

The **GSE** REPORT™

Contents of GSE Report™

“At a time when the stockmarket is showing only fitful enthusiasm, the share-price performance of two companies stands out: Fannie Mae and Freddie Mac. This is not because there has been a sudden boom in home construction. It is a result of their brilliant dexterity in prevailing upon Congress to condone what is, in essence, a rip-off of taxpayers.” (*The Economist*, 11/4/00)

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 - *Market News International* suggests that with the addition of subordinated debt, the GSEs may issue more debt to support more “mission creep” – with subordinated debt, the overall market for GSE debt may expand, in which case, “the implied restraint on GSE growth will be next to none”
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 - [Editorial Note: A detailed analysis of the GSEs’ voluntary initiative is available in the November *GSE Report Special Supplement*.]
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- Fannie & Freddie’s mission regulator – HUD – says GSEs’ voluntary initiative is no substitute for strong oversight (*p. 13*)
 - HUD says it shares concerns of the Mortgage Bankers Association that the lines between the primary and secondary market could blur
- Market observers question the details of Fannie & Freddie’s voluntary initiative and wonder if the GSEs will have separate interpretations about how to implement the initiative (*p. 13*)
 - Market observers also question what role OFHEO will play as the plan goes forward
 - Freddie claims it worked for months with Fannie on the initiative
- *The Economist* magazine calls the GSEs’ voluntary initiative “Another triumph for America’s government-backed mortgage agencies, at the expense of taxpayers.” (*p. 14*)
 - *The Economist* describes the initiative as “a complicated and relatively empty six-point agreement... emphasizing disclosure but making no fundamental difference to the privileged status of Fannie & Freddie”
 - “At a time when the stockmarket is showing only fitful enthusiasm, the share-price performance of two companies stands out: Fannie Mae and Freddie Mac. This is not because there has been a sudden boom in home construction. It is the result of their brilliant dexterity in prevailing upon Congress to condone what is, in essence, a rip-off of taxpayers.”
 - “Fannie Mae and Freddie Mac straddle an interesting line between what America seems to represent around the world (free markets) and what everyone in Washington, DC really loves most (free money for a favored group).”
- OFHEO solicits public comments on risks to the financial system that may be caused by Fannie & Freddie (*p. 16*)
- HUD issues final affordable housing rule for Fannie & Freddie (*p. 16*)
- FHLBanks of Cincinnati, Indianapolis, and Seattle receive approval for their Mortgage Purchase Program (MPP) (*p. 16*)
 - MPP, like the FHLBank of Chicago’s Mortgage Partnership Finance (MPF) program, is a competitor to Fannie & Freddie in the secondary mortgage market
 - MPP program is expected to purchase up to \$2 billion in loans in 2001
- GAO finds that the Farm Credit Administration (FCA) overstepped its authority by issuing a national charter initiative for Farm Credit System banks without submitting the plan to a formal rule-making process (*p. 17*)
 - House Banking Committee Chairman Jim Leach (R-IA) asks the FCA to withdraw its plan
 - Chairman Leach states, “Our financial market system could literally be traumatized with government credit competitively crowding out private markets.”

Fannie Mae and Freddie Mac

- Fannie & Freddie make large political contributions this election cycle (*p. 19*)
 - The two GSEs and their employees gave almost \$3 million this election cycle (the numbers reflect donations from January 1999 – June 2000, so the numbers are expected to be larger when the cycle ends in November)
 - Consumer advocate Ralph Nader stated in June 30, 1999 testimony before the House Budget Committee that some of the GSEs’ government subsidies – intended to lower costs for homebuyers – are being diverted to build political and lobbying efforts “designed to make it difficult, if not impossible, for the Congress to provide (or the public to demand) proper oversight or regulatory improvements which would protect the public, increase support for affordable housing or ensure open competition in the mortgage market.”
- President of Competitive Enterprise Institute (CEI) claims Fannie & Freddie are “Fiscal Frauds” (*p. 20*)
 - “In order to keep their special advantages, Fannie and Freddie lobby government, buy off opponents, and blast away their critics... When you’re allowed to play with ‘Monopoly’ money (and everyone else has to use the real thing), you can buy up all the houses and hotels... Monopoly money just makes it easy to become a *monopolist*. The rapid growth of Fannie and Freddie during the 1990s suggests that the agencies are well on their way to becoming just that.”
 - CEI President suggests that the Justice Department develop a breakup/divestiture plan for the GSEs
 - “They [Fannie & Freddie] weaken the private sector institutions that still play an important mortgage financing role... They entangle commerce and government, leading to a situation akin to that of Europe where government-pampered banks are ‘too big to fail.’ While some of the capital diversion lowers mortgage costs to those eligible for Freddie/Fannie purchases, at least one-third of it goes to their management and shareholders.”
- Citizens Against Government Waste (CAGW) slams the government-guaranteed perks for Fannie Mae bureaucrats (*p. 21*)
 - CAGW also calls for GSE reform in its booklet, “*Prime Cuts Summary: 45 Ways to Leaner Government*”

- *The Christian Science Monitor* questions Fannie & Freddie’s expansion into new business areas, their skyrocketing debt, and their billions of dollars in subsidies (p. 22)
 - Editorial calls for constraints on the GSEs’ growth and more regulation
 - “Obviously, the time has come to decide just how large these two institutions should be, what constraints should be placed on their growth, and how they should be regulated.”
- Fannie & Freddie report double-digit third quarter earnings (p. 23)
 - Earnings are fueled by GSEs’ purchasing of their own mortgage-backed securities for their retained portfolios
 - GSEs’ purchasing of their own mortgage-backed securities is not mission critical for the GSEs and has more to do with maximizing profits
- FM Watch website releases new “Truth Watch” to review Fannie & Freddie’s submission for the September GSE Roundtable (p. 25)
 - FM Watch also highlights the contradictory statements by the GSEs – the “Many Faces of Fannie Mae and Freddie Mac”

Fannie Mae

- *American Banker* article: “Fannie Mae Out to Eat Private Mortgage Insurers’ Lunch Again?” (p. 26)
 - Fannie’s new mortgage insurance structures put the company in a position of selecting a mortgage insurer and setting the pricing
 - Mortgage insurers and lender sources say, “that...has ominous implications for the mortgage industry.”
 - Traditionally, lenders – not the GSEs – have been considered the mortgage insurers’ customers
 - Keefe, Bruyette & Woods, Inc. Analyst David Graifman agrees. “It’s much better to have thousands of customers [lenders] than two [Fannie Mae and Freddie Mac]”.

Freddie Mac

- Large lenders find fault with Freddie’s moves to make it easier for smaller lenders or brokers to sell loans directly to Freddie (p. 28)
 - “This is the GSEs taking another step toward dealing with brokers more directly,” said FM Watch Executive Director Mike House

Federal Home Loan Banks

- FHLBank of Chicago floats and then withdraws a \$100 million stock offering (p. 29)
 - The resources would have been used to grow the FHLBanks’ Mortgage Partnership Finance (MPF) program

Major Events

Another “October Surprise” by the GSEs

Cong. Baker announces an agreement with Fannie & Freddie on a voluntary risk-management initiative by the GSEs

Cong. Baker calls the GSEs’ voluntary initiative a “meaningful first step” but says he will seek additional GSE reforms – Baker will work on legislation to improve the regulation of the GSEs and address the issue of “mission creep”

GSE critics are not satisfied with the GSEs’ voluntary initiative – debt, mission creep, affordable housing, and safety and soundness concerns are still not addressed

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***Market News International* suggests that with the addition of subordinated debt, the GSEs may issue more debt to support more “mission creep” – with subordinated debt, the overall market for GSE debt may expand, in which case, “the implied restraint on GSE growth will be next to none”**

Treasury Department says the GSEs’ voluntary initiative does not address all of its concerns

Citizens Against Government Waste says more significant reforms needed

MBA says there are other important GSE issues such as mission oversight and a clear definition of the secondary market that need to be addressed

America’s Community Bankers says GSEs still need a strong regulator and need to contain GSEs’ mission creep

FM Watch says the GSEs’ voluntary initiative shows that Fannie & Freddie “are finally admitting that the risk to the taxpayers is real” but that the proposal “doesn’t change the need for comprehensive legislation”

[Editorial Note: A detailed analysis of the GSEs’ voluntary initiative is available in the November *GSE Report Special Supplement*.]

GSE proposal for risk-management

- Cong. Baker announced on October 19 that he had reached an agreement with Fannie and Freddie on a proposal containing a series of voluntary risk-management steps to be taken by the agencies that he stated “represents a meaningful first step toward a major victory for American taxpayers.” He notes that the GSEs’ voluntary initiative “lays the groundwork for a new high watermark of corporate responsibility, market transparency, market self-discipline, and proactive protections against systemic risk.” Fannie Chairman Franklin Raines and Freddie Chairman Leland Brendsel participated in the press conference. Fannie and Freddie said their voluntary initiative “will ensure that Freddie Mac and Fannie Mae’s risk management and disclosure standards are at the vanguard of evolving global capital, risk management, and disclosure practices.” The voluntary initiative was developed to “put to rest any questions regarding our future safety and soundness,” said Freddie Chairman Leland Brendsel. (*Statement by Cong. Baker, 10/19/00; Fannie/Freddie joint press release, 10/19/00; Statement by Freddie Chairman Leland Brendsel, 10/19/00*)
- Fannie and Freddie’s safety and soundness regulator – OFHEO – was not aware of the negotiations and was not involved in the agreement. OFHEO Director Armando Falcon cautioned that “these voluntary steps do not in any way substitute for strong regulation.” (*American Banker, Erick Bergquist, 10/26/00*) Falcon also raised concerns about the initiatives, particularly the GSEs’ plans to issue subordinated debt. [See next story in this *GSE Report* for OFHEO’s comments.]

