

The **GSE** REPORT™

Contents of GSE Report™

“Despite the reform consensus among market participants, representatives of the administration, and impartial government officials, I am convinced that Fannie Mae...does not and never has believed in the need for even the smallest measure of reform.” (Cong. Richard Baker, 10/4/00)

“If GSEs are allowed to neglect their mission in the interest of profiting stockholders, the mortgage marketplace, the tax-paying public and American homebuyers will all suffer. Instead of helping American homebuyers realize the American dream, Fannie Mae and Freddie Mac may be racing toward an American nightmare.” (Leslie Paige, Citizens Against Government Waste, *CAGW Government Waste Watch*, Summer 2000)

Major Events

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 - Fannie, which faces increased competition from the MPF program, lobbies heavily against the program
 - Ten trade associations, including the ABA, ACB, and the National Black Chamber of Commerce, sign a letter opposing any cap on the program because it would “stifle marketplace competition” – competition “translates into better rates and ultimately lower prices for homebuyers”
 - FHLBank of Atlanta President Raymond Christian questions whether Fannie & Freddie are truly interested in competition or are simply trying to hold onto their share of the mortgage pie
 - In Fannie & Freddie’s dealings with FM Watch, the GSEs claim that competition is good for the mortgage market, says Christian. At the same time, however, they want to stifle competition from the FHLBanks. “But competition can’t be good in one context and not in another,” he said.
- Freddie funds non-profit mortgage brokerage firm (*p. 9*)
 - Fannie & Freddie officials will volunteer at the firm to reach out to potential loan applicants (initially only one salaried employee at the brokerage firm – a former Freddie official)
 - [Editorial Note: Freddie’s funding of a mortgage brokerage firm and Fannie & Freddie’s employees working/volunteering at the brokerage firm seems contrary to Fannie & Freddie’s claims that they do not want to compete with the banking industry for loan originations and that the GSEs want to remain exclusively in the secondary mortgage market. (On a related note, as part of its employee benefits, Fannie provides 10 hours of volunteer leave each month to employees.)]

- Shadow Financial Regulatory Committee (independent panel of financial services experts) urges full privatization and break up of the housing GSEs (Fannie, Freddie, & the FHLBanks) (*p. 10*)
 - Housing GSEs distort the private mortgage market and are a risk to taxpayers
 - If Congress won't privatize the GSEs then the Shadow group supports a beefed-up version of Cong. Baker's GSE bill
 - The Shadow group calls Cong. Baker's bill a "good first step" but recommends severing all GSEs' ties to the federal government, not just removing the GSEs' line of credit to the Treasury
 - Until the subsidies are removed, the Shadow group recommends on-balance sheet accounting for the value of the subsidy portion of the GSE debt issued each year
 - Until full privatization, the GSEs should be charged a "guarantee fee"
 - The formal names of the GSEs should be changed to remove the words "national" and "federal"
 - Columbia University Professor Charles Calomiris states, "If we can't get full privatization as we envision it, then at least we can use regulation to get us a long part of the way there, and we think if we did, these institutions might themselves become lobbyists for their full privatization."
- Chairman of the House Banking Committee Jim Leach (R-IA) says Treasury Department is "AWOL" on key GSE issues and believes Treasury should be the focus of all GSE policy functions (*p. 11*)
 - Cong. Leach is concerned about Farmer Mac's arbitrage portfolios, Fannie & Freddie's multi-billion dollar bond portfolios, and the Farm Credit System's national charters plan
 - Cong. Leach believes that "continual vigilance by the Executive Branch and Congress over GSEs" is "critical." He adds, "If institutional vigilance is not established, the [GSE] oversight regulators who are, by definition, quasi-captive of their systems, will move American evermore in a governmentalized-credit direction."
- Cong. Leach blasts the Farm Credit Administration's (FCA) controversial initiative to grant national charters to Farm Credit System banks (*p. 12*)
 - Cong. Leach says the implications of the national charter initiative are "extraordinary" and a "reflection of the continual self-generated urge of all GSEs [including housing GSEs] to use their governmentally privileged positions to expand the breadth and scope of their activities in ways that distort the American market system"
 - Cong. Leach asks the GAO to study whether the FCA had authority to issue national charters without a formal rule-making process
 - Treasury Department says FCA's national charter initiative "raises serious questions" about the proper mission of the GSEs
 - ICBA and ABA testify against national charter initiative
 - FCA says it did not overstep its authority by offering national charter initiative
- HUD's fair lending review of Fannie & Freddie's automated underwriting systems due by year-end (*p. 15*)
 - HUD started the investigation in February 1999 – it took until January 2000 before the GSEs provided requested information to HUD
 - An independent study by the Urban Institute in March 1999 found that Fannie & Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers

All GSEs

- Analyst says Senate Banking Committee Chairman Phil Gramm's (R-TX) plans to cap the FHLBanks' successful Mortgage Partnership Finance (MPF) program is "clearly mixed news for Fannie and Freddie investors" (*p. 16*)
 - Cap would limit the FHLBanks' competition against Fannie & Freddie but shows Gramm intends to take a hard look at the housing GSEs next year

Fannie Mae and Freddie Mac

- "Fannie Mae and Freddie Mac: The S&L Bailout of the New Century?" - Citizens Against Government Waste Special Report (*p. 17*)
 - "Like the S&L crisis, the Fannie and Freddie debt threat is not easy to understand. In fact, its complexity has helped them avoid the scrutiny their risky behavior deserves."
 - "Should anything happen that might threaten Fannie Mae and Freddie Mac with collapse under the weight of that debt, rest assured that taxpayers will face another bailout."
 - "If GSEs are allowed to neglect their mission in the interest of profiting stockholders, the mortgage marketplace, the tax-paying public and American homebuyers will suffer."
- National Taxpayers Union warns that Fannie & Freddie pose a double taxpayer threat (*p. 18*)
 - "A new debt crisis is brewing at Fannie Mae and Freddie Mac"
 - "Although Fannie and Freddie officials dismiss any analogy between their current financial position and that of the S&Ls, the facts tell a different story."
 - Congress should establish a timetable to privatize the GSEs and at the very least, should impose ground rules to

curb the GSEs to protect taxpayers

- Fannie expresses interest in a subprime loan underwriting system (p. 19)
 - Concerns about GSEs' entry into subprime:
 - While the GSEs enter the subprime market, subprime lenders are exiting the business "seemingly in herds"
 - Investors and traders are concerned that the GSEs' subprime programs could increase the risk of loan defaults and prepayments, making it more difficult to predict the rate of interest and principal payments used to establish the securities' values
 - Paine Webber analysts note that an economic downturn might lead to greater credit worry about the inclusion of poorer credit loans in Fannie's pools
 - Consumer groups worry that GSEs' entrance into subprime will worsen predatory lending
- Consumer Federation of America's annual conference will include a discussion panel entitled "*Fannie Mae and Freddie Mac Under Attack: Are the Critics Right?*" (p. 21)
- Fannie forms Homeownership Alliance to counter criticisms against the GSEs (p. 22)
 - Organizations joining the group include: Freddie Mac, the Independent Community Bankers Association, the National Association of Home Builders and the National Association of Real Estate Brokers
- Under non-risk based capital rules, Fannie & Freddie met their minimum capital requirements (p. 22)
 - Risk-based capital plan is expected to be finalized by year-end - OFHEO will likely issue the rule at the beginning of 2001- Fannie & Freddie have a year to comply
 - OFHEO says it will release the source code for the stress test models to the public
 - OFHEO Director Armando Falcon would not say whether Fannie or Freddie will meet OFHEO's risk-based capital rule when it is released
- OFHEO submits its five-year strategic plan to Congress (p. 23)
 - Plan will serve as a blueprint for how OFHEO will oversee Fannie & Freddie
 - OFHEO notes that Fannie & Freddie are two of the largest private debt issuers in the world and two of the largest end-users of derivatives
 - OFHEO expects Fannie & Freddie's GSE status will continue to give them advantages over other firms
 - OFHEO expects that Fannie & Freddie are likely to continue to increase their purchases of loans to a broader range of borrowers, including those with varied credit histories.
 - The plan notes that the pace at which Fannie and Freddie's debt is growing and their increasingly central role in financial markets "is likely to continue to raise concerns about the risks they pose to the financial system."
- HUD expects its affordable housing rule for Fannie & Freddie to be released by year-end (p. 24)

Fannie Mae

- The director of a group that counsels low-income homebuyers states, "Fannie Mae has not expanded lending in metro St. Louis or anywhere else as far as I know." (p. 25)
 - "Fannie...does a lot of grandstanding, and it's hard to know what's real," says the director.
- Non-profit group in St. Louis that received \$25,000 from Fannie Mae Foundation disbands after failing to mount an ad campaign to lure new residents to St. Louis neighborhoods (p. 25)
- A.G. Edwards downgrades Fannie to "accumulate" (p. 25)
- Fannie Chairman Franklin Raines blames the press and FM Watch for its stock slide (p. 26)
 - *Dow Jones Newswire* John Connor notes that blaming the press "is a familiar one, often belabored by persons and institutions under fire."
 - Connor further adds that Raines did not spend much time discussing other prominent individuals, which have expressed concerns about the GSEs (including Cong. Richard Baker, Treasury Under Secretary Gary Gensler, and Federal Reserve Board Chairman Alan Greenspan)
 - [Editorial Note: During the 106th Congress (1999-2000), there has been a growing chorus of groups from the "left" and the "right" that have expressed concerns about Fannie & Freddie, including: academics/think tanks; consumer groups; taxpayer groups and policymakers (including Members of Congress, Federal Reserve Board Chairman Alan Greenspan, Treasury Under Secretary Gary Gensler, and others).]
- 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 (p. 34)
 - Fannie has 44 Partnership Offices open across the country
 - National Black Chamber of Commerce claims Fannie may be failing to live up to its commitment to invest \$438 billion in community projects through its Partnership Offices
 - Financial consultant Bert Ely believes Fannie's media events raise ethical questions. "This is an extension of not only their lobbying but also their political action committee contributions," he said. "Everybody knows what they're doing. It's something that many of us find offensive, but that's how they play the political game."

- Fannie claims that its partnership offices were created to “get away from Washington,” yet *Real Estate Finance Today* reports that during the first eight months of 2000, Fannie held no fewer than 87 media opportunities across the country with Congressional Members

Freddie Mac

- Wells Fargo and Bank of America drop out of joint venture with Microsoft’s HomeAdvisor Technologies
 - HomeAdvisor Technologies uses Freddie’s technology (p. 37)
- Freddie purchases its first all-electronic mortgage (p. 37)

Federal Home Loan Banks

- American Bankers Association and America’s Community Bankers express concern about FHLBanks’ capital rule (p. 37)

Major Events

Talks break down between Fannie and Cong. Richard Baker (R-LA) on legislation strengthening regulation of Fannie & Freddie

Cong. Baker says he will pursue stronger GSE regulatory reforms in light of the breakdown

Cong. Baker is “convinced that Fannie Mae...does not and never has believed in the need for even the smallest measure of reform”

Cong. Baker says he will not withdraw or change any current provisions in his GSE bill (HR 3703). He claims his bill was “too modest” and he will draft new legislation between now and the next Congress with stronger provisions

Analyst predicts that GSE reform will be the next big issue for the Banking Committee

- Talks broke down between Cong. Richard Baker (R-LA), Chairman of the House Capital Markets Subcommittee, and Fannie on strengthening regulation of Fannie and Freddie. Cong. Baker outlined the next steps in his effort to pursue even stronger GSE regulatory reforms in light of the breakdown in negotiations with Fannie.
- Cong. Baker says he had been engaged in active negotiation with Fannie for more than a month to find common ground toward establishing an effective GSE regulator. There is no question in Cong. Baker’s mind that the GSE hearings held in his Subcommittee reached a consensus on the need for regulatory reform and GSE oversight. He was even encouraged that Fannie officials publicly stated during the Subcommittee’s recent GSE Roundtable, and during private negotiations that the company was also in favor of strong oversight and open to discussions. **Baker states, “I have now come to the conclusion, however, after several fruitless private sessions and in light of reports today of continued inflammatory public oratory by Fannie Mae’s chairman, that negotiations have broken down. Despite the reform consensus among market participants, representatives of the administration, and impartial government officials, I am convinced that Fannie Mae in fact does not and never has believed in the need for even the smallest measure of reform.”**

Fannie is waiting to see what happens during the November election

- Cong. Baker claims that Fannie is waiting to see the results from the November election. **He states, “Indeed, it seems apparent to me now that Fannie has been trying to run out the clock, to wait and gamble on the outcome of the election, and to try their luck next year. I, too, am perfectly willing to hang the short-term fate of my reform effort on the election. I do not agree that the election will have significant bearing on either the potential or my resolve for reform to become enacted into law next year. Nevertheless, Fannie for some reason seems to have made a choice based on the assumption that any certainty over their government relationship depends on what happens November 7th.”**

Cong. Baker’s bill is “too modest” – he will add stronger provisions

- **After receiving feedback on his bill (HR 3703), Cong. Baker believes “it’s clear to me now that my bill was too modest. Between now and the next session of Congress I intend to draft**

legislation to include new regulatory tools, both stronger than those spelled out in the current bill and more specifically targeted.”

