

The **GSE** REPORT TM

Contents of GSE Report TM

“Political cronyism. Corporate welfare. Billions of dollars in market-distorting subsidies hidden from public view. Fannie Mae and Freddie Mac’s massive profits are their profits. But their debt is our debt. If Congress doesn’t act soon to rein them in, these moochers who sell the American Dream may turn out to be taxpayers’ worst nightmare.”

- Michelle Malkin, nationally syndicated columnist, *Washington Times Op-Ed*, 6/23/00

“We will take on Fannie Mae and take on Frank Raines personally until they meet the needs of working people.”

- Bruce Marks, Executive Director of the Neighborhood Assistance Corporation of America (NACA)

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 - Only two Board Members remain on the five-member FHFB
 - FHFB Spokesman says the FHFB should be able to conduct business as usual under delegated authority - the authority of FHFB Chairman will be delegated to HUD Assistant Secretary William Apgar
- FHFB approves final rule that will shift the responsibility for issuing the FHLBank System's debt from the FHFB to the 12 FHLBanks (p. 27)
 - The FHFB cites concerns over the potential liability of the US to lawsuits – such as the one brought by Orange County – among the reasons why it wants to give up its role as issuer of FHLBank System debt

- FHFB Chairman Bruce Morrison claims the FHLBanks have made a “dramatic” shift away from arbitrage investments to mission-related investments (*p. 28*)
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Major Events

The \$9 billion cap on the FHLBanks' Mortgage Partnership Finance (MPF) program is lifted and the program is changed from a "pilot" program to a "permanent" program

The MPF program is making the FHLBank System a more serious competitor to Fannie & Freddie in the secondary market

Countrywide and GMAC Mortgage may participate in the MPF program

- The Federal Housing Finance Board (the regulator for the FHLBank System) voted to make the pilot MPF program a permanent program and lifted the \$9 billion system-wide dollar cap on the program. The MPF program, sponsored by the FHLBank of Chicago, gives banks and thrift members an alternative to selling conventional and FHA loans to Fannie, Freddie and Ginnie Mae, and instead sell the loans to participating FHLBanks. The final rule, however, suggests that FHA-insured loans should only make up one-third of the FHLBanks' mortgage purchase activity, but there is no hard dollar limit. The FHLBank of Chicago claims that institutions can boost their profits under the MPF program by not having to pay loan guarantee fees to Fannie and Freddie. Under the MPF program, the FHLBank purchases the mortgage from the lender and assumes the interest rate risk, while the lender retains some credit risk not covered by mortgage insurance and servicing. The final rule takes effect immediately upon publication in the *Federal Register*. (*Dow Jones Newswire*, John Connor, 6/29/00; *National Mortgage News Daily*, 6/30/00)
- **"We are very pleased with the removal of the regulatory cap," said FHLBank of Chicago President Alex Pollock. "MPF is a better deal for the mortgage lending members of the Federal Home Loan Banks and the American homebuyers who will benefit as the result of enhanced secondary market competition."** (*National Mortgage News*, Brian Collins, 7/10/00)
- The MPF program started as a pilot program in 1997. Permanent status for the MPF program marked its third anniversary. Eight of the 12 FHLBanks currently participate in the program. According to Brian Collins with *National Mortgage News*, the MPF program has been growing so fast over the last nine months – mainly due to purchases of FHA loans – that production hit \$10.2 billion as of June 30. The FHLBank of Chicago had to get a "no action" letter to stay in business during June. At the beginning of the year, approximately \$1.8 billion in mortgage loans and \$4.4 billion in master commitments were made under the program. In comparison, Fannie bought \$370 billion worth of mortgages in 1999 and Freddie bought \$273 billion. Earlier this year, FHLB Chairman Bruce Morrison, who leaves office this month, noted that once the cap is lifted, he expects the FHLBanks to purchase \$30 billion in loans by the end of 2001 and \$100 billion by the end of 2002. "This could be serious for Freddie Mac and Fannie Mae, especially in years of declining mortgage originations," said *Barron's Online* reporter Jim McTague. (*Barron's Online*, Jim McTague, 5/29/00; *Dow Jones Newswire*, John Connor, 6/30/00; *Dow Jones Newswire*, Tyler Lifton, 6/28/00; *National Mortgage News*, Brian Collins, 7/10/00)
- **Morrison warned that supporters of Fannie and Freddie might make attempts on Capitol Hill to "strangle the initiative in the crib."** (*Dow Jones Newswire*, John Connor, 6/30/00) **Morrison claims Fannie and Freddie have tried to thwart the MPF program to protect their profits from buying and securitizing mortgages. He also condemned Fannie and Freddie's wild growth. "No GSE should have a bigger balance sheet than it takes to accomplish its public mission," he said. Fannie and Freddie "are ballooning their balance sheet way out of**

proportion to what is needed to do their mission because it is profitable.” (*American Banker*, Barbara Rehm, 6/30/00)

Countrywide and GMAC Mortgage may participate in the MPF program

- Adam Tempkin with *Asset Sales Report*, noted that Countrywide and GMAC Mortgage are organizing their business operations to participate in the MPF program. Countrywide Chairman Angelo Mozilo said that the company relocated its charter reinsurance subsidiary from Vermont to a Midwest relocation for the express purpose of gaining access to the MPF program. In late April, the OTS also approved an application from GMAC Mortgage to form a new thrift and to establish an operating subsidiary of the new thrift, with the main purpose of taking part in the MPF program. Only insurance companies, commercial banks, thrifts and credit unions can become members of the FHLBank System, and only members can participate in the MPF program. Since Countrywide and GMAC are not depositories, they have to create a holding company or a subsidiary that is one, which sources say is a relatively easy task to do. (*Asset Sales Report*, Adam Tempkin, 6/26/00)

FHFB approves controversial rule defining the FHLBank System’s core mission activities

The rule does not limit investments in non-mission assets such as mortgage-backed securities (MBS), however, MBS will not be considered “core mission assets”

Senate Banking Committee Chairman Phil Gramm (R-TX) criticized the FHFB’s action on core mission activities and warned that he might take action against the FHFB

Senator Christopher “Kit” Bond (R-MO) has concerns about the core mission activities rule and the impact of the FHLBanks’ MPF program on Ginnie Mae

The FHFB believes the rule is needed to compete with Fannie & Freddie in the secondary market

In other action, the FHFB approves a final rule that expands collateral for FHLBank advances for small banks and thrifts and raises the percentage of non-mortgage collateral that can be offered by small banks and thrifts for FHLBank loans or advances

- On June 29, the FHFB by a 2-1 vote approved a final rule that sets guidelines for the core mission activities of the FHLBanks. The core mission activity rule was considered controversial with Senate Banking Committee Chairman Phil Gramm (R-TX), as well as some industry representatives opposed. (The final rule also included provisions lifting the cap on the FHLBanks’ MPF program and making the MPF program a “permanent” program– see earlier story in this *GSE Report*.) The rule takes effect immediately after publication in the *Federal Register*. (*BNA Daily Report for Executives*, Kenneth Talley, 6/30/00; *FHFB press release*, 6/29/00)
- Under the final rule, core mission activities of the FHLBanks would include:
 - (1) acquiring assets for their members through risk-sharing arrangements (AMA or acquiring member assets include purchasing whole mortgage loans originated by or held by a FHLBank member institution – such as the FHLBanks’ MPF program);
 - (2) making advances to members;
 - (3) issuing standby letters of credit;
 - (4) making targeted investments that support affordable housing and economic development activities and investment in small business investment corporations.

- Similar to a proposed rule published for comment May 3, 2000, the final rule states that, going forward, government insured AMA such as FHA loans can count as core mission activities in an amount up to one-third of the total AMA held by a FHLBank, but adds some flexibility in the calculation of the percentage that was not in the proposed rule.
- The final rule does not restrict beyond current law or regulation the FHLBanks' investment in non-core mission assets such as mortgage-backed securities. The final version of the rule eliminates language in the proposed rule that specifically would have grandfathered the FHLBanks' existing holdings of MBS until maturity. Some industry representatives were concerned that the grandfather language in the proposed rule combined with the fact that proposal did not include investments in MBS as a core mission activity, signaled that the FHFb might restrict MBS investments in the future. (*BNA Daily Report for Executives*, Kenneth Talley, 6/30/00; *FHFb press release*, 6/29/00) The FHLBanks hold \$70 billion in MBS. (*National Mortgage News*, Brian Collins, 7/10/00)

Senator Phil Gramm (R-TX) criticized the FHFb's action on core mission activities and warned that he might take action against the FHFb

