

# The **GSE** REPORT™

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### **Major Events**

- HUD is examining Fannie & Freddie's automated underwriting systems ("black boxes") for racial discrimination (*p. 5*)
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  - The GSEs have been under investigation by HUD for six months
  - A study commissioned by HUD found that Fannie & Freddie's automated underwriting systems and use of credit scoring may be discriminatory
  - Fannie's own consumer survey finds that consumers are suspicious of automated underwriting and credit scoring systems
- Freddie's controversial survey finds that African Americans are twice as likely as whites to have bad credit (*p. 6*)
  - Freddie's survey also found that even when they make the same amount of money as whites, African Americans are still likely to have worse credit
  - The survey creates a backlash against Freddie
  - *Washington Post* columnist, Michelle Singletary, contends that Freddie's announcement that many African Americans have bad credit ensured the "continuation of the stereotype that blacks are too dumb and too irresponsible to handle their own finances. No matter what face Freddie Mac puts on the study, its results are inflammatory. Just how does labeling nearly half of black America as deadbeats help blacks get credit?"
  - National Community Reinvestment Coalition Vice President Joshua Silver says that the survey "smacks of politics" and that perhaps, Freddie may be using the study to say it is not possible to meet HUD's increased affordable housing goals for Fannie & Freddie, "when it may be possible."
  - House Banking Committee Member Maxine Waters (D-CA) hosts a press conference blasting the Freddie survey, calling it incomplete, dishonest, racist, and a "slap in the face" to African Americans. Waters also notes that Freddie has a history of discrimination problems regarding employment as well as lending.
  - Cong. Gregory Meeks (D-NY) questioned Freddie's commitment to African Americans and said that more studies on Freddie could be in order
  - DC ACORN Chapter criticized the study, calling it a "political document" that is intended to shift the blame from Freddie and HUD's affordable housing goals to the borrower, calling it the classic "Blame the Victim." ACORN also announced that Freddie's automated underwriting systems may be discriminatory and that Fannie & Freddie lag the private market in increasing homeownership among underserved groups. ACORN urges Freddie to join Fannie in endorsing HUD's proposal to increase Fannie & Freddie's affordable housing goals.
  - In response to Freddie's survey, the Maryland Insurance Commissioner plans to hold hearings on the use of credit reports by insurance companies
- *National Mortgage News* reports that the EEOC may be filing new discrimination charges against Freddie (*p. 10*)
- Financial Services Roundtable Board of Directors issues a Resolution raising concerns about Fannie & Freddie's expansion beyond their core mission (*p. 11*)

- Fannie/Freddie watchdog group, FM Watch, reveals its six-member Board of Directors (*p. 11*)
  - Despite Fannie's claim that FM Watch is simply a front for the mortgage insurance industry, the six-member board of directors consists of "high profile, heavy weight" executives with much broader financial services interests
  - Frustration and fear surrounding Fannie & Freddie are not confined to the mortgage or mortgage insurance industry
  - In related news, *National Mortgage News* reports that FM Watch has put together an organized and professional lobbying team
- Fannie announces a new pilot product – "Timely Payment Rewards" mortgage – that will allow Fannie to expand into the subprime (A-) market (*p. 13*)
  - Fannie said it plans to target half of all the subprime market (the A- half) with this new product – the other half (B&C market) is not on their current agenda but Raines anticipates that at "some point in the future" they will be able to address the B&C market
  - [No details on whether lenders must use Fannie's automated underwriting system, Desktop Underwriter, to provide this product to consumers, or whether Fannie will charge delivery fees for this product. Statements made by Fannie Chairman Raines indicate that Fannie's technology will play an integral role.]
  - *New York Times* article notes that Fannie is taking on significantly more risk even if this is just a tentative entrance into this market
  - The National Home Equity Mortgage Association (NHEMA) blasts Fannie's new product – NHEMA says the product is beyond Fannie's mission, will drive up costs for consumers (particularly the B&C market), and increases the potential for a taxpayer bailout
  - To further its brand name, Fannie also announces its largest, most comprehensive advertising – Raines would not disclose the amount of money to be spent on the advertising campaign but noted that it is "a lot" and one of its most expensive ever
  - Fannie disputes Freddie's survey linking race with bad credit
- Fannie Chairman Franklin Raines tells Merrill Lynch Investor Conference that the company intends to double its Earning per share (EPS) by the end of 2003 (*p. 16*)
  - Fannie intends to double its EPS growth by – (1) expanding its mortgage portfolio; (2) expanding further into the mortgage market ("non-traditional" products such as subprime, FHA/VA, multifamily, home equity, manufactured housing, reverse mortgages); and (3) expanding the mortgage debt market.
  - To broaden its reach into new markets and lines of business, Fannie is redefining the mortgage market from a \$4 trillion mortgage market (prime conforming conventional) to a \$12 trillion mortgage market to include: *prime conforming conventional (the segment the GSEs originally served), home equity (includes home improvement loans), subprime, multifamily, government (FHA/VA mortgages), manufactured housing, jumbo, and seller financed*
  - Raines demonstrates how Fannie intends to enter all facets of this \$12 trillion mortgage industry
  - "Non-traditional products [jumbo, government, multifamily, subprime, prime home equity] have accounted for fully one-quarter of this year's mortgage portfolio growth." In related news, Fannie purchased a record number of "non-traditional" loans in August
  - Raines discusses his pilot with Home Depot that allows consumers to apply for a home improvement loan right in the store
- Senate votes to fund Fannie & Freddie's safety and soundness regulator, OFHEO, at \$19.5 million for FY 2000 (a 22% increase) (*p. 19*)
  - The Senate vote reverses an earlier vote by the Senate Appropriations Committee to freeze OFHEO's budget at \$16 million
  - The House also approved the full \$19.5 million increase
  - Senate Banking Committee Chairman Phil Gramm (R-TX), the Clinton Administration, Chairman of the House Banking Capital Markets Subcommittee Cong. Richard Baker (R-LA), and consumer advocate Ralph Nader all supported the 22% increase (full funding of OFHEO)
  - Fannie/Freddie watchdog group, FM Watch, praises the Senate for fully funding OFHEO
  - In the future, OFHEO would like to be removed from the annual Congressional appropriations process noting that bank and thrift regulators are not subject to the appropriations process

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

- FHA is in the process of modernizing its multifamily refinancing program to make it more competitive with Fannie & Freddie (*p. 21*)
- Although Fannie & Freddie market their global debt issues (Fannie-Benchmark notes; Freddie-Reference notes) as substitutes for Treasuries --- swaps, not GSE debt, are emerging as the next new benchmark alternative to Treasuries (*p. 21*)

- *Dow Jones* article notes that Fannie & Freddie's callable benchmark debt securities are struggling in comparison to its non-callable program
- Senate approves Armanda Falcon as the new director of OFHEO (Fannie & Freddie's safety and soundness regulator) (p. 22)
  - OFHEO has been without a permanent director for the past two years
- HUD drops its investigation into allegations that Fannie pressured underwriters not to do business with Freddie (p. 23)
- Morgan Stanley Dean Witter is the #1 agency underwriter (p. 24)

### **Fannie Mae**

- "Fannie Mae buys Countrywide. Just Kidding, But..." (p. 24)
- Fannie's President and Chief Operating Officer Lawrence Small, two years shy of his planned retirement, plans to resign in early 2000 to become Secretary of the Smithsonian Institute (p. 24)
  - Small was paid approximately \$4.2 million plus bonuses last year
  - Fannie begins nationwide search for replacement
- Waterfield Mortgage, which just signed an agreement with Fannie moves Fannie's automated underwriting system, Desktop Underwriter, from the back office to the point-of-sale (p. 25)
  - Fannie is changing its role by expanding its technology to the front-end of the origination process
- Fannie announces that it will set aside portions of its Benchmark note and bond sales for minority and women-owned securities firms (provided they are participants in Fannie's "Access" program) (p. 25)
  - Fannie steers business to those companies that participate in Fannie's programs – Debt will be specifically set aside for these companies
  - Fannie is the largest corporate issuer of debt
- Expanding outside its housing mission, Fannie invests \$1.2 million in a shopping center (p. 26)
- For those borrowers who place a deposit, Fannie's San Antonio Partnership Office will provide matching funds (p. 26)
- First reverse mortgage securitization is successful (securitization arranged by private sector) (p. 27)
  - Lenders may be more likely to pool loans for securitization as opposed to selling them off on an individual basis to Fannie
- Women's World Cup soccer champion Mia Hamm will lead the Fannie Mae Foundation's Help for the Homeless Campaign (p. 29)

### **Freddie Mac**

- Freddie expanding into subprime business (p. 30)
  - Freddie has guaranteed or "wrapped" 19 subprime deals valued at approximately \$5 billion since it started its program in 1997
  - Fannie denies that they are interested in guaranteeing or "wrapping" subprime deals
  - One trader notes that Fannie & Freddie are "very, very big investors in AAA securities backed by B&C loans"
- Freddie purchases the largest tranche (\$600 million) of a recent \$1 billion GMAC Commercial Mortgage deal (p. 30)
  - *American Banker* article notes that Freddie is exposed to the entire pool of commercial properties in the \$1 billion deal, not just the apartment loans that Freddie purchased – the deal is backed by a diverse pool of properties – including shopping centers, office buildings, apartment houses, hotels, and warehouses
  - Some institutional investors were upset that all of the multifamily loans in the deal were set aside for Freddie
  - Freddie's implied government guarantee from the US government gives it low borrowing costs, so it could afford to accept a lower spread than other investors
- Freddie and GMAC Commercial Mortgage completed a Freddie/GMAC direct pay credit enhancement for \$188.4 million in tax-exempt bonds and financed \$37.1 million in conventional mortgages (p. 31)
  - The deal was done with three companies, all of which were owners of luxury apartment communities
- Freddie survey finds that conforming loan market has lower and more uniform mortgage rates than the jumbo market (outside Fannie & Freddie's statutory limit) (p. 32)
  - Some questioned Freddie's assertion about pricing in the conforming market
  - Others noted that the jumbo market is smaller and does not have the implied government guarantee that Fannie & Freddie enjoy in the conforming market
  - Mortgage banking company asserts that Fannie & Freddie are adding fees
- Bank of America will lend \$1 billion in affordable housing mortgages in Oakland, CA (p. 33)
  - Freddie has agreed to purchase the loans

- Freddie announces a \$90 million initiative with the South Florida Board of Realtists® (division of the National Association of Real Estate Brokers), Sun Trust, Fidelity Federal, and several local mortgage brokers (p. 33)
  - Program will offer Freddie products to consumers
  - Following in Fannie's footsteps, Freddie begins adding Congressional Member statements to its press releases
- Freddie guarantees a pool of multifamily loans, a \$120 million credit enhancement deal (p. 33)
- Freddie promotes Dwight Robinson to Senior Vice President for Corporate Relations (p. 33)

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

- FHFB publishes its controversial proposal to end FHLBank System arbitrage activities and implement a new risk-based capital standard for the FHLBanks in the *Federal Register*(p. 34)
  - Comments on the proposal are due by December 27, 1999
  - Opposition forms to FHFB's proposal – ACB, ABA, and a group called the Savings Association Trade Executives wants a delay of the proposal
  - Opponents of proposal succeeded in getting an amendment attached to the VA-HUD Appropriations bill that mandates a one-year GAO study of FHLBank capital
  - Meanwhile, GAO releases a study to Cong. Baker (R-LA) supporting risk-based capital standards for FHLBanks
  - House Banking Committee Chairman Jim Leach (R-IA) said the FHFB proposal is far-reaching and will be discussed during the House/Senate conference on financial services modernization. (The House version calls for the FHLBanks while the Senate version calls for a GAO study of the FHLBank capital structure and the need for a risk-based system and permanent capital)
  - Cong. Baker is reportedly expected to argue that the time for a study is over and that Senate conferees should accept the FHLBank provisions in the House version
- FHLBank System is considering “sneaking” language into the financial services modernization bill (currently in House/Senate conference) that would expand the FHLBanks into economic development lending (p. 37)
  - America's Community Bankers gave a list of criteria that must be met before such a proposal is adopted
- FHLBank President of Des Moines was reportedly forced out of his office by the FHFB after derivatives losses (p. 37)
  - More than \$10 million was lost last year by the FHLBank of Des Moines on a speculative “impermissible” derivatives transaction
  - *Dow Jones Newswire* reports that the FHLBank of San Francisco reportedly lost more than \$65 million over a recent 19 month period on “permissible” hedging activities
- FHLBank System's Mortgage Partnership Finance (MPF) program has generated nearly \$1.5 billion in single-family fixed-rate mortgage loans (p. 38)
  - The MPF program is becoming a real competitor to Fannie & Freddie
- FHFB Chairman Bruce Morrison said a potential “iceberg” for the GSEs is an eventual recession – the question is how effectively the GSEs handle the recession (p. 38)
- FHLBank of Boston promotes two to newly created positions (p. 38)

### ***Farm Credit Administration/Farm Credit Banks***

- American Bankers Association and Community Bankers Association are opposed to an amendment in the Agricultural Appropriations bill that they say would unfairly broaden the authority of the Farm Credit System, at the expense of private sector banks (p. 39)
- Commercial banks are gaining market share in agricultural lending at the expense of Farm Credit System (p. 39)
  - However, Farm Credit System still has a virtual lock over commercial banks on farm cooperative borrowing (commercial banks only have 16% of the co-op market)

### ***Ginnie Mae***

- Fannie/Freddie watchdog group, FM Watch, opposes privatizing Ginnie Mae because it hurts competition and consumers (p. 40)
- Results, so far, on the *National Mortgage News* website-viewer survey, is running 2-to-1 in favor of letting Ginnie Mae buy its own securities to build an investment portfolio (p. 40)

## *Major Events*

**HUD is examining Fannie & Freddie's automated underwriting systems ("black boxes") for racial discrimination**

**[Fannie & Freddie control over 95% of the automated underwriting market share]**

**The GSEs have been under investigation by HUD for six months**

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

**Fannie's own consumer survey finds that consumers are suspicious of automated underwriting and credit scoring systems**