- **Cong. Baker appears confident about his chances at regulatory reform in the next Congress. “I feel pretty confident that, given their [Fannie’s] obstinate stance, and the input from others, we can really get something done next year,” he stated.**
- Cong. Baker says he see no reason to change or withdraw any current provisions of his bill, and will instead include additional provisions concerning three main areas of concern:
 - (1) “The need for more bank-like regulation of GSEs, with prompt corrective action authority including cease and desist and creation of a receivership;
 - (2) The need to link the GSEs' favorable government status with adequate mission compliance;
 - (3) And, taking Chairman Greenspan's numerous suggestions, the need to adequately gauge the nature and size of the GSE subsidy, and the relative benefits it affords for the American people, so that Congress can take steps to clearly address its view of the subsidy.”

GSE reform is next big issue for the Banking Committee

- How the GSEs are regulated “is the next big financial issue for the markets,” said Andrew Laperriere, Managing Director at International Strategy & Investment Group. “And this is the next big issue for the Banking Committee.”

Fannie & Freddie respond to Cong. Baker’s comments

- “We agreed with Mr. Baker’s oversight efforts, disagreed with his bill, and agreed always to have good continuous discussions on the issue,” said Fannie Spokesman David Jeffers. “We have not been a part of any recent discussions,” said Freddie Spokeswoman Sharon McHale, who reiterated that Freddie would continue talks with Cong. Baker.

(Statement by Cong. Richard Baker, 10/4/00; Wall Street Journal, Jerry Guidera, 10/5/00)

House Budget Committee Task Force recommends continued monitoring of GSE debt

Raises the possibility of future hearings on the issue

- The Republican Members of the House Budget Committee’s Task Force on Housing and Infrastructure released its findings and recommendations to House Budget Committee Chairman John Kasich on October 5. Among its findings, the Task Force said that there is a concentration of GSE debt and a “continuing need for oversight of the potential financial liabilities” of Fannie and Freddie. The Task Force noted that Fannie and Freddie play a central role not only in the housing finance market but also in the global debt markets.
- The Task Force reported that GSE debt of \$1.4 trillion is about one-half the size of the \$3 trillion of outstanding privately held marketable Treasury debt. There are projections that this debt volume may double to \$3 trillion by 2005 and likely surpass the level of privately held marketable Treasury debt. Although the Federal government does not explicitly guarantee GSE debt, “it is widely thought that there exists an ‘implied’ guarantee by the United States Government.”
- The Task Force recommended continued monitoring of the GSEs. “The Budget Committee should continue to monitor both the level of debt issued, and the credit risks taken, by Government-

Sponsored Enterprises. Because of the complexity of the issue, and the size of the potential liability, it remains a possible topic of future hearings.” (*House Budget Committee’s Task Force on Housing and Infrastructure Majority Member Findings and Recommendations*, 10/5/00)

Congress will not cap the FHLBanks’ successful Mortgage Partnership Finance (MPF) program this session

A cap on the MPF program will effectively “kill” the program – a program that is becoming a strong competitor to Fannie & Freddie in the secondary mortgage market

Senate Banking Committee Chairman Phil Gramm (R-TX) says he will examine the issue next year as part of a broader review of the housing GSEs (Fannie, Freddie, & the FHLBanks)

Fannie, which faces increased competition from the MPF program, lobbies heavily against the program

Ten trade associations, including the ABA, ACB, and the National Black Chamber of Commerce, sign a letter opposing any cap on the program because it would “stifle marketplace competition” – competition “translates into better rates and ultimately lower prices for homebuyers”

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MPF program will not be capped during this session of Congress

- According to Jerry Guidera with *Dow Jones Newswire*, Congress will not impose a cap on the FHLBank’s MPF program during this session of Congress. Opponents of the MPF program were seeking an amendment that would place a \$15 billion cap on the MPF program, effectively killing the program. Senator Gramm had earlier vowed to impose a cap on the program through legislative maneuvering during the year-end government appropriations, but his advisers are now pledging to take up the issue in the next Congress. **“It’s something that we’ll take a look at next year, as part of a broader review of the Federal Home Loan Banks and other housing-related government-sponsored enterprises,”** said Gramm Spokeswoman Christi Harlan. (*Dow Jones Newswire*, Jerry Guidera, 10/12/00)
- Congressional aides and observers noted that the wrangling and maneuvering on both sides of the bill were relatively intense in recent weeks. A number of the FHLBanks hired consultants at Butera and Andrews to support the MPF program, while Fannie hired lobbyists at Williams and Jensen to lobby against the program. (*Dow Jones Newswire*, Jerry Guidera, 10/12/00)

Fannie lobbies against its competitor – the MPF program

- **According to Jerry Guidera with *Dow Jones Newswire*, Senator Gramm has been lobbied heavily by Fannie.** Fannie officials insist that its lobbying effort is aimed at informing lawmakers about the issue and not furthering its position in the secondary mortgage market. “We’re not trying to keep competition out of the marketplace,” said David Jeffers with Fannie. “We just think they should play by the same rules that we do.” **However, according to Guidera, confidential Fannie**

documents underscore that the threat from the FHLBanks is real. In one memorandum, senior Fannie executives called the FHLBanks a “discounter,” and map out a plan to thwart their expansion into the secondary market. Fannie’s memo reads: “The end game of our FHLB strategy will be to convince the FHLBs, through a combination of the development of a competitive fighting brand and a ‘leveling the political playing field’ strategy, that our business is not a business in which they want to compete.” (*Dow Jones Newswire*, Jerry Guidera, 9/25/00, 10/12/00)

Fannie & Freddie claim they are interested in competition, but are they simply trying to hold on to their share of the mortgage pie?

- According to *National Mortgage News*, FHLBank of Atlanta President Raymond Christian questioned whether Fannie and Freddie are truly interested in competition, or are simply trying to hold on to their share of the mortgage pie. In Fannie and Freddie’s dealings with FM Watch, he notes that the GSEs claim that competition is good for the mortgage market. However, Fannie and Freddie want to stifle competition from the FHLBank System. “But competition can’t be good in one context and not in another,” he said. “They can’t have it both ways.” (*National Mortgage News*, Lew Sichelman and Brian Collins, 9/25/00)

Cap on MPF would “kill” the program

- The FHLBanks would easily surpass a \$15 billion cap over the next several months. MPF has already reached \$13.5 billion at the end of August. (*Reuters*, Richard Leong, 9/21/00) John von Seggern, the President of the Council of FHLBanks, said a cap would effectively kill the MPF program. “If we put another cap on it – it’s dead,” he said. “We would be perceived as being a bad business partner because we can’t commit to deliver something and the banks can’t count on us.” (*American Banker*, Erick Bergquist and Rob Blackwell, 9/18/00)
- Alex Pollock, President of the FHLBank of Chicago stated, “The future of MPF should be played out in the marketplace of GSE competition rather than in attempts to preserve duopoly power through political means.” (*MPF press release*, 9/14/00)

Bank and thrift trade associations oppose cap on MPF

- Nine national trade associations sent a joint letter to Senate Appropriations Committee Members asking them to reject an amendment that would place a cap on the MPF program. The groups argued that any limit would “stifle marketplace competition.” According to the trade associations, the MPF creates increased competition in the secondary mortgage market that “translates into better rates and ultimately lower prices for homebuyers.”
- The groups signing the letter included: American Bankers Association, America’s Community Bankers, American League of Financial Institutions, Consumer Bankers Association, Consumer Mortgage Coalition, Council of Federal Home Loan Banks, Financial Services Roundtable, Independent Community Bankers of America, and the National Black Chamber of Commerce. **On September 22, a similar letter was sent to the House Leadership and the full House Appropriations Committee opposing any cap on the MPF program.** The ten groups signing the letter included: America’s Community Bankers; American Bankers Association; American League of Financial Institutions; Independent Community Bankers of America; Consumer Mortgage Coalition; Council of Federal Home Loan Banks; Consumer Bankers Association; The Financial Services Roundtable; National Association of Home Builders; and the National Black Chamber of Commerce. (*MPF press release*, 9/14/00; *National Mortgage News Daily*, 9/21/00; *Joint trade letter to Appropriations Committee Members*, 9/12/00; *Joint trade letter to House*

Background on MPF program

- The MPF program gives banks and thrift members an alternative to selling conventional and FHA loans to Fannie, Freddie and Ginnie Mae, and instead permits them to sell the loans to participating FHLBanks. The program was initiated by the FHLBank of Chicago as a pilot program, and was capped at \$9 billion (\$750 million for each of the 12 FHLBanks). On July 29, 2000, the FHFB approved a final rule that gave the program permanent status and lifted the \$9 billion cap. The program is now offered by nine of the 12 FHLBanks.

Freddie funds non-profit mortgage brokerage firm

Fannie & Freddie officials will volunteer at the firm to reach out to potential loan applicants (initially only one salaried employee at the brokerage firm – a former Freddie official)

[Editorial Note: Freddie’s funding of a mortgage brokerage firm and Fannie & Freddie’s employees working/volunteering at the brokerage firm seems contrary to Fannie & Freddie’s claims that they do not want to compete with the banking industry for loan originations and that the GSEs want to remain exclusively in the secondary mortgage market. (On a related note, as part of its employee benefits, Fannie provides 10 hours of volunteer leave each month to its employees).]

- According to Paul Muolo at *Origination News*, a former Freddie servicing official Peter Boulay has launched a non-profit mortgage brokerage firm based in Reston, VA focusing on new immigrants, minorities and “disadvantaged” borrowers. The firm, “Welcome to America Inc,” (WAI) is being funded initially with \$125,000 in seed money from Freddie. Muolo reports that WAI will have no other ties to Freddie and will seek funding from other companies. “The money I received from Freddie Mac is a no-strings attached donation,” said Boulay. Although WAI will broker the loans and not fund them, the firm will use Freddie’s automated underwriting system and has applied to use Fannie’s automated underwriting system.
- Boulay will initially be the only salaried employee at WAI. However, volunteers, including Fannie and Freddie officials, have agreed to work for WAI by helping to seek out potential loan applicants. WAI is currently authorized to broker loans in 43 states.
- Boulay said he originally talked to Freddie officials about owning a stake in the mortgage brokerage firm. “But they told me that it would put them too close to the origination side of the business...Freddie Mac will have no say on how I run the company.” A Spokesman from Freddie confirmed the donation and said it was the first time Freddie has donated grant money to a lending-oriented business. Muolo notes that Fannie has bought small stakes in minority lending institutions. (*Origination News*, Paul Muolo, September 2000)

Shadow Financial Regulatory Committee (independent panel of financial services experts) urges full privatization and break up of the housing GSEs (Fannie, Freddie, & the FHLBanks)

Housing GSEs distort the private mortgage market and are a risk to taxpayers

If Congress won't privatize the GSEs then the Shadow group supports a beefed-up version of Cong. Baker's GSE bill

The Shadow group calls Cong. Baker's bill a "good first step" but recommends severing all GSEs' ties to the federal government, not just removing the GSEs' line of credit to the Treasury

Until the subsidies are removed, the Shadow group recommends on-balance sheet accounting for the value of the subsidy portion of the GSE debt issued each year

Until full privatization, the GSEs should be charged a "guarantee fee"

The formal names of the GSEs should be changed to remove the words "national" and "federal"

Columbia University Professor Charles Calomiris states, "If we can't get full privatization as we envision it, then at least we can use regulation to get us a long part of the way there, and we think if we did, these institutions might themselves become lobbyists for their full privatization."