- According to Kenneth Talley with the *BNA Daily Report for Executives*, a spokeswoman from Senator Gramm's office said the Senator was displeased with the FHFb's action on core mission activities, and suggested that the Senator might take action against the FHFb. "We are troubled a public official and a public board would go back on assurances given to Congress," she said. "When the Banking Committee returns after the July recess, we will review our options." (*BNA Daily Report for Executives*, Kenneth Talley, 6/30/00)
- Before the FHFb issued the final rule on core mission activities, Senator Gramm urged the FHFb to drop the proposal. In a June 23 letter to FHFb Chairman Morrison, Senator Gramm said that such an action would "violate the spirit" of an agreement Morrison struck with Congress last fall. Senator Gramm cited a letter Morrison sent lawmakers last October that pledged the FHFb would not limit FHLBank investments until new capital standards were established. "Recent proposals by the Board violate the spirit of the commitments embodied in your letter... Rather than proceeding once again down this troubled road, the Board should follow the priorities set for it by Congress and proceed with implementing the statutory instructions contained in the Gramm-Leach-Bliley Act." (*National Mortgage News Daily*, 6/26/00; *American Banker*, Rob Blackwell, 6/27/00)
- Several Senate and House Banking Committee Members also wrote to the FHFb May 26 and June 1 expressing concern about the proposal and urged the FHFb to extend the comment period on the proposal from 30 days to 90 days. In addition, the Members stated that the proposal "does not appear to impose any mandatory investment limits or establish specific targets for new programs of the Federal Home Loan Bank System; however, the proposed rule does appear to lay the foundation for such action at a later date." (*BNA Daily Report for Executives*, Kenneth Talley, 6/27/00)

Senator Christopher "Kit" Bond (R-MO) also has concerns about the rule

- An Appropriations Committee staffer stated that Senator Bond also has concerns about the rule and he plans to consult with Senator Gramm on the issue. Senator Bond is Chairman of the Appropriations Subcommittee for Housing and Veteran's Affairs. "What appropriate steps should be taken with regard to the regulation is clearly something which will be looked at," the appropriations staffer said. Senator Bond also has concerns about the MPF program, including

“what the financial impact of the program might be on Ginnie Mae,” said the staffer. (*National Mortgage News*, Brian Collins, 7/10/00)

FHFB Chairman Morrison responds to Senator Gramm’s concerns – Rule is needed to compete with Fannie & Freddie

- “With all due respect to Senator Gramm, it does not break the letter or the spirit of the agreement,” said FHFB Chairman Morrison. He explained that the final rule simply identifies which FHLBank activities the FHFB believes better serve the public mission of the FHLBanks. (*National Mortgage News*, Brian Collins, 7/10/00) “I think Senator Gramm himself has only passing acquaintance with the issue,” he said. “If I listen to Senator Gramm, it’s like surrender to Fannie and Freddie.” Barbara Rehm with the *American Banker* reports that this is because Morrison sees the MPF program (included in the final core mission activity rule) as an attractive option to selling loans to Fannie and Freddie. Morrison noted that Fannie and Freddie’s expertise is limited to managing market risk. “They have no natural advantages in the management of credit risk. When you tie two commodities together and there’s very few players...the product that is not a have-to product may not be competitively priced. It’s called a tie-in in antitrust language, and tie-ins are always a problem because it means that market power in one market is slopping over.” In response to critics who say the FHFB should revamp the FHLBank’s capital structure before it defines their mission, Morrison said the sequence makes no sense. “You have to tell the people who are going to be buying the stock what you’re going to do with the capital,” he said. He noted that the capital rules will be completed by November 12, as required by the Gramm-Leach-Bliley Act. (*American Banker*, Barbara Rehm, 6/30/00)
- **In a letter to Senator Gramm, Morrison wrote that, “What is at stake is two things: Will there be competition in the mortgage markets such that consumers will benefit from depository institutions becoming more effective competitors to Fannie Mae and Freddie Mac? And will the government favored debt, issued by the Federal Home Loan Banks, which, as Alan Greenspan has recently said, come ‘of necessity, at the expense of other federal or private sector initiatives,’ be used in a way which lowers the cost of housing rather than just increasing the profits of certain shareholders?”** (*Dow Jones Newswire*, John Connor, 6/29/00)

ACB does not want the FHFB to limit FHLBank investments

- Prior to its release of the final rule, the America’s Community Bankers (ACB) urged the FHFB to either withdraw the mission-related assets proposal or defer action until the FHLBanks submit their capital plan. ACB said the proposal, by creating a new category of investments, and by limiting investments in MBS and government-insured loans “is dictating the FHLBanks’ programs and activities.” (*ACB press release*, 6/13/00) The ACB also sent a letter on April 27 to senior House and Senate Banking Committee Members asking for their help in addressing the group’s concerns about the proposal. (*BNA Daily Report for Executives*, Kenneth Talley, 6/27/00) In a prepared statement after the final rule was approved, ACB President Diane Casey said that the FHFB “acted in the best interests of community banks and homebuyers today by agreeing not to impose prospective limits on the investments of the Federal Home Loan Banks and by implementing expanded collateral requirements.” However, she stated that “the FHFB’s decision to define the core mission activities of the Bank System is ill-conceived because it establishes a direction for the FHFB to later mandate specific FHLBank investments or programs.” The ACB said it will work diligently to prevent the establishment of any targets or quotas. (*ACB press release*, 6/29/00)

Expanded collateral rule adopted

- In other action, the FHFB approved a final rule on June 29 that implements provisions of the Gramm-Leach-Bliley Act that expands collateral for FHLBank advances and raises the percentage of non-mortgage collateral, that can be offered for FHLBank loans or advances. The rule enables Community Financial Institutions (CFIs) (FDIC-insured institutions with less than \$500 million in assets) to pledge additional classes of collateral and increase the amount of other real estate-related collateral that can be pledged for FHLBank advances. The rule sets guidelines for the FHLBanks for accepting new types of collateral that can be pledged by banks and thrifts with less than \$500 million in assets to include: small business loans, agriculture loans, or securities representing a whole interest in such loans.
- The final rule follows a proposed rule for comment that was published May 8, 2000, however, the definition for small business loans, small farm loans, and small agri-business loans that can be used as collateral for advances by a CFI is less restrictive than the proposed rule. While the proposed rule sets dollar limits on the loans, the final rule defines small business, small farm, and small agri-business as eligible to be used for collateral as long as they are within the loans-to-one borrower limits of a CFI. According to the FHFB, the provision restricts the size of these loans without imposing a specific dollar limit or requiring unnecessary documentation. The FHFB's final rule will also remove a limit for all CFI members of the FHLBank System on the amount of advances that could be secured by real estate-related collateral other than mortgages (such as home equity loans and commercial real estate loans). The amount had been capped at 30% of a member's capital. The final rule takes effect 30 days after publication in *the Federal Register*. (*BNA Daily Report for Executives*, Kenneth Talley, 6/30/00; *FHFB press release*, 6/29/00; *Reuters*, 6/29/00) Analysts estimate that approximately \$400 billion in additional collateral may become eligible under the new rule. (*American Banker*, Rob Blackwell, 6/30/00)

ABA, ACB and ICBA support the FHFB's final expanded collateral rule

- The American Bankers Association applauded the FHFB's action. "This opens up huge new loan funding sources for banks with less than \$500 million in assets and will enhance all banks' ability to meet the credit needs of their communities," said ABA Senior Counsel, Joe Pigg. (*National Mortgage News Daily*, 6/30/00) The Independent Community Bankers of America applauded the FHFB's action in issuing a final rule expanding collateral. The ICBA urged the FHFB to expand the non-mortgage collateral and use a CFI's loans to one borrower limit as a size control, a change the FHFB made in the final rule. (*ICBA press release*, 6/29/00). The America's Community Bankers believe the FHFB acted in the best interests of community banks and homebuyers by agreeing not to impose prospective limits on the investments of the FHLBanks (such as mortgage-backed securities) and implementing expanded collateral requirements. ACB said it took the lead in working with the FHFB to assure that the potential prohibition on the FHLBanks' MBS investments was deleted from the final mission-related rule. (*ACB press release*, 6/29/00)

Freddie claims it is not considering a “break-up” plan to separate the company into two entities

However, reports surface that Freddie met with Lewis Ranieri (one of the pioneers of the mortgage-backed securities) on the idea

Fannie also denies it is considering any restructuring plans

- Freddie is continuing to deny that it is considering a “break-up” plan. However, according to Patrick Barta with the *Wall Street Journal*, Freddie has been in discussions with Lewis Ranieri (who in the 1980s helped pioneer mortgage-backed securities) about the possibility of Freddie splitting into two companies. Under the plan, one of the companies would focus on Freddie’s traditional mortgage business, while the other could expand into areas not permitted by the company’s charter. Mr. Ranieri claims he talked to Freddie officials about the idea. Through a company spokesman, Freddie Chairman Leland Brendsel confirms that the company spoke with Mr. Ranieri in the spring but could not recall the details and that the company is not considering a split. “We have never considered it,” said Freddie spokeswoman Sharon McHale. “Leland Brendsel did have a meeting with Lewis Ranieri. However it was on another topic,” she said. “While Mr. Ranieri may have thrown out that idea, frankly (Brendsel) paid no attention to it. He dismissed it immediately. He had no recollection that it even came up.”
- According to Barta, under the plan, first reported by *Bond Week*, Freddie would create a holding company with two separate entities. One would operate as Freddie currently does now, buying and selling mortgages, while the other entity would likely not retain the GSE benefits (giving it more freedom to expand into new areas). For example, Mr. Ranieri said the company could take its computer systems (such as its automated underwriting technology) and make the systems available to commercial real-estate clients. He also noted that the new company could originate loans, which Freddie is currently not allowed to do, and the company could also buy and sell investments, like mortgage-backed securities. The idea for splitting the companies “just came up in the context of looking at all of the possible future structures that would accommodate all the things people are talking about,” including Cong. Richard Baker’s GSE legislation (HR 3703), said Mr. Ranieri.
- Barta speculates that “the fact that the plan was even vetted speaks volumes about the troubles Freddie Mac, and its bigger sibling, Fannie Mae, face in the ultra-competitive home-loan market.” Barta notes the current political pressure that the GSEs are experiencing and states that the plan may be a way to “jump-start interest in their stocks among investors.” (*Wall Street Journal*, Patrick Barta, 6/30/00)