- According to a *Dow Jones Newswire* article by Jerry Guidera, HUD is examining the automated underwriting systems of Fannie and Freddie for racial discrimination. The automated underwriting systems (Fannie-Desktop Underwriter; Freddie-Loan Prospector) are used by financial institutions to determine the credit risk of mortgage applicants and the systems virtually guarantee a buyer for the loans. [As reported in previous *GSE Reports*, Fannie and Freddie control over 95% of the automated underwriting market share.]
- HUD Secretary Andrew Cuomo reportedly called the investigation. Six months ago, HUD hired an outside consulting firm and established an in-house team of investigator to examine years of credit-scoring data. A HUD spokesman confirmed the investigation but declined to provide a timeline for its completion.
- Secretary Cuomo said that recent studies traced Fannie and Freddie's underwriting systems to a bias in home lending and a widening of the racial gap in homeownership. "We're working with the GSEs to address these issues," Cuomo stated. "The GSEs initiated the black-box systems, and now their investors are dictating their criteria for providing loans." If a bias is found, HUD is reportedly ready to use laws such as the Fair Lending Act to force modifications to the systems. (*Dow Jones Newswire*, Jerry Guidera, 9/24/99; 9/30/99)

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

- **As reported in a previous *GSE Report*, an independent study commissioned for HUD by the Urban Institute found that that Fannie and Freddie's underwriting guidelines may have an unintentional but adverse impact on borrowers with low incomes, limited wealth and poor credit histories which are "disproportionately minority." The report also noted that Fannie and Freddie "do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities." The report noted that "Primary lenders are making more aggressive efforts" to serve the lower income and minority home buyers "by offering loan products with underwriting guidelines that are more flexible than the GSEs' guidelines." The report also noted that the use of automated underwriting systems and credit scores may place lower-income borrowers at a disadvantage when applying for a loan, even when they are acceptable credit risks. Further, automated systems make it more difficult for "marginal applicants" to receive personalized attention from an underwriter, and some "informants" believe credit scores might not be accurate**

predictors of loan performance, despite contrary claims by the GSEs. According to the *Wall Street Journal*, HUD Assistant Secretary William Apgar stated that the report raises serious questions about [the GSEs'] lending practices and the department will look into these immediately." (*Wall Street Journal*, 4/30/99; HUD Study, "A Study of the GSEs' Single Family Underwriting Guidelines," April 1999)

Fannie's own consumer survey finds that consumers are suspicious of automated underwriting and credit scoring systems

- In Fannie's eighth annual national housing survey, Fannie found that Americans remain suspicious of automated underwriting and credit scoring. Only 25% believe computerized credit scoring is better than having a mortgage application evaluated in the traditional way by a committee, with the rest believing that the traditional process is better because it enables humans to make the underwriting decision. Fannie polled about 1,900 people, including almost 900 who had recently gone through the mortgage process, for its survey. (*Washington Post*, 10/2/99)

**Freddie's controversial survey finds that African Americans are twice as likely as whites to have bad credit**

**Freddie's survey also found that even when they make the same amount of money as whites, African Americans are still likely to have worse credit**

**The survey creates a backlash against Freddie**

***Washington Post* columnist, Michelle Singletary, contends that Freddie's announcement that many African Americans have bad credit ensured the "continuation of the stereotype that blacks are too dumb and too irresponsible to handle their own finances. No matter what face Freddie Mac puts on its study, its results are inflammatory. Just how does labeling nearly half of black America as deadbeats help blacks get credit?"**

**National Community Reinvestment Coalition Vice President Joshua Silver says that the survey "smacks of politics" and that perhaps, Freddie may be using the study to say it is not possible to meet HUD's increased affordable housing goals for Fannie & Freddie, "when it may be possible."**

**House Banking Committee Member Maxine Waters (D-CA) hosts a press conference blasting the Freddie survey, calling it incomplete, dishonest, racist, and a "slap in the face" to African Americans. Waters also notes that Freddie has a history of discrimination problems regarding employment as well as lending**

**Cong. Gregory Meeks (D-NY) questioned Freddie's commitment to African Americans and said that more studies on Freddie could be in order**

**DC ACORN Chapter criticized the study, calling it a "political document" that is intended to shift the blame from Freddie and HUD's affordable housing goals to the borrower, calling it the classic "Blame the Victim." ACORN also announced that Freddie's automated underwriting systems may be discriminatory and that Fannie & Freddie lag the private market in increasing homeownership among underserved groups. ACORN urged Freddie to join Fannie in endorsing HUD's proposal to increase Fannie & Freddie's affordable housing goals.**

**In response to Freddie's survey, the Maryland Insurance Commissioner plans to hold hearings on the use of credit reports by insurance companies**

- Freddie released a survey that found that African Americans are twice as likely as whites to have bad credit. According to Freddie, of the 12,000 respondents, the survey found that 30% had bad credit records. Among African Americans, the survey found that 47% had bad credit, compared to 34% of Hispanics and 27% of whites. "This means that when a black family searches for a mortgage, they are more likely to pay a higher interest rate or be turned down completely because of their credit records," said Dwight Robinson, Senior Vice President of Corporate Relations at Freddie. Freddie's survey also found that even when they make the same amount of money as whites, African Americans are still likely to have worse credit. African American consumers tend to have worse credit ratings than whites, whether they live in households earning less than \$25,000 or in households earning between \$65,000 and \$75,000. For example, among those with incomes under \$25,000, 48% of African Americans had "bad" credit, compared to 31% of white borrowers; in the \$65,000 to \$75,000 income bracket, 34% of African Americans had "bad" credit, compared to 20% of white borrowers. "Bad" credit was defined by Freddie as those individuals that were either 90 days late on a payment in the last two years, or 30 days late on a payment more than once in the last two years, or had a record of delinquent liens, public records or a bankruptcy. Consumers with incomes under \$25,000, 36% had bad credit, as did 22% of those with incomes of \$65,000-\$75,000. According to a Freddie press release, 46% of African Americans own homes compared with 72% of whites.
- Freddie released the survey results during a press conference to announce a new consumer credit education initiative with five black colleges, the National Urban League and the NAACP. In January, Freddie awarded \$1.3 million to five black colleges (St. Augustine's College; Benedict College; Clark Atlanta University; Florida A&M; and Howard University) to begin the process of conducting a national credit survey. The schools and Freddie are analyzing the survey results to develop an initiative to help consumers obtain and maintain good credit, and the National Urban League and the NAACP have agreed to help implement the project. According to a Freddie press release, more than \$2 million has been spent on the program to date. (*National Mortgage News website*, posted 9/23/99; *National Mortgage News*, Karen Thomas, 9/27/99; *White House Bulletin*, 9/21/99; *American Banker*, Joshua Brockman, 9/23/99; *BNA Daily Report for Executives*, Eileen Canning and Pamela Atkins, 9/22/99; *New York Times*, 9/22/99; *Washington Post*, 9/21/99; *Freddie press release*, 9/21/99)

Washington Post columnist, Michelle Singletary, writes a column criticizing the Freddie survey

- **Washington Post** columnist, Michelle Singletary contends that Freddie's announcement that many African Americans have bad credit ensured the "continuation of the stereotype that blacks are too dumb and too irresponsible to handle their own finances. No matter what face Freddie Mac puts on its study, its results are inflammatory. Just how does labeling nearly half of black America as deadbeats help blacks get credit? This is a case, perhaps, of good intentions but bad execution."
- Singletary criticized the company for releasing the data without full analysis and for not analyzing information gathered from borrowers who participated in the focus groups. Singletary writes, "Explaining why blacks may have 'bad' credit is just as important as stating that they have 'bad' credit. Reporting one without the other is irresponsible."

- John Taylor, President and Chief Executive of the National Community Reinvestment Coalition was quoted in the article as stating, “Their strategy for releasing this information was slipshod...In some ways they did more damage than good, because there will be many people who will use this study as a defense for why they don’t do more minority lending.” (*Washington Post*, “*Freddie Mac’s Backhanded Benevolence*,” Michelle Singletary, 9/26/99)

National Community Reinvestment Coalition Vice President Joshua Silver says that the survey “smacks of politics” and that perhaps, Freddie “was trying to avoid more demanding affordable housing goals set by HUD.”

- Michelle Singletary also held a live discussion on the Freddie survey with Joshua Silver, Vice President of Research and Policy at the National Community Reinvestment Coalition. Silver thought Freddie should have released the entire study before announcing results to the public. Singletary asked Silver whether she was “too harsh in criticizing Freddie Mac for releasing a study that did nothing more than really label half of the black population as deadbeats?” Silver did not think Singletary was too harsh and he argued that Freddie published a major finding that was not well documented with several holes in the study which have not been answered by Freddie. **Silver stated, “One could argue that Freddie has not acted responsibly here. Maybe, they are trying to avoid more demanding affordable housing goals set by HUD, by saying we are now already stretching to reach all creditworthy minorities...Let’s say, that this study smacks of politics.”** Expanding upon his remark Silver noted that HUD wants to raise the affordable housing goals for Fannie and Freddie and that “Freddie may be using this study to say it is not possible to raise the percentages...when it may be possible.” (*Color of Money Live with Michelle Singletary*,” *Washington Post*, 9/27/99)

House Banking Committee Member Maxine Waters (D-CA) holds a press conference blasting the Freddie survey, calling it a “slap in the face” to African Americans

- **Rep. Maxine Waters (D-CA) held a press conference on September 29, calling Freddie’s survey a “slap in the face” to African Americans.** According to a *BNA* article by Eileen Canning, Waters stated “I believe this [report] is not credible and that I am insulted by it...It is a slap in the face, and they have red-lined us once again.” She questioned whether the report was timed to deflect criticisms from other studies (Urban Institute and ACORN) on discrimination in the lending market.
- **Waters said the timing of the release was suspect and that the results should be discounted because it was “incomplete, dishonest, and racist.”** In a press release by Waters, she stated, “**Freddie Mac’s singling out of African Americans only contributes to widely held stereotypes of African Americans and credit. It is those very stereotypes that yield the disparate result in credit lending.**” Waters stated, “**I am not going to be as lenient in my criticisms of Freddie Mac any longer,**” she said. “**They will not let go of this notion that we are a bad credit risk...The gloves are off with Freddie Mac,**” she said. Waters also noted that she would ask that the five black colleges involved in Freddie’s consumer credit initiative to reconsider their positions. She further noted that Freddie has a history of discrimination problems regarding employment as well as lending.
- Joining Waters at the press conference, Cong. Gregory Meeks (D-NY) questioned Freddie’s commitment to African Americans and said that more studies on Freddie could be in order. Other participants include ACORN and the National Fair Housing Alliance. (*BNA Daily Report for Executives*, Eileen Canning, 9/30/99; *Cong. Waters press release*, 9/30/99)

### DC ACORN Chapter

- A representative from the DC ACORN chapter criticized the study, calling it a “political document” that is intended to shift the blame from Freddie and HUD’s affordable housing goals to the borrower, calling it the classic “Blame the Victim.” The representative also noted that **Freddie’s automated underwriting systems may be discriminatory. In a press release, ACORN stated “In determining what loans it buys on the secondary market, Freddie Mac tries to fit everyone into a neat, little box through credit scoring. The problem is that not everyone fits into that box. And the people who are left out are disproportionately those with lower incomes and minorities, regardless of their ability to pay off loans. That’s what’s happened with Freddie’s encouragement of banks to adopt standardized credit scoring systems. And that’s why HUD Secretary Andrew Cuomo announced last week that HUD would begin investigation whether Freddie and Fannie Mae’s credit scoring systems violate our country’s fair lending laws by weighing factors unrelated to credit-worthiness.”** (*ACORN press release, 9/29/99*)
- ACORN urged Freddie to join with Fannie in supporting HUD’s proposal to increase the affordable housing goals for Fannie and Freddie. In a letter to HUD Secretary Andrew Cuomo, ACORN President Maude Hurde noted that ACORN supported increased affordable housing goals for Fannie and Freddie and noted that the GSEs lagged the primary market in serving underserved areas. Hurde wrote that the GSEs benefit from substantial public subsidies and have enjoyed tremendous profit in recent years, and that the GSEs should be leading the market in increasing access to affordable housing. **However, Hurde writes that “most market statistics and independent assessments of GSE practices indicate that the GSEs lag behind the market in increasing homeownership among currently underserved groups.”** (*ACORN Letter to HUD Secretary Cuomo, 9/22/99; ACORN press release, 9/29/99*)

### National Fair Housing Alliance

- A representative from the National Fair Housing Alliance asked Freddie how they could use the term “bad credit,” because it was “insensitive.” Doesn’t believe in a education program for minorities but rather should be educating whites on how to treat minorities fairly.