Components of the GSEs’ voluntary initiative

- A summary of the components of the agreement were distributed at the press conference, however, the complete details of the agreement were not available to the public. The components of the voluntary initiative are as follows:
 - (1) Issue subordinated debt – after a three-year phase in - on a semi-annual basis equal to or in excess of 4% of on-balance-sheet assets.
 - (2) Maintain more than three months’ worth of liquidity assuming the GSEs have no access to public debt markets.
 - (3) Implement an interim risk-based capital stress test until permanent risk-based capital regulations are finalized by OFHEO.
 - (4) Initiate public disclosure of interest-rate risk on a monthly basis and disclose credit-risk sensitivity analyses and results on a quarterly basis.
 - (5) Obtain an annual rating from a rating organization and disclose the rating to the public.

(*Statement by Cong. Baker, 10/19/00; National Mortgage News Daily, 10/20/00; Bloomberg, Rob Wells, 10/19/00; Fannie/Freddie joint press release, 10/19/00*)

Cong. Baker says he will introduce a new bill next year

- In terms of Cong. Baker’s current GSE bill (HR 3703), Cong. Baker indicated that this voluntary initiative addresses half of the issues in his bill. “We’re halfway there,” he said at the press conference. “No one thought we would get 10 percent there.” Cong. Baker hoped to address two items with his GSE bill: (1) enhance transparency for market discipline (addressed in agreement); and (2) create an appropriate regulatory structure (not yet resolved).
- Baker stated that although he had agreed to the voluntary adoption of this proposal, he has not relinquished his congressional obligation to ensure that a “real regulator is put in place to monitor the situation.” He noted that he has discussed the possibility of moving GSE oversight to the Treasury Department or even the OTS.

- Cong. Baker indicated that there was no “new products approval process in this proposal” and he was “concerned about the current regulatory structure capacity to monitor new products.” For this reason, among others, he said he will be introducing legislation “calling for the creation of a new regulatory body whose features will include at least the following characteristics: that it is independent; that it has the resources established apart from the appropriations process; and that it has prompt corrective authorities and power to enact them.” (*Statement by Cong. Baker*, 10/19/00) Cong. Baker said he plans to discuss all ideas with regulators before issuing a discussion draft bill when the new Congress convenes next year. (*American Banker*, Michele Heller, 10/20/00) Cong. Baker told *Reuters* on October 19, that he was scrapping his proposal to remove the GSEs’ credit line to the Treasury but said he would try to ensure that a tough new regulator was put in place to oversee their activities. (*Reuters*, 10/20/00)

GSE critics are not satisfied with the GSEs’ voluntary initiative

- **According to Patrick Barta and Jerry Guidera with the *Wall Street Journal*, Fannie and Freddie “scored some much-needed brownie points with their critics in Congress” when they announced their voluntary risk-management proposal, but it “isn’t likely to end the debates” about whether to contain the growth of the GSEs. John Connor with *Dow Jones Newswires* states, “If Freddie and Fannie had hoped to buy political and regulatory peace and quiet for the foreseeable future with their virtue, well, good luck.”**
- Barta and Guidera note that the GSEs’ voluntary initiative “didn’t appease” Cong. Baker who intends to introduce new legislation next year that will strengthen regulation of the GSEs. The proposal has also not silenced other GSE critics, who feel that the voluntary initiative did not provide enough reform. Instead, the initiative has given Fannie and Freddie “a temporary reprieve and allows all parties to leave Washington this year looking as though they made headway.”
- **Barta and Guidera note that “analysts concede that the nonbinding agreement came at little cost” for Fannie and Freddie. Sanford C. Bernstein analyst Jonathan Gray said the proposal would lessen some of the political pressure on the GSEs, but he noted that many of provisions are simply extensions of what the companies already do. For example, the proposal calls for Fannie and Freddie to maintain 5% of their current assets as “liquid assets.” According to Gray, Fannie and Freddie currently hold 8% of their assets as liquid assets. “This is like telling someone who weighs 180 pounds to go on a diet so can keep his weight below 200 pounds,” Gray said. Salomon Smith Barney Analyst Thomas O’Donnell said Fannie and Freddie’s initiatives “cost them very little and yet have attained for them the most important factor impacting the share price: a reduction in political risk.”**
- **ISI Group Managing Director Andy Laperriere is advising his clients that the safety and soundness concerns are gone for the moment, but will likely come up again. He noted a recent Goldman Sachs report that found that Fannie and Freddie will have \$8 trillion in debt by 2010 if current trends hold. (*Wall Street Journal*, Patrick Barta and Jerry Guidera, 10/23/00; *Dow Jones Newswire*, John Connor, 10/20/00)**

Question of whether subordinated debt would be rated without the GSEs’ implied government guarantee

- **According to Tyler Lifton with *Dow Jones Newswire*, the intended purpose of the GSEs’ plans to issue subordinated debt “is to provide an asset that is distinguished from the companies’ debentures and from the implicit government support they enjoy...The problem, however, is**

that some analysts are having a hard time assuring themselves that the same implicit official support won't exist for the subordinated debt."

- **Lifton explains that in essence, subordinated debt "offers a barometer for the market to measure perceived credit problems because in the event of financial difficulties, holders of subordinated debt have a lower priority on the repayment of their investments than do the holders of senior debt." Subordinated debt is more sensitive to credit risk and should more quickly reflect any perceived problems in its yield margins. As Lifton notes, however, "subordinated debt might not fulfill this role quite as effectively for Fannie Mae and Freddie Mac, which are often said to carry an implied government backing... This, combined with a 'too big to fail' syndrome, affords them a unique status that leaves agency debentures trading at lower yields than other, similarly rated bonds. This status could skew market perceptions of their subordinated debt."**
- **Lifton notes that the two largest ratings agencies - Moody's Investors Service and Standard & Poor's - "are taking what appear to be contrasting positions on their potential ratings for the debt." Stanislas Rouyer, Vice President and Senior Credit Officer for Moody's said, "We would still have to make some sort of concession for the implied support." Their special relationship with the government means that the GSEs' subordinated debt won't be assessed with a "stand-alone rating," he said.**
- **"There is a definite level of implied government support," which should cause Fannie and Freddie's subordinated debt to trade at lower yields than that of other institutions such as commercial banks," said Carl de Jounge, Vice President of Global Credit Research at Deutsche Banc Alex. Brown.**
- **According to Lifton, Standard & Poor's does not see the government standing as strongly behind the subordinated debt. S&P's rating "would not assume the government would support the subordinated debt, whereas that support is implicit in the ratings of their senior debt," said S&P Managing Director Michael DeStefano. [Both Moody's and S&P rate the GSEs' debt as AAA-rated because of the implied backing of the Federal government.] (*Dow Jones Newswire*, Tyler Lifton, 10/23/00)**
- **John Connor with *Dow Jones Newswire* reports that one of the alleged benefits of subordinated debt "is that it is supposed to be a risk proxy and a way to promote financial discipline." He added, "But some experts... feel this function will be a nonstarter for the GSEs because 'agency' status will attach at least implicitly to the sub debt." (*Dow Jones Newswire*, John Connor, 10/20/00)**
- **Freddie's Assistant General Counsel Peter Mahoney said he expects Freddie to issue its first subordinated debt in the first half of 2001. He declined to specify the amount of the initial issuance, but said he expects the bonds to have an average maturity of five years or more. (*Reuters*, Richard Leong, 10/31/00)**

Subordinated debt may allow GSEs' to expand "mission creep" (*Market News International*)

- **In an analysis of the GSE proposal by Joseph Plocek with *Market News International*, entitled "US GSE Announcement Revisited: Much Ado re: Nothing," Plocek notes that whether the GSEs' subordinated debt will be eligible for the implied government guarantee - like the GSEs' benchmark debt - is still unresolved. Plocek notes that in fairness, Fannie's debt marketers have not yet had a chance to consider how to set up a program for subordinated**

debt. However, he notes that “if the market perceives the subordinated debt as a different asset from the benchmarks, perhaps the overall market for GSE debt will expand. In that case, the implied restraint on GSE growth will be next to none as the issuance of more debt is used to support more mortgage lending. Mission expansion was the very thing that Rep. Baker began his GSE crusade attempting to pare.” Plocek suggests that by issuing subordinated debt, the GSEs benchmark debt will benefit. “In fact, the expansion of GSE debt outstanding appears to be the intended result of adding capital... The additional of a layer of capital would benefit senior debt holders, producing a windfall to current holders of their benchmarks.” Glenn Migliozzi, Managing Director of Fixed-Income Investments at Fleet Investment Advisors in Boston, seems to agree that subordinated debt will benefit the GSEs’ senior debt. “We have viewed agencies as kind of a safe haven,” and the senior debt will be bolstered when Fannie and Freddie begin issuing subordinated debt class under the new agreement, he said. “We all along have been trying to buy, and certainly do not want to be underweighted in agencies.”