- **In a statement released at its quarterly meeting, the Shadow Financial Regulatory Committee – an independent panel of financial services experts – urged the privatization and break up of the housing GSEs. "This would eliminate the risks now borne by taxpayers, and create a more competitive mortgage market and financial system."** The government could privatize the housing GSEs similar to the way Sallie Mae was privatized in 1996, "although in the case of the housing GSEs it would be desirable to divide these entities into a number of competing companies, to avoid excessive concentration of power in a handful of private firms, and the possibility of a too-big-to-fail bailout of the privatized successors to the housing GSEs." The Shadow group suggests breaking the housing GSEs into eight firms by breaking Fannie and Freddie each into two firms and combining the portfolios of the FHLBanks to create four additional firms.
- **If Congress is unwilling to privatize the GSEs, the Shadow group recommends a stronger and more effective regulatory framework for the GSEs including a beefed-up version of Cong. Baker's GSE bill. The Shadow group notes that Cong. Baker's bill "offers an excellent first step" but "does not go far enough in a number of respects." The Shadow group supports the provision in the Baker bill, which removes the GSEs' line of credit to the Treasury but notes that the bill should go further and sever all links to the federal government. Those links include: (1) Fannie and Freddie's exemption from state and local taxes; (2) the tax breaks for FHLBanks and their bondholders; (3) the subsidies provided to the FHLBanks; (4) the appointment of GSE directors by the Executive Branch; (5) the GSEs' exemption from SEC registration; and (6) the use of GSE securities as collateral for government funds held on deposit in commercial banks. "All of these links should be eliminated."**
- **Until the subsidies are eliminated, the Shadow group recommends on-balance sheet accounting for the value of the subsidy portion of the GSE debt issued each year. "This will clarify for the public the extent to which government resources are being used in support of the housing GSEs and will force Congress to weigh the value of GSE debt issuance against other**

government costs.” **Until full privatization, the group recommends that the GSEs be charged a “guarantee fee” to “compensate taxpayers for the value of the subsidy they receive and the risk they create to taxpayers.” Finally, the names of the housing GSEs should be changed to remove the words “national” and “federal” to “make clear that these entities are not linked to the US government.”**

- **“If full privatization is not immediately feasible, these reforms would substantially remove incentives and control the growth of the GSEs and the costs to taxpayers implied by that growth. Furthermore, such reform might cause the GSEs to consider pushing for full privatization.” Columbia University Professor Charles Calomiris stated, “If we can’t get full privatization as we envision it, then at least we can use regulation to get us a long part of the way there, and we think if we did, these institutions might themselves become lobbyists for their full privatization.”**
- Members of the Shadow Financial Regulatory Committee include:

George G. Kaufman, Loyola University of Chicago
Robert E. Litan, Brookings Institution
Richard C. Aspinwall, Economic Adviser
George G. Benston, Emory University
Charles W. Calomiris, AEI and Columbia University
Franklin R. Edwards, Columbia University
Scott E. Harrington, University of South Carolina
Richard J. Herring, University of Pennsylvania
Paul M. Horvitz, University of Houston
Roberta Romana, Yale Law School
Hal S. Scott, Harvard Law School
Kenneth E. Scott, Stanford University
Peter Wallison, AEI

(BNA Daily Report for Executives, 9/26/00; Statement #164 of the Shadow Financial Regulatory Committee, Privatizing the Housing GSEs, 9/25/00)

Chairman of the House Banking Committee Jim Leach (R-IA) says Treasury Department is “AWOL” on key GSE issues and believes Treasury should be the focus of all GSE policy functions

Cong. Leach is concerned about Farmer Mac’s arbitrage portfolios, Fannie & Freddie’s multi-billion dollar bond portfolios, and the Farm Credit System’s national charters plan

Cong. Leach believes that “continual vigilance by the Executive Branch and Congress over GSEs” is “critical.” He adds, “If institutional vigilance is not established, the [GSE] oversight regulators who are, by definition, quasi-captive of their systems, will move America evermore in a governmentalized-credit direction.”

- Speaking at a House Banking Committee hearing on the Farm Credit Administration’s controversial plan to grant national charters, House Banking Committee Chairman Jim Leach said the Treasury Department has been “AWOL” on significant issues, relating to Fannie, Freddie and the Farm Credit System. He stated that the “Department of Treasury should be front and center in decision-making related to all GSE efforts to expand their reach. Unfortunately, while expressing

generalist concern, Treasury has been AWOL on significant GSE issues, whether it be Farmer Mac's unconscionably large arbitrage portfolios, the ludicrous claims of Fannie and Freddie that their multi-billion dollar bond portfolios are required for liquidity, or the FCS's national charters which could so easily lead to the transformation of an agricultural centric GSE system into one unconstrained by obligations to serve the family farmer."

- **Cong. Leach noted that "continual vigilance by the Executive Branch and Congress over GSEs" is "critical."** He added that the "Department of Treasury, as the gatekeeper for the US government borrowing function and principal economic policy maker in the Executive Branch, should be the focus for all GSE policy functions. Hence, it would seem to me to be quite credible that the Secretary of the Treasury, or his designee, should be on every GSE board and that the Treasury Department should head a permanent inter-agency coordinating committee on all fundamental decision making related to each GSE." **He added, "If institutional vigilance is not established, the oversight regulators who are, by definition, quasi-captive of their systems, will move America evermore in a governmentalized-credit direction."** (*Cong. Leach Statement at Hearing on FCA National Charter Initiative, 10/3/00; Dow Jones Newswire, John Connor, 10/3/00*)

Cong. Leach blasts the Farm Credit Administration's (FCA) controversial initiative to grant national charters to Farm Credit System banks

Cong. Leach says the implications of the national charter initiative are "extraordinary" and a "reflection of the continual self-generated urge of all GSEs [including housing GSEs] to use their governmentally privileged positions to expand the breadth and scope of their activities in ways that distort the American market system"

Cong. Leach asks the GAO to study whether the FCA had authority to issue national charters without a formal rule-making process

Treasury Department says FCA's national charter initiative "raises serious questions" about the proper mission of the GSE

ICBA and ABA testify against national charter initiative

FCA says it did not overstep its authority by offering national charter initiative

- The House Banking Committee held a hearing October 3 on the FCA's controversial initiative to grant national charters to member institutions that currently operate within geographic boundaries. Cong. Leach called for the hearing because he was upset that the FCA decided unilaterally, without formal rule-making, to begin issuing national charters and he was concerned that the initiative may be beyond the FCA's mission. Cong. Leach said in his opening statement, "Seldom have I witnessed a more blatant instance of administrative agency hubris. By fiat, the FCA has essentially excused itself from the inconvenience of formal notice and comment procedures which protect the public from administrative mischief."

GAO study

- Cong. Leach asked the GAO to determine whether the national charter initiative is subject to a formal rule-making process by Congress and the GAO. According to the *American Banker*, if the GAO Report finds that the initiative is subject to a formal rule-making process, implementation would be delayed 60 days. Cong. Leach noted that 82.9% (131 of 158) of the Farm Credit System

direct lending associations have already applied for a national charter. When asked by Cong. Leach whether the FCA would withdraw its plan if the GAO found that the process was inappropriate, FCA Chairman Michael Reyna said “If there is a compelling case, we would have to take that into consideration.”

GSEs expand in ways that distort the market

- **Aside from the process concerns, Cong. Leach claims that the substantive implications of the initiative are “extraordinary.” He stated, “In a broad context, I would stress that the push for national charters is a reflection of the continual self-generated urge of all GSEs to use their government-granted privileges to expand the breadth and scope of their activities in ways that distort the American market system. 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 befits or distorts our financial system. In this case of the FCA and national charters, I have my doubts about any benefits.”**

GSEs expand beyond their missions

- **Cong. Leach said he has concerns about the basic nature of the GSEs and “the inevitability of the desire of managements of systems to attempt to spread their wings and grow beyond their historical mission confines. Hence, I have been concerned with the efforts of the housing GSEs to get into insurance and with the techniques of privatized GSEs – Fannie, Freddie, and Farmer Mac – to abuse their powers with egregious arbitrage and bond purchasing.” He added, “That is one of the reasons why continual vigilance by the Executive Branch and Congress over GSEs is so critical...If institutional vigilance is not established, the oversight regulators who are, by definition, quasi-captive of their systems, will move America evermore in a governmentalized-credit direction.”**

Cong. Leach’s concerns about national charter initiative

- **Cong. Leach is concerned that the initiative would open the floodgate for Farm Credit lenders to move into nonagricultural lending. If that happens, he said, “Our financial market system could literally be traumatized with government credit competitively crowding out private markets.” Cong. Leach added that there is a significant risk that FCS institutions, under a national charter, will increasingly cater to the activities of large agricultural conglomerates to the disadvantage of the family farmer. He was also concerned that national charters could facilitate “cherry picking” and predatory pricing by large Farm Credit System institutions at the expense of local Farm Credit System institutions, and magnify the role of government-privileged institutions at the expense of the private sector. Finally, he was concerned that the charter initiative would result in significant new liabilities to the nation’s taxpayers.**

Treasury Department says FCA’s charter initiative “raises serious questions”

- **In written testimony, Treasury Assistant Secretary for Financial Institutions Greg Baer, said the national charter initiative raises “serious questions” about the mission of the Farm Credit System. Over the long-term, the initiative could reduce competition among lenders. “In particular, they will allow the expansion of a government-sponsored enterprise – which are traditionally created to correct a market failure – at a time when markets are functioning competitively and even growing. Originally intended to complement the banking and thrift industries, the Farm Credit System may grow to mimic them,” he wrote. While banks would likely compete against Farm Credit members “we are concerned that the advantages of GSE status could tip the balance in favor of the Farm Credit System.” Baer added that Congress should “reconsider the role of FHLBanks in agricultural**

credit markets” when reviewing GSE activities in the farm sector. (*American Banker*, Michele Heller, 10/4/00; *Dow Jones Newswire*, Jonathan Nicholson, 10/3/00; *Cong. Leach Statement at Hearing on FCA National Charter Initiative*, 10/3/00)

ICBA, ABA, and Financial Consultant Bert Ely testify against national charters

- Dale Torpey, Chairman of ICBA’s Lending Committee, testified that national charters are “bad public policy” that would allow large, aggressive lenders to cannibalize smaller associations and steal customers of local commercial banks through predatory pricing. ICBA objects to the initiative for the following reasons: (1) initiative has received inadequate public scrutiny and oversight; (2) will not benefit family farmers; (3) removes local control of Farm Credit System by farmer borrowers; (4) does not promote safety and soundness; (5) exacerbates Farm Credit System predatory pricing tactics; (6) suggests some Farm Credit System lenders should lose their privileged GSE status and special tax exemptions and that these benefits should be redirected to needed rural residents; (7) will lead to further consolidation and concentration in American agriculture; (8) local service plans are insufficient to ensure long-term service; (9) FCA’s granting of cross-title charters is an inappropriate and questionable addition to national charters; and (10) no data or FCA analysis exists to justify national charters.
- Dennis Everson, Senior Vice President of First Dakota National Bank, testified on behalf of the ABA. He stated that national charter initiative “serves no credible public policy purpose, raises serious safety and soundness questions, exposes the American taxpayer to incalculable risk, and destroys any shred of the notion that the FCS is a borrower owned and locally controlled cooperative lending organization.” He added that national charters are “not in the best interest of the farmers, ranchers and rural residents FCS was chartered to serve.”
- Financial consultant Bert Ely testified that the national charter initiative would serve no public purpose because large Farm Credit institutions would conduct cherry-picking and predatory pricing to serve the “most desirable agri-business customers.” He claims that national charters would accelerate the pace of consolidation within the Farm Credit System. He noted that larger Farm Credit System organizations will increasingly focus their lending on larger farms and ranches, as well as agribusiness – “the very enterprises which neither need nor deserve the \$1 billion-plus financing subsidy the FCS now delivers to American agriculture.” Ely stated, “most troubling, national charters will create the potential for another FCS-induced agricultural credit crisis, and a second taxpayer bailout of the FCS.” (*Written Testimony before House Banking Committee*, 10/3/00)

FCA says it didn’t overstep its authority

- FCA Board Chairman Michael Reyna told *BNA* that he is confident that the FCA did not overstep its authority by issuing a national charter initiative to member lenders. “This is entirely consistent with the authority granted by the Farm Credit Act,” said Reyna. He added that he does not believe that the GAO will find that the FCA violated either the provisions of the Administrative Procedure Act or the Congressional Review Act. “We’ve had our attorneys look at this and we are fairly certain we haven’t missed anything,” he said. (*BNA Daily Report for Executives*, Adam Wasch, 10/6/00)

HUD's fair lending review of Fannie & Freddie's automated underwriting systems due by year-end

HUD started the investigation in February 1999 – it took until January 2000 before the GSEs provided requested information to HUD

An independent study by the Urban Institute in March 1999 found that Fannie & Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers

- According to Jerry Guidera with *Dow Jones Newswire*, a government spokesman says HUD expects to close its fair lending review of Fannie and Freddie's automated underwriting system by the end of the year. In its review, HUD investigators and outside consultants have been focusing on the so-called "black boxes" with an eye towards patterns of discrimination in the lending tools. (*Dow Jones Newswire*, Jerry Guidera, 10/11/00)

Background:

- HUD has been investigating Fannie and Freddie's automated underwriting systems (which control 95% of the automated underwriting market share) for more than a year. In February 1999, HUD sent letters to Fannie and Freddie requesting information to ensure that the GSEs' systems comply with fair-lending standards. **In March 1999, HUD commissioned an independent study by the Urban Institute, which found that Fannie and Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers. The report also noted that Fannie and Freddie "do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities."** The report noted that "Primary lenders are making more aggressive efforts" to serve the lower income and minority homebuyers "by offering loan products with underwriting guidelines that are more flexible than the GSEs' guidelines." Further, the report noted that "depository lenders are serving low- and moderate-income borrowers better than the GSEs and so the percentage of loans purchased by the GSEs that are originated to low- and moderate-income borrowers is less than the percentage of loans originated in the primary market." The report also noted that "there is some evidence that the GSEs' purchase of loans made to black and Hispanic homebuyers have actually declined (in share and absolute number) over the last two years." (*HUD/Urban Institute Study, "A Study of the GSEs' Single Family Underwriting Guidelines,"* April 1999)
- HUD sent a separate letter to Fannie on December 21, 1999 as a follow-up to its fair lending investigation, accusing Fannie of dragging its feet. In HUD's December 21, 1999 letter to Fannie Chairman Franklin Raines, HUD's General Counsel Gail Laster criticized Fannie for providing information that "was grossly incomplete and did not provide the information necessary for HUD to even begin to perform its legal responsibilities." Laster also noted that Fannie included documents falsely labeled as confidential and proprietary and that the company ignored HUD's request that its Chief Executive Officer certify the information as truthful and correct. Laster returned the documents to Fannie and asked that Fannie provide more detailed and accurate information to HUD by January 31, 2000. (*HUD General Counsel Gail Laster letter to Fannie Chairman and CEO Franklin Raines, 12/21/99; Wall Street Journal, Michael Schroeder, 1/4/00; Dow Jones Newswire, Jerry Guidera, 1/4/00*)

- On January 31, 2000, Fannie turned over information to HUD on its automated underwriting system, Desktop Underwriter. Fannie reportedly provided four boxes of data tapes and documents and data on more than 10 million loans it has purchased using its automated underwriting system as well as loans it declined to purchase. HUD threatened enforcement action against Fannie including civil fines if Fannie did not provide the necessary information to HUD by January 31, 2000. (*Dow Jones Newswire*, Jerry Guidera, 2/1/00; *HUD press release*, 2/2/00; *National Mortgage News*, Brian Collins, 2/28/00) HUD Secretary Andrew Cuomo held a press conference with Fannie Chairman Franklin Raines on February 23, 2000 to announce that Fannie was “cooperating fully” with the review. **HUD Senior Counsel Mercedes Marquez said the review will go beyond fair lending, noting that HUD wants to learn how the GSEs’ systems are affecting the entire mortgage market. Marquez further noted that OFHEO (Fannie and Freddie’s safety and soundness regulator) would also have access to the information.** (*National Mortgage News*, Brian Collins, 2/28/00; *Dow Jones Newswire*, Jerry Guidera, 2/23/00; *BNA Daily Report for Executives*, Adam Wasch, 2/24/00)

All GSEs

Analyst says Senate Banking Committee Chairman Phil Gramm’s (R-TX) plans to cap the FHLBanks’ successful Mortgage Partnership Finance (MPF) program “is clearly mixed news for Fannie and Freddie investors”

Cap would limit the FHLBanks’ competition against Fannie & Freddie but shows Gramm intends to take a hard look at the housing GSEs next year

- In a September 25 analyst report by ISI (International Strategy & Investment), Senator Gramm’s plans to place a cap on the FHLBanks’ MPF program may be “mixed news for Fannie and Freddie.” Analysts Tom Gallagher and Andy Laperriere noted that Senator Gramm was planning on introducing an amendment to the VA-HUD Appropriations bill that would place a \$15 billion cap on the MPF program. When news that the amendment might be successful, Fannie and Freddie’s shares gained since the cap would limit Fannie and Freddie’s competition. [As noted earlier in this *GSE Report*, Senator Gramm decided not to introduce the amendment during this session of Congress.]
- However, the analysts warn that the reason why Senator Gramm wants to introduce the amendment “should give Fannie and Freddie investors pause.” Gallagher and Laperriere note that Senator Gramm wants to hold hearings on the issue next year to ensure that the FHLBanks don’t expand in size before the Senate Banking Committee has a chance to examine the issue. **“In other words, Gramm appears to be serious about putting GSE policy under the microscope.” Senator Gramm’s spokesperson stated that Senator Gramm’s efforts to place a cap on the MPF program “fits into his philosophy of limiting government-sponsored enterprises because of the risk to taxpayers.”**
- **The ISI report states, “In our view the Gramm amendment is clearly mixed news for Fannie and Freddie investors. On the one hand, his amendment would directly benefit the two publicly traded GSEs. On the other hand, this effort to cap the size of the FHLB system is a strong indication that Gramm intends to take a hard look at GSE policy next year.”** (*ISI Morning Political Report*, Tom Gallagher and Andy Laperriere, 9/25/00)

Fannie Mae and Freddie Mac

“Fannie Mae and Freddie Mac: The S&L Bailout of the New Century?” – Citizens Against Government Waste Special Report

“Like the S&L crisis, the Fannie and Freddie debt threat is not easy to understand. In fact, its complexity has helped them avoid the scrutiny their risky behavior deserves.”

“Should anything happen that might threaten Fannie Mae and Freddie Mac with collapse under the weight of that debt, rest assured that taxpayers will face another bailout.”

“If GSEs are allowed to neglect their mission in the interest of profiting stockholders, the mortgage marketplace, the tax-paying public and American homebuyers will all suffer.”

- Citizens Against Government Waste (CAGW) ran a special report on Fannie and Freddie in its newspaper – *Government Waste Watch*. Leslie Paige, Senior Vice President for Policy and Communications writes that Fannie and Freddie have largely accomplished their original mission but their stockholders are “addicted” to Fannie and Freddie’s double-digit growth rates and their massive profits. **“In short, Fannie and Freddie are being pressured into veering from the congressional mandate of helping Americans buy homes in order to pursue a stockholder enrichment scheme. This pursuit of high profit margins could lead to a crisis that would dwarf the S&L debacle.”**
- CAGW noted that there is an increased risk from Fannie and Freddie’s purchasing of a growing share of their own mortgage-backed securities for their portfolios, rather than selling them to private investors. “As these holdings accumulate, so do the risks. Billions of dollars of mortgage interest-rate risk once held by private investors now rests with Fannie and Freddie – backed by no insurance fund and relatively little capital.”
- The GSEs have a substantial advantage over private firms from their implied government guarantee and are able to borrow funds at extremely low interest rates. “That taxpayer subsidy allows Fannie and Freddie to offer below-market financing, thus hurting the competitive mortgage market.”
- The threat from the GSEs is complex. **“Like the S&L crisis, the Fannie and Freddie debt threat is not easy to understand. In fact, its complexity has helped them avoid the scrutiny their risky behavior deserves.”** The GSEs are projected to exceed the entire publicly held national debt by 2003. **“Should anything happen that might threaten Fannie Mae and Freddie Mac with collapse under the weight of that debt, rest assured that taxpayers will face another bailout.”**
- **In conclusion, CAGW notes that “Americans simply cannot afford another debacle like the S&L crisis...The stakes are high. If GSEs are allowed to neglect their mission in the interest of profiting stockholders, the mortgage marketplace, the tax-paying public and American homebuyers will all suffer. Instead of helping American homebuyers realize the American**

dream, Fannie Mae and Freddie Mac may be racing toward an American nightmare.”
(*CAGW Government Waste Watch*, Leslie Paige, Summer 2000)

National Taxpayers Union warns that Fannie & Freddie pose a double taxpayer threat

“A new debt crisis is brewing at Fannie Mae and Freddie Mac”

“Although Fannie and Freddie officials dismiss any analogy between their current financial position and that of the S&Ls, the facts tell a different story.”

Congress should establish a timetable to privatize the GSEs and at the very least, should impose ground rules to curb the GSEs to protect taxpayers

- Peter J. Sepp of the National Taxpayers Union wrote an editorial on the GSEs that appeared in the *Knight Rider-Tribune Business News*. **According to Sepp, “a new debt crisis is brewing at Fannie Mae and Freddie Mac.”** Fannie and Freddie are aiming to become US benchmark securities as the national debt rapidly declines. Earlier this summer, Fannie helped their largest debt issue ever while Freddie announced its intention to become more involved in foreign markets by issuing securities in euros. Sepp asks, **“Why should these shifting tides of high finance concern the average American? Aside from a direct taxpayer subsidy of \$10 billion annually, in just three years Fannie Mae and Freddie Mac are projected to hold \$1.8 trillion in outstanding debt, which the Congressional Budget Office says is implicitly backed by taxpayers. This level would be 14 times the amount of on-balance-sheet debt carried by the ill-fated private company Long-Term Capital Management when it crashed.”**
- Sepp goes further and draws parallels between the GSEs and the S&L crisis. **Sepp states, “Although Fannie and Freddie officials dismiss any analogy between their current financial position and that of the S&Ls, the facts tell a different story.”** According to Sepp, the savings and loan scandal of the 1980s cost taxpayers \$350 billion. This scandal arose from high interest rates in the early 1980s recession which led to S&Ls trying to “grow their way” out of problems through more dangerous ventures. **Sepp writes, “But if a new interest rate crisis were to affect Fannie Mae adversely, history would be repeating itself, not just inflicting itself on a new victim.”** Sepp warns that Fannie has been victim to high interest rates in the past. He noted that Treasury Undersecretary Gary Gensler testified that in the 1980s, Fannie was insolvent on a “mark-to-market basis.” Furthermore, Alan Greenspan has expressed concerns to Congress how “the size of -- and subsidies afforded to-- the GSEs could severely distort financial markets if left unchecked.”
- **The GSEs are skilled in political gamesmanship -- helping to shield them from regulators-- much like the S&Ls of the 1980s, added Sepp.** The GSEs are also exempt from many business practices required to show transparency. They are not required to register securities with the SEC, they do not have to disclose trading positions held by high-level managers and, unlike private lending institutions, are not yet required to maintain a level of risk-based capital.
- Sepp concludes, **“Congress must establish a firm timetable to make the quasi-public housing GSEs fully private.”** Until then, at the very least, Congress should implement several ground rules to curb the GSEs including:
 - Remove the GSEs line of credit with the Treasury;

- Require a full disclosure of all expenditures on lobbying, image advertising, campaign contributions, and grants made through their foundations;
- Cap the volume of debt GSEs can hold.

(*Knight-Ridder Tribune Business News; Bridge News-New York*, Peter J. Sepp, 9/11/00)

Fannie expresses interest in a subprime loan underwriting system

Concerns about GSEs' entry into subprime:

While the GSEs enter the subprime market, subprime lenders are exiting the business "seemingly in herds"

Investors and traders are concerned that the GSEs' subprime programs could increase the risk of loan defaults and prepayments, making it more difficult to predict the rate of interest and principal payments used to establish the securities' values

Paine Webber analysts note that an economic downturn might lead to greater credit worry about the inclusion of poorer credit loans in Fannie's pools

Consumer groups worry that GSEs' entrance into subprime will worsen predatory lending

Fannie interested in subprime automated underwriting system

- According to *Real Estate Finance Today*, Fannie and the US Department of Agriculture expressed interest in NetDecision, a subprime loan underwriting engine. Alex Kang, who introduced the system, said just days after he announced NetDecision, the institutions wondered if the system could be applied to them. Kang noted that the strength of the product is that subprime lenders do not have to develop their own underwriting systems, they can just outsource using NetDecision's software. Kang added that the strength of NetDecision also lies in its other capabilities such as servicing credit cards. (*Real Estate Finance Today*, Chris De Reza, 9/3/00)

Subprime lenders exiting business

- According to Michael Gregory with *Asset Sales Report*, while the GSEs continue expanding into the subprime markets, subprime lenders "seemingly in herds" are exiting the business. At least a few of the sources suggested that the threat of GSEs in the subprime market is a factor scaring lenders out of the market. "Fannie Mae and Freddie Mac are about to skim the cream," said one source. "And that will leave the traditional subprime lenders with the weaker borrowers and the losses; this is called adverse selection." The argument is that, with a weaker borrowing pool, traditional subprime lenders will be forced to charge even higher interest rates for the B- and down credits, if they want to cover their losses. Wright Andrews, partner at Butera & Andrews and Washington counsel for the National Home Equity Mortgage Association (NHEMA) said "there is no question that industry executives are extremely concerned...that the more the GSEs get in, the more devastating it would be to the market." (*Asset Sales Report*, Michael Gregory, 8/22/00)