### In response to Freddie’s survey, the Maryland Insurance Commissioner plans to hold hearings on use of credit reports by insurance companies

- In response to Freddie’s survey, Maryland Insurance Commissioner Steven Larsen plans to hold a hearing in November to review whether insurance companies should be permitted to consider a consumer’s credit history in deciding what rate to charge or whether to issue a policy. Larsen said the hearing was in response to Freddie’s report that found that more African Americans are likely to have bad credit reports. Larsen is concerned that permitting the use of credit would be discriminatory to blacks and other minorities. “I want to be sure insurance companies are not using credit history as a surrogate for redlining people with bad credit,” he said in a statement. Larsen proposed new regulations earlier this year for insurers to follow when using a consumer’s credit history. The proposed regulations, pending in the Maryland General Assembly’s Joint Committee on Administrative Executive Legislative Review, would give the Commissioner authority to obtain and review these credit-scoring models to ensure credit isn’t being using in an arbitrary, capricious, or discriminatory manner, according to the Insurance Administration. The proposal’s status is reportedly uncertain while the hearing is held. (*BestWire, 9/24/99*)

***National Mortgage News* reports that the EEOC may be filing new discrimination charges against Freddie**

- According to *National Mortgage News*, the Equal Employment Opportunity Commission (EEOC) is preparing to file additional employment discrimination charges against Freddie. Debra Katz, the attorney who represents former and current Freddie employees claiming discrimination, noted that the new EEOC charges are similar to charges that have already been filed. The point of the charges, in her opinion, is that “Freddie Mac is not fixing the problem.” EEOC would not comment on the matter. (*National Mortgage News*, 9/27/99)

Background

- Following a 20-month investigation, the EEOC issued a three-page finding in an August 14, 1998 letter, concluding that Freddie Mac’s “discriminatory environment is the result of a lack of interest in promoting equal opportunity among black employees.” The EEOC accused the firm of showing a “disregard for the civil rights of black employees” in its hiring and promotion practices and of creating a “hostile work environment.” The EEOC says it found widespread discrimination against black employees at Freddie Mac and concluded that the company engaged in a pattern of laying off highly qualified black employees while giving preferential treatment and higher salaries to less-qualified whites. The EEOC will attempt to negotiate a settlement. If that fails, the EEOC has the option of filing a formal complaint against Freddie Mac in federal court.
- The EEOC ruling was made public on September 2<sup>nd</sup>, 1998 by attorneys for Tony Morgan, the former Freddie Mac manager whose discrimination complaint led to the investigation. Morgan was a former Director of Executive Corporate Relations at Freddie Mac, who filed a \$15 million civil lawsuit in US district court on June 3<sup>rd</sup> alleging that Freddie Mac had a “racially hostile” work environment. **Morgan charged that his job was down-sized and he was terminated two years ago because he raised concerns about Freddie’s “poor performance” in purchasing mortgages from low-income and minority homebuyers.**
- On March 31, 1996, Morgan was terminated by Freddie as part of a “reduction in force.” Morgan, however, was the only manager that the company let go and the **dismissal occurred shortly after he wrote an internal memo that criticized Freddie Mac’s lending practices for minorities.** Morgan said he was asked by his supervisor to review the company’s loan purchase data in preparation for a report to HUD. **“I wrote that I was struck by Freddie Mac’s poor performance in purchasing the mortgages of minorities and low-income people,” Morgan said in an interview. “When it came to African Americans, the company’s mortgage purchase performance was poor across all income categories.”** Morgan views home ownership as the key to asset accumulation and the creation of wealth, and believes that discrimination is the major reason for the persistent gap between white wealth and black wealth in America. “I noted my concerns in a memo but received no response,” Morgan said. “Instead, I was excluded from attending further meetings. I did not realize it then, but looking back **it was clear that my days at Freddie Mac were numbered after I raised concerns about racism in their lending practices.**”
- Katz alleges that top managers at Freddie Mac were aware of extensive racial misconduct, as well as efforts to curb investment in low income and minority mortgages. According to Katz, **“People who raise questions about affordable housing and other minority-related issues**

**are also being retaliated against.”** Katz said she would cite the EEOC finding in asking a judge to permit Morgan’s case to move forward as a class action suit. With this finding, the EEOC and Freddie scheduled conciliation talks. According to a recent *National Mortgage News* article, Morgan’s case is on hold as the EEOC complaint moves forward. (*Associated Press*, 9/3/98; *Wall Street Journal*, 9/3/98; *Washington Post*, 9/3/98, 9/6/98; *National Mortgage News*, 9/27/99)

**Financial Services Roundtable Board of Directors issues a Resolution raising concerns about Fannie & Freddie’s expansion beyond their core mission**

- The *White House Bulletin* reported that the Board of Directors for the Financial Services Roundtable released a resolution addressing GSEs. According to a Financial Services Roundtable statement, “The resolution expresses the concern that Fannie Mae and Freddie Mac have current and planned activities beyond their core missions including: providing liquidity for home equity and sub-prime loans; undertaking investment portfolio activities beyond housing as well as housing related investments that increase risk; creating consumer financial services ‘accounts’ tied to mortgages; undertaking real estate disposition activities”; and other programs. (*American Banker*, Katharine Fraser, 9/24/99; *White House Bulletin*, 9/23/99)
- Other positions taken by the Financial Services Roundtable include:
  - eliminating GSE subprime activities;
  - restricting or eliminating GSE multi-family construction financing;
  - revising GSE underwriting criteria to force the GSEs to purchase more CRA loans;
  - subjecting GSEs to the Basle capital standards; and
  - reducing private MBS capital to the 20% risk-weighting applied to GSE MBS.
- According to Katharine Fraser with the *American Banker*, the Financial Services Roundtable said that it is concerned that Fannie and Freddie will expand into businesses where they could compete unfairly with private-sector financial services companies.
- The Financial Services Roundtable noted that the GSEs are getting too involved in purchasing home equity and subprime loans and selling real estate and that many of the GSEs’ activities are beyond what is allowed in their charters.
- The Financial Services Roundtable also announced that it had a meeting with Federal Housing Finance Board Chairman Bruce Morrison (regulator of FHLBanks) and the two “agreed to consider approaches in which the financial services industry and the Federal Home Loan Banks can work together to strengthen banks’ role in mortgage markets.” The Financial Services Roundtable is a trade association that represents some of the country’s largest banks. (*American Banker*, Katharine Fraser, 9/24/99; *White House Bulletin*, 9/23/99)

**Fannie/Freddie watchdog group, FM Watch, reveals its six-member Board of Directors**

**Despite Fannie’s claim that FM Watch is simply a front for the mortgage insurance industry, the six-member board of directors consists of “high profile, heavy weight” executives with much broader financial services interests**

**Frustration and fear surrounding Fannie & Freddie are not confined to the mortgage or mortgage insurance industry**

**In related news, *National Mortgage News* reports that FM Watch has put together an organized and professional lobbying team**

- The Fannie/Freddie watchdog group, FM Watch, has revealed the names of its six-member board of directors. The six are:
  - (1) William F. Aldinger, chairman and Chief Executive, Household Finance
  - (2) Dennis Dammerman, Vice Chairman, General Electric Co.
  - (3) Maurice Greenberg, Chairman, American International Group
  - (4) William B. Harrison, Jr., President and Chief Executive, Chase Manhattan Corp.
  - (5) Richard M. Kovacevich, President and Chief Executive, Wells Fargo Bank
  - (6) Thomas H. O'Brien, Chairman and Chief Executive, PNC Bank
  
- According to FM Watch Chairman Gerald Friedman, the board consists of financial services executives because “[t]hey’re concerned that the GSEs are being turned into giant financial services companies” whose products will include not just home equity loans, but construction loans and insurance.” He said the board members were selected because “[t]heir voices are heard by Washington policymakers.” He noted that the board’s job would be to give guidance to FM Watch as it battles against “charter creep” by Fannie and Freddie. The goal of FM Watch is to ensure that the GSEs do not go beyond their core mission of providing liquidity to the primary conventional residential mortgage market. Friedman said the presence of these heavyweights on the board suggests that the frustrations and fears surrounding Fannie and Freddie are not confined to the mortgage or mortgage insurance industries.
  
- **“FM Watch’s Board of Directors is composed of some of the most prominent and respected members of the financial services community,” Friedman stated. “Their interest and willingness to serve is an indication that Fannie Mae and Freddie Mac’s mission creep activities involve not only the mortgage business but potentially many other financial products and services; areas in which consumers are already being well-served by the private sector. This expansion has raised concerns throughout the financial services industry.”**
  
- Despite the broad line-up of the board, Fannie continues to stick to its mantra that this is simply a front for the mortgage insurance industry. “They’re doing what I’d expect them to do,” stated Sharon McHale, Freddie Mac spokeswoman. “We called it like it is. They couldn’t very well put mortgage insurance executives on the board, so they’re doing what politicians do every day – try to paint yourself different than you really are when someone has tagged you.” Fannie’s spokesman David Jeffers said “We have always said that this was a group motivated by mortgage insurers and their allies, all of whom, make their money one of three ways, through mortgage insurance, through financial arrangements with mortgage insurers, or other products that cost consumers more.” However, as FM Watch Chairman Friedman noted, “People like Hank Greenberg, Will Harrison, and Dick Kovacevich don’t take orders from mortgage insurance executives.” (*National Mortgage News website*, posted 9/22/99; *American Banker*, Marc Hochstein, 9/23/99; *FM Watch press release*, 9/20/99)
  
- In related news the National Association of Mortgage Brokers is considering whether to join FM Watch. According to NAMB Executive Vice President Brian Kinsella, the NAMB has been invited to join the group and NAMB’s President Michael Hindman has appointed a task force to examine the issue. (*National Mortgage News website*, posted 9/24/99)

### Professional and organized lobbying team

- *National Mortgage News* reported that FM Watch is not simply relying on its member companies for lobbying efforts, but rather has assembled professional lobbying and public relations firms to counter the political weight of Fannie and Freddie. FM Watch Executive Director Mike House, a partner at Hogan & Hartson, is known for coordinating lobbying campaigns. “In the past six months, FM Watch has put together a good team,” House stated. Besides House, the team includes:
  - Haley Barbour, Barbour, Griffith, and Rogers; (Haley Barbour is former Chairman of the Republican National Committee.)
  - Robert Squier of Squier Knapp, Dunn, who is a well-known Democratic political operative and who has close ties to Vice President Al Gore;
  - Tony Podesta of Podesta.com, who is the brother of White House Chief of Staff John Podesta;
  - Ed Gillespie of Policy Impact Communications; a public relations firm.
  - Akin, Gump, Strauss, Hauer and Feld, a well known law firm specializing in lobbying.
- The article notes that **FM Watch has put together an organized lobbying effort.** “These are the kind of people that open doors on Capitol Hill,” said Jake Lewis, a banking specialist for Ralph Nader and a former House Banking Committee staffer. “I would imagine that line up would be able to sit down with a lot of members of Congress who in the past might not have paid a whole lot of attention,” stated Lewis. (*National Mortgage News*, 9/27/99)

**Fannie announces new pilot product - “Timely Payment Rewards” mortgage - that will allow Fannie to expand into the subprime (A-) market**

**Fannie said it plans to target half of all the subprime market (the A- half) with this new product- the other half (B&C market) is not on their current agenda but Raines anticipates that at “some point in the future” they will be able to address the B&C market**

**[No details on whether lenders must use Fannie’s automated underwriting system, Desktop Underwriter, to provide the product to consumers, or whether Fannie will charge delivery fees for this product. Statements made by Fannie Chairman Raines indicate that Fannie’s technology will play an integral role.]**

***New York Times* article notes that Fannie is taking on significantly more risk even if this is just a tentative entrance into this market**

**The National Home Equity Mortgage Association (NHEMA) blasts Fannie’s new product - NHEMA says the product is beyond Fannie’s mission, will drive up costs for consumers (particularly the B&C market), and increases the potential for a taxpayer bailout**

**To build its brand name further, Fannie also announces its largest, most comprehensive advertising campaign -- Raines would not disclose the amount of money to be spent on the advertising campaign but noted that it is “a lot” and one of its most expensive ever**

**Fannie disputes Freddie’s survey linking race with bad credit**

- At a news conference on September 30, Fannie Chairman Franklin Raines announced a new product - “Timely Payment Rewards” mortgage - that will allow Fannie to enter the subprime

market and a new Fannie Mae Foundation advertising campaign. The product will allow borrowers with slightly impaired credit who do not qualify for a lower conventional mortgage. Borrowers who qualify for the product will be able to obtain a mortgage rate as low as 2% lower than what credit-impaired borrowers typically pay, and will be guaranteed a mortgage rate reduction of 1% after 24 monthly payments without a delinquency. The product is currently a pilot program involving 26 banks in 15 markets. Statements of support for the program by the OTS and the MBA were included in Fannie's press release.

- During the press conference, Raines indicated that Fannie plans to use the product to target half of all the subprime market - which he defines as the A- half. The other half of the subprime market, the B&C paper, is not currently on Fannie's agenda, because according to Raines, Fannie does not know enough about this segment of the market, but he anticipates that at "some point in the future" they will be able to address the B&C market. (*National Mortgage News website*, posted 9/30/99; *Fannie press release*, 9/30/99; *Fannie Mae Foundation press release*, 9/30/99; *New York Times*, 9/30/99; *Bloomberg*, 9/30/99; *American Banker*, Joshua Brockman, 10/1/99, oral remarks by Franklin Raines at 9/30/99 press conference)
- According to an article in *Bloomberg*, of the about \$150 billion in loans made to borrowers with spotty or bad credit last year, Fannie estimates that about \$35 billion would have been available for purchase under the new program. The article reports that there are about \$600 billion in such loans outstanding. (*Bloomberg*, 9/30/99)
- [No details were given on whether lenders must use Fannie's automated underwriting system to offer the product, although it appears that Fannie's technology will play an integral role.]  
"Through dramatic improvements in our risk-assessment technology, which enables us to more precisely identify a borrower's risk of defaulting on his or her home, we can say 'yes' to more borrowers and extend our service to them at lower costs," said Fannie Chairman Franklin Raines.
- *New York Times* article notes that Fannie taking on more risk with this program  
Steven Holmes with the *New York Times* wrote that **"In moving, even tentatively, into this new area of lending. Fannie Mae is taking on significantly more risk, which may not pose any difficulties during flush economic times. But the government-subsidized corporation may run into trouble in an economic downturn, prompting a government rescue similar to that of the savings and loan industry in the 1980's."** Peter Wallison, a resident fellow at the American Enterprise Institute was quoted in the article as stating, **"From the perspective of many people, including me, this is another thrift industry growing up around us,"** he stated. **"If they fall, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry."** (*New York Times*, Steven Holmes, 9/30/99)

NHEMA blasts Fannie's new product, saying the product is beyond Fannie's mission, will drive up costs for consumers (particularly the B&C market), and increases the potential for a taxpayer bailout