- **In further analysis, Plocek notes that “Raising the issue of on-balance-sheet assets begs the question of who is responsible for the trillions of dollars of outstanding securities should there be a real crunch. Sure, mortgage securities are not guaranteed, but would the market be so broad if the securities were not stamped with the GSEs’ names?”** (*Market News International*, Joseph Plocek, with contributions by Rob Ramos, 10/19/00; *Reuters*, Lynn Adler, 10/20/00)

Market News International further analyzes the GSEs’ voluntary initiative

- **“As for risk measurement and management, surely these are programs that the GSEs, being financial giants, already have in place. Perhaps the managers of these programs ought to consider the experience of LTCM [Long Term Capital Management] when they re-assess risk. Maintaining three months liquidity ought to be no problem for firms that already hold more than \$300 billion apiece in their mortgage portfolios. But selling those mortgages when the financial markets are in gridlock is another kettle of fish – and gridlock time is definitely when the reserve will be needed.”**
- **“Last, the requirement for obtaining an independent rating is laudable. But both Moody’s and Standard & Poors already rate the GSEs – and have affirmed their AAA credit. Unfortunately, the ratings are based on implied government backing. What would happen if the highly leveraged GSEs were honestly compared to peer group financial institutions? One suspects that the ratings agencies would be hard pressed to find similarly leveraged banks.”** (*Market News International*, Joseph Plocek, with contributions by Rob Ramos, 10/19/00)

Treasury Department says GSE concerns are not over

- The Treasury Department said that Congress and regulators must continue to monitor GSEs, despite promises by Fannie and Freddie to open themselves up to greater disclosure. “Treasury monitors the Government Sponsored Enterprises (GSEs) on an ongoing basis and has discussed its concerns about a variety of issues with a number of interested parties, including the housing GSEs themselves,” said Treasury Assistant Secretary Michelle Smith. “The measures announced today by Fannie Mae and Freddie Mac, if fully implemented, are useful ones that have the potential to promote market discipline and increase transparency. Of course, there remains a range of issues with respect to the GSEs that warrant continuing attention from financial authorities, the Congress, and their regulators,” said Smith. (*Statement by Treasury Assistant Secretary Michelle Smith*, 10/19/00; *Dow Jones Newswire*, Henry Pulizzi, 10/20/00)

Citizens Against Government Waste says more significant reforms needed

- Citizens Against Government Waste released a statement calling the GSEs' voluntary initiative - Cong. Baker's "October Surprise." The proposal, if properly implemented and vigilantly overseen by Congress "should lead the way to even more significant reforms of the GSEs next year." CAGW said any further reform "must put all three of the housing GSEs [Fannie, Freddie, and the FHLBanks] on a glidepath toward full privatization." (*CAGW press release*, 10/19/00)

MBA says other GSE issues that need to be addressed

- "MBA has not had an opportunity to review the agreement in detail. It appears that the GSEs are taking steps to respond to concerns over risk and regulation," said MBA Senior Staff Vice President for Government Affairs Howard Glaser. "This should allow us to move on to address other important issues involving mission oversight and a clear definition of secondary market boundaries – all for the benefit of the American homebuyer," said Glaser. (*Reuters*, Aleksandrs Rozens, 10/19/00)

America's Community Bankers says GSEs still need a strong regulator and need to contain GSEs' mission creep

- Robert Davis, Managing Director of Government Relations for America's Community Bankers told *BNA* that although the Fannie-Freddie voluntary plan is "very substantial," it is only half the answer. "There is a very important second leg that is not addressed by the plan," said Davis. "The GSEs need a strong regulator and they need to be held to their stated mission." (*BNA Daily Report for Executives*, Adam Wasch, 10/20/00)

FM Watch says GSEs admitted that their capital is insufficient to protect taxpayers – Agreement does not address the problem

- In a statement released to the press at Cong. Baker's press conference with Fannie and Freddie, FM Watch stated that "the GSEs admitted that their capital is insufficient to adequately protect American taxpayers, a position that FM Watch has maintained for over a year. However, the agreement announced today does not effectively address the problem since it is a voluntary agreement." FM Watch went further and noted that Cong. Baker's plans to move forward with legislation to establish a strong single regulator with comprehensive enforcement and oversight authority "is critical for achieving true GSE reform and addressing both safety and soundness and their expansion into new lines of business." (*FM Watch Statement*, 10/19/00) FM Watch Executive Director Mike House said the proposal shows that Fannie and Freddie "are finally admitting that the risk to the taxpayers is real." He added that "this doesn't change the need for comprehensive legislation." (*Dow Jones Newswire*, Jerry Guidera, 10/18/00)

Stocks of Fannie & Freddie skyrocket after agreement

- Fannie and Freddie's stock hit 52-week highs on the day that the proposal with Cong. Baker was announced. Fannie's stock increased \$6.75 to \$77.5625, while Freddie's rose \$4.94 to \$56.4375. Several analysts also upgraded the GSEs' stocks. The agreement is "enormous" said PaineWebber analyst Gary Gordon. "This agreement takes cares of [concerns about] safety and soundness, and that is the great bulk of the arguments about Fannie and Freddie." (*Wall Street Journal*, Patrick Barta and Jerry Guidera, 10/23/00) **PaineWebber's Gordon stated, "All of the measures, in total, are a peace accord with Baker that costs Fannie and Freddie nothing."** (*Bloomberg*, Rob Wells, 10/19/00) Goldman Sachs & Co. Analyst Howard Shapiro said the agreement "takes political risk off the table for Freddie and Fannie and allows investors to focus on their strong operating fundamentals." (*American Banker*, Michele Heller, 10/20/00) Goldman Sachs upgraded both stocks to its "recommended list" designation; Fannie received a \$90 price objective, and

Freddie received an \$80 target. Merrill Lynch upgraded Fannie and Freddie to a near-term buy from near-term accumulate and analyst Michael Hughes also raised Freddie's 12-month price target to \$69 from \$66 and Fannie's target to \$87. "We are upgrading both stocks due to the reduced regulatory risk, which, in turn, enhances the attractiveness of the two companies," said Hughes in a research report. (*Reuters*, 10/19/00)

- The GSEs' announcement with Cong. Baker was "very, very positive for the GSEs," said Laura Clark, Portfolio Strategist at Payden & Rygel (an investment firm). "They did remove a lot of the political uncertainty surrounding the GSEs," she noted. "Some questions do remain, such as the focus on improving regulatory oversight. [Cong. Baker's proposed new bill.] But this did improve our view of agencies and did cause us to reevaluate their current attractiveness." (*Reuters*, Lynn Adler, 10/20/00)
- Prudential Securities Analyst Charles Gabriel believes the agreement is a huge win for the GSEs, Cong. Baker and the Treasury Department. "Although Baker in his remarks yesterday said the agreement resolved roughly half of the issues he sought to address in his bill, we believe it effectively neutralizes 80% of the issues (i.e., safety and soundness/systemic risk; transparency) that have provided the major pretense for his hearings and the seemingly impassioned involvement of the Treasury and Fed Chairman Alan Greenspan in the debate." Gabriel further stated that "we view the threat of legislation in the next Congress as very small." (*Fannie-Freddie Agreement with Treasury, Baker: What Led Up to VW ("Victory-in-Washington") Day?*, 10/20/00)
- "One could argue cynically that the significance of this announcement [GSEs' voluntary initiatives] is tantamount to an announcement that the US has entered into a peace accord with Liechtenstein," wrote Sanford C. Bernstein Analyst Jonathan Gray. It would cost the companies 1 cent a share in profit to meet its new rules now, something that can easily be made up, he said. (*Bloomberg*, 10/27/00)
- Despite Cong. Baker's comments that he would introduce a new GSE bill, Fannie Chairman Franklin Raines told CNBC in a television interview, that he believes market worries have subsided over legislation on the GSEs. "I think there's a belief that the political risk has receded, and that there will not be legislation affecting Fannie Mae," said Raines. (*Reuters*, 10/24/00)

Despite Fannie & Freddie's claims that their recent voluntary risk-management initiative "puts to rest" safety and soundness concerns about the companies, the GSEs' safety and soundness regulator - OFHEO – says the issue of safety and soundness of the GSEs is not off the table

OFHEO raises concerns about the GSEs' voluntary initiative, particularly the GSEs' plan to issue subordinated debt

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OFHEO plans to propose changes to its minimum capital regulation for Fannie & Freddie, early in 2001

- Fannie and Freddie recently announced an agreement with Cong. Baker on a proposal with a series of voluntary risk-management steps by the agencies (see earlier story in this *GSE Report*). Freddie Chairman Leland Brendsel claims that the proposal was developed to "put to rest any questions regarding our future safety and soundness," said Freddie Chairman Leland Brendsel. (*Statement of Freddie Chairman Leland Brendsel*, 10/19/00)
- Fannie and Freddie's safety and soundness regulator – OFHEO – was not aware of the negotiations and was not involved in the agreement. OFHEO Director Armando Falcon cautioned that "these voluntary steps do not in any way substitute for strong regulation." (*American Banker*, Erick Bergquist, 10/26/00)
- In a speech to the Mortgage Bakers Association annual convention, Falcon noted in terms of the GSEs' voluntary initiative, "any effort to enhance public disclosure" of Fannie and Freddie's risks and activities "is very sound public policy," but the voluntary initiative is "certainly not a substitute for OFHEO's plans to improve transparency."
- The following are OFHEO's comments and concerns about the voluntary initiative:
 - (1) Issue subordinated debt – after a three-year phase in - on a semi-annual basis equal to or in excess of 4% of on-balance-sheet assets.
 - **Falcon stated that "it is not clear how useful subordinated debt would be in strengthening market discipline" for Fannie and Freddie. "While I remain open-minded, it's hard to imagine that their GSE status would not in some way influence how their sub debt will trade. Currently all Enterprises securities carry an explicit statement that they are not backed by the full faith and credit of the US government. Yet the market treats these securities as though they are government guaranteed. How and why would the markets treat sub debt any differently?"**