Investors and traders concerned that pool performance could be affected

- Investors are concerned that the GSEs' subprime activity may affect pool performance. Investors question where Fannie and Freddie would place the subprime loans with regard to the securities issues. Currently, market sources said that Fannie and Freddie's subprime loans have been issued alongside the conforming loans in the mortgage pools. Since there is no disclosure as to the concentration of these loans (other than it must be less than 10%) when the pools are securitized,

investors are likely to take issue, as the prepayment and default rates are likely to change. Prepayment models that predict the performance of Fannie and Freddie's securities lose value when there are undisclosed concentrations of non-conforming loans in the pool. "It's a real concern on the part of investors that Fannie and Freddie will dilute the purity of their current passthroughs," said Tom Zimmerman, Head of Asset-Backed Research at PaineWebber. "A lot of investors are going to be upset if they put a whole lot of A-minus loans into those deals." (*Asset Sales Report*, Michael Gregory, 8/22/00)

- As reported in the October 29, 1999 GSE Report, *Bloomberg* reported that Fannie's subprime program – Timely Payments Rewards - is unsettling to investors because if the risky loans start showing up as collateral in the mortgage pools backing Fannie's securities, it could increase the risk of loan defaults and prepayments, making it more difficult to predict the rate of interest and principal payments used to establish the securities' values. "It does represent a threat to the continued integrity of the market," said George Miller, Deputy General Counsel at the Bond Market Association. (*Bloomberg*, 10/4/99)
- Alt-A and subprime loans have different credit profiles than traditional conforming product and can skew the weighted average coupon of a pool because they carry higher rates, said Amitabh Arora, Vice President of Mortgage Research at Lehman Brothers. Arora notes that "Initially, Alt-A and subprime loans will be slower to refinance," and adds that he would like information on the guarantee fee that the agencies charge on each loan because those fees will have higher prepayment implications. Michael Hoeh, Senior Portfolio Manager at Dreyfus Corp. warned that "should the credit environment turn and residential defaults rise, the Alt-A and subprime loans will be the first to default." (*Dow Jones Newswire*, Sara Landis, 10/6/99)
- "I think this is a terrible thing," said one Wall Street observer. "The wide acceptance of the passthrough market, its liquidity, its huge number of committed and occasional players alike are all owed fundamentally at bottom that we are able to understand, model and somewhat control the risk regarding prepayments. The comfort level with prepayments is threatened when they start changing the collateral." "Though on a passthrough it won't make a big difference," said another mortgage-backed securities Wall Street source, "when you leverage it into IO's [interest only], PO's [principle only], super PO's and inverse-IO's, it begins to increase the level of uncertainty, and from our perspective, that is not a good thing."
- Talks have reportedly taken place between the Bond Market Association and Fannie to limit the amount of Timely Payment Reward loans to no more than 10% of TBA (to-be-announced) pools. However, some observers don't buy it. "This is just disingenuous to say this 10% doesn't change the prepayment characteristics of collateral," said a Wall Street source that chose to remain anonymous. "But given the politics of this market and the weight of those entities, their power is lobbying, they have organizations in Congress and so forth. That housing capital is already available for these borrowers, and we don't need Fannie Mae or Freddie Mac to do it, especially since, over time, they crowd out truly private players...Perhaps it makes that A-minus loan a little cheaper, but it doesn't make it that much cheaper, because they charge for it." (*Mortgage-Backed Securities letter*, Adam Tempkin/Frank Musero, 10/11/99)

Paine Webber comments about Fannie's subprime program

- A *National Mortgage News* article by Bonnie Sinnock reported that Paine Webber researchers believe that Fannie's subprime program - the Timely Payment Rewards mortgage – **“will mean less business for companies that are primarily subprime lenders (and are not approved as**

Fannie Mae seller-servicers)." The researchers further noted that the program would also create a narrowing of the credit grade spectrum involved in subprime originations. Although, as Paine Webber points out, the percentage of the lowest credit grade "Timely Reward" loans will be restricted to 10% of the loans in Fannie's pools, however, the top two credit grades in the agency's A-minus category will have no such restrictions. **The researchers noted that some of the credit quality concerns is mitigated by the fact that Fannie has its valuable implied government guarantee, however, the researchers added that there is a possibility of an economic downturn that might eventually lead to greater worry about the inclusion of poorer credit loans in these pools.** (*National Mortgage News*, Bonnie Sinnock, 10/11/99)

Consumer advocates fear the GSEs will only exacerbate predatory lending problems

- According to an *American Banker* article by Robert Julavits, consumer activists fear the entry of Fannie and Freddie into the subprime mortgage business and worry that it will worsen the predatory lending problems, rather than cleaning up the industry. (*American Banker*, 3/27/00)
- When testifying at a September 12 House Banking Capital Markets Subcommittee GSE Roundtable, Bruce Marks from the Neighborhood Assistance Corporation of America was critical of the GSEs' entry into the subprime market. He noted that the GSEs argued that they are moving into the subprime market to move borrowers with good but not perfect credit into the conventional market and to "clean up" the subprime market by pushing their standards onto the subprime market. However, Marks argued that the GSEs incorrectly labeled these borrowers with less than perfect credit as "subprime" in the first place. **Rather than providing conventional loans to these borrowers, the GSEs only want to expand into the subprime market to "exploit" these borrowers with higher interest rates, greater fees, prepayment prohibitions and greater profits for the GSEs and their shareholders. "The GSEs have created this \$300 billion subprime market and now want to profit from it."** He claims that the GSEs want to make 100 to 200 basis points on these borrowers who should be treated as the best and most reliable borrowers. **"If the majority of the subprime loans are correctly evaluated as conventional, the abuses will be dramatically reduced. But the GSEs will not do so because there is too much money in it for them."** Marks argued, **"The GSEs have provided an extraordinary return for their stockholders but have failed in their mission of providing affordable mortgage access to low and moderate income people...It is an outrage that Fannie Mae and Freddie Mac, with over \$10 billion in subsidies, do less for working people than for-profit lenders."** (*GSE Roundtable Oral and Written Testimony*, 9/12/00)

<p>Consumer Federation of America's annual conference will include a discussion panel entitled "Fannie Mae and Freddie Mac Under Attack: Are the Critics Right?"</p>

- The Consumer Federation of America is holding its annual conference - "The Consumer in the Financial Services Revolution" - on November 30 and December 1 at the Jurys Hotel in Washington, DC. Among the topics of discussion at that conference, the CFA plans to host a discussion panel entitled "Fannie Mae and Freddie Mac Under Attack: Are the Critics Right?" The following is a description from CFA on this panel: "Some government, industry, and consumer leaders criticize these government sponsored enterprises for failing to fulfill their mission and acting imprudently financially. Other leaders defend the GSEs for their leadership on housing issues and prudent management of risks. Should Congress pass legislation to address the concerns of the critics, and what impact could this have on housing finance markets." (*Consumer Federation of America brochure on "The Consumer in the Financial Services Revolution" conference*)

Fannie forms Homeownership Alliance to counter criticisms against the GSEs

Organizations joining the group include: Freddie Mac, the Independent Community Bankers Association, the National Association of Home Builders and the National Association of Real Estate Brokers

- Fannie formally announced that it has formed the Homeownership Alliance, which it calls a “broad-based public education organization to promote the American housing system.” **The move is viewed by some in the mortgage industry to counter GSE critics – like the Fannie, Freddie watchdog group – FM Watch.**
- Fannie hired Rick Davis, the former national campaign manager of Presidential candidate John McCain to head the group. Fannie said the group will not lobby members of Congress but will focus on public advocacy through its website. The group also plans to conduct housing-related research for consumers, policy makers, media and those interested in housing issues. In addition, the group plans to hold seminars to highlight threats to the housing industry (e.g., responding to criticisms about the GSEs).
- Besides Freddie the members of the Homeownership Alliance include: The American League of Financial Institutions; The Enterprise Foundation; Independent Community Bankers Association; Local Initiatives Support Corporation; National Association of Home Builders; National Association of Real Estate Brokers; National Bankers Association; and the National Urban League. One notable exception to the group is the National Association of Realtors, which in August said it was considering a decision to join the group (see August 18, 2000 *GSE Report*). [Editorial Note: Other major groups that do not belong to the Alliance include the American Bankers Association, America’s Community Bankers, American Financial Services Association, Consumer Bankers Association, Financial Services Roundtable, and the Mortgage Bankers Association.] (*Dow Jones Newswire*, Jerry Guidera, 9/29/00; *American Banker*, 10/2/00; *Homeownership Alliance press release*, 9/29/00)

Under non-risk-based capital rules, Fannie & Freddie met their minimum capital requirements

Risk-based capital rule is expected to be finalized by year-end – OFHEO will likely issue the rule at the beginning of 2001 - Fannie & Freddie have a year to comply

OFHEO says it will release the source code for the stress test models to the public

OFHEO Director Armando Falcon would not say whether Fannie or Freddie will meet OFHEO’s risk-based capital rule when it is released

- OFHEO is required by statute to determine the capital adequacy of Fannie and Freddie on the basis of both minimum and risk-based capital requirements. OFHEO’s risk-based capital regulation, now six years late, is expected to be finalized by year-end.
- OFHEO announced that under current non-risk-based capital rules (minimum capital rules), as of June 30, Fannie and Freddie hold enough capital to meet US guidelines. Fannie’s core capital of \$19.044 billion exceeded its minimum capital requirement of \$18.688 billion by \$355.70 million. Freddie’s core capital of \$13.368 billion exceeded its minimum capital requirement of \$12.935

billion by \$432.12 million. Core capital is the company's total common stock, perpetual noncumulative preferred stock, paid-in capital, and retained earnings. (*Reuters*, 9/26/00)

- During an October 3 speech before a conference sponsored by Prudential, OFHEO Director Armando Falcon said the agency was on-track to finalizing the risk-based capital rule and sending it to OMB for review by the end of the year. Once OMB has cleared the rule, OFHEO plans to publish the stress test in the *Federal Register* and release the source code for the stress test models to the public. Falcon noted that this will make the stress test fully transparent to all interested parties. When asked whether Fannie or Freddie would meet the stress test when it was released, Falcon said he could not say whether they would meet the test or not. The rule, however, is not enforceable at its release since the GSEs have a year in which to comply with the rule upon its release. Falcon took issue with the fact that unlike all other financial regulators, OFHEO is subject to the uncertainty of the annual Congressional appropriations process. "As we speak, OFHEO is operating under a temporary one week appropriation. My concern is that this lack of financial independence and flexibility could prevent OFHEO from fully carrying out our mission, particularly during a financial crisis at either Enterprise. I have urged Congress to remedy this flaw and exempt OFHEO from the appropriations process." (*Remarks by OFHEO Director Armando Falcon before Prudential Conference*, 10/3/00)

OFHEO submits its five-year strategic plan to Congress

Plan will serve as a blueprint for how OFHEO will oversee Fannie & Freddie

OFHEO notes that Fannie & Freddie are two of the largest private debt issuers in the world and two of the largest end-users of derivatives

OFHEO expects Fannie & Freddie's GSE status will continue to give them advantages over other firms

OFHEO expects that Fannie and Freddie are likely to continue to increase their purchases of loans to a broader range of borrowers, including those with varied credit histories.

The plan notes that the pace at which Fannie and Freddie's debt is growing and their increasingly central role in financial markets "is likely to continue to raise concerns about the risks they pose to the financial system."

- OFHEO sent Congress its FY 2000-2005 strategic plan, which details OFHEO's mission, goals and objectives for the next five years and provides a blueprint for achieving them. OFHEO's three primary regulatory responsibilities are : (1) ensuring the GSEs are adequately capitalized; (2) conducting safety and soundness examinations; and (3) undertaking research and analysis on emerging GSE-related matters.
- OFHEO revised its mission statement to the following: "OFHEO promotes housing and a strong economy by ensuring the safety and soundness of Fannie Mae and Freddie Mac and fostering the strength and viability of the nation's housing finance system."
- The strategic plan stated that Fannie and Freddie are two of the largest private debt issuers in the world. At mid-year 2000, Fannie and Freddie had over \$963 billion in debt outstanding. OFHEO notes that because of their GSE status, the demand for their debt is strong. In addition to GSE debt,

investors hold over \$1.2 trillion in Fannie and Freddie mortgage-backed securities. Enterprise debt and mortgage-backed securities account for about two-thirds of “agency debt.” Fannie and Freddie are also two of the largest end-users of derivatives. Their use has increased by nearly 400% in the last five years, at a rate of just above the annualized rate of growth of the derivatives market as a whole. In 1999, the combined notional amount of derivatives contracts used by Fannie and Freddie totaled nearly \$700 billion, just over one percent of the derivatives market.