- According to *National Mortgage News*, NHEMA blasted Fannie's new A- product. **"Fannie Mae is expanding its mission into areas where it has virtually no experience,"** said Jeffrey Zeltzer. **"Many borrowers will pay more, not less, for their mortgages. And taxpayers should be prepared for a bailout that could rival our savings and loan experience."** NHEMA is concerned that Fannie's program, by narrowing the margins on A- paper, will drive up the costs for B&C borrowers. **"The decades of experience and intense competition within the [home equity] industry have led to interest rates and costs that carefully balance the**

**additional risks that accompany this market,” Zeltzer said. “Our industry is committed to holding down the cost of loans for all borrowers.”**

- NHEMA believes that Fannie’s program will have the following consequences:
  - Borrowers who need the most assistance will suffer immediately;
  - Taxpayers will be taking a huge risk; and
  - An effective marketplace could be destroyed by government intervention.
- **“Fundamentally, we don’t believe Fannie Mae’s new program will work,” said Zeltzer. “It will suffer losses that Fannie Mae has never experienced before, especially when our economic growth slows down. And then you will see Fannie Mae back out of the entire program. But at that point, the entire industry serving consumers with less than perfect credit ratings may have been decimated. Then they will be back where they were 25 years ago – no access to mortgages or loans at all, other than loan sharks.”** (*National Mortgage News website*, posted 10/1/99; *NHEMA press release*, 9/30/99)

#### Advertising campaign

- Raines also announced at the September 30 news conference that the company was planning a new Fannie Mae Foundation advertising/educational campaign, “Your Credit Matters,” to inform consumers about the role credit plays in the homebuying process. Raines announced the release of a new brochure for consumers called “Knowing and Understanding Your Credit.” The campaign will be launched on October 4. The advertising campaign, utilizing English and Spanish language media, will air on national broadcast television and cable networks. The campaign also includes a 30-minute educational program that will air on Black Entertainment Television cable network on Sundays at noon EDT starting on October 10 through January 2, 2000. A statement of support by the FTC on the advertising campaign was also included in the press release. Raines would not comment during the press conference on the amount of money the company was spending on the advertising campaign but noted that it is “a lot” of money and one of the most expensive ever. (*National Mortgage News website*, posted 9/30/99; *Fannie press release*, 9/30/99; *Fannie Mae Foundation press release*, 9/30/99; *New York Times*, 9/30/99; *Bloomberg*, 9/30/99; *American Banker*, Joshua Brockman, 10/1/99)

#### Fannie disputes Freddie’s survey linking race and bad credit

- During the press conference, Raines said Fannie disagreed with Freddie’s survey that concludes minority ignorance about credit issues. Fannie presented a chart that showed just the opposite. According to Fannie, of people who had an understanding about credit issues: White-38%; Black-62%, and Hispanic-46%. (Oral remarks at Fannie’s 9/30/99 press conference) (More details on Freddie’s controversial survey available in this *GSE Report*.)

**Fannie Chairman Franklin Raines tells Merrill Lynch Investor Conference that the company intends to double its Earnings per Share (EPS) by the end of 2003**

**Fannie intends to double its EPS growth by – (1) expanding its mortgage portfolio; (2) expanding further into the mortgage market (“non-traditional” products such as subprime, FHA/VA, multifamily, home equity, manufactured housing, and reverse mortgages); and (3) expanding the mortgage debt market**

**To broaden its reach into new markets and lines of business, Fannie is redefining the mortgage market from a \$4 trillion mortgage market (prime conforming conventional) to a \$12 trillion mortgage market to include: prime conforming conventional (the segment the GSEs originally served), home equity (includes home improvement loans), subprime, multifamily, government (FHA/VA mortgages), manufactured housing, jumbo , and seller financed**

**Raines demonstrates how Fannie intends to enter all facets of this \$12 trillion mortgage industry**

**“Non-traditional products [jumbo, government, multifamily, subprime, prime home equity] have accounted for fully one-quarter of this year’s mortgage portfolio growth.” In related news, Fannie purchased a record number of “non-traditional” loans in August**

**Raines discusses his pilot program with Home Depot that allows consumers to apply for home improvement loans right in the store**

- The following are highlights from Fannie Chairman Franklin Raines speech before the Merrill Lynch Investor Conference on September 14, 1999.

#### Expanded mission

- **Raines stated, “Helping home buyers save money is our job, it's our mission, it's why Congress chartered us, and these strategies are well within our charter.”**

#### Earnings will double by the end of 2003

- Raines was unhappy that the market’s view of Fannie differs so much from the analysts that track the company and Fannie’s own analysts. [An *American Banker* article by Joshua Brockman notes that from the beginning of the year through August 13, Fannie’s shares fell 13.4% (*American Banker*, 8/20/99)]
- Fannie’s market share – in terms of mortgage debt outstanding has grown from 14% in 1990 to 23% and the growth in Fannie’s mortgage portfolio (which delivers the majority of Fannie’s net income) – at 17.9% a year – has been more than twice as fast as the overall market. Fannie had its 12<sup>th</sup> consecutive year of record EPS, a feat which only seven companies in the S&P 500 can match.
- Raines believes that Fannie’s EPS growth in 1999 is on track to exceed the company’s 13.6% EPS growth expectation and that the company will double its EPS growth by the end of 2003. Analysts who cover Fannie say the company will double its EPS by 2004, however, the stock market, is saying Fannie’s EPS growth won’t double until November 2005 at the earliest.
- Fannie will double its EPS growth by:
  - (1) growing its mortgage portfolio;

- (2) expanding further into the mortgage market (“non-traditional” products); and
- (3) expanding the mortgage debt market.

(1) Expand its mortgage portfolio

- Raines believes that despite higher mortgage interest rates, home sales will exceed 1998’s record. **Raines notes that Fannie’s mortgage portfolio –which delivers the majority of the company’s net income – had been averaging 17.9% annual growth. However, the mortgage portfolio has grown at an extraordinary annual rate of 29% so far this year.**

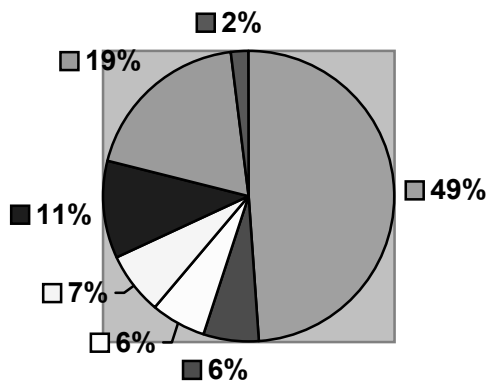
(2) Expanding further into the mortgage market;

- **As redefined by Fannie Mae CEO Frank Raines, “the housing market is an enormous national market, valued at over \$12 trillion, second only to the size of the stock market itself.”** Raines said Fannie currently owns or guarantees about 23% of the mortgage debt market, however, the company plans to expand its market share to 28%.

“Non-traditional products [jumbo, government, multifamily, subprime, prime home equity] have accounted for fully one-quarter of this year’s mortgage portfolio growth.”

Fannie says they’re moving into new areas – “to save consumers money” – [The only market segment Fannie specifically says they cannot enter is the jumbo market -- mortgage loans over \$240,000. Raines, however, notes that “clever lenders” are using piggyback mortgages in loans over \$240,000 that combine a conforming mortgage and a second mortgage and then selling the conforming piece to Fannie.]

\$12 Trillion Mortgage Market:



The following is Fannie Mae’s CEO Frank Raines’ description of the \$12 trillion mortgage market he has redefined, and a review of how Fannie intends to expand into each market segment:

■ Prime Conforming - 49%	■ Prime Home Equity - 6%
□ Subprime - 6%	□ Multifamily - 7%
■ Government - 11%	■ Jumbo - 19%
■ Seller-financed - 2%	

<b>Breakdown of \$12 Trillion Mortgage Market</b>	<b>How Fannie intends to enter each market segment</b>
49% of market -- <b><u>Conforming</u></b>	(Fannie estimates they have 43% of this market share) they will increase their market share in this area by moving into Alt A and ARMs
19% of market -- <b><u>Jumbo</u></b>	Loans aren't available to them over \$240,000 but "clever" mortgage lenders are using piggy-back loans and selling the conforming piece to them.
11% of market -- <b><u>Government (FHA – VA)</u></b>	<b>“Many FHA and VA borrowers could qualify for a Fannie Mae mortgage, and we are going to help them move into our segment of the market and save money. In addition to moving borrowers from the FHA and VA market into the conventional market, we've also stepped up our purchase of government loans, buying \$16 billion so far in 1999 compared to \$6 billion last year.”</b>
6% of market -- <b><u>Subprime</u></b>	“We estimate that about 50 percent of borrowers in the subprime mortgage market are just a notch below qualifying for a low-cost Fannie Mae mortgage.” [With Fannie’s announcement of its “Timely Payment Rewards” product, Fannie is already targeting this 50% slice of the subprime market.]
7% of market -- <b><u>Multifamily</u></b>	Fannie said that although it is the largest investor in multifamily housing, it has room to grow and currently only accounts for 12% of the market. With HUD’s proposal to increase Fannie’s affordable housing goals, “we practically have a government mandate to grow this business aggressively in order to meet the new affordable housing”
6% of market - <b><u>Prime Home Equity</u></b>	<b>“Another way we're going to expand the mortgage debt market is to help consumers capitalize on the equity in their homes for things they need, whether it's reverse mortgages to finance retirement, or home equity loans to expand or improve their homes. For example, we have a pilot with Home Depot stores and some of our lenders where consumers can apply for home improvement loans right in the stores. The demographics for these mortgage products are terrific as Baby Boom families grow and retire. This will move some of the equity side of the \$12 trillion housing market onto the debt side.”</b>

(3) Expanding mortgage debt market

- Fannie said it plans to expand the mortgage debt market. **“Our arena is not just the current \$4.7 trillion debt market but debt currently outside the market and a significant share of the equity part of the \$12 trillion housing market as well,”** he stated.
- **Ways in which Raines sees the company expanded the mortgage debt market is through increasing its business in manufactured housing, reverse mortgages, and home-equity loans.** [Editorial note: Readers should remember that home equity loans are primarily made to predominantly white, middle to higher income *homeowners*. According to the Consumer Bankers Association and the University of Michigan’s Survey Research Center, the most frequent use of

home equity loan proceeds is debt consolidation. Consumers obtain home equity loans and use the proceeds to pay off existing credit card, auto, and other personal debts. Interestingly, using Fannie Mae's estimates, Fannie Mae – on average – will *temporarily* save consumers about \$52 per year/\$1 per week by entering this new line of business, while making billions for their shareholders. Furthermore, 38% of the subprime market is comprised of home equity loans. Contrary to popular public opinion, very few subprime loans are made to minority or low-income homebuyers purchasing a home for their own use.] Raines noted that Fannie had purchased or securitized more than \$8 billion in manufactured housing loans between 1998 and 1999.

#### Using their Monopoly for More Power

- “We will be successful in all of these segments because Fannie Mae is the lowest cost producer in the secondary marketplace,” Raines stated. (*Franklin Raines Speech before the Merrill Lynch Investor Conference, 9/14/99; American Banker, Joshua Brockman, 9/21/99*)

#### Fannie purchased record number of “non-traditional” loans in August

- In related news, *National Mortgage News* reported that Fannie purchased a record number of “non-traditional” loans in November, “a sign that the secondary marketing giant is succeeding in expanding its product mix.” Fannie purchased \$42.54 billion in loans, a 3% increase from August of 1998, and a 13% increase from July. Fannie would not disclose the dollar value of Fannie's non-traditional purchases, however, Jayne Shontell, Fannie Senior Vice President for Investor Relations, said it was a record. Shontell said non-traditional loans included manufactured housing, home equity mortgages, FHA-VA loans, multifamily housing loans, and “Alternative A” mortgages. (*National Mortgage News, Paul Muolo, 9/20/99*)

**Senate votes to fund Fannie & Freddie's safety and soundness regulator, OFHEO, at \$19.5 million for FY 2000 (a 22% increase)**

**The Senate vote reverses an earlier vote by the Senate Appropriations Committee to freeze OFHEO's budget at \$16 million**

**The House also approved the full \$19.5 million increase**

**Senate Banking Committee Chairman Phil Gramm (R-TX), the Clinton Administration, Chairman of the House Banking Capital Markets Subcommittee Cong. Richard Baker (R-LA), and consumer advocate Ralph Nader all supported the 22% increase (full funding of OFHEO)**

**Fannie/Freddie watchdog group, FM Watch, praises Senate for fully funding OFHEO**

**In the future, OFHEO would like to be removed from the annual Congressional appropriations process noting that bank and thrift regulators are not subject to the appropriations process**

#### Increase approved by the Full Senate

- On September 24, the Senate approved full funding for OFHEO at \$19.5 million for Fiscal Year 2000 (a 22% increase over Fiscal Year 1999) per an amendment offered by Senate Banking Committee Chairman Phil Gramm (R-TX). The amendment was included in a manager's amendment to the FY 2000 VA-HUD Appropriations bill (S. 1596). The Senate approved the manager's amendment and the bill on September 24.

### The Senate's vote reverses a decision made earlier by VA-HUD Subcommittee and Senate Appropriations Committee not to increase OFHEO's budget

- The Senate's vote on September 24 reversed a Senate Appropriations Committee vote a week earlier that froze OFHEO's budget at \$16 million (same as Fiscal Year 1999). The VA-HUD Subcommittee and the Senate Appropriations Committee voted on September 15 and September 16, respectively, to set OFHEO's budget at its third straight year of \$16 million. A spokesman for Senator Christopher Bond (R-MO), who introduced the VA-HUD bill, said that Senator Bond did not think OFHEO's budget increase was necessary. The spokesman further noted that Senator Bond believes OFHEO was designed to be an early warning system, not a full-blown agency, and therefore did not need more resources.

### VA-HUD bill will now go to conference

- The House VA-HUD bill (H.R. 2684), approved by the House on September 9, contains a 22% budget increase for OFHEO. The Senate VA-HUD bill will now go to conference with the House version (H.R. 2684) to reconcile differences between the two bills.