Further details of the plan

- Under the plan being considered to split Freddie into two companies, Roddy Boyd with *Bond Week* said the GSE entity would retain the name Freddie Mac and its GSE benefits, and its sole purpose would be to act as a guarantor for mortgage originators (as under the original charter). The other entity, called Newco, would give up the GSE benefits in return for complete operational autonomy. Newco would be spun off to shareholders as a non-regulated privately chartered MBS investment company. Freddie would provide the capitalization for the company from existing funds. However, Newco would be financially separate from Freddie. Freddie’s Senior Vice President Greg Parseghian has even been discussed as the logical candidate to head Newco. (*Bond Week*, Roddy Boyd, 6/19/00)

Freddie denies a proposal to split the company

- Freddie's website says the "story is untrue" and that the *Bond Week* reporter did not speak to any corporate official. The company says it has "no intention of breaking up the company." (*Freddie website*, posted 6/20/00) "We categorically deny the report," said Freddie spokesperson Sharon McHale. "We can't imagine what the supposed sources were thinking," she said. *Bond Week* Executive Editor Greg Joslyn said the publisher stands behind the story as reported. (*Dow Jones Newswire*, Jerry Guidera, 6/20/00) "We stand by the story," said *Bond Week* Reporter Roddy Boyd, the author of the article. (*Bloomberg News*, 6/20/00)
- *Bond Week* later reported that a Freddie spokeswoman said the company was not officially considering a plan to split the company, though she declined to comment whether senior executives have considered the possibility in private conversations. The spokeswoman said Freddie Chairman Leland Brendsel told employees that he has never officially had any conversation with anyone regarding plans to revise Freddie's current structure. (*Bond Week*, 6/26/00)

Fannie denies it has considering any restructuring

- "We are not considering any tinkering with the most successful housing mechanism ever known," said Fannie spokesman David Jeffers. He said splitting Fannie in two "creates an unnecessary division that serves neither shareholders nor public policy interests." He further noted that "Our shareholders have demonstrated their confidence in the way we are currently structured to direct private capital to home buyers. There's no conflict in interests between shareholders and Congress' housing missions." (*Reuters*, 7/6/00)

House Banking Committee Chairman Jim Leach (R-IA) blasts the Farm Credit Administration on its controversial plan to grant national charters to Farm Credit System banks

The plan removes geographic boundaries and allows farm credit banks to compete in each other's territories

Chairman Leach says the plan is a "reflection" of all GSEs to "use their governmentally privileged positions" to expand their activities "in ways that distort the American market system"

- In a June 23 letter to Michael Reyna, Chairman and Chief Executive Officer of the Farm Credit Administration (FCA), Chairman Leach asked the FCA to suspend its efforts to grant national charters to Farm Credit System institutions, beginning January 1, 2001. **Chairman Leach says the plan is "a reflection of the continual self-generated urge of all government-sponsored enterprises to use their governmentally privileged positions to expand the breadth and scope of their activities in ways that distort the American market system."**
- Chairman Leach said the FCA's national charter plan has "extraordinary" implications and urged Reyna to suspend the initiative "until proper processes involving formal rule-making procedures are put in place and until there is adequate opportunity for Congressional scrutiny and oversight."
- The FCA plan will allow farm credit banks to apply for a national charter permitting the Farm Credit System banks to make loans anywhere in the country. Currently, they are restricted to specified regions. Leach is concerned that the plan will "represent implicit approval of expansive activities outside of productive agriculture, and that FCS institutions will increasingly cater to the activities of large agricultural conglomerates to the disadvantage of the family farmer." Leach says

the national charter plan creates the opportunity for a large agricultural entity to gain effective control over a Farm Credit System institution in order to serve its national needs, instead of local needs.

- Leach is also concerned that the national charter plan raises safety and soundness concerns. **“In the area of risk to the taxpayer, Congress must consider whether the FCA’s national charter initiative will result in significant new liabilities to the nation’s taxpayers...it remains understood that the system is a GSE, with a public purpose, and that Congress – as it did in the late 1980’s when it provided up to \$4 billion in bailout authority for the system because of its overextended expansion activities – remains the lender of last resort with the public pocketbook.”**
- Concluding his letter, Leach wrote, **“The irony is that this country has the largest, most vibrantly competitive private sector financial system in the world, but without governmental oversight and restraint, GSEs – whether they be in housing or agriculture – have a natural tendency to push into new market-skewing areas and activities. The question is whether this benefits or distorts our financial system.”**
- John Blanchfield, Director of the ABA’s Center for Agricultural and Rural Banking commended Leach’s letter. “[G]ranting national charters raises a magnitude of safety and soundness issues regarding this taxpayer-supported lender,” he said. “[T]here was no process involved in this plan – no rule, comment period or any effort made for public comment. This idea is the equivalent to OCC and FDIC approving interstate banking with an eight-page booklet.” (*Chairman Jim Leach letter to FCA Chairman Michael Reyna, 6/23/00; BNA Daily Report for Executives, Eileen Canning, 6/26/00; American Banker, 6/26/00; Associated Press, Philip Brasher, 6/23/00*)

<p>House Banking Capital Markets Subcommittee Chairman Richard Baker (R-LA) plans to push ahead on his GSE bill (HR 3703)</p>
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- On a conference call with Wall Street bankers on June 22, Cong. Baker vowed to push ahead on his bill, HR 3703, that would among other things, consolidate regulation of the three housing GSEs (Fannie, Freddie, and the FHLBanks). He promised, however, to move cautiously on the bill and to avoid disrupting any financial markets. “We will move very slowly but very thoroughly,” he said. He also believes that there are enough votes in his Capital Markets Subcommittee to pass the bill out of Subcommittee today. Baker noted that once the bill moves in Subcommittee, Fannie and Freddie will see the value of entering into serious negotiations.
- Cong. Baker estimated that the GSEs’ government subsidy is probably worth approximately \$12 billion a year now. This compares to a 1995 CBO study that estimated the subsidy at \$6.5 billion. He noted that he is having the CBO update the study with the assistance of the Fed. Cong. Baker also noted that recommendations to limit banks’ holdings of GSE securities and debt, if included in any bill, would have a phase-in provision. “If such a change were to occur it would not occur precipitously it would occur in a three- to perhaps five-year window,” he stated. (*Reuters, Joanne Morrison, 6/22/00; Dow Jones Newswire, John Connor, 6/27/00*)

All GSEs

FHFB Chairman Bruce Morrison believes removing the GSEs' line of credit to the Treasury would raise GSE borrowing costs without lessening risks to taxpayers

- According to John Connor with *Dow Jones Newswire*, FHFB Chairman Bruce Morrison criticized proposals to remove the GSEs' line of credit to Treasury. According to a transcript of a speech he gave to a closed-door meeting of FHLBanks System directors in June, Morrison believes removing the GSEs' line of credit to Treasury would create higher GSE borrowing costs without lessening risk to taxpayers. Morrison stated, "The big danger here is that you have the markets withdraw the benefit of the implied guarantee, and what do you get remaining? The risk to the taxpayer remains exactly the same. The huge debt issuance, the huge organizations, the huge dependence on the public on these institutions for housing; just no cost reduction. You know, that's a big lose/lose opportunity that some people seem to be pursuing, and I can't believe they're pursuing that with strategic thought because that doesn't help anybody."
- Morrison further stated that, "If we're going to privatize, OK, let's privatize." He added, **monopoly power must be considered or "you've just got a big Microsoft problem on our hands."** (*Dow Jones Newswire*, John Connor, 6/23/00)

National Mortgage News Daily website surveys its readers on whether the supervision of Fannie, Freddie and the FHLBanks should be consolidated into a single agency

- As of 7/9/00, the results for the survey were 46 respondents who voted "yes" and 23 respondents that voted "no." (www.nationalmortgagenews.com, 7/9/00)

Fannie Mae and Freddie Mac

Comment period closes on federal regulators' proposal that gives all AAA-rated and AA-rated asset-backed securities (ABS) and mortgage-backed securities (MBS) the same capital treatment as Fannie & Freddie's MBS

The proposal puts privately issued ABS and MBS on a more level playing field with Fannie & Freddie's MBS

Comment letters indicate widespread support for leveling the playing field – except from Fannie & Freddie, which are "up in arms" over the proposal

- According to Erick Bergquist with the *American Banker*, Fannie and Freddie "are up in arms" over a proposed rule that would reduce the amount of capital banks must hold against private-label MBS that are rated AA- minus or higher. Under the proposed rule, privately issued bonds would be risk-weighted at the same level as Fannie and Freddie's securities. As Bergquist noted, under current rules, Fannie and Freddie's lower risk weighting has long supplied a strong incentive to buy their securities instead of privately issued MBS.

