to member mortgage-lending institutions and that "the Federal Home Loan Banks have a capital structure that didn't cause much concern while they carried out their traditional role of providing over-collateralized advances to member institutions." He noted, however, that things are different now in light of the FHLBank's new ventures. Christenson stated that "these transactions are beginning to proliferate, exposing federally regulated institutions to risk without adequate capital." The letter stated that the FHLBank System is "expanding its powers and activities with assets and risks held by the FHLBanks, rather than the members," and that "the capital structure of the FHLBanks, and perhaps many other aspects of running the system, is not designed for this dramatic expansion." The letter added, "To take on real risks, the FHLBs must have real capital."

Sources Say the FDIC has Dismissed Fannie's Claims

- According to a *National Mortgage News* article by Brian Collins, sources are indicating that the FDIC has completed its review of Fannie's submission and it is being summarily dismissed as a complaint filed by a competitor. FDCI officials declined to comment.
- Federal Housing Finance Board Chairman Bruce Morrison stated that "My conversations with people at FDIC is that they did not find that submission persuasive" Fannie's "analysis is fatally flawed," Morrison stated in an interview. "If the analysis was true, it would create significant problems for Fannie Mae's own capital," he added. (*Wall Street Journal*, John Connor, 3/29/99; *Dow Jones Newswire*, John Connor, 3/26/99; 3/29/99; *Washington Post*, Kathleen Day, 3/27/99; *Bloomberg News*, 3/29/99; *Mortgage-Backed Securities Letter – American Banker*, 3/22/99; *National Mortgage News website*, posted 3/29/99; *National Mortgage News*, Brian Collins, 5/31/99)

Fannie Chairman Franklin Raines Threatens FHLBank System that they will Face More Regulation if they Continue with their Mortgage Partnership Finance (MPF) Program - a Program that is Competing with Fannie & Freddie in the Secondary Mortgage Market

FHLBank of Chicago President is Flattered at Fannie's Attention over the MPF Program

The MPF Program is Becoming a Real Competitor to Fannie & Freddie – Five FHLBanks are Now Offering the Program

- As reported in the May 28 *GSE Report*, Fannie Chairman Franklin Raines spoke to the Council of FHLBanks (represents 10 of the 12 FHLBanks) on May 25, suggesting that Fannie and the FHLBanks not be adversaries, but instead become allies by mutually agreeing to divide their markets. Fannie would provide portfolio lending and securitization and the FHLBanks would provide advances, as they have done traditionally. By implication, the FHLBanks would agree to drop the Mortgage Partnership Finance (MPF) program and its potential to compete with Fannie and Freddie. The MPF program gives savings institutions and commercial bank lenders a new alternative to holding home loans in portfolio or selling them to Fannie and Freddie. The program allows FHLBanks to purchase mortgage loans originated by member financial institutions. The MPF program allows member institutions to originate and service single-family loans, while the FHLBank books the loans and manages the market risk. It is considered a profitable alternative to selling to Fannie and Freddie. There are now five FHLBanks offering the program – the FHLBanks of Chicago (which began the program), Dallas, Atlanta, New York, and now Pittsburgh. Initially, the FHLBank of Pittsburgh will offer MPF on a limited basis before offering the program more broadly later this year.
- Veiled threats were made by Raines during his speech as he stated that if the FHLBanks did not cooperate with Fannie, than it would pursue a legislative agenda that would subject the FHLBanks to the same capital standards required of Fannie, the same tax treatment, etc. Raines stated that it was “possible” for the FHLBanks to move into the secondary mortgage market business without regulatory changes in capital and other standards. “But quite frankly, I don’t think that’s likely to happen. It is more likely that you will have to face the standards that we face, and we think that is the right outcome.”
- Joshua Brockman with the *American Banker* reported that Alex J. Pollock, President of the FHLBank of Chicago noted that Raines did not mention the MPF program by name, which he felt was an indication that “they don’t like competition from MPF.” He further stated that “We consider that to be highly flattering.” In response to Raines’ charge that the FHLBanks should undergo regulatory changes before offering the MPF program, Pollock stated that “If the proposition is that all housing GSEs should have the same capital requirements, regulation, taxation – I think that’s an extremely good idea.”
- (*American Banker*, Joshua Brockman, 6/1/99; *Fannie Chairman Franklin Raines speech before the Council of FHLBanks*, 5/25/99; *Real Estate Finance Today*, 5/14/99)

FHFB Approves a Temporary Capital Leverage Change to Enhance the FHLBanks' Liquidity in Preparation for the Year 2000 Computer Conversion