[Editorial Note: Moody's said it would continue to factor in the implied government support, if it were to rate the subordinated debt, according to Stanislas Rouyer, Vice President and Senior Credit Officer for Moody's. (*Dow Jones Newswire*, Tyler Lifton, 10/30/00)]

- **Falcon explained that subordinated debt is generally more effective if it is convertible to equity on a permanent basis rather than simply having interest payments suspended, especially when the investor is later made whole.** Also, Falcon noted that the event that triggers the suspension of interest payments or the conversion of debt to equity should occur well in advance of potential insolvency. This would provide maximum market scrutiny and provide Fannie and Freddie with additional incentives to maintain a significant capital cushion. Finally, the issue and trading of subordinated debt “must be sufficiently large and liquid.”
 - **Falcon stated, “While I reserve judgement on the utility of sub debt for a government sponsored enterprise, there is one point on subordinated debt that I want to make crystal clear. I do not believe that subordinated debt is or should be a substitute for real equity capital. A strong regulatory capital standard using real capital is in everyone’s best interest. Currently, subordinated debt does not count for purposes of meeting our minimum or risk-based capital requirements. I have no plans to change that.”**
- (2) Maintain more than three months’ worth of liquidity assuming the GSEs have no access to public debt markets.
- Falcon stated that the GSEs’ plans to maintain at least three months liquidity and 5% of their assets in the form of liquid investments “has no practical effect” on Fannie and Freddie. “They both currently far exceed these standards.”
- (3) Implement an interim risk-based capital stress test until permanent risk-based capital regulations are finalized by OFHEO.
- Falcon noted that “there are hundreds of large and small issues that arise in designing and building a stress test” and that the “manner in which those issues are resolved can have a large impact...on the amount of capital required...The manner in which the Enterprises’ version resolves all these other issues will impact the strength and reliability of their interim test. Indeed, many of their [Fannie & Freddie’s] comments on OFHEO’s rules would have significantly weakened our stress test.”
- (4) Initiate public disclosure of interest-rate risk on a monthly basis and disclose credit-risk sensitivity analyses and results on a quarterly basis.
- Falcon stated that this initiative “is consistent with OFHEO’s views on transparency.”
- (5) Obtain an annual rating from a rating organization and disclose the rating to the public.
- Falcon stated that “these ratings would be similar to risk-to-the-government ratings OFHEO obtained from Standard & Poor’s in 1996. Like other disclosures, ratings such as these can be useful to assess the financial health of each company at a particular point in time, but they are no substitute for a comprehensive regulatory program.”

(Statement by OFHEO Director Armando Falcon before Mortgage Bankers Association Annual Convention, 10/31/00)

OFHEO plans changes to its minimum capital regulation of Fannie & Freddie

- Falcon noted that OFHEO will seek comments on amendments to its minimum capital regulation. According to Falcon, the proposal will call for monthly public reporting of Fannie and Freddie's capital, greater disclosure of how the GSEs meet the standard, and provide incentives for Fannie and Freddie to maintain a healthy cushion above the minimum requirement. [Editorial Note: The minimum capital regulation of Fannie and Freddie is different from OFHEO's risk-based capital regulation of Fannie and Freddie which is expected to be released early next year, and effective a year later.] (*Statement by OFHEO Director Armando Falcon before Mortgage Bankers Association Annual Convention, 10/31/00*)

Fannie & Freddie's mission regulator – HUD – says GSEs' voluntary initiative is no substitute for strong oversight

HUD says it shares the concerns of the Mortgage Bankers Association that the lines between the primary and secondary market could blur

- HUD Assistant Secretary and Federal Housing Commissioner William Apgar said Fannie and Freddie's recent voluntary initiative (see earlier story in this *GSE Report*) is "no substitute for strong regulatory oversight" of the GSEs. He said housing officials share the MBA's concerns that the line separating the primary and secondary market could blur. (*National Mortgage News Daily website, 11/1/00*)

Market observers question the details of Fannie & Freddie's voluntary initiative and wonder if the GSEs will have separate interpretations about how to implement the initiative

Market observers also question what role OFHEO will play as the plan goes forward

Freddie claims it worked for months with Fannie on the initiative

- According to Adam Tempkin with *Mortgage-Backed Securities Letter*, questions are arising from mortgage market observers about how some of the more "nebulous nuances" of the GSEs' recent voluntary initiative will be implemented, and what role OFHEO will play as the plan goes forward.
- "This is not a treaty. This is an agreement to draft a treaty," said Banc of America Managing Director Michael Youngblood. "Now who is going to draft it?"
- The consensus among market observers is that the voluntary initiative leaves many questions unanswered, particularly the role of OFHEO, which was noticeably absent when the GSEs and Cong. Richard Baker (R-LA) announced their initiative on October 19. Tempkin notes that it is also not clear if HUD will have any role in implementing the initiative. "There is a missing fourth party here, maybe even a missing fifth party, if you include HUD," said another MBS participant.
- Freddie Spokeswoman Sharon McHale was quoted as stating, "There seems to be this thought that we developed this with Baker, but that is not the case... We and Fannie Mae spent months working on the package of steps that we announced last week and ensuring that there was an important role for OFHEO in developing it... This was not negotiated between us and Baker or between us and OFHEO. And it all happened in a very quick time

frame...There wasn't this meeting where these things were developed that didn't include outside groups. This was brought to Chairman Baker as a package – it wasn't like we negotiated with him.” [Editorial Note: There were a few articles reporting that Freddie brokered the initiative when talks on improving GSE regulation between Baker and Fannie fell through. According to those reports, Fannie reluctantly took part in the Freddie Mac-led deal. When asked by *Reuters* whether this was true, Fannie Chairman Franklin Raines stated, “Let’s just say the press reports didn’t have everything accurate, but that’s okay. The end result was a very good one,” he added. When asked to elaborate on Fannie’s role in agreeing on the deal, Raines declined to comment. This seems to corroborate Freddie’s Spokeswoman’s claims that the two GSEs had been working on the deal for months.]

- **The GSEs’ initiative includes a pledge by the GSEs to maintain more than three months’ worth of liquidity and maintain a portfolio of 5% of their assets in the form of liquid investments. However, as Tempkin notes, this pledge raises questions, because “within the parameters of the GSEs’ announced commitments, it is possible to arrive at that commitment from a number of different strategies.”** He added, “This has led some observers to wonder whether Fannie and Freddie will arrive at separate agreements, given that the GSEs’ approaches have differed in the past.” Defining liquidity raises many questions. “For instance, do the GSEs allow offsets like prepayments of principal on loans and securities that Fannie and Freddie own? Do they allow offsets to the term of the GSE’s float? Is the 90-days liquidity relative to short-term debt or to long-term debt or to both?” One source who was analyzing the initiative said, “Defining liquidity is not as straightforward as it might seem.” (*Mortgage-Backed Securities Letter*, Adam Tempkin, 10/30/00)

***The Economist* magazine calls the GSEs’ voluntary initiative “Another triumph for America’s government-backed mortgage agencies, at the expense of taxpayers.”**

***The Economist* describes the initiative as “a complicated and relatively empty six-point agreement... emphasizing disclosure but making no fundamental difference to the privileged status of Fannie and Freddie”**

“At a time when the stockmarket is showing only fitful enthusiasm, the share-price performance of two companies stands out: Fannie Mae and Freddie Mac. This is not because there has been a sudden boom in home construction. It is a result of their brilliant dexterity in prevailing upon Congress to condone what is, in essence, a rip-off of taxpayers.”

“Fannie Mae and Freddie Mac straddle an interesting line between what America seems to represent around the world (free markets) and what everyone in Washington, DC really loves most (free money for a favored group).”

- **An article in *The Economist* magazine on Fannie and Freddie notes, “At a time when the stockmarket is showing only fitful enthusiasm, the share-price performance of two companies stands out: Fannie Mae and Freddie Mac. This is not because there has been a sudden boom in home construction. It is a result of their brilliant dexterity in prevailing upon Congress to condone what is, in essence, a rip-off of taxpayers.”** The article further notes that in the past two months alone, Fannie and Freddie stock prices have risen by about 50% and the spread between GSE bonds and Treasuries has shrunk by 30 basis points.

- The article adds, **“Fannie Mae and Freddie Mac straddle an interesting line between what America seems to represent around the world (free markets) and what everyone in Washington, DC really loves most (free money for a favored group).”** And while the GSEs were founded as public institutions that provide capital in the secondary market, “this is a function that many private firms are now well able to perform.” While GSEs are quasi-private companies that trade stocks on the New York Stock Exchange, they also retain many perks from their days as government entities. **The GSEs are exempt from state and local income taxes, which “in the case of Washington, DC-based Fannie Mae costs the beleaguered capital city hundreds of millions of dollars annually.”** The GSEs are also exempt from registering stocks with the SEC, banks can hold GSE debt as collateral for tax deposits, and unlike other corporate loans or bonds, banks can hold an unlimited amount of GSE debt. According to the article, **“Thanks to all these privileges, it is widely assumed in the bond markets that the federal government stands behind the debt of these companies, notwithstanding frequent denials, and would never let them fail. The result is that they can issue debt for almost a percentage point less than other big financial firms, a huge advantage in bringing in business.”**
- *The Economist* notes that earlier this year, a Congressional Committee headed by Cong. Richard Baker took aim at the GSEs’ preferential treatment. Even Alan Greenspan seemed to aid the inquiry when he wrote a letter in August which conceded that the GSEs’ subsidies are “at the expense of other federal or private-sector initiatives and hence are ultimately financed by householders, either through taxes or through the reduced accumulation of wealth.” **However, despite Greenspan’s concerns, the GSEs’ economic prospects seemed to increase, on the presumption that no big reforms were in stock for Fannie and Freddie. The article adds, “the reason soon became clear. Towards the end of October, a complicated and relatively empty six-point agreement between the agencies and Mr. Baker’s committee was reached, emphasizing disclosure but making no fundamental difference to the privileged status of Fannie and Freddie.”**
- The GSEs agreed to more transparency over interest rates and default sensitivity, to subject themselves to reviews from main ratings agencies, to retain three months’ liquidity in case of a financial panic, to issue a subordinated bond that would theoretically be more responsive to market concerns about GSE credit. However, the article notes that it may take a default for this new bond to be taken seriously. **OFHEO Director Armando Falcon questioned the validity of subordinated debt. “Currently all (of their) securities carry an explicit statement that they are not backed by the federal government. Yet the market treats these securities as though they are government-guaranteed. How and why would the markets treat sub debt any differently?”** The article answers by noting that the market won’t treat the GSEs’ sub debt any differently. The article also quotes Peter Wallison, resident fellow at the American Enterprise Institute as stating, “This (the GSEs’ voluntary initiative) is a solution only if you consider that privatization is out of reach, and even then, it is still not a solution.”
- *The Economist* article concludes by calling the GSEs’ voluntary initiative, **“Another triumph for American’s government-backed mortgage agencies, at the expense of taxpayers.”** (*The Economist*, 11/4/00)