- Federal regulators (the Federal Reserve System, FDIC, OCC, and OTS) issued the proposed rule on March 8, 2000, with public comments due June 7, 2000. (*Federal Register*, pages 12320-12352, 3/8/00) The new proposal reflects the views expressed in comments received in response to a proposal issued in 1997. Under the current rules, only Fannie and Freddie mortgage-backed securities hold a 20% risk-weight, while non-agency paper (even AAA-rated paper) have a 50% risk weight. Commercial mortgage-backed securities, asset-backeds and corporates all have a 100% risk-weight. The new proposed rule places all securities rated AA and higher on a level playing field with Fannie & Freddie – all at a 20% risk weight, making private label mortgage-backed securities a more attractive investment for banks.

Widespread support for the proposal

- Bergquist noted that comment letters on the proposed rule indicate widespread support for leveling the playing field – with the exception of Fannie and Freddie. He noted that letters supporting the proposal were received by the Bond Market Association, the American Bankers Association, and the Consumer Mortgage Coalition. The Bond Market Association says the proposal is “well justified.” (*American Banker*, Erick Bergquist, 6/30/00; *National Mortgage News Daily*, 6/27/00) As noted in previous *GSE Reports*, a joint financial services trade letter was sent to the Federal Reserve Board on May 11, 1999 in support of revising the risk-weightings. The letter was signed by the Financial Services Roundtable, America’s Community Bankers, American Bankers Association, Consumer Mortgage Coalition, Mortgage Insurance Companies of America, and the National Home Equity Mortgage Association. (*Joint Bank Trade Letter to Federal Reserve Board*, 5/11/99) The Mortgage Bankers Association also sent a letter to the Fed in support of revising the risk-weightings.

Fannie & Freddie oppose the proposal

- In a June 7 letter, Fannie said it supports the proposal’s attempt to align regulatory capital more closely with transaction risk, however, the rule does not account for the credit risk differences between AA and AAA securities. Fannie recommended that its securities and AAA-rated corporate bonds be assigned lower credit risk weightings than AA-rated bonds and that the recourse rule is “flawed.” The company also noted that regulators should be aware that private-label MBS currently requires a higher risk weighting because mortgages carry higher interest rate risk.
- In a June 7 letter, Freddie noted that the rule would let banks “structure securitizations that reduce the capital requirements to a fraction of what they would otherwise be required to hold, even though the risk exposure remains the same.” (*American Banker*, Erick Bergquist, 6/30/00; *Mortgage-Backed Securities Letter*, Frank Musero, 6/12/00; *National Mortgage News Daily*, 6/27/00)

Market observers note that the proposal could diminish bank portfolio appetite for agencies

- Arthur Frank, head of MBS Research at Nomura Securities International said the proposed changes would “likely diminish bank portfolio appetite for agencies.” The changes would probably “increase bank portfolio demand for investment-grade ABS, CMBS, and private-label MBS, while reduce demand for agency MBS and GSE debt.” Frank also noted that he believes the proposed rule will likely be permanent, based on a favorable comment letter by the Bond Market Association. He notes that the rule could be published as early as the fourth quarter, however, changes may not take effect until next year because the effective date of bank capital requirements is commonly set several months after publication of a rule. (*American Banker*, Erick Bergquist, 6/30/00; *Mortgage-Backed Securities Letter*, Frank Musero, 6/12/00)

Fed up ... or well served by Fannie & Freddie? *Washington Times* provides two dueling views of the GSEs

- The *Washington Times* recently ran point-counterpoint op-ed pieces on the GSEs. Michelle Malkin, a nationally syndicated columnist, wrote a critical piece on the GSEs, while Gregory Fossedal, chairman of the Alexis de Tocqueville Institution, wrote an editorial praising the GSEs. Below are summaries of both their opinions.

Anti-GSE

- According to Malkin, the GSEs are not the companies they claim to be in their “warm and fuzzy” TV, radio and print ads, in which the GSEs claim to be a homeowner’s “best friend.” **“Freddie Mac and Fannie Mae are flawed public-private hybrids that receive unfair advantages in the marketplace.”** Malkin notes that the Congressional Budget Office estimated the GSEs’ receive an average \$6.5 billion subsidy every year from their quasi-government status -- with over one third of the subsidy going to executives and shareholders rather than consumers. **“There is a bill in Congress that would begin weaning the two agencies off the federal dole. It couldn’t happen soon enough.”**
- Malkin quotes Fred Smith of the Competitive Enterprise Institute, who testified on the GSE bill before the House Banking Committee’s Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises in June. According to Smith the GSEs are, **textbook examples of “profit-side capitalism and loss-side socialism.” In other words, says Malkin, when things go right for Fannie and Freddie, they keep the profits. But when things go wrong, government steps in - and taxpayers bear the costs. Smith reminded Congress that “This is what happened in the S&L crisis, and the costs were massive.” Indeed, writes Malkin, “That dreadful bit of loss-side socialism resulted in a \$500-billion bailout by the public.”**
- **“Freddie Mac and Fannie Mae are flawed public-private hybrids that receive unfair advantages in the marketplace,” Malkin writes.** These advantages include state and local income tax exemption, a \$2.25 billion line of credit with the US Treasury. She also noted the executive compensation of GSE officials, like Fannie Mae CEO Franklin Raines’ \$4 million salary and \$6 million in unexercised stock options, and Fannie’s \$6 million spent on lobbying expenses last year. Malkin concluded, **“Political cronyism. Corporate welfare. Billions of dollars in market-distorting subsidies hidden from public view. Fannie Mae and Freddie Mac’s massive profits are their profits. But their debt is our debt. If Congress doesn’t act soon to rein them in, these moochers who sell the American Dream may turn out to be taxpayers’ worst nightmare.”**

Pro-GSE

- Fossedal, however took a different view of the GSEs. He noted that the battle over the GSEs seems to be steeped in envy -- with the GSEs most vocal opponents also their main competitors in the mortgage market. According to Fossedal, the GSEs have done good things for the American mortgage market -- providing liquidity in the mortgage market, and keeping mortgage rates lower. Fossedal noted that the GSEs also stabilize home loans -- providing mortgage funding even during difficult times in the credit industry, such as the 1998 credit crunch. Fossedal also praised the

GSEs for their efforts in providing low- and moderate income housing more affordable in poorer neighborhoods.

- In addition to serving the market well, Fossedal asserted that Congress has made certain that the GSEs stay tightly “tethered” to their original housing mission. He also noted that OFHEO’s risk-based capital tests are so stringent that few banks in the country could pass them.
- To respond to complaints regarding the GSEs subsidies, Fossedal stressed that the GSEs do not abuse their subsidies. “That subsidy now is the rationale used by Fannie Mae’s opponents to press for an increased regulatory burden on both Fannie and Freddie. They complain that a portion of that \$6.5 billion winds up in the pockets of Fannie Mae shareholders and management. In light of the little cost and high benefits, these complaints sound suspiciously as if those corporate banking interests covet the money made by Fannie and Freddie. This is, to say the least, un-public-minded of them.”
- Fossedal concluded by warning that if the GSEs subsidies were eliminated, mortgage rates would rise, the market would become volatile and unstable, housing construction could fall sharply, and the economy would falter in general. “Fannie Mae and Freddie Mac succeeded enormously. They are an example of a government idea that had worked. And is still working well. And if it ain’t broke. Why try to fix it?”

(*The Washington Times*, Editorials, Michelle Malkin and Gregory Fossedal, 6/23/00)

The Evening Standard (London) reports “House party may soon be over for Fannie and Freddie”

- The *London Evening Standard* recently ran an article by Lauren Chambliss, which outlined some problems the GSEs have been facing in recent months. Chambliss noted that Members of Congress along with officials in the international financial economy have begun to sound alarm bells about the economic soundness of Fannie and Freddie. **“The two quasi-government companies may also be at the centre of a systemic imbalance that could have ripple effects overseas where investors, including central banks, have been big buyers of GSE debt.”**
- Chambliss noted that the GSEs receive AAA ratings from Wall Street, even though they have twice the debt level of most US commercial banks. This is due to investor’s belief that the US government (taxpayers) will bail out the GSEs in a financial crunch. The prospect of taxpayers shouldering the financial burden for two huge companies has caused government officials to look into ways to cut the GSEs’ ties to the government, added Chambliss. She added that Alan Greenspan and Treasury officials have gone on record as saying the organization of the GSEs should be examined.
- However, the GSEs’ potential problems do not appear to trouble Wall Street. Chambliss quoted Moody’s analyst Stanislas Rouyer as stating, **“I’m very confident with the triple-A rating based on a combination of financial and business fundamentals being very strong and the implied support from the US government. The relationship between Fannie Mae and the Government is in the form of implied support rather than formal guarantee, but it is important in calculating the rating.”**
- With GSE debt growing by over 20% annually, and Treasury debt shrinking, the GSEs are poised to offer their debt as “benchmark” debt, added Chambliss. Any type of downgrade on GSE debt

could pose problems for US and international financial institutions. According to Chambliss, some US banks have 100% of their capital tied to GSE mortgage-backed securities. In addition, global central banks hold 15% of total GSE debt outstanding.