- During its meeting on May 28, the FHFB passed a temporary increase in the FHLBanks' leverage limit from 20 times total capital, to 25 times. The increase is intended to allow the FHLBanks to hold more cash in case member banks and thrifts need more funding and to warehouse liquid assets to meet demand related to the Year 2000 computer conversion. In support of the increase, the FHFB stated in a resolution that it anticipates that depositor behavior in anticipation of Year 2000 disruptions may affect the liquidity of depository institutions. As a consequence, the FHFB believes that FHLBanks may experience demand for funds late in 1999 and the FHLBanks may experience difficulty selling consolidated obligations during this period. The FHFB also reportedly stated that non-mortgage investments during this temporary increase for FHLBanks with a leverage ratio larger than 20 to 1 should not exceed 12% of the FHLBanks' outstanding consolidated obligations. On June 30, 2000, the leverage ratio would revert back to 20 times total capital.
- During the meeting, the FHFB also unanimously approved a final rule to codify its current procedures, putting down on paper the agency's procedures governing applications for "Approvals or Waivers, requests for No-Action Letters or Regulatory Interpretations, and Petitions for Case-by-Case Determination or Review of Disputed Supervisory Determinations." Morrison stated that "When I got here I was distressed by the fact that we had lots of ways of doing things but none of them were written down and over the last four years we've slowly written them down and now we're actually going to publish them in the *Federal Register*." The rule was subsequently published in the *Federal Register* on June 9, 1999 – its effective date. (*American Banker*, David Harrison, 6/1/99; *BNA Daily Report for Executives*, Eileen Canning, 6/1/99; *Dow Jones Newswire*, John Connor, 6/1/99; *Federal Register*, 6/9/99, page 30880-30888)

After Years of Vacancies, Will all the Director Slots at the Federal Housing Finance Board be Filled?

President Clinton Intends to Nominate a New York State Senator and a Former Senate Aide to the Federal Housing Finance Board to Fill Two Vacancies on the Board

Since March of 1998, Only Three of the Five-Member Federal Housing Finance Board Directors Slots have been Filled

- According to *National Mortgage News*' website, President Clinton sent up the nominations of Douglas Miller and Franz Leichter to be members of the Federal Housing Finance Board (FHFB), the regulator for the FHLBank System. Back in October of last year, President Clinton announced his intention to nominate Douglas Miller, however, Congress adjourned for the year before considering his qualifications. The *American Banker* had reported that Miller was hired on November 9th as Counselor to FHFB Chairman Bruce Morrison. Miller previously served as Chief of Staff and Administrative Assistant to former Senator Larry Pressler from 1991 to 1997, and also as Legislative Director and Legislative Assistant, dealing with foreign relations, defense, intelligence and appropriations issues from 1979 to 1991. Miller would fill the second Republican seat on the five-member FHFB. J. Timothy O'Neill currently sits in the other seat reserved for Republicans. (*American Banker*, 11/30/98; *National Mortgage News website*, posted 10/22/98, 6/9/99; *White House press release*, 10/21/98)
- President Clinton also announced that he intends to nominate Franz Leichter, a New York State Senator (Democrat), to be a member of the FHFB. According to White House press release,

Leichter is a practicing attorney in New York, currently with the law firm of Walter, Conston, Alexander, and Green, P.C. He has been a member of the New York State Senate since 1975, serving on the New York State Banking Committee. (*BNA Daily Report for Executives*, 6/10/99)

- As we've noted in previous *GSE Reports*, the Finance Board is supposed to have five members, but since March of last year has only had three members: (1) FHFBC Chairman Bruce Morrison; (2) Republican J. Timothy O'Neill and; (3) Art Agnos, a former San Francisco mayor who is with HUD and is filling the Board seat reserved for the Secretary of HUD or his designee. A fourth member, Lawrence Costiglio was fired by the White House in March of last year. Costiglio's firing left two vacancies on the five-member FHFBC. Costiglio has been challenging his firing in the court system. O'Neill's term expired in 1997 and he is serving in a holdover capacity.