- OFHEO expects that Fannie and Freddie’s GSE status will continue to give them advantages over other firms in the housing finance market. Fannie and Freddie are likely to continue to increase their purchases of loans to a broader range of borrowers, including those with varied credit histories. The GSEs’ uses of technology will inevitably create opportunities and risk. The GSEs are also expected to continue rapid growth of their retained mortgage portfolios.
- The plan noted that the pace at which Fannie and Freddie’s debt is growing and their increasingly central role in financial markets “is likely to continue to raise concerns about the risks they pose to the financial system.” Fannie and Freddie’s rapid growth of its portfolio would test Fannie and Freddie’s risk management. “A recession accompanied by higher interest rates would test the Enterprises’ abilities to manage the interest rate risk associated with their large retained mortgage portfolios.” (*OFHEO press release, 9/29; OFHEO FY 2000-2005 Strategic Plan, 9/29/00*)

HUD expects its affordable housing rule for Fannie & Freddie to be released by year-end
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- According to Andrew LePage with *Scripps Howard News Service*, HUD officials expect final approval of its affordable housing rule for Fannie and Freddie by year-end, enabling the goals to take effect January 1, 2001. The goals have undergone public review and comments and are now in the final stages of scrutiny by the Clinton Administration. HUD officials says they anticipate few changes to their proposal. (*Scripps Howard News Service, Andrew LePage, 10/10/00*)

Background on HUD’s proposed affordable housing rule

- On March 2, HUD released its proposed affordable housing rule for Fannie and Freddie. The proposal raises the required percentage of mortgage loans for low- and moderate-income families that Fannie and Freddie must purchase from the current 42% of their total purchases to a new high of 50% - a 19% increase in the year 2001. HUD also proposed an increase in the affordable housing goals for families with very low incomes (an increase from the current 14% to 20%) and an increase in the underserved areas, such as central cities and rural areas (an increase from the current 24% to 31%). The proposed rule was published in the *Federal Register* on March 9, 2000. The deadline for comments closed on May 8, 2000. (*HUD press release, 3/2/00; Federal Register, pages 12632-12816, 3/9/00*)

Fannie Mae

The director of a group that counsels low-income homebuyers states, “Fannie Mae has not expanded lending in metro St. Louis or anywhere else as far as I know.”

“Fannie...does a lot of grandstanding, and it’s hard to know what’s real,” says the director.

- Fannie announced on October 6 that it plans to invest \$8 billion to improve St. Louis housing over the next five years. Senator Christopher Bond (R-MO) says Fannie is a “partner and a friend,” which is “doing the right thing.” However, the *Associated Press* reported that the praise for Fannie is not unanimous. “Fannie Mae has not expanded lending in metro St. Louis or anywhere else as far as I know,” said Rob Boyle, Director of the Justine Peterson Housing and Reinvestment Corp., which counsels low-income people seeking mortgages. Boyle complains that Fannie’s standards reject too many borrowers for minor problems with their payment history. Some banks, especially Firststar, offer more lenient loans than Fannie would accept, he said. Those banks keep the loans rather than selling them to Fannie. Boyle said he was unsure what to think about the \$8 billion investment plan. “Fannie, like a lot of banks, does a lot of grandstanding, and it’s hard to know what’s real,” he said. (*Associated Press*, 10/2/00)

Non-profit group in St. Louis that received \$25,000 from Fannie Mae Foundation disbands after failing to mount an ad campaign to lure new residents to St. Louis neighborhoods

- A non-profit group, the City Living Foundation, disbanded after failing to mount an ad campaign to lure new residents to St. Louis neighborhoods. The group received \$322,000 in city money and a \$25,000 grant from the Fannie Mae Foundation. Officials said \$50,000 was paid for a marketing study and two public relations firms received more than \$57,000 for advance work on TV ads and brochures. Much of the rest of the money went for staff members’ salaries and payroll taxes. Theft charges have also been filed against a former employee for allegedly stealing approximately \$17,000 from the group. A spokesman for St. Louis Mayor Clarence Harmon said they’re trying to recoup the money yet to be spent by the group. But there may be little or nothing left after the group issues its final paychecks and pays its last bills. Officials said office equipment and the results of a 1996 marketing study would be turned over to the city. (*St. Louis Post-Dispatch*, Mark Schlinkmann, 9/15/00)

A.G. Edwards downgrades Fannie to “accumulate”

- Fannie was downgraded to “accumulate” from “buy” by A.G. Edwards analyst Joel J. Houck. (*Bloomberg Data*, 10/6/00)

Fannie Chairman Franklin Raines blames the press and FM Watch for its stock slide

***Dow Jones Newswire* John Connor notes that blaming the press “is a familiar one, often belabored by persons and institutions under fire”**

Connor further adds that Raines did not spend much time discussing other prominent individuals, which have expressed concerns about the GSEs (including Cong. Richard Baker, Treasury Under Secretary Gary Gensler, and Federal Reserve Board Chairman Alan Greenspan)

[Editorial Note: During the 106th Congress (1999-2000), there has been a growing chorus of groups from the “left” and the “right” that have expressed concerns about Fannie & Freddie, including: academics/think tanks; consumer groups; taxpayer groups and policymakers (including Members of Congress, Federal Reserve Board Chairman Alan Greenspan, Treasury Under Secretary Gary Gensler, and others).]

- At an October 3 conference sponsored by Prudential Securities, Fannie Chairman Franklin Raines said media reports, planted by rivals, have vastly overblown the level of political risk that the company faces. **Raines says the news reports were to blame for Fannie’s depressed stock prices.** “The news stories out of Washington made this year seem a lot more dangerous for Fannie Mae than it really was,” he said. “If you only followed the *Wall Street Journal* or any of the trade publications, you might have concluded that the fundamental value of the company had changed.”
- Raines blamed the media attention on FM Watch. He claimed one of FM Watch’s goals was to drive down the price of the company’s stock. Raines complained of “new tactics” and “corporate campaigns” where business adversaries try to embarrass a company into “making concessions...you might even try to depress their stock,” he said.
- **FM Watch Executive Director Mike House denied that FM Watch would engage in any type of campaign to drive down Fannie’s stock price.** “One should always be suspect of an organization that seems to find fault with everyone but their own self when it comes to their predicament,” he said. He added that Fannie “wants to blame the media, and other interest groups, for its problems.” House stated, “FM Watch is just one of many raising concerns” about GSEs. “The political problems that Fannie Mae is encountering have been caused by a legitimate debate over their role in the marketplace.”
- Raines says FM Watch “is not going away,” but Congress will take an “if it ain’t broke, don’t fix it” approach to legislative changes. Raines claimed there was a groundswell of support for Fannie, noting the recent formation of the “Homeownership Alliance.” FM Watch’s House says Fannie funded, created, and controls the Homeownership Alliance. (*National Mortgage News Daily*, 10/4/00; *Dow Jones Newswire*, Jerry Guidera, 10/3/00)
- When responding to a question at the Prudential Conference about Fannie’s business mix changes in the next five years, Raines stated that the company expects growth in low down-payment mortgages and growth in the slightly credit impaired borrower market, and more mass customization of loans – like Fannie’s Working Mortgage Product. A follow-up question noted that since Fannie’s risk profiles would rise, then Fannie’s business risk should then rise. Raines disagreed and said that the company will use additional fees and bring in mortgage insurance or

recourse to share the risk to avoid raising the company's business risk. (*Prudential Conference*, 10/3/00)

- **John Connor with *Dow Jones Newswire* notes that while blaming FM Watch and the press for its recent problems, Raines gave “remarkably short shrift” to “those who might be considered prominent among the usual suspects” including:**
 - **House Banking Capital Markets Subcommittee Chairman Richard Baker who introduced a bill to strengthen regulatory oversight of the GSEs, including removing the GSEs' line of credit with the Treasury.**
 - **Treasury Under Secretary Gary Gensler, “who transformed Baker’s low-profile quest to reform regulation of the GSEs, into a higher-profile happening” by testifying in March in favor of key portions of the bill, including removing the Treasury line of credit.**
 - **Federal Reserve Board Chairman who expressed concerns about the GSEs in two letter submissions to Congressman Baker.**
 - Connor writes, “as for Congressman Baker's hearings and statements from the Treasury and Federal Reserve, hey, nothing new here,” according to Raines. "To the outside world, their statements seemed like something new," Raines stated. "To us, they were just old friends in a new forum." What really happened, Raines said, is that "the headlines this year made it look like more was going on than really was."
 - **Connor noted that blaming the press “is a familiar one, often belabored by persons and institutions under fire.” (*Dow Jones Newswire*, John Connor, 10/10/00)**
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[Editorial Note: During the 106th Congress (1999-2000), there has been a growing chorus of groups from the “left” and the “right” that have expressed concerns about Fannie & Freddie, including: academics/think tanks; consumer groups; taxpayer groups; industry groups; and policymakers (including Members of Congress, Federal Reserve Board Chairman Alan Greenspan, Treasury Under Secretary Gary Gensler, and others):]

HUD:

- Conducting investigation on Fannie's and Freddie's new business activities because of concerns that these new programs may be expanding beyond the GSEs' missions. HUD requested information from Fannie and Freddie on its mortgage insurance initiatives. HUD also asked Fannie for information on its offering loan brokers and consumers Internet access to its automated underwriting system, Desktop Underwriter, and a home improvement product with Home Depot. HUD asked Freddie about its Internet programs and its “HomeSteps” Buying Center in California.
- Conducting year-long fair-lending investigation of Fannie & Freddie's automated underwriting systems (should be finalized by year-end). An independent study commissioned by HUD found that Fannie & Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers.
- Issued a rule to increase Fannie & Freddie's affordable housing goals (should be finalized by year-end). HUD Assistant Secretary William Apgar testified that Fannie and Freddie lag the primary

market in serving low-income homebuyers, particularly when it comes to serving African-Americans and Hispanics.

- Expressed a desire to issue a proposed rule that may limit the GSEs' non-mortgage investments. In April 1999, HUD received a preliminary report from Abt Associates that found "justifications for placing some restrictions on non-mortgage investments."

OFHEO:

- Issued a proposed risk-based capital rule covering Fannie & Freddie (should be finalized by year-end).
- Plans to expand its supervision of Fannie & Freddie to include the influence that the GSEs exert over the entire mortgage market. OFHEO says it can help to define the kinds of business activities that are permissible for Fannie and Freddie under their charters.
- Conducting a study on the "systemic risks" associated with Fannie and Freddie [OFHEO Spokeswoman said the study could take six months to a year to complete]. OFHEO Director Falcon stated, "We must understand not just the risks faced by the enterprises, but also the risks they pose to the financial system."
- Delivered its Year 2000 Report to Congress. In its report, OFHEO found that the GSEs could pose increasing risks to the US economy. OFHEO highlighted concerns about the dramatic growth of Fannie and Freddie's debt, and noted that if either Fannie or Freddie were to default, the entire financial system could be at risk. OFHEO said proposals that merit consideration include: repealing the exemption of GSE debt from the limit on an individual bank's credit exposure to any one entity; granting OFHEO the authority to place a severely undercapitalized enterprise in receivership; and taking steps to increase the degree of market discipline of Fannie and Freddie by requiring enhanced federal disclosure of their risk.

Treasury:

- Treasury Under Secretary Gary Gensler testified during a House Banking Capital Markets Subcommittee hearing that the Treasury Department supports removing the GSEs' line of credit with the US Treasury and suggests limiting the amount of GSE debt that commercial banks can hold. The Treasury Department supports elements of Cong. Baker's GSE bill (HR 3703) and believes now is the ideal time to examine the GSEs. Gensler estimated that GSE debt will surpass Treasury debt in three years. He noted that GSEs enjoy special benefits that are not available to other financial institutions, which allow the GSEs to dominate markets. He also noted that the mortgage market's increasing use of GSEs' automated underwriting systems may result in fewer options for consumers.
- Treasury Secretary Lawrence Summers suggested that the President's Working Group on Financial Markets should focus on GSE systemic risk.

Treasury and HUD:

- Released a joint report on June 20 detailing recommendations on legislative, regulatory, and other steps to curb predatory lending. Among its recommendations, the report suggests that Congress should clarify HUD's and the Federal Housing Finance Board's authority to regulate the GSEs to prohibit them from purchasing predatory loans.

Fed:

- Fed Chairman Alan Greenspan has sent two submissions to Cong. Baker addressing concerns about the GSEs. In an August 25 letter to Cong. Baker, Greenspan warned, "if the subsidy enables Fannie and Freddie to hold less capital, then bondholders and taxpayers may be at a greater risk if these GSEs need financial assistance in the future." Greenspan also noted that Congressional oversight

of the GSEs' subsidies were appropriate. "Since these implicit subsidies have important consequences for the structure and efficiency of the financial markets and the productive allocation of real resources, it is appropriate for them to be subject to the Congressional oversight process." Greenspan wrote, the GSEs "clearly benefit from government sponsorship – particularly from the ability to borrow funds at lower cost than comparably situated private-sector borrowers. The lower borrowing costs of these institutions, of course, reflect the widespread belief that the government is unlikely to let a GSE fail." As Greenspan noted in an earlier May 19 letter to Cong. Baker, the subsidies enjoyed by the GSEs may reduce mortgage costs for homebuyers but at the expense of increasing Americans' taxes or reducing their wealth in other ways."