- However, few analysts fear the government will do anything to diminish the GSEs. “At most, say analysts, Congress might limit the \$2.5 billion line of credit to the Treasury that is mostly symbolic since Freddie Mac and Fannie Mae have not used it in recent memory.” Chambliss concluded by quoting another analyst as stating, “I can’t see a situation where the change in credit status would expose any systemic risk to the major Wall Street houses.” And referring to the hits investment banks took during the Asia crisis, the analyst noted, “this isn’t Russia all over again.” (*The Evening Standard (London)*, Lauren Chambliss, 6/20/00)

As the national debt shrinks, GSE debt skyrockets

GSE debt news:

Bank of England’s mid-year *Financial Stability Review* states that the status of Fannie & Freddie is an area the Bank needs to understand

No word from Fed on whether it will continue to use Fannie & Freddie securities in its open-market operations

OCC official says agency debt is not a threat to banks

- As reported in previous *GSE Reports*, as the national debt shrinks, GSE debt has been skyrocketing. As the national debt is paid down, the supply of Treasury securities shrinks. Investors, traders, borrowers, and even the US Federal Reserve are being forced to find new benchmark securities to replace the shrinking number of Treasuries. Among possible alternatives as a benchmark are the debt securities of Fannie and Freddie. Investors view them as “almost” as good as US Treasuries because of the implicit government guarantee on Fannie and Freddie’s securities. Fannie and Freddie would like to replace Treasuries as a benchmark security and the agencies both have bond issuance programs (Fannie – Benchmark bond program; Freddie-Reference bond program) that mirror traditional Treasury operations in size and regularity.
- Criticisms of the GSEs’ skyrocketing debt have increased. **“Efforts by Fannie Mae and Freddie Mac to become bigger players...raise concerns among some policy makers. The two firms are privately owned. Their securities are considered safe largely because the markets assume that the government, which created both agencies, will stand behind them. If this is true, it means taxpayers are assuming an ever larger risk as Fannie Mae and Freddie Mac expand, while the companies’ shareholders enjoy profits at taxpayers’ expense.”** (*Wall Street Journal*, 2/3/00) Says Jim Murphy with *Dow Jones Newswire*, **“Combined Fannie, Freddie, and the FHLBanks have \$2.6 trillion – T as in trillion – of outstanding debt...I can’t explain why the amount of outstanding debt is so huge. I would think that \$2.6 trillion would be enough to provide every man, woman and child in the US who doesn’t own a home with the equivalent of a custom-designed palace on two acres in the Hamptons.”** (*Dow Jones Newswire*, Jim Murphy, 4/12/00)

Bank of England's mid-year *Financial Stability Review* notes that it is important that the market understands accurately the status of Fannie & Freddie

- According to *The Express (London)*, twice a year the Bank of England tries to identify danger areas for the global financial system. In its latest *Financial Stability Review*, Fannie and Freddie are mentioned as areas the Bank of England needs to review. According to the Bank of England, "Reductions in current and prospective government bond supply in some countries, notably the USA and UK, are affecting the environment in which firms manage risk... That is part of the background to the debate about the status of some US agencies (e.g. Fannie Mae and Freddie Mac), which are very large in dollar interest rate-swap markets and whose debt is heavily held by US banks. It is important that the market understands accurately the status of these institutions. Some adjustments in spreads has occurred since testimony to Congress in March by US Under Secretary Gensler. (*Bank of England press release*, 6/29/00; *The Express (London)*, Patrick Hosking, 6/29/00)

No word from Fed on whether it will continue to use Fannie & Freddie securities in its open-market operations

- According to Paul Sherer with the *Wall Street Journal*, the Fed did not say whether it will continue using Fannie and Freddie's securities in its open-market operations. The Fed authorized using these securities last summer on a "temporary" basis to make up for the declining Treasury supply. The issue is being examined as part of a broad study the Fed is compiling on how best to conduct monetary policy in the post-deficit era. Briefing reporters on the change, Fed official Peter Fisher said the study "will take some time." (*Wall Street Journal*, 7/6/00)

OCC official says agency debt is not a threat to banks

- Michael Brosnan, Deputy Comptroller for Risk Evaluation at the OCC stated that US banks' extensive holdings of GSE debt pose no risk to the banks' soundness. "I see no risk," he stated, in reply to a question during the agency's quarterly news briefing. The question of whether bank holdings of GSE debt has recently surfaced, particularly after Treasury Undersecretary Gary Gensler testified that the role of GSEs' debt in the banking system merited scrutiny. Banks face no limits on what they can carry on their books in GSE debt or securities, while they are barred from putting more than 10% of their capital into the bonds of any other issuer. "We believe that Congress should seriously consider the best way to repeal such exceptions, including a sufficient transition period to prevent any market disruption," Gensler testified. He noted GSE debt made up more than one-third of total bank capital in the US and "a significant portion" of banking system assets. OCC's Brosnan would not comment on the merits of a cap on banks' holding of GSE debt, but noted that, if one were imposed banks would have to find other, likely more risk, investment alternatives, including corporate debt or long-term assets with embedded options. "There's lots of alternatives," he said. (*Dow Jones Newswire*, Jonathan Nicholson, 6/30/00; *Reuters*, 6/30/00)

Wall St. Journal's "Dear Abby" editorial on Fannie & Freddie elicits replies from Fannie, Freddie and supporters

- As reported in the June 23, 2000 *GSE Report*, the *Wall St. Journal* ran an editorial in the form of a "Dear Abby" letter from Fannie and "her brother" Freddie on June 19, 2000. The "letter" took the tone of a whiny teenager who has turned to Abby for support to figure out why no one seems to like "Fannie" and her brother. **Abby's advice to "Fannie" was "Shame on you! Such a lot of whining. Why not just give up your 'special relationship' with the government and privatize, privatize, privatize? It's not ladylike to outstay your welcome."**

- John Buckley, Fannie Mae Senior Vice President of Communications, wrote a Letter to the Editor complaining that the *Journal* “took advice columnist Abigail Van Buren’s good name in vain, and ours as well.” Buckley took issue with virtually every point of the editorial, especially “Abby’s” advice to privatize. According to Buckley, the GSEs are already privatized companies, since Fannie stock is traded on the NYSE, and other banks such as the Federal Home Loan Banks, have government charters. However, a few paragraphs later, as Buckley challenges the numbers used by CBO to determine the GSEs’ subsidy, Buckley readily admits that Fannie takes a subsidy from the government -- only disputing the amount Fannie retains for its shareholders and executives.
- David Palombi, Vice President of Corporate Communications at Freddie Mac also sent a letter to complain about Freddie’s treatment. Palombi’s letter hit on a few areas that Buckley failed to cover -- mainly the GSEs’ affordable housing mission. Palombi noted that Freddie does 55% of its business to low- and moderate-income borrowers, and noted, “in your laissez faire world, try getting any non-chartered institution to shoulder that sort of load.” He suggested Freddie’s market dominance stems from its superior product -- and many borrowers like 30-year fixed rate products. Palombi concluded by questioning why so many are worried about the GSEs’ size -- he asserts that the GSEs grow as the housing market does, and will likely fall if the market does, as it did when the refi-boom ended in 1997.
- James C. Miller III, Budget director under President Reagan, and a co-author of a recent report commissioned by Freddie Mac, also wrote a brief Letter to the Editor. Miller asserts that if the GSEs were privatized, the mortgage market would witness a drop in mortgage efficiency because the GSEs main competitors -- depository institutions-- are also subsidized by the government and would not be privatized. According to Miller, since depositories have higher capital costs, if depositories were not privatized and Fannie and Freddie were privatized, the depositories’ extra output (as a result) would cost taxpayers money and would cause efficiency losses that would exceed those currently resulting from subsidies to Fannie and Freddie. Miller concluded by noting that he does not question whether subsidized homeownership is the best option, he only knows that unilateral privatization would not serve the best interests of the mortgage market and American consumers. (John Buckley, Letter to the Editor, *Wall St. Journal*, 6/26/00; David R. Palombi, Letter to the Editor, *The Wall St. Journal*, 7/3/00; James C. Miller III, Letter to the Editor, *The Wall St. Journal*, 7/3/00)

Fannie Mae

Fannie is still refusing to provide information to Congressional Members on what lawmakers have referred to as a “deceptive” and “disingenuous” lobbying effort by Fannie