Status Report of Legislation Containing FHLBank Expansion Provisions

House Commerce Committee Passes HR 10 with FHLBank Provisions on June 10

Administration Continues to Oppose FHLBank Expansion Provisions

House:

- The House Commerce Committee passed HR 10 on June 10 by voice vote. The House Banking Committee passed its version of financial services modernization (H.R. 10) on March 11 by a 51-8 bipartisan vote. As reported in previous *GSE Reports*, 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. Chairman of the House Banking Committee Jim Leach (R-IA) released a statement stating that the House Banking and Commerce Committees will be working together to have a bill on the House floor before the Fourth of July recess. (*American Banker*, 6/11/99; *BNA Daily Report for Executives*, 5/21/99; House Banking Committee press release, 6/11/99)

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 contained 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. As we noted in this *GSE Report*, a provision was 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.
- Separate FHLBank bills have also been introduced in the House and Senate (H.R. 822 and S. 458). The bills were introduced in the Senate (S. 458) by Senator Chuck Hagel (R-NE) and Senator Evan Bayh (D-IN) and in the House (H.R. 822) by Congressman Richard Baker (R-LA) and Congressman Paul Kanjorski (D-PA). The bills would do the following: (1) ease small bank access to FHLBank advances; (2) make thrift membership voluntary; (3) convert the \$300 million REFCorp. obligation to 20.75% of FHLBank earnings; (4) reduce federal intrusion in day-to-day

FHLBank operations; (5) and provide for permanent capital and a risk-based capital standard. (*National Mortgage News website*, posted 2/25/99)

Administration Continues to Oppose FHLBank Expansion Provisions

- According to the *Bank Investment Services Report*, the Clinton Administration issued a “Statement of Administration Policy” on the financial services modernization bills currently under consideration by Congress. According to the article, “Flaws in the [Senate] bill...include not only the op sub provision, but also provisions that would weaken the Community Reinvestment Act; inadequately protect and inform consumers; provide ‘piecemeal’ modification of the Federal Home Loan Bank System; and grant the Federal Housing Finance Board independent litigation authority.” (*Bank Investment Services Report – American Banker*, 5/10/99)
- Prior to his resignation as Treasury Secretary on May 12, Robert Rubin testified on May 5 before the House Commerce Subcommittee on Finance and Hazardous Materials on financial services modernization. During his testimony, Rubin protested a provision in the House financial services bill (H.R. 10) that he stated would allow the Federal Housing Finance Board (FHFB) to cut the FHLBank System’s capital in half. Rubin noted that a considerable amount of debt raised by the FHLBank System did not help homeowners but instead funds “arbitrage activities and short-term lending that benefit the system and its bank and thrift members.” Rubin reportedly called the system’s practices an “abuse of its government subsidy” that also introduces risk into a system that wasn’t designed to handle risk. He urged Congress to at least keep the current capital requirements in place and revise the bill to reform the FHLBank System to ensure that it’s used to stimulate housing. (*Dow Jones Newswire*, David Kopecki, 5/5/99)

Farm Credit Administration/Farm Credit Banks

Farm Credit Administration issues a Rule that would Expand the Farm Credit System Banks into Non-Mission Related Investments

- The Farm Credit Administration (FCA) issued a final rule allowing Farm Credit System banks to purchase a wider array of nonagricultural investments such as asset-backed securities and revenue bonds. According to John Connor with *Dow Jones Newswire*, the rule would expand eligible investments for Farm Credit System banks and associations to include Fannie and Freddie mortgage-backed securities backed by multi-family housing loans. Fannie and Freddie mortgage securities backed by single-family loans are already eligible investments. Connor noted that the FCA rejected Wall Street and system members’ pleas to drop the current 50% portfolio limit on Fannie and Freddie securities because the FCA perceived it as overly restrictive. The FCA, however, said the limit enhances safety and soundness. Further, Connor notes that the FCA established a new 15% portfolio limit on mortgage securities issued by private entities. Municipal bonds that are “rated in the highest investment category” and mature within five years or less were also added to the list of eligible investments.
- According to Connor, the rule also contains a controversial securities valuation provision, which would require Farm Credit System institutions to verify with an independent source the value of any security (other than a new issue) that they purchase or sell. The Presidents Finance Committee for Farm Credit System banks reportedly opposed this provision because it appears to require the banks to solicit a second bid from a competing securities dealer. According to FCA, the Presidents Committee stated that this proposal “would undermine the good reputation of the System and cause

relationships with securities firms to quickly deteriorate,” causing the System to pay higher prices for securities. The FCA, however, said that nothing in the rule would require additional bids, but rather, the verification requirement could be met by confirming the price of a security with an on-line market reporting service or by using internal valuation models. Further, the FCA noted that independent verification of securities prices is a fundamental component of safety and soundness. The rule was published in the *Federal Register* on May 28 and is effective 30 days after publication, counting only those days when one or both houses of Congress are in session. (*Dow Jones Newswire*, John Connor, 6/1/99; *Federal Register*, 5/28/99, page 28884-28900)

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