OFHEO solicits public comments on risks to the financial system that may be caused by Fannie & Freddie

- Fannie and Freddie’s safety and soundness regulator – OFHEO – is soliciting public comments on a study on risks to the financial system, and US housing finance markets in particular, that may be caused by Fannie and Freddie. The notice reads: “This study will examine the nature and magnitude of any risks posed by the Enterprises, whether and to what extent Fannie Mae and Freddie Mac contribute to or mitigate systemic risk, and actions that OFHEO and others could take to limit any systemic risk the Enterprises may pose. The study will help OFHEO enhance its oversight of Fannie Mae and Freddie Mac and improve OFHEO’s ability to contribute to Federal regulation of financial institutions and markets more generally.” OFHEO has identified a number of specific research questions that its study may address as well as any other topics that OFHEO should examine in analyzing the risks posed by Fannie Mae and Freddie Mac. **OFHEO notes that “the pace at which the Enterprises are growing and their increasingly central role in mortgage and financial markets raise the issue of whether, if either Enterprise experienced severe financial distress or failed, the functioning of the financial system in general, or of US housing finance markets in particular, could be disrupted to such an extent that the US or international economies would be adversely affected.”** Written comments to OFHEO are due by December 29, 2000. (*OFHEO press release*, 10/27/00; *Federal Register*, 10/30/00, pages 64718-64720)

HUD issues final affordable housing rule for Fannie & Freddie

- HUD issued a final rule establishing new affordable housing rules for Fannie and Freddie for 2001 through 2003. The new goals feature a higher target for low- and moderate-income housing assistance (50% of mortgages purchased instead of 42%). HUD said the GSEs “have been successful in providing stability and liquidity to large segments of the mortgage markets,” but that “the GSEs must further utilize their entrepreneurial talents and power in the marketplace and lead the mortgage finance industry to ensure that citizens throughout the country enjoy access to the public benefits provided by these federally related entities.” The rule takes effect January 1, 2001, with no transition period. (*Dow Jones Newswire*, John Connor, 10/31/00; *Federal Register*, pages 65044-65229, 10/31/00)

FHLBanks of Cincinnati, Indianapolis, and Seattle receive approval for their Mortgage Purchase Program (MPP)

MPP, like the FHLBank of Chicago’s Mortgage Partnership Finance (MPF) program, is a competitor to Fannie & Freddie in the secondary mortgage market

MPP program is expected to purchase up to \$2 billion in loans in 2001

- The FHLBanks of Cincinnati, Indianapolis and Seattle received regulatory approval from the Federal Housing Finance Board for their Mortgage Purchase Program (MPP). The three FHLBanks have been purchasing FHA-insured loans from member institutions for several months but now the FHFB approved the purchase of conventional loans. Like the FHLBank of Chicago’s MPF program, MPP is a competitor to Fannie and Freddie in the secondary mortgage market. According to Chief Financial Officer of the FHLBank of Indianapolis Milton Miller, the FHLBank System is expected to purchase up to \$2 billion in MPP home loans from member institutions in

2001. The three FHLBanks will begin testing the program with selected customers. Testing will expand to all members sometime next year.

- Under MPP, the FHLBanks will only purchase high-quality, 15 and 30-year fixed-rate mortgages. Unlike Fannie and Freddie, which take on the entire credit risk of the loans they purchase and charge the loan seller a guarantee fee for the loans, the FHLBanks will share the credit risk on the loans with the originator. The FHLBanks will partially protect themselves from credit losses by purchasing supplemental mortgage insurance on the loans. For each pool of loans that they purchase, the FHLBanks will set aside funds in a lender risk account. As they experience credit losses, the FHLBanks will reimburse themselves from the account and if any funds remain, the FHLBanks will return the funds to the originators.
- MPP and MPF were designed as cheaper secondary market alternatives to Fannie and Freddie's mortgage securitization programs for lenders. As an example, FHLBank of Indianapolis' Miller noted that a lender can get \$36,000 more if it sells a \$100 million loan pool to a FHLBank rather than to Fannie or Freddie. Though MPP was developed jointly by the three FHLBanks, each will run its own MPP independently. (*Reuters*, Richard Leong, 11/1/00; *National Mortgage News Daily*, 11/1/00; *American Banker*, Erick Bergquist, 11/3/00)

GAO finds that the Farm Credit Administration (FCA) overstepped its authority by issuing a national charter initiative for Farm Credit System banks without submitting the plan to a formal rule-making process

House Banking Committee Chairman Jim Leach (R-IA) asks the FCA to withdraw its plan

Chairman Leach states, "Our financial market system could literally be traumatized with government credit competitively crowding out private markets."

- The Government Accounting Office (GAO) concluded that the FCA overstepped its authority by offering Farm Credit System banks the option of acquiring national charters without submitting the plan to a formal rule-making process. In a letter to Chairman Leach, the GAO found the FCA violated the provisions of the Administrative Procedure Act and the Congressional Review Act. Chairman Leach had requested the GAO study following an October 3 hearing on the FCA proposal. Farm Credit lenders are currently only permitted to make loans within geographic boundaries.
- Chairman Leach stated that "In light of the GAO's findings that national charters are indeed subject to the statutory requirements of the APA and the Congressional Review Act, it would appear incumbent on FCA Chairman [Michael] Reyna to withdraw the [plan] and suspend all action on pending applications." He added, "For the FCA to go ahead at this point with national charters absent congressional authorization, Treasury Department approval, and the following of administrative processes mandated by law would amount to an assault on the constitutional processes of American governance."
- Chairman Leach had substantive concerns with the national charter initiative, including major procedural defects and major policy implications. He noted that there are safety and soundness implications for Farm Credit System institutions as they venture into geographic areas in which they may be inadequately prepared to assess and manage risk. There is also the potential to undermine the FCS' statutory mandate to serve small local family farmers should a large

agricultural interest acquire dominant control over a single FCS institution to serve its national needs. He also questioned whether national charters will facilitate “cherry picking” and predatory pricing by large Farm Credit System institutions at the expense of local institutions. Finally, he was concerned that the national charters could “result in significant new liability to the nation’s taxpayers as loans are made outside geographic areas of expertise.” He concluded, “Our financial market system could literally be traumatized with government credit competitively crowding out private markets.” (*Statement by House Banking Committee Chairman Jim Leach (R-IA), 10/17/00*)

FCA is reviewing the GAO Report

- FCA Spokesman Hal Decell would not comment on the GAO Report until the FCA had time to review it. However, in an October 3 hearing, FCA Chairman Michael Reyna told Chairman Leach that he would consider delaying the plan if the GAO Report found that the process for implementing national charters was flawed. (*American Banker, Alan Kline, 10/18/00*)

ABA urges Congress to stop the process

- “The proposal to grant national charters to FCS institutions would have destroyed any shred of the notion that the FCS is a borrower-owned and locally controlled cooperative lending organization,” the American Bankers Association said in an October 17 statement. “Given FCS institutions’ track record of unsafe and unsound lending in the past, and the lack of enforcement on the part of their regulator, ABA had urged Congress to stop the process before it was too late.” (*BNA Daily Report for Executives, 10/18/00*)

ICBA welcomes the GAO study

- the Independent Community Bankers Association opposes the national charter initiative and “welcomed” the GAO study. The ICBA also urged Congress to “closely study the negative and controversial implications this policy would have.” (*Congress Daily, 10/18/00*)

Fannie Mae and Freddie Mac

Fannie & Freddie make large political contributions this election cycle

The two GSEs and their employees gave almost \$3 million this election cycle (the numbers reflect donations from January 1999 - June 2000, so the numbers are expected to be larger when the cycle ends in November)

Consumer advocate Ralph Nader stated in June 30, 1999 testimony before the House Budget Committee that some of the GSEs' government subsidies – intended to lower costs for homebuyers – are being diverted to build political and lobbying efforts “designed to make it difficult, if not impossible, for the Congress to provide (or the public to demand) proper oversight or regulatory improvements which would protect the public, increase support for affordable housing or ensure open competition in the mortgage market.”