### Senator Gramm supports increasing OFHEO's budget

- According to Senator Gramm's spokeswoman Christi Harlan, Senator Gramm thinks the proposed \$3.5 million increase is a "pretty small premium to pay," she said, for an agency that oversees two GSEs with \$2 trillion in assets and debt obligations.

### Clinton Administration supports increasing OFHEO's budget

- In a September 22 policy statement on the VA-HUD Appropriations bill, the Clinton Administration said that denying OFHEO's \$3.5 million budget increase "could have serious implications for the safety and soundness of the GSEs by denying implementation of the proposed risk-based capital standards and straining OFHEO's ability to conduct risk-based examinations."
- As reported in previous *GSE Reports*, Cong. Richard Baker (R-LA) and consumer advocate Ralph Nader both support full funding of OFHEO's budget request.

### Background

- The Office of Federal Housing Enterprise Oversight (OFHEO) requested \$19.5 million for Fiscal Year 2000, a \$3.5 million increase (22% increase) over Fiscal Year 1999's budget of \$16 million. OFHEO said the additional funds would pay for 14 new positions and \$2 million was earmarked for two technology initiatives: (1) a data warehouse to help complete OFHEO's risk-based capital stress test and; (2) an online surveillance system. OFHEO warned that if the agency did not receive the 22% increase, it would have impeded its ability to finalize the risk-based capital rule for Fannie and Freddie.

### OFHEO says it needs the increase to keep up with the extraordinary growth of Fannie & Freddie

- OFHEO's Acting Director Mark Kinsey wrote a letter to Senator Christopher "Kit" Bond, Chairman of the Subcommittee on Veterans Affairs and HUD, asking him to reconsider the 22% budget increase.
- To deny the increase "will endanger OFHEO's ability to ensure that Fannie Mae and Freddie Mac are adequately capitalized and operating in a safe and sound manner," Kinsey wrote. Kinsey warned that freezing OFHEO's budget at \$16 million "unnecessarily increases the risks posed to the taxpayers." He also noted the GSEs' retained portfolios of mortgages and mortgage-backed securities, where interest rate risk is concentrated, have grown by over 40% in the last year.

**Kinsey further noted that Fannie and Freddie manage credit risk on \$2 trillion worth of residential mortgages, approximately 45% more than the residential mortgage credit risk managed by the entire bank and thrift industry.**

OFHEO would like to be removed from the appropriations process

- Although OFHEO is subject to the appropriations process, it is not funded by taxpayers. It is funded entirely through fees levied on Fannie and Freddie. OFHEO's budget is submitted to Congress along with that of the HUD. OFHEO believes that the Senate Appropriations Committee and the VA-HUD Appropriations Subcommittee's decision not to increase OFHEO's already lean budget request of \$19.5 million shows the need to remove OFHEO from the appropriations process. Kinsey noted that OFHEO's budget has remained flat in recent years while its responsibilities have increased dramatically. **Kinsey noted that bank and thrift regulators, unlike OFHEO, are not subject to the appropriations process.** (*American Banker*, Joshua Brockman, 9/20/99, Scott Barancik, 9/27/99; *BNA Daily Report for Executives*, Marc Selinger, 9/16/99, 9/21/99, 9/27/99; *National Mortgage News website*, posted 9/23/99; *Wall Street Journal Interactive*, John Connor, 9/17/99, 9/23/99, 9/24/99)

Fannie/Freddie watchdog group, FM Watch praises Senate decision to fully fund OFHEO

- FM Watch praised the Senate for fully funding OFHEO, as part of the larger appropriations bill on September 24. "At a time when Fannie Mae and Freddie Mac are growing by leaps and bounds, a fully-funded OFHEO is critical. The agency plays the vital role of regulating the safety and soundness of the two government-sponsored enterprises," said Mike House, Executive Director of FM Watch. (*FM Watch press release*, 9/29/99)

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

**FHA is in the process of modernizing its multifamily refinancing program to make it more competitive with Fannie & Freddie**

- FHA Commissioner William Apgar stated that the FHA is in the process of modernizing the multifamily refinancing program to make it more competitive with Fannie and Freddie. Over the next 30-60 days, for example, FHA will announce underwriting changes to its refinancing program to make it more attractive to borrowers. (*National Mortgage News*, 9/20/99)

**Although Fannie & Freddie market their global debt issues (Fannie-Benchmark notes; Freddie-Reference notes) as substitutes to Treasuries ---- swaps, not GSE debt, are emerging as the next new benchmark alternative to Treasuries**

***Dow Jones* article notes that Fannie & Freddie's callable benchmark debt securities are struggling in comparison to its non-callable program**

- According to a *Wall Street Journal Interactive* article by Sarah Landis and Dena Aubin, the dwindling supply of Treasury debt has forced investors, dealers and traders to seek more reliable guidepoints for "benchmarks," against which other instruments such as mortgage-backed securities, agency debt, corporate bonds or asset-backed securities – can be gauged. Possible alternatives to Treasuries include swaps, government-sponsored agency debt, and highly-rated corporate debt. The article reports that so far, swaps have become the most viable alternative to

Treasuries. The article notes that in the swaps or derivatives markets, transactions are keyed off of well-known interest rates like the Libor.

- **According to Jack Malvey, Chief Global Fixed-Income Strategist for Lehman Brothers, GSE debt doesn't have a sufficient maturity to serve as a benchmark, since the most liquid GSE issues go out to only 10 years. And many issues are callable, "which creates noise in terms of a common yardstick," he said. Prabhu Palani, Principal in Fixed-Income Product Management for Barclays Global Investors noted that GSE debt issues stumbled during last year's liquidity crisis, as their spreads widened along with other credit-sensitive issues. "It's important for a benchmark to be only interest-rate sensitive and not sensitive to credit risk," said Palani. "Unfortunately, agencies proved to be both." Richard Ciccarone, Co-Director of Municipal Investments at Van Kampen American Capital noted that agency debt could also run into trouble if there were deep recessions in the real estate market. (*Wall Street Journal Interactive*, Sarah Landis and Dena Aubin, 9/13/99, 9/10/99)**

#### Agency callable securities are struggling

- According to an article by Shella Calamba with *Dow Jones Newswire*, Fannie and Freddie callable debt securities are "cheap," however "the sector has so far failed to drum up the kind of demand that so-called 'bullet,' or noncallable, bonds generate." While the agency market has tightened sharply across the board recently, traders say callables have lagged bullet notes by 10 basis points. Calamba noted that when Fannie and Freddie introduced their callable notes in April, there were many investors who purchased the products against mortgages. According to analysts, this strategy backfired when spreads in the sector gapped out in June and July. "People unwound the trade at a loss to get it off their books," said Stuart Sparks, Agency Debt Strategist at Lehman Brothers. Traders and investors said the differential between agency callables and bullets isn't enough to convince them to jump back into a sector that is less liquid. (*Dow Jones Newswire*, Shella Calamba, 9/24/99)

#### **Senate approves Armando Falcon as the new director of OFHEO (Fannie & Freddie's safety and soundness regulator)**

##### **OFHEO has been without a permanent director for the past two years**

- After months of waiting, the Senate voted on September 29 to approve Armando Falcon as the Director of OFHEO. President Clinton nominated Falcon for the OFHEO position back in January. Falcon, who has been working as a consultant for OFHEO since September of 1998, will serve a five-year term at OFHEO. Mark Kinsey has served as OFHEO's acting director since February of 1997 when Aida Alvarez left to head the Small Business Administration. According to *Real Estate Finance Today* article, Falcon will be only the second director of OFHEO since the office was created in 1992.
- During a Senate Banking confirmation hearing on August 5, Falcon testified that his eight years of legal experience at the House Banking Committee, and three years as general counsel, made him qualified to head OFHEO. "Much of my time with the House Banking Committee was spent working on financial institution safety and soundness issues," stated Falcon. He stated that he recognized the important role of Fannie and Freddie to the nation's housing market and said the creation of OFHEO in itself is an example of the federal government's recognition of the need to ensure the long-term financial health of the government-sponsored enterprises."

- Falcon believes that OFHEO is an important juncture in its development. “First, the agency has issued a risk-based capital standard for public comment. OFHEO needs to carefully consider all comments and move towards implementation of a final rule, as required by Congress,” he stated. “Second, last year OFHEO completed a new, comprehensive approach to annual risk-based examination of the enterprises. The agency must now assess the need for any changes in the program,” he stated. “And finally, OFHEO is developing a state-of-the-art surveillance and monitoring system as part of its examination program. This system needs to be fully integrated with the risk-based capital standard and OFHEO’s research and analysis responsibilities. These are just some of the immediate challenges the next director will face.”
- According to a *BNA* article, Falcon received praise from Senator Paul Sarbanes (D-MD), the Committee’s ranking Democrat. Sarbanes stated that Falcon would bring an “impressive set of credentials to the job” and is “eminently qualified.” Sarbanes further stated that Falcon’s experience as a congressional aide “sort of alerts you to what our concerns are.” (*BNA Daily Report for Executives*, Marc Selinger, 8/6/99; *Real Estate Finance Today*, Gwendolyn Glenn, 8/6/99; *Dow Jones Newswire*, John Connor, 9/30/99; *American Banker*, 9/24/99, 10/1/99; *National Mortgage News website*, posted 9/23/99)

<p><b>HUD drops its investigation into allegations that Fannie pressured underwriters not to do business with Freddie</b></p>
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- According to Jerry Guidera with *Dow Jones Newswire*, HUD has dropped its investigation into allegations that Fannie “strong-armed” dealers not to do business with Freddie. In May of this year, HUD announced that it would investigate the accusations. William Apgar, HUD’s Assistant Secretary for Housing, said HUD found no reason to further pursue the issue after four months of investigation. “We clearly had the authority to look into it and we did,” he said, “but we found nothing actionable in our review.”
- The issue revolved around a series of competing benchmark deals in late April, in which the two companies sold more than \$7 billion of new bonds in just a few days of each other. The bonds were sold under Fannie’s callable Benchmark Note program and Freddie’s callable Reference Note program.
- Reportedly, Merrill Lynch, which was hired to manage Freddie’s first debt offering under its large callable Reference Note program, publicly pulled out of leading the deal after announcing its role in the Freddie transaction. According to sources close to the situation, Merrill backed out of the deal “because of pressure from Fannie Mae.” J.P. Morgan was also said to have had its business curtailed with Fannie because the company worked on a Freddie offering that competed with a similar offering with Fannie.
- As Guidera noted, Fannie and Freddie “were said to have carried their rivalry in the secondary mortgage market to the trading floors of Wall Street, fighting to out-manuever each other at every step and stepping on some of New York’s largest and most powerful financial firms.” Guidera notes that after press reports of the competition erupted, dealers said relations between the underwriters and Fannie and Freddie returned to normal. (*Dow Jones Newswire*, Jerry Guidera, 5/20/99, 5/21/99, 9/17/99)

## Morgan Stanley Dean Witter is the #1 agency underwriter

- According to a *Dow Jones Newswire* article by Shella Calamba, Morgan Stanley Dean Witter is the #1 agency debt underwriter for the first nine months of 1999. Formerly top-ranked Goldman Sachs dropped to #5 in rankings. The rankings were released by Thomson Financial Securities Data.
- Morgan Stanley was credited with \$56.6 billion of volume, a 57.9% increase from the \$35.9 billion the firm underwrote in the comparable 1998 period. The company's underwriting volume in the third quarter increased sharply, rising to \$15.1 billion from just \$9.6 billion in the 1998 quarter. (*Dow Jones Newswire*, Shella Calamba, 9/30/99)

## Fannie Mae

### "Fannie Mae buys Countrywide. Just Kidding, But..."

- A *Mortgage Servicing News* article by Paul Muolo reported on the recent "alliance" agreement between Fannie and Countrywide that has the mortgage industry "marveling at what an amazingly good deal Countrywide struck." **Some mortgage players are even noting privately that Countrywide's deal was so good that it looked like Fannie was making Countrywide...an operating affiliate. "I read the press statement," said one Countrywide competitor, "and I have to tell you if you read the thing a few times it looks like Fannie's buying them."** Muolo noted that a stock analyst made a similar comment. "Countrywide is deriving great benefits from Fannie instead of a change in the guarantee fee. Fannie Mae is helping them a lot."
- Muolo notes that details of the alliance agreement are confidential, however there are some details that are public. Countrywide can securitize servicing through Fannie and receive cash "up front" while reducing the amount of capital it has to hold against its housing receivables. By using Fannie's MORNETPlus technology pipeline, Countrywide can also expand its third-party services such as appraisals, and title insurance and the two companies will work to expand Countrywide product base and distribution network. Fannie has also agreed to explore strategies related to Countrywide's Balboa Insurance Group and Countrywide Securities Corp. - a broker-dealer subsidiary which will now have a position in the Fannie medium-term note dealer group.
- **Muolo writes, "Fannie Mae helping out on insurance. Countrywide getting a position in the dealer group? Soon, Countrywide will be selling Fannie Mae stock through its branches. (That's my idea, by the way.) Becoming part of the dealer group is no small matter. Fannie Mae is a frequent seller of debt instruments. The larger Fannie grows the more debt it will sell. Yes, it's Christmas in July for Countrywide."** (*Mortgage Servicing News*, Paul Muolo, August 1999)

**Fannie's President and Chief Operating Officer Lawrence Small, two years shy of his planned retirement, plans to resign in early 2000 to become Secretary of the Smithsonian Institute**