- According to Jerry Guidera with *Dow Jones Newswire*, Fannie is refusing to provide lawmakers with details about a lobbying campaign referred to by some lawmakers as “a deceptive and disingenuous effort.” Tension between lawmakers and Fannie erupted when Fannie authorized phone calls to constituents of the House Banking Capital Markets Subcommittee which generated thousands of unsigned letters (air grams) to lawmakers’ offices from constituents warning that consideration of a GSE bill, HR 3703, had raised mortgage costs. The lobbying campaign became the subject of tense exchanges between lawmakers and Fannie Chairman Franklin Raines during hearings on HR 3703. Lawmakers questioned whether Fannie sufficiently explained to their constituents the intent of the campaign when Fannie sought permission to use their constituents’ names on the letters, especially since random sampling of the letters found correspondence from constituents without their consent.
- Chairman of the House Banking Capital Markets Subcommittee Richard Baker (R-LA), Congressman Donald Manzullo (R-IL), Congressman John Sweeney (R-NY), and Congresswoman Judy Biggert (R-IL) sent a letter to Fannie in June demanding that Fannie provide them details of the lobbying campaign. The lawmakers specifically requested that Fannie give them a copy of Fannie’s contract with the firm handling the constituent phone calls (International Data Management). The lawmakers also requested that Fannie provide the materials in time for their subsequent hearing in mid-June with an explanation of “the appropriateness of how the campaign was conducted.”
- A letter was reportedly delivered to the lawmakers just one day ahead of the Capital Markets Subcommittee June 15 scheduled hearing. In the letter, Fannie Chairman Franklin Raines apologized for any discrepancies or errors in its lobbying effort but strongly defended the effort. He would not, however, provide the lawmakers with information about the contract, calling the information “proprietary.”
- Raines said Fannie officials had arranged meetings with lawmakers to explain the campaign and provide detailed information about the lobbying effort. Raines also offered to discuss the information personally with the lawmakers that complained – except the Chairman of the Capital Markets Subcommittee and the author of HR 3703, Cong. Richard Baker. (*Dow Jones Newswire*, 6/30/00)

Consumer group says it is “intensifying” its campaign to have Fannie’s government charter revoked

Neighborhood Assistance Corporation of America (NACA) calls Fannie’s \$1 Trillion Dollar goal and its affordable housing record a “sham”

- According to Brian Collins with *National Mortgage News*, NACA claims that Fannie is using its government charter to benefit shareholders, not consumers. Bruce Marks, Chief Executive Officer of NACA, said “We are intensifying our campaign to have Fannie Mae’s government charter revoked.” He added that “If you are going to act like a private entity and maximize profits for your shareholders like a private entity, you got to get off the public dole.”
- Marks intends to portray Fannie’s \$1 Trillion Dollar goal and its affordable housing record as a “sham.” Marks said “We will take on Fannie Mae and take on Frank Raines personally until they meet the needs of working people.” (*National Mortgage News*, Brian Collins, 6/19/00)

Fannie claims in its advertisements that it is subject to stringent capital requirements

However, after eight years, OFHEO’s risk-based capital standard for Fannie & Freddie has not been finalized

- According to the *American Banker*, Fannie has been claiming in its advertisements that it is subject to stringent capital requirements. However, as Erick Bergquist with the *American Banker* reported, Fannie’s advertisements do not mention that “the rules Fannie is abiding by are self-imposed and based on Fannie’s best guess of what regulations will be.” Bergquist further noted that in fact, the company has been less than enthusiastic about the proposed capital rule its regulator [OFHEO] has proposed.
- Fannie’s ad claims that the company has to withstand high credit losses “equal to the worst regional experience in the last 20 years,” and that it has to hold “enough capital to withstand interest rates either rising or falling by up to six percentage points and staying there for 10 years.” Fannie Spokesman John Buckley said Fannie’s ads were intended to address charges by critics who have “tried to generate fear about our safety and soundness” and to educate the public about the risk-based capital standards Fannie will be subject to under the Financial Safety and Soundness Act of 1992.” However, although the 1992 law created Fannie’s regulator, OFHEO, and tasked OFHEO to create a risk-based capital rule for Fannie and Freddie, after eight years, the new risk-based capital standard has not been finalized. Since 1993, Fannie has been operating under a risk-based capital model that the company had anticipated the final rule would look like – “Fannie’s best guess of what regulations will be.”
- Critics note that it is a victory for them for Fannie to be addressing the safety-and-soundness issue. “Congress raised concerns, then [Fed Chairman Alan] Greenspan did, Treasury did – so it’s not just us,” said Mike House, Executive Director of FM Watch. “We raised the concern early on, but it has now become a chorus and this is their response.” Peter Wallison, a co-author of *Nationalizing Mortgage Risk* (a paper that among other things, compares Fannie and Freddie to the 1980s S&Ls), noted that Fannie’s ads are “somewhat misleading.” For example, he notes that unlike banks, Fannie says it only invests in one asset – mortgages

– “one of the world’s safest assets.” Wallison states, “This is one of the first times I have seen someone argue that a lack of diversity gives them financial strength...That’s exactly what the S&L industry said before it collapsed.” (*American Banker*, Erick Bergquist, 6/9/00)

Fannie starts purchasing zero down-payment mortgages

- According to *USA Today*, Fannie has started purchasing loans that cover 100% of the cost. In the past, Fannie has declined to purchase mortgages that exceed 97% of a home’s value, but recently the firm has been buying the 100% mortgages on a limited, trial basis “with a select group of lenders.” Fannie officials declined to identify the lenders. Under the pilot, borrowers are required to provide at least 3% of the purchase price to cover closing costs. Fannie Vice President Joseph Biegel says Fannie has not interest in purchasing 103% mortgages. “We frankly think it’s a risky product for the lender, for the borrower and for us,” he said.
- Neil Bader, CEO of IPI Skyscraper Mortgage in New York said he’s concerned about the increase of mortgages with no down-payments. In an economic downturn, consumers may not be able to pay off those big mortgages and a big pile of consumer debt, which could result in a higher default rate. “The question is whether in five years the economy will support those loans,” Bader says. (*USA Today*, 6/15/00)

CitiMortgage and Fannie announce new partnership to provide \$12 billion in affordable housing lending

- CitiMortgage and Fannie announced a new partnership on June 22 that will provide \$12 billion in affordable housing lending over the next five years. To achieve this goal, CitiMortgage has committed to originate and Fannie has committed to purchase \$12 billion in affordable mortgage loans. CitiMortgage plans to originate the loans nationwide through all CitiMortgage affiliates and their business partners, with concentrated marketing efforts in six major metropolitan areas including: the New York City/Tri-State Area; the Baltimore/Washington area; Chicago; Miami/South Florida; Los Angeles/Orange County; and the San Francisco Bay Area. CitiMortgage and Fannie will also join forces with key national organizations to reach targeted markets, including the Local Initiatives Support Corporation, the National Association of Hispanic Real Estate Professionals, the National Association of Real Estate Brokers, and the National Urban League. CitiMortgage will also utilize its alliance with Revelation America, Inc., an African-American church-owned Internet company involving more than 400,000 faith-based organizations, to provide homeownership opportunities. (*Fannie press release*, 6/22/00)

Fannie works with a coalition of lenders and regional housing organizations to help low-income families buy their first homes using newly available government funding

- According to Erick Bergquist with the *American Banker*, Fannie is working with a coalition of lenders, regional housing organizations and charitable trusts to help low-income families buy their first homes using newly available government funding. The program is called the Section 8 Homeownership Initiative. Under the initiative, Fleet Bank, European American Bank, HSBC Bank and Chase Community Development are providing the first mortgage. Fannie has committed to purchase the first mortgage and European American will process them. The non-profit Community Development Corp. of Long Island (CDCLI) will provide the second mortgage using funds from Fannie and other sources to make up the difference between the cost of a home and what residents would be able to afford in a conventional mortgage. The second mortgage is paid

off using HUD Section 8 subsidies, and the borrower only pays the second mortgage if their salaries increase. (*American Banker*, Erick Bergquist, 6/14/00)

One of the largest owner/managers of manufactured homes communities in the US lines up a \$177 million Fannie Mae credit facility

This is Fannie's first credit facility for a manufactured housing REIT

- Chateau Communities has lined up a \$177 million Fannie credit facility through Collateral Mortgage. Chateau, a REIT, is one of the largest owner/managers of manufactured home communities in the United States. Collateral Mortgage funded seven first mortgages secured by seven separate manufactured housing communities comprising 4,467 sites in California, Florida, and Michigan; Fannie in turn purchased the loans from Collateral in exchange for a fixed-rate MBS. The credit facility provides non-recourse mortgage financing on the Chateau properties. Proceeds will be used to replace secured debt and to pay down lines of credit. The credit facility was initially funded with \$116 million and includes an expansion feature under which Fannie could provide \$61 million more. Chateau also has the option to substitute collateral properties without incurring prepayment penalties. While Fannie has arranged credit facilities for 18 multi-family REITs, this is its first one for a manufactured-housing REIT. (*Fannie press release*, 6/19/00; *Commercial Mortgage Alert*, 6/26/00)