- According to campaign finance data compiled by *National Mortgage News* and the Center for Responsive Politics (CRP), during the 1999-2000 election cycle, Fannie and Freddie and their employees donated a “whopping” \$2.95 million to politicians, political action committees, and their parties. As *National Mortgage News* points out, the numbers reflect donations as of June 30, so the numbers are expected to be much larger when the cycle ends in November. [For example, in a *Congress Daily* review of the latest FEC reports filed by the Republican National Committee and the Democratic National Committee, during July and September of this year, Freddie donated an additional \$350,000 to the DNC.]
- Fannie Chairman Raines donated \$10,250 and Freddie Chairman Leland Brendsel donated \$9,500. Freddie and its employees donated \$1.613 million, while Fannie and its employees donated \$1.33 million. According to CRP, combined Fannie and Freddie’s donations account for 57% of all mortgage-related donations. *National Mortgage News* reported that Fannie and Freddie officials gave generously to Congressional Members serving on the House and Senate Banking Committees, which oversee them, and also to Presidential candidates and senior Members of the House and Senate. (*National Mortgage News*, Paul Muolo, 10/23/00; *Congress Daily*, 10/18/00)

Company Name	Overall Donations by Company & Employees	Donation by just Employees	Donations by Company Chairman
Fannie Mae	\$1,613,789	\$43,189	\$9,500
Freddie Mac	\$1,335,181	\$351,445	\$10,250
Totals	\$2,948,970	\$394,634	\$19,750

Notes: Donation information as of June 30. Company employees donated money to both individual candidates and political action committees (PACs). Company donations represent “soft” money contributions only.

Chart Source: Center for Responsive Politics, Additional compiling by *National Mortgage News*. (*National Mortgage News*, Paul Muolo, 10/23/00)

President of Competitive Enterprise Institute (CEI) claims Fannie & Freddie are “Fiscal Frauds”

“In order to keep their special advantages, Freddie and Fannie lobby government, buy off opponents, and blast away their critics...When you’re allowed to play with ‘Monopoly’ money (and everyone else has to use the real thing), you can buy up all the houses and hotels...Monopoly money just makes it easy to become a *monopolist*. The rapid growth of Fannie and Freddie during the 1990s suggests that the agencies are well on their way to becoming just that.”

CEI President suggests that the Justice Department develop a breakup/divestiture plan for the GSEs

“They [Fannie & Freddie] weaken the private sector institutions that still play an important mortgage financing role...They entangle commerce and government, leading to a situation akin to that of Europe where government-pampered banks are ‘too big to fail.’ While some of the capital diversion lowers mortgage costs to those eligible for Freddie/Fannie purchases, at least one-third of it goes to their management and shareholders.”

- Fred Smith, President of the Competitive Enterprise Institute wrote an editorial about the GSEs in the August/September Issue of *CEI Update*. According to Smith, Fannie and Freddie shareholders and executives benefit greatly from their quasi-government status, while taxpayers bear the responsibility for bailing out the two companies. Smith noted that the GSEs “might better be described as government *subsidized* enterprises” since they do not have to pay state or local income taxes, do not have to register their securities with the SEC, and have a \$2.25 billion line of credit with the Treasury. **“Most significantly, the management and shareholders of Freddie and Fannie keep all the profits (and those ‘profits’ have been substantial in recent years) while seeing that losses are borne to taxpayers.”**
- Smith further criticized the GSEs for anesthetizing the market and distorting the allocation of risk. **“The market values Fannie and Freddie not solely on their management skills, but rather on their implicit government guarantee. The market assumes that Freddie and Fannie are safer investments than other ventures. In order to keep their special advantages, Freddie and Fannie lobby government, buy off opponents, and blast away their critics...When you’re allowed to play with ‘Monopoly’ money (and everyone else has to use the real thing), you can buy up all the houses and hotels...Monopoly money just makes it easy to become a *monopolist*. The rapid growth of Fannie and Freddie during the 1990s suggests that the agencies are well on their way to becoming just that.”**
- Smith conceded that Fannie and Freddie were created with good intentions -- to further the American dream of homeownership. However, there are other American dreams (such as having a job, starting a business, etc.) that also require capital. Yet Fannie and Freddie end up diverting this capital into middle- and upper-class housing. “For Fannie and Freddie to decide that housing is our only dream creates a nightmare for those with dreams requiring capital.” He claims Fannie and Freddie have done little to help the poor attain affordable housing. Smith noted that Fannie and Freddie likely raise the price of mortgages, rather than lower them. He cited a HUD study, which showed that Fannie and Freddie have a lower share of the affordable housing market than other private lenders. Smith also added that market distortions such as this only place America at risk. **“They weaken the private sector institutions that still play an important mortgage financing**

role...They entangle commerce and government, leading to a situation akin to that of Europe where government-pampered banks are ‘too big to fail.’ While some of the capital diversion lowers mortgage costs to those eligible for Freddie/Fannie purchases, at least one-third of it goes to their management and shareholders.”

- Smith noted that this type of phenomenon is known as a “moral hazard” -- a situation where one takes more risks because one is not fully responsible for their actions. **“Freddie and Fannie destabilize the American financial system. That’s what the moral hazard is all about: the unintended consequences of helping one American dream at the expense of all others.”** Smith suggested that the Justice Department should be urged to develop a breakup/divestiture plan for the GSEs. **“Were Fannie and Freddie broken into four of so private firms nationwide, each assigned a diversified share of the holdings of the current monopolies, privatization would be much less traumatic and far less risky politically.”**
- Smith concluded his editorial by noting that **“quasi-political and quasi-private, Fannie and Freddie blend the worst aspects of the two worlds: self-interest without responsibility, greed with non-accountability. Private firms can’t compete against Fannie and Freddie’s subsidized enterprise, and the agencies themselves are not held accountable to elected representatives. At best, this mixing of private and political incentives creates marketplace confusion; at worst, it leads to increasing risk and lost opportunities for the American taxpayer. It’s past time to cut the apron strings and privatize these ‘infant industries.’ It’s time they become capitalist adults.”** (*CEI Update*, “*Fannie and Freddie: Fiscal Frauds*,” Fred Smith, August/September 2000)

Citizens Against Government Waste (CAGW) slams government-guaranteed perks for Fannie Mae bureaucrats

CAGW also calls for GSE reform in its booklet, “*Prime Cuts Summary: 45 Ways to Leaner Government*”

- In a recent press release, America’s largest taxpayer watchdog group, CAGW questioned the need for government subsidies to the GSEs. The CAGW noted that Fannie recently was named one of the best companies for working families by *Working Mother* magazine for the numerous perks offered to Fannie’s 4000-plus employees. CAGW noted that Fannie employees receive taxpayer-subsidized perks such as on-site dry cleaners, personal chefs to prepare dinner, on-site concierge service, 10 hours per month of paid volunteer time, and are eligible for 100 percent forgivable loans for housing down payments or closing costs. **“Fannie Mae has an unfair advantage over the 99 other ‘best’ companies. It is able to indulge its employees with these overblown luxuries only because of the billions of dollars in government subsidies it receives,”** said CAGW President Thomas Schatz.
- The CAGW release noted that Fannie and the other GSEs -- Freddie Mac and the Federal Home Loan Banks -- receive unique government benefits such as state and local income tax exemption, a multi-billion line of credit from the US Treasury, and an implied government guarantee of their securities which permits them to realize oversized profits. CAGW President Schatz is quoted as stating, **“Every year, Fannie Mae is exempt from paying hundreds of million of dollars in state and local taxes, money that could be used to fund police, roads, and local public schools, issues very high on the list of concerns of working mothers.”**

- When testifying at the September 12th GSE Roundtable, Schatz stated, **“We are encouraged that Congress is beginning to exercise its oversight over Fannie Mae and demand accountability for their practices.”** (*Citizens Against Government Waste press release, 9/11/00*)
- The CAGW also included GSE reform as one of its recommendations for government reform in their annual pamphlet *Prime Cuts Summary: Forty Five Ways to Leaner Government*. According to CAGW, if the government were to regulate the GSEs’ “mission creep” more closely and eliminate GSE subsidies, the government would save \$1.3 billion in one year and \$4.9 billion over five years. CAGW noted that Treasury Undersecretary Gary Gensler testified in March, 2000 that the GSEs increasing debt load could surpass Treasury’s within five years. **“These activities increase profits for shareholders while increasing the risk for taxpayers, who would likely bear the brunt of any bailout of the GSEs,”** warned CAGW. (*Citizens Against Government Waste, “Prime Cuts Summary: Forty Five Ways to Leaner Government,” August, 2000*)

***The Christian Science Monitor* questions Fannie & Freddie’s expansion into new business areas, their skyrocketing debt, and their billions of dollars in subsidies**

Editorial calls for constraints on the GSEs’ growth and more regulation

“Obviously, the time has come to decide just how large these two institutions should be, what constraints should be placed on their growth, and how they should be regulated.”