**Small was paid approximately \$4.2 million plus bonuses last year**

### **Fannie begins nationwide search for replacement**

- Fannie announced that its President and Chief Operating Officer Lawrence Small will step down in early 2000 to become Secretary of the Smithsonian Institute. Small, 58, joined Fannie in September 1991. Prior to working at Fannie, Small was Vice Chairman of Citicorp/Citibank, where he worked for 27 years. According to the *American Banker*, Small was two years away from his planned retirement.
- According to the *New York Times*, Small was paid \$4.2 million last year. The *American Banker*, reported that Small was paid approximately \$4.25 million plus bonuses last year.
- Fannie has begun a nationwide search to fill the position. The company has retained Tom Neff, Chairman of Spencer Stuart USA, an executive firm, to assist in the evaluation of internal and external candidates to replace Small. (*American Banker*, Hala Habal, 9/21/99; *Associated Press*, 9/14/99; *Bloomberg News*, 9/13/99; *Dow Jones Newswire*, 9/13/99; *Fannie press release*, 9/13/99; *National Mortgage News website*, posted 9/14/99; *New York Times*, 9/20/99; *Reuters*, 9/13/99; *Wall Street Journal Interactive*, 9/14/99)

### **Waterfield Mortgage, which just signed an agreement with Fannie moves Fannie's automated underwriting system, Desktop Underwriter, from the back office to the point-of-sale**

#### **Fannie is changing its role by expanding its technology to the front-end of the origination process**

- [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 and loan officers to secure and complete mortgage loan applications. However, now that Fannie and Freddie are trying to establish themselves as the source for automated underwriting technology, they are circumventing lenders and moving from the back-office to the front-office point-of-sale – controlling more of the origination process and moving closer to consumers.]
- According to *National Mortgage News*, as part of its recent agreement with Fannie, Waterfield will be involved in testing improvements to Fannie's automated underwriting system, Desktop Underwriter, and will be included in Fannie pilot programs. "This agreement will give us the opportunity to combine our own laptop origination systems with Fannie Mae's Desktop Underwriter to provide the next generation in point-of-sale approval functionality," stated Dan Cutaia, Waterfield's Vice President of Product Risk Management. Until now, Waterfield's use of Fannie's Desktop Underwriter has been through its back office. Now the company is planning to put it at the point-of-sale, by running through the loan officer's laptops. Cutaia said the goal for implementing this change is for February 2000. All of Waterfield's retail production is reportedly taken on laptops. (*National Mortgage News*, 9/13/99)

### **Fannie announces that it will set aside portions of its Benchmark note and bond sales for minority and women-owned securities firms (provided they are participants in Fannie's "Access" program)**

#### **Fannie steers business to those companies that participate in Fannie's programs – Debt will be specifically set aside for these companies**

## Fannie is the largest corporate issuer of debt

- Fannie announced that it would set aside portions of its Benchmark note and bond sales for minority- and women-owned securities firms. According to a *Fannie press release*, the securities firms must be participants in Fannie's "Access" initiative. The Access program, according to Fannie, is aimed at increasing participation by minority and women-owned firms in the market for Fannie debt.
- According to *Bloomberg*, Fannie is the largest corporate issuer of debt. Since January 1998, Fannie has sold \$88 billion in Benchmark notes and bonds. Fannie estimates that the minority- and women-owned firms could sell upwards of \$2 billion in Benchmark bonds and notes next year, depending on Fannie's borrowing needs. Fannie expects to sell \$160 to \$170 billion in debt this year and a similar amount next year.
- The firms that are participants in the "Access" initiative "will be regular participants in the sale of Fannie Mae's Benchmark notes and bonds, our largest debt deals," stated Fannie Chairman Franklin Raines. The firms participating in "Access" have already sold \$113 billion in debt since the program began operation in 1993. **According to *Bloomberg*, the difference now is that debt will be specifically set aside for them.** From now on, the selling group for each Benchmark issue or re-opening will include five to seven minority or women-owned firms that are part of Fannie's "Access" program; and these "Access" firms will be eligible for consideration as a Benchmark Notes co-manager if specific performance criteria are met over a period of time.
- The following women- and minority-owned firms are members of Fannie Mae's "Access" program: Berean Capital, Inc., Chicago, IL; Blaylock & Partners, L.P., New York, NY; Gardner Rich & Company, Chicago, IL; Jackson Securities, Inc., Atlanta, GA; Myerberg & Company, L.P., New York, NY; Ormes Capital Markets, Inc., New York, NY; Pryor, McClendon, Counts & Co. Inc., Philadelphia, PA; Redwood Securities Group, Inc., San Francisco, CA; Robert Van Securities, Inc., Oakland, CA; SBK-Brooks Investment Corporation, Cleveland, OH; Siebert Brandford Shank & Company, San Francisco, CA; Utendahl Capital Partners, L.P., New York, NY; The Walton Johnson Group, Inc., Dallas, TX; The Williams Capital Group, L.P., New York, NY (*Bloomberg News*, 9/16/99; *Fannie press release*, 9/16/99; *National Mortgage News website*, posted 9/17/99; *American Banker*, 9/28/99)

## Expanding outside its housing mission, Fannie invests \$1.2 million in a shopping center

- According to a *Miami Herald* article, Fannie invested \$1.2 million from its American Communities Fund in the Shoppes of Liberty City, a 79,000-square-foot shopping center. Redevco Enterprises invested another \$1.2 million in the project and the balance of the \$8 million projects was funded by loans from SunTrust Bank and Eastern National Bank. (*Miami Herald*, 9/24/99; *Fannie press release*, 9/22/99)

## For those borrowers who place a deposit, Fannie's San Antonio Partnership Office will provide matching funds

- According to an article in the *San Antonio Express-News*, a non-profit group, Los Vecinos de las Misiones, has partnered with the Fannie Mae San Antonio Partnership Office to offer a matching-funds program. For someone who wants to buy a house and places a deposit, Fannie will match the

amount, said Aurora Ortega-Geis, Director for Fannie's San Antonio Partnership Office. (*San Antonio Express-News*, 9/22/99)

**First reverse mortgage securitization is successful (securitization arranged by private sector)**

**Lenders may be more likely to pool loans for securitization as opposed to selling them off on an individual basis to Fannie**

- After Financial Freedom Senior Lending Corp.'s \$317 million reverse mortgage securitization in August, the asset-backed securitization marketplace can expect similar deals. (Lehman Brothers arranged the transaction.) A source familiar with the transaction stated "A lot of issuers who previously thought reverse mortgages were difficult to securitize are talking about doing it," a source said. According to an article in *National Mortgage News*, the Financial Freedom – Lehman Brothers' securitization was believed to be the first securitization of a US reverse mortgage portfolio. Reverse mortgage transactions have previously existed internationally. (A reverse mortgage allows homeowners 62 and older to tap the value of their home by getting a loan that does not have to be repaid until they sell the property or die.)
- According to *Asset Sales Report*, lenders have traditionally sold their reverse mortgage loans individually to Fannie, which currently holds the largest portfolio of reverse mortgages. When asked whether Fannie was interested in securitizing these loans, an official with Fannie said it plans to continue holding the loans in portfolio. The article notes, however, that in light of the successful Financial Freedom reverse mortgage securitization, lenders may be more likely to pool loans for securitization instead of selling them on a individual basis. "Securitizing would allow some derivatives in expanding the product menu," said a source for the article, adding that with current conditions, reverse mortgage providers are somewhat limited as to whom they finance. "Securitization would just open up our loans to younger buyers, things that Fannie Mae would not buy, but are appealing to us." (*Asset Sales Report*, 9/20/99; *Bloomberg News*, 9/22/99; *National Mortgage News*, Bonnie Sinnock, 8/30/99)

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

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

- According to a listing on Fannie's website, the company currently has 34 partnership offices "officially" operating. Fannie has announced plans to open or commitments to open partnership offices in the following areas: Columbia, SC; South Dakota; Milwaukee, WI; Bismarck, ND; Pittsburgh, PA; Newark, NJ; Nashville, TN; Salt Lake City, UT and Cheyenne, WY. In a speech before the Long Island Housing Partnership's Annual Meeting, Fannie Chairman Franklin Raines stated that Fannie hopes to expand to 45 partnership offices around the country by the end of the year. (*Fannie Chairman Franklin Raines speech before the Long Island Housing Partnership Annual Meeting*, 6/18/99)

Fannie names new Chief Program Officer for its DC Partnership Office

- Fannie named Charles Jones, Chief Program Officer for Fannie's District of Columbia Partnership office. Prior to this post, Jones was the Deputy Director of Fannie's New York City Partnership

Office. Before that, Jones was Vice President of the Federal Home Loan Bank of New York, and the principal insurance officer for the New York City Rehabilitation Mortgage Insurance Corporation. (*Fannie press release, 9/17/99*)

Congresswoman Eleanor Holmes Norton, DC Mayor Anthony Williams

- Fannie held a press conference with the above officials on September 29 to announce the opening of a new community – The Townhomes at Oxon Creek, a newly constructed 210-home community. The development was funded through a partnership between Fannie, Bank of America, and the District of Columbia. Fannie Chairman Franklin Raines participated in the event. Fannie made a \$2.7 million equity investment in the development. The Townhomes start in the low \$100,000s. (*PR Newswire, 9/27/99*)

Cong. Eva Clayton (D-NC), Cong. Walter Jones (R-NC), Cong. Bob Etheridge (D-NC), Cong. Mike McIntyre (D-NC)

- Fannie issued a press release announcing mortgage relief for hurricane victims in North Carolina. On a case-by-case basis, Fannie will provide lenders the discretion to help borrowers in several ways, including suspending mortgage payments for up to three months, reducing the payments for up to 18 months, or in more special cases, creating longer loan payback plans. Statements from the above officials were included in the press release. (*Fannie press release, 9/20/99*)

Cong. Doug Bereuter (R-NE), Lt. Governor Dave Maurstad, and Lincoln Mayor Don Wesely

- Fannie held a press conference with the above officials to dedicate a new housing development in southwest Lincoln, NE. The residences are available for those earning at or below 60% of the area's median income (\$31,800). (*Fannie press release, 9/20/99*)

Cong. Julia Carson (D-IN) and Indianapolis Mayor Stephen Goldsmith

- Fannie issued a press release to announce that it had purchased \$18 million in bonds from the City of Indianapolis to create 924 affordable apartment units. Statements by the above officials were included in the press release. (*Fannie press release, 9/16/99*)

Cong. Ken Lucas (D-IN) and the Campbell County, Boone County, and Kenton County Judges/Executives

- Fannie issued a press release to announce a \$8.3 million bond financing agreement between Fannie and the Campbell, Boone, and Kenton Counties. Fannie has agreed to purchase an \$8.3 million single-family, tax-exempt mortgage revenue bond issued by the three Northern Kentucky Counties. The bond proceeds are available through seven mortgage lenders. Statements of support by the above officials were included in the press release. (*Fannie press release, 9/22/99*)

Senator Jeff Bingaman (D-NM)

- Fannie issued a press release to announce a partnership with the National Council of La Raza. Up to \$5 million of the initiative's funds will be available to New Mexico residents through First Security Bank and Pioneer Savings. A statement by Senator Bingaman was included in the statement. (*Fannie press release, 9/20/99*)

Cong. Nydia Velazquez (D-NY)

- Fannie held a press conference with Congresswoman Velazquez to present a \$30,000 grant to the Hispanic Federation of New York to launch an employer-assisted housing initiative. (*Fannie press release, 9/20/99*)

#### Cong. Nick Lampson (D-TX)

- Fannie issued a press release to announce a \$10 million mortgage revenue bond agreement with the Jefferson County Housing Finance Corporation. Fannie purchased the \$10 million single, tax-exempt mortgage revenue bond issued by the Jefferson County HFC. A statement by Cong. Lampson was included in the press release. (*Fannie press release, 9/23/99*)

#### Congresswoman Carrie Meek (D-FL)

- Fannie issued a press release to announce that it had invested \$1.2 million from its American Communities Fund for the Shoppes of Liberty City, a 79,000-square-foot shopping center. Redevco Enterprises invested another \$1.2 million in the project and the balance of the \$8 million projects was funded by loans from SunTrust Bank and Eastern National Bank. A statement by Cong. Carrie Meek was included in the press release. (*Miami Herald, 9/24/99; Fannie press release, 9/22/99*)

#### Chicago Mayor Richard Daley, Alderman Daniel Solis

- Fannie held a press conference with the above officials to announce that the company has committed more than \$1 billion as part of its “HouseChicago” program. Fannie Chairman Frank Raines was present at the conference as well as Paul Swan, Vice Chairman of Bank One Mortgage. Fannie also unveiled its New Immigrants Initiative, which includes down payments as low as 3% for eligible working, non-permanent residents who have applied for greed cards. (*Fannie press release, 9/29/99; Chicago Tribune, 9/28/99*)

#### Detroit Mayor Dennis Archer

- Fannie held a press conference with the Mayor Archer, City Council President Gil Hill, and Bank One Mortgage Company to announce a new revised law – Pre-Sale Inspection Ordinance – that will allow all one and two unit residential properties in the City of Detroit to be sold on an “as is” basis. Under the previous requirements, the seller or absentee landlord was required to bring the home “up to code” prior to transfer. The repeal of the 20-year old law was a high priority of the Empowerment Zone financial Institutions Consortium, comprised of Bank One Mortgage, National City, Standard Federal, First Independence, Comerica and the Detroit Board of Realtors. The press conference was held at a newly rehabbed home developed through the work of non-profit, U-Snap-Bac. [It is not clear why Fannie hosted the press conference since they were not one of the companies whose high priority was repealing the law. Fannie also was not involved in the rehab of the home where the press conference was located. However, Mayor Dennis Archer is a member of Fannie’s National Advisory Council.] (*Fannie press release, 9/21/99*)

<p><b>Women’s World Cup soccer champion Mia Hamm will lead the Fannie Mae Foundation’s Help the Homeless Walk</b></p>
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- According to the *Washington Post*, Mia Hamm will lead the Fannie Mae Foundation’s Nov. 20 Help the Homeless Walk. (*Washington Post, 9/29/99*)

## ***Freddie Mac***

### **Freddie expanding into subprime business**

**Freddie has guaranteed or “wrapped” 19 subprime deals valued at approximately \$5 billion since it started its program in 1997**