- The Fed is conducting a broad study on what kinds of securities it should use to conduct monetary policy in the post-deficit era, in light of declining Treasuries. As part of the study, the Fed is examining whether it will continue using Fannie and Freddie's securities in its open-market operations. In August of 1999, the Fed authorized using these securities on a "temporary" basis to manage banking system reserves through the Year 2000 date change in anticipation of any computer complications. These authorizations were scheduled to expire in April 2000, but the Fed decided to extend their use until February of next year. In released minutes from a March 2000 policy-making session, the Fed noted that "the requested temporary expansion of the authority...should not be read as indicating in any way how the committee might ultimately choose to allocate the portfolio, and any interim operations in the broader range of collateral should be capable of being unwound without adverse consequences." Fed official Peter Fisher said the study "will take some time."

Federal financial regulators:

- Federal regulators (the Federal Reserve System, FDIC, OCC, and OTS) issued a proposed recourse rule that gives all AAA- and AA-rated mortgage-backed securities the same capital treatment as Fannie and Freddie's MBS. Under the proposed rule, banks and thrifts would only have to hold 20% risk-based capital against purchases of AAA and AA-rated mortgage-backed securities. Currently, only Fannie and Freddie mortgage-backed securities enjoy this low capital requirement. The proposal would make private label mortgage-backed securities a more attractive investment for banks and would ensure that Fannie and Freddie mortgage-backed securities would not be treated more favorably under bank risk-based capital guidelines than private-label mortgage-backed securities with AAA and AA-ratings.

Congressional Budget Office:

- In its 1999 Annual Report to Congress, CBO listed the following as options for increasing federal revenues: (1) imposing an annual fee on the investment portfolios of the GSEs and (2) requiring the GSEs to register their securities with the SEC.
- Cong. Baker requested that CBO update its 1995 study on the amount of subsidies provided to the GSEs. The CBO concluded that in 1995 the subsidy was worth \$6.5 billion per year to Fannie and Freddie together, of which \$2.1 billion was retained by the shareholders of these institutions, rather than passed through to homebuyers.

Congressional Research Service (CRS):

- CRS issued report on GSEs' expansion efforts by Barbara Miles. The report noted that GSE privileges can act as a barrier to entry by competitors and can result in a GSE monopoly. The GSEs' special privileges allow them to outprice and outcompete the private sector – GSEs have a special incentive to dominate their assigned markets and expand into related markets. Fannie and Freddie have corrected the market failure for which they were first chartered. Difficulties arise when GSEs retain their advantages after the market failure they were created to rectify has been repaired – the GSEs have an incentive to dominate the market by outpricing their competition and

have no competitive incentive to lower their prices. The GSEs' marketing directly to consumers might lead incrementally to GSEs requesting to lend directly to consumers. There is no reason to believe the long-term effect of the GSEs' moving directly to borrowers would improve today's market.

- CRS's Barbara Miles testified before House Budget Committee Task Force that the GSEs' purchasing of MBS had very little to do with the GSEs' mission and more to do with maximizing profits "While it is clear that this increases shareholder value, it is difficult to understand what, if anything, it does for mortgage markets," she stated. Miles also stated that the GSEs create risks to the economy by displacing private sector competition and increasing economic inefficiency. Fannie and Freddie have much weaker market discipline compared to other institutions because the GSEs have the implied government backing, creating new risks to the economy. The GSEs pose systemic and systematic risks to the financial system and to the economy.
- CRS and GAO have been asked by Cong. Baker to conduct studies about the differences in regulatory authority between OFHEO and bank regulators.

Government Accounting Office (GAO):

- A 1999 GAO Report on budget issues suggested that Congress could increase revenues by making Fannie and Freddie pay for their mission oversight. GAO said that "requiring Fannie Mae and Freddie Mac to reimburse HUD for mission oversight expenditures would not only result in (savings estimated at \$10 million a year) but would also enable HUD to strengthen its mission oversight."
- Thomas McCool with GAO testified before House Budget Committee Task Force. He stated that the GSEs' purchasing of their MBS for their portfolios had very little to do with the GSEs' mission and more to do with maximizing profits. McCool stated that "perceived federal sponsorship of the enterprises' activities as GSEs" involves "significant risks and costs." McCool further stated that the GSEs have engaged in complex financial activities "whose relation to their housing mission is not entirely clear... More recently, the enterprises' involvement in other activities – such as automated underwriting – have raised questions as to whether they are attempting to move beyond the secondary market into areas traditionally served by private lenders in the primary mortgage market."

Office of Management and Budget:

- Considered including user fees on Fannie and Freddie as potential revenue raisers in the President's FY 2000 Budget.
- Clinton's FY 2000 budget included a proposal that Fannie and Freddie pay annual assessments – totaling \$10 million a year – to HUD for the cost of oversight.

Cong. Richard Baker (R-LA):

- Introduced the first comprehensive bill addressing GSEs in several years. The bill (HR 3703) would among other things, create a single regulator for the housing GSEs, in an effort to strengthen regulation of the GSEs. Other provisions in the bill include: (1) reforming the approval process for new GSE initiatives; (2) limiting GSEs' non-mission related investments; (3) removing the GSEs' line of credit with the Treasury; (4) imposing uniform risk-based capital requirements on the GSEs; (5) requiring annual credit ratings of each GSE; (6) putting into statute the current GSE practice of maintaining the conforming loan limit to reflect downward movement in average home prices; (6) equalizing the capital treatment of GSE and private-label mortgage-backed securities; and (7) studying the exposure of the deposit insurance funds to GSE failure. After talks with Fannie failed, Cong. Baker pledged to introduce a stronger bill during the next Congress.

- Held several hearings on his bill, and the GSE issue in general, in the House Banking Capital Markets Subcommittee during the 106th Congress: six hearings in 2000 (September 12, July 20, June 21, June 15, May 16, and March 22) and one hearing in 1999 (May 12).

Senate Banking Committee Chairman Phil Gramm (R-TX):

- Indicates he may hold hearings on the housing GSEs next year.

House Budget Committee:

- Holds first hearing on GSE debt, and may hold more hearings in next Congress.

Think Tanks/Academics:

- American Enterprise Institute held several conferences with numerous academics examining concerns about the GSEs.
- American Enterprise Institute released study by Peter Wallison and Bert Ely warning that the growth of Fannie and Freddie poses the threat of an expensive taxpayer-financed bailout.
- Steve Moore from Cato wrote an editorial for *Investor's Business Daily* calling Fannie and Freddie “ticking time bombs of debt” and recommended full privatization of the GSEs. Testifying before a Capital Markets Subcommittee GSE Roundtable, Moore stated “as a longtime analyst of the Federal budget, I am convinced that the unrestrained growth of the GSEs is one of the most economically dangerous developments in our financial markets.”
- Senior Fellow at Heritage Foundation, Daniel Mitchell, wrote an editorial criticizing Fannie and Freddie and suggested that the federal government end the massive subsidies given to Fannie and Freddie because they take money from the poor to “line the pockets of the rich.”
- In an AEI forum on the GSEs, Francis Cavanaugh, who was a former Treasury Department debt manager, advocated that Congress should end all subsidies to the GSEs. Should Congress decide not to end the subsidies, he suggested the following alternatives: (1) providing explicit federal guarantees of GSE securities; (2) charging them a guarantee fee that could be put in a reserve fund should GSEs fail; and (3) allowing the Social Security Trust Fund to invest in the GSE securities.
- Survey from the National Association for Business Economists found that there are substantial concerns about the subsidies Fannie and Freddie enjoy from their GSE status. 60% of those surveyed believed that “risks” exist in continuing the subsidies received by the GSEs.
- Financial markets strategist Doug Noland with David W. Tice & Associates said the US financial system is a “ticking time bomb” and the “leading culprits for this unfolding debacle are none other than the Washington-based Government Sponsored Enterprises”
- Financial Markets Center warned that a “mortgage bubble” could be developing due to excessive borrowing and rising levels of debt issuance by the GSEs.
- Shadow Financial Regulatory Committee (independent panel of financial services experts) urged full privatization and break up of the housing GSEs (Fannie, Freddie, & the FHLBanks). The housing GSEs distort the private mortgage market and are a risk to taxpayers. If Congress won't privatize the GSEs then the Shadow group supports a beefed-up version of Cong. Baker's GSE bill (HR 3703)

Taxpayer Groups:

- Coalition of prominent taxpayer groups formed watchdog group – HomeEc- to examine growing concerns with the GSEs. Group comprised of Citizens Against Government Waste, Citizens for a Sound Economy, the National Taxpayers Union, the Competitive Enterprise Institute, Capitol Watch, the 60+ Association, and the Small Business Survival Committee.

- National Taxpayers Union held a Capitol Hill conference examining Fannie and Freddie's risk to taxpayers. Speakers included the American Enterprise Institute, Competitive Enterprise Institute, and the Cato Institute.
- Tom Schatz with Citizens Against Government Waste testified about CAGW's concerns with the GSEs' mission creep, the amount of debt issued by the GSEs, and the GSEs' purchasing of their own MBS for profit. CAGW strongly supports removing the GSEs' Treasury line of credit.
- Fred Smith with Competitive Enterprise Institute testified that the GSEs should be fully privatized. If the subsidies provided to the GSEs are found to be warranted, then the GSEs should be brought into a normal reporting relationship with the Executive Branch (suggests Treasury) and have Congress decide their powers, budget, operating authority, and compensation schedules. If subsidies are not warranted, then privatize them.

Consumer Groups:

- Consumer advocate and Presidential candidate Ralph Nader testified before the House Banking Capital Markets Subcommittee stating that Congress has "played the role of indulgent parent" to the GSEs for too long. "The GSEs have long since grown beyond adolescence. It is time for GSEs to give up their ties to the federal government that have made them poster children for corporate welfare." When testifying before the Budget Committee in 1999, Nader questioned, "Will this growing duopoly enjoyed by Fannie and Freddie stifle competition by private companies – competition that might reduce costs and encourage innovation in a variety of mortgage products?"
- Martin Luther King III, President and Chief Executive Officer of the Southern Leadership Conference, wrote an op-ed for the November 19, 1999 issue of the *Washington Times* accusing Fannie and Freddie of perpetuating a minority housing gap.
- National Community Reinvestment Coalition says Fannie and Freddie lag the nation's banks in financing single-family and home mortgages for minorities and low- and moderate-income homebuyers. In testimony, NCRC's John Taylor recommended that Fannie and Freddie agree to let lending institutions use their own automated underwriting system or other reputable credit scoring systems without having to use Fannie and Freddie's systems. "The regulatory oversight agency should encourage a wide diversity of credit scoring systems, competing against each other in developing sound and flexible underwriting criteria. This will open more doors to homeownership for minorities and low- and moderate-income homebuyers."
- Peter Skillern of the Community Reinvestment Coalition of North Carolina testified that the group has strong reservations about the GSEs moving into the subprime market. Without adequate protection, the GSEs may do more harm than good.
- William Cunningham, independent investment analyst, testified before a House Banking Capital Markets Subcommittee that he has several concerns with the GSEs, but his main concern was that the GSEs continue to discriminate against minorities through their entrenched system of predicting loans.
- Reverend Grayland Scott Hagler, Senior Minister of the Plymouth Congregational United Church of Christ, testified that the GSEs need more accountability and scrutiny. He accused Fannie of hosting gatherings of consumer groups "to buy submissive loyalty" to the GSEs. "It is dangerous, frightening and undemocratic that GSEs...while receiving millions of dollars in government subsidies, use millions of dollars to lobby Congress, fund political campaigns and silence critics. This is an unfair advantage of these GSEs, and should be corrected."
- Bruce Marks from the Neighborhood Assistance Corporation of America testified that the GSEs should compete on the same level as other non-government entities. He accused the GSEs of being the major causes of predatory lending. He also expressed concern about the GSEs' failing in their missions. "The GSEs have provided an extraordinary return for their stockholders but have failed in their mission of providing affordable mortgage access to low and moderate-income people...It is

an outrage that Fannie Mae and Freddie Mac, with over \$10 billion in subsidies, do less for working people than for-profit lenders.”