- An editorial in the *Christian Science Monitor* questions the activities of Fannie and Freddie, including their expansion into new business areas, their skyrocketing debt and the billions of dollars in subsidies they enjoy. The editorial calls for continued examination of the GSEs' practices and a concerted effort for regulatory reform.
- **The editorial called Fannie and Freddie good examples “of when privileges originally bestowed to help the underprivileged have long since been stretched too far.”** The editors note that the GSEs have served the purpose of providing affordable mortgages to low-income Americans very well. However, “a growing number of critics, even within the US Treasury Department say the two are now too big, too powerful, and have lost sight of their original purpose. Most of all, they pose a hazard to taxpayers if they need a federal bailout.” The editors go on to note that Fannie and Freddie are both in the top 75 of the Fortune 500 companies, and have both enjoyed double-digit growth over the past decade. The GSEs are “beloved by Wall Street, and-- here’s one problem--enjoy enormous political clout.” **In order to feed their double-digit earnings growth, the editorial notes that the GSEs must expand: “to feed their gigantic appetites, these lions have had to forage beyond their original territory and now compete with the private sector in ways never originally intended.”**
- However, **“a growing chorus of critics rightly argues that the two act as private companies when it’s convenient, and use the special government privileges bestowed on them when it’s not.”** Some of the GSEs’ “privileges” include an exemption from registering stocks with the SEC (a savings of \$280 million in 1999) and an exemption from state and local income taxes (\$690 million saved in 1999). **“One relatively new aspect of their competitive advantage is that financial markets think they are too big to fail, and that the US government (read taxpayers) will bail them out in a crisis. It’s not written in stone, but certainly implied.** This ‘implicit’ guarantee is what makes change so difficult. The debt issued by Fannie and Freddie is rated triple-

A. Yet their notes and bonds are not actually guaranteed by the US Treasury, despite what amounts to a symbolic line of credit. While a major recession looks unlikely, taxpayers should rightly worry about projections by leading financial institutions that Fannie and Freddie's debt could soon outpace the national debt and reach \$8 trillion by 2010."

- **The *Monitor* editors note that the GSEs agreed to undergo a few reforms after pressure from their lead Congressional critic, Congressman Richard Baker. While the reforms provide for some monitoring and public disclosure of financial operations, they are "nonbinding and do not go deep enough."** The editors note that Cong. Baker intends to introduce additional legislation next year, which would call for more reform, including an independent regulator. However, **"the public perception that Fannie and Freddie will be bailed out by the US Treasury must change. Their symbolic line of credit must be removed. Their boards should not contain political appointees. And they should scale back to serving only the most-needy low-income buyers."**
- In addition, the GSEs are "substantially" behind private banks and lenders in purchasing mortgages made to African-Americans and Hispanics and they use scare tactics to fend off any calls for reform. The editors of the *Monitor* conclude by stressing, **"obviously, the time has come to decide just how large these two institutions should be, what constraints should be placed on their growth, and how they should be regulated."** (Editorial, *The Christian Science Monitor*, 10/27/00)

Fannie & Freddie report double-digit third quarter earnings

Earnings are fueled by GSEs' purchasing of their own mortgage-backed securities for their retained portfolios

GSEs' purchasing of their own mortgage-backed securities is not mission critical for the GSEs and has more to do with maximizing profits

- Fannie reported that earnings per share increased 16% this quarter, compared with the third quarter of 1999. This was Fannie's 51st consecutive quarter of record earnings. Fannie reported earnings for the third quarter of 2000 of \$1.124 billion, or \$1.09 per diluted common share, which includes an extraordinary gain of \$1.3 million from the early extinguishment of debt. This compares with earnings of \$1.097 billion, or \$1.05 per diluted common share, for the second quarter of 2000 and \$991.0 million, or \$0.94 per diluted common share, for the third quarter of 1999. The earnings were driven by 15.6% growth in Fannie's balance sheet assets, 7% growth in the volume of mortgage-backed securities it guaranteed, and buying back about 3% of its shares. The retained commitments for Fannie's mortgage portfolio during the third quarter totaled \$45.7 billion, the highest since the second quarter of 1999. Fannie's retained mortgage portfolio grew at a 15.6% rate during the third quarter, ending the quarter at \$571 billion, compared with \$504 billion a year ago. Fannie's net income was \$3.283 billion, or \$3.16 per diluted common share, compared with \$2.874 billion, or \$2.73 per diluted common share, for the same period in 1999. Fannie's earnings per share for the first nine months of 2000 were 15.8% above the first nine months of 1999. Fannie Chairman Franklin Raines said Fannie "is on track to deliver our second consecutive year of 15% operating earnings per share growth" and to "meet our goal of doubling earnings per share by 2003." (*Fannie press release*, 10/11/00; *Morgan Stanley Dean Witter Report: Fannie Mae: Boring is Good*, Kenneth Posner and Michael Courtian, 10/13/00; *Dow Jones Newswire*, 10/11/00; *American Banker*, Erick Bergquist, 10/12/00)

- Freddie reported record diluted earnings per common share of \$0.86 for the third quarter of 2000, a 15% increase over third quarter 1999 diluted earnings per common share of \$0.75. Net income for the third quarter was \$645 million, compared to \$564 million for the same period a year ago and \$631 million for second quarter 2000. Freddie's total revenues reached \$1.125 billion in third quarter 2000, an increase of 13% over third quarter 1999, and up from \$1.107 billion in second quarter 2000. Mortgage loans Freddie holds in portfolio rose 2.42% from the year-ago period, to \$57.04 billion. The mortgage-backed securities Freddie holds increased 17% to \$304.6 billion. Freddie's Vice Chairman and President David Glenn cited "strong total portfolio growth" and "excellent credit results" as factors contributing to the results. Freddie's retained portfolio grew sequentially at a 13% annualized rate in the third quarter. Year-over-year, Freddie's portfolio is up 15% from the third quarter 1999. Non-Freddie securities, which include everything from Ginnie Mae loans to subprime - accounted for \$7 billion or 32% of total retained portfolio purchases during the third quarter. Alt-A and A-loans totaled \$15 billion year-to-date, compared to \$13 billion in 1999. (*Freddie press release*, 10/17/00; *American Banker*, Erick Bergquist, 10/18/00; *National Mortgage News Daily*, 10/17/00; *Morgan Stanley Dean Witter Report: Freddie Mac: 3Q00 – Quality Corner*, Kenneth Posner and Michael Courtian, 10/23/00)
- **Tyler Lifton with *Dow Jones Newswire* reported that Fannie and Freddie are posting strong earnings this year, despite a slow down in mortgage origination and the issuance of mortgage-backed securities, an integral part of their businesses. Instead, Fannie and Freddie are making money by "stuffing their portfolios with mortgages and their own MBS, a far more lucrative endeavor but one that has riled their critics." Sanford C. Bernstein Analyst Jonathan Gray noted that in 1993, Fannie and Freddie were keeping one out of every four loans they purchased on their balance sheets. Now, they are keeping one out of every two, and by 2005, will hold two out of every three mortgages they buy, Gray estimated. (*Dow Jones Newswire*, Tyler Lifton, 10/30/00)**
- **The reason Fannie and Freddie are holding onto their mortgages, is that, for the same face value of the loans, they generate about five times more in revenue than by selling them as MBS, said Michael Youngblood, a Managing Director for Banc of America Securities. But there are concerns about the growth in their retained portfolios. "There is concern by some in the marketplace that they are growing their balance sheet assets too quickly. Fannie Mae in particular has said it intends to continue to grow its balance sheet at a very rapid pace," said Barbara Miles with Congressional Research Service. (*Dow Jones Newswire*, Tyler Lifton, 10/30/00)**
- **During a July 25, 2000 House Budget Committee Housing Task Force hearing, representatives from the Congressional Research Service, the Government Accounting Office and Financial consultant Bert Ely all testified that the GSEs' purchase of their own mortgage-backed securities had very little to do with the GSEs' mission and more to do with maximizing profits. All agreed that the purchase of MBS by the GSEs was not mission critical to the GSEs. Barbara Miles with Congressional Research Service stated that the GSEs' repurchase of their own MBS provides profit and risk for the GSEs and does little for the mortgage market. "While it is clear that the this increases shareholder value, it is difficult to understand what, if anything, it does for mortgage markets," she stated. Miles further noted that when a GSE issues a MBS, it is selling off the interest rate risk, but when the GSE purchases its own MBS, it is buying back or "repatriating" the interest rate risk back onto its books. During a September 12, 2000 GSE Roundtable, Miles also testified that**

the GSEs' repurchase of their own MBS does not appear to have a housing rationale behind it. There is nothing that the GSEs do in purchasing their own MBS that would result in the form of lower mortgage rates to homebuyers, she noted. (*Dow Jones Newswire*, Jerry Guidera, 7/25/00; *Testimony before House Budget Committee House Task Force Hearing*, 7/25/00; *Testimony before GSE Roundtable*, 9/12/00)

- **Cong. Richard Baker is quoted as stating, “When you’re buying back you own securities, there’s no explanation for it other than bottom-line profit.” Buying back securities “doesn’t by itself create homeownership opportunities,” he added. Cong. Paul Ryan (R-WI) is also quoted as stating that the practice “is not core to their mission, and is merely taking on unnecessary credit risk.”** (*Wall Street Journal*, Patrick Barta, 7/14/00)

FM Watch website releases new “Truth Watch” to review Fannie & Freddie’s submissions for the September GSE Roundtable

FM Watch also highlights the contradictory statements by the GSEs - the “Many Faces of Fannie Mae and Freddie Mac”

- The FM Watch Website (www.fmwatch.org) has recently been updated to include an in-depth review of Fannie and Freddie’s written submissions to Congressman Richard Baker for the House Banking Capital Markets Subcommittee’s GSE Roundtable on September 12, 2000. In the “Truth Watch” section of the website, FM Watch analyzes the GSEs’ August 25th letters to Cong. Baker which try to explain how the GSEs provide innovative products, their use of debt financing, the benefits of mortgage backed securities, GSE credit risk, supervision by OFHEO, and the GSEs’ mission. FM Watch then contrasts those claims with contrary evidence from various sources and studies.
- The FM Watch website also highlights the “Many Faces of Fannie Mae and Freddie Mac” by using the GSEs’ own contradictory statements and press releases to illustrate their conflicted public mission with their obligations to private shareholders, as well as various contradictory claims to Congress and homeowners. (*FM Watch website*, www.fmwatch.org, 10/17/00)

Fannie Mae

***American Banker* article: “Fannie Mae Out to Eat Private Mortgage Insurers’ Lunch Again?”**

Fannie’s new mortgage insurance structures put the company in a position of selecting a mortgage insurer and setting the pricing

Mortgage insurers and lender sources say, “that...has ominous implications for the mortgage industry.”