**Fannie denies that they are interested in guaranteeing or “wrapping” subprime deals**

**One trader notes that Fannie and Freddie are “very, very big investors in AAA securities backed by B&C loans”**

- According to an *American Banker* article by Joshua Brockman, large mortgage lenders are using Wall Street securitization, to increase their subprime lending efforts, underscoring an increased role of Fannie and Freddie. Traders say that both Fannie and Freddie have been investing in subprime securities, and Freddie has gone a step further, providing guarantees, or “wraps” on the subprime loans being sold.
- The article noted that Freddie guaranteed two recent large deals – a \$411 million deal and a \$794 million deal. The \$411 million securitization deal was of loans originated by Norwest Mortgage and securitized by Greenwich Capital Markets. The \$794 million securitization was of loans originated by Ameriquest Mortgage and securitized by Lehman Brothers.
- According to Faith Schwartz, Director of Alternative Markets at Freddie, the company has done five “T-series” or subprime deals this year valued at \$3 billion. The company has done 19 deals valued at approximately \$5 billion since its inception of the program in 1997. In addition to Norwest and Ameriquest, Freddie has also worked with First Union Corp., New South, BankBoston Corp, and Option One Mortgage Corp. on deals.
- Fannie said it does not plan to provide subprime guarantees. “We have not engaged in doing B&C wrappers,” said Frank Demarais, Vice President for Product Development. “We’re not transacting business with what would be considered the subprime community.”
- A trader in the article noted that Fannie and Freddie were “very, very big investors” that buy AAA securities backed by B&C loans. “By investing in that sector, they’ve had a much greater impact than their involvement as a credit provider, or wrap provider,” he said. (*American Banker*, Joshua Brockman, 9/10/99)

### **Freddie purchases the largest tranche (\$600 million) of a recent \$ 1 billion GMAC Commercial Mortgage deal**

***American Banker* article notes that Freddie is exposed to the entire pool of commercial properties in the \$1 billion deal, not just the apartment loans that Freddie purchased – the deal is backed by a diverse pool of properties – including shopping centers, office buildings, apartment houses, hotels, and warehouses**

**Some institutional investors were upset that all of the multifamily loans in the deal were set aside for Freddie**

**Freddie's implied guarantee from the US government gives it low borrowing costs, so it could afford to accept a lower spread than other investors**

- According to an article by Marc Hochstein in the *American Banker*, GMAC Commercial Mortgage sold \$1 billion of securities in late August that were backed by real estate loans, of which, Freddie reportedly purchased all of the largest tranche – the \$600 million of class A-2 bonds. Hochstein noted that the bonds “appeared to be tailor-made” for a GSE. A diverse pool of properties including shopping centers, office buildings, apartment houses, hotels and warehouses backed GMAC's deal. However, the tranche purchased by Freddie (the class A-2) only receives cash flows from the apartment loans, although Freddie is exposed to the entire pool of commercial properties, not just the apartment buildings. Fitch IBCA said the deal is structured so that losses or shortfalls in interest payments would be allocated pro rata among the AAA classes.
- The article noted that multifamily loans are considered one of the safer types of commercial mortgages, and some market sources were upset that all of the multifamily loans in the deal were set aside for Freddie. Pricing on the tranche that Freddie purchased was not disclosed, however, the article noted that the deal made it harder to sell the other two AAA-rated GMAC tranches which were priced less favorably than other similar tranches in the market priced the same day. The article noted that “Freddie's implied guarantee from the US government gives it lower borrowing costs, so it could afford to accept a lower spread than other investors.” (*American Banker*, Marc Hochstein, 9/14/99)

**Freddie and GMAC Commercial Mortgage completed a Freddie/GMAC direct pay credit enhancement for \$188.4 million in tax-exempt bonds and financed \$37.1 million in conventional mortgages**

**The deal was done with three companies, all of which were owners of luxury apartment communities**

- Freddie, GMAC Commercial Mortgage, Moran & Company, Fairfield Residential, and Sares Regis Group completed a Freddie Mac/GMAC direct pay credit enhancement substitution for \$188.4 million in tax-exempt bonds and financed \$37.1 million in conventional mortgages. Moran/Fairfield, owners of three luxury apartment communities in San Diego County completed a Freddie direct-pay letter of credit substitute for \$108.8 million of tax-exempt bonds and \$21.5 million in conventional mortgages. Moran/Sares Regis, owners of three luxury apartment/townhome communities in south Orange County completed a direct-pay letter of credit substitution for \$79.5 million of tax-exempt bonds and \$15.5 million in conventional mortgages. The Freddie Mac/GMAC direct-pay credit enhancements were issued for 23 years and provide the owners with a AAA credit rating for the tax-exempt bonds. (*Freddie press release, 9/20/99; National Mortgage News website, posted 9/21/99*)

**Freddie survey finds that conforming loan market has lower and more uniform mortgage rates than the jumbo market (outside Fannie & Freddie's statutory limit)**

**Some questioned Freddie's assertion about pricing in the conforming market**

**Others noted that the jumbo market is smaller and does not have the implied government guarantee that Fannie & Freddie enjoy in the conforming market**

**Mortgage banking company asserts that Fannie & Freddie are adding fees**

- A Freddie survey of 76 lenders found that there are lower and more uniform mortgage rates in the conforming loan market than the jumbo market (larger than \$240,000 and outside Fannie and Freddie's statutory limit). According to Freddie, when mortgage interest rates peaked in early August, conforming 30-year mortgage rates topped 8.15% and jumbo mortgages were 8.46%. The survey also found that the 30-year fixed-rate jumbo loans required a family to pay 1% of the loan amount in fees and points and had interest rate quotes ranging from 7.88% to 8.88%. According to Freddie, the jumbo market represents approximately 20% of the dollar volume of new conventional mortgages in 1999, at about \$231 billion. Frank Nothaft, Freddie's Deputy Chief Economist stated that "Because per-dollar loan production and servicing costs decline with loan size, jumbo loans should carry lower interest rates all the same... The fact that conforming rates are substantially lower is a testament to the efficiencies that Freddie Mac brings to the conforming loan market."
- According to the *American Banker*, there were some that questioned Freddie's pricing assertions for the conforming market. According to HSH Associates, the national average for conforming loans in the week that ended August 27 was 7.78% for loans with 0.88 points, but rates from three cities demonstrate that conforming rates do vary. "You do find variations in pricing from market to market," said Keith Gumbinger, Vice President at HSH. "That is the nature of an open, free marketplace."
- William Denton, Vice President for Secondary Market at PNC Mortgages noted that with the mortgage market slowing down and a 40% drop in most lenders' pipelines, "the adjustable-rate mortgage volume is picking up and the fixed rate volume is declining." **Denton stated that in the midst of this, Fannie and Freddie are adding fees similar to those in the private market. He stated, "Now the agencies are starting to adopt expanded loan-to-value risk-based pricing strategies." "It's a way for them to buy more loans, he stated, "but also a way for them to make more income."**
- The jumbo market is "a smaller market, it does not have the implied government guarantee, and the buyers are not exactly uniform," said Peter Paul, President of Headlands Mortgage Co. (*Freddie press release, 9/3/99; American Banker, Joshua Brockman, 9/9/99; National Mortgage News website, posted 9/7/99*)

## **Bank of America will lend \$1 billion in affordable housing mortgages in Oakland, CA**

### **Freddie has agreed to purchase the loans**

- Bank of America has committed \$1 billion in home loans in Oakland, CA over the next five years. Freddie has agreed to purchase the loans. Freddie will also try to sell homes to nonprofit groups who then rent to tenants with an option to buy within three years. Freddie will operate two information centers in Oakland to guide prospective homebuyers through the process. The city of Oakland is expected to pay \$500,000 in mortgage insurance for the program. The Oakland alliance concentrates on seven neighborhoods and seeks to help 10,000 additional families buy homes. Besides Bank of America and Freddie, the alliance includes the city of Oakland, the Home Buyer Assistance Center, the Low Income Housing Fund, the Local Initiatives Support Corp. and other nonprofit groups. Bank of America's Neighborhood Advantage Credit Flex and Zero Down mortgage products will be made available to moderate- and low-income homebuyers. (*National Mortgage News website*, posted 9/16/99; *San Francisco Chronicle*, 9/16/99; *San Francisco Examiner*, 9/16/99; *American Banker*, 9/29/99)

## **Freddie announces a \$90 million initiative with the South Florida Board of Realtists® (division of the National Association of Real Estate Brokers), Sun Trust Bank, Fidelity Federal, and several local mortgage brokers**

### **Program will offer Freddie products to consumers**

### **Following in Fannie's footsteps, Freddie begins adding Congressional Member statements to its press releases**

- Freddie announced a \$90 million initiative – Housing Help to Ownership (H2O) - with the South Florida Board of Realtists®, Sun Trust Bank, Fidelity Federal, and several local mortgage brokers. H2O provides home buyer counseling, through Money Management International (an affiliate of the National Foundation for Consumer Credit). The press release contained statements of support from Congressman Hastings (D-FL) and Congresswoman Meek (D-FL). The products offered under the H2O program include Freddie's Affordable Gold 97 (which requires a down payment of 3% from borrower's own resources), Community Gold (which allows down payments even lower and includes ability to both purchase and renovate the home with one mortgage) and Alt 97 (permits no down payment from borrowers' own funds). (*Freddie press release*, 9/9/99)

## **Freddie guarantees a pool of multifamily loans, a \$120 million credit enhancement deal**

- Freddie closed a \$120.8 million credit enhancement with Berkshire Mortgage Finance (a REIT). Freddie provided a replacement credit enhancement and liquidity facility for a pool of 10 mortgages that were financed by mortgage revenue bonds issued by the Florida Housing Finance Corporation. The 10 bond-financed properties consist of more than 2,700 apartment units. Most of the buildings have 20% of their apartments set aside for tenants with incomes of 80% or less of the area's median gross income. (*American Banker*, 9/21/99)

## **Freddie promotes Dwight Robinson to Senior Vice President for Corporate Relations**

- Freddie announced that it had promoted Dwight Robinson to the position of Senior Vice President for Corporate Relations, where he will oversee industry relations, corporate communications, and community relations. Since March 1998, Robinson has served as Freddie's Vice President of Industry Relations. He joined Freddie in 1999 as Director of the Single-Family Affordable Housing Initiatives department, but left Freddie in 1993 to become President of Ginnie Mae. Later he was appointed Deputy Secretary of HUD. (*Freddie press release, 9/15/99; National Mortgage News website, posted 9/17/99*)

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

**FHFB publishes its controversial proposal to end FHLBank System arbitrage activities and implement a new risk-based capital standard for the FHLBanks in the *Federal Register*.**

**Comments on the proposal are due by December 27, 1999**

**Opposition forms to FHFB's proposals – ACB, ABA, and a group called the Savings Association Trade Executives wants a delay of the proposal**

**Opponents of proposal succeeded in getting an amendment attached to the VA-HUD Appropriations bill that mandates a one-year GAO study of FHLBank capital**

**Meanwhile, GAO releases a study to Cong. Richard Baker (R-LA) supporting risk-based capital standards for FHLBanks**

**House Banking Committee Chairman Jim Leach (R-IA) says the FHFB proposal is far-reaching and will be discussed during the House/Senate conference on financial services modernization. (The House version calls for the adoption of a risk-based capital structure and permanent capital for the FHLBanks while the Senate version calls for a GAO study of the FHLBank capital structure and the need for a risk-based system and permanent capital)**

**Cong. Baker is reportedly expected to argue that the time for a study is over and that Senate conferees should accept the FHLBank provisions in the House version**

FHFB publishes its controversial proposal to end FHLBank System arbitrage activities and implement a new risk-based capital standard for the FHLBanks

- The FHFB published its controversial proposal in the *Federal Register* on September 27 that would phase out the arbitrage investments of the FHLBank System and establish a new risk-based capital proposal for the FHLBank System. Comments on the proposal are due on or before December 27, 1999.

### Background on proposal

- The FHFB's proposal would phase-out and eventually eliminates the FHLBanks' arbitrage activities. The proposal was likely made in response to criticisms from the Treasury and Congress for the FHLBanks' arbitrage activities and investments - specifically, using its implied government guarantee from its GSE status to borrow heavily at preferential rates and then investing the proceeds in higher yielding instruments that are often unrelated to the system's mission of assisting housing and community development. After a five-year transition period, the FHFB proposal -

referred to as the “Financial Management and Mission Achievement (FMMA) Regulation” - requires that 100% of what the FHLBank System borrows in the capital markets must be used to finance core mission activities in support of broadly defined housing and community development missions. Under the proposal, the 100% standard would be effective January 1, 2005.