Fannie realigns its management and forms new electronic commerce unit (Fannie Mae/e-Business) and a new systems and operations unit

- Fannie announced the formation of a new electronic commerce unit and a new systems and operations division that will combine its former corporate information services and operations department. Fannie promoted Julie St. John to Executive Vice President and Chief Technology Officer and Michael Williams as President of Fannie's electronic commerce unit (Fannie Mae/eBusiness), the company's business unit dedicated to developing e-commerce strategies. According to the *American Banker*, St. John's appointment is subject to board approval.
- Fannie said St. John will be responsible for the company's enterprise systems and operations, a new division consisting of the combined departments formerly known as corporate information services and operations. She will oversee all of the technology and operations in all the various business units and will have the management responsibility for more than half of Fannie's employees. St. John is currently Senior Vice President, Guaranty and Franchise Technology and most recently managed Fannie's Y2K contingency planning and the company's technology upgrading. Her new duties include those of former Chief Information Officer William Kelvie, whose position was eliminated but who stays on as Senior Strategic Technology Adviser to the Chairman. St. John will report to Daniel Mudd, Vice Chairman and Chief Operating Officer.
- Williams will head Fannie's new eBusiness unit. Williams joined Fannie in 1991 and most recently served as Senior Vice President for Electronic Commerce Initiatives for the Single-Family Business and SVP for Customer Applications and Technology Integration. Williams will report directly to Fannie Chairman Franklin Raines.
- Fannie also named Lynda Horvath Senior Vice President of the new products unit. Horvath is currently Senior Vice President for Financial and Structured Transactions. Fannie also named Thomas Lund Senior Vice President of Financial and Structured Transactions and Mercy Jimenez

as Senior Vice President of the southwestern region. Lund is currently the Senior Vice President for the southwestern region, and Mercy Jimenez is currently the Vice President of Marketing in the southwestern region. (*Fannie press release*, 6/30/00; *Dow Jones Newswire*, 6/30/00; *American Banker*, 7/10/00)

President Clinton appoints former Atlanta Mayor Maynard Jackson to Fannie's Board

- Former Atlantic Mayor Maynard Jackson was appointed by President Clinton to serve on the Board of Fannie – “one of the most prestigious federal appointments,” according to *the Atlantic Constitution*. The position does not require Senate confirmation. Its directors are paid to serve on the board, and before being appointed, directors undergo extensive scrutiny by both the FBI and the White House Office of Legal Counsel. Jackson was a three-term mayor of Atlanta. (*Atlanta Constitution*, 6/30/00)

Democratic Presidential candidate Al Gore announces a tax proposal for energy-saving home and car purchases with representatives from Fannie

- Democratic Presidential candidate Al Gore announced a proposal for spending \$48.2 billion over 10 years on tax credits for people who buy fuel-efficient vehicles and homes. Gore made his announcement at a construction site on the east side of Columbus, OH in a new subdivision of energy-efficient homes in Blacklick – standing alongside representatives of Fannie and the construction company that is building the new homes. (*Bloomberg*, 6/28/00)

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

Fannie has 44 partnership offices open across the country

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

Hiring of political officials blurs the line between public service and private enterprise

- **A spokeswoman for the Fannie/Freddie watchdog group, FM WATCH, stated that “many of those hired by Fannie Mae and Freddie Mac are specifically assigned to oppose any legitimate debate on Capitol Hill, in the administration, in the White House and the industry, about Fannie Mae's and Freddie Mac's role.”** (*American Banker*, Joshua Brockman, 7/16/99)

Fannie has 44 partnership offices

- According to Fannie's website, the company has 44 partnership offices open across the country. (http://www.fanniemae.com/contact/partnership_offices.html, 5/22/00)
- The Fannie Mae Foundation announced it has provided more than 10 million consumers with Fannie's home buying guides through a six-year-old home ownership program. (*Inman News Feature*, 6/26/00)

Senator Susan Collins (R-ME), Cong. Thomas Allen (D-ME), Portland Mayor Cheryl Leeman, Leiston Mayor Kaileigh Tara

- Fannie and its Northeastern Regional Office held a press conference with the above named officials to announce a \$2 billion investment plan in affordable and rental financing as part of “House Northern New England.” Fannie also announced that Dennis Corrigan would be the Director of the Northern New England Partnership Office. From 1994-1997, Corrigan served as Chief of Staff and General Counsel to the Deputy Attorney General of the United States. (*Fannie press release, 6/26/00*)

Senator John Edwards (D-NC)

- Senator Edwards joined Fannie to announce the statewide availability of Fannie’s mortgage product, the Timely Payments Rewards Mortgage. (*Fannie press release, 6/26/00*)

Cong. Spencer Bachus (R-AL) and Birmingham Mayor Bernard Kincaid

- Fannie held a press conference with the above named officials and representatives from Baptist Health System to announce a new employer-assisted housing plan partnership. (*Fannie press release, 6/26/00*)

Cong. John Tanner (D-TN)

- Cong. Tanner joined Fannie in convening a housing forum with Middle Tennessee housing leaders. (*Fannie press release, 7/6/00*)

South Carolina Governor Jim Hodges

- Governor Hodges and Fannie’s Chief Economist David Berson joined Fannie’s South Carolina Partnership Office Advisory Council to discuss affordable housing issues. (*Fannie press release, 6/21/00*)

Albany, NY Mayor Jerry Jennings and MBA President Kit Sumner

- The MBA, Fannie, and Fleet Bank, HSBC Bank pledged \$1 million for a new program in the City of Albany aimed at helping first time homebuyers. The program was announced at a City Hall news conference by Albany Mayor Jerry Jennings, MBA President Christopher Sumner, and Fannie Executive Vice President Robert Levin. The program will provide loans between \$2,000 and \$5,000 for down-payment assistance or closing costs in conjunction with obtaining a first mortgage. Financing for the home mortgage program was made possible through a \$1 million commitment from Fannie through its Down Payment Assistance Investment Note (DPAIN). The City invested \$100,000 and Fleet and HSBC Bank, each invested \$75,000 in the DPAIN. Fannie’s DPAIN is used to create a loan fund, administered by the City, which consumers can use for down payment and closing cost assistance. DPAIN is available to individuals of all income levels who purchase a home within the city through the Albany Home Store, to be opened soon. The Albany Home Store will provide a one-stop location for comprehensive counseling and services to assist individuals in becoming successful homebuyers in the city. Although the program is local and relatively small, MBA President Sumner said he sees the potential for developing similar programs in other cities. (*MBA press release, 6/19/00; American Banker, 6/21/00*)

Memphis, TN Mayor Willie Herenton

- Mayor Herenton joined Fannie to announce \$3 million in new-downpayment and closing cost assistance for Memphis families. (*Fannie press release, 6/21/00*)

Hope, NJ Mayor Timothy McDonough

- Mayor McDonough joined Fannie's New Jersey Partnership Office Advisory Council to discuss affordable housing issues facing the state. (*Fannie press release, 6/20/00*)

Texas State Representative Helen Giddings (D-TX)

- State Representative Giddings joined Fannie and CTX Mortgage Company to celebrate a family's home purchase made possible by a new low down-payment mortgage product by CTX Mortgage. (*Fannie press release, 6/22/00*)

Fannie makes a series of technology announcements
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Six lenders and 20 brokers recognized for using Fannie's technology systems

- During the National Association of Mortgage Brokers Annual Convention, Fannie recognized six lenders who have originated more than \$1 billion of wholesale business using Desktop Originator. The six lenders are Bank of America, First Horizon Home Loan Corporation, First Union Mortgage Corporation, InterFirst division of ABN-AMRO Mortgage Group, Monument Mortgage, and RBMG, Inc. These six lenders join last year's inductees: Crestar/SunTrust Mortgage; CrossLand Mortgage; Flagstar Bank; HomeSide Lending; Irwin Mortgage; Ohio Savings Bank; and Trustcorp Mortgage. Fannie also recognized the top 20 brokers for using Desktop Originator to process more than \$500 million dollars in mortgage loans. These brokers are: Alpha Mortgage Corporation, AmeriNet Financial Systems; Ameristar Mortgage Corp; CO&F Mortgage Corporation; CMG Mortgage; Coats & Co; Drew Mortgage Associates; Elite Funding Corporation; FM Lending Services; Hancock Mortgage Corp.; Homeowners Mortgage Corporation; Jericho Investments Co.; Jupiter Mortgage Corp.; Land Home Financial Services; Mortgage Masters; Mortgage One, Inc.; Northeast Mortgage Corporation; Powder House Mortgage; Premier Mortgage Group; and Sibcy Cline Financial Services. (*Fannie press release, 6/26/00*)

Fannie unveils SURF

- Fannie unveiled Servicers' Reconciliation Facility (SURF) to aid servicers on its website (www.fanniemae.com). SURF provides registered servicers with web-based access to data for their Fannie loans directly from Fannie's LASER™ database, the company's primary source of loan accounting data. (*Fannie press release, 6/21/00*)