Traditionally, lenders – not the GSEs – have been considered the mortgage insurers’ customers

Keefe, Bruyette & Woods, Inc. Analyst David Graifman agrees. “It’s much better to have thousands of customers [lenders] than two [Fannie Mae and Freddie Mac]”.

- Marc Hochstein with the *American Banker* wrote an article about two insurance structures that Fannie has been quietly promoting since the summer, that insurers and lender sources say are more threatening to the mortgage insurance business than anything Fannie has done in the past.
- In one of the structures – a Fannie partnership with HomeSide Lending – borrowers do not pay directly for mortgage insurance coverage. Instead they pay a higher interest rate, while Fannie negotiates the entire mortgage insurance with a private insurer. In the other structure, the mortgage insurer gives Fannie a portion of the premiums it collects from borrowers. Fannie then gives the lender a lower guarantee fee in return for the lender providing all of its mortgage insurance business to the participating insurer. Hochstein notes that Freddie denies that premium-sharing is involved. Insurer and lender sources have two main problems with the new structures. Under both structures, Fannie takes part of the revenue stream that would normally go to the mortgage insurer and Fannie is put in the position of selecting the insurer and setting the pricing. Traditionally, mortgage insurers have considered lenders as their customers. Under the new structures, Fannie becomes the mortgage insurers’ customer. Hochstein notes that mortgage insurers and lender sources say, “that...has ominous implications for the mortgage industry.” Keefe, Bruyette & Woods, Inc. Analyst David Graifman agrees. “It’s much better to have thousands of customers [lenders] than two [Fannie Mae and Freddie Mac],” he said.
- Four of the six mortgage insurers – Mortgage Guaranty Insurance Corp., Radian Guaranty, PMI Mortgage Insurance Co., and Republic Mortgage Insurance Co. - have agreed to participate in the new mortgage insurance structures. Sources say the companies were motivated to participate in the new structures because they were afraid of losing market share if they refused. Since Fannie is the largest purchaser of mortgages, sources say Fannie is using its market clout to push the new structures on the industry. Two of the six mortgage insurers have declined to participate in the structures – GE Mortgage Insurance Corp. and United Guaranty, a subsidiary of American International Group, Inc. They note that losing market share would be preferable to letting a GSE take control of the transaction and some of the revenue. “The question is who your customers are – lenders or the GSEs?” said Thomas H. Mann, President and CEO of GE Mortgage Insurance. “For us, the answer is clear: Our lenders are our customers, period.” Charles Reid, President and Chief Executive Officer of United Guaranty said he has not seen anything in writing on the new structures but from what was described to him, his company would not participate in such structures. “It could lead to there being two purchasers of mortgage insurance – the two GSEs,”

Mr. Reid said. “While we do enjoy our relationships with the GSEs, we would also like to retain our relationships with multiple lenders.”

- Sources note that the four companies participating in the structures are publicly traded companies that must disclose their earnings quarterly. Therefore if their market shares slip, their stock prices suffer. The two companies, which are not participating in the structures, are subsidiaries of large, diversified conglomerates, which are not subject to the same pressures. Foxx-Pitt Kelton Analyst Chad Yonker speculated that political reasons might also be a factor in the mortgage insurers’ participation in the structures. “My understanding is that Fannie Mae is not willing to play with those two [GE Mortgage Insurance and United Guaranty], he said, “because AIG and GE have been bashing Fannie in Washington. Those two companies are being given the cold shoulder by Fannie and Freddie more than the public guys, which have decided that, while they’ll remain members of FM Watch, it’s better to stay quiet.”
- Gerald Friedman, the Chairman of FM Watch and a former mortgage insurance executive believes that Fannie and Freddie’s intrusion into the mortgage insurance business dates back to the mid-1990s when the GSEs told lenders they could get lower guarantee fees if they obtained pool insurance policies from specific insurers. “At that moment, right then, the GSEs started to get into the primary market,” he said. “They got in between the mortgage insurers and their customers.” When provided a description of Fannie’s new insurance structures by a reporter, Friedman noted that the insurers participating in the project are “sacrificing their long-term viability...When you share profits with a duopoly that can crush you under their heel, it’s like trying to hug a gorilla,” he said. “There’s no such thing as a partnership with a GSE because you can’t negotiate.” (*American Banker*, Marc Hochstein, 10/23/00)

Freddie Mac

Large lenders find fault with Freddie's moves to make it easier for smaller lenders or brokers to sell loans directly to Freddie

"This is the GSEs taking another step toward dealing with brokers more directly," said FM Watch Executive Director Mike House

- An *American Banker* article by Erick Bergquist reported that some big lenders are upset about Freddie's moves this year that make it easier for small mortgage companies to sell their loans to the GSE. "This is the GSEs taking another step toward dealing with brokers more directly," said FM Watch Executive Director Mike House.
- In May, Freddie changed its eligibility rules to let mortgage companies sell its loans without keeping the servicing rights. As Bergquist noted, servicing loans is a prohibitively costly business to enter, and has kept some lenders from becoming serious players in the mortgage industry. Freddie also reduced by 75% to \$250,000 the minimum net worth a seller must have to sell Freddie loans. Industry observers note that some big lenders interpreted this as meant to help small lenders or brokers bring loans directly to Freddie. "I believe a lot of the lenders would think it's an indication that the GSEs are trying to establish direct business links with mortgage brokers for the purpose of facilitating dealing with them," said a former top executive at one of the nation's biggest bank-owned mortgage companies. "And there's always the risk they could eventually circumvent the seller-servicer" (the lender that services its own loans), added the former executive. The former executive added that Fannie and Freddie's automated underwriting systems might even let Fannie and Freddie eliminate their net-worth requirements for sellers.
- As Bergquist noted, concerns about the GSEs moving closer to brokers, started in the mid-to-late 1990s when the GSEs made their automated underwriting systems available to brokers. By offering brokers access to their systems, the former top executive said the GSEs created a direct link with brokers, which could now get their loans approved by Fannie or Freddie. The significance of the move was not lost on the major seller-servicers, which were used to dealing exclusively with the GSEs. Ultimately, this was a way for the GSEs to establish more direct links with the seller-servicers' own broker clients. Freddie's Vice President of Single-Family Business Jeff Hayward denied that Freddie is courting direct business with brokers. "We're not out to take large lenders' customers away. Our objective is to continue to approve quality lenders that can help us fulfill our mission," he said.
- **Critics believe that Fannie and Freddie are merely biding their time before letting the brokers in. The former executive noted that some seller-servicers are concerned about losing their intermediary status between brokers and the GSEs.** (*American Banker*, Erick Bergquist, 10/23/00)

Federal Home Loan Banks

FHLBank of Chicago floats and then withdraws a \$100 million stock offering

The resources would have been used to grow the FHLBanks' Mortgage Partnership Finance (MPF) program

- According to Paul Muolo and Brian Collins with *National Mortgage News*, the FHLBank of Chicago floated a \$100 million stock offering to its members and then withdrew the sale just nine days later. The FHLBank of Chicago said in a statement that it withdrew the offering “in response to continuing discussion of the capital restructuring for the FHLB system under the Gramm-Leach-Bliley Act.”
- One industry source speculated that the FHLBank of Chicago’s regulator – the Federal Housing Finance Board – said it would take action against the Chicago Bank if the offering was not withdrawn. A FHLBank of Chicago Spokesman denied any pressure from the regulator. However, several weeks after the Chicago Bank withdrew its offering, *National Mortgage News Daily (MortgageWire)* reported that the Federal Housing Finance Board issued a supervisory notice explaining that the FHLBank System’s whole capital structure is transitioning into a new risk-based capital system, and that the issuance of additional stock would only complicate the process. FHFB Acting Chairman William Apgar said the supervisory notice was only a reminder to the FHLBanks that they must get regulatory approval prior to issuing additional stock. “It has been our policy all along that stock offerings have implications for safety and soundness and need to be reviewed prior to issuance,” Apgar told *MortgageWire*. Even under the risk-based capital system (not yet finalized), “any significant change in the capital plan has to be reviewed by the Finance Board,” he stated. The supervisory notice says that a FHLBank must notify the FHFB two weeks prior to an offering or sales date. The notification requirement does not apply to the payment of dividends with stock.
- A senior mortgage manger, requesting that his name not be used, said FHLBank Chicago President Alex Pollock “received a lot of telephone calls about this and Alex quickly came to the conclusion that this was not a good idea and the timing could not have been worse.” Muolo and Collins note that the “timing” issue refers to a recent proposal by Senate Banking Committee Chairman Phil Gramm (R-TX) to cap the MPF program – a competitor to Fannie and Freddie. A Spokeswoman for Senator Gramm acknowledged that committee staff monitored the stock offering. She stated, “Chairman Gramm had the same concerns about the Chicago bank’s plans as he does about most of the FHLBanks and other GSEs when they get into lines of business that weren’t specifically allocated to them...And we think this unusual stock offering fell into that territory.” She added that Senator Gramm communicated his concerns through his staff and the FHLBank of Chicago “did the right thing.” (*National Mortgage News*, Paul Muolo and Brian Collins, 10/9/00; *National Mortgage News Daily website*, 10/17/00, 10/18/00)

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