- Ed Mierzwinski, US Public Research Interest Group stated in a *USA Today* article (8/4/00), “For too long Congress has treated them [Fannie and Freddie] with kid gloves.”
- Harry C. Alford, President of the National Black Chamber of Commerce sent a letter to Fannie claiming Fannie may have failed to live up to its commitment to invest \$438 billion in community projects through its local Partnership Offices across the country.
- Consumer Federation of America plans a panel discussion at its upcoming annual conference (November 30 – December 1) entitled “*Fannie Mae and Freddie Mac Under Attack: Are the Critics Right?*”
- Controversy swirled around a study that Freddie released in 1999 that found that regardless of income, African Americans are twice as likely as whites to have bad credit. House Banking Committee Member Maxine Waters (D-CA) held a press conference calling Freddie’s survey a “slap in the face” to African Americans. The DC ACORN Chapter and the National Fair Housing Alliance also participated in the press conference. The DC ACORN Chapter criticized the study, calling it a “political document” that was intended to shift the blame from Freddie and HUD’s affordable housing goals to the borrower, calling it the classic “Blame the Victim.” The DC ACORN Chapter also stated in a press release that Freddie’s automated underwriting systems may be discriminatory. “In determining what loans it buys on the secondary market, Freddie Mac tries to fit everyone into a neat, little box through credit scoring. The problem is that not everyone fits into that box. And the people who are left out are disproportionately those with lower incomes and minorities, regardless of their ability to pay off loans.”

FHLBanks:

- The FHLBanks’ MPF program becomes a stronger competitor to Fannie & Freddie in the secondary mortgage market. The FHFBI lifted the \$9 billion cap on the MPF program and the program was changed from a “pilot” status to a “permanent” program. Efforts to re-impose a cap on the program have as yet been unsuccessful.

Industry Groups:

- America’s Community Bankers (ACB) criticized Freddie for violating its charter by participating in a joint Internet venture with Microsoft called HomeAdvisor Technologies. [OFHEO later concluded that Freddie’s Microsoft venture was not inconsistent with its GSE charter and did not raise safety and soundness concerns.] ACB also issued a broad policy statement raising its concerns about Fannie and Freddie.
- Mortgage Bankers Association (MBA) issued policy statement raising its concerns about Fannie and Freddie. The MBA is also convening a blue-ribbon panel of industry experts to develop a definition of the primary and secondary mortgage market, which it feels is not clearly defined in the GSEs’ charters.
- Financial Services Roundtable (FSR) Board of Directors issued a resolution raising its concerns about Fannie and Freddie’s expansion beyond their core mission.
- National Home Equity Mortgage Association (NHEMA) issued policy statement raising its concerns about Fannie and Freddie.
- The ACB, MBA, FSR and NHEMA all testified about their GSE concerns before House Banking Capital Markets Subcommittee.
- The California Association of Realtors’ Board of Directors approved a motion to monitor the GSEs’ business practices.

Others:

- Larry Lindsey (Presidential candidate George W. Bush's top economic advisor and former Federal Reserve Board Governor) said he supports a close examination of the GSEs.
- US Conference of Mayors passed a resolution supporting strengthening the affordable housing goals for Fannie and Freddie.
- In a front-page *Wall Street Journal* article entitled "Why Calls are Escalating to Clip Fannie and Freddie's Wings," John Gibbons, former Freddie Mac Chief Financial Officer (who left the company earlier this year to pursue other options), was quoted as stating, "You can say, sure, the risk is small, But, because the stakes are so high, it might be time to take a closer look." In that same article, former Fannie Mae Board Member and Dallas developer Vance Miller told the *Wall Street Journal* reporter that the GSEs are "reaching for too much business. They're going for some much more risky loans." (*Wall Street Journal*, Patrick Barta, 7/14/00)

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

National Black Chamber of Commerce claims Fannie may be failing to live up to its commitment to invest \$438 billion in community projects through its Partnership Offices

Financial consultant Bert Ely believes Fannie's media events raise ethical questions. "This is an extension of not only their lobbying but also their political action committee contributions," he said. "Everybody knows what they're doing. It's something that many of us find offensive, but that's how they play the political game."

Fannie claims its partnership offices were created "to get away from Washington," yet *Real Estate Finance Today* reports that during the first eight months of 2000, Fannie held no fewer than 87 media opportunities across the country with Congressional Members

National Black Chamber of Commerce criticizes Fannie's Partnership Offices

- Harry C. Alford, President of the National Black Chamber of Commerce sent a letter to Fannie the week of October 2 claiming Fannie may have failed to live up to its commitment to invest \$438 billion in community projects through its local Partnership Offices across the country. Kermit R. Thomas, the lead lobbyist on banking issues for the National Black Chamber of Commerce said members of his organization have complained that Fannie has not delivered on its pledges. Mr. Alford asked Fannie for proof that it has fulfilled its commitments. A spokeswoman for Fannie denied the accusation and said mayors and community activists could vouch for the program's accomplishments. (*American Banker*, Dean Anason, 10/6/00)

Fannie claims its partnership offices were created "to get away from Washington," yet Fannie and its partnership offices hold numerous press conferences with Congressional Members

- Fannie's Betsy Hildebrandt claims that Fannie's media events with Congressional Members "are not directed from Washington." She said most of the events happen in their Partnership Offices and "are basically product introductions where the member of Congress has asked us to participate in a program." She claims the Partnership Offices were created to develop relationships in local communities. "The idea of the Partnership Offices was to get away from Washington," she said. "It's been a wildly successful initiative."

- Research by *Real Estate Finance Today* found that during the first eight months of 2000, Fannie held no fewer than 87 media opportunities across the US with Congressional Members. This compares with 60 media events in all of 1999. The events in both years have involved 29 members of the Senate (of whom 12 are up for re-election in 2000) and 95 Members of the House (most of whom face contested re-election bids). Since 1999, Fannie has held media events with at least 13 Members of the House Banking Committee and seven Members of the Senate Banking Committee. However, according to *Real Estate Finance Today*, Fannie has held no events with Cong. Richard Baker who has introduced a bill to strengthen regulation of the GSEs. (*Real Estate Finance Today*, Michael Sorohan, 9/11/00)

Fannie's media events raises ethical questions

- Financial consultant Bert Ely said that while Fannie's media events demonstrate the company's influence with Congress, they also raise ethical questions. "This is an extension of not only their lobbying but also their political action committee contributions," he said. "Everybody knows what they're doing. It's something that many of us find offensive, but that's how they play the political game." (*Real Estate Finance Today*, Michael Sorohan, 9/11/00)

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, 9/6/00)

Senator Christopher "Kit" Bond (R-MO) and St. Louis Mayor Clarence Harmon

- Fannie held a press conference to announce a new \$8 billion "House Metro St. Louis" investment plan over the next five years and to announce the completion of the initial "House St. Louis" investment plan. (*Fannie press release*, 10/2/00)

Cong. Luis Gutierrez (D-IL) and Cong. Rod Blagojevich (D-IL)

- Fannie held a press conference with the above officials and CitiMortgage to announce a new partnership to finance \$2.7 billion in affordable mortgage lending to Chicago families. (*Fannie press release*, 9/11/00)

Cong. John Larson (D-CT) and Hartford, CT Mayor Michael Peters

- Fannie held a press conference with Hartford Mayor Peters and GMAC Mortgage to welcome a family into their new home made possible by Fannie's Flex 97 mortgage product through GMAC. A statement of support by Cong. Larson was included in Fannie's press release. (*Fannie press release*, 9/7/00)

Cong. Michael Castle (R-DE)

- Fannie held a press conference with Cong. Castle to announce the HomeBuyer Funds Finder, a web-based application that will be pilot-tested with lenders and other housing professionals in Delaware to help identify downpayment and closing cost assistance programs. The application will be tested with up to 40 Delaware housing professionals, including lenders, housing counselors, real estate professionals, and other housing professionals. (*Fannie press release*, 9/12/00)

Cong. Bob Goodlatte (R-VA) and Mayor Carl Hutcherson, Jr.

- Fannie held a press conference with the above named officials to celebrate the future site of The Vistas at Dreaming Creek – a mixed-use apartment community. To help finance the development, Fannie purchased \$5.5 million of the \$7.5 million tax-exempt bonds issued by the Lynchburg Redevelopment and Housing Authority. The Vistas will include one-, two- and three-bedroom

rental apartments, ranging in size from 800 square feet to 1,150 square feet with a view of Candler Mountain. Standard amenities include: high speed Internet access; fully-equipped kitchen with microwave; a full size washer and dryer; central heat and air; wall-to-wall carpeting; and a private balcony or patio. (*Fannie press release, 9/18/00*)

Cong. Roscoe Bartlett (R-MD) and Frederick, MD Mayor James Grimes

- Fannie held a press conference with the above named officials to celebrate the grand re-opening of an affordable housing complex. (*Fannie press release, 9/25/00*)

Cong. Julia Carson (D-IN)

- Fannie held a press conference with Cong. Carson and representatives from Irwin Mortgage to announce a \$1 billion multicultural homeownership initiative to help immigrant and minority families attain homeownership. Fannie has committed to purchase \$1 billion in affordable, targeted loans originated by Irwin Mortgage. (*Fannie press release, 9/11/00*)

Cong. Charles Stenholm (D-TX)

- Fannie announced an \$11.8 million mortgage revenue bond purchase agreement with the West Central Texas Regional Housing Finance Corporation. A statement of support by Cong. Stenholm was included in the press release. (*Fannie press release, 9/25/00*)

Washington, DC Deputy Mayor Eric Price and DC City Councilmembers

- Fannie held a press conference with the above named officials and CitiMortgage to announce a new partnership to provide \$1.4 billion in affordable mortgage lending to Washington, DC and Baltimore Metropolitan area families. (*Fannie press release, 9/21/00*)

Jackson, MS Mayor Harvey Johnson

- Fannie held a press conference with Mayor Johnson to announce an employer-assisted housing plan for Mississippi Blood Services. (*Fannie press release, 9/28/00*)

Henderson, NV Mayor Jim Gibson

- Fannie held a press conference with Henderson Mayor Gibson and Republic Mortgage to welcome a first-time homebuyer into a new home under employer assisted housing initiative. (*Fannie press release, 9/18/00*)

Freddie Mac

Wells Fargo and Bank of America drop out of joint venture with Microsoft's HomeAdvisor Technologies

HomeAdvisor Technologies uses Freddie's technology

- According to Robert Julavits with the *American Banker*, two companies that had planned to become partners in Microsoft's HomeAdvisor Technologies Inc. – Wells Fargo and Bank of America - quietly pulled out of the deal early this summer after closely examining the venture. Reportedly after completing due diligence several months ago, the two companies decided not to invest in the start-up. Freddie is still involved in the project. Freddie has provided significant technology contributions to the venture and has a financial interest in the new company. Freddie's Loan Prospector pricing and underwriting tools are embedded in HomeAdvisor's technology. Chase Manhattan and GMAC-Residential Funding Cop. are still involved as equity partners and users of the technology. Preliminary reports are that HomeAdvisor Technologies will establish a new business-to-business e-commerce platform to automate steps in the home-buying process, such as credit checks, appraisals, and underwriting decisions. (*American Banker*, Robert Julavits, 10/11/00)

Freddie purchases its first all-electronic mortgage

- Taking advantage of legalized use of electronic signatures, Freddie purchased its first all-electronic mortgage. The mortgage was originated in Utah and made legally binding through the recently passed E-Sign Act (effective October 1). Mountain America Credit Union in Salt Lake City originated and closed the mortgage and CUNA Mutual Mortgage in Madison, WI is servicing it. The participants used Digital Handshake technology from iLumin Corp. for the transaction. (*National Mortgage News Daily*, 10/3/00; *Real Estate Finance Today*, Chris De Reza, 10/9/00)

Federal Home Loan Banks

American Bankers Association and America's Community Bankers express concerns about FHLBanks' capital rule

- According to Richard Cowden with *BNA*, the ABA raised concerns about the FHFB's proposed rules to implement a new capital structure for the FHLBanks, and has organized a task force to submit further recommendations prior to the November 20 comment deadline. The ABA made available to *BNA* a three-page memo outlining its major concerns with the capital proposal. Among its concerns, the ABA would like more time for the 12 FHLBanks to adapt to the new requirements and would like each FHLBank to be required to provide detailed, prototype capital plans to offset difficulties involved in setting up the new capital structure.
- The ACB reportedly has similar concerns, according to Eric Mondres, ACB's Senior Government Relations Counsel. "It [the capital restructuring] is a little like having an IPO for 12 large companies at the same time," he said. ACB's position is that the "Board should not approve any [capital] plan until all plans have been submitted." The ABA and ACB are also concerned that any

changes to the current structure might cause their members institutions to experience a taxable event. The ABA and ACB voiced a need that the FHLBank will continue to receive its long-standing 10% risk weighting. (*BNA Daily Report for Executives*, Richard Cowden, 10/13/00)

- *National Mortgage News Daily* reported that the ABA also does not believe that the FHLBank should be able to pay higher dividends on subclasses of stock that are issued to fund specific activities, such as the mortgage purchase program, but instead the benefits should be distributed to all members of the FHLBanks. “Selective benefits restricted to a particular subclass could cause the cooperate [nature of the FHLBank System] to fracture along subclass lines,” the ABA warns in a comment letter. The ABA did not object to the requirement that FHLBank members purchase a subclass of stock in order to participate in a certain activity or product. (*National Mortgage News*, 10/12/00)

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