- The FHFB proposal would also change the FHLBanks’ capital requirements with plans to create a risk-based capital requirement for the FHLBanks based on credit risk, market risk, and operations risk. The FHFB stated that the proposed requirements would be created from historical credit loss experience, stress tests using interest-rate scenarios over a 20-year period, and the stress test scenarios developed by OFHEO recently for Fannie and Freddie. The FHFB in the proposed regulation also defined risk-based capital to include all retained earnings and non-redeemable stock, and up to 50 percent of all other stock. According to a *BNA* article by Eileen Canning, the risk models under the regulation would require FHFB approval. The *BNA* article further noted that the proposal calls for a contingency liquidity requirement based on a seven-day lockout from the consolidated obligations markets and credit concentration limits. In addition, the proposed regulation sets a minimum total capital requirement of 3 percent of assets instead of current liabilities-based leverage ratio, stating that consolidated obligations cannot exceed 20 times capital. According to the FHFB, the FHLBanks are overcapitalized. The FHFB stated that the proposed minimum capital to assets requirement of 3 percent is greater than required by statute for Fannie and Freddie (2.5%) and equals the minimum tier 1 capital required by primary bank regulators for banks without supervisory concerns.
- The FHFB proposal also allows the FHLBanks to acquire a broader range of assets than currently permitted. The proposal authorizes the FHLBanks to authorize the following broader range of assets: debt securities of investment grade, equities that count as core mission activities (e.g. SBICs), and Mortgage Market Assets (MMA). MMA would be considered mission assets because these assets would require risk-splitting between FHLBanks and their members. The FHFB considers the FHLBank Systems’ Mortgage Partnership Finance (MPF) program – currently in pilot form - as a MMA. Prohibited investments under the proposal include equities other than those defined as core mission assets, foreign securities, non-rated or below investment grade debt, commodities and foreign currencies. (*Federal Register*, 9/27/99, pages 52148-52210; *BNA Daily Report for Executives*, Eileen Canning, 7/29/99, 9/29/99; *Dow Jones Newswire*, John Connor, , 7/28/99, 9/22/99, 9/27/99, 9/28/99; *FHFB Fact Sheet, Proposed Financial Management and Mission Achievement Regulation*, 7/28/99; *National Mortgage News website*, posted 7/28/99)

#### Opposition builds to FHFB proposals – ACB and ABA want delay of proposal

- **The America’s Community Bankers (ACB) wrote a letter to key members of the House and Senate Banking Committees asking lawmakers to delay adoption of the plan until it can be reviewed by Congress. “The proposed rule is extremely complex, has far-reaching implications for the FHLBank System and may pose new restrictions and inappropriate risk on the System,” said Robert Davis, Director of Government Relations at the ACB. Davis further stated, “The Finance Board would be prudent to delay any FMMA rulemaking, particularly rules mandating the System’s mission-related activities and changing the ability of the regional FHLBanks to hold and manage assets on behalf of member shareholders, until S. 900 is enacted and the System has had an opportunity to adjust to the new law,” Davis stated.**
- ACB sent the letters to Senate Banking Committee Chairman Phil Gramm (R-TX), Sen. Paul Sarbanes (D-MD), the committee’s ranking Democrat, House Banking Committee Chairman Jim

Leach (R-IA), Cong. LaFalce (D-NY), the committee's ranking Democrat, House Capital Markets, Securities, and GSE Subcommittee Chairman Richard Baker (R-LA), Cong. Paul Kanjorski (D-PA), the subcommittee's ranking Democrat, and Sen. Hagel (R-NE), Vice Chairman of the Senate Financial Institutions Subcommittee. (*ACB press release, 9/27/99; BNA Daily Report for Executives, Eileen Canning, 9/29/99; National Mortgage News website, posted 9/28/99*)

- According to *National Mortgage News*, **the American Bankers Association (ABA) is requesting that the FHFB extend its comment period on the proposal until March to avoid Y2K problems. "A 90-day delay would ensure that the proposal does not interfere with the Federal Home Loan Banks' ability to meet liquidity needs [of member institutions] which may arise from the Y2K issue."** (*National Mortgage News website, posted 10/4/99*)

Opponents get amendment added to VA-HUD Appropriations bill mandating GAO study of FHLBank capital

- According to *National Mortgage News*, **opponents of the FHFB risk-based capital proposal succeeded in getting an amendment included in the VA-HUD Appropriations bill that mandates a one-year GAO study of possible revisions to the FHLBank capital structure. The FHLBank study amendment was reportedly offered by Senator Chris "Kit" Bond (R-MO) and is considered a "placeholder" for a possible moratorium amendment. The article notes that there is a group called the Savings Association Trade Executives that wants Congress to pass a two-year moratorium on implementation of the proposed changes, while Congress considers changes in the FHLBanks' capital structure.** (*National Mortgage News website, posted 9/27/99*)

Meanwhile, GAO issues a report to Cong. Baker (R-LA) on FHLBanks' capital needs

- According to *National Mortgage News*, GAO says in a report to Cong. Richard Baker (R-LA) that it has conducted numerous studies on the FHLBanks' capital needs and has "consistently supported the establishment of risk-based capital standards" The article notes that Cong. Baker is expected to argue that the time for a study is over and that the Senate conferees should accept the FHLBank provisions in the House version. *National Mortgage News website, posted 10/1/99*)

Chairman Leach said the proposal will be examined during House/Senate conference Committee on the financial services modernization bill

- According to the *BNA*, House Banking Committee Chairman James Leach (R-IA) said, "This is a far reaching proposal by the Finance Board, and we are taking a look at it during House/Senate Conference Committee on the financial services modernization bill. The House version of the financial services modernization bill (HR 10) calls for the adoption of a risk-based capital structure and permanent capital for the FHLBanks while the Senate version (S. 900) calls for a GAO study of the FHLBank capital structure and the need for a risk-based system and permanent capital. Chairman Leach, who chairs the financial services conference committee, said that he, House Commerce Committee Chairman Thomas Bliley (R-VA), and Senate Banking Committee Chairman Phil Gramm (R-TX) would write a joint financial services compromise bill. The goal is to produce a bill that both houses can vote on by October 20, Leach stated. (*BNA Daily Report for Executives, Eileen Canning, 9/29/99; BNA Daily Report for Executives, 10/1/99*)
- **FHFB Chairman Bruce Morrison said that those who seek to delay the proposal want to retain arbitrage. Former Assistant Secretary Richard Carnell supports what the FHFB wants to do, but he added, "I'm a little skeptical whether they'll follow through with it."** (*Dow Jones Newswire, John Connor, 9/28/99*)

**FHLBank System is considering “sneaking” language into the financial services modernization bill (currently in House-Senate conference) that would expand the FHLBanks into economic development lending**

**America’s Community Bankers gave a list of criteria that must be met before such a proposal is adopted**

- According to a *BNA* article by Eileen Canning, the FHLBanks are reportedly working on a proposal to expand into economic development lending by creating a program that would provide over \$100 million a year in funding for economic development, such as small business lending or lending for neighborhood community programs, such as daycare facilities. According to a source at the Federal Housing Finance Board (FHFB), they are currently looking for a legislative vehicle in which to attach the proposal and may attempt to “sneak it into the financial services modernization” legislation currently in a House-Senate conference.
- The proposal, modeled after the FHLBanks’ Affordable Housing Program, is according to a FFB source, still “in a very premature stage.” The source said the proposal would stretch out the FHLBanks’ payments to the Resolution Funding Corp. (REFCorp.) and “redirect half of it.” As a result, the program “would score as budget neutral,” the source told *BNA*. The proposal would also allow for an additional \$160 million a year for economic development lending.
- Robert Davis, Director of Government Relations at America’s Community Bankers, stated said there were certain criteria that must be met first before a proposal is adopted:
  - “Are these assets that are generated by member institutions and then supported by the FHLBank System assets that have risk return characteristics that are appropriate for the FHLBanks as a whole?”
  - “How will the Treasury Department feel about looking for funds elsewhere if the Finance Board rediverts funds?”
  - How will the REFCorp. bondholders be paid in the interim?”
- The program, on its face, is neither good or bad in Davis’ opinion, however, “the proof is going to be in the pudding.”
- A spokeswoman from the American Bankers Association declined to comment on the proposal and stated that “it is too early for us to have a reaction. We don’t know the particulars.” (*BNA Daily Report for Executives*, Eileen Canning, 9/14/99)

**FHLBank President of Des Moines was reportedly forced out of his office by the FHFB after derivatives losses**

**More than \$10 million was lost last year by the FHLBank of Des Moines on a speculative “impermissible” derivatives transaction**

***Dow Jones Newswire* reports that the FHLBank of San Francisco reportedly lost more than \$65 million over a recent 19 month period on “permissible” hedging activities**

- According to a *Dow Jones Newswire* article by John Connor, the FHFB reportedly forced the President of the FHLBank of Des Moines, Thurman (“Sam”) Connell, out of his position after the FHFB found derivatives losses at the Bank exposed internal problems. More than \$10 million was lost last year on a speculative derivatives transaction last year. The FHFB said it made the decision to terminate Connell and that his package was consistent with the FHLBank System’s rules governing “involuntary terminations.”
- Connor notes that the FHFB was “not concerned with the Des Moines Bank’s loss, as such, but rather with the controls problems the transaction brought to light.” The transaction in question was a speculative interest rate swap that was reportedly “impermissible.” This was in contrast to the FHLBank of San Francisco’s “permissible” hedging activities that resulted in the institution incurring losses of more than \$65 million over a recent 19 month period. (*Dow Jones Newswire*, John Connor, 9/30/99)

**FHLBank System’s Mortgage Partnership Finance (MPF) program has generated nearly \$1.5 billion in single-family fixed-rate mortgage loans**

**The MPF program is becoming a real competitor to Fannie and Freddie**

- According to *National Mortgage News*, the FHLBank of Chicago President Alex Pollock stated that the FHLBank System’s MPF program has generated nearly \$1.5 billion in single-family fixed-rate mortgage loans, up from \$1 billion at the start of the year. According to Pollock, there are currently 68 approved MPF lenders and another 65 institutions seeking approval. The MPF program is a competitor to Fannie and Freddie in the secondary mortgage market. Under the MPF program, a FHLBank member institution can retain most of the credit risk on a mortgage loan and the servicing, while the FHLBank of Chicago manages the interest rate risk and market risk. (*National Mortgage News website*, posted 9/15/99)

**FHFB Chairman Bruce Morrison said a potential “iceberg” for the GSEs is an eventual recession - the question is how effectively the GSEs handle a recession**

- According to a *Wall Street Journal Interactive* article by John Connor, FHFB Chairman Bruce Morrison cited the possibility of an eventual significant recession as his leading concern when asked after a luncheon speech if the housing GSEs face any potential “icebergs” going forward. He noted the economic expansions don’t last forever and that the housing GSEs have grown rapidly in recent years. **Morrison noted that the question is how the GSEs will handle a significant recession. He did think not there would be too big a disruption, unless, their risk management tools are similar to those of Long-Term Capital Management – the hedge fund that had to be bailed out last year.** (*Wall Street Journal Interactive*, John Connor, 9/15/99)

**FHLBank of Boston promotes two to newly created senior posts**

- According to the *American Banker*, the FHLBank of Boston has named Michael Wilson as Senior Executive Vice President and Chief Operating Officer and Frank Nitkiewicz as Chief Financial Officer and Treasurer, both newly created posts. Wilson, who was formerly the Executive Vice President of Finance, will now be in charge of treasury, credit, human resources, information technology, and communications. Nitkiewicz, who was Senior Vice President and Treasurer, will now oversee the treasury operations, accounting control, and financial research functions. (*American Banker*, 9/27/99)

## *Farm Credit System/Farm Credit Banks*

**American Bankers Association and Community Bankers Association are opposed to an amendment in the Agricultural Appropriations bill that they say would unfairly broaden the authority of the Farm Credit System, at the expense of private sector banks**

- According to an American Banker article by Craig Woker, the American Bankers Association and the Community Banker's Association are "fuming" over a proposed amendment to the Agricultural Appropriations bill that they believe would "unfairly broaden the authority" of the Farm Credit System at the expense of banks. The amendment, introduced by Senator Tom Harkin (D-IA) transfer lending and investment powers of a government-funded company – Alternative Agricultural Research and Commercialization Corp. – to a Farm Credit System Lender, Denver-based CoBank (as reported in an *American Banker* article on 9/13/99, the CoBank made more than half of all loans to co-ops in 1997).
- The Alternative Agricultural Research Corp. invests equity capital and lends money to ventures. Woker contends that banking associations believe that giving authority over the Corp. to the quasi-governmental CoBank would give CoBank an advantage over private sector agricultural banks in competing for loans.
- **"This deal really smells," said John Blanchfield, Manager of Agricultural Banking and Rural Development at the American Bankers Association. "CoBank wants this authority really bad, and that disturbs me because this appears to be a major expansion of the Farm Credit System."**
- **"The issue needs more scrutiny," said Mark Scanlan, Agricultural Affairs Director at the Independent Community Bankers of America. "There are two many potential implications that need to be dealt with in a short time."** The Farm Credit Administration has not taken a position on the proposal because it doesn't know enough about the proposal. (*American Banker*, Craig Woker, 10/1/99)

**Commercial banks are gaining market share in agricultural lending at the expense of Farm Credit System**

**However, Farm Credit System still has a virtual lock over commercial banks on farm cooperative borrowing (commercial banks only have 16% of the co-op market)**

- According to an article by Alan Kline with the *American Banker*, commercial banks are gaining market share in the last decade at the expense of their rival, the Farm Credit System. However, the Farm Credit System "has maintained a virtual lock on one type of borrower: the farm cooperative." Kline noted that the USDA statistics show that just one Farm Credit lender alone – the Denver-base CoBank made more than half of all loans to co-ops in 1997, while banks had just a 16% share in the co-op market. The nation's co-ops borrowed approximately \$20 billion in 1998 – about 12% of the total dollars lent to the agriculture industry. (*American Banker*, Alan Kline, 9/13/99)

## *Ginnie Mae*

### **Fannie/Freddie watchdog group, FM Watch, opposes privatizing Ginnie Mae because it hurts competition and consumers**

- FM Watch released a bulletin stating that the group opposes privatizing Ginnie Mae because it hurts competition and consumers and that any serious discussions about privatizing Ginnie Mae should be part of a broader discussion regarding “the proper role of the GSEs in the America’s housing system.”
- **According to the FM Watch bulletin, “Privatizing Ginnie Mae will lessen competition, risk the future stability of FHA and VA, and further concentrate economic power in the remaining Congressionally chartered secondary market enterprises – Fannie Mae and Freddie Mac. Ginnie Mae competes with the GSEs in securitizing mortgage loans. Removing Ginnie Mae from this equation will simply strengthen the duopoly that currently exists, leaving the marketplace with less competition and consumers with less choice and higher costs.”** (*FM Watch Bulletin*, 9/30/99)

### **Results, so far, on the *National Mortgage News* website-viewer survey, is running 2-to-1 in favor of letting Ginnie Mae buy its own securities to build an investment portfolio**

- *National Mortgage News*’ website is surveying visitors to its website on the question of whether Ginnie Mae should be allowed to purchase its own securities to build an investment portfolio. As of September 24, the results were a 2-to-1 in favor. At midday September 24, the results were 78-40 in favor. (*National Mortgage News* website, posted 9/24/99)

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