Finet.com (owner of iQualify.com) and Ellie Mae announce a technology partnership

- Finet.com signed a strategic alliance with Ellie Mae, which provides technology for the mortgage industry. The alliance will integrate Finet's iQualify technology into Ellie Mae's customized mortgage originator websites. Participating mortgage originators through the Ellie Mae Business Center (a business-to-business Internet-based transaction portal), which interfaces with the originator's private label website hosted by Ellie Mae, will now be able to offer their prospective borrowers iQualify's automated underwriting loan analysis technology and the products of Monument Mortgage (a subsidiary of Finet.com). Qualified consumers will be able to apply for a loan on the Ellie Mae broker's website and receive approval within minutes for a loan funded by Monument Mortgage. [Editorial Note: iQualify was the first website to allow consumers direct access to Fannie's automated underwriting system, Desktop Underwriter.] (*Finet.com press release, 6/27/00*)

LionInc. announces alliance with the NAMB

- LionInc.com announced an alliance with the National Association of Mortgage Brokers that will result in a co-marketing membership campaign. Both organizations plan to implement Internet

strategies to their own audiences of mortgage originators. (*National Mortgage News Daily*, 7/5/00)
[Editorial Note: The LionInc.com website allows sponsored brokers access to Fannie's Desktop Originator using the LionInc.com website to certify underwriting decisions and conditions at the "point of sale" (when the broker is sitting with the borrower during the initial visit.) LionInc.com is a mortgage industry website providing products and rate information to mortgage brokers.]

Freddie Mac

Freddie contributed \$250,000 in soft money to the Republican National Committee in May

- According to *Congress Daily*, Freddie Mac contributed \$250,000 to the Republican National Committee in May. (*National Journal's Congress Daily*, 6/26/00)

Federal Home Loan Banks

FHFB Chairman Bruce Morrison officially resigned, effective July 4

Only two Board Members remain on the five-member FHFB

FHFB Spokesman says the FHFB should be able to conduct business as usual under delegated authority - the authority of FHFB Chairman will be delegated to HUD Assistant Secretary William Apgar

- In a June 29 letter to President Clinton, FHFB Chairman Bruce Morrison officially resigned his appointment as FHFB Chairman, effective July 4. Federal Housing Finance Board Chairman Bruce Morrison announced June 6 that he will step down in July to become Vice Chairman of GPC/O'Neill & Associates, an international public relations and governmental consulting firm. Morrison has chaired the FHFB since 1995.
- Morrison's resignation leaves the FHFB with only two Board Members on a five-member Board: FHFB Director J. Timothy O'Neill and a seat reserved for the Secretary of Housing and Urban Development or his designee (currently filled by Assistant HUD Secretary William Apgar). **Robert Davis, America's Community Bankers' Managing Director of Government Relations, said that "If Morrison leaves before they approve a replacement, they [FHFB] won't have a quorum, and they can't take any action on the issues." Davis said regulatory guidelines require the FHFB to have at least three board members in order to transact business. A FHFB Spokesman, however, said that even with just two members, the FHFB should be able to conduct business as usual under delegated authority. The Spokesman said HUD's Apgar would be delegated the authority of Chairman.**
- Four nominees (including current Director Timothy O'Neill) are waiting to be confirmed by the Senate: Allan Mendelowitz, formerly a senior official at the GAO; Franz Leichter, who served in the New York State Senate; Douglas Miller, who served as chief of staff to then Sen. Larry Pressler; and current FHFB Director Timothy O'Neill, who remains on the board although his term has expired.

- So far, the Senate Banking Committee has not taken up the nominations, and no confirmation hearings are scheduled. The *American Banker* reported that the next Chairman of the FHFBS will be installed under a Presidential recess appointment. Although *Dow Jones* reported that White House Press Secretary Joe Lockhart said “no one had made me aware of any recess appointments coming up.” A FHFBS spokesman said that Mendelowitz and Leichter are strong prospects for the Chair of the FHFBS, however, the Chairman would not be named until at least one nominee is confirmed. (*American Banker*, 11/30/98, 6/12/00, Marc Hochstein and Sarah MacDonald, 6/7/00; *BNA Daily Report for Executives*, 6/7/00, 6/9/00, 6/10/99, 7/7/00; *Dow Jones Newswire*, John Connor, 6/6/00, 7/7/00; *National Mortgage News website*, posted 10/22/98, 6/9/99, 6/7/00, 6/9/00; *White House press release*, 10/21/98; *Wall Street Journal*, 6/9/00)

FHFBS approves final rule that will shift the responsibility for issuing the FHLBank System’s debt from the FHFBS to the 12 FHLBanks

FHFBS cites concerns over the potential liability of the US to lawsuits – such as the one brought by Orange County – among the reasons why it wants to give up its role as issuer of FHLBank System debt

- The FHFBS approved a final rule that devolves to the FHLBanks the authority to issue consolidated obligations (COs) through the FHFBS’s Office of Finance. Currently, the FHFBS issues the FHLBank System debt, also through the Office of Finance. The change will have no substantive effect on the debt issuance process or on the joint-and-several liability of the FHLBanks to bondholders. “The Finance Board should not be involved as both the issuer and the regulator for the Federal Home Loan Banks,” said FHFBS Chairman Bruce Morrison. The final rule was published in the *Federal Register* on June 7 and takes effect July 1, 2000.
- The final rule also requires the Office of Finance to prepare the combined FHLBank System annual and quarterly financial reports as part of the CO issuance function. The rule establishes a new capital leverage standard for the FHLBanks, changing from a liability-based limit to an asset-based limit. The Gramm-Leach-Bliley Act requires the FHLBanks to be subject to asset-based leverage limits and risk-based capital requirements.
- The final rule differs from the proposed rule published January 4, 2000 in that it does not address the restructuring of the Office of Finance regarding managing joint asset activities or the size of its board of directors. Those proposals remain under active consideration by the FHFBS and will be addressed in future rulemaking. (*FHFBS press release*, 6/5/00, *Federal Register*, 36290-36304, 6/7/00)

FHFBS cites concerns over the potential liability of the US to lawsuits – such as Orange County – among the reasons why it wants to give up its role as issuer of FHLBank System debt

- According to John Connor with *Dow Jones Newswire*, the FHFBS cited a desire to remove the potential for conflict of interest in its role as regulator of the FHLBank System and issuer of debt as a reason for the shift. “While the Finance Board has long been uncomfortable serving in both of these capacities, the process, while awkward, has worked quite successfully,” the FHFBS said. “However, the Finance Board’s discomfort turned to concern over potential liability for the United States as a result of litigation arising from the bankruptcy of the County of Orange, California. In the course of the Orange County litigation, (which has since been settled with respect to the Banks, the FHLBank System’s Office of Finance and the United States), the United States District Court for the Central District of California held that Orange County had stated a claim for relief based on

its contention that the United States violated the federal securities laws in the issuance of certain COs,” the FHFB stated.

- “The District Court also found that Orange County’s claim for ‘restitution’ under the provisions of the Administrative Procedures Act was not barred by the doctrine of sovereign immunity,” it said. “The Finance Board does not endorse these holdings, but has determined to limit any further risk to the United States from such suits,” the FHFB said. “By taking the proposed action, the Finance Board can accomplish this goal as well as that of making the Banks responsible in name for this most central aspect of their business.”
- In the wake of its 1994 bankruptcy, Orange County sued the FHLBanks and the FHFB. The Orange County lawsuit was settled in 1998 with a payment by Merrill Lynch & Co. to Orange County. (*Dow Jones Newswire*, John Connor, 1/5/00)

FHFB Chairman Bruce Morrison claims the FHLBanks have made a “dramatic” shift away from arbitrage investments to mission-related investments

- According to John Connor with *Dow Jones Newswire*, FHFB Chairman Morrison said the FHLBank System has engineered a “dramatic” shift to mission-related investments. In a recent letter to Senator Chuck Hagel (R-NE), Morrison noted that five years ago the FHLBanks System’s arbitrage investments were at the top of the list of FHLBank concerns of many members of Congress and the Treasury Department. “And rightly so,” he stated. “The FHLBanks balance sheets reflected 40% mission-related activity and 60% arbitrage investment activity,” he stated. “The arbitrage activity did not further the mission of the FHLBanks,” he said. In his letter, Morrison noted that the FHFB has been making efforts to rein in the arbitrage activities of the System. He wrote, “I am pleased to report that, to date, these efforts have resulted in dramatic changes in the FHLBank balance sheets.” He said 75% of the FHLBanks’ assets currently are “mission-related, but there is no substantive, business-related mission why they can not achieve higher percentages over time.” (*Dow Jones Newswire*, John Connor, 6/30/00)

FHFB issues final rule on standards regarding elections of Directors at the FHLBanks

- The FHFB issued a final rule amending its regulations to address the status of the 1999 and 2000 elections of directors at each FHLBank and to provide standards regarding the manner in which the FHLBanks must stagger their boards. The final rule is effective August 7, 2000. (*Federal Register*, pages 41560-41576, 7/6/00)

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